For much of 2021, taking estate planning action has been a tricky proposition. Over the first half of the year, we have been monitoring the impact of the evolving post-pandemic reopening, a new president's economic agenda and, most of all, the various proposed tax law changes that call into question traditional estate planning techniques. Now, with the arrival of summer, we find ourselves in a season of opportunity to prudently take action.

From a monetary policy perspective, we continue to operate in a period of historically low interest rates. Low interest rates present an opportunity for individuals to use various tax planning techniques to efficiently transfer wealth from one generation to another. However, many of these planning techniques were highlighted in proposed legislation earlier this year. This legislation, if passed, would not only curtail the effectiveness of some techniques but also eliminate other techniques altogether. Further, portions of the proposed legislation were intended to become law retroactively to the beginning of 2021. The potential for retroactive legislation justifiably caused many individuals and advisors to pause planning actions.

However, with the release of the Biden administration's budget and the Treasury Department's explanation of the budget's revenue provisions, we now have better insight into the timing of proposed tax law changes (to read more on Biden's budget, please see Biden Budget Released with Few Surprises for Individuals). With the exception of a change to the capital gains and dividends tax rate, all proposed tax law changes are, for now, prospective in nature. Even more encouraging from a tax planning perspective is that many of the tax planning techniques mentioned in earlier suggested legislation are not included in the proposed budget.

Instead, the president has focused a portion of the budget's revenue on policy changes aimed at untaxed capital appreciation. Not only is he seeking to raise the top tax rate on capital gains and dividends to match ordinary income tax rates, he is also introducing new taxable recognition events for capital appreciation, i.e., taxing appreciation of capital assets when transferred as a gift during life or at death. While this new recognition of capital gains is a fundamental change to the current income tax structure, it should not discourage anyone from taking action today. In fact, it is another factor calling for action now.

Given the prospective focus of the president's budget and the current low interest rate environment, what steps should we consider taking this summer? Here, we take a look at some low interest rate planning techniques.

Intrafamily loans

This technique can be a convenient, low-cost way to assist family members with purchasing a home, starting a business or affording living costs. However, loans can also be used by the borrower to invest in the market. Consider the following hypothetical scenario:

- Parent lends $1 million to Child using a nine-year note, interest only, at the Internal Revenue Code prescribed interest rate of 1% (July 2021).
- Child invests cash into a diversified portfolio that produces a 7% annualized return.
- After repaying the note in year 9, Child is left with approximately $850,000.

Using a low interest rate loan, the parent has retained legal right to the $1 million principal and passes $850,000 of appreciation to the child — gift tax free. (To read more about intrafamily loans, please see [Intrafamily Loans: A Financial Resource to Consider in a Difficult Economy.])

Sale to a grantor trust

What if you own a low-cost-basis portfolio of stocks and don't have the cash to lend to your child? Is it possible to "lend" assets to your child? Consider the following hypothetical case:

- Parent creates trust for Child that allows Parent to reacquire trust assets in the future by swapping in different assets of equivalent value.
- Parent funds the trust with cash or marketable securities using a small amount of Parent's lifetime exemption.
- Next, Parent transfers the low-cost-basis assets of $1 million into the new trust in exchange for a note like the nine-year note at 1% previously described.
- At the end of the note term, the trust repays the note by passing a portion of the low-basis stock back to Parent. The trust would retain the value of assets in excess of the note, with the balance free of estate or gift tax. Additionally, Parent could "swap" assets into the trust that have a higher basis than the assets now sitting in the trust.
- Assuming the same 7% annualized return above, Child is left with $850,000 of value in the trust.

To further leverage wealth transfer opportunities of a sale to a grantor trust, business entities and other assets could possibly be sold at a discounted value depending on the terms of the agreement.

Grantor retained annuity trust (GRAT)

The GRAT is another efficient technique used to transfer asset appreciation to beneficiaries with minimal gift or estate tax consequences. Often GRATs are designed to last two to three years to leverage historically low interest rates and market volatility. Consider the following example:

- Grantor transfers $1 million of assets to a two-year trust and retains an annuity totaling $1,018,019 (July 2021 1.2% interest rate as set monthly by the Internal Revenue Code).
- Assets remaining in the trust after the annuity payments have been made to the Grantor will pass to beneficiaries, tax free.
- If asset values decline, all assets will pass back to Grantor as if never created.
- Assuming an annual portfolio growth rate of 8%, this GRAT would transfer over $100,000 to beneficiaries, gift and estate tax free.

GRATs can be extremely effective during periods of market volatility. If asset values within the GRAT spike, the grantor is permitted to "swap in" more stable assets to lock in gains for future beneficiaries. Since varying asset classes often move out of step, GRATs can be created with a single asset class or even a single concentrated stock position. Creating several GRATs at the same time can diversify exposure and increase the odds of overall success. Success is also increased by employing a cascading or rolling GRAT strategy which moves each annuity from an existing GRAT into a newly established GRAT. By doing this, the grantor increases the odds of capturing asset appreciation for intended beneficiaries. (More about GRATs can be found [here].)

Charitable lead annuity trust (CLAT)

A CLAT functions much in the same way as a GRAT except for one key difference: The annuity payments are made to charity rather than the grantor. For individuals who have philanthropic goals as well as family legacy goals, a CLAT may be a desirable planning technique. Consider the following hypothetical scenario:

- Grantor transfers $1 million of assets to a 20-year trust.
- Grantor selects a charity to receive an annual annuity of $56,538 for a total of $1,130,755 over the full 20-year term of the trust (July 2021 1.2% interest rate as set monthly by the Internal Revenue Code).
- Assets remaining in the trust after the annuity payments have been made to charity will pass to beneficiaries, tax free.
- Assuming an annual portfolio growth rate of 6%, this CLAT would transfer over $1,127,300 to beneficiaries, gift and estate tax free.

Charitable lead trusts can be an effective way to balance an individual's desire to benefit charity and family in a tax-efficient manner. When deployed in a low interest rate environment like today's, the results can be significantly rewarding.

Conclusion

Now that we have a sense of the president's policy focus and potential timing for tax law changes, we should be making summer plans — plans that involve taking advantage of our currently low interest rate environment and some tried-and-true estate planning techniques.

To learn more, contact your Glenmede Wealth Advisor or visit us at Glenmede.com.