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IT'S NEVER TOO LATE

(Estate Planning Ideas for the "Golden Years")

A mistake commonly made by estate owners in their 60's and 70's is thinking that the clock has run out on their chances to do some creative estate planning. The actual case of an Arizona estate owner (with the facts appropriately disguised) vividly demonstrates that -- even at age 75 -- it's not too late to preserve big pieces of the estate for your beneficiaries.

What if --

* You are age 75 and in fairly good health.

* Your investment portfolio is worth $3.5 million, and you own a home worth $600,000.

* You have no other major assets.

* The federal estate tax has been reinstated, using the 2009 urles.

Summary: Through a carefully crafted combination of annual $13,000 gifts and two special purpose trusts, you might reduce your estimated $270,000 federal estate tax bill to zero.

"<u>Annual</u> <u>Exclusion</u>" <u>Gifts</u> -- You may already be familiar with this concept. You know that you can give up to $13,000 each year to any number of people. Such gifts are <u>excluded</u> from your gift tax reporting responsibilities, thus earning the name "annual exclusion" gifts.

Suppose that your only estate tax reduction device were annual exclusion gifts. Suppose also that you made such gifts to two grandchildren each year for the rest of your life expectancy. *You would save over $160,000 in estate taxes* even before figuring in the return on invested funds.

There are at least two "downside" considerations involved in making annual gifts like that. The first and most obvious is that you might not live your projected life expectancy. Just as important, in the opinion of many, is the fact that too much money too soon can have a negative impact on the development of young people. You must evaluate the potential impact on your grandchildren. Of course, you could also make gifts to your adult children and enjoy the same estate tax benefits.

"<u>Qualified</u> <u>Personal</u> <u>Residence</u> <u>Trust</u>" ("QPRT") -- You would transfer your house to this special purpose trust, retaining the right to live in it for, say, ten years. In legalese, that would be the "term" of the trust.

During that ten-year period, nothing changes. You still use the house when and as *you* want to; you still pay the homeowner's insurance premium; the real estate taxes are still deductible by you for income tax purposes; guests still come to *your* home.

At the end of ten years, your children become the beneficiaries of the QPRT. In effect, they then own the house. If you are still alive, an "arms' length" lease at fair market rental allows you to continue to live there. Those lease payments are very tax-effective because they are actual cash transfers <u>out</u> of your taxable estate, but they don't count against annual exclusion limits.

When the house was transferred to the trust, the IRS says that you made a gift of about $230,000. (The exact amount depends on interest rates when you made the gift.) If you are still living in ten years, that $230,000 (rather than the $600,000 market value) is the only part of the value of the house on which you will ever pay gift or estate tax.

There's the "catch," of course -- "If you are still living in ten years." If you aren't, the government will want to tax the full value of the house as part of your estate. There's no *penalty.* You would simply have failed to accomplish your tax planning objective regarding the house.

It may not be an exaggeration, then, to say that there is no downside to this planning tactic. The potential upside is eliminating the entire estate tax (even without annual exclusion gifts) if the house appreciates at only 3% annually during the term.

The third and final tactic is another kind of special purpose trust -- a *<u>G</u>rantor <u>R</u>etained <u>A</u>nnuity <u>T</u>rust* ("GRAT"). You could put part of your investment portfolio into a GRAT.

A GRAT differs from a QPRT in at least two important ways. First, the GRAT requires that a regular payment be made to the grantor (the person who creates the trust). Second, there is a possibility that death during the term will result in only <u>part</u> of the value of the GRAT assets being included in the grantor's estate. (The law is too complex to give you any greater certainty than "a significant chance," and it should be noted that in some situations the full value will be included.)

Suppose that -- like our Arizona client -- you were to transfer $1 million of your $3,500,000 investment portfolio to a ten-year, 5% "term" GRAT. You would receive a $50,000 annual payment for ten years, after which your children would become the trust beneficiaries. You would be treated for transfer tax purposes as having made a gift of about $582,000 when you created the trust. Over $400,000 would have "disappeared" for gift and estate tax purposes.

GRATs give estate owners much more "design" freedom. You can custom tailor them better than you can QPRTs. The few numbers used here to illustrate a GRAT should not be taken as the "last word" on the subject.

The best overall strategy for most estate owners might be a combination of all three -- annual exclusion gifts, a QPRT and perhaps a modest GRAT. You may even find yourself able to utilize other techniques like private annuities or self-canceling installment notes.

In any event, it's too early to give up. You can retain for your beneficiaries much of the fruit of your life's work. Plan on it.

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