

Consider making gifts of devalued family assets

BY JESSICA GALLIGAN GOLDSMITH

For business owners, as well as investors in real estate and other currently depressed assets, today's cloudy economic environment has a silver lining. With property undervalued and interest rates near historic lows, this is an excellent time to pass assets to the next generation.

Business owners may want to consider using grantor retained annuity trusts, or GRATs, to transfer undervalued assets without incurring gift tax, which is still in effect this year despite the temporary repeal of the estate tax.

A GRAT is an estate planning technique that allows you, as the grantor, to pass family businesses, closely held stock, real estate, partnerships, LLC interests and/or other hard to value property to the next generation.

The structure works as follows: First, you create an irrevocable trust, contribute assets to the trust and retain an income stream for a term of years chosen by you. You are taxed on income

earned by the trust, including capital gains, during the GRAT term.

Second, you choose whether to retain excess income above the annuity, including capital gains, thereby sharing in the eventual recovery or sale of any assets held in the trust, or leave the excess income for your beneficiaries.

Finally, you must survive the GRAT term or the property in the trust will be included in your estate.

In order to avoid generating a gift tax, the income payments over the GRAT term should be equal to the initial fair market value of the contributed property, plus interest. Thus, your income stream is dependent on the current appraised property value and current interest rates. In this economic environment, your business or property may well be undervalued, and further control and marketability discounts are usually available for gifts of minority interests. Because property values and interest rates are both unusually low, this may be the ideal time for you to create a GRAT.

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At the end of the GRAT term, if you survive, all of the remaining property in the trust passes to your chosen beneficiaries, either outright or in further trust. Any increase or recovery in the value of the property contributed, as well as any amount earned above the IRS interest rate, passes to your beneficiaries without gift tax, and has been removed from your estate. Any property that is likely to appreciate or even simply to recover from its current depressed value is ideal for a GRAT, particularly if it produces income that helps fund your income stream.

The chart at right shows two examples of five-year GRATs. The first trust is created when the property contributed has a depressed value of \$3 million. The second is created when the property has

Appraised property value	Value of property after one-third (1/3) combined discounts for lack of control and lack of marketability	Income stream (annuity) paid to the grantor over 5 years at current 3.2% IRS interest rate (no gift tax is incurred)	Appreciation of the property during the 5-year GRAT term	Amount left for beneficiaries at the end of the 5-year GRAT term
\$3 million	\$2 million	21.97% of \$2 million or \$439,400 per year for 5 years = \$2,197,000	\$1.5 million	\$2,303,000
\$4.5 million	\$3 million	21.97% of \$3 million or \$659,100 for 5 years = \$3,295,500	None	\$1,204,500
Total savings				\$1,098,500

recovered to its normal value of \$4.5 million.

Certain members of Congress have proposed legislation designed to end the use of discounts on family owned businesses and to require a minimum

10-year GRAT term. So far, such legislation has failed to pass. However, since it is possible that the use of these techniques will be limited in the near future, business owners and others interested in passing assets to their families may want

to act now.

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