

Price & Farrington's Estate and Tax Planning FastFacts

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Estate, Tax and Family Wealth Planning for Advisors and Clients

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A Perfect Time for Some Estate Planning Techniques + *Remembering Abe*

We've addressed *estate tax planning* in these pages over the years. With the new administration now ensconced in Washington D.C., we might finally be approaching some certainty in the highly political and maddeningly unpredictable area of federal estate taxes.

The current picture. The *applicable exclusion amount*, i.e., the amount that can pass free of estate taxes at death, is a generous \$3.5 million in 2009, with amounts exceeding that taxed at an effective rate of 45%. The amount is unlimited in 2010 and then reverts to just \$1 million and a 55% top tax rate in 2011. It is widely assumed that Congress won't allow the unlimited exclusion amount in 2010 to happen and that we should expect to see estate tax law changes this year under the Obama administration.

Discounts. For ten years now, the legislative agenda of the IRS has included elimination of *fractional*

interest discounts on family controlled entities. These discounts allow *minority business interests with limited marketability* to be transferred to family members or others at less than full value, allowing a larger amount of otherwise taxable assets to be transferred out of the estate over time. Proposed legislation introduced in the U.S. House of Representatives a month ago would limit the ability to obtain such discounts on most types of property other than actively managed businesses.

The *discounting* of taxable assets is often combined with estate planning transactions, such as *Grantor Retained Annuity Trusts* (GRATs), sales to *Intentionally Defective Grantor Trusts* (IDGTs) or outright gifts of *Family Limited Partnership* interests to achieve wealth transfer objectives.

GRATs and IDGTs. A GRAT is a trust into which the taxpayer transfers property and retains the right to be paid a *fixed annual annuity* from the trust. The taxable gift is reduced by the value of the annuity payments coming back to the taxpayer, and is often set at an amount that reduces the taxable gift to zero. An IDGT is similar to the GRAT except that the assets are transferred to the trust in exchange for a *promissory note* instead of an annuity. The purpose of both techniques is to *freeze the value of the transferred property for estate tax purposes by permanently removing the assets' appreciation from the taxpayer's estate and passing the future appreciation on to the taxpayer's heirs.* These techniques will still be effective even without discounts, but discounts do increase the likelihood of achieving *tax-advantaged transfers* by increasing the size of the tax-advantaged gift.



Charles P. Farrington and Glenn D. Price

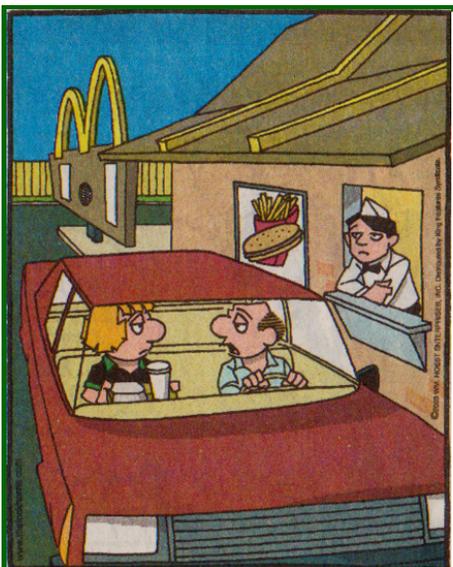
Restrictions coming? Act now.

Some commentators have said that Congress may go even further and change or even eliminate some of these techniques. One possible change would eliminate the ability of the taxpayer to "*zero-out*" the taxable gift on a GRAT (i.e., to calculate the numbers such that the amount of the taxable gift ends up being zero). Instead, the taxable gift would be required to be at least 10% of the original contribution to the GRAT. If legislation imposing such restrictions is passed, the opportunity to use any of these techniques — especially if they are combined with family-controlled entities — may be closing. Since new restrictions would likely be effective *after* the date of enactment of new legislation, the time to take advantage of these powerful, tax-advantaged wealth transfer techniques is *now*.

Interest rates and valuation.

In any event, even if the law doesn't change, the time to implement these strategies is especially ripe now. The potential benefits of entering into this kind of planning has increased dramatically during the past few months.

Aside from any possible dis-



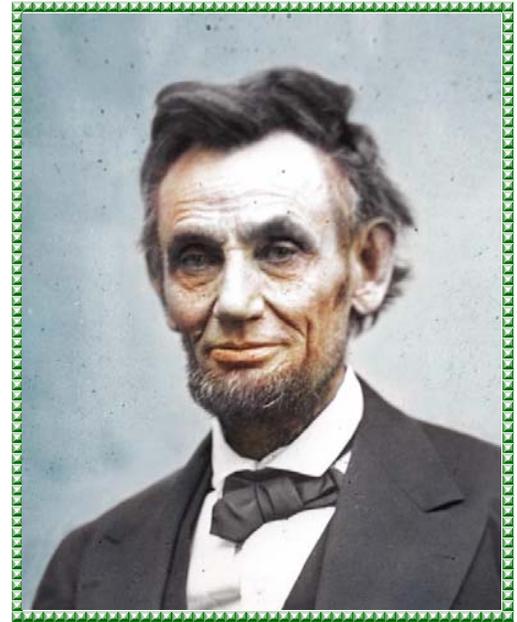
"Yet another bad economic indicator...
That was our broker."

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counting on family-controlled entities, the two main factors that determine the effectiveness of these techniques are *interest rates* and *valuation*. The lower the interest rate that is required on any annuity or promissory note received in exchange for a transfer of property, the greater the wealth transfer benefits are for the family. For example, if \$5 million in property is transferred to a trust in exchange for a note bearing interest at 2% and the property appreciates at 8%, more than \$300,000 passes gift tax-free per year. The IRS publishes the minimum rates monthly and the rates in February, 2009 are the lowest ever by .5% and almost 2% lower than just a year ago. In addition, with the market downturn, these estate planning techniques provide a great opportunity to “freeze” the value of the property at the current depressed value and to pass the upside to the beneficiaries. So, aside from any potential estate tax law changes, the current economic environment provides

excellent opportunities for estate tax planning through wealth transfers.

Freezing and accessing the assets. The downside to any family wealth transfer is obviously the loss of access to the funds, especially with the current uncertainty in the market and the global economy. However, much of this form of planning simply freezes the value of the estate and the transferor retains access to the original value of the transfer through the annuity or promissory note payments. In addition, flexibility can be built into the plan to allow for discontinuation of future transfers if the desired wealth transfer has been achieved or if the transferor would like to preserve more assets for himself or herself. Therefore, despite the market uncertainty, the likelihood of estate tax law changes along with the extremely favorable current wealth transfer environment makes this the ideal time for such planning. In fact, taxpayers facing a permanent exposure to estate tax at 45% on any amount over \$3.5 million (or \$7 million for a husband and a wife) — assuming that’s the final legislated amount — will probably never see a more opportune time than right now.



Fellow-Countrymen:

“...On the occasion corresponding to this four years ago, all thoughts were anxiously directed to an impending civil war. All dreaded it—all sought to avert it... Both parties deprecated war; but one of them would *make* war rather than let the nation survive; and the other would *accept* war rather than let it perish. And the war came.

...Neither party expected for the war, the magnitude, or the duration, which it has already attained. Each looked for an easier triumph, and a result less fundamental and astounding. ...Both read the same Bible and pray to the same God; and each invokes His aid against the other.

With malice toward none; with charity for all; with firmness in the right, as God gives us to see the right, let us strive on to finish the work we are in; to bind up the nation’s wounds; to care for him who shall have borne the battle, and for his widow, and his orphan—to do all which may achieve and cherish a just, and a lasting peace, among ourselves, and with all nations.”

The Quotable Abe Lincoln

- I can make more generals, but horses cost money.*
- I don't like that man. I must get to know him better.*
- I will prepare and someday my chance will come.*
- I care not much for a man's religion whose dog and cat are not the better for it.*
- I have always found that mercy bears richer fruits than strict justice.*
- The best way to get a bad law repealed is to enforce it strictly.*
- People are just as happy as they make up their minds to be.*
- The Lord prefers common-looking people. That is why he makes so many of them.*
- Tact is the ability to describe others as they see themselves.*
- If I were two-faced, would I be wearing this one?*
- If I had eight hours to chop down a tree I'd spend six hours sharpening my ax..*

Remembering A. Lincoln

We can’t let this month go by without acknowledging that February 12, 2009 was the bicentennial of the birth of the sixteenth president of the United States, **Abraham Lincoln** (February 12, 1809—April 15, 1865), consistently rated over the years by historians and the public as this nation’s greatest president.

Note: Strangely enough for a lawyer, A. Lincoln (as he customarily signed his name) never executed a will. Following Lincoln’s death, his son Robert (the only one of Lincoln’s four sons to ever reach adulthood) called upon long-time Lincoln family friend and Supreme Court justice David Davis to take charge of the estate.

From Lincoln’s Second Inaugural Address, delivered March 4, 1865 on the portico of the Capitol:

