

Private Client Group

Gift and Estate Planning Technique

www.BlankRome.com

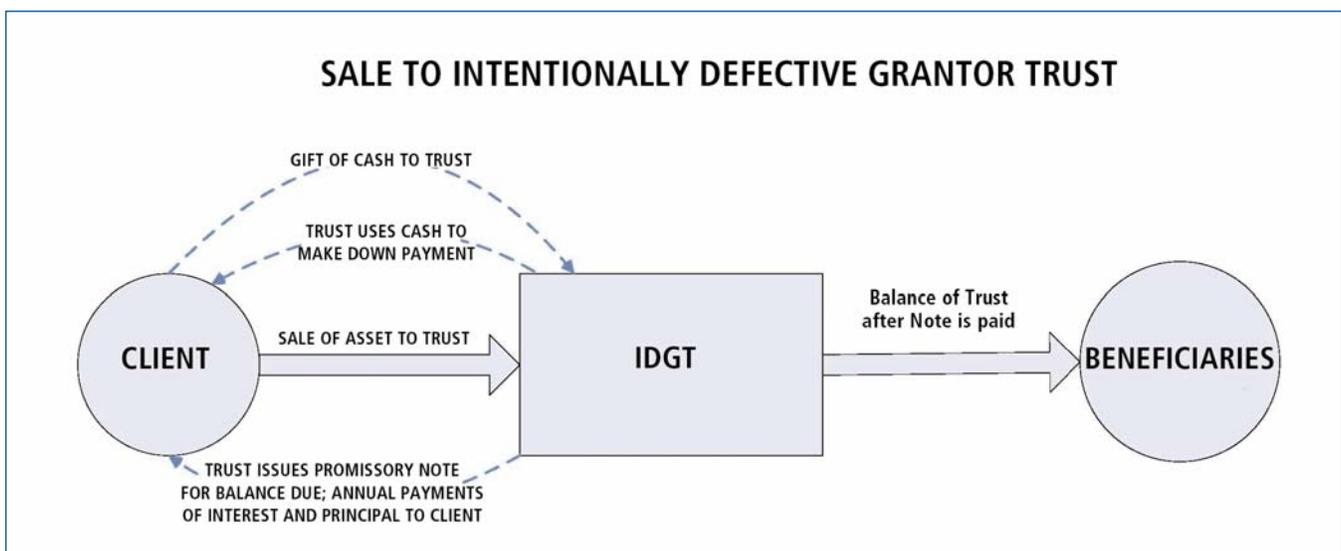
Installment Sales to Intentionally Defective Grantor Trusts

An installment sale to an Intentionally Defective Grantor Trust (“IDGT”) is a gift and estate planning technique that involves the sale of appreciated or appreciating assets to a trust established by you that is structured so that the assets of the trust are excluded from your estate for Federal estate tax purposes, but considered to be owned by you for Federal income tax purposes. The trust is considered a “grantor trust” for Federal income

taxes. As such, the trust is disregarded as a separate taxable entity, and you will be required to report on your personal Federal income tax return all of the taxable income (both ordinary income and capital gains) of the IDGT. This tax payment will inure to the beneficiaries of the trust but is not considered an additional gift for Federal gift tax purposes. Note, however, that the same rule does not necessarily apply for state income tax purposes.

For example, Pennsylvania requires a IDGT to file its own income tax return and pay its own tax.

The technique is structured as a combination of a gift and a sale to the IDGT. In a typical arrangement, you would first provide “seed” money to the IDGT, by making a gift, usually cash, to the trust. This cash can be used to make the down payment referred to below. Next, you would sell one or more appreciated assets to the IDGT in exchange



© 2007 BY BLANK ROME LLP Notice: The purpose of this newsletter is to review the latest developments which are of interest to clients of Blank Rome LLP. The information contained herein is abridged from legislation, court decisions and administrative rulings and should not be construed as legal advice or investment advice or opinion, and is not a substitute for the advice of counsel or an investment adviser. Any Federal tax advice contained herein is not intended or written to be used, and cannot be used by you or any other person, for the purpose of avoiding any penalties that may be imposed by the Internal Revenue Code. This disclosure is made in accordance with the rules of Treasury Department Circular 230 governing standards of practice before the Internal Revenue Service. Any written statement contained herein relating to any Federal tax transaction or matter may not be used by any person without the express prior written permission in each instance of a partner of this firm to support the promotion or marketing of or to recommend any Federal tax transaction(s) or matter(s) addressed herein.

for a promissory note (“Note”) in the amount of the purchase price, which may provide for installment payments over a period of time, with interest at the minimum required IRS interest rate or annual “interest only” payments with a “balloon” payment of principal at the end of the term. Often, the IDGT makes a down payment of 10%–15% of the purchase price, using the “seed” money referred to above. Typically, the property sold to the IDGT secures the Note. In addition, where possible, we recommend that the beneficiaries of the IDGT personally guarantee the payment of the Note.

Since the IDGT is disregarded for Federal income tax purposes, the sale transaction between you and the trust has no Federal income tax consequences. No gain or loss is recognized on your sale of the assets to the IDGT; you are not required to report the sale on your Federal income tax return; you are not taxed separately on the interest payments that you receive from the IDGT; and you will continue to be taxed individually on all income generated by the IDGT as if it did not exist.

This technique is economically similar to the grantor retained annuity trust (“GRAT”) technique. However, while there are some advantages over the GRAT technique, there are also disadvantages.

One advantage of the IDGT technique is that a lower interest rate can be used as compared to a GRAT. The required interest rate used to value a GRAT is 120% of the Federal midterm rate in effect on the date of the gift. (The midterm rate is used for loans of over 3 but less than 9 years). For a sale to an IDGT, the minimum

required interest rate is only 100% of the applicable Federal interest rate, which varies based on the term of the Note. In most cases, the IDGT interest rate is lower than the GRAT interest rate. As a result, the IDGT technique produces estate and gift tax savings at a lower total net return as compared to a GRAT.

Second, if the grantor dies during the term of the Note, the assets of the IDGT will not be subject to Federal estate taxation, whereas with a GRAT all or substantially all of the value of the GRAT as of the date of death will be subject to Federal estate taxation.

A major disadvantage of the IDGT as compared to a GRAT is that the IDGT technique is based

only upon tax practitioners’ interpretations of various provisions of the Internal Revenue Code, reported cases, and rulings, but is not specifically sanctioned under the law. As a result, there is some degree of legal uncertainty about the IDGT technique. On the other hand, the GRAT technique is statutorily approved in the Internal Revenue Code and in regulations, reported cases, and rulings.

A second disadvantage of a sale to an IDGT is that if you die during the term of the Note, the “grantor trust” status of the IDGT will terminate and you or your estate may have to recognize the deferred gain attributable to the unpaid portion of the principal of the Note. ■

Blank Rome’s Private Client Group

The Private Client Group represents clients in all aspects of estate and business planning, estate and trust administration, and estate and tax litigation. Our clients include entrepreneurs, Fortune 500 executives, professionals, and other high-net-worth individuals and their families as well as unmarried couples.

Estate Planning

We view ourselves as “family business advisors,” whose collaborations with our clients’ accountants, investment advisors, financial planners, and life insurance professionals enable us to tailor the most appropriate and tax-effective plan for asset management, business succession planning, and the transmission of wealth to subsequent generations.

Trust and Estate Administration

Our team of experienced attorneys, paralegals, and fiduciary accountants works closely with executors, trustees, and beneficiaries to provide a smooth and orderly administration of trusts and estates.

Trust and Estate Litigation

Blank Rome attorneys handle complex estate-related litigation in Florida, New Jersey, New York, and Pennsylvania.