

## GIFTING STRATEGIES FOR AN ECONOMIC DOWNTURN

### ***WHY NOW IS AN EXCELLENT TIME TO GIVE AWAY ASSETS TO LOVED ONES***

As strange as it may seem, now — in the middle of a deep recession — may be an excellent time for you to make substantial gifts to your loved ones. A smart gifting strategy is always an important piece of an estate plan. But thanks to a confluence of four factors — depressed asset values, an increase of the annual gift tax exclusion, very low interest rates and proposed legislative changes — it's never been more advantageous to give gifts to family members than right now.

Doing so can help loved ones through tough times while you benefit by removing assets from your taxable estate. With the estate tax repeal scheduled for 2010 likely to itself be repealed, reducing the size of your taxable estate is as important as ever.

### ***ASSET VALUES LOW, OPPORTUNITIES HIGH***

Because of the economic downturn, many assets have lost significant value. It's particularly attractive to make lifetime gifts of assets whose values are depressed, but likely to appreciate significantly when the economy recovers. Those assets may include real estate, stocks and interests in a closely held business.

The benefit of gifting when asset values are low is twofold: 1) you can transfer a greater number of shares or greater percentage of the asset without giving away more value for gift tax purposes, and 2) you can remove all future appreciation on the asset from your taxable estate.

What's more, the simplest strategy for removing assets from your estate — making annual exclusion gifts — is more powerful because the exclusion increased in 2009 by \$1,000 to \$13,000 per recipient, for each donor, without tapping any of your (or your spouse's) \$1 million lifetime gift tax exemption.

Before making gifts, it's important to consider income taxes. If your heirs inherit assets when you die, the tax basis of the assets is generally "stepped up" to their current fair market value, minimizing, or even eliminating, capital gains taxes in the event of a sale. However under a gifting program, the basis of assets that you transfer to family members isn't stepped up.

### ***INTEREST RATES LOW, TRUSTS MORE POWERFUL***

Trusts are commonly used tools in estate planning. Now, thanks to very low interest rates, certain trusts — such as a grantor retained annuity trust (GRAT) or a charitable lead annuity trust (CLAT) — are even more attractive.

In this instance, the relevant interest rate is the Section 7520 rate. It's an assumed rate of return the IRS employs to value certain interests for gift tax purposes. The good news is that in February the rate dropped to a record low of 2%. The rate has increased to 2.6% in April, but that's still near the record low.

The Sec. 7520 rate comes into play when using a GRAT or a CLAT because the remainder beneficiary receives what's left in the trust at the end of the trust's term, after all of the annuity payments have been made. (In a GRAT, you receive the annuity payments; in a CLAT, one or more charities receive the payments.)

Basically, the lower the Sec. 7520 rate, the smaller the remainder interest will be and, therefore, the lower the gift tax. If the trust's earnings outperform the Sec. 7520 rate (which is likely when interest rates are low, assuming a five- to 10-year trust term), those excess earnings will be transferred to the remainder beneficiaries tax free.

## **FLPS AND FLLCS STILL BENEFICIAL BUT REQUIRE CAUTION**

Gifting interests in family limited partnerships (FLPs) and family limited liability companies (FLLCs) can be advantageous for a variety of reasons. But for tax purposes, it may be especially beneficial now. First, low asset values mean you can transfer more FLP or FLLC interests at a lower tax cost. Second, proposed legislation that could eliminate valuation discounts on gifts of FLP and FLLC interests means you may want to make such gifts as soon as possible, to help ensure they qualify for discounts.

Transfers of FLP or FLLC interests are subject to gift tax, but they can qualify for the annual gift tax exclusion. So when asset values are lower, you can transfer more interests tax free, or at least at a lower tax cost.

You can further leverage gifts of FLP or FLLC interests by taking advantage of valuation discounts. Currently, if an FLP or FLLC is properly structured and managed, discounts for lack of control and lack of marketability can be applied to the value of transferred interests for gift tax purposes. For example, the total value for gift tax purposes of an FLP divided among six family members might be substantially less than the value of the FLP's underlying assets.

You should be aware that the ability of families to claim valuation discounts may be in jeopardy. Lawmakers have been proposing eliminating or limiting the tax-saving advantages of FLPs and FLLCs for several years. Thus far, nothing has come to fruition. However, because of budget concerns, Congress may now be more motivated to pass such legislation.

As of this writing, a bill has been introduced (H.R. 436) that would eliminate gift tax valuation discounts for transfers of minority interests in FLPs, FLLCs and other "nonactively-traded" interests if the transferee and certain family members control the entity. It also wouldn't allow valuation discounts to the extent such entities own nonbusiness assets, such as marketable securities. If this bill is signed into law, the changes would be effective prospectively.

Any gifting strategy requires consideration of many factors, so consult your tax and estate planning advisors for assistance. Put the economic downturn to work for your advantage.

*To ensure compliance with requirements imposed by the IRS, we are required to inform you that any U.S. federal tax advice contained in this communication (including attachments) is not intended or written to be used, and cannot be used, for the purpose of 1) avoiding penalties under the Internal Revenue Code or 2) promoting, marketing, or recommending to another party any transaction or matter addressed herein.*