

# TAXATION



*presents*

## **2024 Estate and Gift Tax Conference**

Panel 5: Ouch Those Interest Rates Hurt-Or Do They-  
Planning In a High Interest Rate Environment

Thursday, March 21, 2024

12:40pm - 1:25pm

Speakers: Kristin Capritto and Wayne Johnson

### ***Conference Reference Materials***

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# OUCH!: Do Those Interest Rates Hurt? Planning in a High Interest Rate Environment

1

*Presented to*

**2024 ESTATE AND GIFT TAX CONFERENCE  
CLA TAXATION SECTION, E&G TAX COMMITTEE**

UC San Francisco School of Law  
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# Interest Rate Planning Strategies

5

## Low Rates

- ▶ Intrafamily loans and forgiveness gifting
- ▶ Installment Sales to IDGTs
- ▶ Grantor Retained Annuity Trusts (GRATs)
- ▶ Charitable Remainder Annuity Trusts (CRATs)

## High Rates

- ▶ Qualified Personal Residence Trusts (QPRTs)
- ▶ Grantor Retained Income Trusts (GRITs)
- ▶ Charitable Remainder Trusts
- ▶ Consider swapping assets of equal value to achieve new basis on death\*

# Rates and Planning – A Chain Reaction



# APPLICABLE FEDERAL RATES

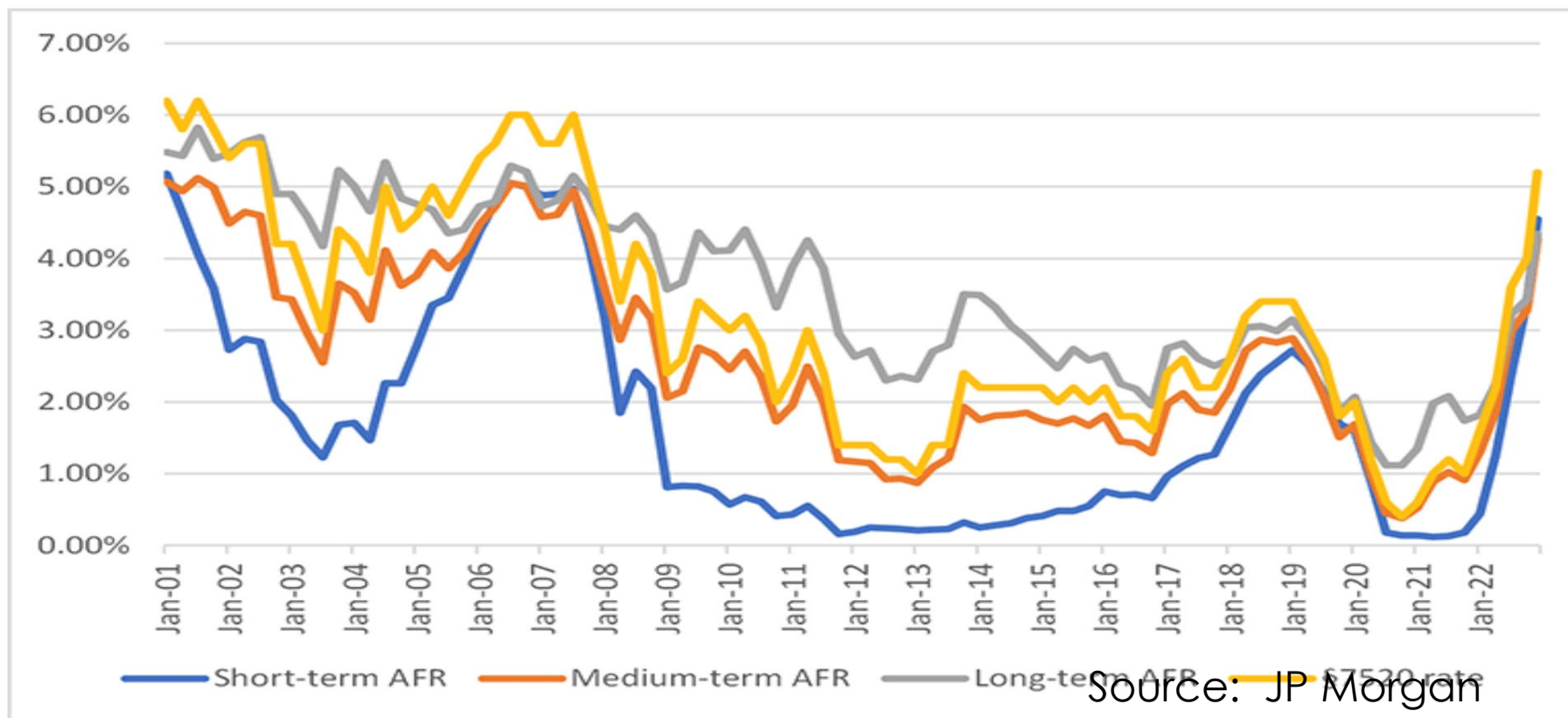
AFR	Applicable Federal Rate
Short Term AFR	Loan term of 0-3 years
Midterm AFR	Loan term of 3-9 years
Long Term AFR	Loan term of 9+ years
§7520 Rate	<p>AFR used to determine present value of an annuity, an interest for life or a term of years, a remainder or reversionary interest, or a transfer to a CRAT</p> <p>Equal to 120% of the midterm AFR (compounded annually) for the month during which valuation date is, then rounded to nearest 0.2%</p>

IRS publishes the AFR monthly as a revenue ruling at:

<https://www.irs.gov/applicable-federal-rates>



# Historical Federal Interest Rates



# AFR 2000-Present

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
2024	5.20	4.80	5.00	5.20	-	-	-	-	-	-	-	-
2023	4.60	4.60	4.40	5.00	4.40	4.20	4.60	5.00	5.00	5.40	5.60	5.80
2022	1.60	1.60	2.00	2.20	3.00	3.60	3.60	3.80	3.60	4.00	4.80	5.20
2021	0.60	0.60	0.80	1.00	1.20	1.20	1.20	1.20	1.00	1.00	1.40	1.60
2020	2.00	2.20	1.80	1.20	0.80	0.60	0.60	0.40	0.40	0.40	0.40	0.60
2019	3.40	3.20	3.20	3.00	2.80	2.80	2.60	2.20	2.20	1.80	2.00	2.00
2018	2.60	2.80	3.00	3.20	3.20	3.40	3.40	3.40	3.40	3.40	3.60	3.60
2017	2.40	2.60	2.40	2.60	2.40	2.40	2.20	2.40	2.40	2.20	2.40	2.60
2016	2.20	2.20	1.80	1.80	1.80	1.80	1.80	1.40	1.40	1.60	1.60	1.80
2015	2.20	2.00	1.80	2.00	1.80	2.00	2.20	2.20	2.20	2.00	2.00	2.00
2014	2.20	2.40	2.20	2.20	2.40	2.20	2.20	2.20	2.20	2.20	2.20	2.00
2013	1.00	1.20	1.40	1.40	1.20	1.20	1.40	2.00	2.00	2.40	2.00	2.00
2012	1.40	1.40	1.40	1.40	1.60	1.20	1.20	1.00	1.00	1.20	1.00	1.20
2011	2.40	2.80	3.00	3.00	3.00	2.80	2.40	2.20	2.00	1.40	1.40	1.60
2010	3.00	3.40	3.20	3.20	3.40	3.20	2.80	2.60	2.40	2.00	2.00	1.80
2009	2.40	2.00	2.40	2.60	2.40	2.80	3.40	3.40	3.40	3.20	3.20	3.20
2008	4.40	4.20	3.60	3.40	3.20	3.80	4.20	4.20	4.20	3.80	3.60	3.40
2007	5.60	5.60	5.80	5.60	5.60	5.60	6.00	6.20	5.80	5.20	5.20	5.00
2006	5.40	5.20	5.40	5.60	5.80	6.00	6.00	6.20	6.00	5.80	5.60	5.80
2005	4.60	4.60	4.60	5.00	5.20	4.80	4.60	4.80	5.00	5.00	5.00	5.40
2004	4.20	4.20	4.00	3.80	3.80	4.60	5.00	4.80	4.60	4.40	4.20	4.20
2003	4.20	4.00	3.80	3.60	3.80	3.60	3.00	3.20	4.20	4.40	4.00	4.20
2002	5.40	5.60	5.40	5.60	6.00	5.80	5.60	5.20	4.60	4.20	3.60	4.00
2001	6.80	6.20	6.20	6.00	5.80	6.00	6.20	6.00	5.80	5.60	5.00	4.80
2000	7.40	8.00	8.20	8.00	7.80	8.00	8.00	7.60	7.60	7.40	7.20	7.00

# Less Favorable – Intrafamily Loans

10

- ▶ Private loan between family members
- ▶ Help children purchase home or business
- ▶ Value of the asset being loaned is frozen and the appreciation passes to beneficiary free of estate and gift tax,
- ▶ Avoid imputed interest by using AFR
- ▶ Structure as an arms distance transaction → need purchase and sale contract
- ▶ Consider title company costs/fees, attorney fees, recording fees, etc.
- ▶ Still frequently more favorable than present commercial lending rates
- ▶ Use discounts by having lender/grantor purchase as a TIC, hold a seller carried note
- ▶ Consider using annual gift tax exclusion for forgiveness
- ▶ But... forgiven interest is income to borrower/beneficiary, and forgiven interest is income to lender/grantor unless otherwise deductible

# Less Favorable – Intentionally Defective Grantor Trusts

- ▶ Grantor generally makes initial lump sum gift to irrevocable trust, and then can subsequently sell or loan additional assets to the trust.
- ▶ Since trust irrevocable and completed gift to trust by grantor, no inclusion in estate
- ▶ Trust structured so grantor still taxed on trust's income (why “defective”)
- ▶ Grantor receives interest bearing promissory note as collateral for loan
- ▶ If assets sold to IDGT, done as and installment sale
- ▶ Rate on the note determined by AFR, so lower the rate the higher the appreciation of the assets in the trust as a result of lower note payments
- ▶ Assets generally need to appreciate in excess of interest rate for this to be advantageous—determining appropriate assets/combination of assets is crucial to garner benefit

# Less Favorable - Grantor Retained Annuity Trusts

- ▶ Grantor contributes assets to trust
- ▶ Grantor receives income stream for set term or until death (annuity)
- ▶ Upon expiration of term or on grantor's death, assets pass to beneficiaries and not included in grantor's gross estate
- ▶ Usually best for highly appreciable assets
- ▶ Amount of interest grantor receives is the §7520 rate (hurdle rate)
- ▶ Any appreciation on assets in excess of the hurdle rate passes to beneficiary outside of grantor's taxable estate
- ▶ §7520 rate is fixed for the duration of the GRAT, so when rates are low, less "hurdle" and a higher amount of assets pass to the beneficiaries without §2036 inclusion in grantor's estate

# More Favorable - Qualified Personal Residence Trusts

- ▶ Grantor contributes real property to irrevocable QPRT, retains the right to live in property rent-free for a set number of years (QPRT term)
- ▶ Taxable gift = appraised value of property, less value of grantor's right to live in the residence, as determined by a calculation involving AFR, grantor's age, value of property, and length of QPRT term
- ▶ High interest rates = lower present value, lower gift value, and lower E&G tax
- ▶ Grantor must outlive term, otherwise inclusion for remainder interest value in term
- ▶ Trade off is no stepped-up basis
- ▶ Great for vacation homes which will stay in family, remember to lease back if grantor still living there/primary use person upon expiration of term
- ▶ Use of fractional interest discounts helpful (i.e., take out of joint tenancy, move into a TIC, take discount results in transfer property at a lower value/less exemption used by grantor(s))

# More Favorable - Grantor Retained Income Trusts

- ▶ Grantor transfers assets to irrevocable trust, retains interest in all net income for term of years
- ▶ When term ends/on death of grantor, remaining assets pass to remainder beneficiaries
- ▶ Value of grantor's retained interest in trust reduces value of trust for gift tax purposes, but only if beneficiaries are not members of grantor's family
- ▶ Members of the grantor's family = grantor's spouse, lineal descendants of grantor or grantor's spouse, and siblings of grantor or grantor's spouse
- ▶ Great technique for unmarried couples, friends, nieces/nephews, more distant relatives—consider for unmarried, childless clients
- ▶ As §7520 rate increases, value of remainder interest and taxable gift decreases (term must be set upon contribution)

# More Favorable - Charitable Remainder Trusts

- ▶ Inverse of a CLAT, allows grantor to provide regular income stream to non-charitable beneficiaries for term of trust, remaining trust assets left to charitable beneficiaries
- ▶ Upon contribution to the CRT, grantor receives income tax deduction based on remainder value being left to charity
- ▶ §7520 rate used to calculate value of remainder to charity → higher the §7520 rate, the higher potential income tax deduction for grantor
- ▶ Great option for low basis assets which can be sold by trustee of CRT in exchange for income producing assets (avoid gains, create income stream)
- ▶ Consider for philanthropically inclined clients with taxable estates, particularly before 2026 exemption drop



# Exercising Swap Powers

16

- ▶ Look at higher basis assets, income generation, income needs of client
- ▶ Document carefully!
- ▶ Consider decanting (for those states where an option)
- ▶ Discuss family dynamics and expectations if beneficiaries are not synonymous between trusts/plans
- ▶ Obtain a qualified appraisal (if values not apparent, obvious, self-proving)
- ▶ Consider discounts and/or fractional interest in family partnerships or LLC—but watch out for related party transactions, use disinterested trustees, and “don’t get cute” with interpretation of §672(c)

# Review Trusts With Formula Clauses

17

- ▶ Loan forgiveness on death documents? Look twice to avoid inclusion, consider forgiveness before 2026
- ▶ Does that GSTT clause still make sense? “Remember when” isn’t all that long ago...
- ▶ What about large specific gifts, with remainder to others? Will there be sufficient assets to pay estate tax on death?
- ▶ Review anything with a foreign spouse
- ▶ Old A/B/Cs?
- ▶ Disinterested trustees?

# For More Information

18

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**Questions?**