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Timely and Creative Trust Vehicle: GRATs
First in a Series of Three Features

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The following is a discussion of an effective estate planning option/gifting technique that could serve to reduce your taxable estate and, more importantly, provide benefits to your chosen beneficiaries.

The status of the federal estate tax still remains unsettled, but we maintain with near certainty that there will be a federal estate tax in place for years to come. It is expected that the individual exemption from estate tax will become permanently fixed beginning January 1, 2009 at \$3,500,000 per person. If you find yourself in the situation of needing to plan for the imposition of estate tax on your estate, you may wish to consider a Grantor Retained Annuity Trust (a "GRAT"), which is an estate planning minimization strategy to be carried out during your life that implements "leveraged gifts," meaning you as the donor make the gift at a discounted value.

The GRAT is particularly attractive in today's low interest rate environment. As discussed below, the value of the gift into this type of trust is determined in part by the applicable interest rate. The lower the interest rate, the lower the transfer tax cost imposed on getting the asset to the ultimate beneficiaries, your loved ones.

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Establishing a GRAT is a way of "freezing" the value of assets for estate tax purposes and getting the appreciation out to the next generation, while allowing the grantor to retain the benefit of the assets. You establish an irrevocable trust for a term of years and retain an interest in the trust, in the form of a fixed annuity payment, for that term. At the end of the term, the assets remaining in the trust, which ideally would be the appreciation earned on the assets during the GRAT term, pass to your chosen beneficiaries.

The benefits of the GRAT are as follows:

- The gift tax value of your gift to the trust is discounted for the present value of the annuity interest you retain in the trust assets, and
- The value of the annuity can be tailored to virtually equal the value of the assets transferred to the GRAT so no gift at all is involved. The trust assets will not be included in your gross estate as long as you outlive the term of the GRAT, so that any appreciation between the date of the gift and the date of your death will not be subject to estate tax. If, however, you do not survive the term of the GRAT, the assets in the trust will be included in your gross estate at their date-of-death value.

GRATs are popular with individuals who have assets that are expected to increase in value, such as pre-IPO or depressed stock.

With a GRAT, the hope is that the assets in the GRAT will appreciate at a greater rate than the “applicable federal rate” set by the IRS pursuant to Code Section 7520 for the month in which the GRAT is established (e.g. for February 2008 the AFR is 4.2%). If, as anticipated, the assets in the GRAT appreciate at a rate greater than the 7520 rate in effect at the time of the GRAT’s creation, that appreciation will pass to your chosen beneficiaries when the GRAT term is up free of any transfer tax. GRATs, whose term can be as brief as two years, are popular with individuals who have assets that are expected to increase in value, such as pre-IPO or depressed stock.

Example of a GRAT: Selling a Business, Passing Proceeds to Heirs while Minimizing Taxes

An individual (the “grantor”) owns shares in a business that sells a type of useful environmental technology. He expects to cash in on the shares at some point in the near future and anticipates that when he does he will receive a windfall from a buyer. (Please note, however, that he does not have any kind of written purchase agreement in place.) He obtains an appraisal of his shares from a qualified professional appraiser. The grantor knows that he can afford to part with some of the future expected earnings off these shares and would like to move some of that appreciation down to his two children. He transfers 30% of the shares into a 4-year GRAT that will ultimately convert into an irrevocable trust for the benefit of his children.

For this hypothetical, we make some assumptions (and to keep it simple no discounts are applied in this analysis): the 30% interest is valued at \$1,000,000 and the 7520 rate for the month of transfer is 4.2%. Setting up the GRAT to make level payments the percentage payout is 27.7 % so the payments are \$276,786 a year. This serves to “zero out” the GRAT so he ends up making a taxable gift to the remaindermen of the trust, his children, of less than \$1. He files a gift tax return to memorialize this gift. In year 2 of the GRAT, his shares and the shares held in the GRAT are sold at a premium of 12% over their value at the time the GRAT was founded. Based on the sale, the GRAT’s 30% interest is now worth \$1,357,812. Accordingly, that appreciation over the \$1,107,143 (the sum total of the annuity payments back to him from the GRAT) is able to pass out to his children, via the irrevocable trust for their benefit, free of any transfer tax, making the GRAT a very effective tax minimizing technique for this grantor.

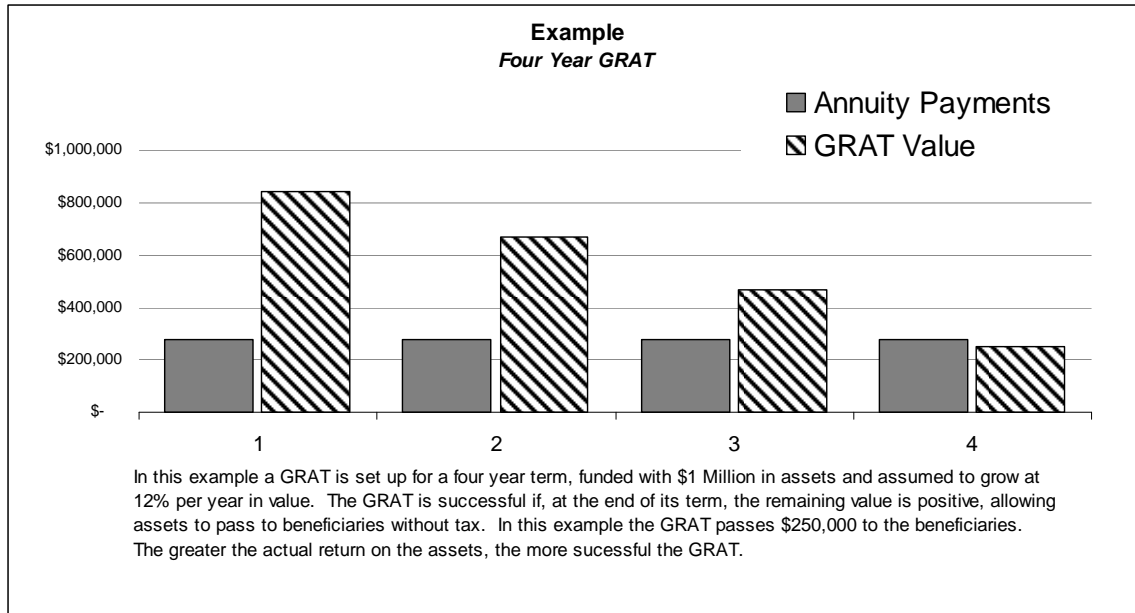


Chart created by Welch & Forbes LLC using figures generated by NumberCruncher 2008.01, Stephan R. Leimberg and Robert T. LeClair.

To sum up, if you anticipate having a taxable estate and if you are able to part with the value of an asset or its income stream during your life, a GRAT may be a great way for you to move that value out to the next generation at a discount. Moreover, GRATs are especially attractive in the current low interest rate environment. To hear more about any of these estate planning options, please contact your Welch & Forbes LLC portfolio manager who can guide you in the appropriate questions to ask your estate planning attorney or put you in touch with one of the attorneys at Steffensen, Herman & Doggett, LLC.

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