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Legal Matters®

Estate Planning
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Using intrafamily loans in your estate plan

Interest rates are still at historic lows, despite an expected Federal Reserve rate hike. At times like these, families have a unique opportunity to transfer wealth via an intrafamily loan.

An intrafamily loan is a way for family members to loan money to each other at a special rate. They might be used to help a relative buy a house or finance a startup, for example. But for some families, they're a tool to transfer assets outside the lifetime gift tax exemption.

When making an intrafamily loan, interest rates are typically lower than those from commercial lenders. However, the IRS sets an Applicable Federal Rate (AFR) each month that would be the lowest allowable rate.

Let's say you provide your grandson with a $100,000 loan for five years at 1.4% (the AFR for February 2022). Your grandson invests that money and earns a return of 8%. At the end of the loan period, your grandson retains nearly $40,000 in returns, after paying principal and interest.

Bigger loans, of course, have the potential to yield bigger returns. (A $1 million loan for five years at 6% could generate more than $330,000 in returns.) No matter how big the loan, it won't impact your lifetime gift tax exemption — provided the recipient does, in fact, pay it back.

Because intrafamily loans are typically made at lower interest rates, your relative will pay less overall than going through a traditional lender. Meanwhile, the interest you receive could exceed the rate you'd get out of a CD or money market fund.

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Intrafamily loans must be properly executed to avoid negative tax consequences such as gift tax or taxable income. Establish the appropriate paper trail and demonstrate an intention to collect. If the loan goes into default, you'll need to take legal steps toward collection or begin forgiving the loan using your annual gift tax exclusion (for 2022, up to $16,000 per recipient, double if your spouse joins in the gift), if possible.

Intrafamily loans can be tricky from both an emotional and legal standpoint. Work with an estate planning attorney to safeguard your loan and your tax plans.

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Strategies for gifting to grandchildren

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Making financial gifts to your grandkids can be a great way to help your descendants get a good start in life. Depending on the size of your estate, it may also be a tool to maximize gifts to your heirs while reducing the taxes due upon your death.

Before giving, be sure you understand the tax consequences of your gifts. Here are some options and tips to think about before you give:

Know the tax rules. You can give each grandchild up to $16,000 a year (in 2022) without creating a taxable event. Two grandparents together can give up to $32,000 per grandchild (or any recipient) per year with no reporting requirements.

For example, a married couple with six grandchildren may give away up to $192,000 per year without gift tax implications. If you have a large estate and expect to exceed the federal estate tax exemption ($12.06 million in 2022, $24.12 million per couple), maxing out your annual exclusion gifts can be one strategy to optimize your wealth transfer.

If you're thinking about gifts as a way to get money out of your estate, start planning now. The $12 million estate tax exemption is set to revert to $6 million in 2026.

Of course, you need to keep enough for your own needs. Grandparents who could potentially deplete their estates with long-term care needs should know that any gifts can interfere with their Medicaid eligibility for up to five years. If that's your situation, planning for after-death gifts may be a better option.

Talk to the grandchild's parents first. Communicate with your kids before making a large gift to your grandchildren. Your kids may have strong feelings about how much financial support their children should have, and when. Likewise, they may have insight into a grandchild's problem spending issues or even legal challenges that they've kept private from you.

Paying for college. If your goal is to put money away for a grandchild's education, 529 plans are a tax-advantaged way to do that. Be aware, you can also make unlimited payments for tuition and medical expenses for anyone you like, with no estate tax consequences. Just be sure you pay the school or healthcare provider directly.

UTMA or UGMA accounts. UTMA and UGMA accounts are taxable investment accounts set up to benefit a minor, but controlled by an adult custodian until the child reaches a certain age, between 18 to 21, depending on what state they live in. Money in these accounts can be used in any way for the child.

IRAs. As a grandparent, you can open an IRA for your grandchild and help them get a start on retirement savings. To be eligible, your grandchild must have earned money during the year. You can contribute as much as they earn, annually, up to $6,000.

Trusts. Giving to grandchildren through a trust can offer you more flexibility and control over how those funds are distributed. One of the advantages of a trust is that you can work with an attorney to draft guidelines on when the income and principal will be available to the grandchild and/or how the money can be used.

Gifting strategies will vary considerably by family. To determine the best way to provide for your grandchildren, consult an estate planning attorney.

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How to protect your child's inheritance from their spouse

One concern we hear in the estate planning process is how to protect an adult child's inheritance from their spouse. Sometimes this stems from a place of animosity or concern over a child's problem partner. Some people are concerned about divorce-proofing the assets they'll leave behind for their kids. Still others simply believe that inheritances are best kept in the "family."

Naming your child alone as inheritor. The most basic option you have is to leave your inheritance to just one spouse. Even if your child lives in a community property state, an inheritance would be considered individual property.

However, once that property becomes "comingled" with other marital assets it becomes community property. Your son or daughter will need to place the inheritance in an account in their name only, and they will not be able to place any new funds in this account. Your child will need to be very careful to keep their inheritance separate and should likely consult with an attorney to ensure they do not inadvertently comingle their property.

Likewise, sometimes the income produced by one spouse's property can be considered community property. So comingling the income from

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Making it easier for loved ones to settle your estate

For many people, estate planning is about more than transferring assets after you're gone. It can be about making life easier on your survivors and smoothing the way for your loved ones at what is sure to be a difficult time. If that's one of the "gifts" you'd like to leave behind, consider taking the following steps.

Work with an attorney: Consult an attorney who will help you prepare a correctly executed will and/or living trust. Depending on your situation, some people choose a living trust as a beneficial way for their heirs to avoid the probate process.

With a living trust, you transfer title of your assets to the trust during your lifetime. When you pass away, trust assets can be transferred immediately, outside of the courts and probate process.

If you aren't using a living trust, consider other strategies to transfer at least some of your assets easily, without the delay of probate. You could designate a beneficiary on banking and money market accounts, making them payable on death, for example.

Alternately, you can set up a separate bank account with your trusted executor as co-signer. Consider setting up a nominal account with enough funds to cover funeral expenses or home repairs that would be beneficial before a sale.

Set up powers of attorney: Unfortunately, many one of us may go through a period of time when we are no longer able to care for ourselves or make our wishes known. Setting up power of attorney documents can make that difficult transition easier on your loved ones.

The person you appoint can be given the power to make financial decisions and/or healthcare decisions, including the ability to consent to giving or withholding medical treatments.

Make an asset inventory: Maintain an updated list of the assets in your estate. That keeps your loved ones from having to figure out what you have and where. Provide periodic updates to your executor. If you're not comfortable sharing specific dollar figures, simply sharing where your accounts are located is helpful.

Consider, too, whether it makes sense to consolidate your banking and investment relationships into fewer accounts as you age. That can also simplify and streamline the process.

Gift sentimental items: Divvying up your financial assets is one thing, but some families struggle with sentimental personal items like artwork, heirloom dishes, or jewelry. One way to avoid strife is to designate those items directly in your will or in a "personal property memorandum."

A personal property memorandum can be written outside your will, as long as the will refers back to it. Once that's set up properly, you can update this document as often as you like, without officially updating your will.

Communicate during your lifetime: If possible, talk to your heirs about your estate plans before you pass away, particularly if your plan might otherwise contain unpleasant surprises. When people understand why you made certain choices, it's easier to accept them. Communication, and properly executed planning documents, can be key to a smooth process.

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How to protect your child's inheritance from their spouse

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the inheritance with the inheritance itself could destroy its separate status.

Leaving the inheritance in a trust. As an alternate strategy, you can leave your son or daughter's inheritance in a trust, naming them as trustee. Creditors, divorcing spouses, and other invaders will not have access to your child's inheritance to the extent that assets are left in the trust. Again, depending on the withdrawal rights set up in the trust, your child could withdraw funds and comingle them or otherwise use them to benefit their spouse.

If there is greater concern, the trust can be set up with an independent trustee. Such an arrangement limits your son or daughter's access to the inheritance. Assets can only be dispersed at the discretion of the trustee, so you'd need to be clear about establishing those withdrawal or distribution rights when drafting the trust.

Think carefully before bypassing your child's partner in your estate plans. Know what you'd like to happen if your child passes away before their spouse. Would you intend to leave their spouse out entirely? Skip them and transfer to their kids? These aren't always easy questions to answer. An experienced estate planning attorney can help you consider potential what-ifs and plan accordingly.

This newsletter is designed to keep you up-to-date with changes in the law. For help with these or any other legal issues, please call our firm today. The information in this newsletter is intended solely for your information. It does not constitute legal advice, and it should not be relied on without a discussion of your specific situation with an attorney.

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Washington first state with public long-term care

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Earlier this year, Washington State's Long Term Care Trust Act went into effect, creating the nation's first publicly funded long term care benefit.

Washington lawmakers developed the LTC Trust Act in order to protect their state budget from the exorbitant costs of Medicaid-covered long-term care. The trust will be funded by a mandatory 0.58% payroll tax on all W2 wage earners. The Washington trust has a lifetime benefit maximum (annually adjusted) designed to cover approximately one year of long-term care.

Washington residents who had previously purchased LTC insurance had the option to opt out. However, short notice of the deadline created a last-minute rush to purchase private care insurance.

Other states considering a LTC social insurance program include California, Hawaii, Illinois, Michigan, Minnesota and New York. With the Washington bill in place, there's a framework that may help states accelerate their plans.

Your estate planning attorney can help you and your family plan for future long-term care needs. Talk to your advisors about how you'll pay for long-term care and ways to protect family assets.