Estate Planning *Fast* Faxts

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Estate, Tax and Family Wealth Preservation Planning For Advisors

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THE PRICE IS RIGHT

Gifting stock to family or charity

Here's some advice to pass on to your clients:

The bad news is that many stocks have taken a beating lately. The good news is that if you are going to give them to your kids, you can make the gift at a lower cost in gift taxes. And if the shares recover, you won't be cursing the April market crash anymore.

An example: We know of a 65 year old chief executive of a manufacturing company and his 60 year old wife who decided in January to give their two grown children a $3 million portfolio of highly appreciated stocks, including Lucent, Microsoft, Proctor & Gamble and AOL. They dawdled for a few months, unsure how best to minimize taxes.

Then came the market plunge of April 14, at the end of which their holdings fell to $1.95 million (sound familiar?). Their attorney swung into action, setting up a family limited partnership, giving each child a 45% minority interest while the parents retained a 10% interest and control of the portfolio as general partners. An outside appraiser concluded the gifts to the kids qualified for a combined 40% lack of marketability and minority interest discount. (For more on FLP's, see our May, 2000 *Fast*Faxts.)

Result: After the couple applied their annual gift exclusion of $20,000 per child, the $1,032,305 that remained was more than covered by their lifetime gift-tax exemptions, currently $675,000 each. Had they made the transfer in January, they would have used up not only their entire exemption, but owed an extra $100,000 as well. They got a much bigger bang for their buck by acting quickly before their stocks went back up.

It's the flip side of a basic rule of philanthropy: give away stocks when they are high. If you have a collection of highly appreciated shares and want to make a charitable gift, get rid of the shares you think are due for a fall.

There are some disadvantages of gifts like the one made in our example. If the stocks fall further, the couple will have wasted some of their gift exemption. And when a share of stock is sold, either by the partnership or the heirs, the seller has to pay capital gains tax because the donor's basis carries over. In contrast, if the parents die holding the stock, the children would benefit from the step-up in basis at death, permanently escaping capital gains tax.

You have to chart your own path, taking into account such things as the likelihood you will hold onto the appreciated shares indefinitely and the possibility you will need the money yourself in retirement. But don't overlook the tax-savings possibilities that can come from artful gift-giving. Here are a few options:

Grantor Retained Annuity Trust. This is a good way to transfer rapidly appreciating and high-yielding assets. Though GRATs work best when interest rates are low, they may still be useful when rates are higher, if the value of the assets put into them is temporarily depressed.

Example: You transfer securities with a current market value of $1 million to a GRAT for a ten year term. The GRAT pays you a fixed annuity of $158,000 a year for 10 years. You can take the payment in cash or in stock (which avoids triggering the capital gains tax). At the end of 10 years, what's left in the trust goes to your heirs. If the current applicable discount rate (ADR) were 7.8%, you made a gift to your heirs worth $58,275 when you set up the trust. But if the stocks really grow at 12% a year, your heirs will get a portfolio worth $335,000 in today's dollars. A smart estate planner might combine a GRAT with an FLP to further depress the taxable value of what you're giving your kids.

Charitable Lead Annuity Trust. This is another good option when interest rates are low and/or potential asset growth high. A CLAT may be more appropriate than a GRAT if you have more than enough current income and you give to charities anyway. A CLAT pays a charity a fixed annuity for a set number of years and the heirs get what's in the trust when it terminates. The IRS calculates the present value of the charity's annuity using the current ADR . You subtract that present annuity value from the starting value of the trust, and what's left is the taxable gift you're making to your kids. Again, the taxable gift is made—and any gift taxes due are paid—at the start.

Example: A $1 million lead trust pays the charity a 7% fixed annuity, $70,000 a year, for ten years. The present value of the annuity is $474,000. So the taxable gift to the heirs is $526,000. But if the (well chosen) assets in the trust really appreciate at 12% a year, the remainder going to the kids will be nearly $1.9 million. Caution: if you put only stock in the trust, you'll have to sell some to pay the charity its $70,000 a year. You will owe the capital gains tax. If stocks are left in the trust at the end, your kids will get your basis in the stocks and not the step-up in value they would get if you left them the stocks at your death.

What if you're a bear instead of a bull? One option is to do nothing. If you believe stock values will fall further, but you aren't looking to sell out of a position, sit tight. It may be even cheaper to transfer assets next year.

Another option is a Charitable Remainder

"My only crime, Denise, was loving you too much. That and embezzling your trust fund."

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"THE NUTS & BOLTS of HIGH TECH COMPANIES"
Thurs. Oct. 19, 10:00 a.m.-12:15 p.m.

"THE NUTS & BOLTS of ESTATE PLANNING"
Thurs., Oct. 19, 7:00 p.m.-9:15 p.m.

"ADVANCED ESTATE PLANNING FOR ESTATES OF $2M and UP"
Tues., Oct. 24, 10:00 a.m-12:15 p.m.

"IRA PLANNING: TOOLS, TIPS and TRAPS"
Tues., Oct. 24, 7:00 p.m-92:15 p.m.

All Seminars – Bellevue Hyatt Hotel
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