

ESTATE PLANNING advantage

The Estate Planning Newsletter of Sirote & Permutt

Make Low Interest Rates Work for Your Estate Plan: GRATS and Loans to Family Members



We all follow the news, and many are shocked and alarmed to read about our unpredictable economy. The housing market and gas prices are reminders that economic development is currently less prosperous than in past decades. Various interest rates issued by the Federal government act as economic indicators. One such interest rate, known as the "Section 7520 Rate," is issued by the Internal Revenue Service on a monthly basis to project interest rates for estate, gift and income tax purposes. This rate has remained historically low over the past six to eight years and has created the opportunity for certain gifting techniques that allow taxpayers to make transfers to intended beneficiaries with a lower (or no) gift tax cost. With this in mind, consider the following two techniques.

GRATS

The first technique is known as a Grantor Retained Annuity Trust (GRAT). When a GRAT is formed, an individual transfers assets to a trust for a term of years. During the pre-selected term, an annual annuity amount is paid to the transferor. At the end of the GRAT term, assets remaining in the GRAT are paid to remainder beneficiaries. Although the transfer to the remainder beneficiaries (or a trust for them)

does not happen until after the pre-selected term ends, the value of the gift for gift tax purposes is determined by calculating the present value of the remainder interest at the time of transfer of assets to the trust. The present value is calculated by applying the Section 7520 Rate to the term of the trust and required annuity payments. The lower the 7520 Rate, the lower the reportable gift for tax purposes. If assets in the GRAT outperform the Section 7520 Rate, the added value moves to the remainder beneficiaries at the end of the term without being treated as a gift for tax purposes. During an economy with a relatively low 7520 Rate, the opportunity for GRAT assets to outperform the 7520 Rate is greater. Therefore, the opportunity to maximize gift tax savings by using a GRAT is greater. The Section 7520 Rate for October is 3.8%.

To realize the benefits of a GRAT, the person transferring the property must outlive the pre-selected term, and total return on the assets must exceed the Section 7520 Rate. If the person making the transfer dies before the pre-selected term ends, there is no negative tax effect;

(Continued on Page 2)



LEGISLATIVE UPDATE:

EXTENSION OF THE IRA CHARITABLE ROLLOVER

President Bush has signed into law the Emergency Economic Stabilization Act of 2008. The Act includes a retroactive extension of the IRA Charitable Rollover which applies to distributions made throughout both the 2008 and 2009 tax years. This extension allows people who are 70 1/2 and older to donate up to \$100,000 from their IRAs to public charities tax-free. It is important to note that the Act does not expand the IRA Charitable Rollover to allow tax-free donations to split-interest trusts or private foundations.

TRANSFER TAX UPDATE

The estate tax-free amount will increase to \$3.5 million in 2009 while the gift tax-free amount will remain at \$1 million. Additionally, the exemption from generation-skipping tax, which may be imposed on property left or gifted to grandchildren, is currently \$2 million and will also increase to \$3.5 million from \$2 million in 2009. The current estate and gift tax laws are scheduled to sunset in 2010. However, legislation is currently pending in Washington, and the upcoming elections will have a dramatic effect on what ultimately happens to these transfer taxes.

The annual gift tax exclusion amount will increase from \$12,000 to \$13,000 beginning January 1, 2009. Also, note that amounts paid directly to providers for qualified tuition and medical expenses continue to be exempt from gift and generation-skipping tax.

typically, all or most of the GRAT assets will be included in his or her estate for tax purposes. If assets do not earn more than the Section 7520 Rate, there could potentially be no assets at the end of the GRAT term to distribute to the remainder beneficiaries. A GRAT performs best with assets expected to appreciate.

The choice of assets is important. For example, a minority interest in an S Corporation (with high cash flow and discounts in value for lack of control and marketability) is ideal. In addition, the decline in value of many marketable securities (e.g., bank stock) has created an advantageous environment for GRATs. Low stock values and a low §7520 Rate combined with potential improvement in the market create opportunities to move future appreciation to beneficiaries with little or no gift tax consequences.



Melinda M. Mathews advises professionals and business people in planning estates and insurance to accomplish personal goals and minimize estate taxes.



Craig M. Stephens is co-chair of the Estate Planning Group at Sirote & Permutt. He focuses on taxation, estate planning, and trust and estate administration.

Loans to Family Members

Our current low interest environment favors loans to family members and other intended beneficiaries. Some individuals make annual exclusion gifts of \$12,000 to each family member. If an individual wants to make an additional transfer, but does not wish that transfer to be treated as a gift for tax purposes, the individual might make a loan to the beneficiary at the present low applicable interest rate. The loan should be documented with a promissory note, and an appropriate interest rate applied to avoid gift treatment depending upon the terms of the loan and whether the loan calls for annual, semi-annual, quarterly, or monthly payments. The required minimum interest rate varies. Each month, the IRS issues the appropriate interest rates that must be charged in order to avoid gift treatment and/or imputed interest for income tax purposes. Currently, those rates are lower than the rates a commercial institution might charge. For example, a two year loan with annual payments could have an interest rate of 2.19% in October. The difference between the IRS-imposed rate and the commercial rate is not considered an additional gift to your intended beneficiaries; rather, it is a way to benefit loved ones.

To learn more, ask your estate planner to discuss these or alternate techniques that fit your personal situation.

A Place for an Ethical Will in Your Estate Plan



When we help our clients complete their estate plans, the process usually includes a discussion about the assets they own, how they would like for those assets to be distributed after their death, and the use of techniques to accomplish those goals, while saving as much estate and gift tax as possible. At the end, the estate plan may be embodied in documents such as a Last Will and Testament, one or more trusts, a power of attorney, a health care power of attorney and a living will. All of these documents are extremely important and, in our humble opinion, are best written by your attorney. However, the most valuable legacy you leave may not be prepared by your attorney and is not legally enforceable. I am referring to an ethical will.

Some have called an ethical will a love letter to your family. It is a means of passing along your spiritual and personal values, lessons learned from the past and hopes for future generations. It might include reminders of heritage, offers of forgiveness or expressions of gratitude.

The concept of an ethical will is not a modern idea. It is said to trace its roots to biblical times, and the Bible is certainly replete with stories such as Jacob instructing his children from his deathbed on how to live their lives. Such accounts suggest the first ethical wills were delivered orally. Indeed, an ethical will need not be a written document; although, having it preserved in a manner that allows it to be consulted again and again and passed through generations adds to its value. If an ethical will is not a modern idea, modern technology has been brought to bear, with people recording their personal histories and hopes for their descendants on videotape, CDs and DVDs.

You have probably seen or heard of Professor Randy Pausch's Last Lecture, in which he acknowledged he was dying of pancreatic cancer and exhorted his listeners to achieve their childhood dreams, passing along inspirational lessons he had learned. Although his last lecture, through online videos, print and broadcast media and subsequent publication of a book has had a wider audience than most ethical wills, it nevertheless is an example of leaving behind a precious piece of yourself for your loved ones.

While there are certain formalities that must be observed in order for your Last Will and Testament to be legally valid, there are no such restraints upon your ethical will. It might take any form and include anything you want to convey. To get started, you might make notes about your greatest successes or failures, happiest memories, and wishes for your family. You might include your favorite scriptures or poems, or compose your own. You might compile family photographs and mementos and leave an account of your family history. You may be the last one alive who knows those kinds of things. The most important thing is to speak from your heart and remember that your ethical will may be the gift to your family for which you are most remembered.



Leigh A. Kaylor is in the Birmingham office of Sirote & Permutt. She advises clients on nonprofit and tax-exempt organizations, tax law and planning, charitable planning and estate administration.