

# Depressed Asset Values Provide Unique Opportunity For Wealth Transfer Planning

## Depressed Asset Values Provide Unique Opportunity For Wealth Transfer Planning

**Insight — 7/25/2003 12:00:00 AM**

Recent depressed asset values have caused some to postpone implementation of effective estate planning strategies. However, current values and historically low interest rates provide a unique opportunity to transfer substantial wealth now which will benefit family members for several future generations. Using the federal exemption equivalent for taxable gifts of \$1,000,000 per person to transfer current low asset values should be viewed as an opportunity. If you believe in the long-term growth of the stock market, or your closely held business, then transferring assets to future generations at these "bargain" prices can be a valuable strategy for the family. Depressed stock and business values can be considered a "natural discount" taken alone. When considered in combination with valuation discounts available from various wealth transfer strategies and current low interest rates, the "double" discount makes this a particularly attractive time to make gifts with property that is expected to appreciate during a market recovery. Brief descriptions of some of these techniques follow.

### **Family Limited Liability Companies and Limited Partnerships**

Family Limited Liability Companies and Limited Partnerships (LLCs and FLPs) can be used to consolidate investments, to share income with family members in lower tax brackets, and for long-range estate planning through the use of "dynasty" trusts. When parents transfer interests in an LLC or FLP to trusts for the benefit of children and grandchildren, they transfer asset value and shift asset growth from themselves to younger generations. Transferred interests may be valued at a discount for gift tax purposes as a result of the lack of control and marketability of the limited interest shares. If transferred shares constitute a minority interest, they may be subject to additional discounts. LLC and FLP transfers can leverage the \$1,000,000 gift tax and the \$1,100,000 generation-skipping transfer tax exemptions, as well as the \$11,000 annual gift tax exclusion, while providing significant estate tax reduction. Over time, LLC or FLP interest gifts can produce significant family wealth transfer at substantially reduced taxes.

### **Grantor Retained Interest Trusts**

Grantor Retained Annuity and Unitrusts (GRATs and GRUTs) are irrevocable trusts into which a donor (such as a parent) makes a gift of property while retaining an annual income stream for a specific period of

time. The present value of the right to the annual income stream is subtracted from the full value of the property transferred when determining the taxable value of the gift for transfertax purposes. The formula that determines the value of the retained income stream is interest-rate sensitive and produces a lower taxable gift when interest rates are low, as they are now. The amount of property that remains in the trust at the end of the trust term after making the annual payments passes to the donor's family free of any further gift or estate tax. GRATs and GRUTs can result in substantial transfer tax savings to the extent the growth of the assets in the trust outpaces the stream of income returned to the grantor.

### **Sale to an Intentionally Defective Grantor Trust**

This estate planning technique takes advantage of the differences between the income and transfer tax treatment of irrevocable trusts. When an irrevocable trust is structured carefully, the donor can be treated as the "owner" for income tax purposes while having made a completed gift for transfer tax purposes. The purpose of attempting to achieve this discrepant result is to effect a sale to the trust that does not produce a capital gain to the donor, but produces an irrevocable transfer of property and its appreciation from his or her estate. In return for the transfer of property, the trust gives the donor a note, which carries a market rate of interest. At the end of the term when the note is repaid, the donor has transferred the appreciation with no transfer tax liability. Moreover, if the asset which was the subject of the sale was discounted at the time of the sale (shares in an LLC, FLP or family -owned business, for example), the amount which will be paid to satisfy the note will be less than the original underlying value of the asset transferred, providing additional leverage.

### **Charitable Lead Trust**

A Charitable Lead Trust (which may be an annuity trust or unitrust-CLAT or CLUT) is an irrevocable trust, which pays an income stream to charity for a described period of time, and then pays the remaining value of the trust to the donor's family members at the end of the term. The present value of the charitable income stream is a gift tax deductible interest, which will reduce the taxable value of the remainder interest passing to the donor's family at the end of the term. As with a GRAT or GRUT, the value of the deductible interest is determined according to a formula. If the trust is created during life, the donor will receive a gift tax deduction for the value of the charitable income interest. If created at death, the deduction will offset estate taxes. In addition, all payments by the trust to charities are fully income tax deductible, unlike itemized charitable deductions on one's income tax return which are subject to reduction at certain income levels. In effect, the trust provides an opportunity for unlimited charitable income tax deductions, while, at the same time, providing attractive wealth transfer opportunities.

### **Timing is Crucial**

Because Grantor Retained Interest Trusts, Sales to Defective Trusts, and Charitable Lead Trusts use characteristics that benefit from low interest

rates, their use is particularly attractive now. Funding these vehicles with assets at current low values that can be expected to perform well during a market recovery can compound the advantages of sophisticated wealth transfer planning.

All of these strategies are highly technical and contain potential pitfalls along with their many potential benefits. Holland & Hart's Wealth Transfer Planning is ready to help you take advantage of the unique opportunity afforded by current economic conditions.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

---

*This publication is designed to provide general information on pertinent legal topics. The statements made are provided for educational purposes only. They do not constitute legal or financial advice nor do they necessarily reflect the views of Holland & Hart LLP or any of its attorneys other than the author(s). This publication is not intended to create an attorney-client relationship between you and Holland & Hart LLP. Substantive changes in the law subsequent to the date of this publication might affect the analysis or commentary. Similarly, the analysis may differ depending on the jurisdiction or circumstances. If you have specific questions as to the application of the law to your activities, you should seek the advice of your legal counsel.*