Enhancing Wealth Transfer with an Intentionally Defective Grantor Trust (IDGT)

CASE STUDY

HIGHTOWER Trust Company

A STRATEGIC ESTATE PLANNING TOOL FROM HIGHTOWER TRUST COMPANY

CLIENT PROFILE: Robert and Susan Miller, both in their early 60s, have built significant wealth through their privately held business and a diversified investment portfolio. Their net worth exceeds $30 million, and they want to pass on their business interests and investments to their children in a tax-efficient manner while maintaining some control over the assets.

CHALLENGE:

Estate Tax Exposure: With the current federal estate tax exemption at $13.99 million per individual (as of 2025), a large portion of their estate will be subject to a 40% estate tax upon their passing.

Avoiding Large Upfront Gift Taxes: They want to transfer significant wealth but without incurring substantial gift tax liability.

Maintaining Control & Cash Flow: Robert and Susan wish to sell assets to a trust for their children while still receiving an income stream.

SOLUTION: The Millers' Hightower advisor recommended an **INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT)** and suggested naming Hightower Trust Company as trustee. After receiving a referral to an estate planning attorney, the Millers collaborated with the attorney to establish the trust and designate Hightower Trust Company as trustee. An Intentionally Defective Grantor Trust (IDGT) is an irrevocable trust designed to remove assets from the grantor's taxable estate while still being treated as the grantor's asset for income tax purposes. This "defect" (intentional for planning purposes) allows the grantor to sell appreciating assets to the trust in exchange for a promissory note without triggering capital gains tax. The assets then grow outside the estate, transferring wealth tax-efficiently to heirs.

HOW AN IDGT WORKS:

1. They establish an IDGT and seed it with a gift (e.g., $1 million).
2. They sell $10 million in appreciating business interests to the IDGT in exchange for a 10-year promissory note, avoiding capital gains tax.
3. The IDGT repays the note over time using the income from the business, with interest at the IRS minimum rate (Applicable Federal Rate or AFR).
4. The business interests continue to appreciate inside the trust, free from estate tax.
5. At the end of the note term, the remaining assets in the trust pass to their children tax-free.
   - At it's core, an Intentionally Defective Grantor Trust is designed so that the grantor, rather than the trust is responsible for paying income taxes on the trusts earnings. This "defect" is intentional, allowing the trust assets to grow unburdened by tax obligations while effectively reducing the grantor's taxable estate. The promissory note adds an additional strategy within the IDGT that supports the Miller's sizable estate considerations.

KEY BENEFITS OF AN IDGT

- **Eliminates Estate Tax on Future Growth:** The business and investments inside the trust appreciate free from estate taxes.
- **No Capital Gains Tax on the Sale:** The grantor is still considered the owner for income tax purposes, avoiding recognition of capital gains on the initial sale.
- **Tax-Efficient Wealth Transfer:** The grantor pays income taxes on trust earnings, effectively making an additional tax-free gift to the beneficiaries.
- **Retains Cash Flow:** The grantor receives structured payments from the promissory note, helping ensure continued income.

POTENTIAL RISKS & CONSIDERATIONS

1. **Mortality Risk:** If Robert or Susan pass away before the note is fully repaid, the outstanding balance could be included in their estate.
2. **Asset Performance:** If the assets in the trust underperform, the IDGT may struggle to make note payments.
3. **Irrevocable Structure:** Once assets are sold to the trust, they cannot be reclaimed by the grantor.

RESULTS: By implementing the recommendations of their Hightower advisor and collaborating with the estate attorney, the Millers successfully executed the IDGT strategy. This approach not only facilitated the transfer of wealth outside their taxable estate but also ensured that their children inherit assets free from estate taxes. At the same time, they continue to receive income through structured note payments, allowing them to maintain financial security while achieving their estate planning goals.

> **At Hightower Trust Company, we specialize in working with clients and their advisors to help families design and implement IDGTs to help maximize estate planning efficiency.**

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