



Inspiring and Connecting Thoughtful Giving

Toledo Community Foundation

toledocf@toledocf.org

300 Madison Avenue

Suite 1300

Toledo, Ohio 43604

P. 419.241.5049

F. 419.242.5549

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For philanthropists wishing to maximize the impact and life of their charitable gifts, the Foundation provides *resources for thoughtful giving*. Using its expertise and personalized services, **Toledo Community Foundation** helps donors transform their philanthropic impulse to measurable community impact. Beyond the gifting of assets, the Foundation helps donors identify issues of importance to them and *inspires engagement* with community organizations addressing these issues, thereby maximizing the impact of charitable gifts and creating a greater sense of fulfillment.

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Hurry Up and Fund That Trust

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The estate tax has lapsed for 2010 but could come back with a vengeance next year. Now Congress is trying to put limits on a popular trust families use to avoid the tax.

Because this type of trust works best at times when interest rates are low and asset values are depressed -- times like these, in other words -- estate planners are urging clients to set one up before Congress makes them far less attractive.

Called a grantor-retained annuity trust, or GRAT, it allows people to give a portion of an asset's future profits to heirs tax-free. Thomas Bentley, a certified financial planner at Truepoint Inc. in Cincinnati, is setting up one for a local entrepreneur who wants to give his three children a stake in his fast-growing business.

"We're recommending that he move ahead now, before Congress passes a bill," Mr. Bentley says.

The trusts, whose life span can be as short as two years, are popular with families that have assets expected to increase in value, such as a family business or depressed stock.

To raise revenue, Congress is seeking to impose restrictions on GRATs. Most important, it would require that the trusts remain in place for a minimum of 10 years. That would make them less useful for people with shorter life expectancies. The reason: If a GRAT owner dies before the trust expires, its entire value generally becomes subject

to the estate tax.

The 10-year limit also could make these trusts less profitable for investors and entrepreneurs like Mr. Bentley's client, who frequently favor two-year GRATs to lock in short-term gains on volatile assets and transfer much of the profits to heirs before the trend reverses. (Establishing a GRAT typically costs between \$1,000 and \$10,000, depending, in part, on the type of assets involved.)

Most observers say passage of the GRAT legislation is all but certain. "I think it is very likely that whenever Congress turns to the estate tax it will include the GRAT reform in the package," says Clint Stretch, managing principal for tax policy at Deloitte Tax.

Still, the measure as currently written wouldn't impose a 10-year minimum term on GRATs already in existence. So, until Congress acts, "we can still do short-term GRATs," says Don Weigandt, a wealth adviser at JPMorgan Private Bank. "We've been encouraging clients to take advantage of them before they disappear."

Despite the expiration of the estate tax this year, estate planners are urging clients to limit their potential exposure to the tax. After lapsing on Jan. 1, 2010, the levy is slated to return on Jan. 1, 2011 -- at a higher rate (55%) and lower exemption amount (\$1 million) than in 2009, when, at 45%, it affected only estates valued at \$3.5 million or more.

With interest rates as low as they are today, GRATs are especially attractive. That is because to avoid paying a 35% gift tax on the assets put into one, a GRAT's owner must agree to take back assets of the same value, plus an interest payment, known as the "hurdle rate."

In October, that rate, calculated monthly by the Internal Revenue Service, fell to a record low of 2%. As a result, if a GRAT's assets were to appreciate by, say, 10% a year, the owner would have to take only two percentage points of the gain -- leaving eight percentage points for the heirs, tax-free.

GRATs also work well with beaten-down assets. Since 2008, parents have been using the trusts to transfer stocks, real estate and other assets they believe are temporarily depressed, potentially reducing the size of their own estates and giving their heirs a chance to cash in on a rebound. (Due to complexities relating to the generation-skipping tax, GRATs are tricky to use for the benefit of grandchildren.)

Shares in family limited partnerships and privately held companies also are good candidates. In part because such investments can't be easily traded, they can often be put into a GRAT at a discount to their true value, Mr. Bentley says.

To take advantage of October's 2% hurdle rate, Mr. Bentley says his client will transfer about \$500,000 of stock into a GRAT this month. That represents about 25% of his stake in his company.

Over the trust's five-year term, the client will take back approximately \$400,000. (That is the value of the \$500,000 put into the trust after a 20% discount is applied.) In addition, the entrepreneur will pocket a 2% annual interest payment. Thanks to the discount, as long as the value of his stock doesn't dip below \$400,000, the GRAT will be able to transfer something to his heirs.

If the client sells his business, on the other hand, the value of his company could triple or even quadruple, Mr. Bentley estimates. At that rate, the GRAT could amass as much as \$1.5 million for the heirs, he says.

Aside from premature death, there is little downside risk to GRATs. In part because the tax code sanctions these trusts, Mr. Weigandt says, there is little risk of an IRS challenge. If the assets inside a GRAT fall in value, the parents would be no worse off than if they hadn't established it to begin with, though they would be out the fees they paid. The trust would simply pay them back what is left of their investment by the time it expires.

Email: familyvalue@wsj.com

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