



Client Update: Estate Planning Opportunities in Troubled Times

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The continued economic troubles are presenting some of the best opportunities in years for transferring wealth to younger generations without incurring any gift or estate tax.

Gift & Estate Tax Law Clarity. On April 29, Congress passed a \$3.5 Trillion Fiscal Year 2010 Budget which includes provisions that would freeze the current 2009 estate tax rate at 45% and make permanent the exemption amount of \$3,500,000 for individuals (or \$7,000,000 for married couples). In the absence of such legislation, the gift and estate tax would have lapsed in 2010, and then returned to a maximum rate of 55% in 2011, with a \$1,000,000 exemption for individuals. Clarifying the maximum rates and applicable exclusion amounts should give taxpayers the clarity and certainty necessary to formulate their lifetime gift and estate plans.

Low Interest Rates and Depressed Asset Values. Historically low interest rates and depressed asset values present a variety of gift and estate planning opportunities. Each individual may make an annual gift of \$13,000 (indexed for inflation) and a lifetime gift of \$1,000,000 free of gift tax. Because asset values are currently depressed, this is a good time to make a gift of appreciating property to the second generation. In addition to passing the \$13,000 tax free, you are able to pass the future appreciation on the property tax free. With asset values depressed, the hope and expectation is that the asset values will eventually recover.

Today's low interest rates make inter-family loans an attractive way to transfer wealth. An individual may make a tax-free loan to a family member provided that the loan is subject to a statutory interest called the Applicable Federal Rate (AFR). The mid-term AFR for May 2009 is approximately 2.04%.

IDGTs. A popular estate tax strategy for an owner of a privately-held business is to sell interests in the business to an Intentionally Defective Grantor Trust (IDGT) in exchange for a promissory note. The note must bear interest at a statutory rate, which is currently near historic lows. An IDGT is a type of trust that is treated as owned by the Grantor for purposes of federal income tax rules, but treated as transferred to the trust beneficiaries for purposes of federal estate tax purposes.

An installment sale of interests in a family business passes interests in the company to the second generation and ensures that any future appreciation in the value of the company is transferred without being subject to a transfer tax. An installment sale to an IDGT is particularly attractive in the current economic environment because it takes advantage of the current low interest rates as well as depressed business asset values.

GRATs. Another estate planning technique that is bolstered by low interest rates and depressed asset values is the use of a Grantor Retained Annuity Trust (GRAT). A GRAT is a trust which pays the grantor an annual payment for a fixed term, then distributes the remaining assets to the trust beneficiaries. Upon funding the GRAT, the grantor makes a gift to the trust beneficiaries in an amount equal to his or her contribution to the GRAT *plus* statutory interest earned on the principal *minus* the annuity payments that will be paid to the grantor. If the GRAT is funded with appreciating assets and the prevailing interest rate over the term is greater than the applicable statutory term when the GRAT is formed, it is possible to transfer significant amounts of wealth to the trust beneficiaries free of gift tax.

Contact Us. If you have questions or comments about this Client Update, please reply to dmccullough@spain-law.com.