Proskauer

newsletter

Personal Planning Strategies

September 2011
in this issue

A report for clients and friends of the firm.

Use It or Lose It - Increased Gift and GST Exemption Amounts Expire on 12/31/12..... **1**

Take Advantage of Low Interest Rates and Valuation Discounts.... **6**

Creating a "GRAT": Heads You Win, Tails You Break Even..... **7**

Intra-family Loans: A Simple Yet Effective Estate Planning Tool... **9**

Edited by **Henry J. Leibowitz**
Contributor: **Yvonne M. Perez-Zarraga**

With over a century of combined experience, the lawyers of Proskauer's Personal Planning Department regularly provide their diverse clientele – from business entrepreneurs and corporate executives to sports figures and performing artists – with their Personal Planning Strategies newsletter, a critical source of information which identifies significant issues of interest to Proskauer's clients. The Personal Planning Strategies newsletter provides articles addressing the latest statutory changes and developments affecting retirement, estate, insurance and tax planning, as well as cutting-edge corporate, real estate and tax concepts.

Use It or Lose It - Increased Gift and GST Exemption Amounts Expire on 12/31/12

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act") was signed into law, making significant modifications to the estate, gift and generation-skipping transfer ("GST") taxes. The 2010 Act:

- reduced the estate, gift and GST tax rates to 35%.
- increased the estate tax exemption from $3.5 million to $5 million.
- increased the GST tax exemption from $1 million to $5 million.
- reunified the estate and gift tax exemptions so that an individual can gift up to $5 million during life.

Unfortunately, these favorable provisions of the 2010 Act will remain in effect only through December 31, 2012, when the act is scheduled to sunset. Unless the law changes, in 2013, the law reverts to the 2001 law, and the top gift and estate tax rate will be 55% and the estate and gift tax exemptions will be $1 million. In addition, the GST tax rate will revert to 55% and the GST tax exemption will be $1 million (indexed for inflation). Moreover, certain favorable provisions in the GST tax laws that were enacted in 2001 would no longer apply. Thus, in order to avail yourself of the maximum benefits under the temporary new law, you may wish to consider one or more of the following planning

techniques, each of which can significantly reduce your taxable estate at death by taking advantage of the provisions of the 2010 Act prior to 2013.

Use Your Exemption to Make Non-Taxable Gifts

With the increase in the gift tax exemption from $1 million to $5 million per person, you now have the ability to reduce your estate by simply making direct gifts to your descendants or anyone else you wish to benefit (or to trusts for your descendants or anyone else, as discussed below). In fact, a married couple can gift $10 million to their descendants without paying gift tax. Even if you used your entire gift tax exemption in prior years, the additional $4 million increase in the gift tax exemption is available to you ($8 million for a married couple).

Additionally, in the event that you made loans to your children or grandchildren, you may wish to consider using your new gift tax exemption to forgive those notes.

Making gifts during life not only reduces your estate by the amount gifted, but also by all the appreciation on that gift over time. For example, if you make a $5 million gift this year and die twenty-five years from now, the value of that gift, including appreciation, will be over $21 million, assuming 6% growth (or over $10 million, assuming only 3% growth).

Gifts in Trust

Although it is simple to make a direct gift of cash or marketable securities to various individuals, there are many advantages to using your new exemption amounts to make gifts of property in trust instead of outright gifts to individuals. Gifts to trusts for the benefit of your descendants allow you to allocate your GST tax exemption to that trust. Allocating your GST tax exemption to the trust enables the funds in the trust, plus all future growth, to pass to your descendants without the imposition of any estate or GST tax at each beneficiary's death.

Gifts in trust also provide an additional opportunity for the trust's income to be taxed to you instead of to the trust or the trust beneficiaries. This lets you, in essence, make additional tax-free gifts to the trust of the amount of the tax that the trust otherwise would pay. This type of trust is known as a grantor trust.

Furthermore, gifts in trust are protected from claims by the beneficiary's creditors, including spouses, and ensure that the assets do not pass outside the family bloodline. These benefits apply at every generation for the longest period allowed under law.

Leveraging Your Gifts

Leveraging your gift tax exemption provides you the opportunity to get more bang for your buck from your gift. For instance, an alternative to making a gift of cash would be to form a partnership or limited liability company ("LLC") and give away part of that partnership or LLC to a trust for the benefit of your descendants. The advantage of gifting interests in a partnership or LLC is that such interests may be able to be valued in such a way that discounts would be available on account of the gift being a minority interest in the partnership or LLC and/or due to restrictions on transfer in the partnership or LLC agreement. Assuming a 30% discount, a gift of a partnership or LLC interest with an

underlying value of $14 million would still be under the $10 million combined gift tax exemption of you and your spouse. Additionally, as mentioned above, GST tax exemption could be allocated to the trust, enabling both the interest transferred to the trust and all future growth to pass to your descendants without the imposition of any estate, gift or GST tax.

Tax Rates for Taxable Gifts (those above the $5 million exemption amount)

In 2011 and 2012, the gift tax rate is 35%. In 2013, that rate is scheduled to revert to 2001 rates (ranging from 41% to 55% for gifts over $3 million). Thus, to the extent that you wish to make taxable gifts (those in excess of $5 million, the current individual lifetime gift exemption), you may wish to consider making such gifts in the next two years. In addition to paying tax at a lower rate, the gift tax paid is removed from your estate (assuming you live for three years or more from the date the gift is made) and all the appreciation on the gifted asset is removed from your estate.

By way of example, a gift of $5 million made in 2012 by an unmarried individual who had used his $5 million gift tax exemption in 2011 would result in a gift tax payable of $1,750,000. In 2013, the same $5 million dollar gift would result in a gift tax payable of $2,750,000. Moreover, assume that the individual dies in 2020 and that there is 5% growth, the gift tax of $1,750,000 and the appreciation of $2,387,277 (compounded annually over eight years) would be removed from the estate tax-free.

Non-Reciprocal Trusts Created by Married Couples

Let's suppose you really do not want to make a gift at this time, but you also do not want to waste the savings available by the increased exemption amount available in 2011 and 2012. You can have your cake and eat it too by creating a trust for the benefit of your spouse. By doing so, the assets transferred to such trust (and any growth on such assets over time) would be outside of your estates. But if you felt like you needed to use some of the funds in the trust, your spouse could simply receive a distribution from the trust. If you added your descendants as potential beneficiaries of the trust, the Trustee also could make a distribution to one or more of them, which would also occur free of gift tax. This flexibility would allow (but not necessarily require) distributions to be made to your spouse or descendants. Since distributions are not required, the funds also could accumulate in the trust and not be subject to any further estate, gift or GST tax. It is possible for each spouse to create trusts for each other, if desired. This sort of trust could be viewed as a protective device to be used against the exemption amount being lowered in the future.

Domestic Asset Protection Trusts/Single Individuals

A similar approach that should work if you are a single individual would be for you to create a domestic asset protection trust ("DAPT"), of which you can be a beneficiary. Such a trust must be formed in a jurisdiction that has "DAPT" legislation, such as Delaware. By creating a DAPT, the assets transferred to the trust are outside your estate, but remain available for your use (as long as a Delaware resident or trust company acts as your co-trustee and is in charge of making the distributions to you). As with the trusts for spouses described above, there would be no requirement that you take distributions (unless you need them), so, to the extent that you don't, the trust principal and growth

can accumulate within the DAPT free of any future estate, gift or GST tax. Best of all, Delaware's strong asset protection statutes protect the assets of the DAPT from your creditors, and the creditors of any remainder beneficiaries for whom the trust assets are ultimately meant to benefit.

Gifts of Real Property

An especially useful planning technique for those who own a residence or a vacation property is transferring that property to a trust for the benefit of your descendants (or other beneficiaries) and then leasing the house back from the trust. Because the gift of the property is made in trust, GST tax exemption can be allocated to the trust, enabling the property, plus all future appreciation, to pass to your descendants without the imposition of any estate or GST tax at the beneficiary's death. Furthermore, if you have more than one descendant whom you wish to benefit, you can create multiple trusts and transfer partial tenancy-in-common interests in the property to each trust, which will enable you to discount the value of the property transferred on account of each trust receiving a fractional undivided interest in the property. Finally, if the trust(s) is structured as a grantor trust, your payment of rent to the trust for your use of the gifted property will not constitute taxable income to the trust, essentially allowing you to make additional tax-free gifts to the trust.

In addition to the above technique, the use of a qualified personal residence trust ("QPRT") continues to be a great option for transferring real property out of your estate and to your descendants at a reduced gift tax cost. To create a QPRT, you transfer title to your personal residence (either a principal home or a vacation home) to a trust that contains certain provisions required by the Internal Revenue Code. The trust provides that you, as grantor of the trust, retain the exclusive right to live in the residence for a specified term of years (which you must outlive to avoid estate tax inclusion), during which you continue to be responsible for paying property taxes and other expenses to maintain the residence. Upon expiration of the term, the personal residence, including any appreciation in its value, passes pursuant to the terms of the QPRT (i.e., to your children, or trusts for their benefit) without any further exposure to gift tax. Upon creation of the QPRT, you make a taxable gift equal to the fair market value of the residence at the time of the transfer less the actuarial value of your retained right to live in the residence. As the trust term increases, the value of your retained interest also increases, resulting in a decrease in the amount of the gift. Thus, for older clients, the increased $5 million dollar exemption gives you the opportunity to create a shorter term QPRT and still be able to shelter the gift of the remainder interest. It is also possible to transfer partial interests in a residence to a QPRT to obtain fractional interest discounts in the value of the property transferred.

Purchasing Additional Life Insurance in Trust

The proceeds from a life insurance policy owned in your own name will be subject to estate tax at your death. In contrast, the proceeds from a life insurance policy owned by an irrevocable life insurance trust ("ILIT") will generally pass free of estate taxation. Thus, ILITs have been, and continue to be, a very useful and basic estate planning device. One of the past difficulties of administering an ILIT was how to transfer funds to an ILIT without incurring gift tax, particularly if an individual did not have many children and

grandchildren to count as beneficiaries of an ILIT. This problem was particularly applicable to funding large insurance policies. On account of the increase in the lifetime gift tax exemption to $5 million, it has become much easier to fund trusts to purchase life insurance. Individuals with existing ILITs may wish to purchase additional life insurance or keep policies that they were thinking of terminating.

You may wish to consider making a large gift to an ILIT now, to protect against the exemption amount being decreased in the future, instead of merely making transfers to the ILIT when premiums are due. Since the gift occurs when the funds are transferred to the ILIT (as opposed to when life insurance premiums are paid), a large gift to an ILIT while the $5 million exemption is in place will allow the trustee of the ILIT to pay premiums for many years without worrying about the gift tax exemption being decreased.

Some individuals may think that they no longer need life insurance to provide liquidity to pay estate tax since the estate tax exemption is $10 million for a married couple. But with the uncertainty of the estate tax system after 2012 (only a $1 million estate tax exemption and a 55% tax rate), it may be more important than ever to include life insurance as part of your estate plan. Waiting to see what happens in 2013 before purchasing life insurance has the risk that you will not be as healthy then as now, precluding the purchase of life insurance. Furthermore, even if qualifying for additional life insurance in the future will not be a problem, funding the ILIT may be more difficult with a lesser gift tax exemption amount.

A Sale to an Intentionally Defective Grantor Trust

A sale to an intentionally defective grantor trust is used to "freeze," for estate tax purposes, the value of the assets you sell to the trust by exchanging them for a promissory note with a stated interest rate and principal amount. Any and all appreciation on the assets after the sale to the trust is not included in your estate, and if the asset is an interest in a limited partnership, limited liability company or a closely held corporation, a discount should apply to the sales price.

- To employ this technique, you would first create an irrevocable trust that would be a "grantor trust" for income tax purposes (the "Grantor Trust"). A grantor trust is a trust where all of the income of the trust is taxed to you and any transactions between you and the trust are disregarded for income tax purposes. This is created by your retaining certain powers in the trust. The Grantor Trust would be structured so that the assets in the trust at your death would not be included in your estate for estate tax purposes.

- You would then sell assets to the Grantor Trust in exchange for a promissory note, which could be drafted so that you receive interest only and principal in a single balloon payment at the expiration of the note (for example, in nine years). The annual interest payments you would receive from the Grantor Trust under the note would not be taxable income to you because it is a grantor trust for income tax purposes (and thus, it would be treated as if you were paying yourself interest which is not considered taxable interest).

- Most practitioners believe that, in order for the sale transaction to be respected by the IRS, the Grantor Trust should be funded, before the sale takes place, with at least

10% of the value of the assets the Grantor Trust is purchasing (the "seed money"). One way to satisfy this requirement is by a gift to the Grantor Trust of the seed money prior to the sale. With the recent increase of the gift tax exemption to $5 million ($10 million for married couples), you can make a significant tax-free gift to a Grantor Trust to enable it to purchase additional assets from you (up to $90 million for married couples), the appreciation on which will escape future estate taxation.

- A further advantage of utilizing a sale to a defective grantor trust is that you can allocate a portion or all of your GST exemption to the irrevocable Grantor Trust that is created to purchase your assets. Since, in addition to your lifetime gift exemption, your GST exemption also has been increased to $5 million ($10 million for married couples), you have a higher amount of GST exemption to allocate to the Grantor Trust, the result of which would be to shelter the appreciation in the trust from the future imposition of GST tax.

A Potential Pitfall: The Clawback

Some practitioners have raised the concern that if a donor uses the increased exemption of $5 million during 2011 and 2012, and, in 2013, that exemption is reduced back to $1 million, then, upon the death of the donor, there could be a potential clawback of the gifts made in excess of that reduced exemption when determining the estate tax owed by the donor's estate. However, there is nothing in the current law to suggest that the government would take this approach.

We feel that individuals should take full advantage of the current exemption amounts and rates while the opportunity is still there. Gifts always have the advantage of transferring future growth out of one's estate, in addition to removing the assets that have been transferred. We recommend that you contact your personal planning attorney to discuss the best way to utilize your increased exemption amounts.

Take Advantage of Low Interest Rates and Valuation Discounts

The current combination of depressed asset values and low interest rates makes this a perfect time to implement wealth transfer strategies that are designed to transfer future appreciation. Several techniques rely on investment returns that outpace the interest rates set by the Internal Revenue Service. Therefore, you should discuss with us, now, how intra-family loans, sales to intentionally defective grantor trusts, grantor retained annuity trusts and charitable lead annuity trusts can enable you to pass assets to the next generations at the lowest possible transfer tax cost.

Moreover, Congress recently approved the debt ceiling bill which was signed by President Obama on August 2, 2011. This new law calls for a joint committee to consider tax law changes. In the past, legislative changes were considered that would effectively eliminate valuation discounts of closely-held interests such as in family limited partnerships. Currently, the appraisals required as evidence of the fair market value of assets involved in intra-family transactions can take into account minority interest and lack of marketability valuation discounts. Typically, those discounts reduce the asset value by 30%. If, these discounts would no longer be permissible, the purchase price or gift tax cost of intra-family transactions would be increased by that 30%.

Additionally, other past legislation would have significantly curtailed the advantages of GRATs (see article explaining GRATs on page 7). There is a good chance that this legislation will be resurrected by the joint committee that will consider tax law changes.

There is no certainty that the law will change, but if you have been considering creating a GRAT, or enacting a plan to give or sell interests in a closely-held business or family limited partnership to your family members, this may be the most favorable time to move forward.

Creating a "GRAT": Heads You Win, Tails You Break Even

Creating a grantor retained annuity trust (commonly referred to as a "GRAT") is a relatively simple way to transfer property to your children at virtually no gift tax cost. In addition, because of the low interest rate environment and down markets, the advantages of creating a GRAT are magnified. When properly structured, a GRAT can pass to your children all of the future appreciation of the transferred property and reduce the value of the gift to virtually zero.

Trust Pays an Annuity to You

In a typical GRAT, you contribute assets to a trust which provides that you are to receive an annuity annually for a fixed number of years. The annuity amount is typically a stated percentage of the initial fair market value of the trust. It can be stated as a fixed percentage or as a percentage that can increase as much as 20% a year over the trust's term.

At all times during the term of the trust, you will receive the predetermined annuity amount, regardless of how much income the trust actually generates or whether its value rises or falls. To the extent that the income is insufficient to cover the annuity payments, trust principal will be paid to you to make up any shortfall.

At the end of the period, the property remaining in the trust passes to the ultimate beneficiaries of the trust, typically your children or other family members, in further trust or outright, depending upon your preference. Alternatively, you can delay the transfer of assets to your children by naming a trust for your spouse and your descendants as the beneficiary until the spouse's death, at which time your children (or other family members) become the beneficiaries.

Gift Tax Is Minimized

The creation of a GRAT constitutes a gift to the ultimate beneficiaries for gift tax purposes, but the value of that gift is only the initial value of the trust assets reduced by the present value of the annuity you have retained. The calculation of the present value of your retained annuity is based, in part, upon the current interest rates promulgated by the IRS, commonly referred to as the "hurdle" rate (i.e., the 7520 rate). In order for a GRAT to be successful, the assets used to fund the GRAT must appreciate faster than the IRS hurdle rate. At the hurdle rate for September 2011 of 2.00%, it is easier to have a successful GRAT. Since interest rates are near historic lows, the potential tax savings are maximized.

The most popular use of this device in sophisticated estate plans has been the short-term, "zeroed-out" GRAT, in which the term is limited to two or three years and the annuity amount is maximized in order to produce as small a taxable gift as possible. In this way, anticipated short-term growth in the trust assets can be availed of without risking longer-term uncertainty, and the risk of depreciation is neutralized by virtually eliminating the gift tax cost. With this short-term GRAT, the gift to your children can be nearly "zeroed-out."

Suppose you create a GRAT with $5,000,000 to pay yourself an annuity of $2,575,195.50 per year for two years. Applying September's hurdle rate, the value of your retained interest is approximately $4,999,999.58 and the taxable gift is only $.42. If the principal of the trust appreciates over the two-year period, so that, after receiving your annuity payments, there are assets remaining in the GRAT – whether one dollar or millions of dollars – your children will receive that amount at virtually no gift tax cost. If the value of the trust goes down, you will simply get back everything you put in, and you will have lost nothing. Distributions may be made in-kind so there is no need to sell any property in order to receive your annuity payments.

In a two-year zeroed-out GRAT, your children or other named beneficiaries will receive the remaining principal in the trust at the end of two years at no gift tax cost to you or them.

No Extra Cost If You Die Prematurely

If you die prior to the end of the annuity period, the annuity will continue to be paid to your estate and the value of the assets in the GRAT at your death will be included in your gross estate for estate tax purposes. Your estate will receive credit for any gift tax already paid, however. Thus, although you will have lost the tax advantage the GRAT was designed to achieve, your estate will be in the same position had you not created it.

Gift of Stock in a Closely-Held Business

You may be able to achieve substantial benefits by transferring a closely-held business interest or depressed real estate, which you anticipate will increase in value, to your GRAT. In fact, this may be the ideal estate planning device for such a transfer to your children, because you may be in a much better position to predict the future growth of your own business than that of other property.

Of particular appeal is the fact that the GRAT also removes the risk of undervaluing a closely-held business interest or real estate for gift tax purposes. With an outright gift, there is no way to guard against a substantial gift tax deficiency if the value of the property is increased by the Internal Revenue Service. But if instead the gift is the remainder interest in a "zeroed-out" GRAT, and if the annuity amount is expressed as a percentage of the initial value of the trust principal (rather than a dollar figure), any increase in the value of the business (or real estate) determined on an audit of the gift tax return would result almost entirely in an increase in the value of the retained interest and, in turn, in only a nominal gift tax increase.

In the previous example, if the IRS successfully asserts that the value of your company's stock transferred to the trust is $6,000,000 instead of $5,000,000, because your annuity is defined as a percentage of the value of the stock, your annuity is now worth $5,999,999.50 and the value of the resulting gift to your children, is $.50 instead of $.42.

Income Tax Considerations

Since the GRAT is a "grantor trust" for income tax purposes, all of its income and deductions are included on your personal return, as if there had been no transfer at all, until the property passes to the ultimate beneficiaries of the GRAT. Therefore, the GRAT is generally income tax-neutral, meaning that your income taxes should be the same whether or not you create the GRAT. If you choose to keep the property in trust for your children (or your spouse and children) after the two-year GRAT period, the continuing trust or trusts also can be structured as grantor trusts so that you can continue to pay the income tax attributable to the trusts' income each year until you choose otherwise. Your payment of the trust's income tax essentially is an additional tax-free gift to your children.

Summary

When properly structured, a GRAT can truly have a "heads you win, tails you break even" result. By adjusting the terms of your trust, you can nearly eliminate the gift tax associated with the transfer of property to your children.

Upon termination of the GRAT, all the appreciation on the assets in excess of the hurdle rate will pass to your children free of gift tax. But if the appreciation is not as expected, or if you do not survive the term of the trust, there are no adverse tax consequences.

Finally, in designing the manner in which the ultimate beneficiaries of the GRAT are to receive the trust assets at the end of the GRAT period, you may choose among many options available to achieve the result most consistent with your family and financial objectives.

Intra-family Loans: A Simple Yet Effective Estate Planning Tool

An intra-family loan is a basic estate-planning technique which has a very low transaction cost. Under rules set forth in the Internal Revenue Code, it is possible to make loans to family members at lower rates than those charged by commercial lenders without it being deemed a gift. As discussed below, the lender, usually a parent or grandparent, must charge interest in order to avoid making a gift to the borrower but this interest rate may be as low as 1.63% for a loan for a term of three to nine years, with interest paid annually, made in September 2011. The lender also can structure the loan as a balloon note meaning that the borrower pays interest only during the course of the loan and only repays the principal at the end of the term.

Economic Benefits of Intra-family Loans

If a parent makes an interest-free loan to a child or grandchild, the Internal Revenue Service will treat the foregone interest as a taxable gift. In order to prevent the IRS from treating a part of the loan itself as a gift, the parent must charge a certain minimum

interest, which is known as the applicable federal rate ("AFR"), which the Treasury determines every month. To the extent that the interest charged on the loan is lower than the interest calculated with the AFR, that amount will be imputed as income to the parent, even though the parent does not actually collect it. Furthermore, the IRS will treat that amount as a gift to the child, which would require the filing of a gift tax return. However, if a parent establishes a bona fide creditor-debtor relationship with adequate stated interest, the intra-family loan will not be characterized as a transfer subject to the gift tax.

Intra-family loans create an opportunity to shift wealth from one family member to another family member, usually a child or grandchild, if that child or grandchild can earn a greater return on the amount borrowed than the AFR. The minimum interest rate required to be used depends on the period of time of the loan, and the current AFRs are very low. In September 2011, if interest is paid annually on a loan, the AFR for short-term loans (loans for up to three years) is 0.26%. The AFR for mid-term loans (loans from three to nine years) is 1.63%, and the long-term AFR rate for loans over nine years is 3.57%. The AFR for demand loans is the AFR for short-term loans in effect for the period for which the foregone interest is being determined (i.e., monthly), compounded semiannually. To the extent that a child or grandchild is able to earn a higher rate of return on the borrowed funds than the interest rate being paid, he or she is able to keep the excess without any gift taxes being paid.

For example, if a parent makes a nine-year loan to a child of $2 million, the loan will be a successful estate planning tool if the child can earn over 1.63% with the money borrowed. If the child invests the $2 million for the nine years at a 5% annual rate of return, he or she will have about $3,102,656 at the end of the loan, and will only have to repay his or her parents $2,313,275 throughout the course of the loan. Therefore, the child is entitled to keep the difference of about $789,381 without any gift tax consequences. If the parent was going to make the same investment that the child made anyway, the risk to the family as a whole has not changed and the loan was a successful way to transfer wealth to the next generation.

Other Benefits

Outside of a wealth transfer concept, intra-family loans also may be more beneficial than third-party loans because they allow the total interest expense paid over the course of the loan to stay within the family rather than being paid to a bank. In addition, an intra-family loan can allow children who have poor credit history to buy a home or to start a new business. Furthermore, it allows families to avoid the normal expenses incurred with loans, such as administrative costs, closing costs and appraisal fees. Also, if a child wants to pay off the loan early, the terms of the loan can be structured so that there are no prepayment penalties.

Additional Tax Benefits

The IRS allows any individual to make a gift to another person free of the gift tax each year up to the amount of the annual exclusion, which is currently $13,000. In addition to the annual exclusion, every person is allowed a $5 million lifetime exemption from the gift tax. Therefore, even if an individual gives more than $13,000 to a single person in a given

year, the gift amount which is above $13,000 will not be subject to tax unless the individual has already given $5 million in taxable gifts throughout his or her life.

Because intra-family loans are not gifts, they do not count towards an individual's lifetime gift tax exemption. Therefore, even if an individual has used up all of his or her $5 million lifetime exemption from the gift tax, he or she can still make a loan to a family member without paying gift tax. Furthermore, a grandparent can make a loan to a grandchild without being subject to the generation-skipping transfer tax.

In addition, an intra-family loan can be used to take advantage of the $13,000 annual exclusion. A parent can forgive up to $13,000 per year per family member (and up to $26,000 if a married couple splits the gift or makes his or her own gift) without any adverse gift tax consequences. However, the parent will have interest income in any year in which interest is forgiven.

Conclusion

An intra-family loan can be used as a simple and effective wealth transfer device. Such a loan is a successful estate planning tool if a family member earns a higher return on the money borrowed than the AFR, thus today's low AFR presents an opportunity to lock in a low interest rate on an intra-family loan.

The Personal Planning Department at Proskauer is one of the largest private wealth management teams in the country and works with high net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

If you have any questions regarding the matters discussed in this newsletter, please contact any of the lawyers listed below:

BOCA RATON

Elaine Bucher
561.995.4768 — ebucher@proskauer.com

Albert W. Gortz
561.995.4700 — agortz@proskauer.com

George D. Karibjanian
561.995.4780 — gkaribjanian@proskauer.com

David Pratt
561.995.4777 — dpratt@proskauer.com

LOS ANGELES

Mitchell M. Gaswirth
310.284.5693 — mgaswirth@proskauer.com

Andrew M. Katzenstein
310.284.4553 — akatzenstein@proskauer.com

NEW YORK

Henry J. Leibowitz
212.969.3602 — hleibowitz@proskauer.com

Lawrence J. Rothenberg
212.969.3615 — lrothenberg@proskauer.com

Lisa M. Stern
212.969.3968 — lstern@proskauer.com

Philip M. Susswein
212.969.3625 — psusswein@proskauer.com

Ivan Taback
212.969.3662 — itaback@proskauer.com

Jay D. Waxenberg
212.969.3606 — jwaxenberg@proskauer.com