



NORTHERN
TRUST

Lifetime Asset Transfers: An Overview

QPRTs, GRATs, and the Fundamentals of Sales to Grantor Trusts

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Lifetime Asset Transfers: An Overview



Mathematics Behind Lifetime Transfers

In the Estate

\$11.4 Mil.

Out of the Estate

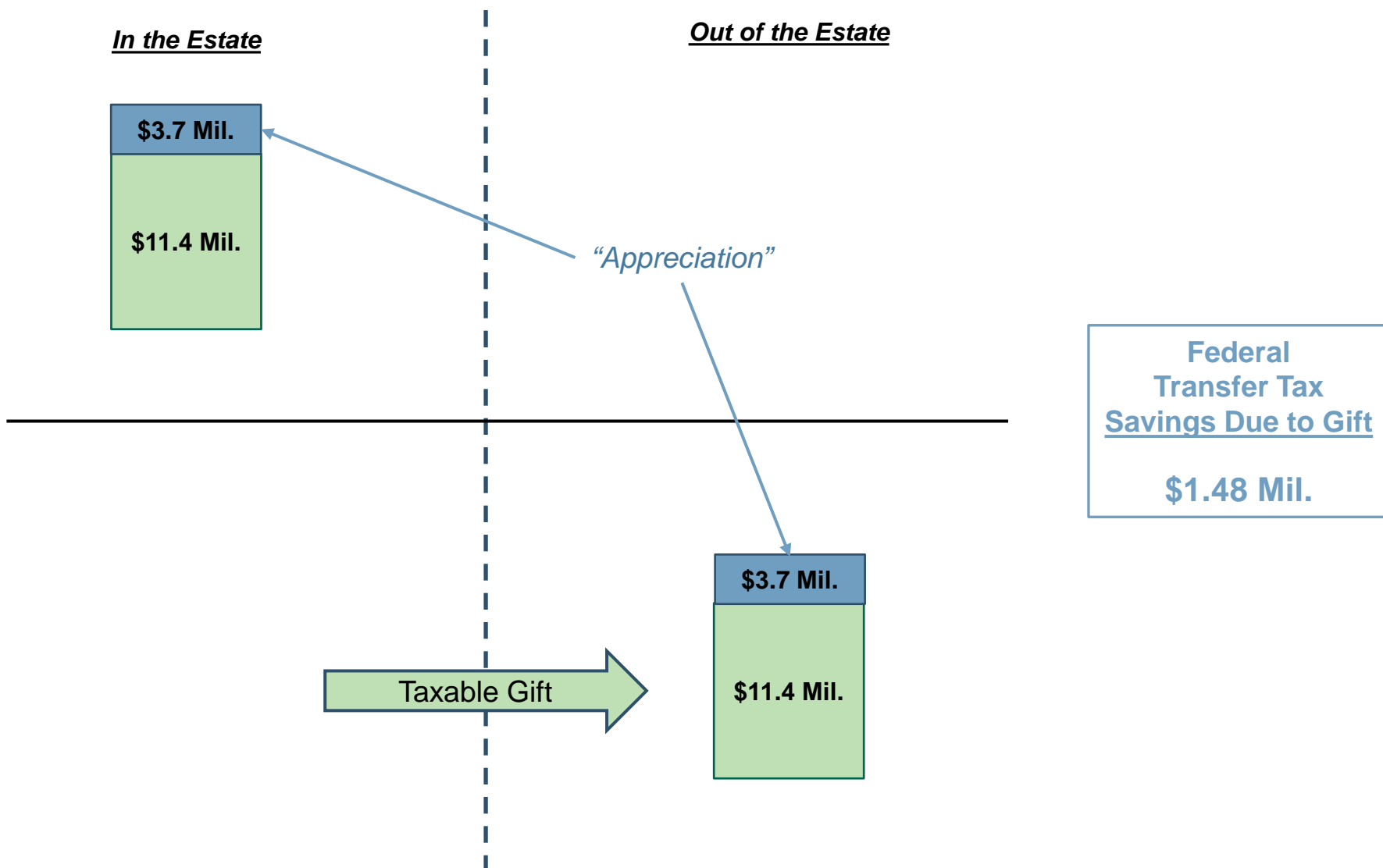
Taxable Gift

\$11.4 Mil.

Federal
Transfer Tax
Savings Due to Gift
\$0

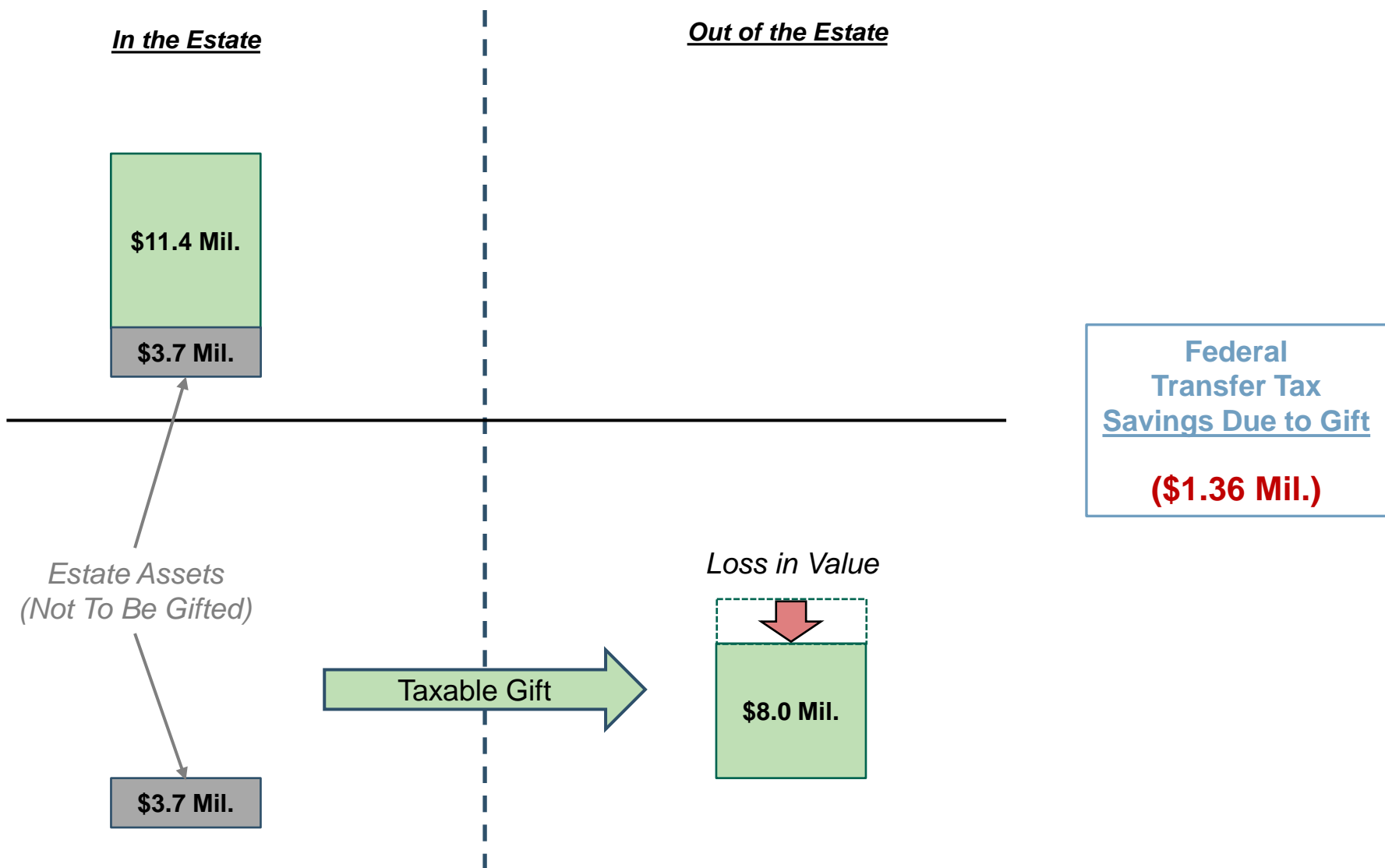


Mathematics Behind Lifetime Transfers: Appreciation



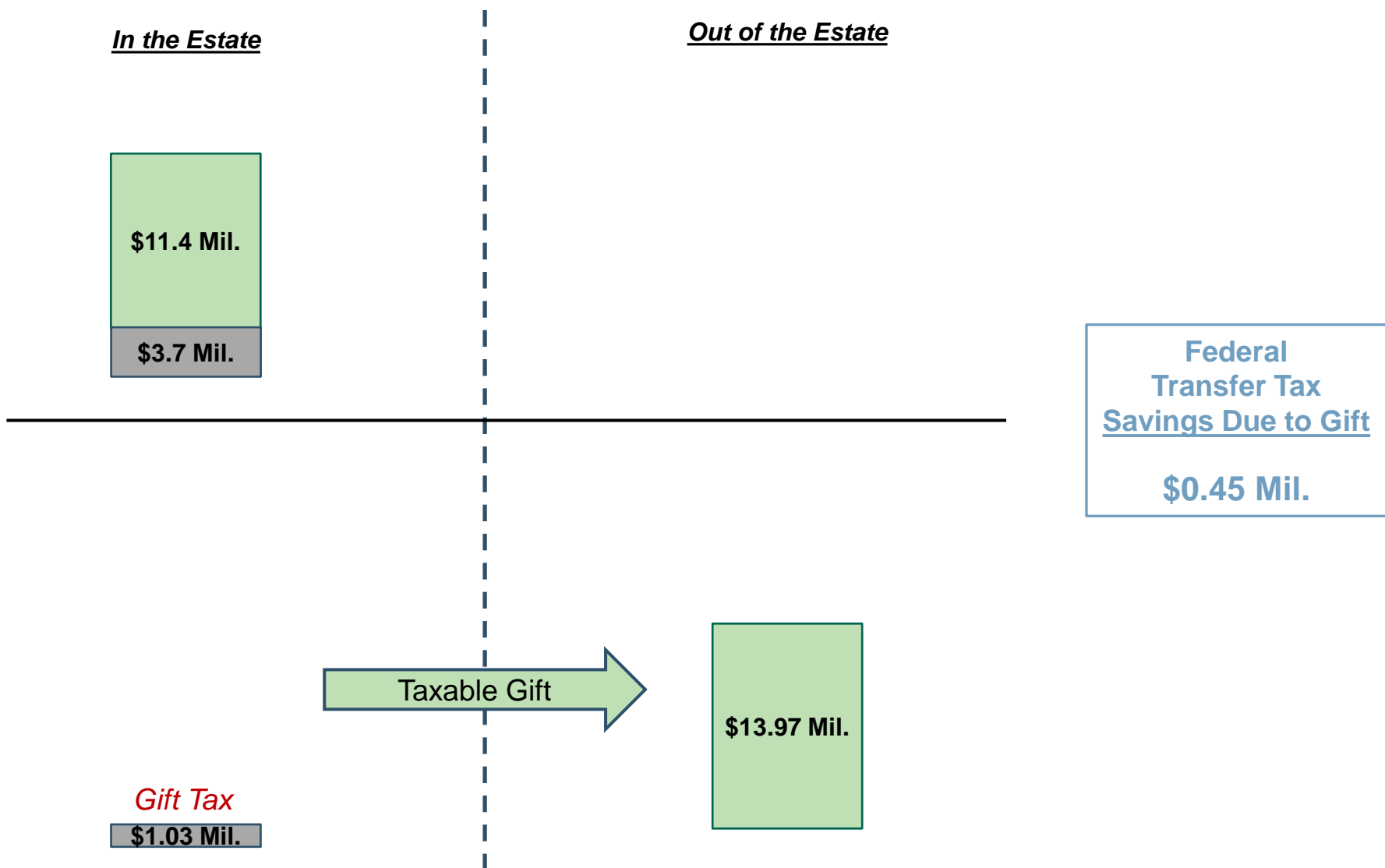


Mathematics Behind Lifetime Transfers: Loss In Value



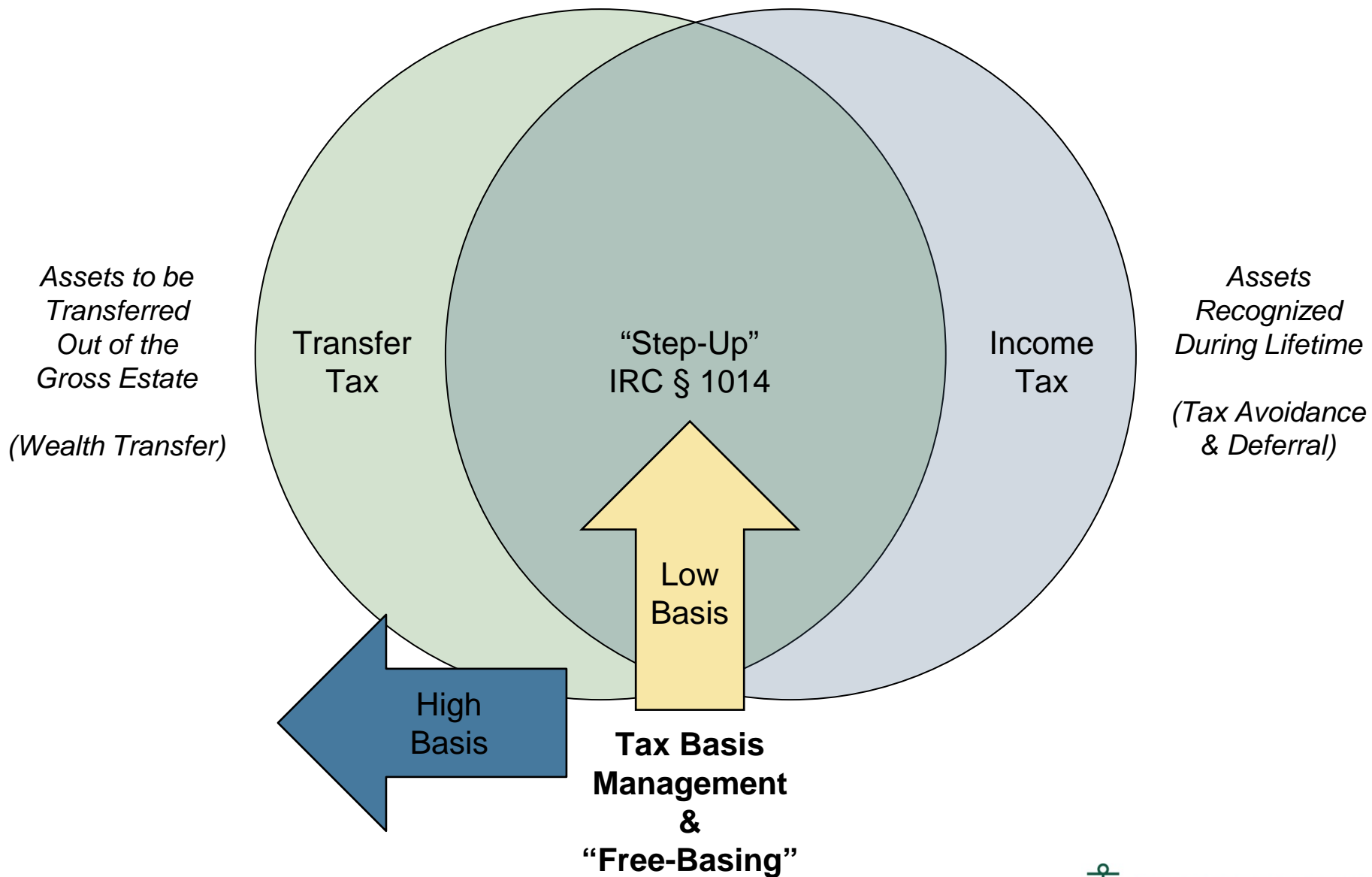


Mathematics Behind Lifetime Transfers: Tax Exclusivity



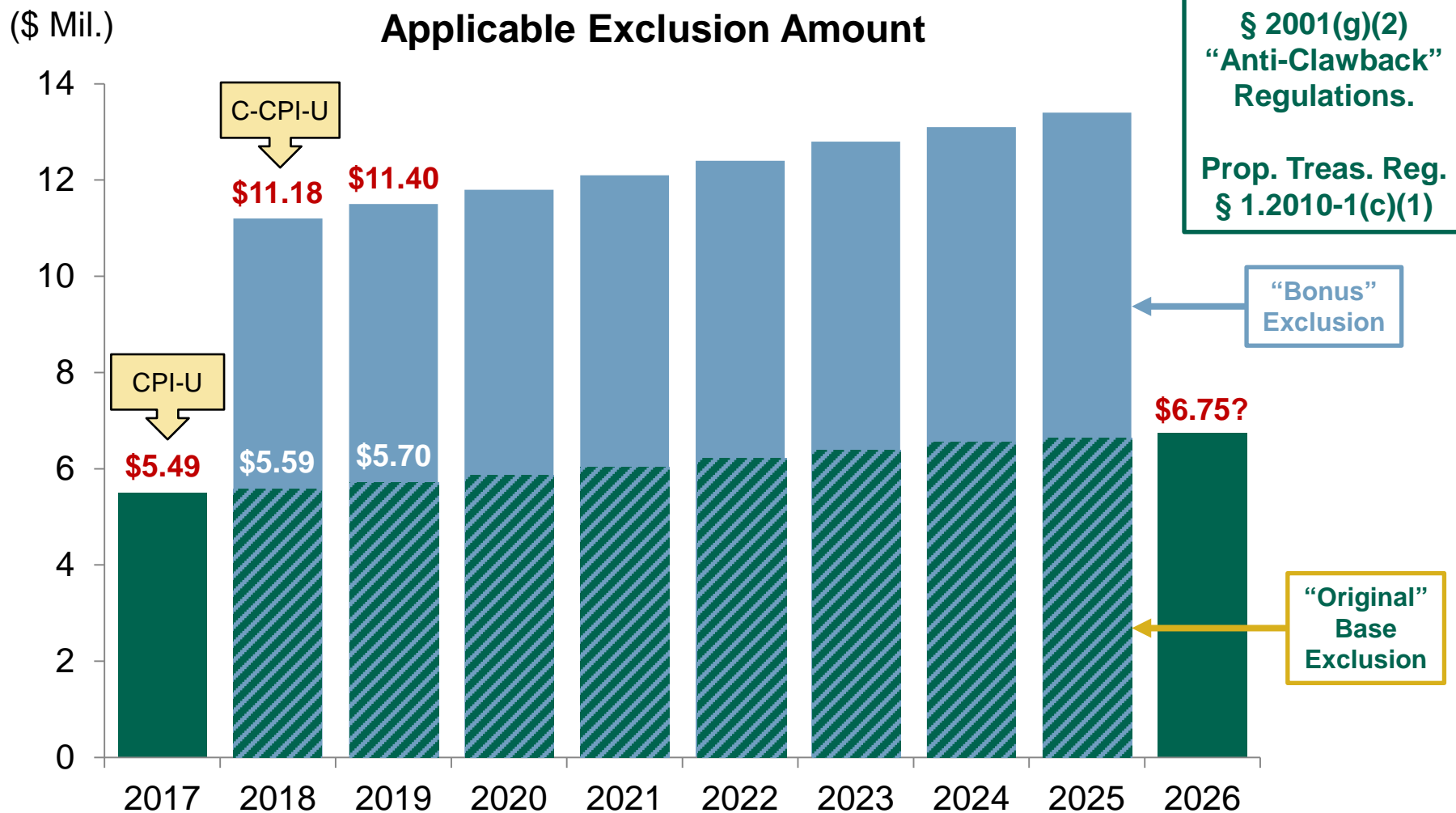


The Transfer Tax Landscape: Venn Diagram





2012 All Over Again?





To Gift or Not to Gift: That's the Question...

Up to Wealthy

\$0 to ~\$11.4 Mil.

- ❑ Limit taxable gifts
- ❑ Preserve Applicable Exclusion
- ❑ Take advantage of free “step-up” in basis
- ❑ Limit valuation discounts
- ❑ Transfers of wealth in excess of the Applicable Exclusion via “zeroed-out” techniques
- ❑ Transfer high basis assets to IDGTs with “swap” power

“Middle Class” Wealthy

~\$11.4 Mil. to ~\$40.0 Mil.

- ❑ Taxable gifts in excess of the “Original” Applicable Exclusion depend on whether taxpayer can afford to make such gift
- ❑ Careful consideration of “split-gift” election (or NOT) in certain years
- ❑ Spousal Lifetime Access Trusts
- ❑ Retained cash flow techniques (i.e., preferred partnership freezes)
- ❑ Trusts that provide maximum “flexibility”

Ultra-Wealthy

Above ~\$40.0 Mil.

- ❑ Large taxable gifts to use “Original” and “Bonus” Applicable Exclusion
- ❑ Transfer to IDGTs (with “swap” power)
- ❑ Valuation discount planning
- ❑ “Zeroed-out” techniques, leveraging taxable gifts (i.e., installment sale)
- ❑ “Free-basing” with marital deduction and estate reduction planning with surviving spouse

Consider:

Applicable Exclusion gifts of cash (or marketable securities), and
Exercise of “swap” power in the future.



Estate Tax Cost vs. Income Tax Savings From "Step-Up"

Taxable Estate

(\$ Mil.)

\$25.0

\$20.0

\$15.0

\$10.0

\$5.0

\$-

2019

2021

2023

2025

2027

2029

*Transfer Tax Cost
In 2024 of
Taxable Estate?*

49.6%
Cost For
Step-Up
in Basis

Max 16.0%
Cost For
Step-Up
in Basis

"Free"
Step-Up
in Basis

*Federal Applicable
Exemption Amount*

*Phase-out of NYS
Exemption*

*New York State
Exemption Amount*

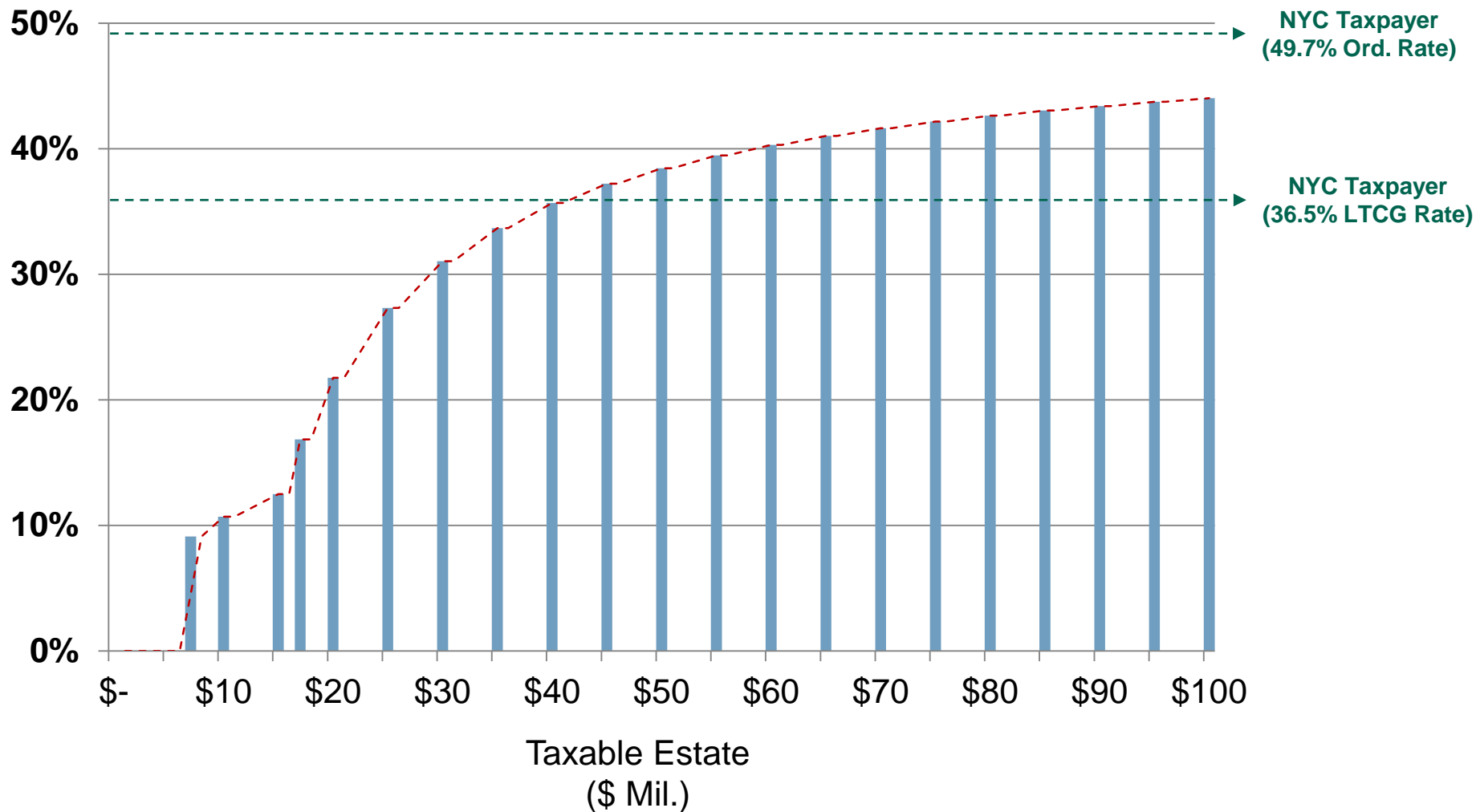
Doubling Permanent?

*Expiration of
Doubling?*



Effective Transfer Tax Rate for New York City Taxpayers

Combined Federal and NYS Transfer Tax Rate (2024)





Some Assets Benefit from “Step-Up”—Some Do Not

“Step-Up” Important
[Higher Valuation]



Asset Type

Tax Characteristic

Creator-Owned Copyrights, Trademarks, Patents & Artwork

Ordinary Transforms to Long-Term

“Negative Basis” Commercial Real Property LPs

Recapture & >100% Long-Term

“Bonus Depreciation” Qualified Property under § 168(k)

§ 1245 Recapture

Oil & Gas Investments

§ 1245 Recapture

Artwork, Gold & Other “Collectibles”

28% Long-Term

Low Basis Stock

20% Long-Term

Roth IRA Assets

Tax Free & No Surcharge

Qualified Small Business Stock (QSBS)

§ 1202 Gain [50, 60, 75 or 100%] Exclusion

High Basis Stock

Minimal Gain

Fixed Income

Typically Minimal Gain

Cash

Basis = Face Value

Passive Foreign Investment Company (PFIC) Shares

No “Step-Up”

Stock at a Loss

Capital Loss Erased

Variable Annuities

Partially IRD

Traditional IRA & Qualified Plan Assets

100% IRD

“Step-Up” not Important
[Lower Valuation]



- Remember the “Freebies”
 - ◆ Annual Exclusion Gifts
 - ◆ Ed/Med Gifts
 - ◆ UGMA / UTMA and Minors Trusts
 - ◆ Section 529 Plans
 - ◆ “Crummey” Trusts (not just for Irrevocable Life Insurance Trusts)

- Default should be a gift to an “Intentionally Defective Grantor Trusts” (IDGTs) with “Swap Power”

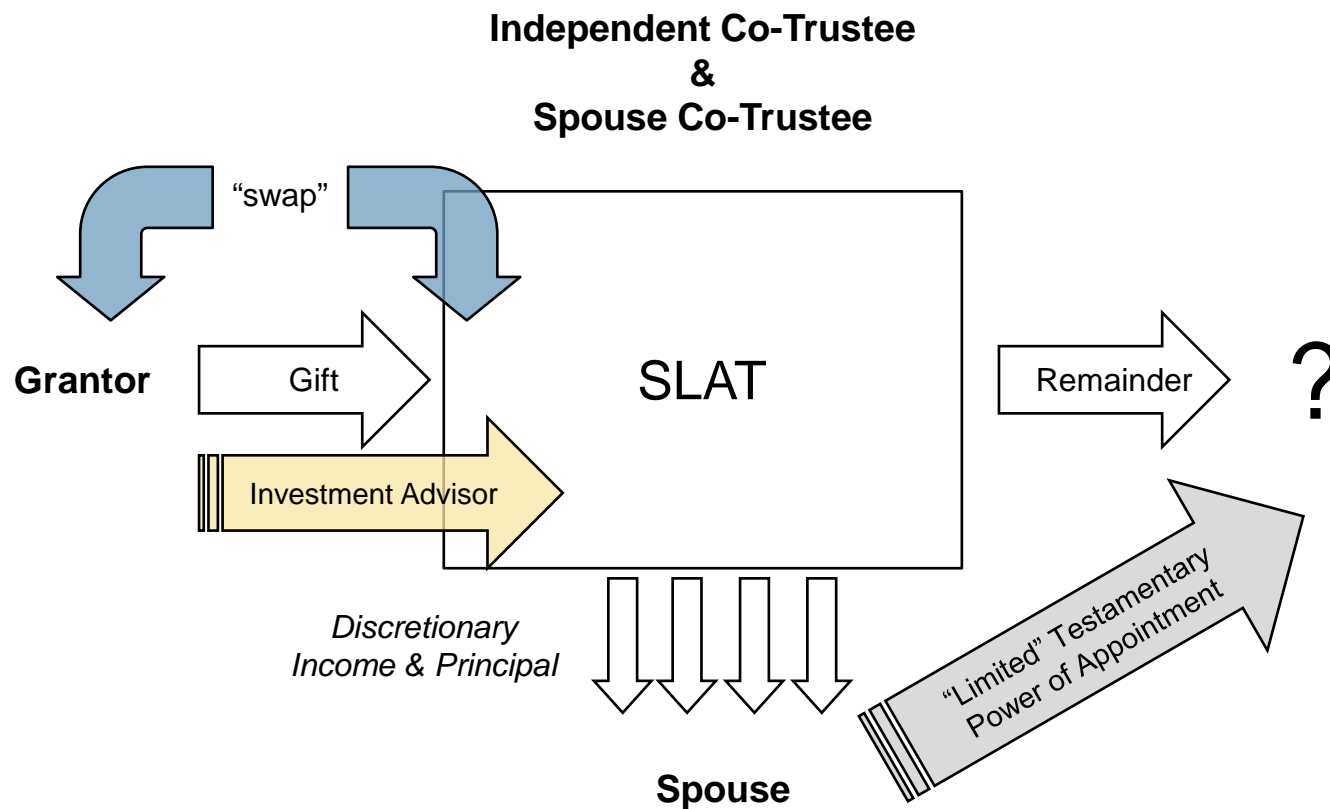
- “Defined Value” vs. “Price Adjustment” Clauses

- Carryover Basis under § 1012

- Valuation Discount Planning
 - ◆ Discount is the wealth equivalent of appreciation out of the estate
 - ◆ Family limited partnership (FLP) transfers
 - ▶ IRS retracted proposed treasury regulations under § 2704 (lapsing rights and restrictions by family)
 - ▶ Challenged under § 2036(a)(2) (retained right in conjunction with any person to designate who could enjoy the property or its income)



Spousal Lifetime Access Trust





Net Gifts? Financed Net Gifts? Net, Net Gift?

Net Gift

$$\frac{\text{Tentative Tax}}{1 + \text{Rate of Tax}} = \frac{\$1,000,000 \times 40\%}{1 + 40\%} = \$285,714$$

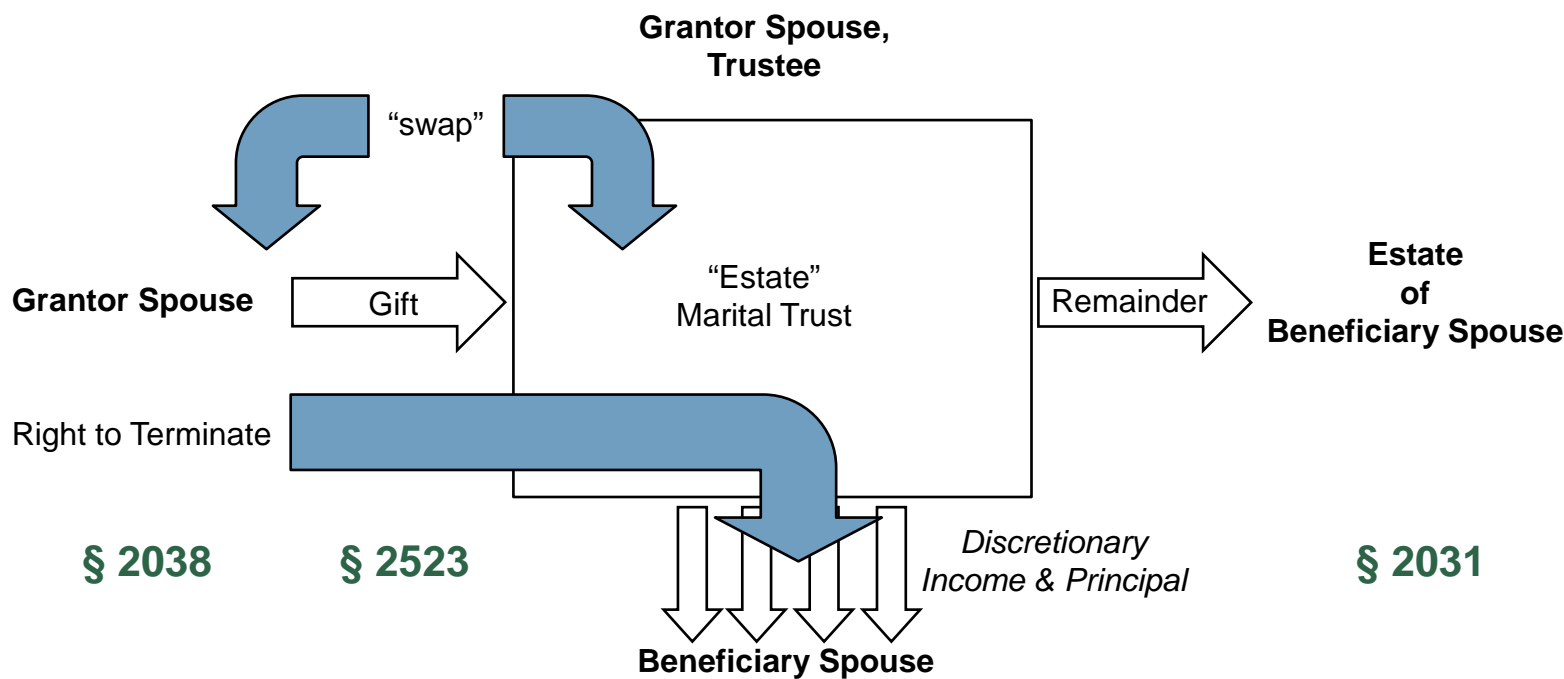
Financed Net Gift





Don't Forget About Inter-Vivos Marital Deduction Trusts

- Qualified Terminable Interest Property (QTIP) Marital Trust
- General Power of Appointment Marital Trust
- “Estate” Marital Trust
- Section 2038 Estate Marital Trust





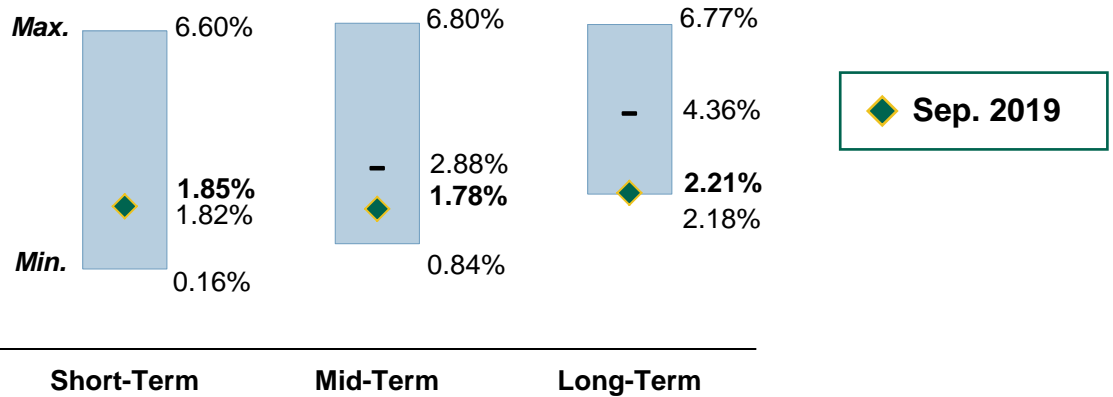
*QPRTs, GRATs, and
The Fundamentals of Sales to
Grantor Trusts*



Still Very Low AFR and Section 7520 Rates

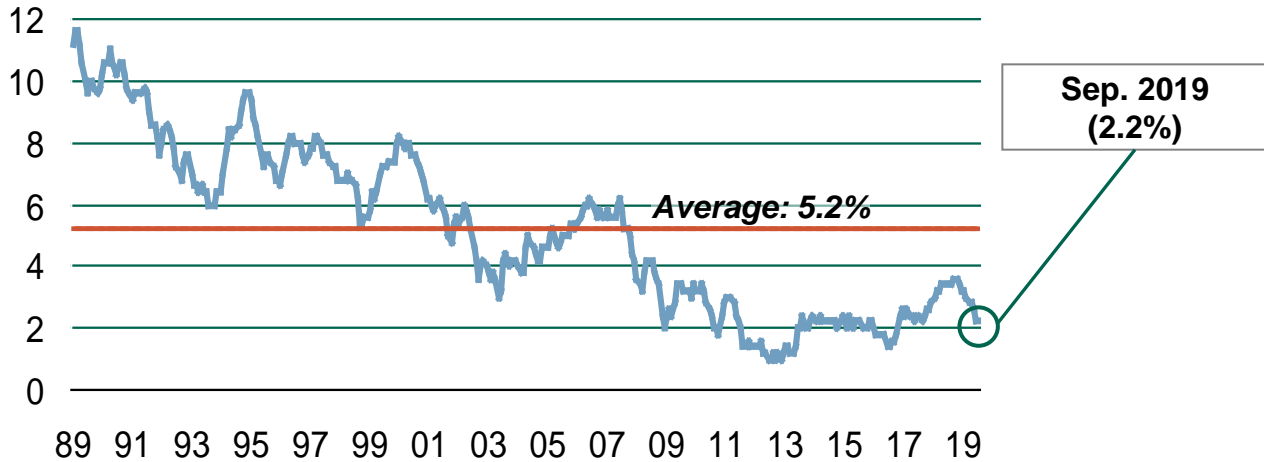
Applicable Federal Rates*

Jan. 1998 – Sep. 2019



- Intra-Family Loans
- Sales to IDGTs
- SCINs

Section 7520 Rate (%)**



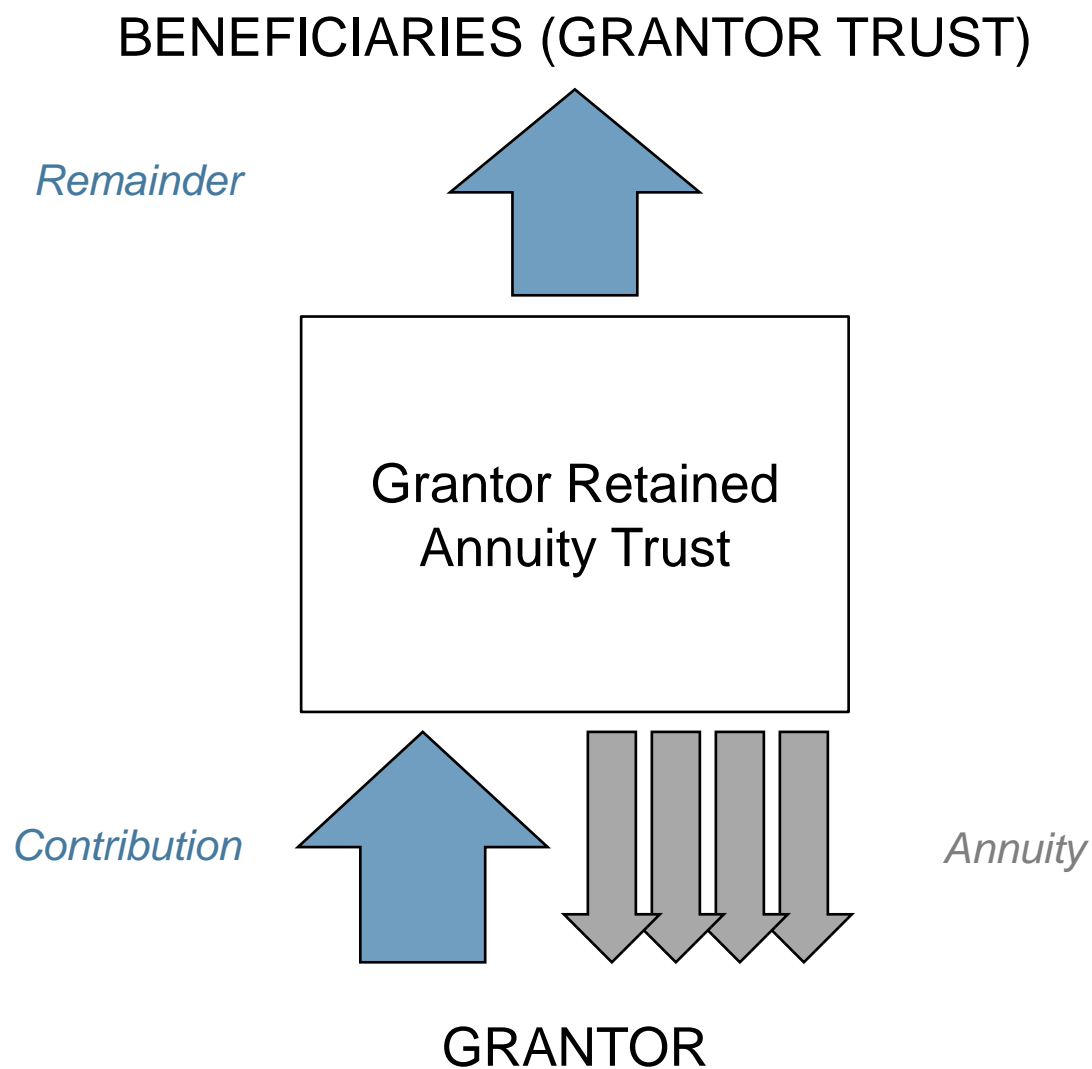
- GRATs
- QPRTs
- CLATs
- Private Annuities

*Section 1274(d) of the Internal Revenue Code of 1986, as amended (Code), compounded annually.

**Code Section 7520.

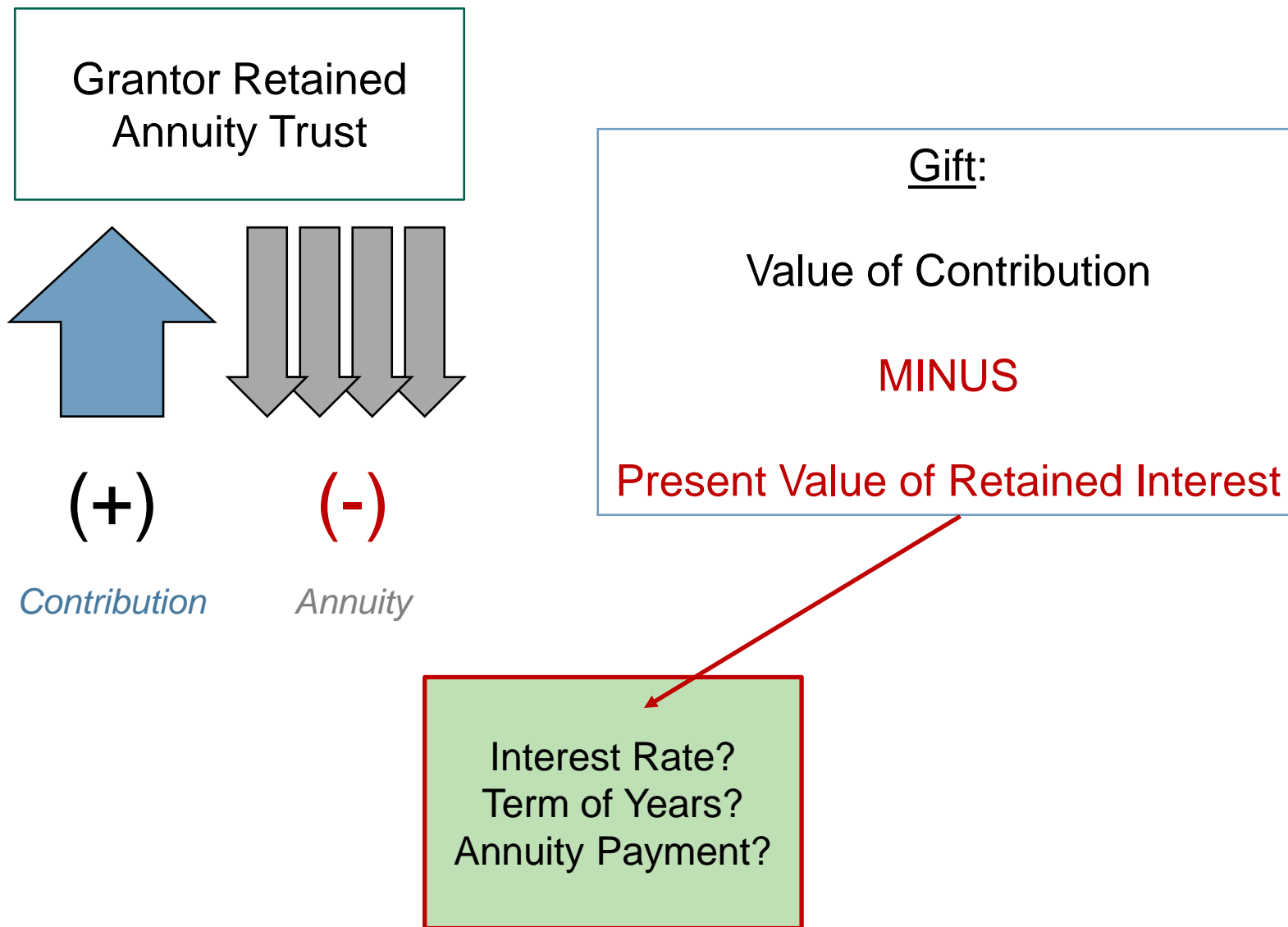


Grantor Retained Annuity Trusts





Calculation of the Taxable Gift





“Zeroed-Out” GRAT: Fixed Annuity

7520 Rate of 6.0%
10 Year Term
\$10 Mil. Contribution

Fixed Annuity

- 1. \$1,358,680
- 2. \$1,358,680
- 3. \$1,358,680
- 4. \$1,358,680
- 5. \$1,358,680
- 6. \$1,358,680
- 7. \$1,358,680
- 8. \$1,358,680
- 9. \$1,358,680
- 10. \$1,358,680

Total: \$13,586,800

Present Value = \$10,000,000

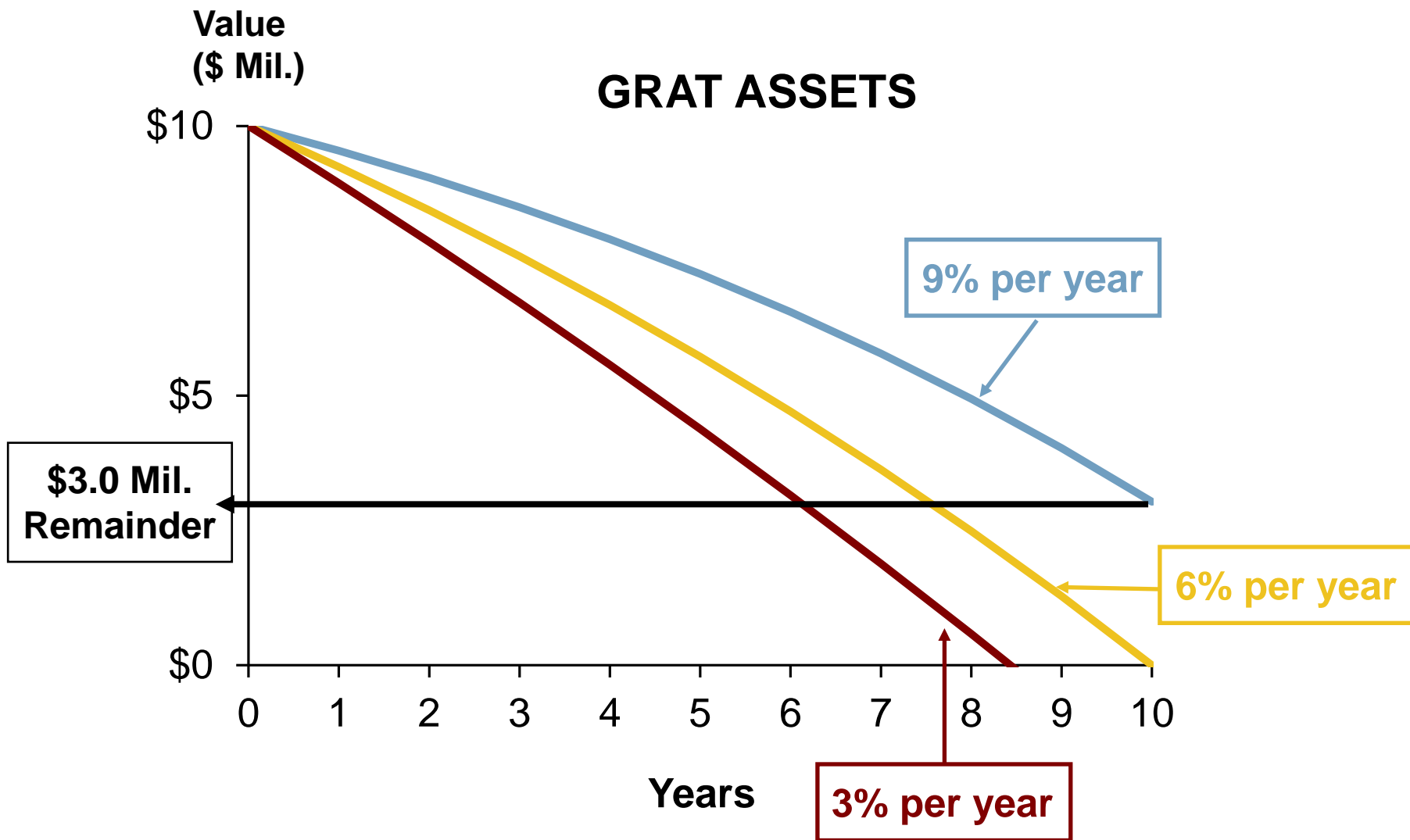


Amount to Grantor



7520 Rate: Assumed Rate of Return

GRAT ASSETS





Returns Are Rarely Average

	<u>Average Return</u>	<u>Return Path 1*</u>	<u>Return Path 2*</u>
Year 1	9.3%	10.1%	-22.1%
Year 2	9.3	1.3	-11.9
Year 3	9.3	37.6	-9.1
Year 4	9.3	23.0	21.0
Year 5	9.3	33.4	28.6
Year 6	9.3	28.6	33.4
Year 7	9.3	21.0	23.0
Year 8	9.3	-9.1	37.6
Year 9	9.3	-11.9	1.3
Year 10	9.3	-22.1	10.1
CAGR	9.3%	9.3%	9.3%

*Return Path 1 represents the annual return of the S&P 500 from 1993-2002 and Return Path 2 is the reverse of the returns.



Path Returns Is Equally As Important

- \$10 Million GRAT
 - 10 Years
 - \$1,358,680 Annuity

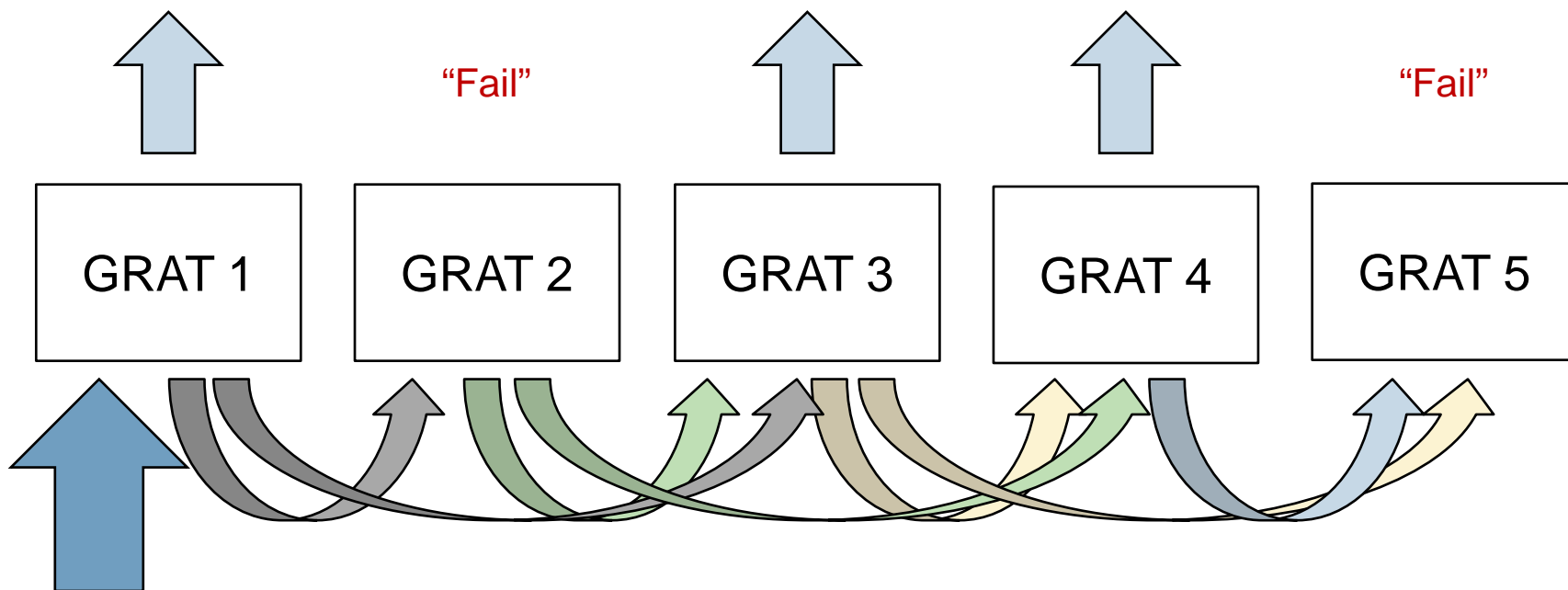
	Grantor	Remainder
Average Return	\$13.6 Mil.	\$ 3.4 Mil.
Return Path 1	\$13.6	\$ 8.0
Return Path 2	\$ 8.0	\$ 0.0

“FAIL”



Short-Term (2-Year) “Zeroed-Out Rolling” GRATs

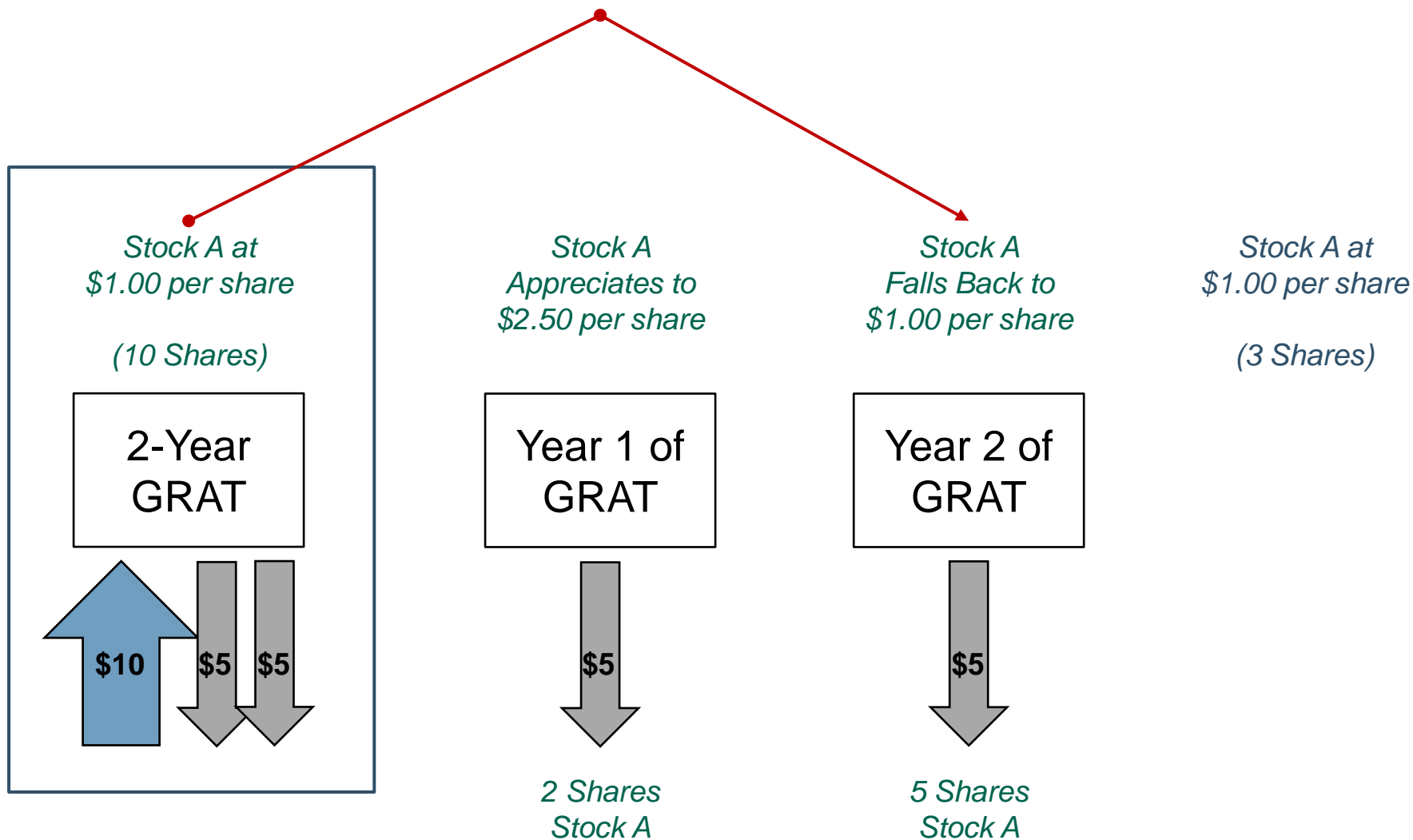
BENEFICIARIES (GRANTOR TRUST)



GRANTOR



Short-Term GRATs Are About Volatility (Not Return or 7520 Rate)





Additional Things About GRATs

- Qualified Annuity Payments
 - ◆ Commutation (prepayment) of term holder's interest is prohibited
 - ◆ May increase by no more than 20% than the previous year's payment
 - ◆ Annuity payment may not be paid by a note, debt instrument, option, or other similar financial arrangement

- GRAT is subject to Estate Tax Inclusion Period (ETIP) rules for GST tax purposes

- GRITs are still possible for the benefit of nieces and nephews

- Estate tax inclusion amount is not necessarily the value of the assets in the GRAT at the time of death

- Allowable or Possible Planning
 - ◆ GRAT can borrow from third party to pay annuity
 - ◆ "Locking" GRAT value by "swapping" assets including grantor's promissory note
 - ◆ Multiple GRATs taking "long" and "short" investment positions or "preferred" and "common" interests
 - ◆ Sale of remainder interest to another trust (e.g., GST exempt IDGT)
 - ◆ Remainder can vest in a limited liability company



What About Very Long Term GRATs?

50 Year GRAT

Annuity	\$	331,757.22
Interest Rate		2.2%
Years		50
PV of Grantor's Retained Interest	\$	10,000,000
Annuity Factor		30.14252399
Life Factor		0.663135528
Remainder Factor		0.336864472

60 Year GRAT

Annuity	\$	301,777.31
Interest Rate		2.2%
Years		60
PV of Grantor's Retained Interest	\$	10,000,000
Annuity Factor		33.13701708
Life Factor		0.729014376
Remainder Factor		0.270985624

70 Year GRAT

Annuity	\$	281,326.46
Interest Rate		2.2%
Years		70
PV of Grantor's Retained Interest	\$	10,000,000
Annuity Factor		35.5458926
Life Factor		0.782009637
Remainder Factor		0.217990363

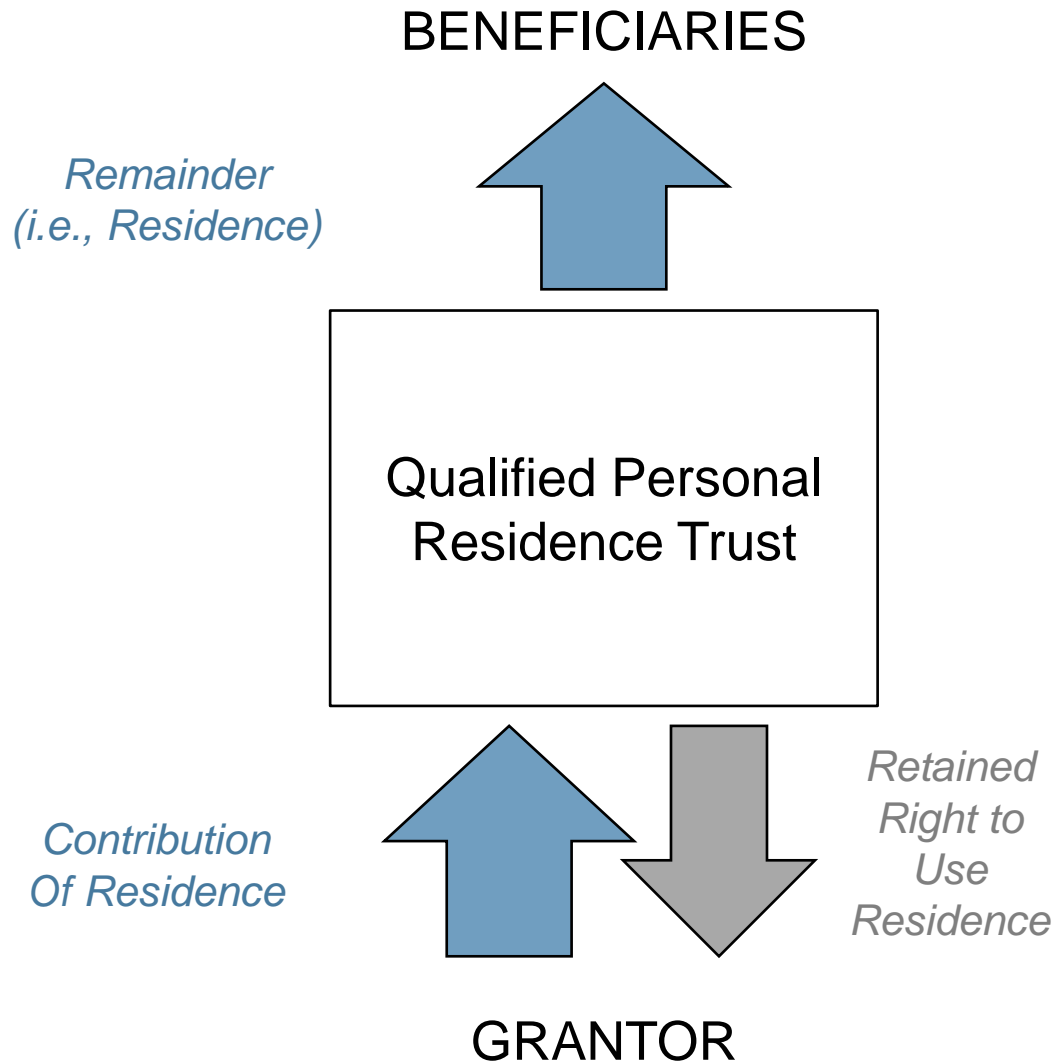
7520 Rate at Death	\$	§ 20.2036-1(c)(2): Amt. Incl.
1.0%	\$	33,175,722.12
2.0%	\$	16,587,861.06
3.0%	\$	11,058,574.04
4.0%	\$	8,293,930.53
5.0%	\$	6,635,144.42
6.0%	\$	5,529,287.02
7.0%	\$	4,739,388.87

7520 Rate at Death	\$	§ 20.2036-1(c)(2): Amt. Incl.
1.0%	\$	30,177,731.37
2.0%	\$	15,088,865.69
3.0%	\$	10,059,243.79
4.0%	\$	7,544,432.84
5.0%	\$	6,035,546.27
6.0%	\$	5,029,621.90
7.0%	\$	4,311,104.48

7520 Rate at Death	\$	§ 20.2036-1(c)(2): Amt. Incl.
1.0%	\$	28,132,645.63
2.0%	\$	14,066,322.81
3.0%	\$	9,377,548.54
4.0%	\$	7,033,161.41
5.0%	\$	5,626,529.13
6.0%	\$	4,688,774.27
7.0%	\$	4,018,949.38

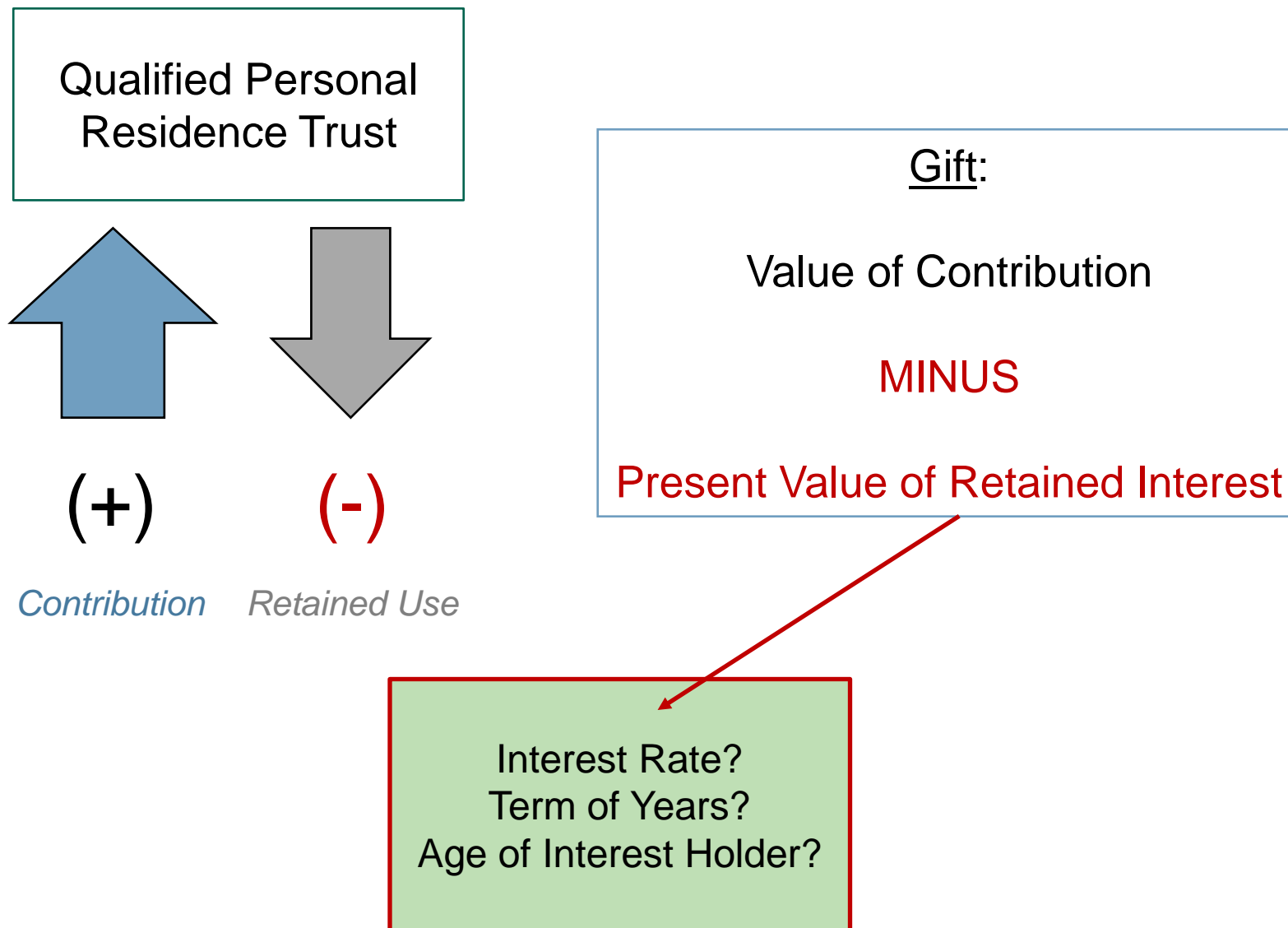


Qualified Personal Residence Trusts





Calculation of the Taxable Gift





No “Zeroed-Out” Gifts with QPRTs

Resulting Taxable Gift 50-Year Old Grantor \$1.0 Mil. Residence/Contribution		
Term	2.2% 7520 Rate	6.0% 7520 Rate
10 Years	\$752,900	\$522,620
20 Years	\$517,150	\$249,180
30 Years	\$282,660	\$94,540
40 Years	\$82,650	\$19,190
50 Years	\$5,320	\$860



Additional Things About QPRTs

- Commutation of term holder's interest is prohibited

- Limitations to QPRTs
 - ◆ Residence may not be purchased by grantor or grantor's spouse during term or after term
 - ◆ Fair market value rent must be paid to owners after expiration of the term

- Sale of residence with no intent to repurchase will convert QPRT to GRAT

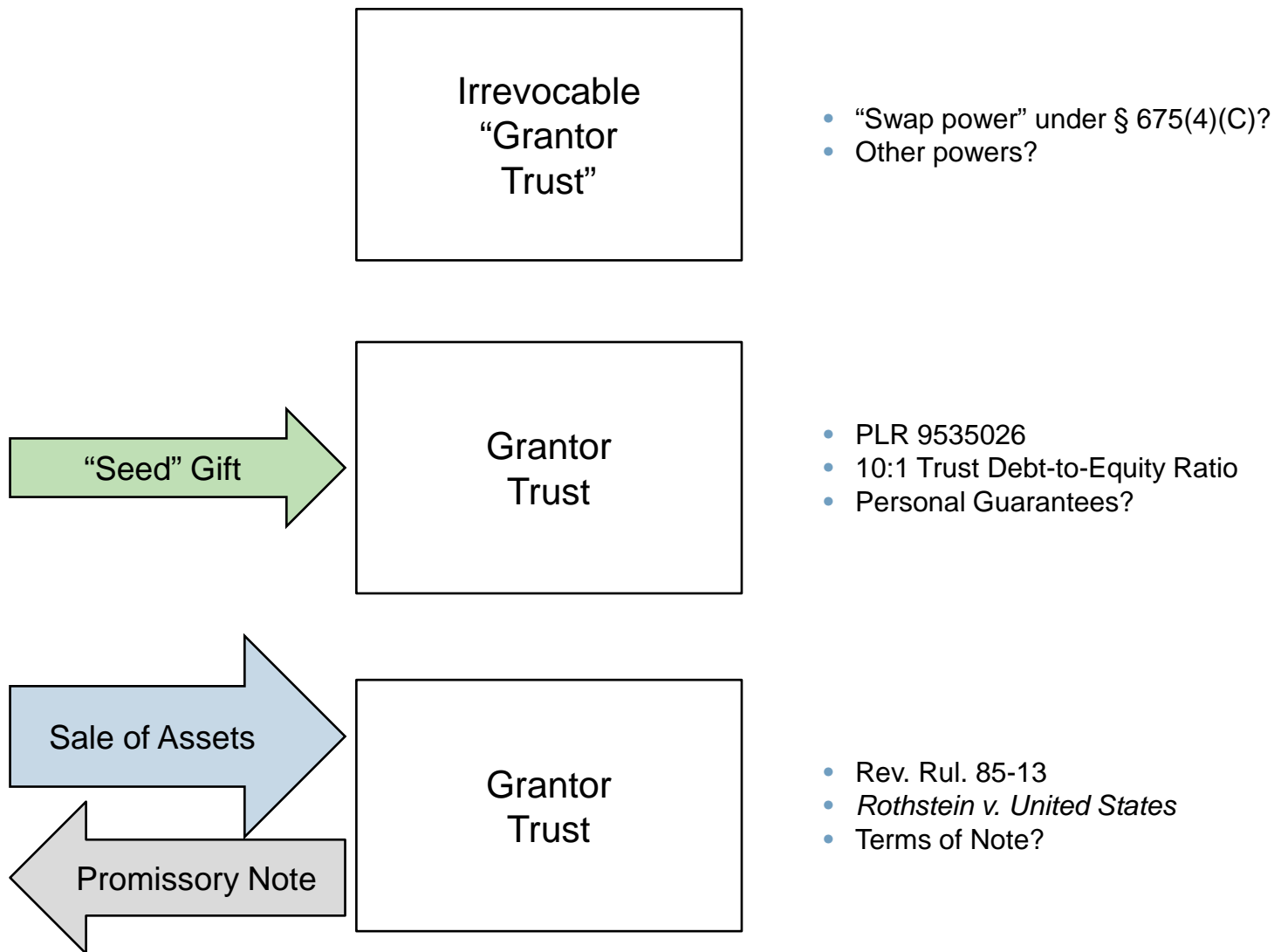
- Personal residence
 - ◆ Includes interest holder's principle place of business
 - ◆ Can be rented when interest holder is not occupied by interest holder
 - ◆ Can be used rent free by family members

- Possible to cause estate tax inclusion (and "step-up" in basis) on QPRT assets

- Alternatives to QPRTs include:
 - ◆ Joint split-interest purchase
 - ◆ Remainder Purchase Marital Trust



Installment Sales to IDGTs





The Valuation of Promissory Notes in the Future

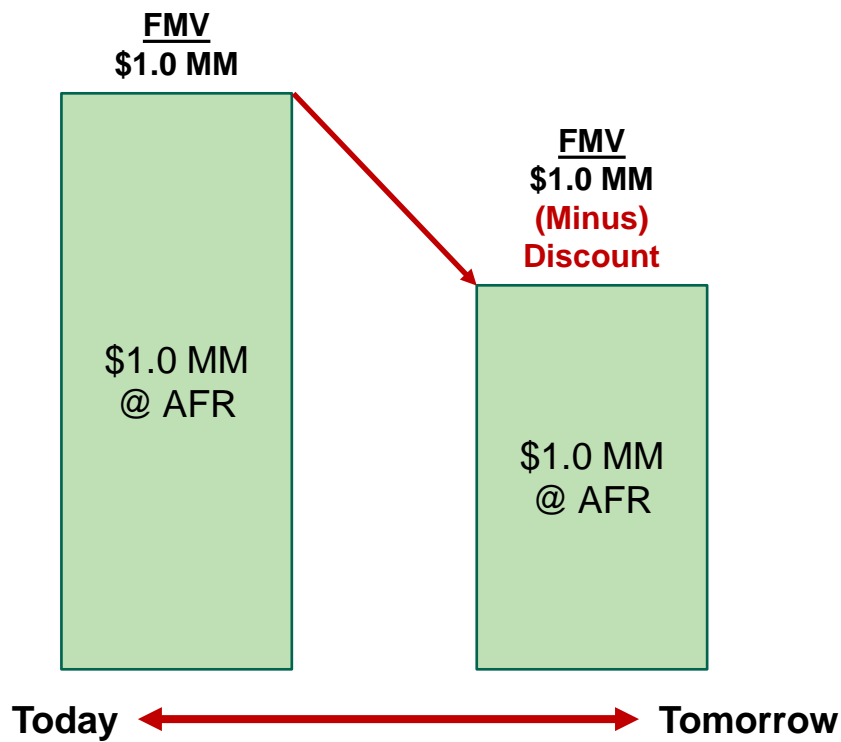
“In the case of an entity engaged in an active trade or business, at least 60 percent of whose value consists of the nonpassive assets of that trade or business, and to the extent that the liquidation proceeds are not attributable to passive assets within the meaning of section 6166(b)(9)(B), such proceeds may include such a note or other obligation if such note or other obligation is adequately secured, requires periodic payments on a non-deferred basis, is issued at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds.” Prop. Treas. Reg. 25.2704-3(b)(iv).

Loans and Installment Sales Today

- ◆ Applicable federal rate (long-term, not short or mid-term);
- ◆ 10% (or less) equity;
- ◆ No prepayment penalty; and
- ◆ Adequate security not required.

Promissory Notes Will Need to Be:

- ◆ Adequately secured;
- ◆ Requires periodic payments on a non-deferred basis;
- ◆ Issued at market interest rates; and
- ◆ Has a fair market value equal to the liability.

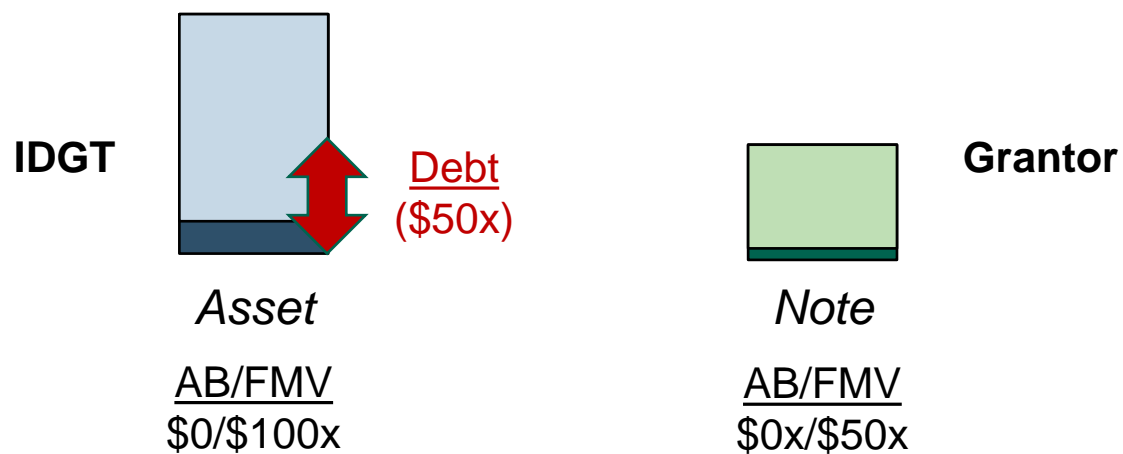




Eliminating Outstanding Installment Notes, Avoiding Gain At Death, And Getting A “Step-Up” On The IDGT Property



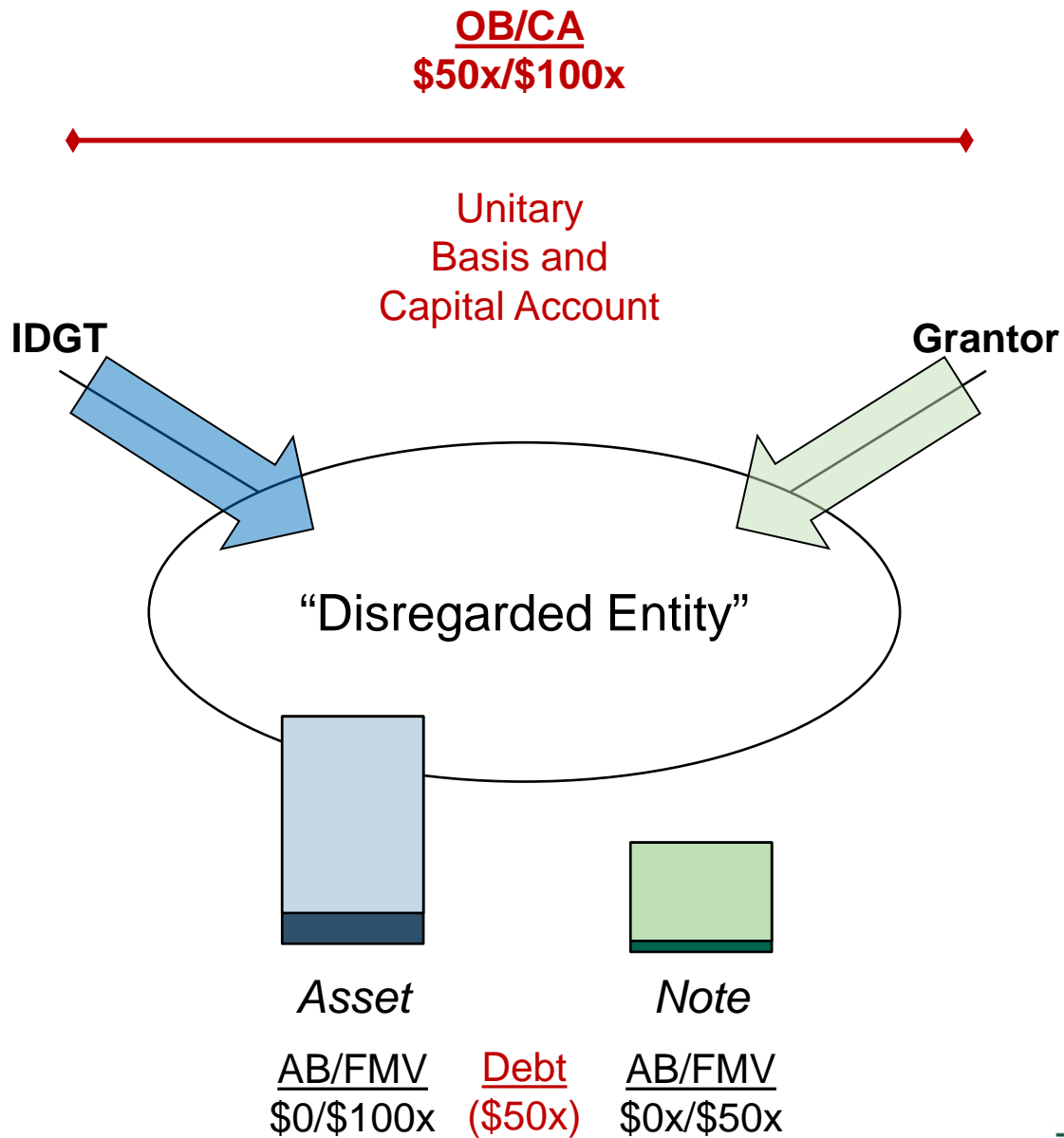
Installment Sale to IDGT and Outstanding Note



**Potential \$50x Taxable Gain
Upon Conversion of
Grantor Trust to Non-Grantor Trust**

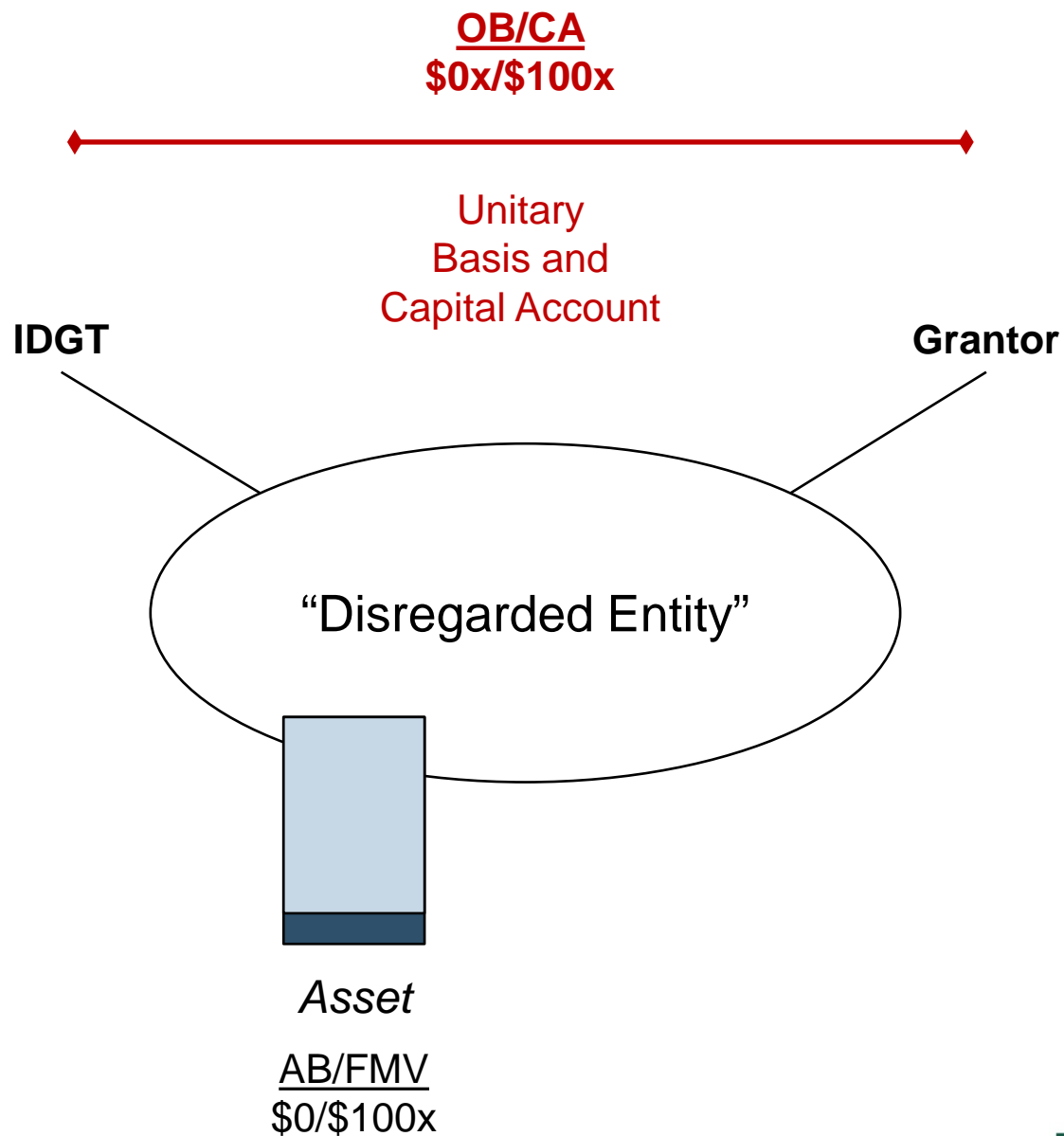


Contribution to Disregarded Entity



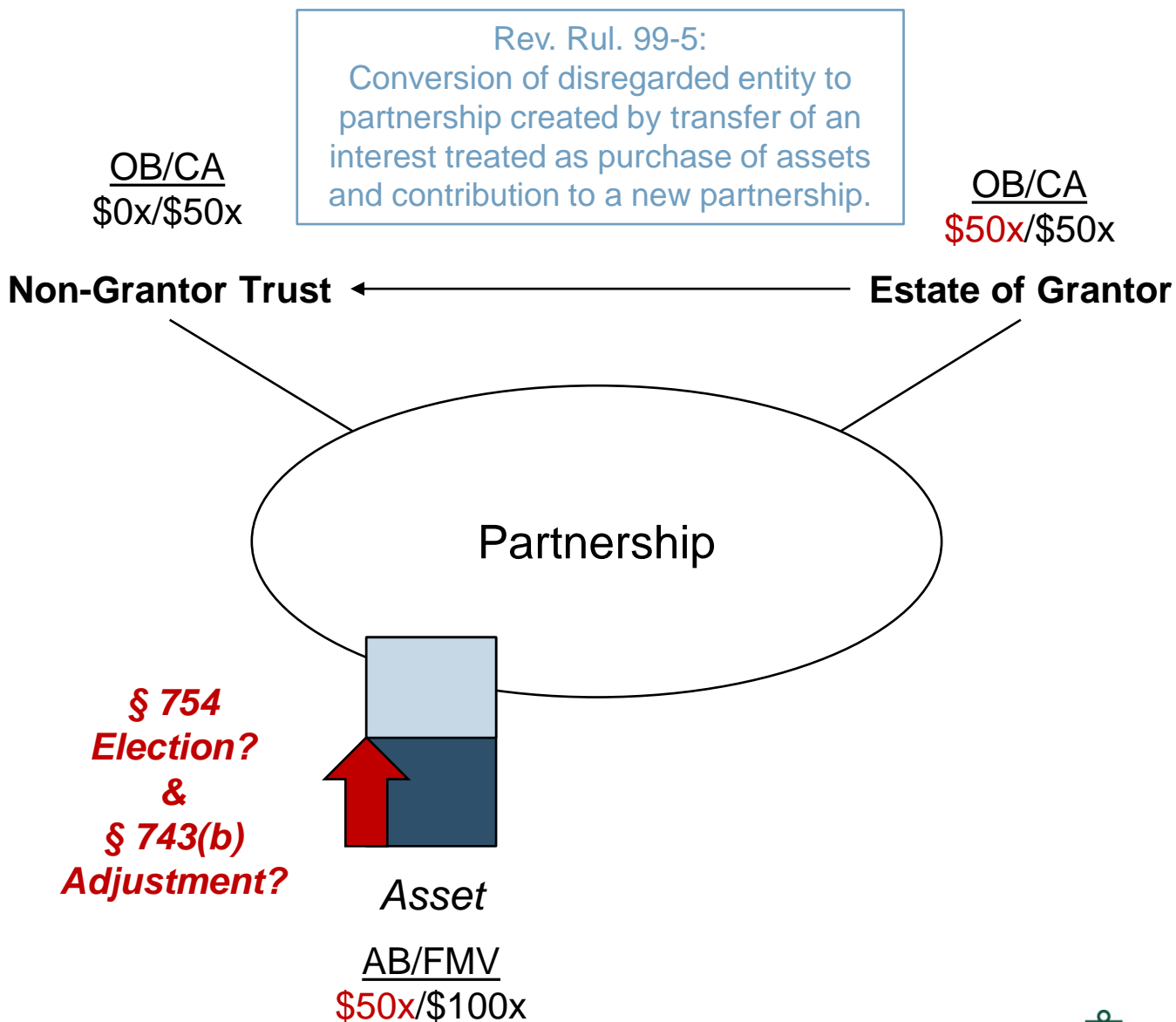


Debt Merges and Disappears





Conversion to Non-Grantor Trust & Partnership at Death





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