



# The Wealth Counselor

A monthly newsletter for wealth planning professionals

## Motivating Clients to Plan Now: Taking Advantage of Low Interest Rates and More

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With lingering uncertainty as to the economy and the federal estate tax, many clients - and their advisors - are wondering what planning they should do now, if any. No one can predict how quickly we will experience an economic turnaround or whether Congress will act on the estate tax. However, there are many non-tax reasons why clients should plan today, irrespective of the economy or their estate tax. And for those clients who may be subject to estate tax, we know that it is generally better for clients to act now rather than to wait, particularly given our historically low interest rates and some of the structural estate and gift tax changes proposed by the IRS.

This issue of *The Wealth Counselor* explores some reasons why it is in clients' best interest to act now and discusses strategies that may create the biggest opportunities for clients - and you - today.

### Planning Needs Unrelated to the Economy or Estate Tax

Many planning needs are unrelated to the economy or the estate tax. They include:

- Disability and retirement planning;
- Special needs planning;
- Divorce protection;
- Spendthrift protection;
- Creditor protection; and
- Second marriage protection.

These planning needs may be even more significant for clients with fewer assets than for wealthier clients.

### *Disability Planning*

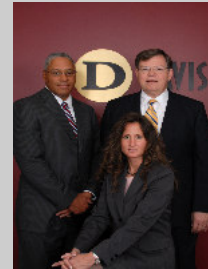
As America's population ages, disability planning takes on ever-increasing importance.

From [Francis Brown](#)

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Here are some sobering statistics about Americans age 65 and older:

- 43% will need nursing home care;
- 25% will spend more than a year in a nursing home;
- 9% will spend more than 5 years in a nursing home; and
- The average stay in a nursing home is more than 2.5 years.

Plus, the rate of nursing home cost increases greatly exceeds the inflation rate. Clients with estates that would not have been taxable in 2009 are, or should be, very worried about how they will pay for that kind of care if they need it.

**Planning Tip:** Careful consideration of long-term care insurance is critical for most clients.

Also of concern is who will care for your clients and whether they will care for them in the way your clients desire. For many, there is a strong desire to stay at home as long as possible. For others, the companionship found in an assisted living facility makes that choice preferable. Still others need care that cannot be provided at home at all or only at prohibitive cost. Incapacity will deprive a client of the ability to implement his or her goals and objectives.

**Planning Tip:** A trust with carefully drafted disability provisions is the best way to ensure that each client's planning meets his or her personal goals and objectives.

### ***Special Needs Planning***

This is another area unrelated to the economy or the estate tax. According to the U.S. Census Bureau, in 2000:

- 51.2 million Americans reported having a disability;
- 13-16% of U.S. families had a child with special needs;
- 15 out of every 1,000 children born in the U.S. had an Autism spectrum disorder; and
- Between 1 and 1.5 million Americans had an Autism spectrum disorder.

Because of medical care advances many special needs that used to mean shortened life expectancy no longer do, so many more special needs children are outliving their parents. Planning that fails to properly plan for a special needs person can have disastrous consequences, including loss of means-tested government benefits. A Special Needs Trust that incorporates specific care provisions is a critical component of the planning for a special needs person who requires ongoing support.

Insurance on the life of a special needs person's parents or grandparents can provide the trust funds necessary to pay for the care of a special needs beneficiary that is not provided by means-tested and other government benefits.

**Planning Tip:** Clients with special needs children or grandchildren are typically very motivated to plan for them.

### ***Beneficiary Protection Planning***

Protecting an inheritance from being lost in a divorce or to a beneficiary's creditors is a serious client concern. The potential for creditor attack or for beneficiary dissipation of an inheritance is greater during difficult economic times. Many older generation clients fear that their children and grandchildren lack strong financial decision-making skills.

Divorce rates exceed 50% nationally. Many clients today express concern about their children and grandchildren divorcing - they don't want the assets they worked so hard to accumulate winding up in the hands of a former daughter- or son-in law, etc. Divorce rates increase in difficult economic times, making this planning even more important now.

### ***Blended Family Planning***

A higher divorce rate leads to more second and subsequent marriages - each with a higher statistical probability of ending in another divorce. With blended families (i.e., with potentially his, her, and their kids), it is critical that each parent's planning protect his or her children in the event that parent leaves a surviving spouse. Failure of blended-family parents to do this type of planning practically guarantees that somebody's kids will be disinherited or a messy probate will result.

**Planning Tip:** Carefully drafted estate plans protect beneficiaries from divorce, creditors and themselves. Such plans can also provide for children from prior marriages, which is often the only way to ensure that these beneficiaries actually receive any inheritance.

### **Reasons for Estate Tax Planning**

#### ***Certainty as to the Federal Estate Tax***

The prospect for a repeal of the federal estate tax in the foreseeable future is essentially zero and, in half of the U.S. jurisdictions, there is a state estate tax (the threshold for which is as low as \$338,000 per person in one jurisdiction, and \$675,000 in several others). Nobody knows whether Congress will act anytime soon - especially in light of the recent federal spending developments. If Congress does nothing, the federal estate tax exemption will be \$1 Million, with a maximum 55% rate, for clients dying on or after January 1, 2011. Therefore, clients who are not likely to die in 2010 should plan for estate taxes.

Moreover, the IRS and many in Congress see this as an opportunity to eliminate several wealth transfer planning techniques, such as value adjustments for family-owned entities and zeroed-out grantor retained annuity trusts (GRATs).

**Planning Tip:** The more time that passes in 2010 without Congressional action on the estate tax, the less likely there will be any change in 2010. This is because both

Republicans and Democrats apparently wish to make this an issue for the mid-term elections in November.

Because of the virtual certainty that we will continue to have an estate tax, many of your clients must plan if they wish to avoid paying it. As the U.S. Supreme Court said:

*Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. Therefore, if what was done here was what was intended by [the statute], it is of no consequence that it was all an elaborate scheme to get rid of [estate] taxes, as it certainly was.*

For clients who may be subject to federal or state estate tax, there is a significant benefit to plan sooner rather than later, particularly given today's historically low interest rates.

#### ***Utilizing Estate Freeze Techniques***

From a tax perspective it is far better for clients to give assets away during lifetime than to have the same assets be subject to estate tax at death - particularly if the gift falls within the \$1 Million lifetime exclusion or the gift tax annual exclusion, currently \$13,000.

For example, suppose Rachel Donor transfers \$1 Million today to her children. Assuming those assets grow at 10%, Rachel's children will have \$1,930,690 in ten years. If instead Rachel waits to transfer those assets at her death and there is only a \$1 Million exemption, the \$1,930,690 will be subject to federal estate tax of at least \$418,810, resulting in a net to the children of only \$1,511,879.

For clients whose estates are going to be taxable under any foreseeable circumstance, taking advantage of the 2010 gift tax rate of 35% may offer great overall tax savings.

#### ***Grantor Trusts***

A "grantor trust" is something defined twice by the Internal Revenue Code - one way for income taxes and another way for estate and gift taxes. In other words, ***the rules don't match***. Therefore, with careful design, an irrevocable trust can be made to be a grantor trust for income tax purposes - yet not be a grantor trust for gift and estate tax purposes.

By using this long-standing wrinkle in the Internal Revenue Code, the strategies for transfers of assets by gifts and sales to irrevocable trusts can be virtually "supercharged." Making the recipient trust a grantor trust for income tax purposes but not for estate tax purposes produces tax-free compounding of income in the trust and estate depletion for the donor through the attribution of that income to the donor. And, paying those taxes is ***not*** an additional gift to the trust.

In our previous example, if the transfer was to an income tax grantor trust, Rachel's paying the tax on the trust income would make the trust grow to \$2,593,742, or ***\$663,052***

*more than if the gift were directly to the children and they paid the tax.*

**Planning Tip:** Clients sometimes tire of paying taxes on income not received or clients' economic situations change and they can no longer afford to pay the extra taxes. To deal with such contingencies, good planning includes having a "spigot" provision in these grantor trusts so that the income tax grantor trust status can be turned off.

### ***Historically Low Interest Rates***

The last piece of the puzzle is today's historically low interest rates. The following chart shows recent Applicable Federal Rates (AFRs) - the "safe harbor" interest rates provided by the government for, among other things, intra-family loans.

Loan Term	November 2009	December 2009	January 2010	February 2010	March 2010
3 Years or Less (Short Term)	0.71%	0.69%	0.57%	0.72%	0.64%
3-9 Years (Mid Term)	2.59%	2.64%	2.45%	2.82%	2.69%
More than 9 years (Long Term)	4.01%	4.17%	4.11%	4.44%	4.35%

The "7520 Rate," which is used in calculating remainder interest values and charitable benefits in Grantor Retained Annuity Trusts ("GRATs"), Charitable Lead Annuity Trusts ("CLATs"), and Charitable Remainder Annuity Trusts ("CRATs"), is 120% of the mid-term rate.

These low interest rates make the strategies discussed below even more attractive, particularly when applied to interests in an FLP or FLLC the fair market value of which is lower than the value of its assets because of lack of control and reduced marketability. As noted above, these adjustments are hated by the IRS and there is talk of eliminating them in any estate tax legislation.

### ***Installment Sales to Grantor Trusts and GRATs***

A prior version of *The Wealth Counselor* compared and contrasted installment sales to grantor trusts and GRATs. Suffice it to say that both of these strategies are aided by low interest rates, particularly historically low interest rates like we are experiencing now.

**Planning Tip:** Consider gifting rapidly-appreciating *volatile* assets to a GRAT and selling rapidly-appreciating assets to a grantor trust through either an installment note or self-canceling installment note (SCIN).

## Charitable Lead Trusts

The Charitable Lead Trust (CLT) is a type of charitable trust that can be used to reduce or virtually eliminate any estate or gift tax on wealth transfers. In a CLT, the client creates a trust that grants to a charity or charities, for a set number of years, the first or "lead" right to receive a stream of equal payments from the trust. At the end of the term of years, whatever is left in the trust goes to the remainder beneficiaries, typically the client's children or grandchildren. If the CLT runs out of assets, the remainder beneficiaries get nothing.

CLTs (like GRATs) benefit from low interest rates. That is so because, in determining the current value of the CLT's remainder interest, the IRS assumes that the assets in the CLT will grow at the Section 7520 rate in effect when the CLT is established. Therefore, CLTs created now (whether during lifetime or at death) benefit from the current historically low interest rates.

In a typical CLT, the calculated remainder interest value is set very near, but just slightly above, zero. That way, the remainder passes to the beneficiaries without using any significant amount of the client's gift tax exemption. The statute of limitations runs on all aspects of the transaction, including asset valuation, upon the filing of the associated gift tax return.

**Planning Tip:** For charitably minded clients with estates anticipated to be taxable, the Charitable Lead Annuity Trust, in today's low-interest environment, offers an excellent opportunity to make charitable gifts and, as an added benefit, transfer wealth to the client's beneficiaries without using up lifetime gift tax exemption.

**Planning Tip:** Charitable Lead Annuity Trusts are particularly suited for hard-to-value assets (such as real estate or family limited liability company interests) and assets which are expected to grow rapidly in value.

## Conclusion

Despite lingering economic difficulty and estate tax uncertainty, there are numerous reasons why clients should plan *now* rather than wait until we have more economic and estate tax certainty - and many of these reasons exist regardless of clients' net worth. Furthermore, for clients who may be subject to federal or state estate tax, the benefits of planning sooner rather than later, combined with today's historically low interest rates, creates a great opportunity for the planning team to help them meet their wealth transfer and other planning goals and objectives.

*To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax adviser based on the taxpayer's particular circumstances.*

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Member of

The Advisors Forum

to your clients. Please feel free to [contact me](#) if you have any questions about this or any matters relating to estate or wealth planning.

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