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Discounting Devices From The Trenches

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As a result of the changes to the tax laws passed by Congress in recent years, it is important to review any estate planning you may have previously done, and that you take time to address estate planning issues you may have also been neglecting. While some changes have been made, the estate tax continues to be the most significant threat to the passage of family wealth from one generation to the next. However, with proper planning, the impact of this confiscatory tax can be minimized while leaving your assets largely intact for the benefit of future generations. Perhaps the most effective tool to accomplish this and other goals is known as the "SuperGRAT."

The SuperGRAT is a two step estate planning device which combines a limited liability company (LLC) with different trusts to achieve various business and tax planning goals. Step one involves establishing an LLC to hold the assets you wish to eventually pass to family members. The LLC is a separate legal entity which, like a corporation, provides liability protection for its owners, but it is treated like a partnership for income tax purposes, as opposed to the double-taxation associated with corporations. The LLC is divided between controlling and non-controlling interests, and the controlling interests are retained by you so you keep total control during your lifetime over the assets held in the LLC.

Step two is performed by transferring the non-controlling LLC interests into irrevocable trusts. These trusts are designed to give you the right to the income from the LLC assets for a fixed term of years. After the fixed term expires, you may choose to reacquire these non-controlling LLC interests to allow you to continue to receive the income or they will pass in trust for your specified beneficiaries, the "remainder beneficiaries" of the trusts.

In addition to allowing you to maintain control over the assets and keep the right to the income from the assets, the SuperGRAT plan effectively allows you to remove future appreciation on the assets from your estate for tax purposes while at the same time substantially compressing the value of the assets for current gift tax purposes.

For example, assume Mr. and Mrs. Cassidy, husband and wife, both age 65, together own real estate or other assets valued at $1 million which generate a net cash flow of $90,000 annually. Under the SuperGRAT method, this real estate is placed into an LLC with the Cassidy Living Trust holding the 1% controlling interest as "Managing Member" and Mr. and Mrs. Cassidy each individually holding a 49.5% "Non-managing Member" interest. Mr. Cassidy then transfers his Non-managing Member interest into an irrevocable trust which will pay him income of just under $45,000 per year for the next ten years. However, this income payment is just the minimum, and the trust is also allowed to pay income in excess of this amount to Mr. Cassidy. Likewise, Mrs. Cassidy will transfer her Non-managing Member interest into a separate irrevocable trust which will pay her income of just under $45,000 per year for the next ten years, and this income payment too is only a minimum, and the trust may pay income in excess of this amount to Mrs. Cassidy.

By putting these two 49.5% Non-managing Member interests in trust irrevocably, Mr. and Mrs. Cassidy have made a gift of these interests to the remainder beneficiaries. However, the value of this transfer for gift tax purposes is not 99% of the value of the LLC assets, or $990,000, but merely $109,184 as calculated under tax tables and guidance provided by the IRS. This accomplishes a valuation compression ratio of nearly 9 to 1, allowing Mr. and Mrs. Cassidy to move $9 of assets from their taxable estate at a tax value of only $1! And this amount can be offset by only a small portion of each spouse's $1,000,000 applicable exclusion amount (formerly unified credit amount) which can pass tax free. Additionally, all future appreciation will pass estate and gift tax free to the beneficiaries specified by Mr. and Mrs. Cassidy.

As illustrated, the SuperGRAT is a powerful estate planning tool that allows you to remove property from your estate for tax purposes at a substantially reduced gift tax value, while retaining for yourself control over the property and the right to receive the income from the property. It also allows you flexibility for future planning and the advantage of providing creditor protection for your beneficiaries.

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