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June 2009 Newsletter

THE ECONOMY HAS SLASHED MY NET WORTH AND YOU ARE TELLING ME THAT I SHOULD CONSIDER GIFTING! DO YOU THINK I HAVE TOTALLY LOST MY MIND?

It may sound crazy, but we are in an environment that has created an unprecedented estate planning opportunity.

Preserving a meaningful financial legacy for one's family is often a key goal in a client's investment choice and estate planning considerations. Given the recent downturn and the stock market drops, clients may be left wondering what assets they will have left to leave. While the financial markets may appear gloomy, three important factors have created an opportunity which most of us have never seen before and probably will never see again in our lifetimes. These three factors, depressed asset values, low interest rates and proposed legislation, present a great opportunity in savings on the

transfer of assets to the next generation. It may seem counter intuitive to transfer assets when the valuation is low. In reality, transferring assets at a lower value allows the cost of recovery growth (capital gains tax) to be placed on the next generation rather than experiencing a higher rate estate tax at the parents death.

In general, depressed valuations allow you to transfer certain assets from your estate to the next generations with less transfer tax. In addition, low interest rates can provide advantages in using certain wealth-transfer vehicles or intra-family loans. For example, the rates set by the Internal Revenue Service for use in one of the most popular wealth-transfer vehicles, known as a grantor retained annuity trust ("GRAT") is now at an historic low (2.4% for transfers made in May, 2009 as compared with 3.4 % for transfers in December, 2008 and as high as 6.2% for some transfers in 2007). The rates for intra-family loans are at similar

historic lows, now just roughly 0.81% for a short-term loan.

When the markets recover, that recovery is on the next generations balance sheet rather than the parents. Psychologically, it may be a matter of the brain battling the heart, but in the long run the financial results may be substantial.

BASIC GIFTING TECHNIQUES

The use of gifting is a simple wealth transfer technique. Gifting essentially reduces the amount of an individual's estate on which federal estate tax is to be paid. Currently, the tax code permits \$3.5 million to be exempted from estate taxes, \$1 million of which may be given away before death as gifts. With the recent proposed legislation, it appears that the \$3.5 million exemption will remain. For 2009 you can give away up to \$13,000 per beneficiary ("yearly per donee exclusion") without having to pay taxes. In addition to the yearly donee exclusion, a \$1 million lifetime exclusion applies to gifts above the yearly per donee exclusion.

As an example, consider: if you have 500 shares of Stock A that traded at 100, with the gift-tax exclusion at \$13,000, you would have been able to transfer on 130 shares and utilize the yearly per donee exclusion to avoid gift taxes. But if the shares had been knocked down by 40%, in line with the broader market, you can transfer 217 shares tax-free. The same thinking

applies to getting the most out of the \$1 million exemption. With depressed values, an individual can gift more shares and transfer the expected gain to future generations thus eliminating that amount from the individuals gross estate. This same concept works not only for shares of publicly traded stock, but for ownership interests in closely held family businesses and real estate as well.

Gift-giving is the simplest of all estate-planning moves for a down market. If you are not comfortable reducing your current assets to save the next generations something on the estate tax, you need to realize that it's not an all or nothing proposition: You could give in smaller increments. In fact, that may be desirable because there may be substantial valuation discounts available for gifting of minority interests.

A GRAT CAN ADD EVEN MORE BENEFITS

Another way to take advantage of the current economic situation is the use of a GRAT. A GRAT is an irrevocable trust designed to transfer the appreciation on assets contributed to it with minimal or no gift-tax consequences. This strategy becomes more fruitful in a low rate environment. The IRS mandates the interest rate to be used in a GRAT.

The mechanics of a GRAT used in a low rate environment is as follows: An individual can set up a GRAT and

fund it with \$1 million in badly depressed assets (either stock, real estate or ownership interest in a close-held family business). Assuming the simplest scenario and a trust term of two years (it could be longer), the GRAT would make annuity payments to the parents valued at \$518,081 in each of those two years. That payment is based upon a calculation of present value based upon the current IRS rate and those payments can be made in cash or stock. If the asset appreciates more than those payments (which the odds being good with a low "hurdle" rate of 2.4% that the assets will appreciate at rate higher than the "hurdle" rate), the excess goes to your beneficiaries tax-free. If it turns out the asset has appreciated less than those \$518,081 payments, the trust fails. The asset returns to the donor, and the donor can start another GRAT and try again. A rolling GRAT strategy allows multiple possibilities of catching the asset's rise at a valuable moment. For those who keep rolling assets from one GRAT to another, today's market swings, which is a curse to most investors becomes a positive planning tool. Also, since the GRATs have a standard structure, setting up the second or third one is less expensive than the first.

Is a GRAT for you? This question can be answered by reviewing your total estate plan.

Is there an optimum age to set up a GRAT? As with other estate-planning techniques, it is better to start earlier than later. That's because you can

expect more appreciation over the long term and because if you die before the GRAT's term ends, the assets in it become part of your estate.

LOANS

Many estate planning techniques are established to help the next generations after death. However, lending money to the next generation now may be a more beneficial option. In lending money during lifetime, you may not only be able to appreciate the benefits of such loan by seeing the money in action, but you can also realize an estate tax benefit.

As with GRATs the IRS has established rates for intra-family lending. Currently, that rate is around .81%, although there are somewhat higher rates for medium and long-term loans. In addition, these loans can be structured as interest-only, with a balloon payment at the end of the term. Those rates are at historic lows. If the next generations use the loaned money and earn more than the IRS's rate on the funds you've lent them, they keep those gains tax-free. Unlike a gift, in which the rights to assets are completely relinquished during an individual's lifetime, a loan may be the ideal wealth transfer technique for individuals wishing to retain some rights to their assets during their lifetime.

IS THIS A LIMITED TIME OFFER?

If you are concerned about reducing the amount of an estate tax to be paid by your heirs, you may want to explore these options sooner than later. History tells us that the current economic situation resulting in depressed valuation will not last forever. History also tells us that the current low interest rates will not last forever. And, of course, it is probable that we will see new legislation shortly. Proposed legislation has already been introduced dealing with revisions to the estate tax laws. One of such proposals would prohibit discount for gifting of ownership interests in closely held family business and other passive investments such as real estate and stocks and bonds. For these reasons, one could certainly argue that time is of the essence.

NEW ATTORNEY JOINS THE FIRM

Nick Smith joins us after more than five years of practice in the Dayton area where he focused on complex commercial litigation, including securities, data privacy, patent and trademark, and mass tort class action litigation. He is a 2003 graduate, summa cum laude, of The Moritz College of Law at The Ohio State University and a 2000 graduate, cum laude, from The Scripps School of Journalism at Ohio University. During the summer of his second year of law school, Nick clerked for the Honorable Chief Justice Moyer of the Supreme Court of Ohio.

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WHAT TOPICS WOULD YOU LIKE TO LEARN MORE ABOUT?

If there are topics that you would like us to address in future updates, please let us know by either emailing the topics of interest to us at info@mfhslaw.com or calling Devin at (937)461-5980 who will make sure that the information is passed on to the appropriate individual.

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