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The Silver Lining: A Great Time To Gift!

Veronica K. Cerruti

Although it may seem like the current economic climate is full of doom and gloom, there is actually a positive side to current market conditions. This is an optimal time for individuals to review their estate planning and to reconsider gifting assets to their heirs. Due to the decline in asset values and low interest rates, the cost to transfer assets has substantially decreased. In addition, if transfers of assets with depreciated values are made now, all appreciation that takes place after the markets rebound will be out of the donor's estate with no transfer tax effect.

The simplest way to take advantage of this pro-gifting environment is to make full use of the annual gift tax exclusion. For 2008, each individual may transfer up to $12,000 ($24,000 for a couple) to any other individual without paying gift tax.[1] This means that a married couple with two children can transfer $24,000 to each child (for a total transfer of $48,000), without paying gift tax. This reduces their estate not only by the $48,000 gifted, but also by the future appreciation on that $48,000. While a gift of stock trading at $100 / share earlier this year would have been limited to 480 shares, now that same stock trading at $75 / share results in a gift of 640 shares.

In addition to the annual gift tax exclusion, each individual has a $1,000,000 lifetime exemption from gift tax ($2 million for couples). *[Note that gifts that use the lifetime exemption will, however, reduce the donor's estate tax exemption].*[2]

The lifetime gift tax exemption is often used to make larger gifts of interests in businesses, real estate or family partnerships. The declining values of these entities combined with the volatility of the markets and current low interest rates allow these types of gifts to be leveraged. Leveraging in

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this context means valuing the interest at an amount less than is represented by the proportionate ownership of the interest. This is done by discounting the value of the asset through the use of marketability and minority discount strategies. Due to current market conditions, the available discount percentages have increased. By utilizing discounting techniques, assets with undiscounted values in excess of $1,000,000 may be transferred to beneficiaries without causing a taxable gift.

One popular gifting strategy is the grantor-retained annuity trust ("GRAT"). A GRAT is an irrevocable trust to which a donor contributes assets. The trust pays the donor a fixed amount for a term of years and, at the end of that term (assuming the donor has survived), the assets remaining in the GRAT are removed from the donor's estate and pass to the trust's remainder beneficiaries (usually the donor's children or grandchildren). The gift on the creation of the GRAT is the value of the property less the value of the interest retained by the donor. The performance of GRATs improves with lower interest rates and declines with higher rates because the projected value of a GRAT's remainder is inversely related to the Section 7520 Rate.[3] *The lower the 7520 Rate, the more attractive the use of a GRAT.* Why? Because to the extent that the assets contributed to the GRAT appreciate more than the 7520 Rate, the excess passes to the remainder beneficiaries free of gift tax. If the trust assets earn more than the 7520 Rate (which is currently low at 3.6% for November 2008), that excess growth will be transferred out of the donor's estate to the beneficiaries free of gift tax.

Similar gifting techniques are available for charitably minded donors, including the use of charitable lead trusts.

This newsletter is merely a summary. If you are interested in further exploring the idea of gifting, please consult with your individual estate planning advisor.

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[1] The annual gift tax exclusion will increase to $13,000 in 2009.

[2] Under current federal estate tax law, each individual has an exemption from estate tax equal to $2,000,000. This amount is set to increase to $3,500,000 in 2009. In 2010, the federal estate tax is slated for repeal for one year (the gift tax remains). In 2011, the federal estate tax returns, with a $1,000,000 estate tax exemption. Congress is currently debating revisions to the federal estate tax law.

[3] IRC Section 7520 establishes the rate (the Section 7520 Rate) used to calculate the present value of term interests, life interests, annuities, and remainders. The Section 7520 Rate is always 120% (rounded to the nearest two-thirds of one percent) of the AFR for midterm obligations with semiannual compounding.

back to top

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Veronica Koneski Cerruti Ms. Cerruti's practice focuses on estate and tax planning, with an emphasis on family wealth transfers for large estates, sophisticated estate, gift and generation-skipping transfer tax savings techniques, and complex probate and trust administrations. Her practice includes: preparation of wills, trusts and ancillary documents; business succession planning; generation-skipping and dynasty trust tax planning; estate and trust administration; prenuptial and postnuptial agreements; irrevocable insurance trusts; court proceedings relating to the administration, modification or termination of irrevocable trusts; and trust accounting.