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Cutting-Edge Estate Planning Strategies for Effective Wealth Transfer

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Ensuring a meaningful legacy for your clients and their loved ones is a challenging task. As a planner, you can now devise wealth transfer strategies to minimize tax implications and protect how your clients pass on financial assets and other property to family members.

Lifetime gifts are preferable to testamentary transfers because they allow income and appreciation to grow free of any gift or estate tax for the grantors' heirs. Your clients are presently permitted to annually give up to $14,000 of assets or non-cash property ($28,000 for spouses splitting gifts) without counting toward their indexed lifetime gift tax exemption of $5.43 million. Be sure to also leverage the wealth transfer potential of making unlimited payments directly to qualified medical and education providers on behalf of your clients' beneficiaries.

In tandem with the guidance of a qualified estate planning attorney and tax professional, you should assess the grantors' gifting capacity, donative intent, and future cash flow needs prior to structuring gifts for their substantial estates (i.e., larger than the current indexed $5.43 million estate tax exemption). Consider employing the following estate planning techniques to maximize the timely benefits of these fundamental gifting strategies and to enhance the financial security of your clients' future generations.

Minimizing Gift Tax Value

Decide to take advantage of current low interest rates by establishing grantor-retained annuity trusts (GRATs) to remove large assets that are expected to increase in value, so your grantor clients can transfer appreciated property to their heirs tax-free when the trust ends. The annuity payments can be set high enough so that their present value almost equals the value of the assets contributed to the GRAT, resulting in a minimal taxable gift value or “nearly zeroed out” GRAT.

GRATs are optimal wealth planning vehicles if the transferred assets are expected to outperform the Internal Revenue Code (IRC) Section 7520 rate (hurdle rate) over the duration of the grantors’ retained interest in the property. They can be especially effective with clients who have potentially appreciating assets, such as depressed stock or shares in a private company that eventually go public. GRATs are susceptible to mortality risk, as part or all of the remaining GRAT assets will be subject to estate tax if the grantor dies before the GRAT ends.

Fortunately, you can mitigate this risk and achieve your clients’ goals by establishing a series of overlapping short-term rolling GRATs. Seek the oversight of legal counsel in creating rolling GRATs that will have the potential to move greater wealth over a shorter period of time. Note that a rolling GRAT strategy is generally an efficient alternative, because it provides grantors with multiple opportunities to transfer substantial assets, even in unfavorable market environments.

In contrast to conventional GRATs, rolling short-term GRATs can flourish on volatility and lend themselves to aggressive, even varying, asset allocations. Interest rates are typically not a key factor of overall performance with rolling GRATs, as low initial rates often rise as the trusts turn over, and vice versa.

Magnifying Wealth with a Charitable Benefit

Similar to GRATs, charitable lead annuity trusts (CLATs) offer possible estate and gift tax-free methods of shifting future appreciation to your clients' descendants. A grantor is entitled to a yearly charitable deduction for the annuity to a designated charity from the CLAT for a number of years. Consider CLATs for high net worth clients who have identifiable philanthropic desires and no need for current income.

The lower the IRC Section 7520 rate, the higher the charitable deduction will be for the charity's annuity interest in a CLAT. Consequently, you may guide donor clients to use the lowest of the four applicable months' hurdle rates when planning the date on which to establish a CLAT. Coordinate this wealth transfer process with qualified accountants and estate lawyers who can maximize the tax benefits and impact of the donation on your clients' families and preferred causes.

CLATs are not an efficient vehicle to transfer assets to your clients' grandchildren, as distributions at the end of a CLAT's term may be subject to GST tax. To avert the potential application of the GST tax, you can plan for the trust assets to be distributed to your donor clients' then-living children when the CLAT term ends.

CLATs are generally most efficacious as long-term vehicles. It's prudent to fund these trusts with diversification as a priority because too much volatility over an extended period can deplete the assets in the trust. You should secure low initial interest rates to enhance the probability of passing on substantial wealth to your clients' future generations.

Keeping Wealth in the Family

Talk to your clients about the possibility of doing a family loan, another tax-free wealth transfer approach that may be useful for passing on an amount greater than either the annual gift exclusion or the lifetime gift exemption. Work in conjunction with an estate planning attorney who can appropriately draft these family agreements to pass muster with the IRS. Ensure that the intra-family loans are fully documented and suitably structured, so the money will be paid back on schedule.

The IRS has established special interest rates for loans, known as the “applicable federal rates” (AFRs), which are set monthly. Inform your clients that making intra-family loans may be favorable because of their current low interest rates. Any appreciation of the loaned assets exceeding these interest rates passes free of gift or estate tax to your clients’ family members.

In addition, an intra-family mortgage loan may be a reasonable alternative to assist your clients’ children with poor or no credit history in buying a home. Recognize that your lending clients may forgive part of the loans each year up to the annual gift tax exclusion amount, without gift tax ramifications. One caveat is that your clients’ parents or children (or both) may not be comfortable with this type of lending relationship, and gift taxes may occur if interest payments fall behind.

Gifting with Advanced Grantor Techniques

Your grantor clients can appropriately use an installment sale to an intentionally defective grantor trust (IDGT), another advantageous planning technique to further leverage the expected appreciation of trust property over prevailing interest rates. Similar to the family loan strategy, if the assets sold to the trusts earn a higher rate of return than the interest payable on the note, the excess represents a tax-free transfer to your clients’ remainder beneficiaries. In essence, the property that is sold to the trust should generate sufficient cash flow to pay down the note.

IDGTs are considered “defective” because the transfer of assets is complete for estate tax purposes but incomplete for income tax purposes. In effect, grantors are not required to report the sale transaction on the income tax return, even though they are considered to be owners of the trust property for income taxes. Note that grantors transfer additional appreciated assets to their family members by continuing to pay the trusts’ income tax liability, even potentially after the notes are repaid.
A pivotal advantage of the IDGT as a wealth transfer strategy over other techniques is that the sale structure and note may be devised with significant flexibility and customization. With the advice of legal counsel and tax attorneys, you can have the grantor client make a seed gift to an IDGT in order to support the subsequent purchase of assets. This seeding is suggested to ensure the sale will be established as a bona fide sale, rather than a gift. Further, the grantor clients’ flexibility in deferring payment on the note can make IDGTs more appealing than GRATs for illiquid assets with only minimal cash flow.

Enhancing Legacy Planning

Think about leveraging dynasty trusts for your clients and families who desire to transfer prodigious assets throughout multiple generations with minimal additional estate or GST taxes. Only some states and jurisdictions allow such long-lasting trusts. With the counsel of a seasoned estate planning attorney, you should verify the applicable state law with respect to the maximum allowable period of the dynasty trust.

Dynasty trusts can make tax-free, discretionary distributions to your grantor clients’ children, grandchildren, or future descendants, while the principal stays in these trusts over time. These dynasty trusts offer flexibility and provide your clients’ families with the possible means to establish a financial legacy that passes along family values as well as money. Design these trusts with family money available to help for life events, such as exorbitant medical costs, college education, and down payments for homes.

Conversely, dynasty trusts may demotivate your clients’ children or grandchildren to work because they will be expecting to receive regular trust income. There is also a greater chance for family disputes as the number of dynasty trust beneficiaries increases over time.

Preserving Family Assets and Relationships

In collaboration with an estate planning lawyer and qualified tax professional, you should review your clients’ asset protection strategies. Be careful to segregate business and professional risks. Weigh the merits of placing your clients’ family businesses, real estate investments, or other personal property into a limited liability company (LLC) or family limited partnership (FLP) to mitigate the risk of creditors taking any personal assets due to business financial difficulties.

Be cognizant that a FLP can be an efficient way to manage and control your clients’ family assets while providing for tax-efficient wealth transfer. Valuation discounts arising from lack of liquidity and marketability will apply for gift tax purposes, because limited partners have no say in running the partnership and usually cannot sell against their interests.

Consider how the payments of estate and gift taxes will be funded when implementing FLP planning. There will be situations in which an estate will need liquid funds to pay post-death taxes and expenses.

Closely monitor your wealth transfer plans, as future tax laws may determine whether there should be changes in current estate strategies. The planning that may have been appropriate years ago may not be suitable now.

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