GUNSTER'S

Family Wealth Compass

Charting A Course For Your Family's Future

February 2012 *Gunster.com*

In This Issue

Attorneys

Planning Around Low Interest Rates: The Good, The Bad and The Indifferent

As we are all too well aware, interest rates have reached historic lows and the U.S. Treasury rates have followed suit. This news is disheartening for income investors; however, there are results of these low rates which present some unique estate planning opportunities. The two rates that provide these opportunities are: (1) the low so-called "7520 rate" [Internal Revenue Code ("IRC") section 7520 interest rate], which is but 1.4% for February 2012; and (2) the low applicable federal rate ["AFR"], now ranging from 0.19% to 2.55% for February 2012. These rates are used to determine the federal income tax and transfer tax consequences of transfers of interests in property.

The Good

Taking Advantage of the Low 7520 Rate. The opportunities arising from the decreased 7520 rate result from the fact that the lower the assumed interest rate, (i) the more an annuity stream is worth, (ii) the less an income interest is worth, but (iii) more the remainder interest following the income interest is worth.

Grantor Retained Annuity Trusts.
One strategy designed to take advantage of the increased value of an annuity stream stemming from the low 7520 rate is the use of a Grantor Retained Annuity Trust ["GRAT"]. In the GRAT, the grantor typically makes a gift to a trust which is set up as an annuity, payable to the grantor for a set number of years [the "term"]. When the GRAT's term ends, any remaining property is passed on to the designated remaindermen, as a gift. Since the gift is valued as of the date of trust formation, based on the 7520 rate at that time, if the assets in the GRAT produce a total return in excess of that 7520 rate, this excess growth will pass to the remainder beneficiaries free of transfer tax. The lower the 7520 rate when the GRAT is formed, the more likely it is that the trust assets will produce a return in excess of that rate; thus, the more likely there will be an increased remainder amount to be transferred to the remainder beneficiaries free of transfer tax. Further, even if the return on the assets does not exceed the

continued on page 2

It's After October 1, 2011: Your Durable Power of Attorney May Be "Valid" But Is it "Effective"?

"Valid" does not necessarily mean "effective." Under Florida's new Power of Attorney Act [the "Act"], which became effective as of October 1, 2011, a valid power of attorney is basically one that was executed properly under the laws of the applicable jurisdiction. Therefore, powers of attorney ["POAs"] that were properly executed prior to October 1, 2011, are generally still valid. However, your POA, even if valid, may not be effective to accomplish your planning goals. For example, a pre-October 1, 2011, POA appointing John and Jane as Attorneys-in-Fact or "Agents," but not specifying that they must act jointly, would nonetheless have required their joint action to be effective. Under the Act, under

continued on back page

Designated Representatives – Improving Trust Efficiency and Privacy

When a person establishes an irrevocable trust or when a revocable trust becomes irrevocable upon the grantor's death, the Florida Trust Code gives the trust beneficiaries certain rights to be kept informed about the trust. Most such rights are held by the trust's "qualified beneficiaries." Most simply put, all current beneficiaries and all remaindermen – including charities – are "qualified beneficiaries." A bit more specifically, the term "qualified beneficiaries" includes those to whom income or principal could or must be distributed at the time, those who would be next in line for any of those distributions should one of the current beneficiaries die (or disclaim) before the trust ends, and those who

continued on page 3

continued from front page
7520 rate, if the GRAT is "zeroed-out" (meaning that the value of the grantor's retained interest is equal to the value of the property transferred to the trust, resulting in a remainder of zero), there will be no real cost to creating the GRAT aside from transactional costs.

Private Annuities. Now is also a great time to consider a private annuity. A private annuity is an agreement between two parties (neither of which is an insurance company) whereby a person [the "annuitant"] transfers assets to the obligor [typically a person or group of persons who would be the annuitant's heir(s)] in return for unsecured payments from the obligor to the annuitant for the life of the annuitant. The interest rate used for calculating the payments on the annuity is the 7520 rate, which cannot be changed once it is set. The lower the 7520 rate, the lower the required annuity payments to the annuitant and the greater the value of the property to potentially pass to the obligor, free of transfer taxes.

Charitable Lead Annuity Trusts. For those with charitable planning goals, a Charitable Lead Annuity Trust ["CLAT"] can produce benefits similar to a GRAT. In a CLAT, the trust makes fixed annuity payments to the charity during its term. At the end of the CLAT, any remaining value in the trust is passed to the non-charitable remainder beneficiaries as a gift which is valued as of the date of the CLAT's formation. Any growth in the trust assets in excess of the 7520 rate will pass to the non-charitable remainder beneficiaries free of transfer tax; thus, the lower the 7520 rate, the better for those beneficiaries. (Keep in mind, however, that non-grantor charitable lead trusts generally will not generate a current income tax deduction for the donor/grantor, although the value of the transferred assets will be eliminated from the grantor's gross estate).

Gifts of Remainder Interest to Charity. Those who are charitably inclined may also want to consider making a gift to charity of a remainder interest in a personal residence or farm, while retaining the right to use the property during their lifetimes (which will generate a current income tax deduction). Because the retained right to use the property is valued the same way as an income stream, the lower the 7520 rate, the less the deemed value of the retained income interest and the greater the charitable remainder gift and the corresponding income tax deduction for the grantor should be.

Taking Advantage of the Low AFR. The decrease in the AFR provides an opportunity for estate planning because these are the rates that are used to evaluate loans for both income and transfer tax purposes.

Sales to Intentionally Defective Grantor Trust. One of the most popular estate planning techniques for large estates, the sale of property to an Intentionally Defective Grantor Trust ["IDGT"], is especially attractive when interest rates are low. These work particularly well for sales of family businesses and other appreciating assets. In this technique, the grantor typically creates an irrevocable trust for one or more of the grantor's children, grandchildren, and more remote heirs. It may be structured as a a trust designed to continue for multiple generations [a "Dynasty Trust"]. The IDGT is structured to be a "grantor trust" for income tax purposes, meaning the trust is ignored for income tax purposes and all transactions of the trust are taxed directly to the grantor. It is also structured so that the trust assets will not be included in the grantor's gross estate at death. The grantor then sells property to the IDGT in exchange for an installment note that pays the grantor interest at the lowest possible rate (i.e., the AFR). To the extent that the actual return on the transferred property exceeds the stated interest rate on the installment note, that excess passes – free of transfer tax – to the IDGT beneficiaries. Therefore, the lower the AFR, the lower the note payments from the IDGT back to the grantor need be, and the more property that can potentially be passed from the IDGT to its beneficiaries free of transfer tax.

Intra-Family Loans. Another technique which may be utilized to take advantage of the lower AFR is the use of an intra-family loan. Typically, this would be a parent/lender loaning money to his or her child/borrower. In order to avoid such a loan being recharacterized as a gift, the stated interest rate on the loan must be at least equal to the AFR (and the interest must in fact be paid). To the extent the funds loaned to the borrower appreciate at a rate greater than the AFR, that excess will essentially have been transferred to the borrower free of transfer tax. Accordingly, as in the case of the sale to an IDGT, the lower the AFR, the lower the required interest payments on the intra-family loan need be and the greater the potential tax-free gift.

The Bad

Negative Low Rate Effects on Some Estate Planning Techniques. The same qualities of a low 7520 rate and a low AFR that are good for the above estate planning techniques operate with less favorable effects on some other techniques.

Qualified Personal Residence Trusts. Now may not be the ideal time to establish a Qualified Personal Residence Trust ["QPRT"]. Whether or not this is a good time to establish a QPRT depends on the individual's goals, lifestyle, and to whom he or she wants his or her residence to pass at the end of the QPRT term. This is because retaining the right to use a personal residence for a given term is equivalent to retaining an income stream. Thus, the lower the 7520 rate, the less the income stream is worth and the greater the value of the remainder. When the 7520 rates are low, a QPRT is particularly beneficial if the remainder is passing to charity because the amount of the charitable gift and the grantor's corresponding income tax deduction will increase as the 7520 rate decreases. However, if the remainder is instead passing to noncharitable beneficiaries (e.g., children of the grantor), the value of the taxable gift of the remainder interest increases as the 7520 rate decreases. Nonetheless, this is not to say that a QPRT is not currently advisable or is not beneficial, in the absence of a charitable remainder beneficiary. There is still a transfer tax benefit from creating a QPRT having noncharitable remaindermen, even though it will most likely be noticeably less than it would have been in a higher interest rate environment. Even if such a QPRT residence does not increase at all in value from the date of funding the QPRT to the date the income interest ends (as may be the case today, due to the economy), the remainder interest will nonetheless be transferred to the noncharitable remaindermen at a lower transfer tax value than an outright gift of the entire residence. As remainder beneficiaries, the noncharitable remaindermen are deemed to have received less than a whole interest in the residence and the transfer tax value is reduced to account for that. These remaindermen technically receive only the remainder interest – even though the "remainder" is actually the whole residence! Thus, one should simply be aware that a QPRT is generally more advantageous when interest rates are higher.

continued on following page

Right: Kevin Kane, John Cole and Jason P. Van Lenten join Gunster in our Jacksonville office.

Charitable Remainder Annuity Trusts and Charitable Gift Annuities. An individual's charitable deduction for a contribution to a Charitable Remainder Annuity Trust ["CRAT"] – or for the purchase of a Charitable Gift Annuity ["CGA"] - decreases as AFR rates decline, since the value of the individual's annuity stream rises as interest rates fall. The decline in the amount of the charitable income tax deduction for the donor comes into play because the amount of that deduction (in either case) is equal to the value of the assets contributed less the value of the retained annuity interest in those assets. Additionally, in the case of a CRAT, low interest rates may preclude an income tax charitable deduction entirely because the trust must pass two tests to qualify as a CRAT (and thus be eligible for the charitable deduction). Basically, these two tests are: (1) the charitable deduction (based on the calculated remainder value) must be at least equal to ten percent of the original gift/donation value, with the minimum CRAT payout rate to the annuitant being five percent per year (no matter how low the AFR may be); and, (2) based on the age of the donor and the required payout rate, there must be at least a five percent probability that there will be assets remaining for the charitable beneficiary, when all is said and done. Both these CRAT tests become more difficult to meet when interest rates are low. While CGAs are not required to pass these tests, they– and the donor/annuitant– must consider another issue: the CGA must have a charitable value that is more than ten percent of the funding amount or the charity's obligation to pay the annuity may cause the charity to pay tax on what is called "acquisition indebtedness." Thus, problems may arise as interest rates fall because the charity will have taxable income if the initially determined value of the remainder is not more than ten percent of the CGA's funding amount. As with QPRTs, however, not all news is "bad" news for CRATs and CGAs when interest rates are low. In the case of a CRAT, while the donor's charitable deduction is lower than it would be if interest rates were higher, the charitable deduction of any beneficiary who relinquishes his or her annuity interest to charity increases as interest rates decline. For CGAs, the amount of each annuity payment which is excluded from the donor's income increases as interest rates fall.

The Indifferent

Not All Transfer Tax Planning Techniques Are Affected by Low Rates. The foregoing are examples of estate and gift tax planning concepts that are prone to rather dramatic effects by low rate environments – some "good"… some "bad." There are others that are generally minimally affected, if at all. Below is an example of a technique which is relatively "indifferent" to the low rate environment.

Unitrusts. For all intents and purposes, unitrusts (whether charitable or non-charitable) are unaffected by changes in the 7520 rate. If the unitrust makes payments annually (rather than more frequently) and the valuation date is the same as the payment date, a change in 7520 rates is of no consequence. This is because, if a person owns a fixed percentage of the fair market value of assets as revalued annually, the values of the unitrust interest and the remainder interest will always be the same in relation to each other. Further, even if payments are made more frequently than annually, or if there is a gap between the valuation date and the payment date (meaning that an adjustment to the payout rate is required under the IRC), the effect that interest rates play on this adjustment is minimal. Thus, changes in required payout rates for unitrusts may essentially be ignored for estate planning purposes. Unitrusts basically "shrug their shoulders" – indifferently – at low rate environments.

Designated Representatives

continued from front page

would be in those classes if the trust were to terminate on the date any given notice or report is due to be provided to all qualified beneficiaries. Not only are qualified beneficiaries entitled to request a copy of the trust documents and information concerning the trust's assets, they are also entitled to an annual accounting – whether or not such a request is made by them. Because of the extensive reach of these informational requirements, trust administration can become very cumbersome as the trust information and accountings must generally be provided to all qualified beneficiaries of the applicable trust or sub-trusts for their information, consent, or approval. Many times the trustee is not able to act until that consent or approval is obtained. Perhaps even more concerning is the fact that all qualified beneficiaries will be receiving a lot of information about irrevocable trusts created for their benefit to which many grantors simply do not want all of them to have access.

Fortunately, it is now possible to both improve the administrative efficiency of your trust and maintain trust privacy by appointing a "designated representative" for the trust beneficiaries in the provisions of your trust. Effective July 1, 2007, the new Florida Trust Code enables a grantor to name in the trust instrument one or more adult persons to represent and bind the trust beneficiaries. Additionally, the grantor may authorize any person, other than the trustee of the applicable trust, to nominate one or more persons as designated representative(s).

There are, however, some limitations on who is qualified to serve as a designated representative. First, the trustee of the applicable trust may not serve as the trust's designated beneficiary. Additionally, a beneficiary of the trust will not be qualified to be the designated representative of another trust beneficiary unless (1) the person is named by the grantor or (2) the person named is the represented beneficiary's spouse, grandparent, or descendant of a grandparent of the beneficiary or the beneficiary's spouse.

These small limitations on who may be appointed aside, the inclusion of a designated representative in your trust instruments should be considered if you are interested in improving administrative efficiency and/or keeping your trust and information about the trust from one or more beneficiaries.

Your Durable Power of Attorney

continued from front page

the same document, these same Agents would now be allowed to act independent of one another. Aside from certain banking transactions whereby multiple Agents may only act independent of one another, the Act will require additional language to ensure that your Agents, in fact, act jointly.

Whereas, in the good old days one's estate plan was locked in place, the Act now enumerates "Super Powers" that allow your Agents to have great latitude in modifying your estate plan, including powers to create, modify, and terminate trusts. You may authorize these Super Powers, broadly or restrictively, by initialing each and every authorized power. Although the power to make gifts is also a Super Power, it is unclear whether the grandfather provisions of the Act apply to gifting powers in pre-Act POAs that do not comply with the new statute. Under the Act, you must specifically enumerate all powers you want your Agent to have. A "blanket grant of authority" [e.g., "to do all the principal could do"] now confers no authority on your Agent. Yet, the Act does contain two specific "blanket" banking and investment power provisions which, if expressly conferred, provide general authority for banking and investment transactions. Each authorization contains a litany of related powers; however, some expected authority is not included among them. For example, the investment powers contain no power to initiate, buy, or otherwise trade commodity futures, or stock put/call positions. Those, among other powers, have to be separately enumerated in order to be effective.

My Agent Gets Paid?

Did you anticipate that your Agent would charge compensation for serving in such capacity? Out of love and affection or moral obligation, certain Agents ("Qualified Agents") will now be entitled to compensation that is "reasonable under the circumstances," in addition to reimbursement of reasonably incurred expenses. The right of a Qualified Agent to compensation is bestowed by the Act whether or not the POA expressly authorizes compensation. However, a non-"qualified" Agent may not be compensated for serving, no matter what the POA says. Among others, your spouse, blood relatives, financial institutions with Florida trust powers and a place of business in Florida, a Florida attorney, a certified public accountant, and individuals who have never been an Agent for more than three principals at the same time will be "Qualified Agents."

You May Have a "Spring" In Your Step – But Not In Your New Power of Attorney.

So-called "springing" powers of attorney delay their effectiveness pending some particular triggering event. Typically, the triggering event is upon the principal's inability to handle his or her financial affairs because of mental and/or physical disability. The power then "springs" into effect. With a narrow exception for military personnel with deployment-contingent "springs," a durable POA executed after September 30, 2011, may not "spring"but rather is effective upon execution. Subject to the above caveats regarding the effectiveness of Super Powers, "springing" durable powers of attorney, duly executed before October 1, 2011, remain valid after such date.

Out-of-State Durable Powers in Florida – "In" or "Out"?

Durable POAs, duly executed and enforceable in other states, will be deemed valid in Florida. However, they are generally only effective in Florida with respect to powers which are specifically enumerated in the instrument itself. For example, certain gifting powers or powers to modify or amend one's estate plan may not be effective in Florida if not separately initialed in compliance with the Act. There may also be delays in a third party agreeing to accept the POA. Although delay or rejection may be avoided by providing an "opinion of counsel" letter attesting to the validity and effectiveness of the POA, this is an additional expense you will most likely not look forward to incurring. If you are domiciled in Florida, it would be prudent to execute a new POA under the Act. Be prepared, however, for a lengthy discussion of your options with your counsel prior to setting pen to paper to initial the specific authority that should be granted to your Agent.

So Now What?

If you have a Florida Durable POA executed prior to October 1, 2011, ask your attorney if it is now fully "valid" and "effective," as you intended. If you have an out-of-state durable POA, ask a Florida attorney to review it and advise you. In any case, consider re-executing a new Florida Durable POA as soon as possible.