MOSES & SINGER LLP

Wealth Preservation Advisor

April 2008

Letter from the Chairs:

This issue of the Wealth Preservation Advisor, together with our next issue, will focus on estate planning strategies available to grandparents who wish to pay for their grandchildren's education expenses in the most tax efficient manner. As you might imagine, we receive many inquiries from our clients on this issue, and we believe that we have some interesting techniques to share with you.

On only a slightly different topic, we also want to note that many estate planning opportunities are made more attractive when interest rates are low, as they are currently. Therefore, if you have been postponing your estate planning, for whatever reason, we would strongly suggest that now might be the ideal time for you to move forward.

Finally, we take this opportunity to congratulate Daniel S. Rubin, who was recently named to *Worth* magazine's Top 100 Attorneys serving private clients, Gideon Rothschild, on being honored with the "Distinguished Estate Planner" award by the National Association of Estate Planners and Councils, and Gideon, Daniel and Irving Sitnick, who were recently listed as "New York Super Lawyers" in *The New York Times Magazine*.

Gideon Rothschild Irving Sitnick

Planning Alert

Current Low Rates Provide Planning Opportunities

Every month, the Internal Revenue Service issues its "Applicable Federal Rates" for the following month. These rates are a key component in many estate planning strategies and, as a general rule, lower rates provide for significant opportunities to shift wealth to junior generations.

The Applicable Federal Rates for the current month are historically low. In fact, the last time that the rates were lower was in August 2003 (which was itself near an historic low). As but a small example, the current rate for a loan of three years or less is 1.85%!

What does this mean for you? It means that now is the time to:

1. Transfer assets to a grantor retained annuity trust (GRAT).

2. Sell appreciating property to a dynasty trust for a note.

4. "Refinance" existing intra-family notes which may bear a higher rate.

3. Make an "intra-family" loan to your children or grandchildren.

As an example of the planning available, if a loan of $1 million were made to a child for 3 years at 1.85% and the child invests the proceeds in an investment earning 10%, the excess after 3 years of $269,765 will have been transferred to the child gift tax free.

If you wish to explore any of these or other opportunities, please contact one of our partners.

Gifts of Prepaid Tuition Expenses

In a consistent string of Private Letter Rulings, the Internal Revenue Service has sanctioned a taxpayer's ability to prepay multiple years of the tuition expense of their grandchildren without federal gift or generation-skipping transfer tax consequence. And, as college and private school tuition continues to rise, the ability to prepay multiple years of tuition expense in a tax-efficient manner has become a particularly significant estate planning technique.

Background

Subject to certain exceptions, a gift tax is imposed on any gratuitous transfer of property. However, the Internal Revenue Code affords an unlimited gift tax exclusion for gifts of qualified tuition expenses for full-time or part-time students paid directly to a qualifying educational organization.

The exclusion is available only for amounts paid as direct tuition costs and, therefore, does not include expenses related to room and board. However, a "qualifying educational organization" is broadly defined to include any type or level of school, from private elementary, middle and high schools, to colleges and trade schools, provided only that the primary function of the organization is the presentation of formal instruction, that the organization maintains a regular faculty and curriculum and that the organization has a regularly enrolled student body.

In addition to the federal gift tax, the Internal Revenue Code imposes a generation-skipping transfer tax (a "GST tax") on any transfer to a "skip person", such as a grandchild or more remote descendant of the transferor. However, any gift which qualifies for the unlimited gift tax exclusion for gifts to educational organizations also avoids the imposition of the GST tax.

The Technique

While the prepayment of multiple years of tuition expense for a grandchild can provide one with the immediate ability to make a tax-free transfer of significant dollars, the gift must be made in a particular manner if one is to fall within the presumed "safe harbor."

First, the transfer to the educational organization must be non-refundable. Consequently, if the grandchild is not offered enrollment, or later withdraws from the school, the gifted funds may not be returned to the donor.

Second, the funds may not be transferable to another educational organization.

In addition, in each of the private letter rulings that have been issued by the Internal Revenue Service to date, the grandparent making the prepaid tuition gift entered into an agreement with the educational organization requiring either the donor or the child's parent to cover any subsequent increases in tuition in future years, though this point does not appear to be essential for the favorable gift and GST tax result, and potentially could be negotiated away.

Is a Private Letter Ruling Necessary?

In order to ensure that a taxpayer's particular plan for prepaying tuition qualifies for the unlimited gift and GST tax exclusion, it is prudent, although not absolutely required, to first obtain a private letter ruling from the Internal Revenue Service confirming the absence of any adverse tax consequences in connection with the proposed gift.

A private letter ruling is a response issued by the Internal Revenue Service to a request from a taxpayer regarding the tax consequences of a transaction or, as here, a proposed transaction. In general, while a private letter ruling issued to another taxpayer can provide a donor with guidance as to the potential consequences of a transaction (since it reflects the opinion of the Internal Revenue Service), the tax law does not bind the Internal Revenue Service to the guidance issued in the private letter ruling, except as regards the taxpayer to whom the ruling was issued.

Requesting a private letter ruling from the Internal Revenue Service involves submitting a complete statement of all of the facts relating to the proposed gift transaction, as well as copies of any agreements (with the educational organization, or otherwise) relating to the proposed transaction, together with the taxpayer's analysis of the governing tax law. And, although private letter rulings are published by the Internal Revenue Service and, consequently, become part of the public record, the identifying facts (such as the donor's name and personal information and other identifying details), are redacted from the published private letter ruling.

Contrast Alternate Techniques

Prepaying multiple years of tuition directly to an educational organization provides certain advantages over the more common "Section 529 Plan" to subsidize grandchildren's tuition expenses. Most significant in this regard are that (i) gifts to a Section 529 Plan require the use of one's annual exclusion (currently limited to $12,000 per beneficiary per year),* and (ii) Section 529 Plans limit qualifying educational expenses to college or graduate education. However, depending on the circumstances, it may be advisable to utilize 529 plans in conjunction with prepaying multiple years of tuition directly to the educational organization in order to provide grandchildren with additional funds for non-tuition expenses such as room and board, which is permitted under the rules governing Section 529 Plans.

* *A special election can be made to front-load a Section 529 Plan with five years of annual exclusion gifts.*

Conclusion

The ability to make a gift of multiple years of prepaid tuition is an opportunity for grandparents to gift large amounts to their grandchildren without imposition of federal gift or GST taxes. We encourage you to contact our office to further discuss utilizing this technique for the benefit of you and your family. ■

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Contact Us

If you have any questions about information contained herein, please contact any member of the Trusts and Estates and Wealth Preservation practice.

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