

Ask a Trust Officer: GRATs

Dear Trust Officer: Given the lack of a federal estate tax at the moment, is there a wealth transfer opportunity that I should be taking advantage of?

–Open to Suggestions

Dear Open: We don't recommend dying this year as a method of avoiding federal estate tax, obviously. The federal gift tax, which applies when lifetime taxable gifts have exceeded \$1 million, is imposed at only a 35% rate this year, the same as the top income tax rate. Next year it is scheduled to return to 45%, matching the 2009 federal gift tax rate. If you expect to make taxable gifts in the course of your wealth transfer planning, this could be a good year for it. However, be aware that some observers believe that if Congress restores the estate tax for 2010 on a retroactive basis, they will also restore retroactively the 45% rate for gift taxes.

There is another tax strategy that could be curtailed this year, but it hasn't been at this writing. It's the Grantor-Retained Annuity Trust, or GRAT. The grantor transfers assets to an irrevocable trust for a specific number of years, as short as two years. The trust pays the grantor a fixed sum every year until the end of the trust, when the assets pass to children or other family members. If the assets go up in value, all the appreciation passes to heirs free of gift or estate tax.

The terms of the trust can be adjusted to bring the gift tax exposure all the way down to zero. That's one facet that Congress would like to change. Another proposal would require GRATs to last for a minimum ten-year term. That adds mortality risk to the arrangement. If the grantor dies before the end of the trust, the trust assets are brought back into the taxable estate, and the effort will have been for nothing. Still, in a tax sense the family is no worse off for having attempted the GRAT.

A jobs bill that has already passed the House of Representatives (H. R. 4849) includes these GRAT changes, so the window of opportunity for this strategy could be closing.

Do you have a question concerning wealth management or trusts? Send your inquiry to Dick Corcoran at rjcorcoran@fnbsf.com.

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