THE WALL STREET JOURNAL.

How Volatility Eases Estate Planning

By Kelly Greene – August 20, 2011

Market volatility may be tough on the nerves, but it could be a boon for wealthy families looking to shelter assets from taxes while helping their children.

Two other factors affecting many estate-planning strategies also are favoring families right now: Interest rates are exceedingly low, and Congress has increased the federal gift-tax exemption to $5 million from $1 million for individuals through 2012, after which it reverts back to $1 million.

Dieter Braun

"This is a golden opportunity to plan," says Martin Shenkman, an estate-planning lawyer in Paramus, N.J.

Here are three ways to take advantage of this confluence of events:

• **Discounts.** People with large chunks of stock in privately held companies have at least one reason to cheer recent economic events: The volatile stock market allows them to give away such stock at a bigger discount.

Whatever the market is doing, you typically get a discount when you give away a portion of your stock in a business that doesn't trade publicly because it may be hard to find a buyer. The Internal Revenue Service generally allows a 30% to 35% discount on such stock for that reason, says Lance Hall, managing director of FMV Opinions, an estate- and gift-tax valuation firm in New York.

But when the publicly traded markets are more unpredictable than usual, owners of private stock have successfully argued for larger discounts on the value of their holdings as well. Mr. Hall has used an indicator of market volatility known as the VIX to defend larger discounts on transfers of stock in private companies.

The VIX—short for the Chicago Board Options Exchange Volatility Index—measures the expected volatility of the Standard & Poor's 500 index over the next 30 days and tends to move in the opposite direction from stocks.

In less-turbulent times, the VIX typically hovers below 20, Mr. Hall says. In recent weeks, it has reached intraday highs unseen since the aftermath of the May 2010 "flash crash."

In the fall of 2008, when the VIX averaged 56.6, Mr. Hall says he started recommending discounts in the 45% to 65% range on privately held stock. Now, with the VIX veering above 40 this week, discounts for gifted stock could be in the 40% to 50% range, he says.

"It's a great time to gift private equity, because not only do you not have to pay gift tax, but the discount for marketability has shot up, too," Mr. Hall says.

• **GRATs.** If your holdings are in battered stocks of publicly traded companies or a family business, you may want to consider a grantor-retained annuity trust, or GRAT. Such trusts work best when interest rates are low, as they are currently.

With a GRAT, you give an asset to a trust—but also retain the right to annuitized payments for a set time period. What you really are giving away is any future appreciation on the asset tax-free, says Jonathan Forster, an estate-planning lawyer at Greenberg Traurig in McLean, Va.

If the markets rally, a GRAT lets you transfer most of the upside in any bundle of assets to your children, or to a trust for their benefit, without paying gift tax, says Carlyn McCaffrey, an estate-planning lawyer at McDermott Will & Emery in New York. Yes, the gift-tax exemption is currently $5 million, "but the people who want to do GRATs want to give away more than that."

The term of the GRAT can be as short as two years, making them popular with families with assets expected to appreciate, such as depressed stocks or a family business.

One caveat: Assets you put in a GRAT have to appreciate more than the "hurdle rate," which is calculated by the IRS and is currently 2.2% a year. But a number of stocks have dividends yielding more than that, including Exxon Mobil, McDonald's and AT&T, meaning the assets could easily beat that hurdle, Mr. Forster says.

For families trying to pare the size of their estates, "it's low-hanging fruit," he says.

What if the assets continue to fall in value? Either the assets go back to the original owner, or that owner can "reset" the GRAT by buying back its assets and transferring them to a new GRAT. But if they increase in value, the trust gets the benefit. "It's a no-lose situation from an estate-planning point of view," Ms. McCaffrey says.

To raise revenue, Congress has been seeking to impose more restrictions on GRATs, including a requirement that they be in place for at least 10 years, she says. So far, though, the legislation hasn't passed.

• **Loans.** Families also can take advantage of the convergence of low interest rates and low stock prices by making an intrafamily loan to fund an investment.

"You could lend $10 million to a trust that benefits your kids and tell them to buy stock," Mr. Forster says. Alternatively, the children could buy commercial real estate or some other depressed asset. They would get anticipated appreciation on the assets after paying back the loan.

"In this environment, you don't have to get too complicated," Mr. Forster says, "because the factors are all pointing in your favor."