Three wealth transfer ideas that make tax sense now

Logic and emotion may suggest that now is not the time to give anything away. Yet, although there hasn't been much to applaud in the financial news recently, an environment of depressed asset values and low interest rates actually may make it a good time, from an estate planning perspective, to consider some of your options.

Transferring assets to your children and grandchildren during your lifetime helps them now, while at the same time, decreasing the size of your estate and your estate tax exposure. But the IRS keeps a watchful eye out so that people don't try to give away *too* much now to avoid tax later. (That's why there is a gift tax.)

Here are three steps to discuss with your estate planning advisors:

1. Take advantage of gift-giving opportunities

Family gifts are a good place to start. You can give up to $13,000 in 2009 to anyone you wish, gift tax free. When couples make the gifts together, the amount doubles ($26,000). Do that regularly over the years, and you can remove the potential threat of taxes on a significant sum.

Take this hypothetical: Jay and Kay have two children. They plan to write checks to each of them in December for $24,000. Suppose they own stock in XYZ Company, which had been valued at $50 per share earlier in the year. Had they made gifts of the stock instead of cash back then, they could have transferred 960 shares. In December the stock is valued at $32 per share and they can give away 1,500 shares. So more shares pass to their children tax free and, presuming that the XYZ Company shares rebound, any future appreciation is removed from their estates.

Two more gift giving ideas. One, beyond the gift tax exclusion, you and your spouse each have a $1 million gift tax exemption. The difference is, should you use it or any part of it, your *estate tax* exemption, $3.5 million in 2009 drops dollar for dollar.

Two, you can help children or grandchildren with medical or education expenses tax free as well. There is no dollar limit on these gifts as long as they are paid directly to the health provider or school.

2. Make a low-interest loan

Low-interest rates make loans an attractive way to transfer money to your offspring—as long as you follow the rules that will keep the loan from being treated as a gift.

IRS publishes monthly rates that set the minimum interest you must charge based on the loan's maturity date. For example, in November 2008, if your children borrowed money from you for nine years (a "mid term" loan), the annual interest rate must be at least 2.97%.

If your child then takes the money and invests it, what's left after making the interest payments to you is "profit." Want to help your children with the purchase of a home? Loan them the money at the current low rates and make annual exclusion gifts each year to help them buy down principal. But don't forgive the loan—you could face unpleasant gift or income tax consequences.

3. Set up a GRAT

A more sophisticated way to transfer wealth to your children (or others) is to set up a grantor annuity trust, or GRAT). You transfer assets that you expect to grow in value in the coming years to the GRAT and receive annuity payments based on the initial value of the assets in the trust, at a set annual income rate and for a specified number of years.

The transfer to the trust is a gift based upon the value of what's left in the trust (the remainder) after the trust ends, reduced to reflect the time that passes until the assets are distributed to your children. The IRS assumes an interest

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rate—3.6% in November 2008—that the trust's assets will earn. If the actual income earned by the trust is higher, the excess stays in the trust and accumulates (as, presumably, over time, so will the value of the assets themselves).

At today's low interest rates, the remainder in the trust can grow significantly. Your children won't have to pay any tax on what the trust distributes to them, and the assets (and appreciation) escape tax in your estate as well.

But setting up a GRAT is not risk free. If you die before the trust ends, the assets will be included in your estate for estate tax purposes. The major tax benefit—avoiding tax on the appreciation of the assets—has been lost, plus you are out of pocket for the fees that you paid to set up and administer the trust. And, should the value of the assets in the trust decrease, you have used up a greater portion of your $1 million gift tax exemption for a transfer with a lesser value. In the worst-case scenario, the GRAT could be exhausted if the value of the assets falls precipitously.

If these ideas have stimulated your thinking, we would be glad to discuss them with you further, as well as present other strategies that may be appropriate for you and your family. Because some of these strategies are time sensitive from a tax-saving standpoint, we recommend that you contact us soon.

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