

Minimizing Taxes

ESTATE PLANNING IN UNCERTAIN TIMES

By Frances M. Patterson, CPA

Virtually all investors agree that 2008 has been a year of economic turmoil. Corporate giants have toppled, and we have faced portfolio devaluations and bailouts. Interest rates are lower than they have been in many years. We are facing a change in leadership in Washington, and most planners are anticipating significant tax legislation in the coming years. While the future of the estate tax remains uncertain, most planners believe that the estate tax will not disappear and will continue to impact estates that exceed values of \$3,500,000 to \$5,000,000.

The current environment of low interest rates and low market values makes some estate planning strategies very attractive and worth considering. The strategies that benefit from a low interest rate environment include grantor retained annuity trusts (GRATS) and sales to intentionally defective grantor trusts (IDGTS). The low interest rates have the effect of minimizing the income interests, maximizing the remainder interests, and lowering the gift taxes associated with the transactions. Depressed portfolio values can further reduce gift tax costs when the gifts are of undervalued securities. These gifts can be outright gifts of securities or can also include transfers of family limited partnership (FLPS) interests.

GRANTOR RETAINED ANNUITY TRUSTS (GRAT)

A grantor transfers property to a trust and takes back an annuity for a fixed term. At the end of the term the remainder interest passes to the remainder beneficiary. It is best to fund a GRAT with rapidly appreciating assets such as interests in a closely held business. As long as the underlying assets outperform the 7520 rate (the rate used to determine the annuity payment) you have shifted value out of your estate. The January 2009 7520 rate is 2.4%. Because this is a grantor trust, the grantor also pays the income taxes on the earnings of the trust, further reducing your estate. You must outlive the term of the trust for this technique to be effective.

DEFECTIVE GRANTOR TRUSTS (IDGT)

In this case the grantor sells income producing property to a defective grantor trust. The trust is taxed as a grantor trust for income tax purposes but the assets are not included in your estate for estate tax purposes. The grantor takes back a note which can be structured in various ways. The interest rate used to calculate the payments is the Section 1274 rate (AFR) and is generally less than the 7520 rate used in GRAT calculations. The terms of the note can be flexible, including balloon payments and interest only payments. Like the GRAT, if the assets sold outperform the interest rate you have shifted value out of your estate. Unlike the GRAT, the grantor does not need to outlive the term of the trust. However, if the grantor dies before the note is paid off, the remaining principal balance is included in the estate.

FAMILY LIMITED PARTNERSHIPS (FLPS)

The family limited partnership has been used as an effective wealth transfer tool for some time. Although the FLP has come under increasing scrutiny by IRS, it is still a structure that facilitates wealth transfer between generations. The FLP can be funded with a variety of assets including securities and real estate. The parents typically take back general and limited partner interests. The limited interests can then be gifted to younger generations over time. Because you are gifting minority limited interests discounts can be taken for lack of control and lack of marketability.

Estate planning in troubled economic times has its challenges but also has opportunities. A periodic review of your current estate plan is a vital part of planning for the future and may lead you to decide to explore some of these options.

Frances M. Patterson, CPA

Elliott Davis, LLC
fpatterson@elliottdavis.com
(864) 242-3370



www.elliottdavis.com
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Greenville Office:

200 E. Broad Street, Suite 525
Greenville, SC 29601
Phone: (864) 242-3370
Fax: (864) 232-7161

Michael Hronchek
Managing Director
MHronchek@elliottdavis.com

Ty Dealy
Managing Director
TDealy@elliottdavis.com

Derik Reynecke
Vice President
DReynecke@elliottdavis.com

Aaron Zeide
Associate
AZeide@elliottdavis.com

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