



# "Giving" Advice



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## ABOUT YOUR FOUNDATION

Since 1973, the **Toledo Community Foundation** has provided individuals, families and businesses interested in the well-being of our community with an *efficient, effective, low-cost, professionally managed* mechanism to achieve their charitable goals.

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

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## Shift That Wealth Now

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**By Ashlea Ebeling**

Stock prices and interest rates are down and the estate tax is here to stay. Time to think about gifts and GRATs.

When Republicans controlled Congress, the estate tax seemed to be doomed to an early demise. Lawyers specializing in wealth transfer found their services a tough sell. Clients were reluctant to shell out fat fees and certainly didn't want schemes that involved paying gift taxes now in lieu of estate taxes later if there was a chance there wouldn't be an estate tax when the time came.

But busy days are here again for the lawyers, and not just because of the changed political outlook. Certain techniques that let you move big bucks to your kids while you're alive at reduced or no gift tax cost—for example, grantor-retained annuity trusts—work best when both interest rates and asset values are depressed. "GRATs are smoking hot right now. Not only do we have low interest rates, but we have depressed real estate values," exults Jeffrey Baskies, a Boca Raton estate planning lawyer.

How rich do you have to be to think about transferring wealth early? Not very, particularly if you live in certain states. Someone who dies this year can pass \$2 million to nonspousal heirs free of federal estate tax. That rises to \$3.5 million next year and is likely to settle there or higher. But 23 states impose their own estate or inheritance taxes, some at far lower wealth levels; New Jersey and Rhode Island exempt only the first \$675,000 going to nonspousal heirs. (You can transfer an unlimited amount to a spouse who is a U.S. citizen without federal or state gift or estate tax.)

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.

The good news is that most affluent folks don't need to do fancy stuff; they can give away enough assets using the annual gift tax exclusion. Anyone can give \$12,000 a year in cash, stock or property to any other person, without worrying about federal or state transfer taxes. A husband and wife can give their two grown children, and their kids' spouses, \$96,000 a year. Cut in four grandchildren and \$192,000 can be passed between generations every year. Noncash gifts—say, a family cruise—count against the \$12,000. But if you pay someone's tuition or medical bills and send the check directly to the school or health provider, it doesn't eat into the \$12,000 exclusion.

What if you want to transfer a bigger chunk at once? You also get a single lifetime gift tax exclusion of \$1 million, which, when used, reduces dollar for dollar the amount you can pass to heirs free of federal estate tax.

Deciding which assets to give away can be tricky. You must consider both estate and capital gains taxes and make some educated guesses. Under current law—and likely in the future too—an asset passed on at your death gets a "step-up" in value to what it is worth at that time. So your heirs can sell it right away without owing capital gains tax. That means if your estate isn't likely to be taxed, you probably don't want to give away a highly appreciated asset. On the other hand, when you give an asset during your life, the recipient takes on your basis in it, or its current market value, whichever is lower. That means you can't transfer an unrealized loss and usually shouldn't be giving away property that's worth less than you paid for it. Sell it, book the loss yourself and give the cash.

What assets should you give away? If you have appreciated stock you want to sell now, you might do well giving it to an adult grandchild and letting him or her sell it. That's because folks at or below the 15 percent ordinary income tax bracket—for example, a single with \$40,000 in gross income—qualify this year for a new 0 percent capital gains rate. (Caution: Full-time students don't qualify for the 0 percent rate unless they're married or 24 or older.)

What if your estate is likely to be taxable? Then you want to give assets with growth potential to get that growth out of your estate. Jonathan Forster, a tax lawyer with Greenberg Traurig in McLean, Va., reports that a client worth \$80 million just put her shopping center interests into a family limited partnership and gave some shares in the partnership to her kids. "She wrote a check to the IRS for \$200,000 in gift tax," he says. "She believes it's in her best interest to move assets, particularly at today's depressed values."

It's not just the sagging real estate market that made this transfer smart. Putting the real estate in the partnership reduced the appraised value of her gift; this "discount" is legit because the kids can't easily sell their minority partnerships or force Mom to sell the real estate and distribute cash.

Also, while estate and gift taxes carry the same nominal 45 percent tax rate, the gift tax works out to be cheaper. Why? If you give a \$1 million gift to your daughter, you have to send a check for \$450,000 in gift tax to the government. But if you leave that same \$1.45 million in your estate, the 45 percent tax is levied on the whole amount. So the IRS gets \$652,500 and your daughter only \$797,500.

While the gift tax may be cheaper, most folks would still rather not pay it, which is why grantor retained annuity trusts are popular. You put assets like stocks, commercial real estate or shares of a family business in a trust that pays you a fixed annual annuity for a set number of years. At the end of that term what's left in the GRAT goes to your kids.

The key is this: The value of what's left for the kids, for gift tax purposes, is calculated by subtracting from the trust's value the discounted present value of your annuity. The discount rate (known as the Section 7520 rate) comes from a formula based on Treasury note yields. At the moment, Treasury yields are low, and Section 7520 spits out 3.2 percent. That makes the annuity look valuable and the remainder look small. If your assets earn more than 3.2 percent, you will have got a break on gift taxes.

Say you put \$1 million of assets in a GRAT paying you an annuity of \$355,000 a year for three years. As far as the IRS is concerned, you haven't given the kids anything at all, since that annuity will exhaust all the principal and earnings. Yet if the GRAT assets grow at 8 percent a year, there will be \$110,000 left for your kids. By contrast, to set up a zero gift tax value GRAT in August 2007, when the 7520 rate was 6.2 percent, you would have had to pay yourself a \$375,000 a year annuity, leaving only \$42,000 for the kids, assuming the same 8 percent return. (One catch: You need to survive the term of the trust or else everything ends up back in your estate.)

"Capturing a change in the rates makes a difference, but the bigger play is by putting in assets where you expect a sudden spike in value," says Janine Racanelli, head of JPMorgan Private Bank's Advice Lab. Recently she's seen executives of financial firms whose stock has taken a drubbing funding GRATs with their company stock.

What if you bet wrong and the depressed assets you stick in a GRAT head further south? There will be nothing left for the kids and you'll be out the setup fees (\$5,000 and up for a lawyer and \$5,000 and up for an appraiser, if needed), plus annual accounting fees. "Some see GRATs as a lawyer/CPA/ appraiser annuity," concedes Baskies.

If you'd like to help charity as well as your kids (and your lawyers), there's another GRAT-like ploy that benefits from low interest rates: the charitable lead annuity trust. The annuity payments go to charity, instead of to you, and your kids get what's left. Vaughn W. Henry, a Springfield, Ill. charitable gift planner, recently helped a doctor set up a charitable

lead trust holding \$1.5 million in stock. The trust will pay \$105,000 a year for 15 years to good causes. The doc's three kids get what's left. The low discounting rate tells the IRS that the doctor has given his kids the equivalent of only \$264,000 in immediate cash. But if the portfolio earns 8 percent a year, they'll get \$1.9 million, better than double what they would get if he were to hand over \$264,000 and they invested it at 8 percent.

The tax treatment of this kind of charitable trust? The doctor doesn't get an immediate income tax deduction for the present value of the income stream given away or a deduction for the payments to charity over the years. Instead the trust declares capital gains and dividends as its own income, while claiming the \$105,000 payments as charitable deductions. Usually, the trust winds up with little or no income tax due.

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