

Window of Opportunity to Transfer Asset Appreciation Free of Gift and Estate Taxes

Finding ways to transfer assets to your family without making significant taxable gifts is critical to the goal of passing the wealth you have accumulated to the next generation. A "GRAT" can leverage the confluence of today's depressed asset values and low interest rates to help you achieve this goal. However, this is a window of opportunity that exists today and may close in the very near future.

Once you have accumulated enough wealth to satisfy your own needs, transferring assets to the next generation - instead of to the IRS - becomes an important goal. The federal estate tax will take 45% of all assets valued in excess of \$3,500,000 that you transfer at death to anyone other than your spouse. Many states, Massachusetts among them, also impose a state estate tax.

Unfortunately, you can't make significant gifts during life to avoid estate taxes later. Under today's rules, you can gift \$13,000 per donee, per year, free of the federal gift tax. Gifts in excess of \$13,000 to any donee in any year (so-called taxable gifts) however, must be reported on a federal gift tax return. Once the aggregate of all such taxable gifts exceeds \$1,000,000, a hefty federal gift tax will be due. Even taxable gifts which are within the \$1,000,000 lifetime exemption in effect are added back to your estate for estate tax purposes (with only the appreciation on these gifts avoiding estate tax). Given these limitations, a GRAT can be an attractive strategy to achieve your wealth transfer goals.

"GRAT" is an acronym for grantor retained annuity trust. This kind of trust allows you to use favorable provisions of the tax code to transfer assets free of gift and estate taxes. Here's how it works: You establish an irrevocable trust (i.e., the GRAT) and fund it with assets you believe have the chance to appreciate in value significantly. You then pick a term for the trust, for example three years. In this example, over the next three years you must receive back from the trust assets equal in value to those you placed in it plus a growth factor established by the IRS. This growth factor, the so-called "7520 Rate," fluctuates monthly, and is currently at an historic low of 2.6%. All growth in those assets post-transfer to the trust in excess of 2.6% passes to your family free of gift and estate taxes.

As an example, you can establish a three year GRAT and fund it with \$3,000,000 of stock in a publicly traded company that you feel will increase in value once the market rebounds. Since over the next three years you will receive back the \$3,000,000 plus an additional 2.6%, in establishing the GRAT you are not making a taxable gift. If the stock grows at a rate of 10% for the next three years, there will be approximately \$500,000 left in the trust at the end of its term to pass to your family tax-free. This is appreciation that otherwise would have been in your estate for tax purposes. Obviously, the greater the growth the greater the tax-free gift to your family. The plan works even better if the stock pays a dividend as any dividends add to the growth passing to your family.

GRATs are truly a no-lose proposition because if the assets do not grow more than the 7520 Rate, you are just back where you started as though you had not created the GRAT in the first place.

While GRATs are often funded with stock in publicly traded companies, they can offer even greater benefits when funded with successful new ventures. GRATs can be funded with stock of start-up entities that hold the potential for explosive growth, but have minimal value at the moment the GRAT is funded. Since the GRAT can be structured to be a "S" shareholder, you can transfer interests in smaller start-ups without creating income tax problems.

That which is too good to be true cannot last forever. There is currently talk in Congress of amending the tax laws to reduce the benefits offered by GRATs and, at some point, interest rates and asset values will rise. Therefore, now is the time to use a GRAT to get assets to your family rather than to the IRS.

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