

Estate Planning Strategies in a Low-Interest-Rate Environment

The federal government requires the use of certain published interest rates to value various items used in estate planning, such as an income, annuity, or remainder interest in a trust. The government also specifies interest rates that a taxpayer may be deemed to use in connection with certain installment sales or intra-family loans. These rates are currently at or near historic lows, presenting several estate planning opportunities.

Low interest rates favor certain estate planning strategies over others. For example, low interest rates are generally beneficial for a grantor retained annuity trust (GRAT), a charitable lead annuity trust (CLAT), an installment sale, and a low-interest loan. On the other hand, low interest rates generally have a detrimental effect on a qualified personal residence trust (QPRT) and a charitable gift annuity. But interest rates have little or no effect on a charitable remainder unitrust (CRUT).

Grantor retained annuity trust (GRAT)

In a GRAT, you transfer property to a trust, but retain a right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your designated beneficiaries, such as family members. The value of the gift of the remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. Also, if you survive the trust term, the trust property is not included in your gross estate for estate tax purposes. If the rate of appreciation is greater than the IRS interest rate, a higher value of trust assets escapes gift and estate taxation. Consequently, the lower the IRS interest rate, the more effective this technique can be.

Charitable lead annuity trust (CLAT)

In a CLAT, you transfer property to a trust, giving a charity the right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your designated beneficiaries, such as family members. This trust is similar to a GRAT, except that you get a gift tax charitable deduction. Also, if the CLAT is structured so that you are taxed on trust income, you receive an up-front income tax charitable deduction for the gift of the annuity interest. Like with a GRAT, the lower the IRS interest rate, the more effective this technique can be.

Installment sale

If you enter into an installment sale with family members, you can generally defer the taxation of any gain on the property sold until the installment payments are received. However, if the family member resells the property within two years of your installment sale, any deferred gain will generally be accelerated. The two-year limit does not apply to stocks that are sold on an established securities market.

You are generally required to charge an adequate interest rate (based on IRS published rates) in return for the opportunity to pay in installments, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, your family members can pay for the property in installments while paying only a minimal interest cost for the benefit of doing so.

Low-interest loan

A low-interest loan to family members might also be a useful strategy. You are generally required to charge an adequate interest

rate on the loan for the use of the money, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, you can provide loans at a very low rate, and family members can effectively keep any earnings in excess of the interest they are required to pay you.

Effect of low rates on other strategies

Charitable remainder unitrust: You transfer property to a trust, retaining a stream of payments for life or a number of years, after which the remainder passes to charity. You receive a current charitable deduction for the gift of the remainder interest. Interest rates have no effect if payments are made annually at the beginning of each year, and low interest rates have only a minimal detrimental effect if payments are made in any other way.

Qualified personal residence trust: You transfer your personal residence to a trust, retaining the right to live in the home for a period of years, after which the residence passes to your designated beneficiaries, such as family members. The value of the gift of the remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. The lower the IRS interest rate, the less effective this technique can be.

Charitable gift annuity: You transfer property to a charity in return for the charity's promise to make annuity payments for your life (or for the lifetimes of you and your spouse). You receive a current charitable deduction for the gift of the remainder interest. The lower the interest rate, the lower the amount of your charitable deduction. Also, charities have generally been forced to reduce payout rates offered because of economic uncertainties and the low-interest-rate environment.

Are There Gaps in Your Insurance Coverage?

Buying insurance is about sharing or shifting risk. For example, health insurance will cover some of the cost of medical care. Homeowners insurance will assume some of the risk of loss in the event your home is damaged or destroyed. But oftentimes we think we're covered for specific losses when, in fact, we're not. Here are some common coverage gaps to consider when reviewing your own insurance coverage.

Life insurance

In general, you want to have enough life insurance coverage (when coupled with savings and income) to allow your family to continue living the lifestyle to which they're accustomed. But changing circumstances may leave a gap in your life insurance coverage.

For example, if you have life insurance through your employer, changing jobs could affect your insurance coverage. You may not have the same amount of insurance, or the policy provisions may differ. Whereas your prior employer may have provided permanent life insurance, now you may have term insurance that will expire on a predetermined date. Review your income, savings, and expenses annually and compare them to your insurance coverage, and be mindful that changing circumstances may require a change in the amount of insurance coverage.

Homeowners insurance

It's not always clear from reading your homeowners policy which perils are covered and how much damage will be paid for. It's

important to know what your homeowners policy covers and, more important, what it doesn't cover.

You might think your insurer would pay the full cost to replace your home if it were destroyed by a covered occurrence. But many policies place a cap on replacement cost up to the face amount stated on the policy. You may want to check with a building contractor to get an idea of the replacement cost for your home, then compare it to your policy to be sure you have enough coverage.

Even if your policy states that "all perils" are covered, most policies carve out many exceptions or exclusions to this general provision. For example, damage caused by floods, earthquakes, and hurricanes may be covered only by special addendums to your policy, or in some cases by separate insurance policies altogether. Also, your insurer may not cover the extra cost of rebuilding attributable to more stringent building codes, or your policy may limit how much and how long it will pay for temporary housing while repairs are made.

To avoid these gaps in coverage, review your policy annually with your insurer. Also, pay attention to notices you may receive. What may look like boilerplate language could actually be significant changes to your coverage. Don't rely on your interpretations—seek an explanation from your insurer or agent.

Auto insurance

Which drivers and what vehicles are covered by your auto insurance? Most policies provide coverage for you and family members residing with you, but it's not

always clear-cut. For instance, a child who is living in a college dorm is probably covered, but a child who lives in an off-campus apartment might be excluded from coverage. If you and your spouse divorce, which policy insures your children, particularly if they are living with each parent at different times of the year? Notify your insurer about any change in living arrangements to avoid a gap in coverage.

Other gaps include no coverage for damaged batteries, tires, and shocks. And you might not be covered for stolen or damaged cell phones or other electronic devices. Your policy may also limit the amount paid for a rental while your vehicle is being repaired.

In fact, insurance coverage for rental cars may also pose a problem. For instance, your own collision coverage may apply to the rental car you're driving, but it may not pay for all the damage alleged by a rental company, such as loss of use charges. If you're leasing a car long term, your policy may cover the replacement cost only if the car is a total loss or is stolen. But that amount may not be enough to pay for the outstanding balance of your lease. Gap insurance can cover any difference between what your insurer pays and the balance of your lease.

Policy terms and conditions aren't always easily understood, and you may not be sure what's covered until it's time to file a claim. So review your insurance policy to be sure you've filled all the gaps in your coverage.



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