

PRIVATE CLIENT SERVICES

>> ALERT

THREE REASONS WHY NOW IS THE TIME FOR ESTATE PLANNING

Although the current economic environment is troubling, there is one area of personal planning that could benefit tremendously from all the bad news: estate planning. This alert describes three reasons why now is a good time for everyone to review their estate planning and consider implementing certain planning techniques.

1. LOW VALUES

Low asset values present an opportunity both for making gifts and for an estate freeze. With respect to gifts, each year an individual can make gifts to an unlimited number of recipients of up to \$13,000 per recipient, and can give an additional \$1 million during his or her lifetime, without paying gift taxes. Now is an ideal time to use the annual exclusion and the lifetime credit to make gifts of stocks or other assets which have suffered losses in value but which may rebound in value in coming years. For example:

- >> Grandfather owns 1,000 shares of XYZ Bank. Last year, XYZ Bank shares traded for \$40, today they are trading at \$10.
- >> Grandfather can make a gift of all 1,000 shares of XYZ Bank stock today to Granddaughter, either outright or in trust, and the entire gift will qualify within the \$13,000 annual exclusion from gift tax.

- >> Grandfather will pay no gift tax on the gift, and will not use any of his \$1 million lifetime exemption from gift tax.

An “estate freeze” refers to any of several estate planning techniques that transfer the future appreciation of an individual’s assets to children or other beneficiaries. The starting point for these techniques is the current fair market value of those assets. Many of these values are currently depressed, and it is relatively easier to transfer future appreciation using an estate freeze now than when values are high.

Of course many people are concerned about maintaining their own lifestyle and may be hesitant to lock in to a plan that involves transferring wealth to their children and grandchildren in today’s challenging environment. However, sophisticated estate freeze transactions such as GRAT’s and sales to grantor trusts allow one to transfer future appreciation without giving up the economic benefit of one’s current wealth.

2. LOW RATES

The IRS sets the minimum interest rates which individuals must charge when making loans to family members or to trustees of family trusts. These rates are adjusted monthly based on various economic facts and, due to troubling macroeconomic elements, are at all time lows. For example, the minimum rate for a loan of up to three years is currently 0.72%. If an adult

>> *continues on next page*

THE BOTTOM LINE

Low valuations, low interest rates, and potential legislative changes make the current environment a unique time to try to reduce future estate taxes by implementing sophisticated estate plans now. The most effective techniques involve transferring the future appreciation of assets you select, but retaining the economic benefit related to those assets.

child believes he or she can achieve a greater return (in a CD, a bond, or any other investment) than 0.72%, then parent can make a wealth transfer to child—without gift tax consequences—merely by means of a loan, based on the rate arbitrage. For example:

- >> Mother lends Son \$500,000. Mother charges Son interest of 0.72%, the minimum rate allowable by the IRS.
- >> Son invests the \$500,000 in a three year CD paying 3.72%. After making an annual payment of interest to Mother, Son nets \$15,000 per year.
- >> At the end of the third year, Son redeems the CD and repays Mother. Son has netted a total of \$45,000 as a result of the rate arbitrage—and Mother has not made any gifts to Son (meaning that she can simultaneously also be making \$13,000 annual exclusion gifts).

The benefit of these extremely low interest rates is even greater when they are applied to an estate freeze, rather than a simple intra-family loan. As a result, it is easier than ever to move future appreciation to children or other beneficiaries with little or no gift tax.

3. POTENTIAL LEGISLATIVE CHANGES

Congress is currently considering changes to the federal estate and gift taxes that could make planning more difficult in the future. As a result, it is important to act quickly.

As an example of legislative changes being considered, a bill pending in the House of Representatives would eliminate valuation discounts that have become a key component of sophisticated estate plans. In order to value family owned companies and most other assets (other than publicly traded securities) for estate planning purposes, one must engage a qualified appraiser. Historically, these appraisers have determined that the value of such assets should be subject to discounts to take into account factors such as lack of marketability and lack of control. For example:

- >> Family Co. holds assets worth \$10 million. Uncle makes a gift of a 10% interest in Family Co. to nephew.
- >> In accordance to gift tax regulations, a qualified appraiser is engaged to determine the value of the gift. The appraiser may determine that the value of the 10% interest carries a 30% discount due to lack of control and lack of marketability. As a result, for gift tax purposes Uncle makes a gift worth only \$700,000 rather than \$1 million.

In an effort to raise revenue, the proposed legislation would eliminate these valuation discounts—which would result in an increased estate and gift tax burden associated with sophisticated estate planning.

If this legislation is passed and is effective going forward from the date of enactment, many will look back on the first part of 2009 as an historically great window of opportunity for estate planning. There is a risk such legislation would be effective retroactive to 2009, and this risk must be taken into account when implementing any new planning. However, there are methods of accounting for such risk with prudent planning.

FOR MORE INFORMATION

Lewis A. Rubin, Partner/Chair
Private Client Services
212.468.4801
lrubin@dglaw.com

Daniel L. Kesten, Partner
Private Client Services
212.468.4876
dkesten@dglaw.com

or the D&G attorney with whom
you have regular contact.

DAVIS & GILBERT LLP

T: 212.468.4800
1740 Broadway, New York, NY 10019
www.dglaw.com

© 2009 Davis & Gilbert LLP