

WILLMS, S.C.

LAW FIRM

TO: Clients and Friends of Willms, S.C.

FROM: Attorney Andrew J. Willms

DATE: April 30, 2013

RE: Planning for Tax Law Changes with GRATs and SLATs

President Obama's 2014 budget proposal would reduce the lifetime gift tax exemption from the current \$5.25 million (indexed for inflation) to \$1,000,000 (not indexed for inflation). As a result, individuals who are hoping to give or bequeath large amounts to children and more remote descendants may be able to save taxes through use of the gift tax exemption amount before the President's proposals have a chance to become law.

Notwithstanding the foregoing, there are several reasons why many of us are reluctant to make large gifts during our lifetimes, including:

- Concern about our personal financial security;
- Loss of control over the gifted funds;
- Fears about the way the gifted funds will be used by the recipient;
- The loss of the step up in basis at death; and
- Uncertainty about future law changes.

Fortunately, Spousal Limited Access Trusts ("SLATs") and Grantor Retained Annuity Trusts ("GRATs") can be used to overcome these concerns.

GRATs

A Grantor Retained Annuity Trust is a special type of gift trust whereby the person establishing the trust is entitled to receive an annuity payment from the GRAT each year for a period of years (the "Term Period").

The tax code allows the value of this annuity to be deducted when determining the amount of the gift for tax purposes. As a result, if the value of the annuity equals the value of the initial gift, then the creation of the GRAT does not result in a taxable gift. If the person who creates the GRAT outlives the Term Period, the assets that remain in the GRAT (if any) when the annuity ends will pass to the ultimate beneficiaries of the GRAT tax free. However, if the person who creates the trust dies before the Term Period expires, then all of the assets held in the GRAT are estate taxable. Often this risk can be covered by a term insurance policy.

The President's budget proposal would amend the rules governing Grantor Retained Annuity Trusts so as to require GRATs to have a term period of at least 10 years. This change would increase the odds of the grantor dying during the Term Period which would undo the estate and gift tax savings created by using a GRAT. In addition, the amount of the annuity payment could not decline during the Term Period. This change would also reduce the effectiveness of a GRAT with respect to assets that are expected to appreciate rapidly.

The President also proposes to add a requirement that the creation of a GRAT results in a taxable gift upon formation, thereby precluding so called zeroed-out GRATs. The minimum required gift upon formation is yet to be determined, but it is likely to be no less than a minimum percentage (e.g. 10%) of the amount initially transferred to the GRAT.

SLATs

Married couples who wish to take advantage of the current gift tax exemption without significantly changing their current economic situation may want to consider establishing a Spousal Limited Access Trust.

This type of planning involves one spouse using his or her gift tax exemption to fund an irrevocable trust for the benefit of the other spouse. The donee spouse would be the beneficiary of the SLAT, and as such could receive income and principal as needed. When the donee spouse dies, assets that remain in the SLAT could be given to the couple's descendants, free of the federal estate tax. It should also be possible for the person who funds the SLAT to become the beneficiary of the SLAT if the donee spouse dies first, without triggering estate taxes.

Conclusion

In summary, GRATs and SLATs make it possible to enjoy the tax benefits of a significant lifetime gift without reducing your personal financial security. Please call our office to schedule an appointment with Andrew Willms if you would like to discuss how a GRAT or a SLAT could be used as part of your estate plan.

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