Private Wealth Management

USING YOUR ESTATE PLANNING TOOLBOX TO FIX YOUR CLIENT'S INCOME TAX PROBLEMS

Important Information

- Goldman Sachs does not provide legal, tax or accounting advice. Clients of Goldman Sachs should obtain their own independent tax and legal advice based on their particular circumstances.
- The information herein is provided solely to educate on a variety of topics, including wealth planning, tax considerations, estate, gift and philanthropic planning.

- Once the purpose and use of the family's capital has been determined, strategies should be developed to maximize the investment risk-adjusted, after-tax wealth that may be applied to those purposes and uses.
  - Under current transfer tax laws, almost all of the US population (estimates are over 99.93%) does not have to worry about strategies that reduce transfer taxes.
  - However, according to the Gallup poll on May 24, 2017, 54% of Americans own stocks and presumably would welcome strategies that would lower income taxes on their individual investments and/or trust investments.
  - There are strategies that reduce both the income taxes on capital and the transfer taxes on capital.
  - Planning for those two taxes does not have to be, and should not be, an "either, or" exercise.

Tax Efficient Investing and Basis Management Uses the Mathematical Power of Tax-Free Compounding Deferral

- Consider the table below:

	Taxes Delayed Until Year 30 (1)	Taxes Paid Annually (2)	% Increase in Annual Rate of Return to Breakeven Compared to Delayed Tax (2-1)/1
4% Annual Return			
Ordinary Income Tax - Current Tax Rate of 40.8%	4.00%	4.83%	20.65%
LTCG Tax - Current Tax Rate of 23.8%	4.00%	4.43%	10.84%
8% Annual Return			
Ordinary Income Tax - Current Tax Rate of 40.8%	8.00%	10.75%	34.37%
LTCG Tax - Current Tax Rate of 23.8%	8.00%	9.36%	17.04%
12% Annual Return			
Ordinary Income Tax - Current Tax Rate of 40.8%	12.00%	17.13%	42.78%
LTCG Tax - Current Tax Rate of 23.8%	12.00%	14.47%	20.61%

Tax Efficient Investing and Basis Management Uses the Mathematical Power of Tax-Free Compounding Deferral (Continued)

- Since the 1933 and 1934 Securities Acts were passed, the S&P 500 (or what the S&P 500 would have been before the measure was invented) for the period 1935-2016, taking dividends into account, has grown at a compounded mean annual rate of 12.5% and a compounded median annual rate of 14.7%.
- **As the table above demonstrates, if a taxpayer can defer taxation for 30 years, and if the mean annual rate of his investments is 12%, that taxpayer would have to increase his annual rate of return by 42.78% to achieve the same result, if that non-deferred rate of return is subject to ordinary income tax rates (40.8%) under current law.**
- **If a taxpayer can defer taxation 30 years, and if the mean annual rate of his investments is 12%, that taxpayer would have to increase his annual rate of return by 20.61% to achieve the same result, if that non-deferred rate of return is subject to capital gains income tax rates (23.8%) under current law.**

- A perfect income tax and transfer tax strategy, or combination of strategies, would accomplish all of the following:
  - The strategy would be consistent with the taxpayer's nontax investment goals and stewardship goals.
  - The strategy would eliminate a taxpayer's current transfer taxes and/or transfer taxes that may be imposed by a future Congress.
  - The strategy would either enhance the basis of the taxpayer's low basis assets to equal their fair market value, or eliminate any capital gains if the assets are sold.

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Comparison of the Advantages and Considerations of Some Favorite Lifetime Planning Trust Techniques in Which the Grantor is a Deemed Owner of the Trust Assets For Income Tax Purposes

- Consider the following example:

Cam Compatible Creates an Intentionally Defective Grantor Trust for the Benefit
<u>of His Spouse and Family and Makes Certain Sales to That Trust ("SIDGT") Technique</u>

Cam Compatible owns $150,000,000 in financial assets. Cam and affiliates contribute $130,000,000 to a family limited liability company ("FLLC") (Transaction 1). In a separate and distinct transaction (Transaction 2) Cam contributes $11,180,000 to a trust that is a grantor trust for income tax purposes. The trust treats his wife, Carolyn, as the discretionary beneficiary and gives her certain powers of appointment over the trust. Cam, at a much later time (Transaction 3), sells non-managing member interests to that trust, pursuant to a defined value allocation formula, in consideration for cash and notes.

Due to considerations with respect to retaining entity distribution, amendment and liquidation powers, Cam could retain the 0.01% Class A managing member interest and transfer the 0.99% Class B managing member interest. The Class A managing member interests would control all entity managing member decisions, including investment management decisions that are not delegated to the Class B managing member interest. The Class B managing member interests would control all distribution, amendment and liquidation decisions.

Cam could give his Class B managing member interest to a grantor trust in which the initial trustee is an advisor or family member he trusts. Cam could have the power to replace the trustee of that donee trust with a new trustee, as long as the replacement trustee is not related or subservient. Assuming a 33.3% valuation discount, the technique is illustrated below:

The SIDGT Technique

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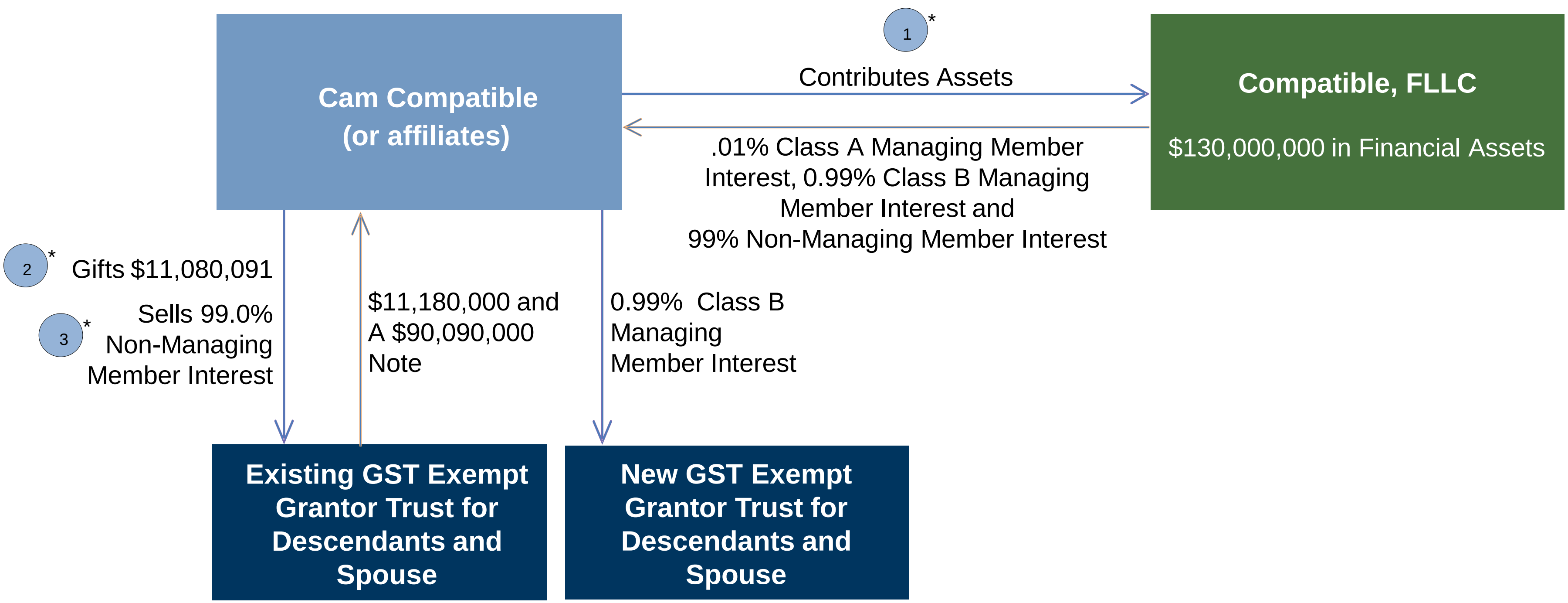


* These transactions need to be separate, distinct and independent.

- The Advantage of Locating Income Tax Inefficient Asset Classes Inside a Grantor Trust That is Not Subject to Estate Taxes.
  - The technique of asset class location in order to improve the after-tax, after-risk adjusted rate of return for an investment portfolio.
  - Location of tax inefficient investment classes in a grantor trust significantly ameliorates the income tax inefficiencies of those classes, because transfer taxes are saved when the grantor pays the income taxes of the trust.
  - For instance, as the following table illustrates, under the assumptions of the table, if the remaining unrelated income is taxed after the grantor's death inside a grantor trust, a 12.24% improvement in annual pre-tax return is necessary for a 100% turnover fund (e.g., a hedge fund) to equal a 5% annual turnover fund (e.g., a total market index fund). If the funds are instead owned by the taxpayer and not by a grantor trust, a 72.29% annual pre-tax improvement in return is necessary for a 100% turnover fund to equal a 5% annual turnover fund.

Income Tax and Basis Enhancing Advantages of the SIDGT (Continued)

	Annual Growth Rate Required on a $1mm Equity Fund Which Has a 2% Dividend Rate to Achieve $2mm (After Tax) for Investor's Beneficiaries for an Investor Who Dies in 10 Years(1), Depending Upon How a Fund is Located, and Percentage Improvement to Equal Equity Fund with 5% Turnover(2), 20% Turnover(3) or 50% Turnover(4)																											
	No Estate Planning Fund Owned by Investor								Estate Planning Techniques Fund is Not Subject to Estate Taxes but Grantor's Estate is Subject to Estate Taxes																Fund Owned by Charity			
Equity Fund's Annual Turnover of Assets	Fund is Owned by Investor and Investor's Estate is Not Subject to Estate Tax Because of Existing Exemptions and/or Charitable Bequests				Fund is Owned by Investor and is Fully Taxable in the Investor's Estate				Fund is in a Grantor Trust and Grantor Buys the Assets from the Grantor Trust for Cash Shortly Before Grantor's Death				Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years Before Grantor's Death				Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years After Grantor's Death				Fund is Held in a Non-Grantor Trust and Remaining Unrealized Income is Taxed in 10 Years				Fund is Not Subject to Income Taxes or Estate Taxes Because Fund is Owned by a Charity			
	A				B				C				D				E				F				G			
		(2)	(3)	(4)		(2)	(3)	(4)		(2)	(3)	(4)		(2)	(3)	(4)		(2)	(3)	(4)		(2)	(3)	(4)		(2)	(3)	(4)
Indexed Fund with 5% Annual Turnover(5)	5.98%	N/A	N/A	N/A	11.83%	N/A	N/A	N/A	5.65%	N/A	N/A	N/A	6.21%	N/A	N/A	N/A	6.66%	N/A	N/A	N/A	7.08%	N/A	N/A	N/A	5.18%	N/A	N/A	N/A
Active Beta Indexed Fund with 20% Annual Turnover(6)	6.73%	12.58%	N/A	N/A	13.21%	11.66%	N/A	N/A	6.05%	7.03%	N/A	N/A	6.39%	2.78%	N/A	N/A	6.59%	-1.06%	N/A	N/A	7.45%	5.18%	N/A	N/A	5.18%	0.00%	N/A	N/A
Managed Fund with 50% Annual Turnover(7)	7.70%	28.80%	14.41%	N/A	15.15%	28.04%	14.66%	N/A	6.50%	15.12%	7.56%	N/A	6.64%	6.78%	3.89%	N/A	6.69%	0.41%	1.48%	N/A	8.01%	13.11%	7.54%	N/A	5.18%	0.00%	0.00%	N/A
Hedge Fund with 100% Annual Turnover(8)	10.25%	71.33%	52.18%	33.01%	20.39%	72.29%	54.29%	34.56%	7.48%	32.37%	23.68%	14.98%	7.48%	20.34%	17.08%	12.69%	7.48%	12.24%	13.45%	11.79%	10.25%	44.75%	37.63%	27.97%	5.18%	0.00%	0.00%	0.00%

(1) These calculations ignore the effect of investment management fees, state income taxes and investment friction costs. These calculations assume the estate planning vehicles are created without paying gift taxes. An equity fund owned by a tax exempt entity would need 5.18% annual growth rate of return over 10 years, assuming a 2% dividend rate, to achieve $2mm.
(2) % annual improvement necessary to equal fund with 5% annual turnover.
(3) % annual improvement necessary to equal fund with 20% annual turnover.
(4) % annual improvement necessary to equal fund with 50% annual turnover.
(5) 100% short-term realized gains in year 1; 0% short-term realized gains and 100% long-term realized gains in years 2-10.
(6) 100% short-term realized gains in year 1; 10% short-term realized gains and 90% long-term realized gains in years 2-10.
(7) 100% short-term realized gains in year 1; 25% short-term realized gains and 75% long-term realized gains in years 2-10.
(8) 100% short-term realized gains in years 1-10.

Considerations of the SIDGT (Pages 27-37 of the Paper)

- There may need to be substantive equity in the trust from prior gifts (is 10% equity enough?) before the sale is made.
- State income tax considerations.
- The IRS could be successful in the argument, that because of the step transaction doctrine, a valuation discount is not appropriate in valuing the transferred entity interest.
- If the assets decrease in value, the gift tax exemption equivalent may not be recoverable.
- There may be capital gains consequences with respect to the note receivables and/or note payables that may exist at death.
- On the death of the grantor there will be no step-up in basis in the assets owned by the grantor trust.
- The IRS may contest the valuation of any assets that are hard to value that are donated to a grantor trust or are sold to such a trust.
  - The problem and a probable solution: defined allocation transfers.
  - A second probable solution: a defined dollar.
  - A third probable solution: defined value allocation clauses involving both a defined dollar transfer by the donor and a parallel formula qualified disclaimer by the donee.

- Consider the following example:

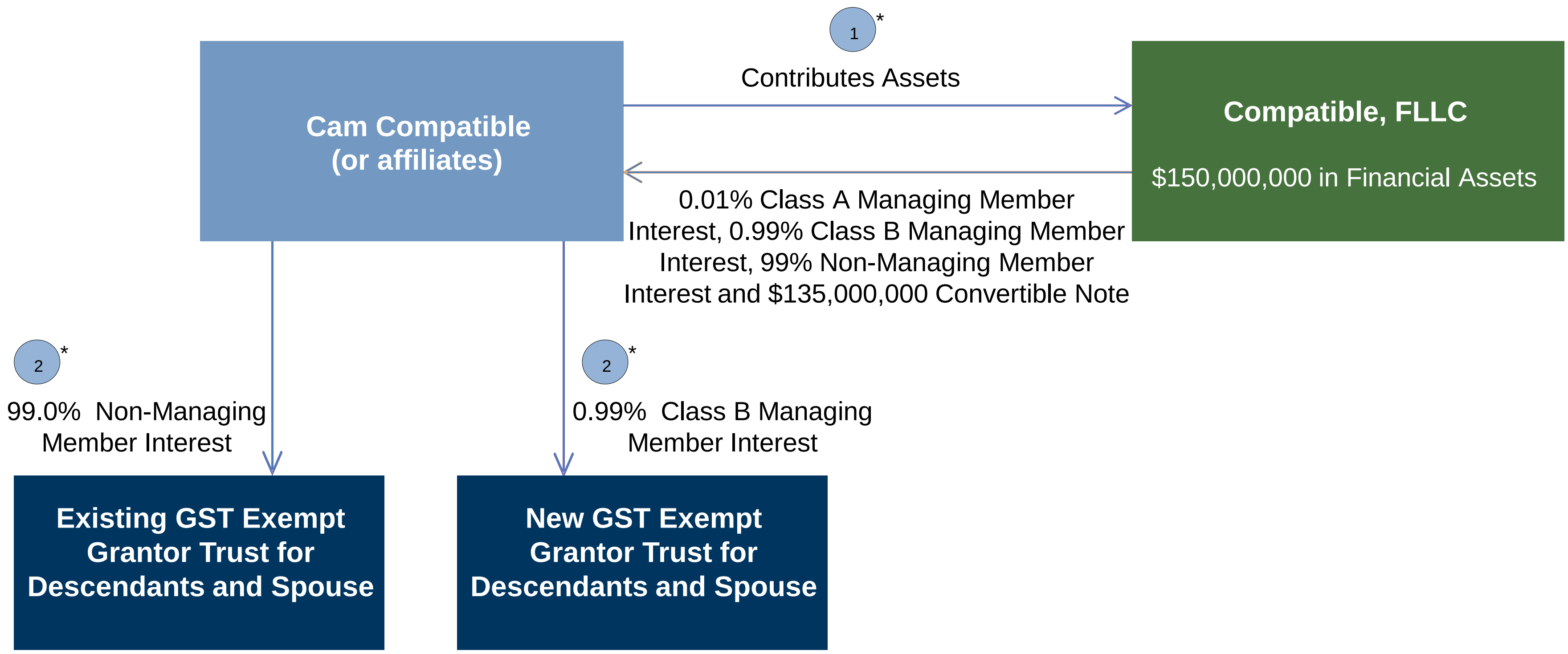
Cam Compatible Creates a Leveraged Single Member LLC
<u>and Then Contributes His Non-Managing Interests to a Grantor Trust</u>

Cam Compatible owns $150,000,000 in financial assets. Cam and affiliates (who are not recognized for income tax purposes) contribute $150,000,000 in assets to a FLLC and receive a 0.1% Class A managing member interest, a 0.99% Class B managing member interest, a 99% non-managing member interest and a $135,000,000 convertible note (Transaction 1). The note could be converted at any time at the option of the holder to that number of Compatible, FLLC units that are equal in value to the then outstanding principal of the note. The note could have a mandatory conversion feature at the death of the holder of the note. In a separate, independent and distinct transaction (Transaction 2) Cam contributes his 99% non-managing member interest to a grantor trust. Like Example 2, the trust treats his wife, Carolyn, as the discretionary beneficiary and gives her certain powers of appointment over the trust.

Due to considerations with respect to retaining entity distribution, amendment and liquidation powers, Cam could retain the 0.01% Class A managing member interest and transfer the 0.99% Class B managing member interest. The Class A managing member interests would control all entity managing member decisions, including investment management decisions that are not delegated to the Class B managing member interest. The Class B managing member interests would control all distribution, amendment and liquidation decisions.

Cam could give his Class B managing member interest to a grantor trust in which the initial trustee is an advisor or family member he trusts. Cam could have the power to replace the trustee of that donee trust with a new trustee, as long as the replacement trustee is not related or subservient. Assuming a 25.5% valuation discount for the transferred member interests, the technique is illustrated below:

The LAIDGT Technique



* These transactions need to be separate, distinct and independent.

Income Tax and Basis Enhancing Advantages of the LAIDGT (Pages 39-41 of the Paper)

- It has all of the income tax and basis enhancing advantages of the SIDGT technique.
- In addition to the income tax and basis enhancing advantages of the SIDGT technique this technique has the following income tax and basis enhancing advantages.
  - At some point in the future the balance of the retained note could be converted into a preferred partnership interest without any income tax consequences on the conversion.
  - The disregarded entity status for income tax purposes of the FLLC can be easily turned on or off by admitting or redeeming other owners who are not grantor trusts.
  - The note could be a convertible note at the election of the holder of the note into that number of units of non-managing interests of the FLLC equal to the then outstanding principal of the note. That conversion right could be mandatory at the death of the holder of the note. Such a conversion feature would have the following advantages:
    - The conversion feature would support the value of the note.
    - The conversion feature would give the holder of the note the option to participate in the growth of the FLLC assets after the conversion.
    - The conversion feature could lead to a step-up in basis of the assets of the FLLC to the extent of the outstanding principal value of the note at the death of the holder.

Income Tax and Basis Enhancing Advantages of the LAIDGT Technique (Continued)

- A donor, under the LAIDGT technique, may retain investment control of the family's assets and may also retain limited control of any distributions from the transferred entity interests to family members, if that limited control is compliant with IRC Sec. 2036(a)(2) and IRC Sec. 2038. The holding of *Powell v. Comm'r*, 148 TC 18 (2017) needs to be considered. That case held, if there is not a substantive nontax reason for the creation of the partnership, that a decedent's right to amend a limited liability agreement and/or terminate the agreement, with the consent of all other partners, was a retained interest within the meaning of IRC Sec. 2036(a)(2). It should be noted that many commentators have criticized that holding. The Supreme Court held in *Helvering v. Helmholz*, 295 U.S. 93 (1935), that a joint power to alter beneficial enjoyment, amend an agreement or terminate an agreement is not sufficient to produce inclusion in the gross estate if it merely reproduces rights already available under applicable state law. Therefore, the *Powell* holding that the partners collective right to terminate the partnership agreement by unanimous agreement resulted in estate taxation under IRC Secs. 2036 or 2038 may be in error because under state law partners always have that right. *See also Tully Estate v. Comm'r*, 528 F.2d 1401 (Ct. Cl. 1976).

- However, the cautious taxpayer could adopt one or more of the following safe harbor strategies from application of IRC Secs 2036(a)(2) and 2038 that the IRS, through its revenue ruling process, or Congress, through its legislative history, has provided:

  – If a donor is a general partner of a partnership, or is a managing member of a FLLC, he or she may retain a distribution power if that distribution power is subject to a standard in the organizing documents that could be enforced by a court (*see* Revenue Ruling 73-143, 1973-1 C.B. 407); and/or

Income Tax and Basis Enhancing Advantages of the LAIDGT Technique (Continued)

- There could be two different classes of managing member interests with the donor retaining a Class A managing member interest that has all management powers (including investment management powers) that are not delegated to the Class B managing member interest with the Class B managing member interest having distribution, amendment and liquidation powers. The Class B managing member interest could be contributed by the donor to a trust in which a family member (other than the donor) or family advisor is the trustee. The donor could have the right to remove and replace the trustee, as long as the replacement is not related or subordinate (see Revenue Ruling 95-98, 1995 C.B. 191); and/or

- The general partnership interest or managing member interest, that has the distribution power, the liquidation power and the amendment power, could be contributed by the donor to a corporation. The corporation's organizational documents should have normal fiduciary duties for management and the stockowners. Under those circumstances, the donor could own the voting stock and his transferees could own the nonvoting stock (see Revenue Ruling 81-15, 1981-1C.B. 457); and/or

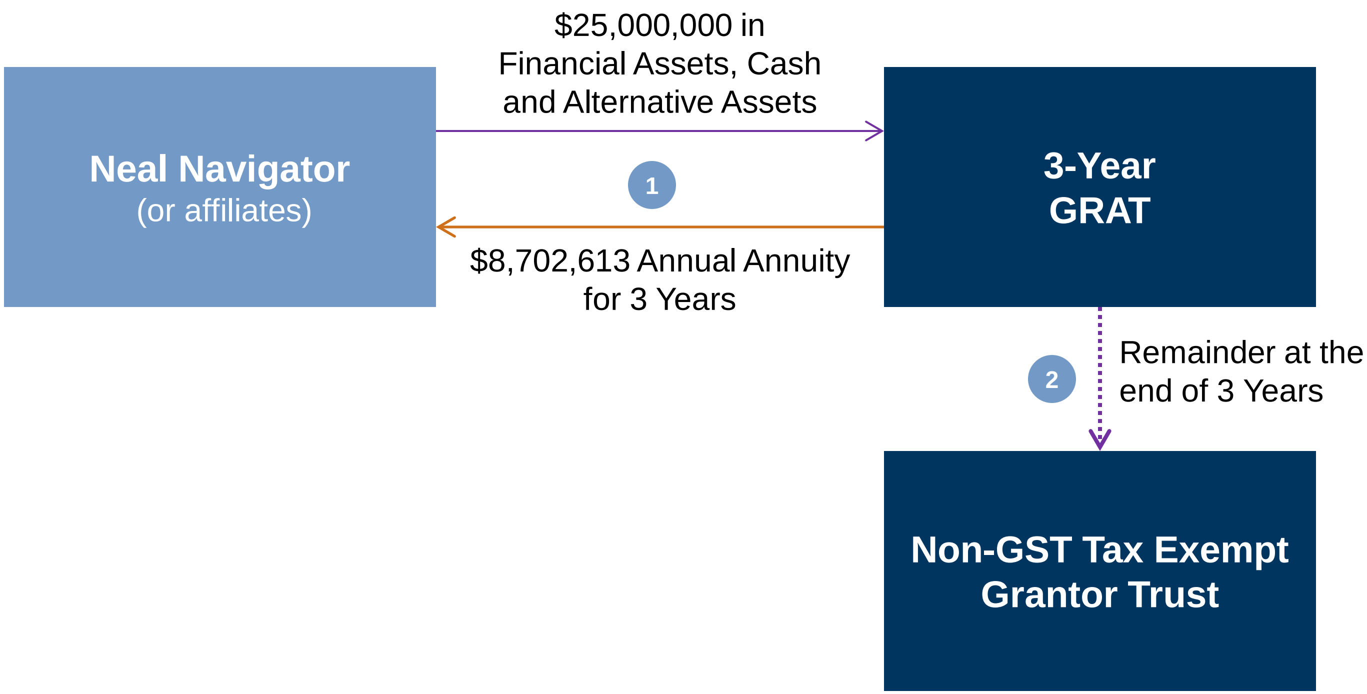
- The donor recapitalizes an entity in which the only retained interest of the donor in the entity is a voting preferred interest that entitles the donor to a majority vote. Strong Congressional legislative history in 1990, when it repealed IRC Sec. 2036(c), indicates that under those circumstances the donor should be able to give away, or sell, all other interests in the entity and IRC Secs. 2036(a)(1) or 2036(a)(2) should not apply.

Considerations of the LAIDGT (Page 41 of the Paper)

- This technique has the same considerations as the SIDGT technique, except the consideration of the note being considered as a retained equity interest in the trust.

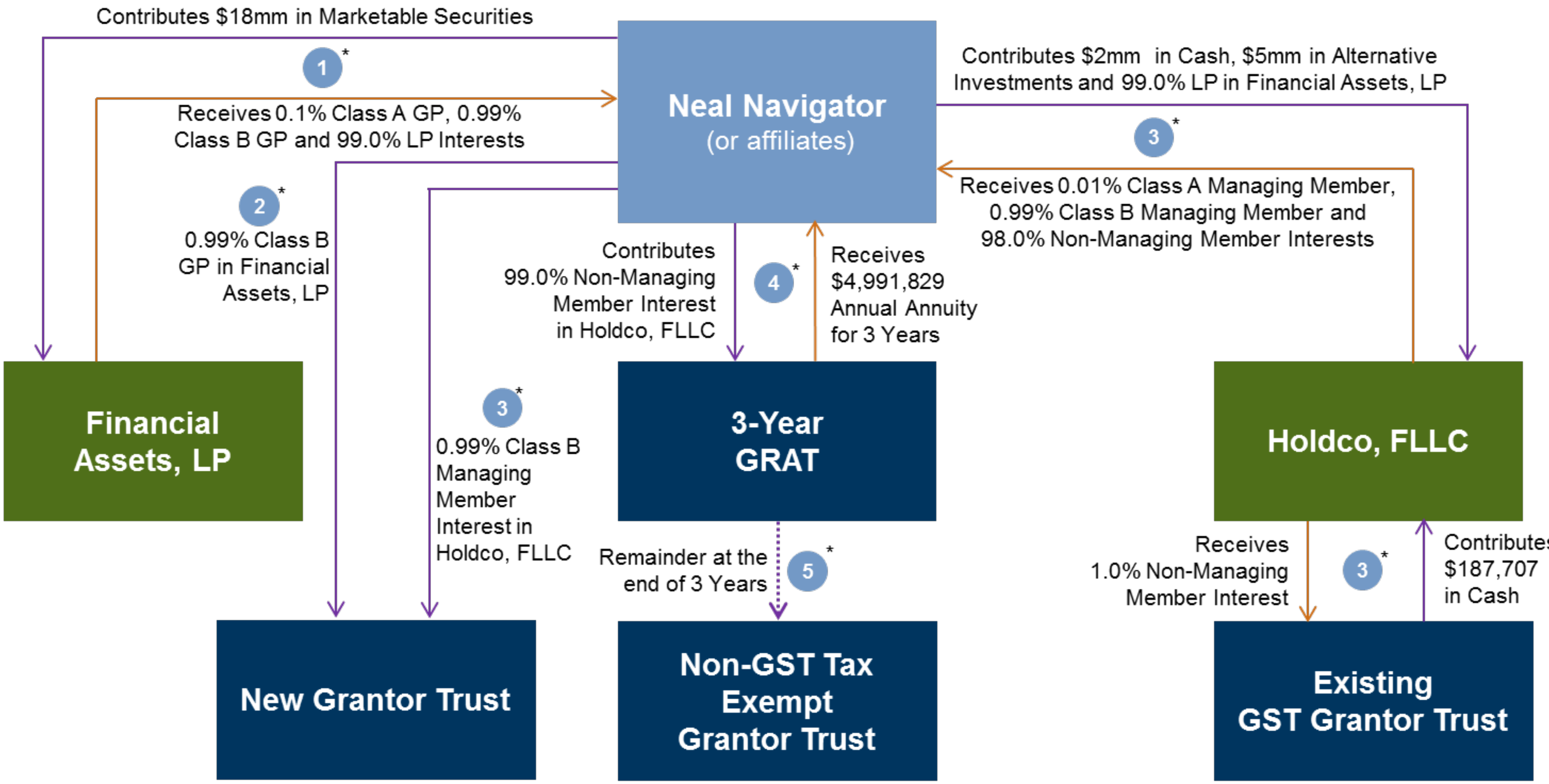
Grantor Retained Annuity Trust ("GRAT") Technique (Page 41-50 of the Paper)

GRAT Technique A (Without the Use of Discounted Interests in Entities)



GRAT Technique (Continued)

GRAT Technique B (With the Use of Discounted Interests in Entities)



*These transactions need to be separate, distinct and independent.

Income Tax and Basis Enhancing Advantages of a GRAT (Pages 45-46 of the Paper)

- Ability of grantor to pay for income taxes associated with GRAT gift tax free and substitute assets of the GRAT income tax-free.
- A GRAT does not require the use of the unified credit and the unified credit can be saved to protect the estate cost of a taxpayer dying with low basis assets.

Considerations of Using a GRAT (Pages 46-50 of the Paper)

- Financial reasons why a GRAT may not succeed.
  - Some assets are not volatile.
  - Some GRAT investments are only profitable if the investment is long.
- If a GRAT is not administered properly, the retained interest by the grantor may not be deemed to be a qualified interest.
  - The Atkinson worry.
  - The annuity amount must be paid annually.
  - Paying the grantor in satisfaction of his retained annuity interest with hard to value assets may disqualify his retained interest from being a qualified interest, if the assets are valued improperly.
  - The contribution of assets to the traditional GRAT structure must be made at the exact point of the creation of the GRAT.
- The retained annuity interest is valued using the valuation principles under IRC Sec. 7520, which is typically higher than interest on an intra-family note.
- A successful GRAT could regress to the mean by the end of the term of the GRAT.
- The traditional GRAT structure may not satisfy a client's stewardship goals because the investments of the GRAT may have been too successful.

Considerations of Using a GRAT (Continued)

- The GST tax exemption may be difficult to leverage through the use of a traditional GRAT structure.
- A traditional GRAT structure will not be successful in transferring assets if the grantor does not survive until the end of the term of the GRAT.

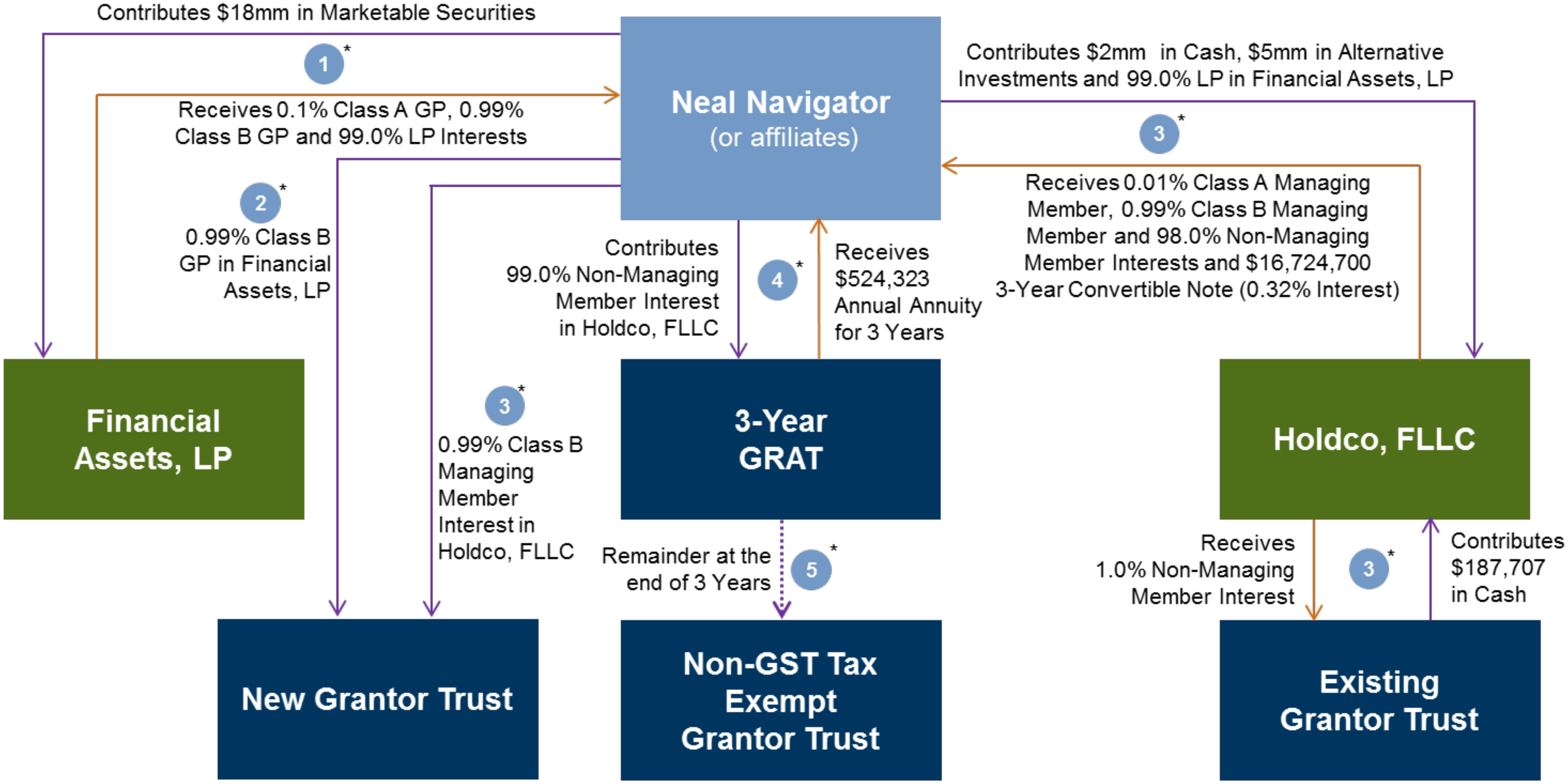
Possible Structural Solutions to Address Certain Administrative and Certain Stewardship Disadvantages of a Traditional GRAT (Pages 50-53 of the Paper)

- Structural solutions to prevent the inadvertent additional contribution of assets to a GRAT.
  - When creating the GRAT, the grantor may wish to consider a provision that prohibits any additional contributions to the GRAT and if any additional contribution is made, a new GRAT must be created specifically to hold that contribution.
  - The grantor of the GRAT may wish to consider initially making the trust revocable. Once all assignments to the trust have been completed, the grantor could amend the trust to make it an irrevocable GRAT.
- Structural solutions to ensure that the annuity amount is always deemed to be paid on a timely basis.
  - The grantor of the GRAT may wish to consider a provision in the trust document that provides (pursuant to a formula) a portion of the trust that is equal to the annuity amount due to the grantor shall not be subject to the trust.
  - If that portion remains in the hands of the trustee after the annuity payment date, the trustee shall hold such property only as a nominee, or as an agent, for the grantor.
  - The grantor may also wish to consider a provision in the trust document that the portion of the trust estate that is being held in that agent capacity can be comingled with the trust assets and that the person also serving as trustee has full authority, as agent, to invest the property.
- Structural solutions to limit the amount that is received by the remainderman of the GRAT.
  - A structural solution for a donor with those stewardship goals is to put a cap on the amount left in the trust for the benefit of his descendants at the end of the annuity term.
  - To the extent that the value of the assets of the GRAT on its termination exceeds that cap, there could be a provision that requires that excess to revert back to the donor.

Possible Structural Solutions to Address Certain Administrative and Certain Stewardship Disadvantages of a Traditional GRAT (Continued)

- Solutions to reduce the mortality risk in GRATs.
  - The grantor could sell her retained annuity interest.
  - The grantor could use a life insurance to hedge against an early grantor death.
  - The grantor could purchase the remainder interest in a profitable GRAT from the remainder beneficiaries.
  - The GRAT could be created by the grantor in consideration of full and adequate consideration.
  - In order to keep the GRAT annuity amount very low, the donor could use a combination of the following strategies: a member interest in a FLLC could be contributed to the GRAT and the donor could allocate part or all of his gift tax exemption to the GRAT and reduce the retained annuity.

- Consider the following example:



*These transactions need to be separate, distinct and independent.

Summary of the Key Advantages of a LAGRAT in Comparison to a Traditional GRAT

- Performs much better in bear, flat and bull markets.
- The “Atkinson” worry about paying a GRAT annuity with a hard-to-value asset may be eliminated.
- Has many of the same advantages that a sale to a grantor trust has in comparison to a GRAT. For example, a retained note is much more flexible than a retained annuity.
- The LAGRAT technique avoids the necessity of continually creating GRATs using the so–called “cascading GRATs” technique.
- The LAGRAT technique locks in today’s low interest rate.
- The LAGRAT technique has a lower “hurdle rate” than a GRAT.
- There may be an extra level of valuation discount in using the technique.
- Disregarded entity status can be turned “off” or “on again” by simply admitting or redeeming member interests that either turn single member LLC status off or on.

Summary of the Key Advantages of a LAGRAT in Comparison to a Defined Value Allocation Sale to a Grantor Trust

- Does not require a significant use of gift tax exemption, which may be wasted if markets deteriorate.
- In the future the IRS may be able to ignore defined value sales by changing its regulations.
- Better authority that sales to single member FLLC's should be ignored by the IRS for income tax purposes than sales to a grantor trust.
- smaller chance of an audit of a transfer to a GRAT than a sale (even a defined sale) to a grantor trust.
- Smaller chance that the retained note will be recharacterized as a deemed retained interest in the donee trust under equitable tax principles because of too much leverage. if the retained note is recharacterized as an equity interest it will be recharacterized as an equity interest in the FLLC and not a retained interest in the GRAT.
- Disregarded entity status can be turned "off" or "on again" by simply admitting or redeeming member interests that either turn single member FLLC status off or on.

Considerations of the LAGRAT Technique (Pages 59-63 of the Paper)

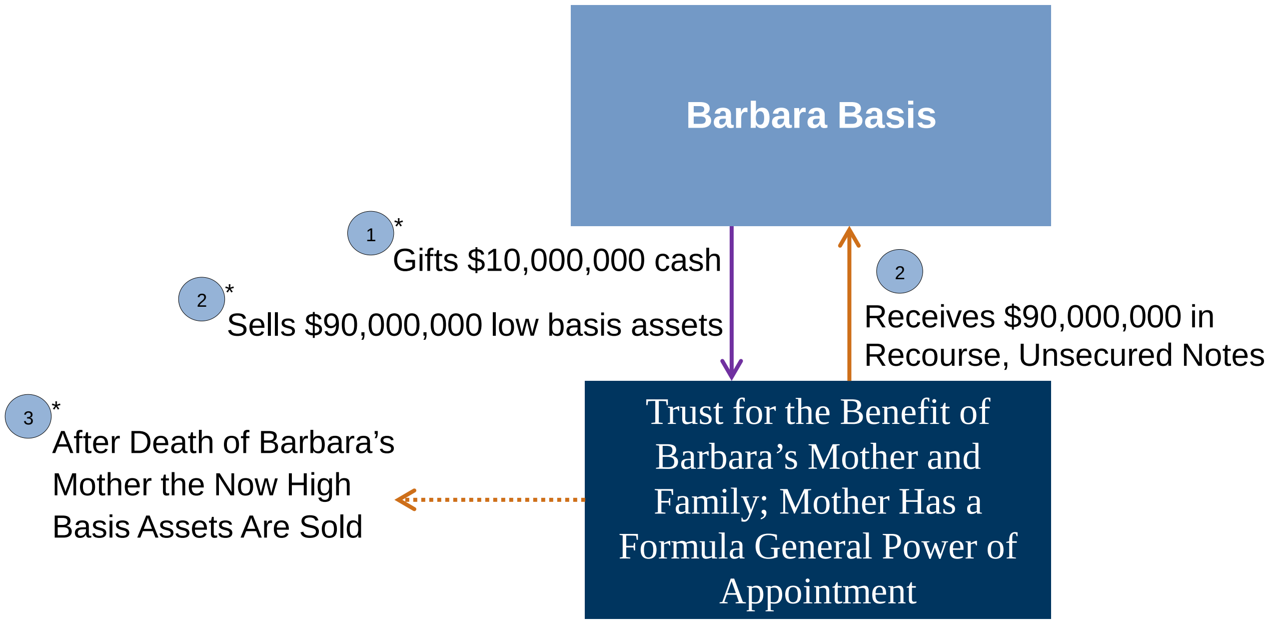
- If the grantor does not survive the term of the GRAT, part or all of the net value of the leveraged FLLC interests owned by the GRAT and the then value of the outstanding note receivable from the FLLC could be taxable in the grantor's estate.
- The LAGRAT is more complex to initially create than the traditional GRAT (but it is less complicated than using the alternative "freeze" technique of cascading GRATs that would be created each year).
- Care must be taken to make sure that there is not a violation of the Treasury regulation that prohibits "issuance of a note, or other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount." However, it is permissible for a grantor to loan money to enable a GRAT to make an investment, if the loan proceeds can be traced for that purpose. Since the GRAT is being created after the creation of the leveraged Holdco, it should be clear that the grantor's receipt of a note from Holdco is in exchange for a contribution of an asset to Holdco.
- Care must be taken to make sure that the IRS cannot successfully take the position that the creation of Holdco, FLLC should be ignored for gift tax purposes and that the retained notes are in reality retained trust interests in the GRAT that do no constitute a qualified annuity interest under IRC Sec. 2702.
- Care must be taken if the underlying asset that is sold or contributed to the single member FLLC is stock in a subchapter S corporation.

Gifting and Selling Low Basis Assets to a Grantor Trust Where an Older Generation is a Beneficiary and is Subject to an Older Generation's General Power of Appointment and Estate Taxes (the Upstream Intentionally Defective Grantor Trust or "UPIDGT") (Pages 227–232 of the Paper)

- A taxpayer could gift cash and then later sell, pursuant to a defined value assignment, some of his low basis assets (for adequate and full consideration) to a grantor trust in independent transactions. The beneficiaries of the trust could be the taxpayer's descendants and an older generation beneficiary, such as a parent.
- The older generation beneficiary could be given a formula general power of appointment that will be structured to include those trust assets in his or her estate, to the extent that inclusion does not cause the older generation beneficiary to incur estate taxes.
- If the older generation beneficiary's estate is small, that general power of appointment may not result in any estate taxes being assessed against his estate.

The UPIDGT Technique

- Consider the following example:



* These transactions need to be separate, distinct and independent.

Income Tax and Basis Enhancing Advantages of the UPIDGT Technique (Page 228 of the Paper)

- This technique has the same advantages as a SIDGT.
- The assets of the trust will receive a step-up in basis on the older generation beneficiary's death equal to the fair market value of the assets.
  - The non-depreciable trust assets could be sold after the older generation beneficiary's death and reinvested without capital gains tax consequences.

Transfer Tax Advantages of the UPIDGT Technique (Page 229 of the Paper)

- The assets of the trust may be generation-skipping tax protected.
- The older generation beneficiary may not have to pay estate taxes because of her general power of appointment, if her then available unified credit exceeds the net value of the trust.
- Also consider the income and transfer tax advantages that could accrue if the older generation exercises her testamentary general power of appointment in favor of a BDOT (a beneficiary deemed owner trust, which is discussed below) in which the younger generation creator of the UPIDGT is the initial beneficiary.
  - That exercise of the general power of appointment must be independent and there must not be any prior understanding that the older generation would so exercise that power.
  - A BDOT could become, under those circumstances, an ideal trust for the younger generation (Barbara) to sell her individual assets to the BDOT, or the younger generation could use the LAIDGT technique with that BDOT.

Considerations of the UPIDGT Technique (Pages 229-232 of the Paper)

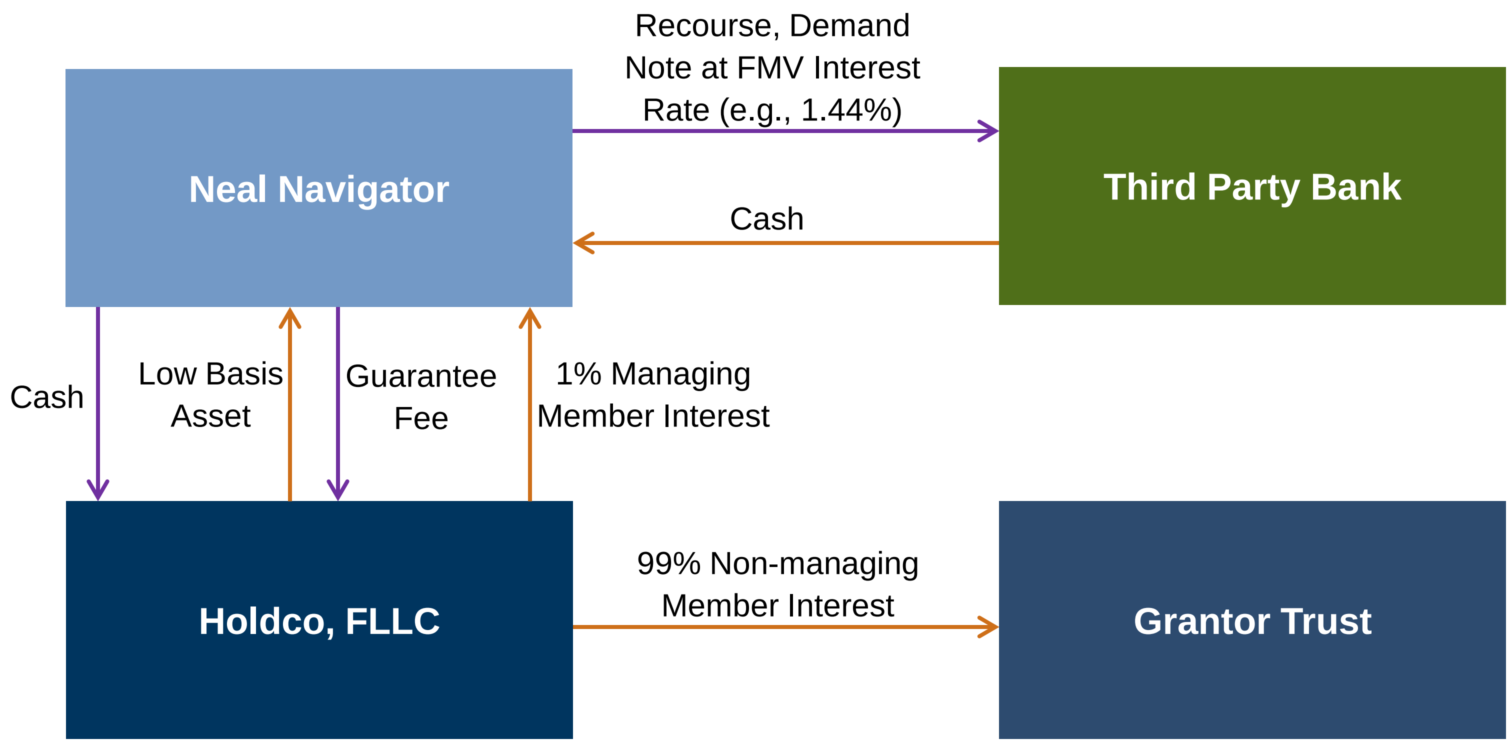
- The grantor of the trust will still have a low basis in his or her note upon the death of the older generation beneficiary.
  - However, after the older generation beneficiary's death the note may be satisfied, without tax consequences, with the now higher basis assets owned by the trust.
- The older generation beneficiary could exercise his or her general power of appointment in an unanticipated way.
  - That possibility could perhaps be mitigated by requiring that an independent, non-adverse trustee approve any exercise of a general power of appointment before it is effective.
- Many of the same considerations for the use of a grantor trust and a sale to a grantor trust would also be present for this technique.
- The effect of IRC Sec. 1014(e) must be considered, if cash is not given and low basis assets are used to capitalize the trust.

Considerations of the UPIDGT Technique (Continued)

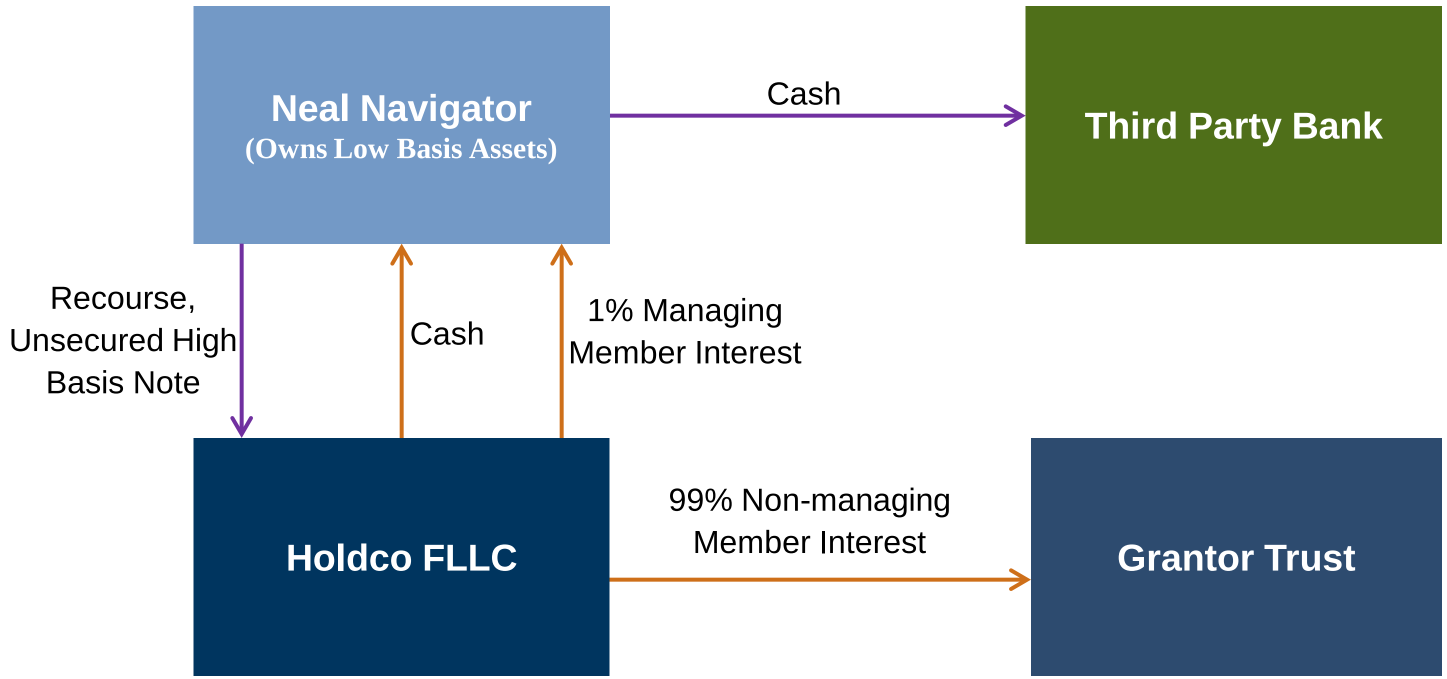
- The effect of Treas. Reg. §20.2053-7 may need to be considered with respect to receiving a full basis step-up for the gross value of an asset.
  - In the example, the debt is unsecured and the debtor has personal liability to the lender. As a consequence, the full value of the gross assets could be included in the value of the decedent's estate and the liability will be separately deducted.
  - What if the debt is secured and the liability is non-recourse? Consider Treas. Reg. §2053-7. What is the meaning of the word "need" as it is used in the regulation?
  - Fortunately, Prop. Reg. §1.1014-10(a)(2) provides: "The existence of recourse or non-recourse debt secured by property at the time of the decedent's death does not affect the property's basis, whether the gross value of the property and the outstanding debt are reported separately on the estate tax return or the net value of the property is reported."
- Is grantor trust status lost for the original grantor when the older generation beneficiary dies and the trust assets are included in the beneficiary's estate?
  - Treas. Reg. §1.671-2(e)(6) contains an example that would seem to indicate that the grantor trust status would not change.
  - It should be noted that this consideration should not exist, if the older generation beneficiary exercises her general power of appointment in favor of a BDOT in which the younger generation UPIDGT creator is the initial BDOT beneficiary, because the BDOT will be a grantor trust to that younger generation creator.
- IRC Sec. 1014(b)(9) needs to be considered for property that has depreciated.

Various Techniques to Enhance the Basis of Assets Held in an Income Tax Disregarded Entity (Pages 64-67 of the Paper)

- Consider Hypothetical Transaction #1 illustrated below:

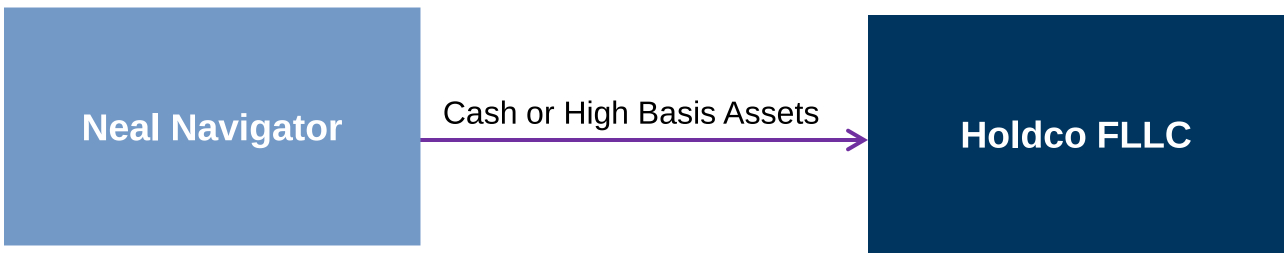


- Consider Hypothetical Transaction #2 illustrated below:



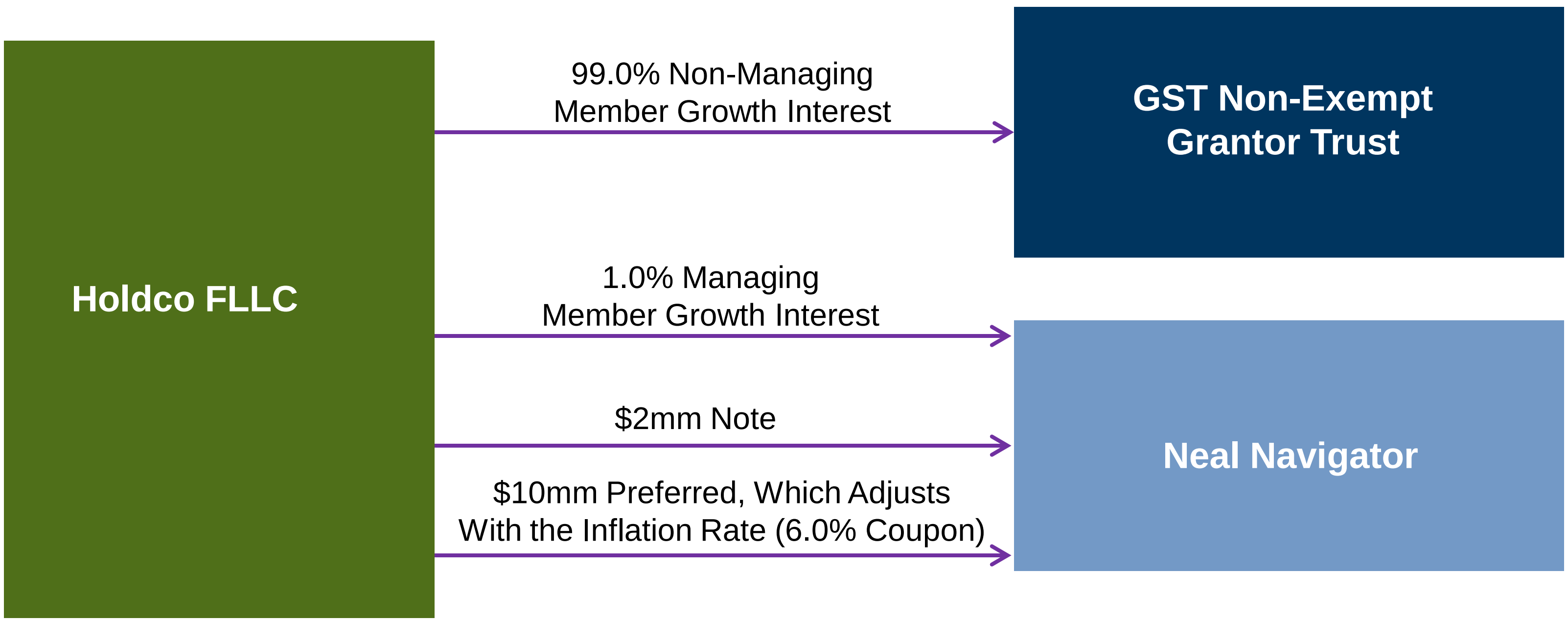
Income Tax and Basis Enhancing Advantages of the LAIDGT and/or LAGRAT Techniques (Continued)

- Upon the death of Neal Navigator, the estate satisfies the note to Holdco FLLC with the now high basis assets or cash (if the high basis assets are sold after the death of Neal Navigator).
  - Consider Hypothetical Transaction #3 illustrated below:



Income Tax and Basis Enhancing Advantages of the LAIDGT and/or LAGRAT Techniques (Continued)

- Another basis enhancing strategy opportunity with the LAGRAT technique is to convert part or all of the retained note at some point to a preferred member interest in the FLLC. In that manner an IRC Sec. 754 election could be made on the death of Neal Navigator and a partial basis step up of the assets of Holdco FLLC could be achieved.
- This example, after the conversion of $10,000,000 of the $12,000,000 note, is illustrated below:



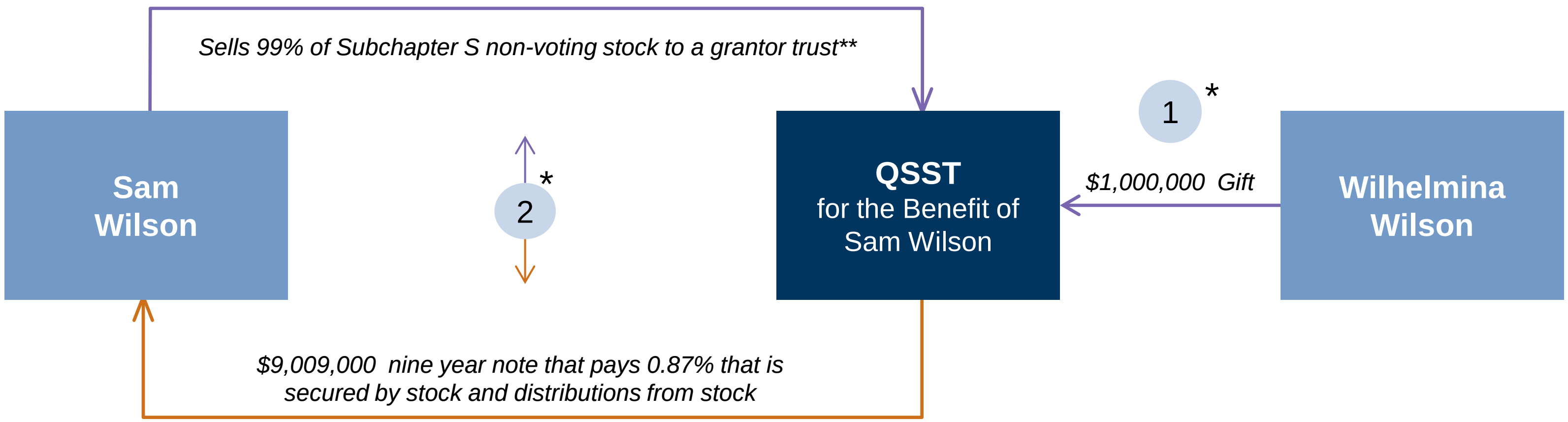
Income Tax and Basis Enhancing Advantages of the LAIDGT and/or LAGRAT Techniques (Continued)

- Another basis enhancing strategy is to make the note that the taxpayer receives in the LAGRAT technique (or the LAIDGT technique) convertible into that amount of FLLC or limited partnership units that is equal, at the time of the conversion, to the then principal value of the note.
  - The conversion could happen anytime at the election of the holder of the note, or the payor of the note.
  - The note could also be designed with a mandatory conversion to equity equal to the principal value of the note at the death of the holder of the note.
  - An IRC Sec. 754 election could be made when the FLLC or limited partnership units are transferred or sold to pay for transfer taxes.
  - The act of conversion is not subject to income taxes. *See* Revenue Ruling 72-265
- There is greater authority that a sale to a single member FLLC will be treated as a nontaxable sale to a disregarded entity for income tax purposes than there is for a sale to a grantor trust.

Private Wealth Management

Comparison of the Advantages and Considerations of Some Favorite Lifetime Planning Trust Techniques in Which the Beneficiary is a Deemed Owner of the Trust Assets For Income Tax Purposes

The Advantages and Considerations of a Transferor Selling Subchapter S Stock to a Qualified Subchapter S Trust ("QSST") Created By a Third Party That is a Grantor Trust as to the Subchapter S Stock, That Names the Transferor as a Beneficiary and Gives the Transferor a Special Limited Power of Appointment (Pages 73-79 of the Paper)



* These transactions need to be separate, distinct and independent.

** It is assumed there is a 30% discount and the Subchapter S assets are worth $13,000,000.

Advantages of the Technique
(Pages 75-76 of the Paper)

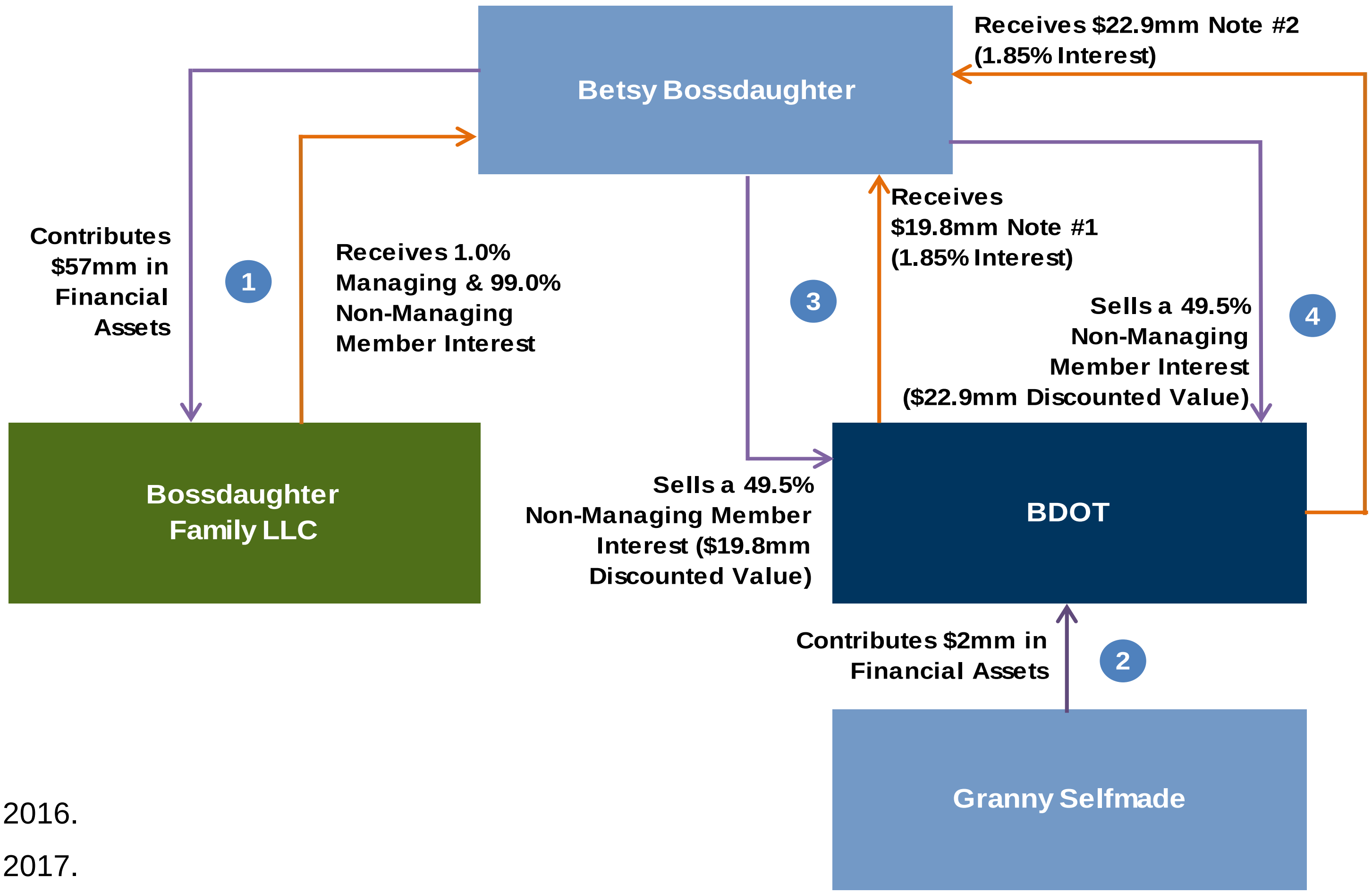
- May provide better defenses to the bona fide sale considerations of IRC Secs. 2036 and 2038 than the beneficiary grantor trust that is funded with $5,000.
- Circumvents federal capital gains tax treatment on the sale of the Subchapter S stock.
- There is not any concern about the effect of any lapse of withdrawal rights.
- It has the advantage of allowing the seller to be a beneficiary of the trust and have a power of appointment over the trust.
- It has the potential of mitigating gift tax surprises.
- Appreciation will be out of the seller's estate.

Considerations of the Technique
(Pages 76-79 of the Paper)

- There may need to be substantive equity in the trust from prior gifts (is 10% equity enough?) before the sale is made.
- The disadvantage of utilizing a Subchapter S corporation.
- Need to file a federal gift tax return.
- Federal income tax considerations.
- State income tax considerations.
- Could lose the benefits of using the gift tax exemption.
- Step Transaction Doctrine.
- Creditor rights and related estate tax issues.
- Incomplete gift issues.
- The transferor is the only beneficiary of the trust.

- A third party could create an inter vivos or testamentary estate tax protected trust, of any value, in which the beneficiary is the deemed income tax owner. This technique allows significant initial funding, which is different than the beneficiary defective inheritor's trust ("BDIT"), which generally is only funded with $5,000 of assets when it is created. Under IRC Sec. 678(a)(1), if a beneficiary of a third party created trust has the unilateral power to "vest income" of a trust then the trust is disregarded for income tax purposes and the net taxable income of the trust is taxable to the beneficiary. In order to vest income of the trust, the beneficiary of the trust should have the unilateral power to withdraw all of the net taxable income of the trust to himself, with all of the assets of the trust being available to satisfy that withdrawal power, including the trust's accounting income, the trust's corpus and the trust's proceeds from sales of the trust corpus.

- A BDOT is particularly effective if the beneficiary of the BDOT sells into the BDOT as the following example illustrates.



1. Occurs in 2016.
2. Occurs in 2017.
3. Occurs in 2017.
4. Occurs in 2021, assuming the net worth of the BDOT grows to $4,800,000 before sale.

Potential Future Values in 30 Years

			Consumption		IRS Income Tax				
	Bossdaughter Children (1)	Bossdaughter Children & Grandchildren (2)	Direct Cost (3)	Investment Opportunity Cost (4)	Direct Cost (5)	Investment Opportunity Cost (6)	Embedded Capital Gains Tax (7)	IRS Estate Tax (@ 40%) (8)	Total (9)
30-Year Future Values									
No Further Planning	$89,948,174	$22,759,465	$43,902,703	$60,266,542	$27,710,079	$34,146,049	$167,518	$59,965,449	$338,865,979
Hypothetical Technique	$0	$169,144,803	$43,902,703	$60,266,542	$28,775,165	$34,146,049	$2,630,716	$0	$338,865,979
Present Values (discounted at 2.5%)									
No Further Planning	$42,882,134	$10,850,408	$20,930,293	$28,731,633	$13,210,577	$16,278,879	$79,863	$28,588,089	$161,551,877
Hypothetical Technique	$0	$80,638,548	$20,930,293	$28,731,633	$13,718,349	$16,278,879	$1,254,175	$0	$161,551,877

Income Tax Advantages of the Technique
(Pages 83-84 of the Paper)

- The technique has all of the income tax advantages of the SIDGT technique.
- Failing to take the withdrawing income is not relevant to the IRC Sec. 678 analysis.
- The BDOT can be designed to be very flexible for any calendar year by giving a trustee, or a protector, the power to change the withdrawal power for a future year or years.
- The BDOT has many income tax advantages that a complex trust does not have.
  - The taxable income is taxed at the beneficiary's marginal income tax rate, which is frequently lower than the trust's marginal income tax rate.
  - The beneficiary of a BDOT can take an IRC Sec. 179 expense deduction while a complex trust's ability to take that deduction is limited.
  - Depending upon the BDOT beneficiary's tax bracket, and/or how active the beneficiary is in a closely held business, the 3.8% net investment income tax will not apply while under the same circumstances it may apply to a complex trust.
  - The BDOT can be a shareholder of a S corporation without some of the considerations of an ESBT.
- Capital losses can be passed through to the beneficiary of the BDOT.
- The capital gains benefit of a residence that is inherent under IRC Sec. 121 will be available to sales of residences owned by a BDOT.
- There are increased opportunities for charitable planning because the inherent limitations under IRC Sec. 642(c) will be eliminated.
- A BDOT should avoid overlapping state fiduciary income taxation.
- The consideration of the beneficiary deemed inheritor's trust ("BDIT") losing part of its beneficiary deemed owner status, when it is substantially funded, if it is designed to have an initial pecuniary withdrawal right, does not exist with the BDOT technique.

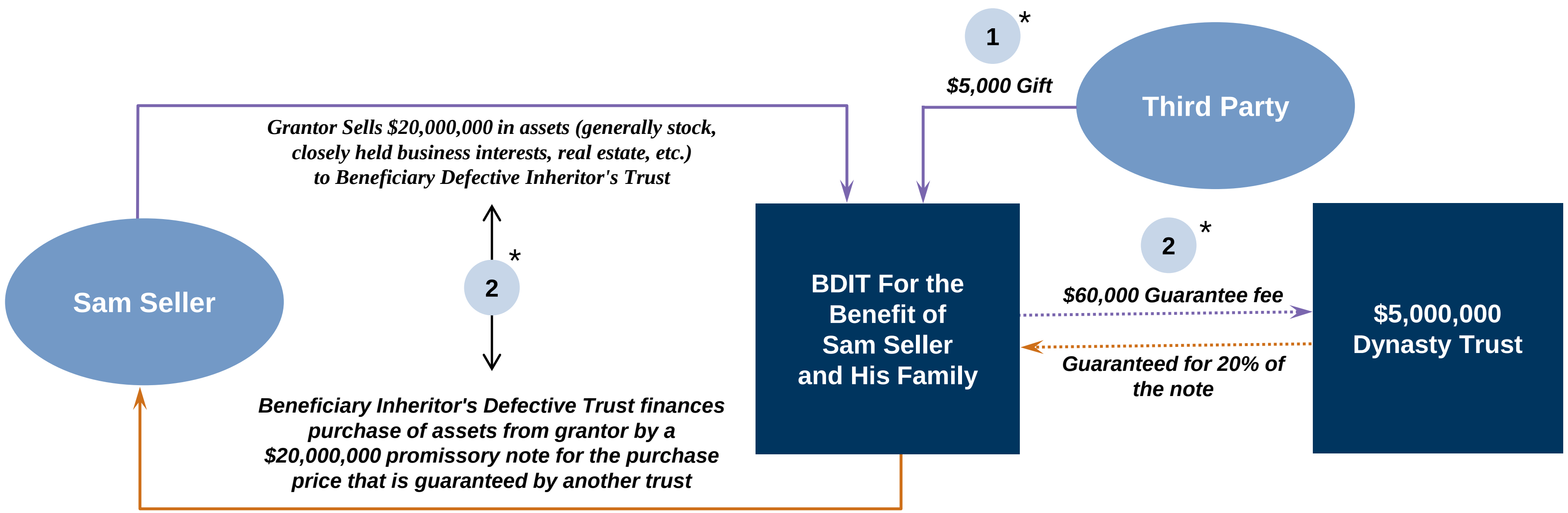
Transfer Tax Advantages of the Technique
(Pages 84-85 of the Paper)

- The beneficiary has the opportunity by her actions to increase the value of the BDOT and, thus, the amount that is not subject to estate taxes.
- Because the beneficiary is the deemed income tax owner of the BDOT, there is flexibility to allow the beneficiary to sell life insurance policies to the BDOT.
- The BDOT can own non-qualified deferred annuities.
- The BDOT has all of the transfer tax advantages of a SIDGT.
- The BDOT technique has a greater safety valve than the SIDGT for protecting the seller, since the seller both has withdrawal rights in and is a discretionary beneficiary of the BDOT.

Considerations of the Technique
(Pages 85-87 of the Paper)

- In order to receive the lapse of power transfer tax protection of IRC Secs. 2041(b)(2) and 2514(e)(2), it is important that the withdrawal power can be applied against the entire income and/or corpus and/or proceeds of the entire corpus, of the BDOT.
- If creditors can reach part of the withdrawable, but untaken, BDOT funds under the appropriate state law then that part that the creditors can reach will be taxable in the BDOT beneficiary's estate, whether or not that BDOT beneficiary has those potential creditors. However, almost all states protect the annual lapse of a withdrawal power from creditors, if the annual lapse does not exceed 5% of the then value of the corpus of the BDOT.
- In light of the above considerations, the beneficiary of a BDOT may wish to notify the trustee of the BDOT, in any calendar year, that he or she desires to withdraw that amount of net taxable income that is the greater of (i) that amount of net taxable income that the beneficiary has previously notified the trustee that he or she wishes to withdraw; (ii) that amount of net taxable income that is equal to the income taxes owed by the beneficiary of the BDOT; or (iii) that amount of net taxable income that exceed 5% of the value of the corpus of the trust.
- The sale of assets to a BDOT has most of the considerations of a SIDGT with the following exceptions.
  – There is less danger that the sale to a BDOT will be a taxable gift because of the presence of the seller's beneficial interest and special power of appointment over the BDOT, would make the gift an incomplete gift.
  – The grantor trust status can remain longer because of the seller's beneficial interest in the trust.
  – There is greater opportunity to convert the retained note to a private annuity.
- The sale of assets to a BDOT has some of the considerations of a sale to a BDIT, except the BDOT has the potential to have much more corpus and, thus, substance with the use of a leveraged sale.

- A BDIT is a trust that is a grantor trust, not as to the trust's settlor (the "Settlor") but as to a trust beneficiary (the "beneficiary"). That is, the trust is specifically designed not to trigger any of IRC Secs. 673, 674, 675, 676, 677 or 679, but intentionally to trigger IRC Sec. 678.
  - The $5,000 BDIT Guaranteed technique is illustrated below:



*These transactions need to be separate, distinct and independent.

- This technique has all the potential income tax advantages of the BDOT technique.
- Potential transfer tax advantages of the $5,000 BDIT guaranteed sale technique.
  - If the technique works, it has many of the same advantages as the sale to a grantor trust with the additional exit strategies of the transferor not only having access to the cash flow from the note, but also having access to the cash flow of the trust for his or her support and maintenance.
  - Additionally, if the technique works, the transferor has the ability to change his or her mind as to future stewardship goals through the power of appointment mechanism.
- Transfer considerations of the $5,000 BDIT guaranteed sale technique.
  - Does the guarantee fee have substance?
    - In Revenue Procedure 2013-3 Section 4.01 (43), the IRS announced it would not rule on this transaction if "the value of he assets with with the trust was funded by the grantor is nominal compared to the value of the property purchases."
- Unlike a conventional sale to a grantor trust in which the seller does not have a retained interest or power over the trust, under the $5,000 BDIT Guaranteed Sale Technique, the seller is also a beneficiary of the BDIT and will have a retained interest or power, which will trigger IRC Secs. 2036 or 2038, unless an exception applies.
- Under the "parenthetical exception" contained in both IRC Sec. 2036 and IRC Sec. 2038, these provisions do not apply "in case of a bona fide sale for an adequate and full consideration in money or money's worth."

- If the exception does not apply, the sold property is included in the beneficiary's gross estate at its date-of-death value, reduced by the consideration paid under IRC Sec. 2043.

- The application of the parenthetical exception under IRC Secs. 2036 and 2038 requires not only that the transfer be for "full consideration," but that it is "a bona fide sale". In the family partnership context, courts have held that the "full consideration" and "bona fide sale" requirements are two separate tests.

- The courts have also held that for a transfer to be a bona fide sale the transfer of assets to the partnership must have a significant nontax investment purpose. Whether this requirement would apply to a sale under the $5,000 BDIT Guaranteed Sale Technique, and what it would mean in that context, are uncertain.

- Estate tax considerations if under applicable state law or federal bankruptcy law the seller/beneficiary's creditors can reach the BDIT assets under the $5,000 BDIT guaranteed sale technique.

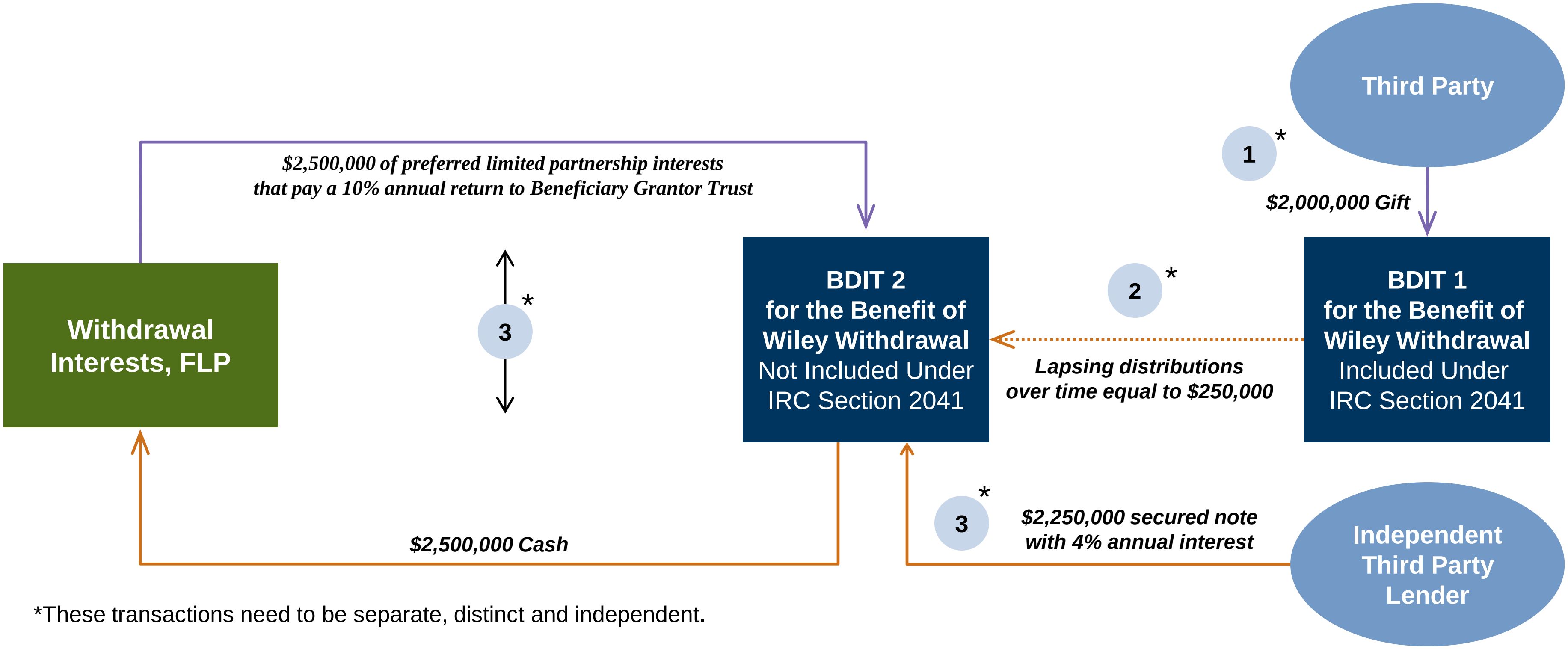
- If it is possible for a current or future creditor of an assigning seller/beneficiary to reach that part of the trust assets that are sold, then that part of the trust may not constitute a complete gift for gift tax purposes.

Income Tax Considerations With the $5,000 BDIT Guaranteed Sale Technique

- It is necessary for the settlor of the BDIT to steer clear of grantor trust status.
- Release vs. lapse
  - One issue with respect to any BDIT in which there is a lapse of a withdrawal right, is whether IRC Sec. 678(a)(2) applies when the power is cut down by a lapse rather than a release. If a lapse occurs pursuant to the terms of the trust, can the powerholder be said to have "partially released or otherwise modified" the power?
  - Is a lapse a release or other modification as required by IRC Sec. 678(a)(2)? The private rulings imply that the answer is yes.
- Assuming a lapse can qualify as a release or other modification, the next issue with respect to any BDIT in which there is a lapse of a withdrawal right is whether a power that has lapsed completely (either all at once or in stages over time) remains one described in IRC Sec. 678(a)(2), given the statute's requirement that the IRC Sec. 678(a)(1) power have been "<u>partially</u> released or otherwise modified" (underscoring added).
- One way to read IRC Sec. 678(a)(2) is that if the beneficiary once had a IRC Sec. 678(a)(1) power, IRC Sec. 678(a)(2) applies as long as the beneficiary has any continuing interest or power that would make a self-settled trust a grantor trust, even if the beneficiary no longer has any power to withdraw. This reading is not certain, however, and some practitioners would argue that the power to withdraw must continue to some extent for the lapse to be "partial".

A Substantially Funded BDIT Created By a Hanging Power Lapses in Another Substantially Funded BDIT (Pages 97-101 of the Paper)

- Consider the example illustrated below:



*These transactions need to be separate, distinct and independent.

Advantages of the Substantial Lapsing Hanging Power Created By the BDIT Technique

- Transfer tax advantage.
  - A high yielding preferred partnership interest may make excellent collateral to an independent third party lender.
  - Over time, as the note is paid down, and also over time as more assets are available to the trustee because of future lapsing distributions to BDIT 2, greater equity will exist in the trust.
  - This equity could support subordinated note sales of other assets (e.g., preferred partnership interests) by Wiley Withdrawal. All of this could be done without the necessity of guarantee fees or sales of remainder interests in GRATs.
  - Furthermore the leverage is coming from an independent third party lender instead of the transferor/beneficiary of the BDIT.
- Income tax advantage.
  - It has the same income tax advantages as the SIDGT technique.

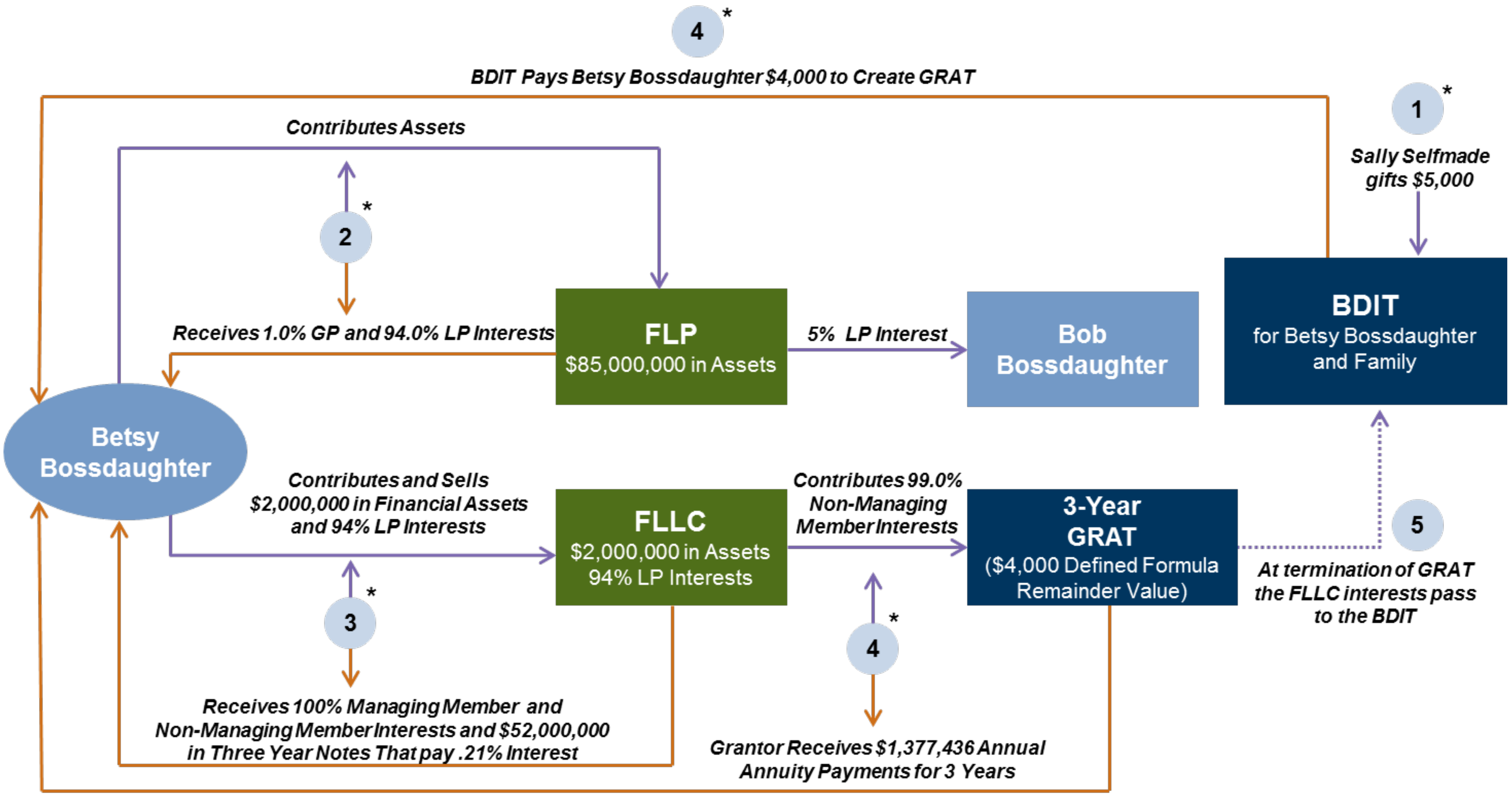
Considerations of the Substantial Lapsing Hanging Power Created By the BDIT Technique

- Use of a BDIT raises many of the income tax issues discussed with the BDIT.
- IRC Sec. 2041 issues.
  - If the beneficiary should die in the early years of the trust, a substantial portion of the original trust, which is subject to IRC Sec. 2041, will be included in his estate because of the unlimited power to withdraw assets to the extent the unlimited power to withdraw assets is still in existence.
- Use of a third party lender.
  - This technique may also require the existence of an asset that is attractive as security to a third party lender, because a third party will demand collateral that has substantial inherent cash flow and safety. A high yielding preferred partnership interest, in which the other assets of the partnership are subordinated to the preferred partnership interest, may be such an asset.
- Pecuniary withdrawal right issues.
  - This use of the BDIT, in which there is a lapse of a withdrawal right, calls for the settlor to contribute to the trust property with a value greater than $5,000, so that the beneficiary's power of withdrawal cannot lapse in full at the end of the first year and must lapse over time as a "hanging power".
  - Assuming the trust appreciates in value, the power may lapse faster if it is defined as a pecuniary amount, because the appreciation will increase the potential annual lapse without increasing the amount withdrawable under the power.
  - However, this raises another IRC Sec. 678 consideration: whether the trust could lose its status as a wholly grantor trust in a year in which, because of appreciation in the value of the trust, the pecuniary amount withdrawable under IRC Sec. 678(a)(1), plus the portion of the trust subject to IRC Sec. 678(a)(2) by reason of prior lapses, totals less than the current value of the trust.

Considerations of the Substantial Lapsing Hanging Power Created By the BDIT Technique (Continued)

- Under Treas. Reg. §1.671-3(a)(3), the IRS could also argue that the portion of the trust represented by such excess appreciation is not currently subject to the grantor trust rules, so the BDIT is no longer wholly a grantor trust.
- Moreover, in the absence of subsequent depreciation, it seems that the portion not subject to IRC Sec. 678(a)(1) can never become subject to IRC Sec. 678(a)(2), so that the trust never again becomes wholly grantor, although some argue otherwise.
- The IRS has never taken this approach in its private letter rulings regarding trusts that qualify to be Subchapter S shareholders because they are grantor trusts.
- One solution to the problem discussed in the preceding paragraphs may be to initially define the beneficiary's withdrawal right as extending not to a pecuniary amount but to 100% of the trust property, lapsing each year as to 5% of the trust (or such greater percentage as equals $5,000 in value). This will require more time for the power to lapse completely.
- It should be noted that some practitioners believe that the "portion" rule of Treas. Reg. §1.671-3(a)(3) does not apply when the beneficiary's pecuniary power of withdrawal is large enough to make all property added to the trust withdrawable, even if subsequent appreciation or income accumulation increases the trust's value above the pecuniary amount. In such a case, all value in the trust is attributable to property over which the beneficiary once had a power of withdrawal.
- The beneficiary could have captured all the increasing value for himself by promptly exercising the power, but instead allowed it to "lapse" as to such value. Therefore it can be argued that any value that is no longer withdrawable is covered, at least in a policy sense, by IRC Sec. 678(a)(2).

- Consider the example illustrated below:



*These transactions need to be separate, distinct and independent.

Advantages of the BDIT Remainder Purchase Technique

- The assets of the BDIT, if the transferor is not a deemed donor under equitable principles, will not be subject to estate taxes in the transferor's estate.
- It has the same income tax advantages as the LAGRAT technique.
- Has the advantage of allowing Betsy access to cash flow from note payments, and as a beneficiary of the BDIT.
- The transferor has flexibility to change the future beneficiaries of the trust through the exercise of a special power of appointment.
- Has the potential of avoiding gift tax surprises.
- Appreciation will be out of the transferor's estate.

Considerations of the BDIT Remainder Purchase Technique

- In order for the full and adequate consideration exception under IRC Sec. 2036 to apply, the courts may find the remainder interest of the GRAT that is sold may need to have a substantive value much greater than $4,000.
- Need to file a federal gift tax return.
- State income tax considerations.
- Step transaction doctrine could apply.
  - If the IRS can demonstrate, because of the thin capitalization, the $4,000 payment should be ignored, then under other equitable principles it may be able to establish the creation of the BDIT lacks independence, and the deemed grantor of the trust will be the beneficiary.
- Creditor rights and related estate tax issues.
- Incomplete gift issues.

Creation of and Additions to a BDIT Could Accrue By Providing That the Withdrawable, But Untaken, Funds of the BDOT, That Do Not Exceed 5% Corpus Limitation, Are to Be Held Under Trust Provisions Similar to BDIT Provisions After Each Lapse of the Withdrawal Power of the BDOT (the "BDOT Created BDIT") (Pages 106-107 of the Paper)

- Consider the example illustrated below:

Trust 1 Provisions

Original Trust Corpus Contributed By a Third Party Plus Growth of That Corpus That Has Not Been Withdrawn or Lapsed (the IRC Sec. 678(a)(1) Part of the Trust)

Beneficiary Has the Right to Annually Withdraw the Net Taxable Income of the Trust

Trust 2 "BDIT" Provisions

Lapsed Corpus of Trust 1 That Was Not Withdrawn Plus Growth of That Corpus (the IRC Sec. 678(a)(2) Part of the Trust)

Beneficiary Has a Special Power Of Appointment and Has the Right to Annually Withdraw Assets Under an Ascertainable Standard Relating to the Health, Education, Support, or Maintenance of the Beneficiary

74.25% Non-Managing Interest of Holdco

$31,704,750 Note

24.75% Non-Managing Interest of Holdco

$10,568,250 Note

Advantages of the BDOT Created BDIT Technique

- A BDIT created in this fashion has all of the advantages that may exist with a BDIT, including the advantage that the "Trust 2" part of the trust will be treated under IRC Sec. 678(a)(2) as a grantor trust to the beneficiary.
- This technique does not require the use of guarantees to support the integrity of the note that may lack substance under equitable tax principles.
- Since there is a much better chance the retained note of the seller to the trust, who is also a beneficiary of the trust, will be treated as a bonafide note there is less IRC Secs. 2036 and 2038 risk with the technique than a BDIT that is only created with $5,000.
- There may be greater creditor protection under the above Trust 2 provisions than the Trust 1 provisions.

Considerations of the BDOT Created BDIT Technique

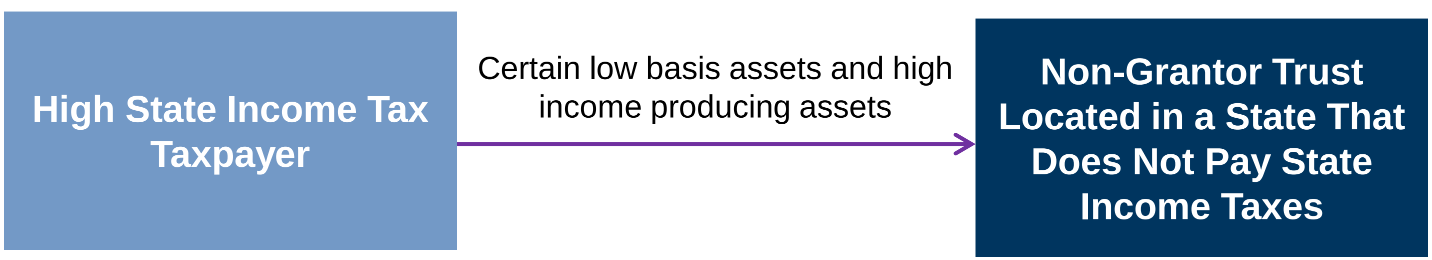
- Depending on how the lapse of the withdrawal power is implemented there could be the consideration that part of the trust may not be considered a grantor trust.
- A beneficiary has the automatic right to access the income and principal of Trust 1, which, under the terms of the agreement, is not the case for Trust 2.

Private Wealth Management

Comparison of the Advantages and Considerations of Some Favorite Lifetime Planning Trust Techniques in Which the Beneficiary is a Deemed Owner of the Trust Assets For Income Tax Purposes

Using a Non-Grantor Trust to Save State Income Taxes (Pages 108-109 of the Paper)

- Obviously, some states have much higher income tax rates than other states. Eight states do not have any state income taxes. Several more states do not subject income accumulated in non-grantor trusts that are created in those states to their state income taxes.
- The problem of high state income taxes could be particularly acute, if the taxpayer anticipates that sometime in the future he may sell some valuable low basis assets.
- A taxpayer who lives in a high income tax state may have low basis assets that he anticipates may be sold in the near future. That taxpayer may also have income producing securities from which he does not need that income for his consumption needs.
- That taxpayer could transfer those assets to a non-grantor trust whose situs is in a state that does not have any state income taxes on the income earned and accumulated by those trust assets
  - Consider the example illustrated below:



Advantages of Using a Non-Grantor Trust to Save State Income Taxes

- Substantial state income taxes could be saved.
- The taxpayer using his or her increased gift tax exemptions could create a non-grantor trust in a state that does not tax that trust income, which could save income taxes and transfer taxes.
- A non-grantor trust used for these purposes could be created without paying gift taxes: by the use of the taxpayer's exemption; by creating a trust that is incomplete for gift tax purposes; or by creating a martial deduction trust that qualifies as a QTIP trust and is designed to be a non-grantor trust with respect to the principal earnings of the QTIP trust.
- There could be multiple non-grantor trusts.

Using the Combination of Multiple Non-Grantor Trusts and Preferred Interests in Pass Through Businesses, to Save Federal Income Taxes By Using the Deduction Under IRC Sec. 199A, Which Otherwise Would Not Be Available (Pages 109-110 of the Paper)

- If a non-grantor trust has an interest in a pass through business and has an amount of taxable income below the 32% bracket (which is currently $157,500) that non-grantor trust will receive a 20% deduction on the amount of the qualified business income ("QBI") allocated to the trust.

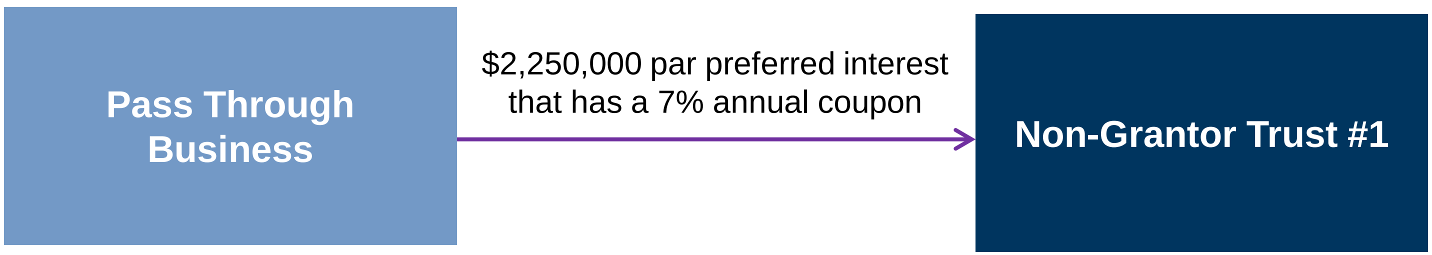
- This is true, even if the income comes from a service business that would not otherwise qualify as qualified business income, the income is subject to the W-2 wages limit under IRC Sec. 199A(b)(2)(B)(i), or the income is subject to the W-2 wages and property limit under IRC Sec. 199A(b)(2)(B)(ii).

- In order to manage the amount of QBI allocated to the non-grantor trust, the non-grantor trust's interest in the business could be a preferred interest with the coupon being equal to $157,500 in the first year with an increase each year in the par value of the preferred interest equal to the inflation adjustment that determines the 32% bracket.

- The par value of the preferred interest could be designed to increase at the same percentage rate as the 32% bracket increases. The coupon cannot be a guaranteed payment because that would be treated like salary income under IRC Sec. 199A.

Using the Combination of Multiple Non-Grantor Trusts and Preferred Interests in Pass Through Businesses, to Save Federal Income Taxes By Using the Deduction Under IRC Sec. 199A, Which Otherwise Would Not Be Available (Continued)

- A tool to keep the taxable income at that $157,500 threshold amount is for the trustee to invest in assets, other than its business interest, that do not produce any, or very little, taxable income (e.g., municipal bonds or non-dividend paying stocks).
  - Consider the example illustrated below:

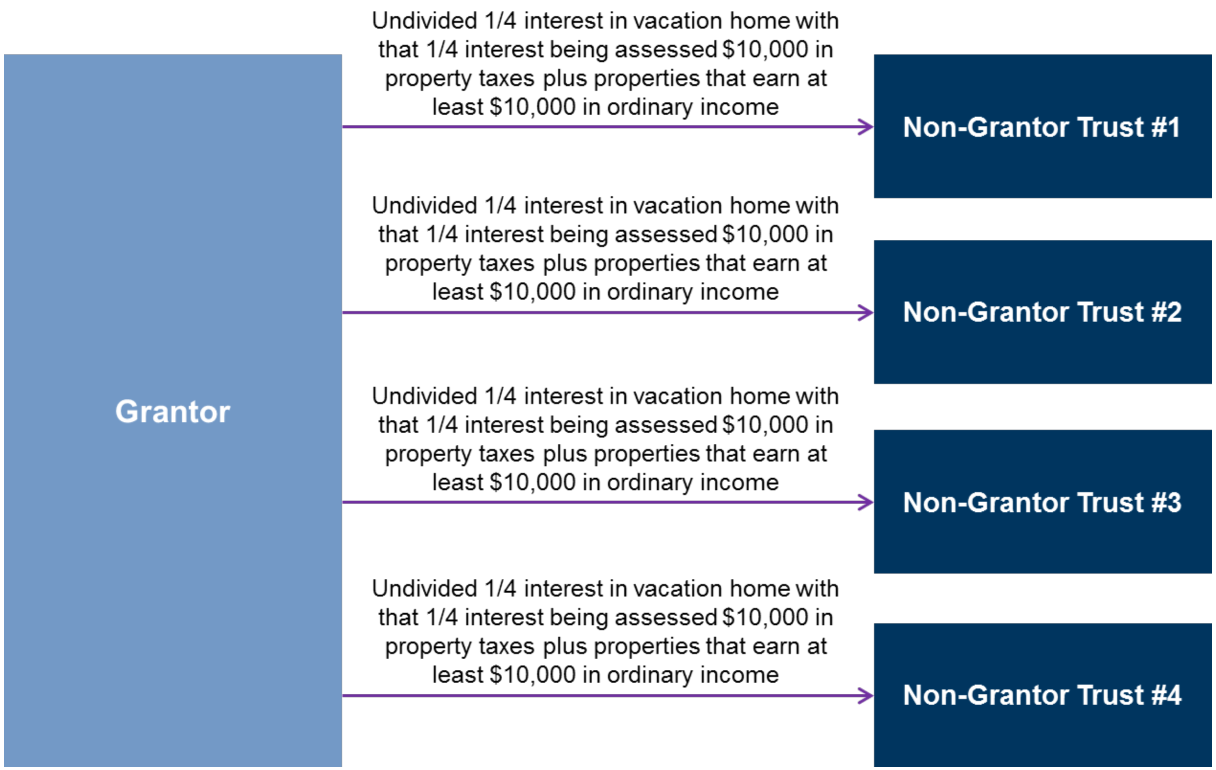


Advantages of the Technique

- The technique lowers the family's income taxes associated with the family business.
- There could be multiple non-grantor trusts.
- For many families there should not be any gift taxes associated with the gifts to the non-grantor trusts, either because of the increased exemption, or because the non-grantor trusts are designed to be an incomplete gift (a so-called "ING trust").
- Because of Revenue Ruling 83-120, if a preferred interest is used, the yield can be relatively high in comparison to the then prevailing interest rates, without causing gift tax consequences.

Using Multiple Non-Grantor Trusts to Multiply the $10,000 Capped Deduction for Property Taxes (Pages 110-111 of the Paper)

- An owner of real estate may split his or her ownership of the real estate into multiple undivided interests and contribute each of those undivided interests, along with ordinary income producing property, to different non-grantor trusts assuming each of those non-grantor trusts has at least $10,000 of ordinary income the $10,000 capped deduction for property taxes can be used for each new non-grantor trust.
  - Consider the example illustrated below



Advantages of the Technique

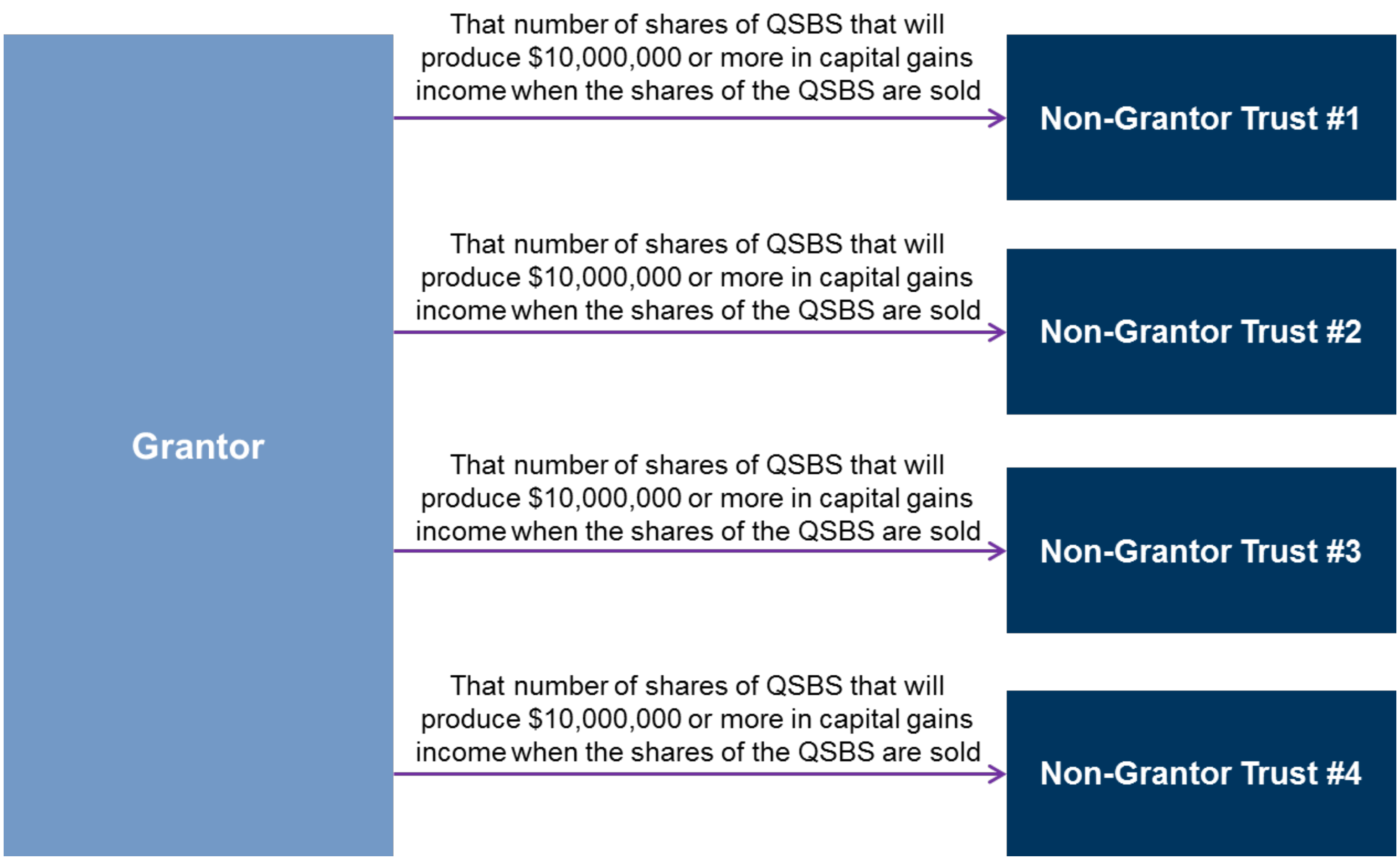
- This technique has the same advantages as using non-grantor trusts to save state income taxes
- For many taxpayers, the complexity of creating an ING trust may not be necessary. The object of this technique is to save federal income taxes, not state income taxes. Assuming the taxable income of the trusts is basically at a break even amount, the state income tax issues should be insignificant.

Using Multiple Non-Grantor Trusts to Multiply the $10,000,000 Deduction From Capital Gains Taxes for Sales of Qualified Small Business Stock ("QSBS") (Pages 111-112 of the Paper)

- An owner of shares of QSBS, as defined in IRC Sec. 1202(c), could give shares of his QSBS stock to multiple non-grantor trusts in order to receive multiple $10,000,000 deductions under IRC Sec. 1202(b)(1)(A) from the capital gains tax for the collective sale of that stock.
- If a C corporation meets the requirements of being QSBS and is held for more than five years, all of the inherent capital gains will be excluded subject to the greater of two statutory limits.
- One of those limits is 10 times the adjusted basis of the QSBS issued by such corporation and disposed of by the taxpayer during the taxable year.
- For many owners of shares in a QSBS this limitation may be significant because of the modest basis a start up business may have.
- However, the other limit, in many circumstances, is much more generous.
- This limitation is equal to $10,000,000, regardless of the taxpayer's basis in the QSBS stock, reduced by the aggregate amount of eligible gain taken into account by the taxpayer for prior taxable years and attributable to dispositions of stock issued by the corporation.

Using Multiple Non-Grantor Trusts to Multiply the $10,000,000 Deduction From Capital Gains Taxes for Sales of QSBS (Continued)

– Consider the example illustrated below



Advantages of the Technique

- This technique has the same advantages as using non-grantor trusts to save state income taxes

Considerations With Creating Multiple Non-Grantor Trusts (Pages 113-118 of the Paper)

- Either by the IRS applying future IRC Sec. 643(f) regulations (which could be issued by Treasury in the near future), or by the IRS using equitable tax principles such as "substance over form," two or more non-grantor trusts could be treated as one non-grantor trust. On August 8, 2018 proposed regulations were issued. Under the proposed regulations spouses are treated as one person. Under the proposed regulations there need to be significant non-tax differences between the substantive terms of the two trusts.
- It is difficult to design a non-grantor, incomplete gift trust (sometimes referred to herein as "ING trust").
  - While the ING trust must be designed carefully to provide that the grantor does not retain powers over the trust for income tax purposes that would make it a grantor trust under IRC Secs. 671-677, the ING trust must also be carefully designed to provide that the grantor of that trust has enough retained powers over the ING trust to make the creation of the trust incomplete for gift tax purposes.
  - The power to control beneficial enjoyment under IRC Sec. 674, the power to revoke the trust and reinvest trust property under IRC Sec. 676, and the power to distribute income for the benefit of the grantor or the grantor's spouse under IRC Sec. 677, all will not exist, if the grantor's power is only exercisable with an adverse party's approval.
    - However, under a IRC Sec. 677 regulation a trust is a grantor trust under IRC Sec. 677, even if an adverse party exists, if its income is applied, or may be applied at the discretion of the trustee, or must be applied by the trustee to discharge the debts of the settlor, or the settlor's spouse.
      - Because of developing creditor protection law, creditor protection may be in some doubt for residents of common law states creating trusts subject to the laws of DAPT states.
      - It should also be noted, that because of the interaction of developing creditor protection law and federal bankruptcy law, creditor protection may also be in some doubt for even residents of DAPT states for 10 years after a trust's creation.
      - Generally, it does not matter to the IRS that such a creditor of the grantor exists. What matters to the IRS is that the grantor could create such a creditor who could attach the trust assets.

Considerations With Creating Multiple Non-Grantor Trusts (Continued)

– Having the presence of an adverse party does not prevent the application of IRC Sec. 673 to make a trust a grantor trust.

- However, until recently, the IRC Sec. 673 statutory language has not been interpreted to suggest that a discretionary exercise in favor of the grantor can be assumed to determine whether a reversion actually exists. While the term reversion is not defined, it has traditionally been defined by the IRS as the interest remaining with the owner of a vested estate upon transferring a lesser vested estate to another person. Under this definition, if a grantor has transferred his entire interest, and not a lesser interest, then IRC Sec. 673 should not apply.

- In PLR 201642019, the IRS revoked part of PLR 201426014 and held that under IRC Sec. 673(c), the subject trust was a grantor trust, because members could resign from a distribution committee, which under the terms of the trust would cause the trust to terminate and revert to the grantor. An IRC Sec. 673(c) “fix” for this IRS position might be to draft the trust to provide if such resignations occurred, the ING trust would continue without providing the trustee with any discretion to make distributions to the grantor.

– The ING trust also needs to be designed in a manner where certain retained powers by the grantor exist which will make the trust incomplete for gift tax purposes, but those retained powers must not make the trusts grantor trusts.

- The grantor needs to retain a testamentary power of appointment over the remainder beneficiary interests of the trust.

- The grantor needs to also have powers that make the grantor’s transfer to the trust incomplete for its current beneficiary interests.

- The grantor could have a retained power under which distributions could only be made from the trust with the consent of the grantor and the majority of a distribution committee.

- The grantor could retain the sole power to make trust distributions from trust principal for the health, education, maintenance and support of his descendants.

- Distribution committee members of an ING trust should avoid having a general power of appointment with the distribution powers that they have.

Considerations With Creating Multiple Non-Grantor Trusts (Continued)

- The statutory exception under IRC Sec. 2514(c)(3)(A) could apply to avoid gift tax consequences for distribution committee members when a distribution is made to a beneficiary other than that committee member.
- The statutory exception under IRC Sec. 2514(c)(3)(B) could apply to avoid gift tax consequences for a distribution committee member when a distribution is made to a beneficiary other than that committee member.
    - A general power of appointment is not deemed to exist if the holder can only exercise the power in conjunction with a person who is adverse to the exercise of the power.
- A state could interpret IRC Secs. 671-677 differently than the IRS does, or because of operation of state law, which is inconsistent with federal law, one or more of those sections apply to make the trust a grantor trust for state law purposes.
    - For instance, a state may interpret IRC Sec. 673(c), or IRC Sec. 677, differently than the IRS does.
    - State grantor trust statutes could operate differently in that state than the Internal Revenue Code does.
    - For instance, in 2014 New York state passed legislation providing that a non-grantor trust created in another jurisdiction will be treated as a grantor trust for New York state income tax purposes, if the trust meets both the following requirements: (i) the trust qualifies as a grantor trust under IRC Sec. 671 679 and (ii) the grantor’s transfer to the trust is treated as an incomplete gift.
    - One solution for New Yorkers fearful of a future state capital gains tax event for one or more of their low basis assets is for them to consider contributing those assets to a trust located in a state that will not tax capital gains that qualifies as a QTIP trust. That QTIP trust could be drafted to be taxed as a grantor trust for accounting income and a non-grantor trust for capital gains income.
- The QTIP technique may also be a solution for taxpayers who live in high state income tax states other than New York. It is easier to draft a trust, in which a grantor does not retain IRC Sec. 671-678 powers, if the grantor does not have to retain powers to make the trust an incomplete gift trust. It is true that the income of an inter vivos QTIP trust will be subject to the high state income tax state’s income taxes, but that can be reasonably managed with the trust’s asset class mix. For example, after the low basis assets are sold, the resulting sale proceeds could be invested in non-taxable bonds and/or low dividend paying stocks.

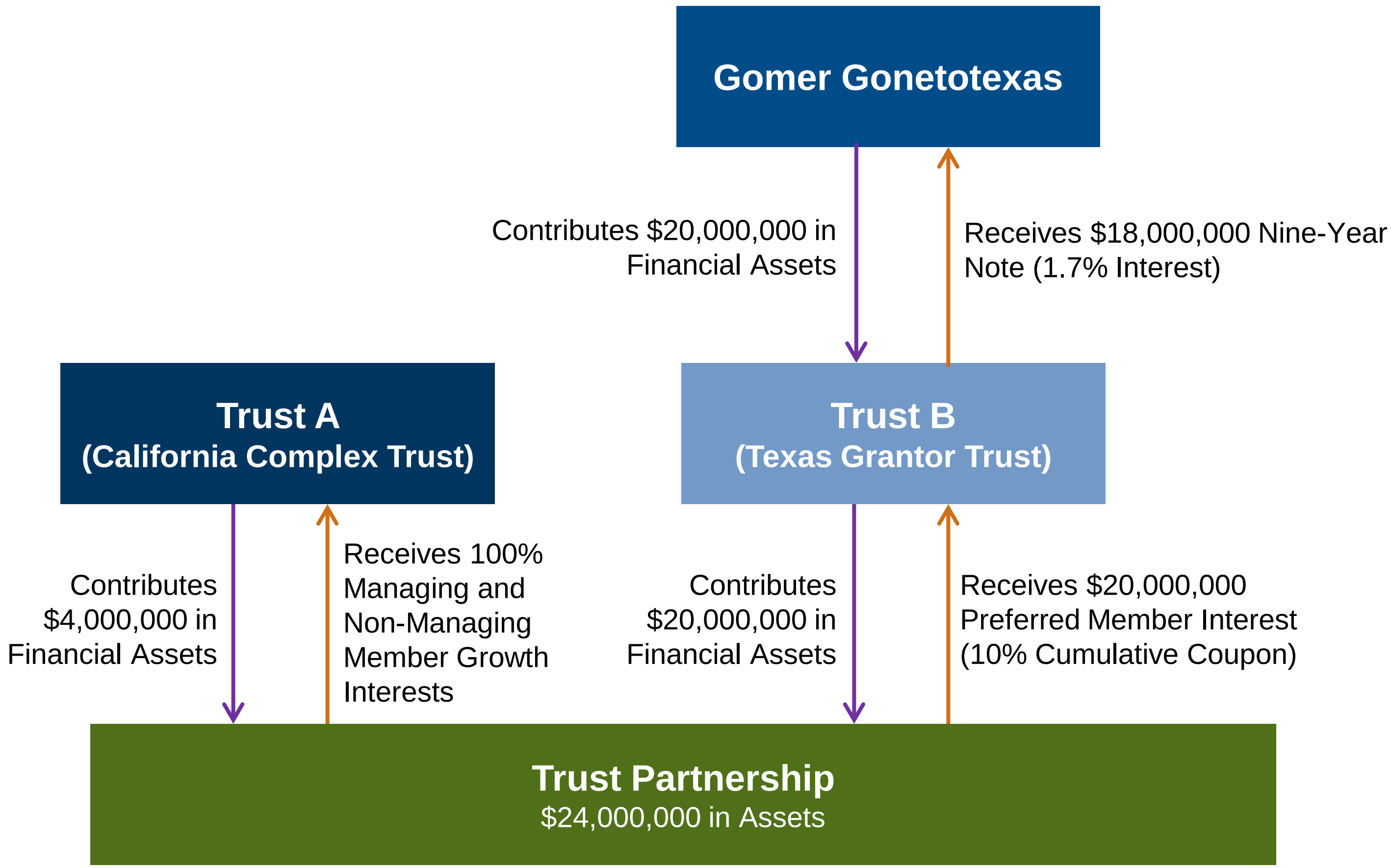
Considerations With Creating Multiple Non-Grantor Trusts (Continued)

- The overall cumulative federal revenue considerations of the techniques described above may lead Treasury to be more aggressive in protecting federal revenues.
  - To date, the IRS has been relatively benign in using the tools it has to prevent the creation of multiple non-grantor trusts, perhaps because that benign position generally did not affect federal revenues (in fact, in some cases those positions may have increased federal revenues). Because of the potential federal revenue loss identified above, the reader may conclude that benign IRS behavior may not continue.

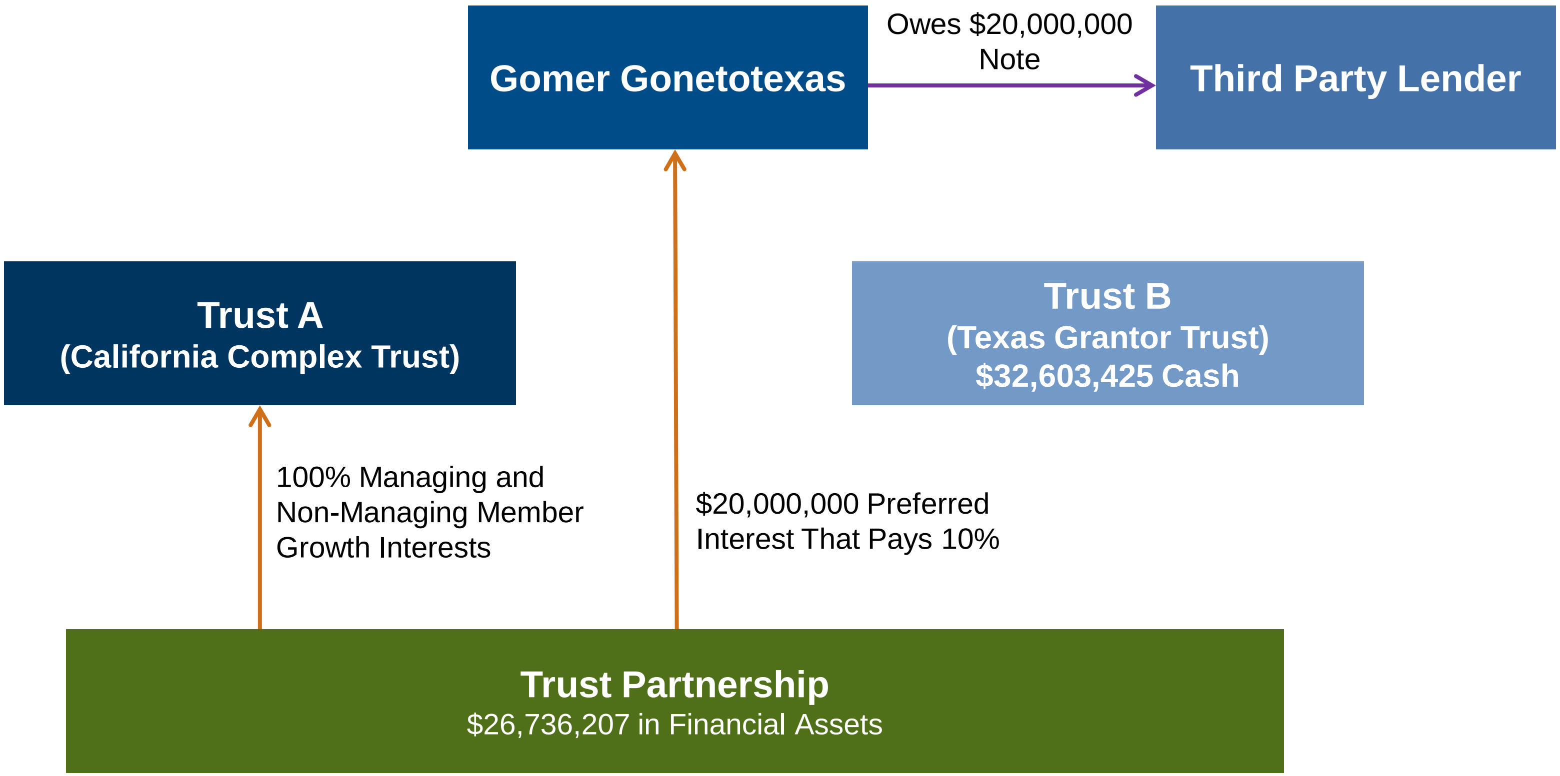
Private Wealth Management

Comparison of the Advantages and Considerations of Some Favorite Planning Techniques to Reduce the State and Federal Income Taxes of Non-Grantor Trusts Without Making Cash Distributions to the Trust Beneficiary

– Hypothetical Transaction #1:



– Hypothetical Transaction #2 (Seventeen Years After Hypothetical Transaction #1):



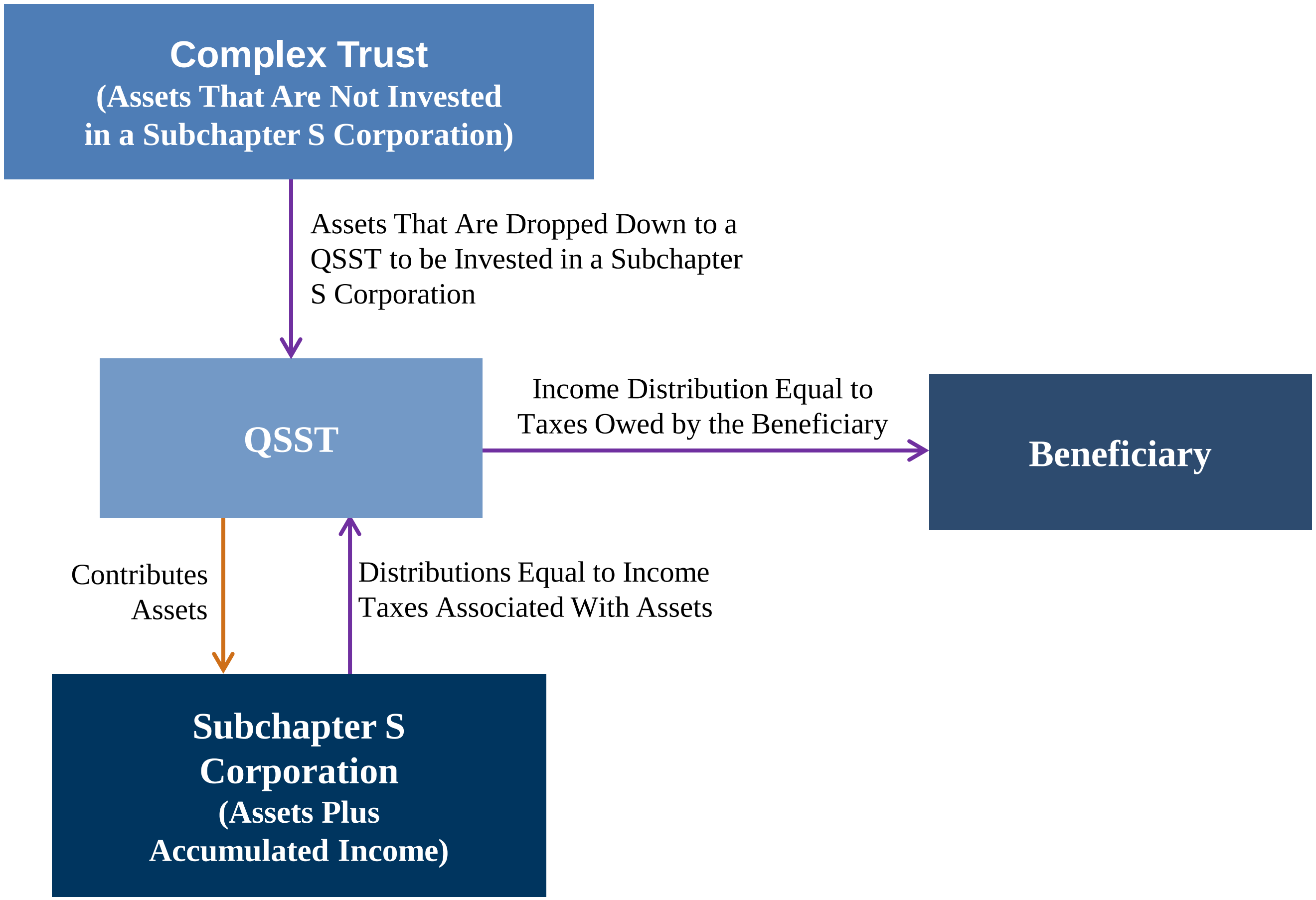
- In certain circumstances it may be more profitable for the old trust to sell the high basis assets to the new trust for a low interest (AFR rate) note to the new trust.

Income Tax Advantages (Page 128 of the Paper)

- Significant transfer taxes can be saved under this technique.
- Significant state income taxes and the investment opportunity costs associated with those state income taxes can be saved with this technique.

	Gonetotexas Beneficiaries			Consumption		IRS Income Taxes		CA Income Taxes		Opportunity Cost/ (Benefit) of 3rd Party Note	IRS Estate Tax (at 40.0%)	Total
	Children	Children & Grandchildren										
		California Complex Trust	Texas Grantor Trust	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost			
20-Year Future Values												
No Further Planning	$15,428,576	$9,609,259	$8,690,000	$12,772,329	$13,053,175	$14,270,950	$13,698,567	$1,264,013	$995,794	$0	$10,285,717	$100,068,380
Hypothetical Technique	$0	$4,000,000	$43,359,947	$12,772,329	$13,053,175	$15,967,067	$14,173,982	$0	$0	($3,258,119)	$0	$100,068,380
Present Values (discounted at 2.5%)												
No Further Planning	$9,415,611	$5,864,252	$5,303,254	$7,794,581	$7,965,974	$8,709,146	$8,359,837	$771,391	$607,704	$0	$6,277,074	$61,068,825
Hypothetical Technique	$0	$2,441,084	$26,461,316	$7,794,581	$7,965,974	$9,744,237	$8,649,969	$0	$0	($1,988,336)	$0	$61,068,825

- Consider the following example:



Income Tax and Basis Enhancing Advantages of the Technique
(Page 132 of the Paper)

- The beneficiary may be in a lower tax bracket than the trust and is taxed on the taxable income allocated to the QSST. The taxes associated with the beneficiary being the deemed owner of the QSST may equal the cash distributed by the QSST to the beneficiary, which will limit any cash build up in the beneficiary's estate.
- There is not any concern about the effect of any lapse of withdrawal rights.
- If the subchapter S corporation participates in a trade or business, and if the current beneficiary of the QSST materially participates in that trade or business, or is in a lower marginal bracket, significant health care taxes may be saved with the technique.
- The beneficiary of the QSST will have access to the accounting income distributed to the trust.
- The trust is much more flexible than a simple income only trust and may be administered to simulate a complex trust without the income tax and health care tax disadvantages of a complex trust.

Transfer Tax Advantage of the Technique (Page 133 of the Paper)

- The transfer tax advantage of this technique is that it preserves whatever inherent transfer tax advantage the trust has without distributing net cash assets from the trust to beneficiaries.

Considerations of the Technique (Pages 133-134 of the Paper)

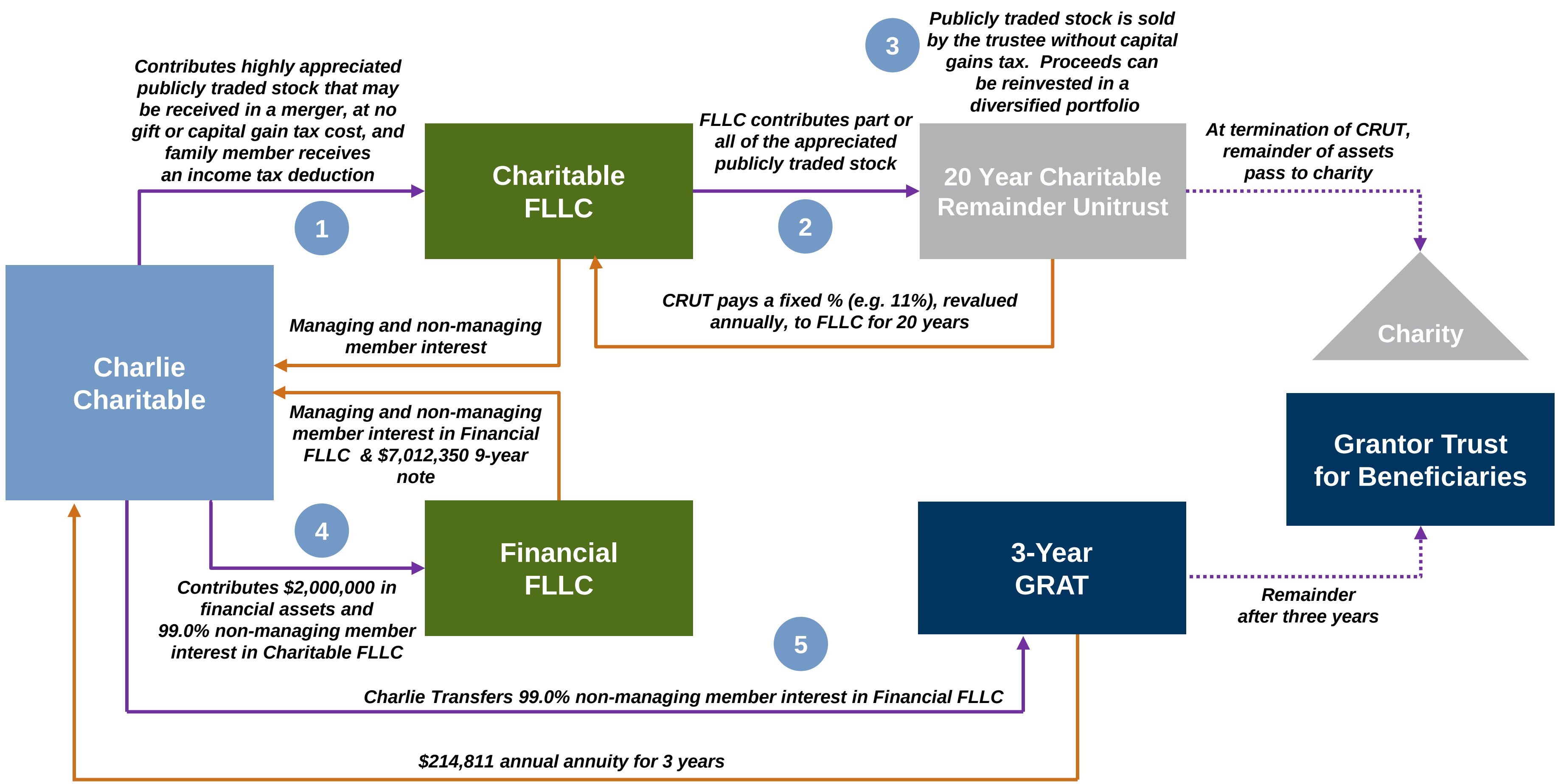
- The federal income tax considerations with utilizing a subchapter S corporation.
- Any income of the QSST that does not accrue from subchapter S stock earnings will be taxed under normal subchapter J rules.
- State income tax considerations.

Private Wealth Management

Comparison of the Advantages and Considerations of Some Favorite Lifetime Charitable Planning Techniques

Use of a LAGRAT When One of the Assets of the FLLC is a Non-charitable Interest in a Charitable Remainder Unitrust ("CRUT") (Pages 135-143 of the Paper)

- Consider the following example:



Income Tax and Basis Enhancing Advantages of the Technique
(Page 140 of the Paper)

- The income tax advantages of creating a LAGRAT.
- The income tax advantage of eliminating the capital gains tax on that part of the gains that will be allocated to the charity under the tiered income tax rules.
- The income tax advantage of lowering opportunity costs by delaying taxes on the portion of the original gain that is not allocated to charity.
- The income tax advantage of a charitable deduction in year one for the actuarial value of the remainder interest of the CRUT passing to charity.

Transfer Tax Advantage of the Technique (Pages 140-143 of the Paper)

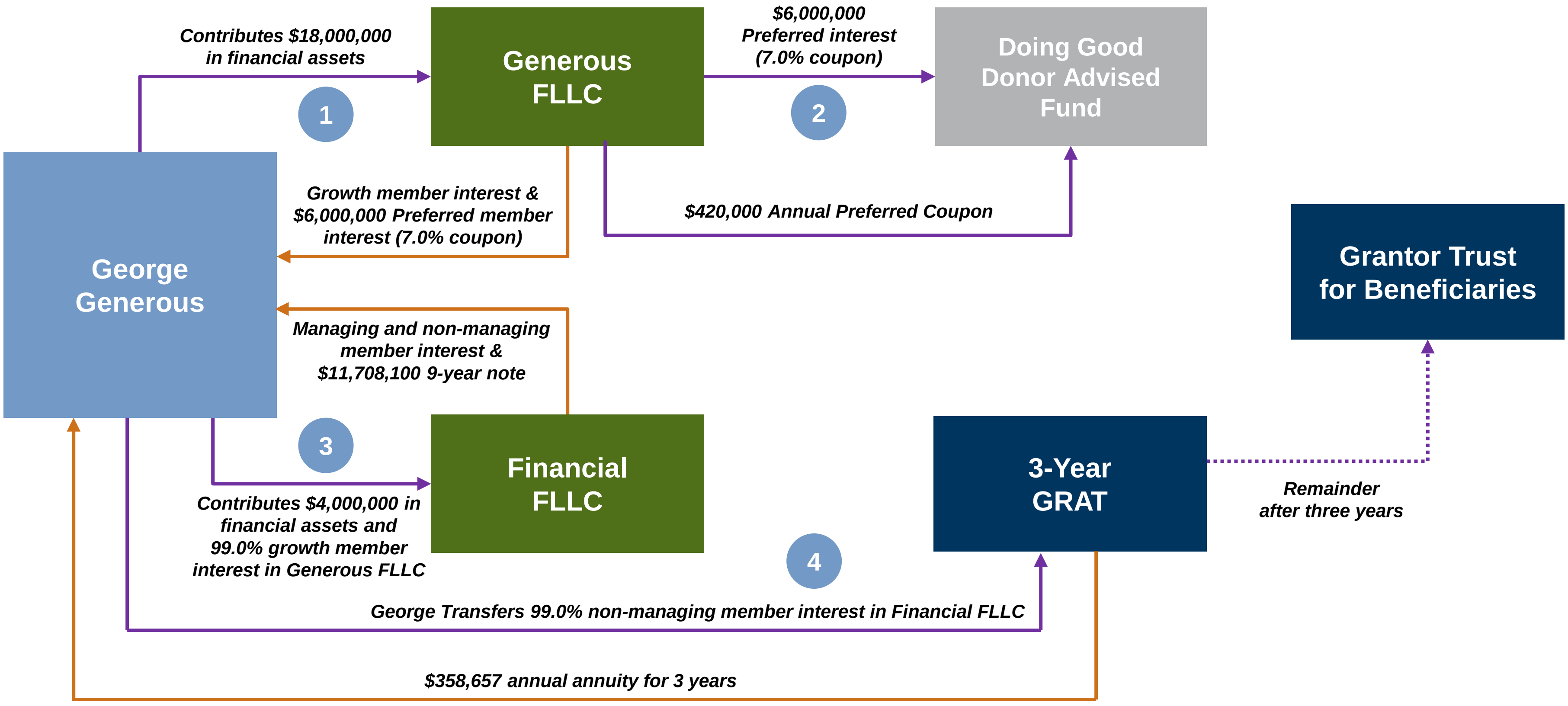
- The tax advantage of integration, which produces advantageous comparative results:

Hypothetical Technique (Assumes $9.83mm Estate Tax Exemption Available)	Charlie's Descendants	Charity	Charlie's Consumption Direct Costs	Consumption Investment Opportunity Costs	IRS Taxes on Investment Income	IRS Investment Opportunity Costs	IRS Estate Taxes (@40.0%)	Total
Future Values at the end of 25 Years Assuming an Annual Compounded Rate of Return at 7.4%								
Stock Sale, No Planning	$19,745,860	$0	$5,123,665	$7,440,046	$11,792,247	$23,763,728	$6,610,574	$74,476,121
Simulated Tax Holiday (No Initial Capital Gains Tax and No Estate Tax) 78% - 22% Split Between Family and Charity	$27,251,647	$7,539,379	$5,123,665	$7,440,046	$11,817,313	$15,304,071	$0	$74,476,121
FLLC/CRUT/Holdco/LevGRAT, Charlie gives remaining estate to charity	$24,972,689	$7,539,379	$5,123,665	$7,440,046	$12,581,416	$16,818,926	$0	$74,476,121
FLLC/Holdco/LevGRAT (no CRUT), Charlie gives remaining estate to family	$25,552,526	$0	$5,123,665	$7,440,046	$12,596,156	$23,763,728	$0	$74,476,121

Considerations of the Technique (Page 143 of the Paper)

- Generally, investments that are made inside the CRUT should be marketable stocks and bonds. A trustee of a CRUT should avoid any investments that may have unrelated business taxable income.
- The technique will have the same considerations as the creation of a LAGRAT.

- Consider the following example:



Income Tax Advantages of the Technique (Pages 145-149 of the Paper)

- The donor may receive an income tax deduction for the discounted present value of the charity's right to receive the par value of the preferred on termination of the FLLC, even though that might occur after the donor's death.
- The donor should receive an income tax charitable deduction, in the year of the gift, for the discounted present value of the 7% coupon that is to be paid to charity.
- In addition to receiving an upfront charitable income deduction for the present value of the annual coupon of the preferred that is paid to the charity, the donor also receives an indirect second annual deduction with respect to the future preferred coupon payments against his income and health care taxes because of the partnership tax accounting rules.
- The donor will also avoid the built-in capital gains tax on the sale of any low basis asset that is contributed for the preferred interest.
- Assuming a low basis asset will be sold, the "out of pocket" cost of a gift of a preferred interest to a public charity, or donor advised fund, is minimal because of the above tax advantages.
- Income tax valuation advantage: IRS concedes preferred partnership interests should have a high coupon.

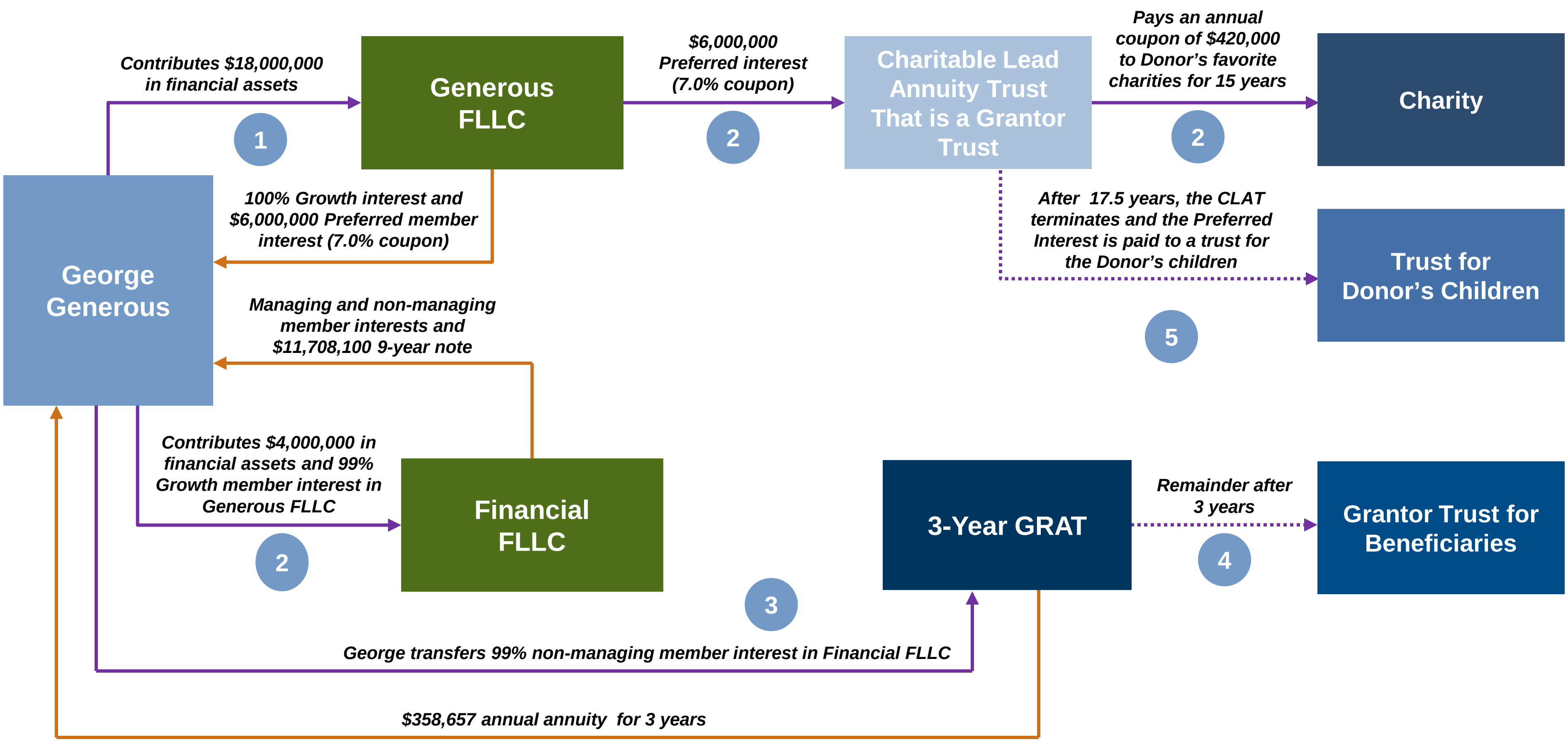
Income Tax Advantages of the Technique (Continued)

	Tax Efficiency Ratio of Charitable Gifts (Present Value of Total Net Tax Savings ÷ Present Value of Total Out of Pocket Cash)
Description	
No Further Planning Except for $420,000 Annual Gift to Charity: Bequeaths $6mm to Charity at Death	**20.78%**
Hypothetical Technique: Creation of an FLLC with Growth and Preferred Interests; Gift of a $6,000,000 Preferred Interest to Charity That Pays an Annual 7% Coupon	**70.09%**

Considerations of the Technique (Pages 149-153 of the Paper)

- Despite state property law, the IRS may take the position that the gift of the preferred interest of an FLLC should be considered a non-deductible partial gift of the underlying assets of the FLLC.
- If the gift of the preferred interest is to a donor advised fund (instead of some other public charity) care should be taken to make sure there is not a tax on excess business holdings under IRC Sec. 4943.
- The taxpayer must comply with certain reporting requirements in order to receive a deduction for the fair market value of the donated preferred interest.
- If there is unrelated business taxable income associated with assets owned by the FLLC, some public charities will not accept the gift of the preferred interest in the FLLC.

- Consider the following example:



Income Tax Advantages of the Technique (Page 155 of the Paper)

- The donor will not pay income taxes or healthcare taxes on income that is allocated to the CLAT, if the CLAT is a conventional CLAT and is not a grantor trust.
- The donor will receive an upfront deduction against income taxes for the actuarial value of the annuity interest paid to charity if the CLAT is a grantor trust.

Considerations of the Technique (Pages 155-158 of the Paper)

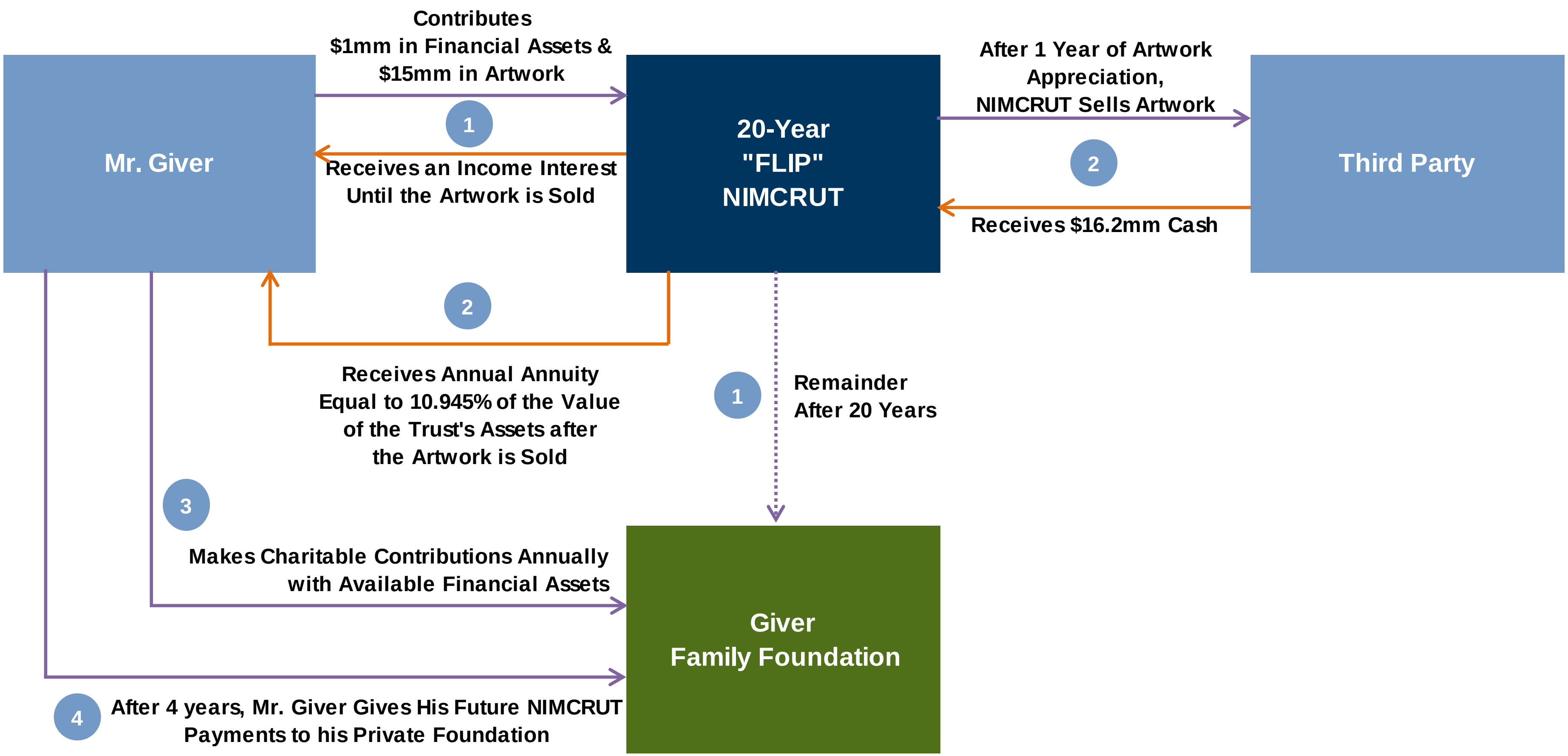
- The partial interest rule should not apply for gift tax purposes or income tax purposes (if a grantor CLAT is used), but the IRS may make the argument.
- Care should be taken to make sure that there is not a tax on excess business holdings under IRC Sec. 4943.
- If the CLAT is a grantor trust the grantor will pay the income taxes on the earnings of the CLAT.

Planning for Gifts of Art to a Private Foundation That Will Eventually Be Sold By That Private Foundation (Pages 158-164 of the Paper)

- If a taxpayer wishes to give his private foundation some artwork, which will eventually be sold, that taxpayer is faced with the prospect of very little tax subsidization.
- If the taxpayer first sells the art and then gives cash to his private foundation, the taxpayer will get a charitable deduction for the value of the cash that is contributed to the private foundation.
- However, the taxes on the sale of the artwork could be very steep. If a taxpayer sells art the appreciation of the art will be taxed at a federal income tax rate of 28%.
- If the taxpayer does not sell the artwork but instead contributes it to his foundation, which then sells the artwork, the taxpayer will avoid the 28% tax on the appreciation of the artwork. However, the taxpayer will only receive an income tax charitable deduction equal to his basis in the artwork.
- Is there a technique that could closely simulate the tax result that would occur if a taxpayer could both receive an income tax deduction for the full fair market value of the artwork he contributes to his foundation and also not be taxed on the sale of the artwork by the foundation? There may be.

Planning for Gifts of Art to a Private Foundation That Will Eventually Be Sold By That Private Foundation (Continued)

- Consider the following illustrated example:



Income Tax Advantages of the Technique (Pages 160-163 of the Paper)

- Because of the operation of IRC Sec. 170(a)(3), the charitable income tax deduction associated with the remainder value of the artwork may be postponed until the art is sold by the NIMCRUT and the deduction may be determined by using the sale proceeds at the moment the remainder gift is complete.
  - The argument is that the contribution of the artwork is not complete, because of operation of IRC Sec. 170(a)(3), until the artwork is sold and the cash proceeds are received. When the contribution is finally complete (thanks to the IRC Sec. 170(a)(3) suspension) it is a gift of cash, not tangible property for an unrelated use.
- The taxpayer has all of the advantages of using a NIMCRUT.
  - Among the advantages of using a NIMCRUT is that there will not be any immediate capital gains tax on the sale of the artwork. The recipient will only pay that tax on a delayed basis under the tiered income tax rules when the other classes of income have been used in the payout of the unitrust payments.
  - The taxpayer will receive a charitable income tax deduction for the transfer of his term interest in the NIMCRUT equal to its actuarial value at the time of the transfer, if the taxpayer's gift is not pre arranged at the time of the creation of the NIMCRUT.

Income Tax Advantages of the Technique (Continued)

From the Point of View of the Charity
Simulated Tax Holiday vs. No Further Planning Techniques vs. Hypothetical Techniques Under Two Different Scenarios
Summary of Hypothetical Results of $16,000,000 of Assets
Post Death Scenarios Assuming Mr. Giver Has a Life Expectancy of 10 Years

	Charity (1)	IRS Income Tax Direct Cost/ (Benefit) (2)	IRS Income Tax Investment Opportunity Cost/(Benefit) (3)	IRS Estate Tax (at 40.0%) (4)	Value of Art Sale Proceeds Plus $1mm (5)
10-Year Future Values					
Simulated Tax Holiday	$48,918,504	($10,955,058)	($7,532,668)	$0	$30,430,777
No Further Planning Technique #1	$40,821,195	($6,156,930)	($4,233,488)	$0	$30,430,778
No Further Planning Technique #2	$36,785,934	($3,765,801)	($2,589,355)	$0	$30,430,778
Hypothetical Technique #3, Scenario A	$45,978,246	($10,842,512)	($4,704,957)	$0	$30,430,778
Hypothetical Technique #3, Scenario B	$44,553,902	($9,943,734)	($4,179,391)	$0	$30,430,778
Present Values (discounted at 0.0%)					
Simulated Tax Holiday	$48,918,504	($10,955,058)	($7,532,668)	$0	$30,430,777
No Further Planning Technique #1	$40,821,195	($6,156,930)	($4,233,488)	$0	$30,430,778
No Further Planning Technique #2	$36,785,934	($3,765,801)	($2,589,355)	$0	$30,430,778
Hypothetical Technique #3, Scenario A	$45,978,246	($10,842,512)	($4,704,957)	$0	$30,430,778
Hypothetical Technique #3, Scenario B	$44,553,902	($9,943,734)	($4,179,391)	$0	$30,430,778

Income Tax Advantages of the Technique (Continued)

From the Point of View of Art Giver
Simulated Tax Holiday vs. No Further Planning Techniques vs. Hypothetical Techniques Under Two Different Scenarios
Summary of Hypothetical Results of $16,000,000 of Assets
Post Death Scenarios Assuming Mr. Giver Has a Life Expectancy of 10 Years

	Net Present Value (discounted at 2.5%)		
	Charitable Income Tax Savings (1)	Capital Gains Tax on Sale of Art (2)	Income Tax Benefit of Strategy (1)-(2)
Simulated Tax Holiday[1]	$10,955,058	$0	$10,955,058
No Further Planning Technique #1[2]	$9,432,930	$3,276,000	$6,156,930
No Further Planning Technique #2[3]	$3,765,801	$0	$3,765,801
Hypothetical Technique #3, Scenario A[4]	$12,498,033	$1,655,521	$10,842,512
Hypothetical Technique #3, Scenario B[5]	$11,599,255	$1,655,521	$9,943,734

(1) Simulated Tax Holiday - Mr. Giver receives a full deduction for giving cash and art to his foundation; foundation may sell the art without any capital gains tax attributable to Mr. Giver; Mr. Giver makes annual gifts to charity to the extent that he has extra cash.

(2) No Further Planning Technique #1 - sale of art; net proceeds from sale of art after taxes contributed to foundation; annual gifts to charity to the extent that Mr. Giver has extra cash.

(3) No Further Planning Technique #2 - art contributed to foundation; deduction limited to art basis; foundation sells art; annual gifts to charity to the extent that Mr. Giver has extra cash.

(4) Hypothetical Technique #3, Scenario A - art contributed to a flip NIMCRUT; net proceeds of NIMCRUT distributions plus available cash are annually contributed to foundation; Mr. Giver receives a deduction for remainder interest of NIMCRUT when art is sold equal to sale proceeds.

(5) Hypothetical Technique #3, Scenario B - art contributed to a flip NIMCRUT; net proceeds of NIMCRUT distributions plus available cash are annually contributed to foundation; Mr. Giver receives a deduction for remainder interest of NIMCRUT when art is sold equal to basis of art.

Considerations of the Technique (Pages 163-164 of the Paper)

- For the trust to be a qualified charitable remainder trust, it may be necessary for some deduction to be allowed at the time the trust is created.
- Perhaps the easiest way to satisfy this requirement is for the grantor of the NIMCRUT to also contribute assets that are not subject to IRC Sec. 170(a)(3), such as financial assets.
- In order to get the benefit of the delayed deduction for the remainder interest in the NIMCRUT at the full cash value of the remainder interest it may be important that the delayed deduction not be treated as capital gain property.
- It is important, under rev. rul. 86-60, for the assignment of the remaining term interest in the NIMCRUT to be eligible for the gift tax charitable deduction that there not be any secondary non-charitable interests.
- In calculating the donor’s deduction, the assignment must be valued actuarially under IRC Sec. 664 using unitrust valuation based on the trust’s stated payout rate, and not limited to the value of an income interest under IRC Sec. 7520.

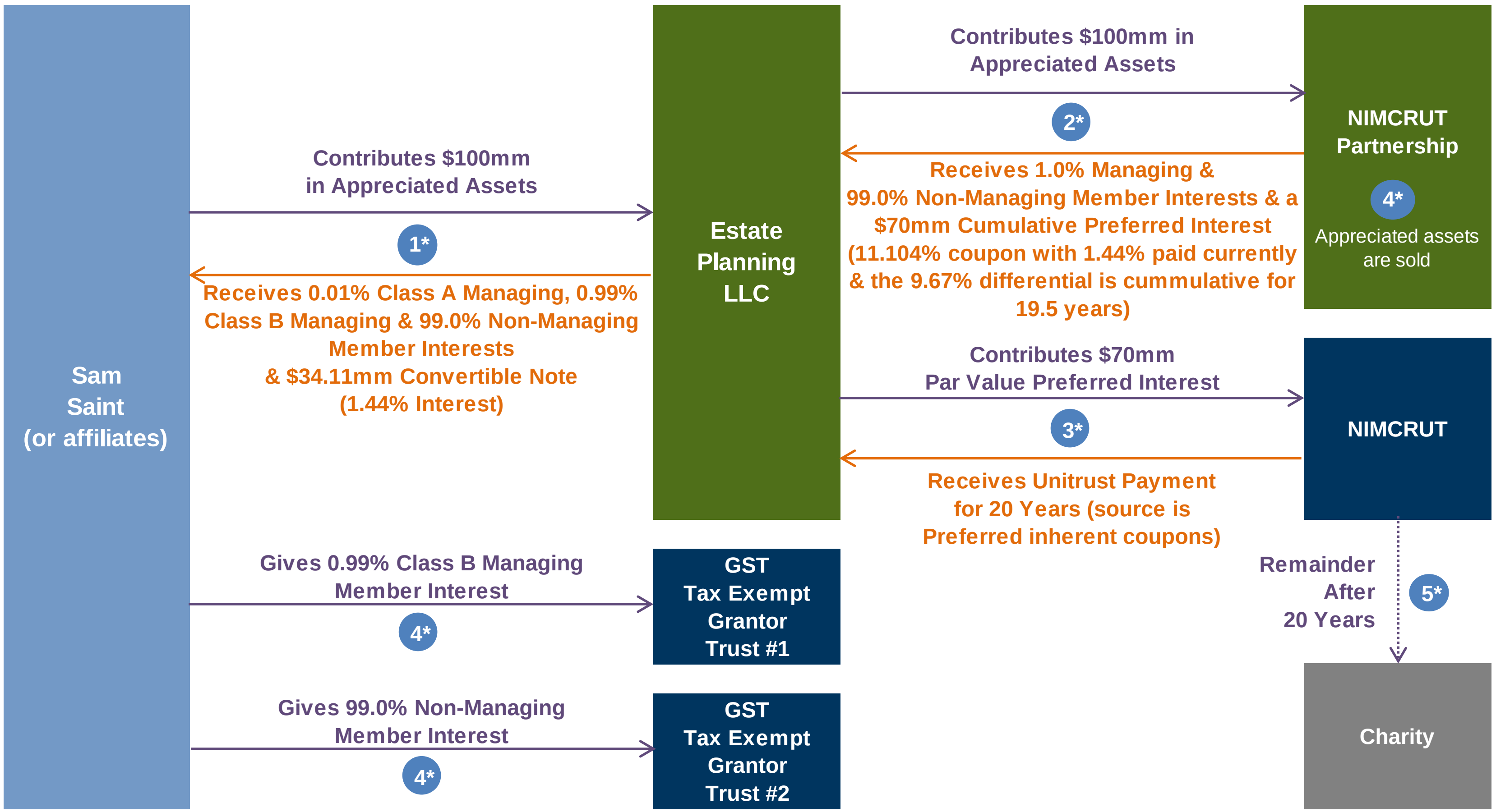
- Consider the following example:

Sam Saint Contributes a Deferred Coupon Preferred
Partnership Interest Interest to a NIMCRUT in Combination With
the LAIDGT Technique in Order to Save Income and Transfer Taxes

Sam Saint is very wealthy. A significant part of his $150,000,000 portfolio ($100,000,000) is in Growing, Inc. stock (a publicly traded stock). Sam has no basis in his shares of Growing, Inc. stock. Sam would like to diversify out of that stock in a tax efficient manner. Sam and his family need very little cash flow from that part of his portfolio (Growing, Inc.) for at least 20 years. Sam would like to see approximately 18% of the future value of his then projected estate (before estate taxes) pass to his favorite charities with the rest of his estate passing to his family. Sam is also interested in strategies that will allow him to diversify, in a tax-efficient manner, his highly appreciated Growing, Inc. stock. Sam would like to minimize his gift and estate taxes. Sam asks his tax advisor, Pam Planner, for a suggestion.

Using the Technique of Contributing a Preferred Interest in a Family Limited Partnership to a NIMCRUT in Combination With the LAIDGT Technique (Continued)

- A possible solution is illustrated below:



*Transactions need to be separate, distinct and independent.

Advantages of the Technique (Pages 168-176 of the Paper)

- In this example, seventy percent of the gain, if LLC sells the securities, should be allocated to the NIMCRUT and there would be no tax on that allocated gain.
- The future taxable income of the LLC should be allocated to the Preferred Unitholders to the extent of the preferred return, which allows for significant deferral of taxable income.
- In this example, the donor will only have to pay federal income tax resulting from items of income and gains allocated to the NIMCRUT only upon receipt of distributions from the NIMCRUT, which only occur when the NIMCRUT recognizes trust accounting income.
- In this example, the income tax deduction of $7,000,000 that Sam receives for the remainder value of the NIMCRUT can be used to offset the gain recognized by the residual units.
- Assuming the sale proceeds earn 7.5% a year for 20 years with 2% being taxed as tax free income and 5.5% being taxed as capital gains (with a 30% turnover) the technique produces powerful income tax and estate tax savings over a 20-year period in comparison to no further planning and a similar estate plan with no charitable gift.
  - Under these assumptions, the plan produces over $5,000,000 more for the family and around $43,000,000 for the family's charitable causes in present value dollars in comparison to doing the same LAIDGT estate plan without the NIMCRUT partnership technique.
  - The primary reason the technique works so well is power of pre tax compounding of delaying the taxation of the taxable income that is allocated to the NIMCRUT ("income tax opportunity cost" in the table below).

Advantages of the Technique (Continued)

– On the estate planning side, besides the power of pre tax compounding, the valuation discounts are greater because a hypothetical buyer is not going to pay for the amount that goes to charity and there are potential greater discounts with a two tiered subsidiary partnership structure. See the table below:

			Consumption		Lifetime IRS Income Taxes		Tax Liability of Estate		
	Charity (1)	Saint Family (2)	Direct Cost (3)	Opportunity Cost (4)	Direct Cost (5)	Opportunity Cost (6)	Embedded Capital Gains Tax Liability[1] (7)	Estate Taxes (@ 40%) (8)	Total (9)
20-Year Future Values									
No Further Planning	$0	$213,531,608	$63,861,644	$66,600,089	$65,937,250	$108,772,669	$0	$118,474,405	$637,177,665
Hypothetical Technique #1[2]	$0	$301,956,854	$63,861,644	$66,600,089	$69,462,172	$108,772,669	$8,223,995	$18,300,241	$637,177,665
Hypothetical Technique #2[3]	$70,000,000	$310,919,013	$63,861,644	$66,600,089	$72,638,284	$34,867,342	$2,818,388	$15,472,904	$637,177,665
Present Values (Discounted at 2.5%)									
No Further Planning	$0	$130,312,136	$38,972,906	$40,644,099	$40,239,588	$66,380,799	$0	$72,301,487	$388,851,014
Hypothetical Technique #1[2]	$0	$184,275,494	$38,972,906	$40,644,099	$42,390,745	$66,380,799	$5,018,865	$11,168,106	$388,851,014
Hypothetical Technique #2[3]	$42,718,966	$189,744,839	$38,972,906	$40,644,099	$44,329,034	$21,278,526	$1,719,981	$9,442,664	$388,851,014

(1) Embedded capital gains tax liability of assets that pass to the family that are not subject to estate taxes. This capital gains tax is only paid when those assets are sold.
(2) Hypothetical Technique #1 - Leveraged Assets Gifted to GST Tax Exempt Grantor Trusts without Using a NIMCRUT Partnership
(3) Hypothetical Technique #2 - Leveraged Assets Gifted to GST Tax Exempt Grantor Trusts in Combination With Using a NIMCRUT Partnership

Assumptions:	
Total estimated rate of return over the next 20 years	7.50%
Rate of Return Taxed at Ordinary Rates	0.00%
Rate of Return Taxed at Ordinary Rates	2.00%
Rate of Return Taxed at Capital Gains Rates	5.50%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	23.80%
Ordinary Income and Health Care Tax Rate	43.40%
Annual Consumption from these Sources	$2,500,000

Assumptions (continued):		
NIMCRUT Partnership - Growth Interest Valuation Discount	40.0%	
Estate Planning Partnership - Valuation Discount	30.0%	
NIMCRUT Partnership-Preferred Interest	$70,000,000	
NIMCRUT Partnership-Total Preferred Coupon/Currently Paying %	11.104%	1.44%
IRS 7520 Rate	6.275%	
IRS Applicable Federal Rate (long-term)	0.000%	
CRUT Payout	0.000%	
Charitable Deduction	$7,001,400	
Tax Savings from Charitable Deduction ($7,001,400 @ 20.0%)	$1,400,280	

Considerations of the Technique (Pages 176-181 of the Paper)

- Will the deferral of the receipt of trust accounting income distributable to the NIMCRUT's non-charitable beneficiary cause the NIMCRUT to fail to function exclusively as a charitable remainder trust?
  - The actual or potential use of the income deferral technique should not violate public policy. Congress created qualified charitable remainder trusts to ensure that the amount received by a charitable organization at the end of the trust reflects the amount on which the donor's charitable deduction was based. Congress' purpose will not be thwarted by the NIMCRUT's actual or potential use of the income-deferral technique because it will in no way reduce the amount receivable by charity at the end of the term.
  - The grantor's "use" of the NIMCRUT's assets should be a "permitted use." In Technical Advice Memorandum 9825001 (October 29, 1997), the Service had the chance to apply its "primary use" theory to a charitable trust in which the trustee had purchased deferred annuity contracts. However, after holding that the deferral of income was a "permitted use" of trust assets so as to not be an act of self-dealing, the Service concluded that "the purchase of the deferred annuity contracts [did] not adversely affect [the trust's] qualification as a charitable remainder trust under IRC Sec. 664 and the current regulations thereunder." Implicit from this ruling is that if the grantor's use of trust assets is "permitted," then such use will not cause the trust to fail to function exclusively as a charitable remainder trust.
  - The NIMCRUT will have a significant charitable component.
  - There is no published authority prohibiting the creation of a charitable remainder trust that enhances value to both the individual and the charity by deferring the payment of income, despite the donor's retention of control, probably because income deferral is inherent in the concept of a NIMCRUT.

Considerations of the Technique (Continued)

- Will the use of the LLC to defer the receipt of trust accounting income distributable to Sam be deemed an act of self-dealing under IRC Sec. 4941 and the regulations thereunder?
  - In TAM 9825001, the Service examined self-dealing under two theories (this TAM examined the purchase of a deferred annuity unitrust by a NIMCRUT). Under the first theory—whether the trustee's purchase of a deferred annuity naming the grantor and his wife (disqualified persons) as annuitants constituted an act of self-dealing—the Service found no act of self-dealing because the grantors received no current benefit because of the contingent nature of the annuities (similarly, under the facts of this example, there is no current benefit to the annuitants of the NIMCRUT).
  - The Service ultimately concluded that the transaction did not constitute self-dealing. IRC Sec. 4947(a)(2) charitable remainder trusts are different from regular IRC 501(c)(3) private foundations because a disqualified person is entitled to receive income from the trust as provided in the trust instrument. The income interest is, in itself, a use of trust assets for the benefit of the disqualified person. Inherently, any investment decision regarding the trust assets that increases or decreases the amount of payout of this income interest is inherently a use for the benefit of the disqualified person. IRC Sec. 4947(a)(2)(A) specifically excludes from the self-dealing rules payments made by charitable remainder trusts to income beneficiaries.
  - Thus the relevant question is whether the deferral of income is a "permitted use." According to the ruling, the presence of an unreasonable effect on the charitable remainder interest distinguishes a permissible use of trust assets from an impermissible use. The IRS noted that the facts did not clearly indicate that the disqualified person controlled, compelled or influenced the trustee's investment decisions so as to manipulate the trust's assets for the disqualified person's benefit.
  - Finally, in determining whether the deferral is a permitted use, the Service will examine whether it causes an unreasonable effect on the charitable remainder interest. The unreasonable effect requires an evaluation of the income realized by the charitable interest as well as the appreciation in value of the charitable assets over the term of the trust. Because the Service does not second-guess the investment decisions of the trustee in this regard, the "unreasonable effect" means something more than just bad investment judgment. In the case of this example, the deferral of income is permitted because the charitable remainder interest is not unreasonably affected. The charitable remainder interest only can be advantaged, not disadvantaged, by deferral of the receipt of trust accounting income through investment in the FLP – hardly an unreasonable effect.

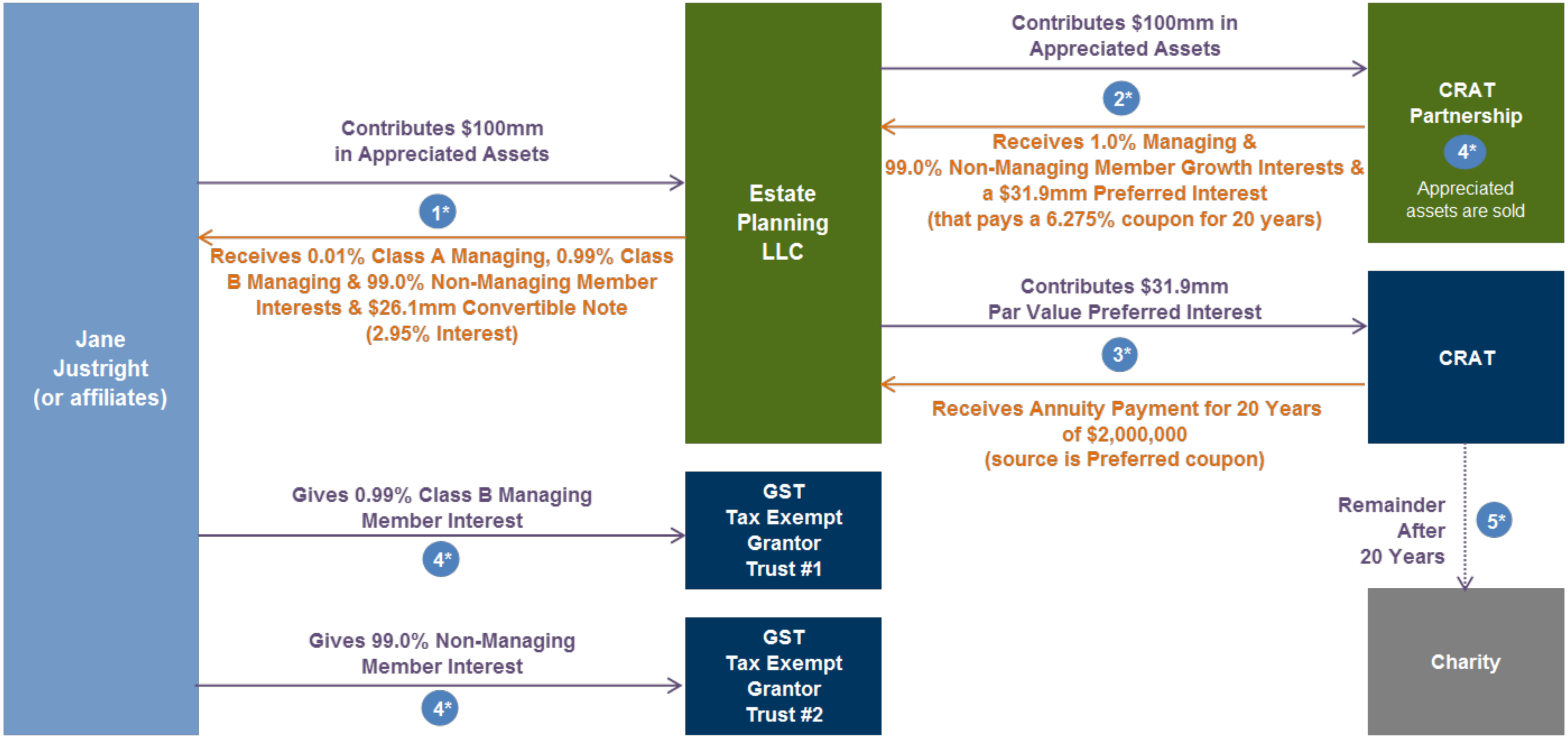
- Consider the following example:

Jane Justright Contributes a Preferred Partnership Interest to a CRAT in
Combination With the LAIDGT Technique in Order to Save Income and Transfer Taxes

Jane Justright, like Sam Saint, is very wealthy. Jane, like Sam, has a $150,000,000 portfolio ($100,000,000 is in Growing, Inc. stock, a publicly traded stock). Jane has no basis in her shares of Growing, Inc. stock. Jane would like to diversify out of that stock in a tax efficient manner. Jane likes the tax deferral and cash flow aspects of charitable remainder annuity trusts (CRATs). She desires steady cash flow and has deferred charitable intent - up to a point. She does like the potential windfall aspect of charitable remainder trusts: (i) she could die early; and/or (ii) the investments of the trust could out perform the IRS assumed earnings rate built into the actuarial tables. Jane thinks it is particularly unfair that she would not receive an income tax deduction for that windfall, if it occurs. Jane asks her attorney, Fay Fair, what she can do to ensure that she receives tax justice, if she creates a charitable remainder annuity trust. Jane also asks her attorney, Fay Fair, to assume she would like a little over 9% of her projected estate (before estate taxes) to go to her favorite charities with the remainder going to her family. Jane would also like to minimize her gift and estate taxes.

Using the Technique of Contributing a Preferred Partnership Interest in a Family Partnership to a CRAT in Combination With the LAIDGT Technique (Continued)

- A possible solution is illustrated below:



*Transactions need to be separate, distinct and independent.

Advantages of the Technique (Pages 183-185 of the Paper)

- There will be no immediate capital gains taxes on that proportionate part of the partnership that is owned by the CRAT when the Growing, Inc. stock is sold. The future taxable income of the LLC should be allocated to the Preferred Unitholders to the extent of the preferred return, which allows for significant deferral of taxable income.
- Since the preferred coupon is being paid currently, it will probably have a lower rate of return than the deferred preferred coupon used in the preferred interest with a NIMCRUT .
  - The preferred coupon can provide the cash flow that donor's desires.
- A donor's fear of a charitable windfall for the charity with the use of the CRAT technique is at least partially addressed by the use of preferred partnership interest.
- This technique also provides current cash flow to those client's and/or families who need the current cash flow.
- The income tax deduction of the remainder value of the CRAT can be used to offset the gain recognized by the non preferred owners.

Advantages of the Technique (Continued)

- The synergies of this technique can produce powerful income tax benefits and estate planning benefits as the table below illustrates:

			Consumption		Lifetime IRS Income Taxes		Tax Liability of the Estate		
	Charity (1)	Justright Family (2)	Direct Cost (3)	Opportunity Cost (4)	Direct Cost (5)	Opportunity Cost (6)	Embedded Capital Gains Tax Liability[1] (7)	Estate Taxes (@ 40%) (8)	Total (9)
20-Year Future Values									
No Further Planning	$0	$213,531,608	$63,861,644	$66,600,089	$65,937,250	$108,772,669	$0	$118,474,405	$637,177,665
Hypothetical Technique #1[2]	$0	$302,196,270	$63,861,644	$66,600,089	$69,548,356	$108,772,669	$8,425,071	$17,773,567	$637,177,665
Hypothetical Technique #2[3]	$31,872,510	$317,986,205	$63,861,644	$66,600,089	$64,411,446	$86,727,806	$5,717,966	$0	$637,177,665
Present Values (Discounted at 2.5%)									
No Further Planning	$0	$130,312,136	$38,972,906	$40,644,099	$40,239,588	$66,380,799	$0	$72,301,487	$388,851,014
Hypothetical Technique #1[2]	$0	$184,421,602	$38,972,906	$40,644,099	$42,443,341	$66,380,799	$5,141,576	$10,846,691	$388,851,014
Hypothetical Technique #2[3]	$19,450,867	$194,057,741	$38,972,906	$40,644,099	$39,308,434	$52,927,460	$3,489,508	$0	$388,851,014

(1) Embedded capital gains tax liability of assets that pass to the family that are not subject to estate taxes. This capital gains tax is only paid when those assets are sold.
(2) Hypothetical Technique #1 - Leveraged Assets Gifted to GST Tax Exempt Grantor Trusts without Using a CRAT Partnership
(3) Hypothetical Technique #2 - Leveraged Assets Gifted to GST Tax Exempt Grantor Trusts by Using a CRAT Partnership

Assumptions:	
Total Estimated Rate of Return Over the Next 20 Years	7.50%
Rate of Return Taxed at Ordinary Rates	0.00%
Rate of Return Taxed at Ordinary Rates	2.00%
Rate of Return Taxed at Capital Gains Rates	5.50%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	23.80%
Ordinary Income and Health Care Tax Rate	43.40%
Annual Consumption from these Sources	$2,500,000

Assumptions (continued):	
CRAT Partnership - Growth Interest Valuation Discount	40.00%
Estate Planning Partnership - Valuation Discount	30.00%
CRAT Partnership - Preferred Interest	$31,872,510
CRAT Partnership - Preferred Coupon	6.28%
IRS 7520 Rate	3.40%
IRS Applicable Federal Rate (long-term)	2.95%
CRUT Payout	6.28%
Charitable Deduction	$3,292,343
Tax Savings from Charitable Deduction ($3,292,343 @ 20.0%)	$658,469

Considerations of the Technique (Page 185 of the Paper)

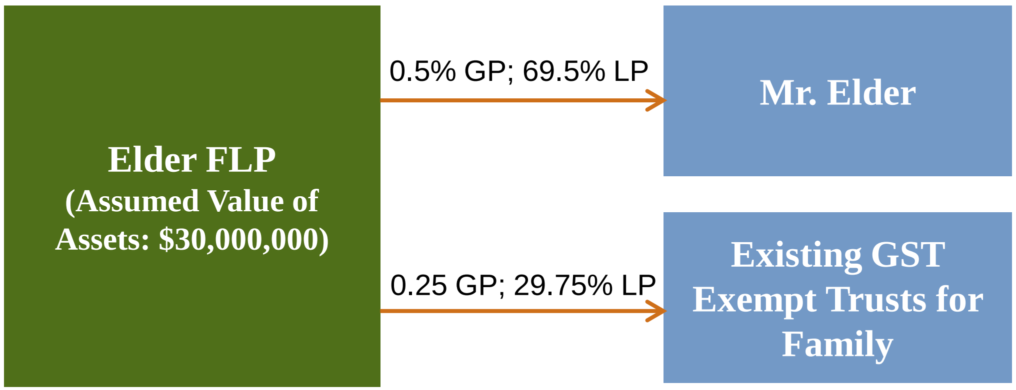
- This technique does not defer the taxation of cash flow, if the client does not need that cash flow. Stated differently, this technique has the potential of distributing more cash flow than a client needs and, thus, accelerates tax consequences unnecessarily.
- This technique is not appropriate for that part of a client's portfolio, which the client wishes to put into ordinary income investments (because of the disadvantages inherent in the tiered income rules) or in unrelated business income investments.

Private Wealth Management

Comparison of the Advantages and Considerations of Some Favorite Post-Mortem Planning Techniques

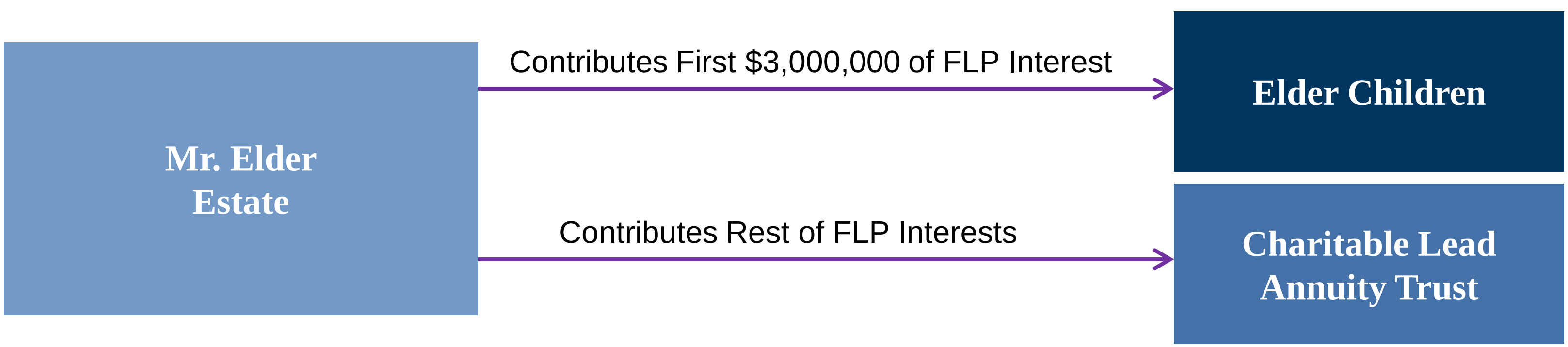
Use of a Leveraged Buy-Out of a Testamentary Charitable Lead Annuity Trust ("CLAT") (Pages 185-191 of the Paper)

- Consider the following example:
  – During Ed's lifetime he creates a FLP with his family:



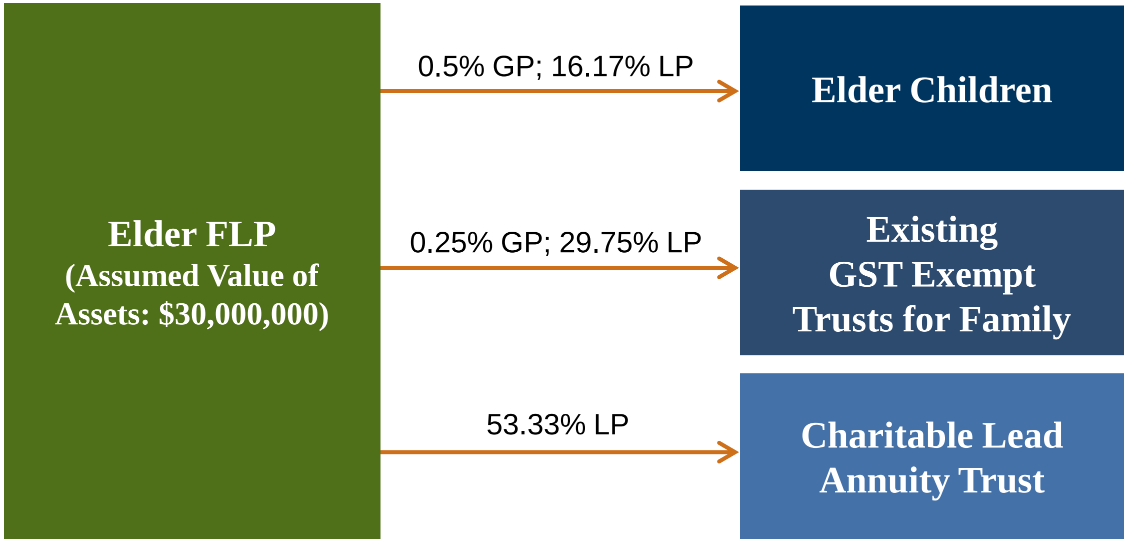
Elder, LP Partner	Ownership (%)
Mr. Elder	0.5% GP; 69.5% LP
Existing GST Exempt Trusts for Family	0.25% GP; 29.75% LP

  – After Ed's death his will conveys his FLP interests as follows:



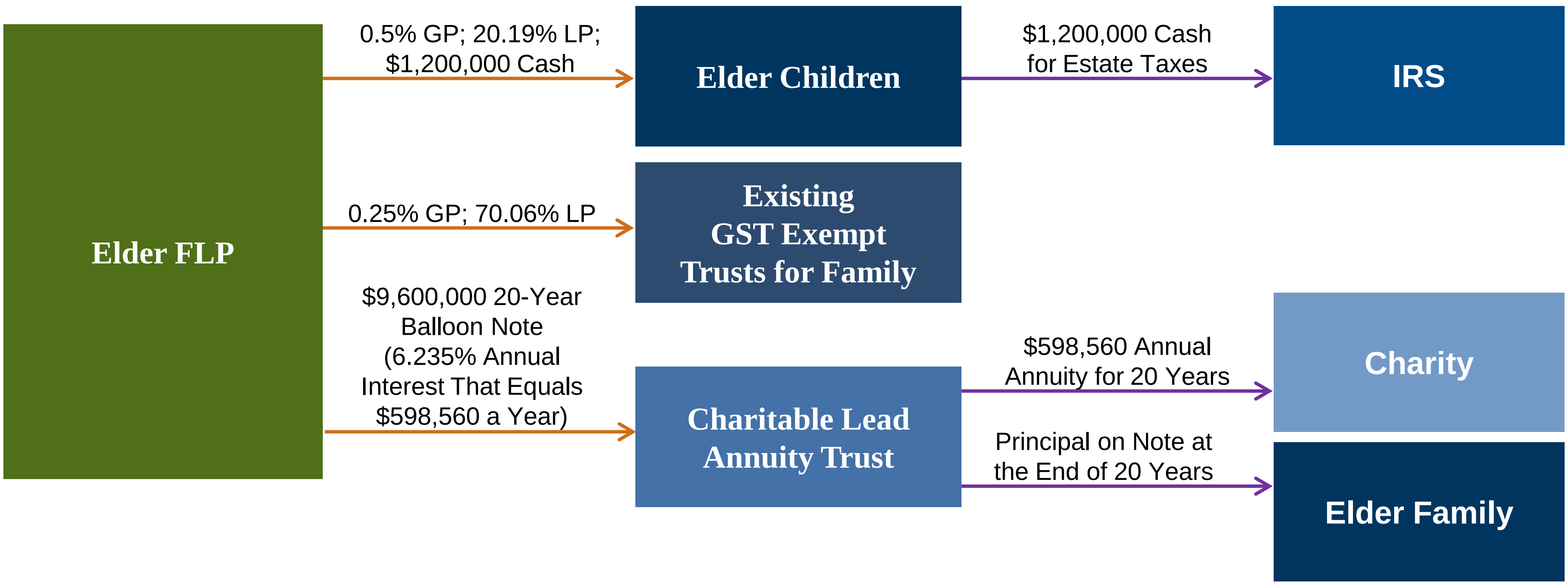
Use of a Leveraged Buy-Out of a Testamentary Charitable Lead Annuity Trust ("CLAT") (Continued)

– The percentage ownership of Elder FLP before any redemption pursuant to a probate court hearing is as follows:



Use of a Leveraged Buy-Out of a Testamentary Charitable Lead Annuity Trust (“CLAT”) (Continued)

– After a probate hearing the children’s interest is partially redeemed and the CLAT’s interest is totally redeemed as follows:



Income Tax and Basis Enhancing Advantages of the Technique
(Page 188 of the Paper)

- There is a partial step-up in basis in the decedent's partnership interest that is bequeathed to a zeroed-out CLAT.
- There will be income tax deductions for the interest paid to the CLAT, assuming the investment income of the partnership is greater than the interest expense.

Transfer Tax Advantages of the Technique (Pages 188-191 of the Paper)

- No estate taxes have to be paid with a gift to a properly structured and implemented zeroed-out CLAT.
- If the decedent bequeaths a dollar gift to his family and the rest of his estate to a zeroed-out CLAT, his will acts like a defined value allocation clause.
- Significant improvement in the after tax net worth for both the family of the decedent and the decedent's favorite charitable causes will accrue because of this technique.
- The family does not have to wait 20 years to access the investments, if the investments are successful.

Transfer Tax Advantages of the Technique (Continued)

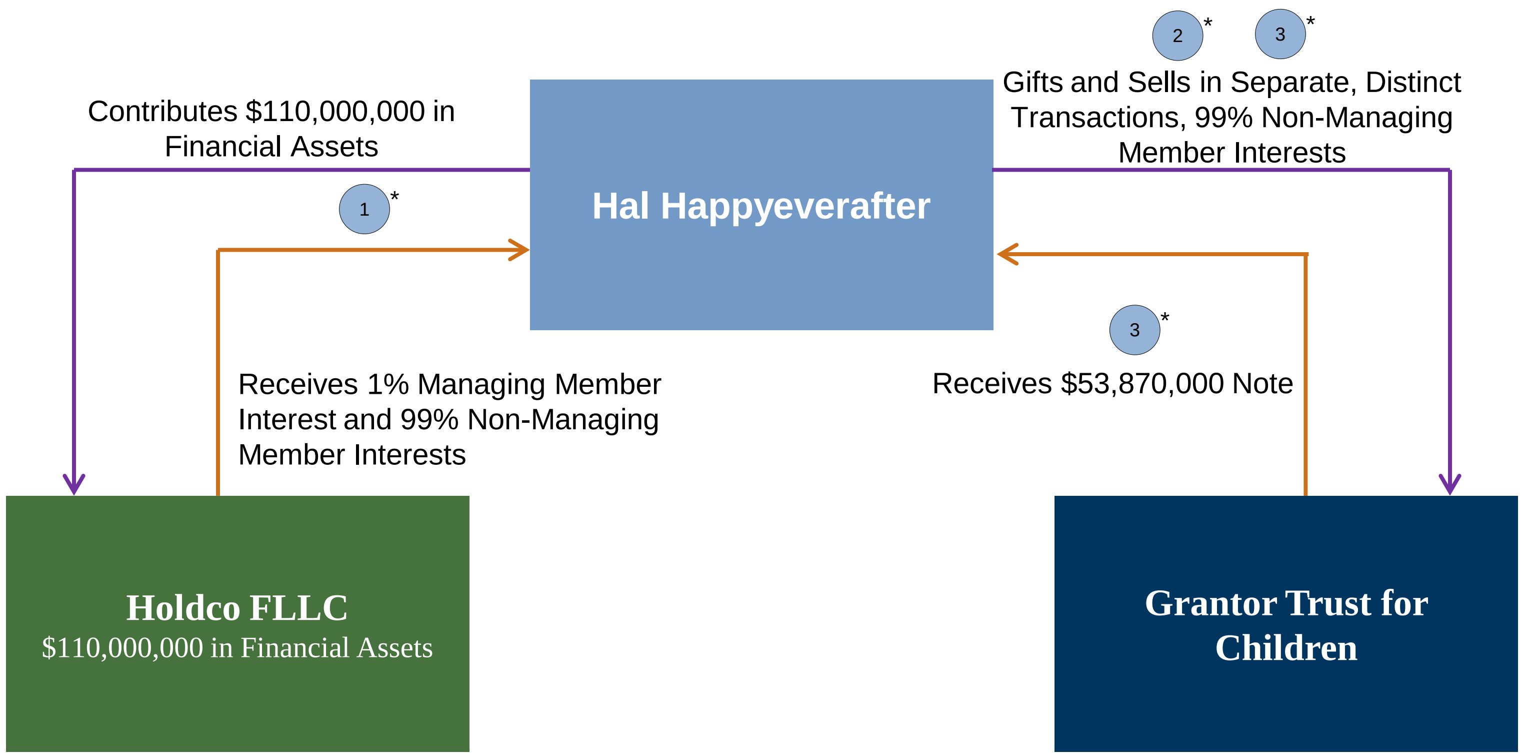
Summary of Results For $30 Million of Assets Growing at 7.50% Per Year (Pre Tax) –
No Further Planning vs. 20 Year Testamentary CLAT Technique; 20 Year
Future Values; Post-Death Scenarios (assuming Mr. Elder dies in year 1)

Technique	Elder Children	Elder GST Exempt Trust	Charity	IRS Taxes on Investment Income	IRS Investment Opportunity Cost	IRS Estate Tax	Total
No Further Planning - No Discount Allowed	$33,734,275	$27,222,640	$0	$19,049,212	$39,429,406	$8,000,000	$127,435,533
No Further Planning - Discount Allowed	$42,018,677	$27,222,640	$0	$21,535,391	$31,858,825	$4,800,000	$127,435,533
Hypothetical Technique - CLAT Redemption Discount Allowed - $3mm to Family	$26,774,735	$40,677,004	$25,920,450	$16,803,779	$16,059,565	$1,200,000	$127,435,533
Hypothetical Technique - CLAT Redemption Discount Allowed - $10mm to Family	$41,011,327	$27,292,259	$7,020,122	$20,117,950	$27,993,875	$4,000,000	$127,435,533

Considerations of the Technique (Page 191 of the Paper)

- Need to get probate court approval.
- Leverage could work against the family unless a carefully constructed partnership sinking fund is utilized to pay future interest payments.

- Consider the following example:



* These transactions need to be separate, distinct and independent.

Income Tax and Basis Enhancing Advantages of the Technique
(Page 193 of the Paper)

- There is a step-up in basis of the deceased spouse's assets at her death.
- There is an opportunity through using borrowing strategies from third party lenders for the surviving spouse to increase the basis of the family's assets during his lifetime.
- All of the income tax and basis enhancing advantages of creating a grantor trust and selling assets to a grantor trust are present with this technique.

Transfer Tax Advantages of the Technique (Pages 194-195 of the Paper)

- Significantly more assets may be passed to the next generation by using this technique than using the exemption to fund a credit shelter trust that is taxed as a complex trust.

	Beneficiaries		Consumption		IRS Income Tax				
	Happyeverafter Children	Happyeverafter Children & Grandchildren	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Costs	Embedded Capital Gains Tax Liability	IRS Estate Taxes at 40%	Total
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
10-Year Future Values									
Traditional Credit Shelter Planning: first to die spouse creates a credit shelter trust with her unified credit and balance of estate goes to a marital deduction trust	$84,901,072	$34,357,075	$22,406,764	$8,689,346	$12,693,504	$4,550,782	$414,058	$56,600,715	$224,613,316
	$119,258,147		$31,096,110		$17,658,344				
Traditional Credit Shelter Planning: First to die spouse creates a credit shelter trust with her unified credit; surviving spouse gifts and sells LLC interests to a new GST tax exempt grantor trust	$19,537,175	$138,767,406	$22,406,764	$8,689,346	$14,060,949	$4,550,782	$3,576,111	$13,024,783	$224,613,316
	$158,304,580		$31,096,110		$22,187,842				
Hypothetical Technique: First spouse to die bequests estate to surviving spouse; surviving spouse gifts his lifetime gift and the DSUE amounts to a grantor trust; Hal sells the remaining non-managing member interests to the grantor trust	$157,853,517	$2,780,000	$22,406,764	$8,689,346	$14,060,949	$4,550,782	$3,576,111	$10,695,846	$224,613,316
	$160,633,517		$31,096,110		$22,187,842				

Transfer Tax Advantages of the Technique (Continued)

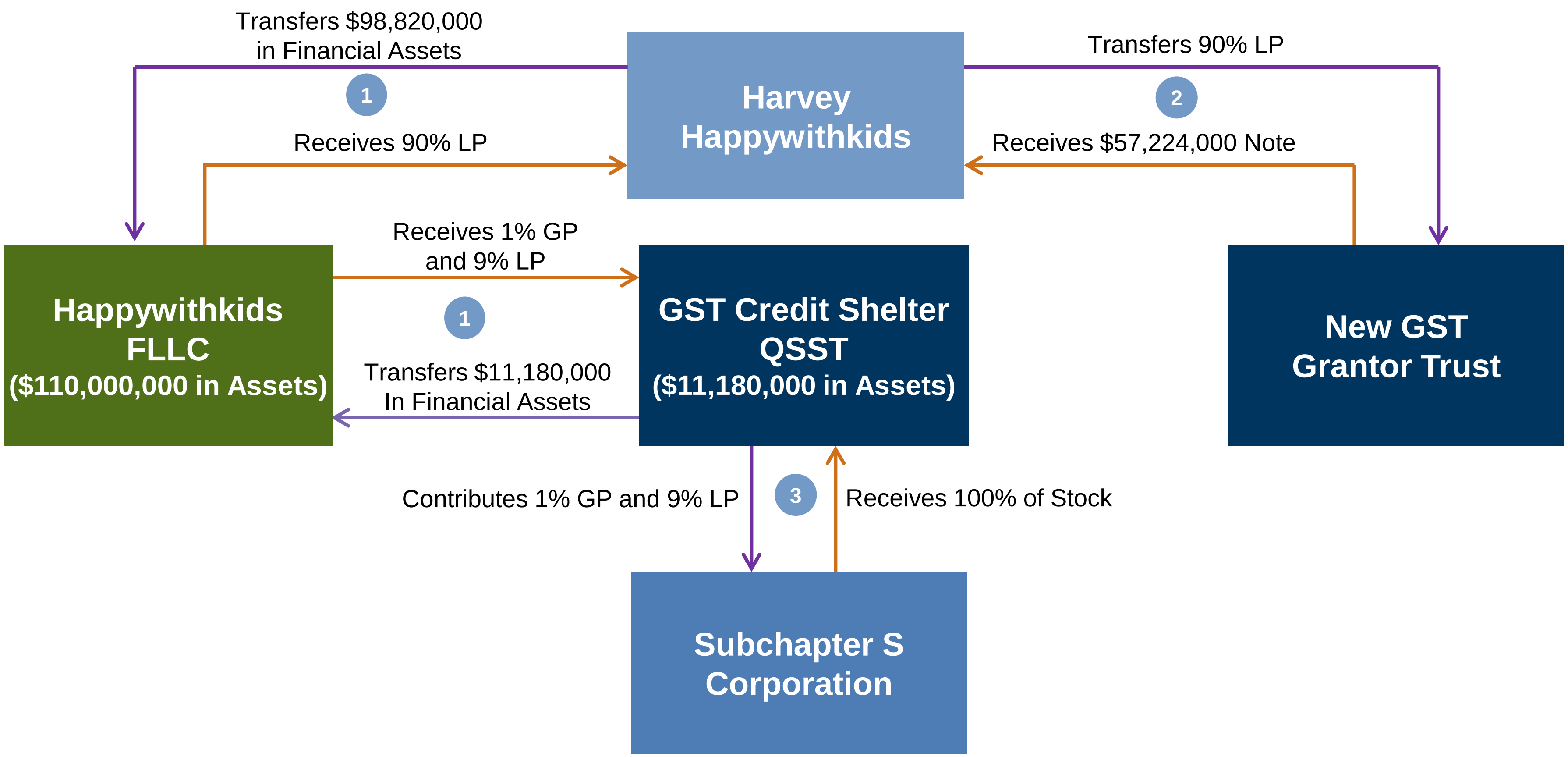
- Significantly more assets may receive protection from creditors by using sales to grantor trusts with the use of the DSUE amount then using the exemption to fund a credit shelter trust.
- The surviving spouse's rights with respect to assets owned by the grantor trust, and cash flows produced by those assets, are pursuant to a flexible contract, rather than discretionary distributions by a trustee who is subject to fiduciary considerations.

Considerations of the Technique (Pages 195-196 of the Paper)

- The surviving spouse may not transfer the DSUE amount in the manner that the deceased spouse anticipated.
- If the surviving spouse has creditor issues at the time of the first spouse's death, creating a family trust with the deceased spouse's unified credit will provide better protection from those creditors.
- This technique has the same considerations as the creation of a grantor trust and a sale to a grantor trust.
- The GST tax exemption is not portable.
- It may be more advantageous to convert a traditional credit shelter trust, with its attendant creditor protection and GST advantages, to a section 678 grantor trust by using the QSST technique.
- It may be more advantageous for the decedent to have created the grantor trust during her lifetime and use her exemption to create the grantor trust for the benefit of the spouse before death.
- Like all leverage techniques, if the underlying assets stay flat or decline there is not any advantage to the technique and to the extent a gift tax exemption is used, the technique operates at a disadvantage.

Using the Synergies of a Credit Shelter Trust Becoming a QSST, a Surviving Spouse Creating a FLP and a Surviving Spouse Giving and Selling Interests in the FLP to a New Grantor Trust (Pages 196-199 of the Paper)

- Consider the following example:



Income Tax and Basis Enhancing Advantages of the Technique
(Page 198 of the Paper)

- There is a step-up in basis of the deceased spouse’s assets at her death.
- There is an opportunity through using borrowing strategies from third party lenders for the surviving spouse to increase the basis of the family’s assets during his lifetime.
- All of the income tax advantages of a SIDGT are present with this technique.

Transfer Tax Advantages of the Technique (Pages 198-199 of the Paper)

- Significant estate taxes can be saved with this technique.

<table>
<tr><th rowspan="2"></th><th colspan="2">Beneficiaries</th><th colspan="2">Consumption</th><th colspan="3">IRS Income Tax</th><th rowspan="2">IRS Estate Tax (@ 40%)</th><th rowspan="2">Total</th></tr>
<tr><th>Happywithkids Children</th><th>Happywithkids Children & Grandchildren</th><th>Direct Cost</th><th>Investment Opportunity Cost</th><th>Direct Cost</th><th>Investment Opportunity Cost</th><th>Embedded Capital Gains Tax</th></tr>
<tr><th></th><th>(1)</th><th>(2)</th><th>(3)</th><th>(4)</th><th>(5)</th><th>(6)</th><th>(7)</th><th>(8)</th><th>(9)</th></tr>
<tr><td colspan="10">10-Year Future Values</td></tr>
<tr><td rowspan="2">Traditional Credit Shelter Planning: First to die spouse creates a credit shelter trust with her unified credit and balance of estate goes to a marital deduction trust</td><td>$95,044,358</td><td>$34,357,075</td><td>$11,203,382</td><td>$4,344,673</td><td>$13,238,320</td><td>$4,690,485</td><td>$414,058</td><td rowspan="2">$63,362,905</td><td rowspan="2">$226,655,255</td></tr>
<tr><td colspan="2">$129,401,432</td><td colspan="2">$15,548,055</td><td colspan="3">$18,342,862</td></tr>
<tr><td rowspan="2">Traditional Credit Shelter Planning: First to die spouse creates a credit shelter trust; surviving spouse gifts and sells LLC interests to a new GST tax exempt grantor trust</td><td>$27,346,315</td><td>$142,293,544</td><td>$11,203,382</td><td>$4,344,673</td><td>$14,717,018</td><td>$4,690,485</td><td>$3,828,961</td><td rowspan="2">$18,230,877</td><td rowspan="2">$226,655,255</td></tr>
<tr><td colspan="2">$169,639,859</td><td colspan="2">$15,548,055</td><td colspan="3">$23,236,464</td></tr>
<tr><td rowspan="2">Hypothetical Technique: first to die spouse creates a credit shelter trust that is converted to a QSST; surviving spouse gifts and sells LLC interests to a new GST tax exempt grantor trust</td><td>$27,346,315</td><td>$142,293,544</td><td>$11,203,382</td><td>$4,344,673</td><td>$14,717,018</td><td>$4,690,485</td><td>$3,828,961</td><td rowspan="2">$18,230,877</td><td rowspan="2">$226,655,255</td></tr>
<tr><td colspan="2">$169,639,859</td><td colspan="2">$15,548,055</td><td colspan="3">$23,236,464</td></tr>
</table>

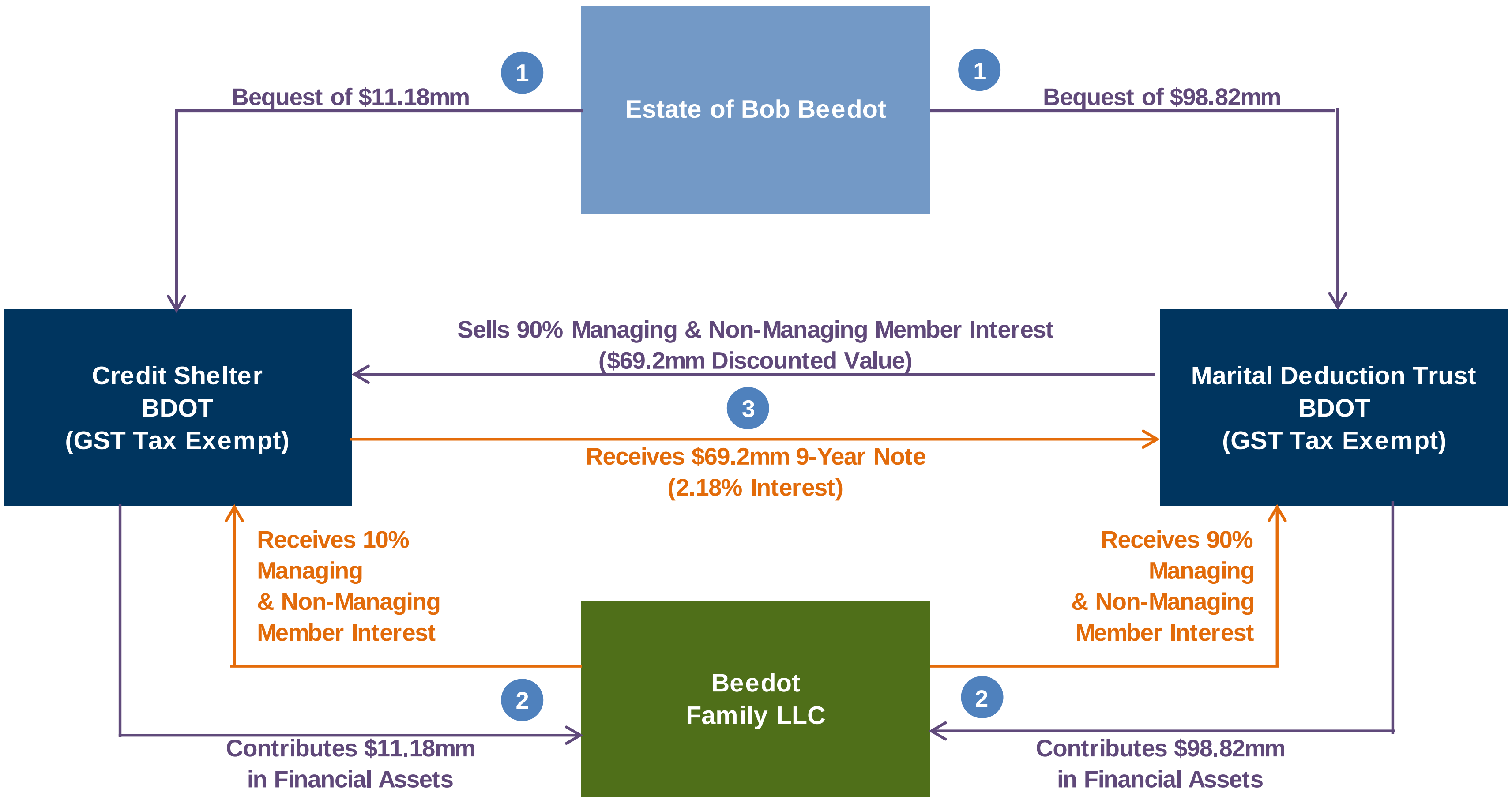
Transfer Tax Advantages of the Technique (Continued)

- Under this example, Harvey Happywithkids has a considerable safety net of being a beneficiary of the GST Credit Shelter Trust QSST, if he ever needs those resources.
- It has all of the advantages of converting a complex trust to a QSST.
- It has all of the transfer tax advantages of a SIDGT.
- Since under this technique, there is not a sale to a trust in which the seller is a beneficiary, there is much less IRC Secs. 2036 and 2038 pressure on the technique.

Considerations of the Technique (Page 199 of the Paper)

- The surviving spouse only has flexibility to change the beneficiaries of the GST credit shelter QSST (assuming the surviving spouse has a power of appointment over the trust) and any assets the surviving spouse owns (which may be significantly depleted by the time of his death).
- This technique has the same considerations of converting a complex trust to a QSST.
- This technique has the same considerations as sales of limited partnership interests to a grantor trust.

Both the Credit Shelter Trust and the Marital Deduction Trust Are Designed to be a BDOT for the Benefit of the Surviving Spouse; Both Trusts Contribute Their Assets to a FLLC; and, After That Contribution, the Marital Deduction Trust Sells its Member Interests in the FLLC to the Credit Shelter Trust (Pages 200-203 of the Paper)



Income Tax and Basis Enhancing Advantages of the Technique
(Page 201 of the Paper)

- There is a step-up in basis of the deceased spouse’s assets at his death.
- There is an opportunity through using borrowing strategies from third party lenders for the surviving spouse to increase the basis of the family’s assets during her lifetime.
- All of the income tax and basis enhancing advantages of creating a grantor trust and selling assets to a grantor trust are present with this technique.

Transfer Tax Advantages of the Technique (Pages 202-203 of the Paper)

- Significantly more assets may be passed to the next generation by using this technique than using the exemption to fund a credit shelter trust that is taxed as a complex trust and a marital deduction trust that is taxed as a complex trust.

	Beneficiaries		Consumption		IRS Income Tax			IRS Estate Tax (@ 40%)	Total
	Beedot Children (1)	Beedot Children & Grandchildren (2)	Direct Cost (3)	Investment Opportunity Cost (4)	Direct Cost (5)	Investment Opportunity Cost (6)	Embedded Capital Gains Tax (7)	(8)	(9)
10-Year Future Values									
Traditional Credit Shelter Planning: first to die spouse creates a credit shelter trust with his unified credit and balance of estate goes to a marital deduction trust	$86,124,803	$32,858,879	$11,203,382	$4,344,673	$23,662,299	$8,610,683	$392,061	$57,416,535	$224,613,316
	$118,983,682		$15,548,055		$32,665,044				
Traditional Credit Shelter Planning: first to die spouse creates a credit shelter trust and balance of estate goes to a marital deduction trust; the credit shelter trust and the marital deduction trust create an LLC; the marital trust sells LLC interest to the credit shelter trust	$29,178,407	$123,128,879	$11,203,382	$4,344,673	$25,054,497	$8,610,683	$3,640,523	$19,452,272	$224,613,316
	$152,307,286		$15,548,055		$37,305,703				
Hypothetical Technique: first to die spouse creates a credit shelter trust, that is a BDOT, and a marital deduction trust, that is also a BDOT; the credit shelter trust and the marital deduction trust create an LLC; the marital deduction trust sells LLC interests to the credit shelter trust	$19,675,355	$139,000,798	$11,203,382	$4,344,673	$25,044,447	$8,610,683	$3,617,074	$13,116,903	$224,613,316
	$158,676,153		$15,548,055		$37,272,205				

- The surviving spouse's rights with respect to assets owned by the BDOT, and cash flows produced by those assets, are substantial.

Considerations of the Technique (Page 203 of the Paper)

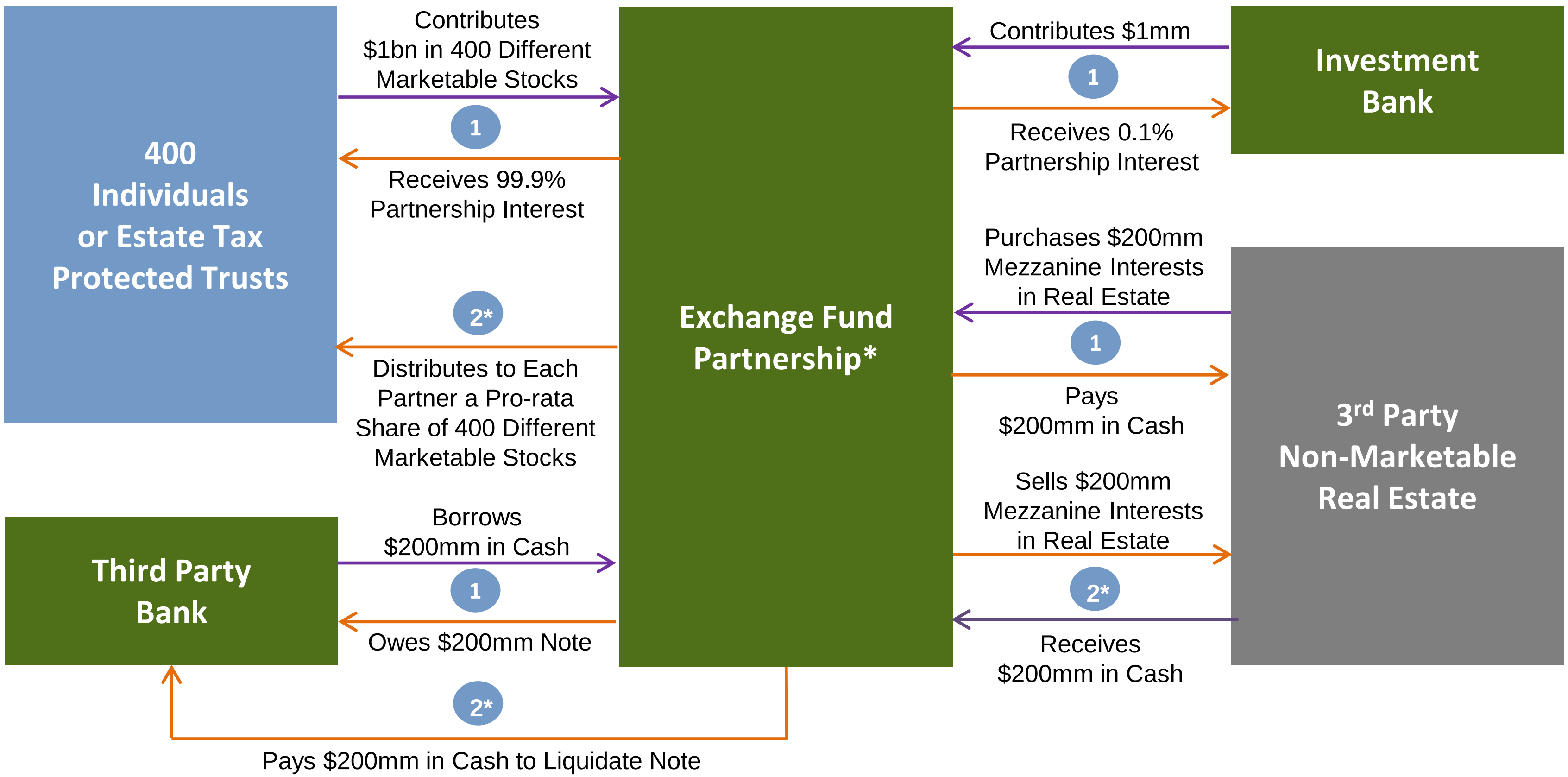
- This technique has the same considerations as the creation of a BDOT and sale to a BDOT.
- This technique has the same considerations as the creation of a grantor trust and a sale to a grantor trust.
- Like all leverage techniques, if the underlying assets stay flat or decline there is not any advantage to the technique and to the extent a gift tax exemption is used, the technique operates at a disadvantage.
- The marital trust must also give the surviving spouse the right to withdraw all the trust's accounting income for life in addition to giving the surviving spouse the right to withdraw the net taxable income for life. A spouse's right to withdraw accounting income satisfies the regulations applicable to marital trusts, including QTIP trusts. See Treas. Reg. §§20.2056(B)-5(F)(8) and 20.2056(B)-7(D)(2). Another alternative is to give the surviving spouse the right to withdraw the net taxable income and to require the accounting income to be distributed. If accounting income is required to be distributed, and if the surviving spouse is also given the right to withdraw the net taxable income, does the trust remain a wholly grantor trust under IRC Sec. 678 because of the spouse's power to withdraw net taxable income? The answer should be yes, because the grantor trust rules prevail over the otherwise applicable trust rules. See Treas. Reg. §1.671-2(d).

Goldman Sachs

Private Wealth Management

Comparison of the Advantages and Considerations of Some Favorite Partnership Planning Techniques

- Consider the following example:*



2* above is 7 years and 1 month after the Exchange Fund Partnership is created, the following occurs: (i) the partnership sells its mezzanine interest in real estate for cash; (ii) the partnership liquidates the debt owed to the 3rd Party Bank; and (iii) the partners liquidate their interest in exchange for their pro-rata interest in each stock owned by the partnership.

* Each transaction must be independent, separate and distinct.

Income Tax Advantage of the Technique (Pages 205-206 of the Paper)

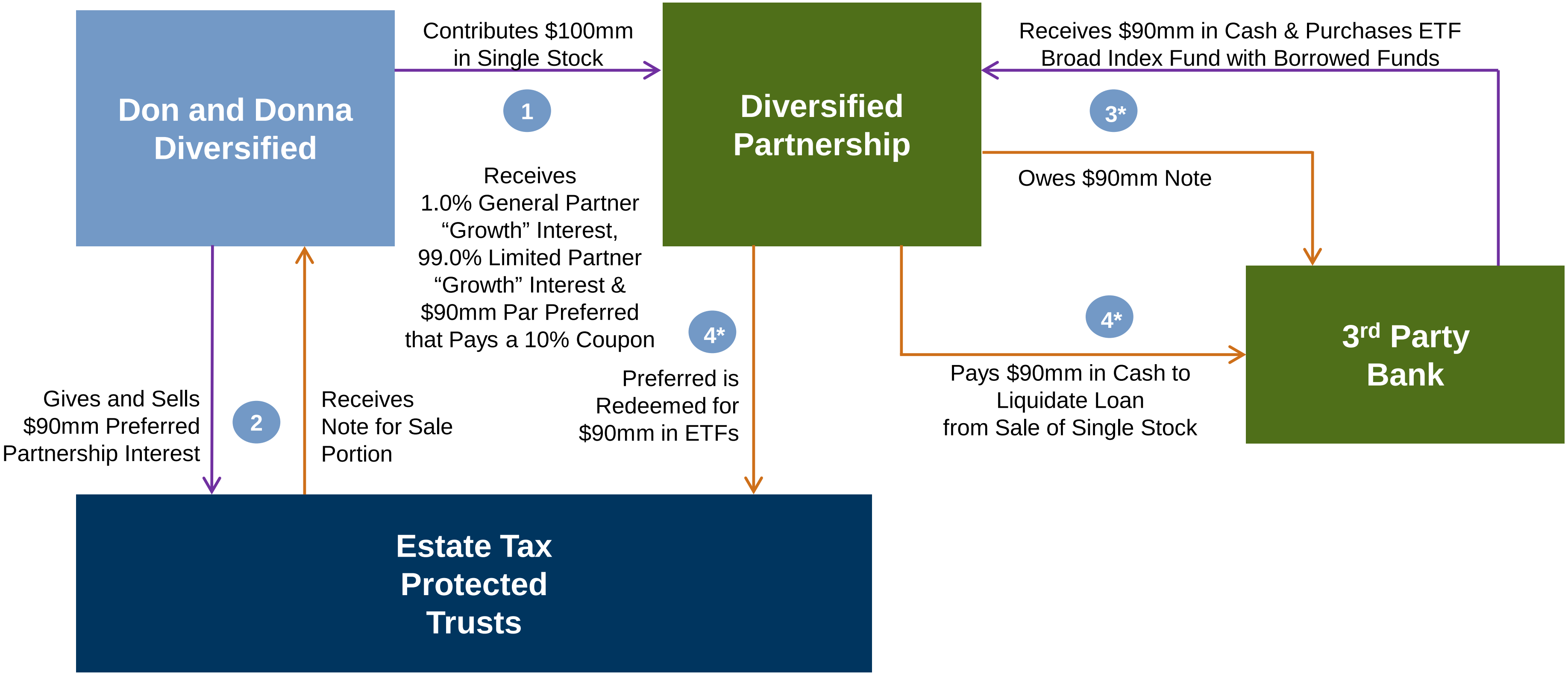
- The owner of the exchange fund will achieve diversification of his portfolio that has much less volatility, and achieve a seven-year or longer delay in paying a capital gains tax for that diversification.

Considerations of the Technique (Pages 206-207 of the Paper)

- Care needs to be taken to make sure there is not a deemed sale on the formation of the partnership under IRC Sec. 721.
- Care should be taken to make sure IRC Secs. 704(c), 737 and 707 do not apply.
- Each partner's basis in the assets that each partner receives on liquidation will equal that partner's total outside basis of the liquidated partnership interest.
- There are economic considerations in using exchange funds:
  - The lack of liquidity (there may be a six month or longer notice period before a partner can withdraw);
  - The financial management fees and third party bank loan interest may exceed the profits on the real estate investment;
  - The desire of the fund manager to accept certain securities than an investor would otherwise not invest; and
  - The performance of the other securities accepted into the fund over the seven-year period.
  - The taxpayer may only be able to diversify a limited amount of his single stock position because of limitations inherent in accepting stock from several taxpayers.

Using Closely Held Family Partnerships to Achieve Diversification and to Defer and Lower Income Taxes By Using Various Forms of Mixing Bowl Transactions (Example One) (Pages 207-215 of the Paper)

- Consider the following leveraged reverse freeze example:*



3* above is 7 years and 1 month after it is assumed (i) that the note owed to Don and Donna Diversified by the Estate Tax Protected Trusts has been paid; (ii) the grantor trust status is removed from the trusts and the trusts become complex trusts; (iii) the Diversified Partnership borrows $90mm from a 3rd Party Lender (Don and Donna guarantee the loan) and invests $90mm in ETFs.

4* above is when the $90mm preferred interest is redeemed for the ETFs and the partnership sells the $100mm Single Stock in order to pay off the 3rd party note.

*Each transaction must be independent, separate and distinct.

Advantages of the Family Partnership Mixing Bowl Techniques (Example One)
(Pages 212-213 of the Paper)

- Management fees do not have to be paid to a third party investment bank.

- The income tax benefit of the withdrawal: the illustrated "family structure" opportunities can provide the family an ability to manage the position through an appropriate controlled legal entity, while offering the potential for a long-term exit strategy that can be accomplished on a deferred tax basis.

  – In the example on slide 142 there will be no immediate tax consequences to the family trust diversifying its zero basis single stock position from its $90,000,000 position until the trust decides to sell part or all of its $90,000,000 diversified ETF position.

- In comparison to the exchange fund, this illustrated mixing bowl technique provides the retention of upside in the original appreciated position, albeit without diversification until the stock is sold, and without the lack of control with exchange funds.

- By using partnership division techniques that are in compliance with IRC Sec. 708, partnership assets could be isolated where basis planning is most useful.

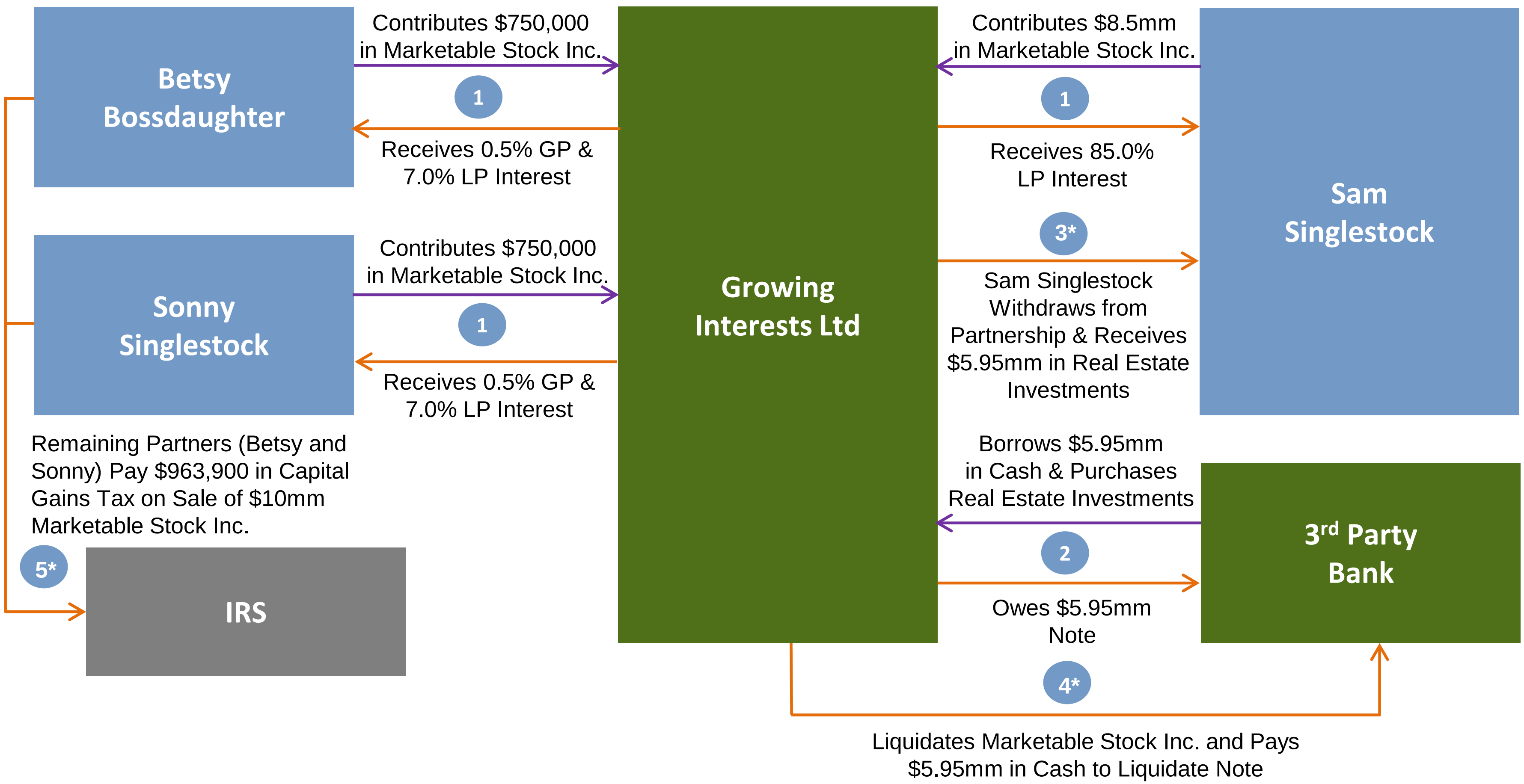
- The net result of the transactions in the example on slide 142 is that only a 2.38% initial capital gains tax has to be paid. If instead the zero basis $100,000,000 single stock had been sold with the sale proceeds being reinvested in a low turnover index fund, a combined 23.8% capital gains tax and Sec. 1411 tax would have to be paid.

- Transfer tax benefit of a withdrawal from a long-term partnership structure.

  – In the example on slide 142 the transfer tax benefits of the trust owning a 10% compounding preferred interest could be significant especially if the underlying stock does not grow at that same pace.

Using Closely Held Family Partnerships to Achieve Diversification and to Defer and Lower Income Taxes By Using Various Forms of Mixing Bowl Transactions (Example Two) (Pages 210-211 of the Paper)

- Consider the following example:



3*, 4* and 5* above happen more than 7 years after the creation of the partnership.

* Each transaction must be independent, separate and distinct.

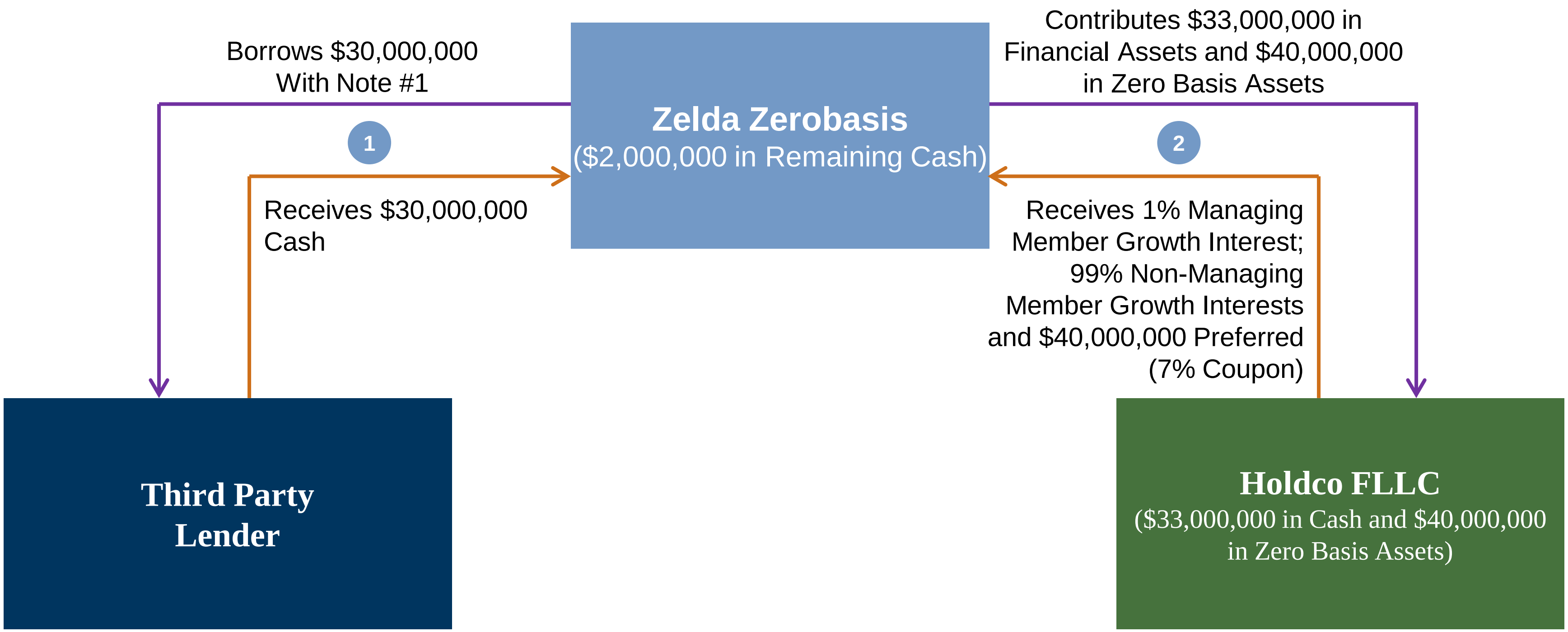
Advantages of the Family Partnership Mixing Bowl Techniques (Example Two)
(Pages 212-213 of the Paper)

- Management fees do not have to be paid to a third party investment bank.
- The income tax benefit of the withdrawal: the illustrated "family structure" opportunities can provide the family an ability to manage the position through an appropriate controlled legal entity, while offering the potential for a long-term exit strategy that can be accomplished on a deferred tax basis.
  - In the example on slide 144 the real estate investment will retain its zero basis without the imposition of a capital gains tax until it is sold, at which time Sam will recognize capital gains taxes. If Sam chooses to operate the real estate until his death, then IRC Sec. 1014 would apply upon his death and the real estate will receive a step-up in basis to its then fair market value. Betsy and Sonny, if the partnership makes an IRC Sec. 754 election, will receive a basis adjustment because of IRC Sec. 734(b) in the retained Marketable Stock that should allow the partnership to retire its debt with modest tax net consequences.
- In comparison to the exchange fund, this illustrated mixing bowl technique provides the retention of upside in the original appreciated position, albeit without diversification until the stock is sold, and without the lack of control with exchange funds.
- By using partnership division techniques that are in compliance with IRC Sec. 708, partnership assets could be isolated where basis planning is most useful.
- The net result of the transactions in the example on slide 144 is that Betsy and Sonny's collective net worth (assuming a 23.8% capital gains rate), after capital gains taxes and/or contingent capital gains taxes, will increase by 170.7%.
- Transfer tax benefit of a withdrawal from a long-term partnership structure.
  - In the example on slide 144 the valuation discount associated with the liquidation of Sam's limited partnership interest, if it is accurate, will not result in a gift tax, even though the fair market value of the remaining partnership interests owned by Betsy and Sonny will increase in value. This is because the withdrawing partner, Sam Singlestock, under the assumptions, received full and adequate consideration.

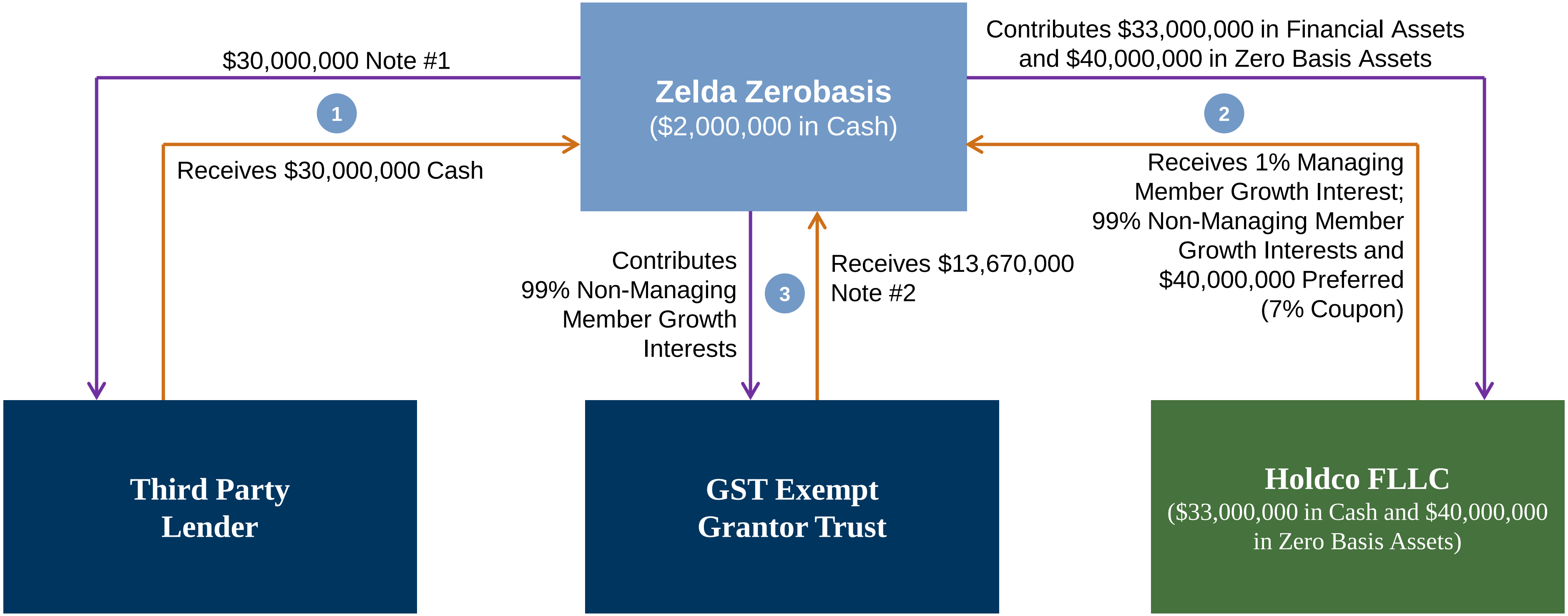
Considerations of the Mixing Bowl Technique (Pages 213-215 of the Paper)

- General considerations:
  - The individual transactions comprised in each technique must be independent, separate, and distinct. They must avoid application of the partnership anti-abuse rules. In the example on slide 142, it is important that the partnership operate as an "investment partnership" within the meaning of IRC Sec. 731(c)(3)(A)(iii) to prevent the distributed ETF units from being treated as money under IRC Sec. 731(c)(1).
- Tax consequences on formation of the partnership needs to be avoided.
  - Formation of the partnership should not be a taxable event under IRC Secs. 721 or 351, because there is not any diversification. There should not be any gift tax consequences on the formation of the partnership.
- Tax consequences when the partnership interests are redeemed need to be avoided.
- There is exposure that Congress could change the law, by the time a partner withdraws (*e.g.*, IRC Secs. 732 or 752 of the Code could be amended) and that the favorable liquidation rules would no longer be available. there is also exposure in that the IRS could change its regulations.
- Like all leverage techniques, if the underlying assets stay flat or decline there is not any advantage to the technique and to the extent a gift tax exemption is used, the technique operates at a disadvantage.
- If these techniques are used it will take at least seven years of partnership aging before the "safety" of diversification can be used.

- Consider the following example:
  - Hypothetical Transaction #1:

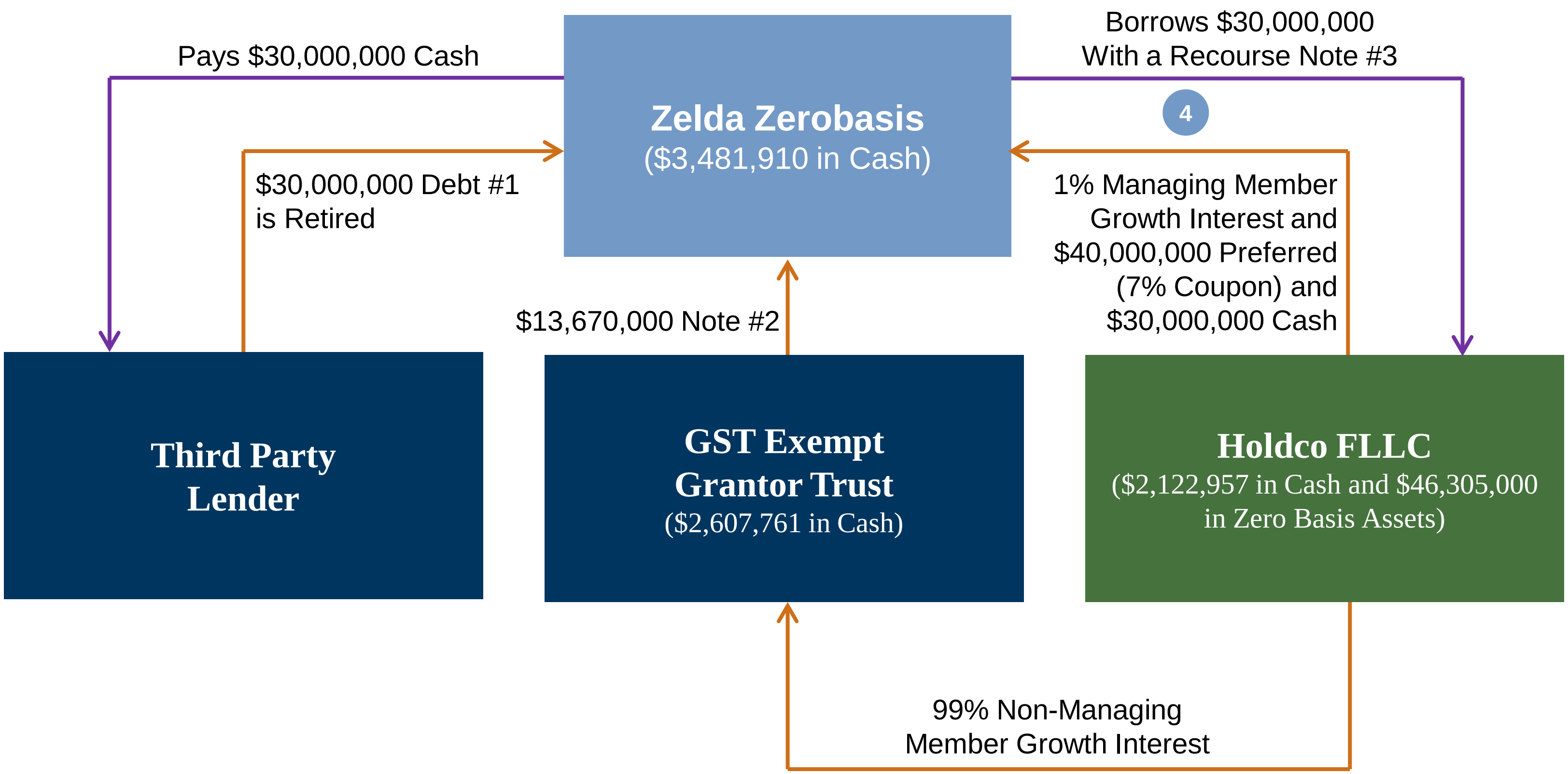


– Hypothetical Transaction #2:



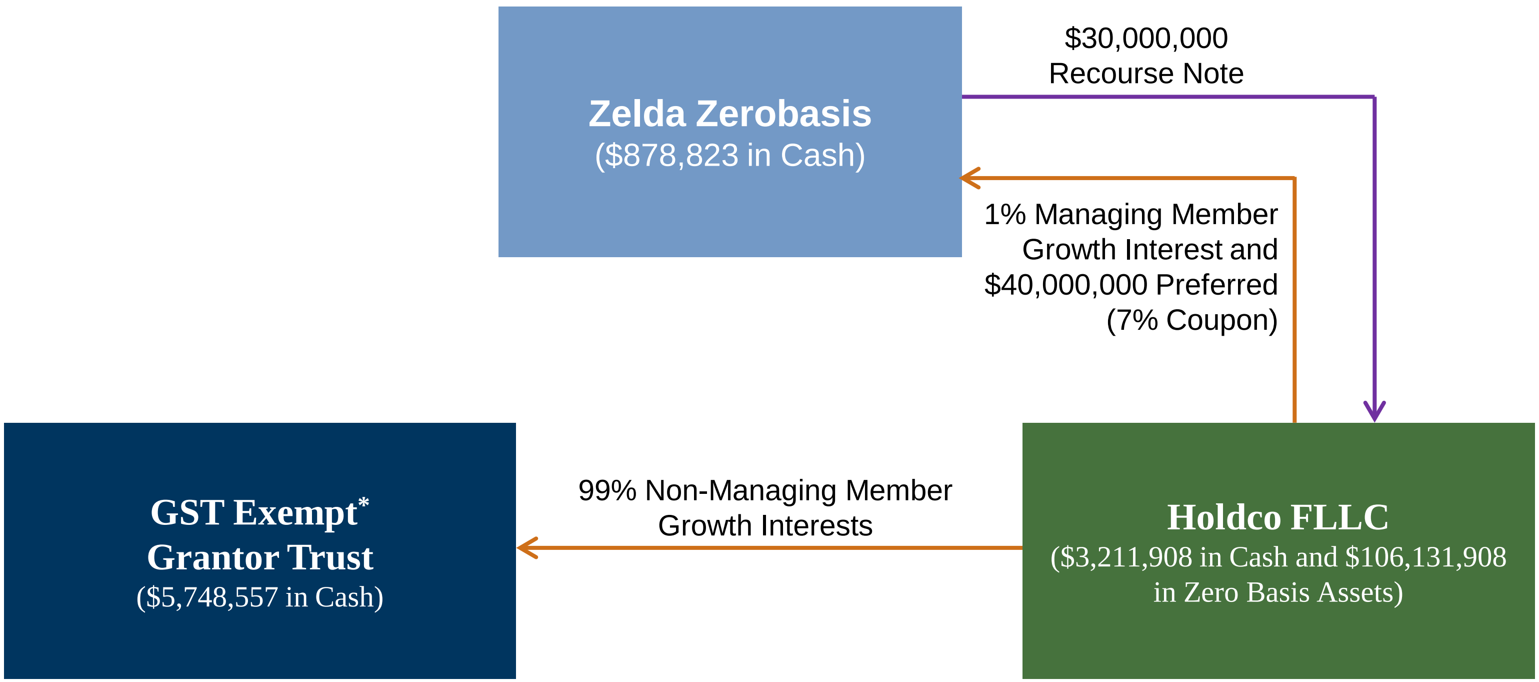
The Use of a Retained Preferred Partnership Interest and Third Party Leverage to Generate Effective Estate Planning and Basis Planning (Continued)

– Hypothetical Transaction #3:



The Use of a Retained Preferred Partnership Interest and Third Party Leverage to Generate Effective Estate Planning and Basis Planning (Continued)

– The moment before Zelda's death in 20 years the structure under the above assumptions may be as follows:



*Grantor Trust status removed in year 18.

Income Tax and Basis Enhancing Advantages of the Technique
(Page 219 of the Paper)

- This technique has the same advantage of being able to use third party borrowing by a disregarded entity to achieve basis adjustment in low basis assets.
- **The net effect of the illustrated technique is that for every $1 of the taxpayer's estate exposed to estate taxes there is a $4 increase in the basis of the low basis assets subject to the technique.**

Transfer Tax Advantages of the Technique (Pages 219-220 of the Paper)

- The net after income and transfer tax savings to Zelda are projected to be substantial:

	Zerobasis Children (1)	Zerobasis Children & Grandchildren (2)	Consumption (3)	Consumption Investment Opportunity Cost (4)	Opportunity Cost/(Benefit) of Borrowing from 3rd Party Lender (5)	IRS Income Tax (6)	IRS Income Tax Investment Opportunity Costs (7)	Estate Taxes (8)	Total (9)
20-Year Future Values									
No Further Planning: Bequeaths Estate to Family	$44,616,886	$8,530,000	$12,772,329	$13,053,175	$0	$15,575,474	$15,627,875	$29,744,590	$139,920,329
Hypothetical Technique: Bequeaths Remaining Estate to Family	$3,135,638	$82,597,794	$12,772,329	$13,053,175	($11,079,903)	$22,247,774	$15,103,098	$2,090,425	$139,920,329
Present Values (Discounted at 2.5%)									
No Further Planning: Bequeaths Estate to Family	$27,228,389	$5,205,611	$7,794,581	$7,965,974	$0	$9,505,259	$9,537,238	$18,152,259	$85,389,311
Hypothetical Technique: Bequeaths Remaining Estate to Family	$1,913,589	$50,407,034	$7,794,581	$7,965,974	($6,761,743)	$13,577,170	$9,216,982	$1,275,726	$85,389,311

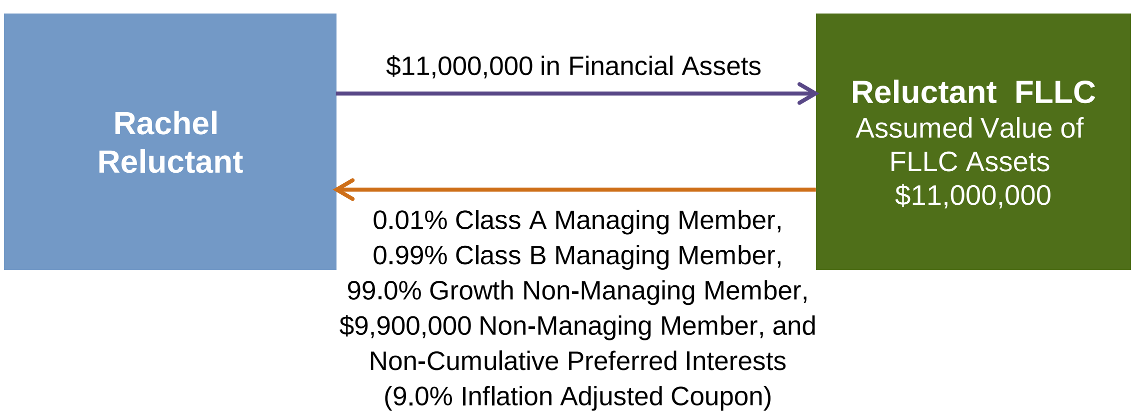
- This technique also has the same advantages as the SIDGT.

Considerations of the Technique (Pages 220-221 of the Paper)

- This technique has the same considerations as a SIDGT, except this technique may address step-up in basis planning in a more advantageous manner.
- Care must be taken to comply with the gift tax valuation rules of IRC Sec. 2701.
- Third party financing, at least on a temporary basis, may be necessary.
- This technique has many of the same considerations as a grantor trust has in third party borrowing to achieve basis adjustment in low basis assets.

Preferred Partnership Freeze That is IRC Sec. 2701 Non-Compliant to Solve the Problems Associated With a Disappearing Exemption and a Client Who Needs Cash Flow Using the Intentionally Defective Preferred Interest Partnership or "IDPIP" Technique (Pages 221-227 of the Paper)

- What is the IDIP technique?
  - A taxpayer, because of the increased gift tax exemption, may be concerned that he or she cannot use the increased exemption because of the need to access the cash flow from the assets that could be given away.
  - However, if the increased gift tax exemption is not used that taxpayer may be concerned that the increased gift tax exemption may be eliminated in 2026, or earlier, depending upon future elections.
  - A taxpayer, with that profile could retain a preferred interest in a FLP or a FLLC, which uses his new exemption, even though the preferred is retained, and still achieve substantial estate tax savings because the preferred is subject to estate taxes as if it is worth zero for estate tax purposes.
  - Consider the following example:



FLP Partner	Ownership %
Rachel Reluctant (or affiliates)	0.01% Class A Managing Member, 0.99% Class B Managing Member, 99.0% Growth Non-Managing Member $9,900,000 Non-Managing Member, and Non-Cumulative Preferred Interests (9% Inflation Adjusted Coupon)

Advantages of the IDPIP Technique (Pages 225-226 of the Paper)

- In the above example, the beginning non-cumulative preferred interest coupon of $891,000 (9% times $9,900,000) is designed to grow with inflation. There is flexibility because the preferred is non-cumulative. There is flexibility because the preferred is non-cumulative.
- The preferred is also designed to give Rachel the right to put the preferred to the partnership at any time and receive the par value of the preferred from the partnership.
- If there is not enough net cash flow in the FLLC in any one year to pay all of the preferred coupon, the coupon will only be paid to the extent the net cash flow exists. If Rachel does not withdraw all that she could under her noncumulative preferred coupon rights there is case law that it will not be considered a gift.
- If Rachel is in a position to control the investments of the FLLC that investment power alone should not constitute a legal right as described in IRC Secs. 2036 or 2038.
- At a later time, in an independent and distinct transaction, Rachel could give 99% “growth” non-managing interests in the FLLC to a generation-skipping exempt grantor trust for the benefit of her family.
- The Class A managing member interests would control all entity managing member decisions, including investment management decisions, that are not delegated to the Class B managing member interest.
- The Class B managing member interests would control all distribution, amendment and liquidation decisions.
- Due to considerations with respect to retaining entity distribution, amendment and liquidation powers, Rachel could retain the 0.01% Class A managing member interest and transfer the 0.99% Class B managing member interest to a trust in which a trusted family friend or advisor is the trustee. Rachel could retain the right to replace that trustee, as long as the replacement is not related or subservient.

Advantages of the IDPIP Technique (Continued)

- See the illustration below:

Rachel Reluctant

Gift of Growth Member Interests (Assumed Discounted Value of $770,000) →

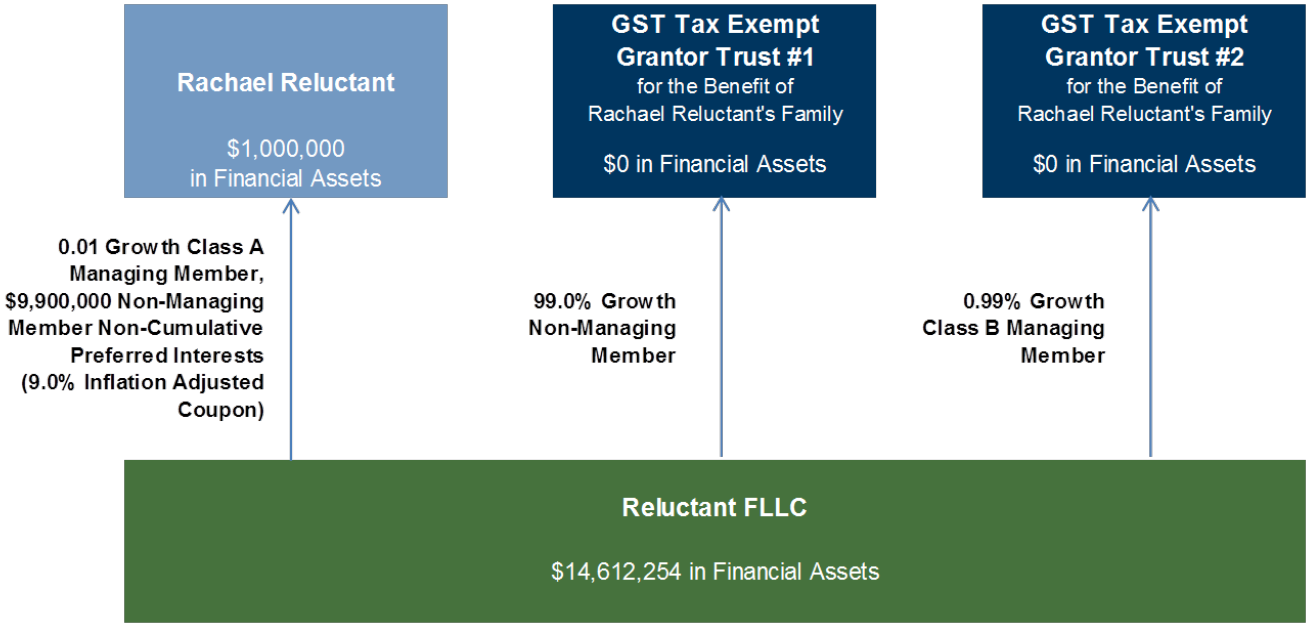
GST Exempt Grantor Trusts #1 and #2 for the Benefit of Rachel Reluctant's Family

FLP Partner	Ownership %
Rachel Reluctant (or affiliates)	0.01% Class A Managing Member, $9,900,000 Non-Managing Member, and Non-Cumulative Preferred Interests (9% Inflation Adjusted Coupon)
GST Exempt Grantor Trust #1	99.0% Growth Non-Managing Member
GST Exempt Grantor Trust #2	0.99% Class B Managing Member Interest

- If the preferred interest is non-cumulative, and does not have any fixed liquidation rights, it will be worth "0" for gift tax purposes under the subtraction method because of the operation of the valuation rules under IRC Sec. 2701.
- However, those rules, for gift tax purposes, do not affect the minority and marketability discounts associated with gifts of junior ("growth") interests.
- Also, the valuation rules under IRC Sec. 2701, do not apply in determining the amount of any generation skipping gift.

Advantages of the IDPIP Technique (Continued)

- <u>The $9,900,000 "extra gift" caused by the gift tax valuation rules will be mitigated by subtracting the amount of that $9,900,000 "extra gift" in calculating the estate taxes at Rachel's death</u>. *See* IRC Treas. Reg. § 25.2701-5(a)(3).
- The further good news is that mitigation does not affect the calculation of the value of the preferred interest for estate tax purposes, which can lead to basis step up advantages, if an IRC Sec. 754 election is made by the partnership.
- In 15 years, at the time of Rachel's death, under the above assumptions, Rachel's balance sheet and the family FLLC balance sheet will be as follows:



Advantages of the IDPIP Technique (Continued)

- Despite the fact that Rachel has available the cash flow from almost all of her assets, and those assets have a value more than double the available transfer tax exemption in 2025, the technique is very effective in minimizing estate and gift taxes.
- There will be no estate tax, there will be no gift tax, and there will be a step up in basis on around $11,000,000 of the assets, if an IRC Sec. 754 election is made by the FLLC on her death. The same step-up in basis would probably not be available with a note sale to a grantor trust. *See* the table below:

	Total to All Descendants		Consumption		Income Tax			
	Reluctant Children	Reluctant Children and Grandchildren	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost	Estate Taxes (@ 40%)	Total
15-Year Future Values								
No Further Planning: Bequeaths Estate to Family (assumes $7.9mm estate tax exemption available at death)	$4,894,296	$7,900,000	$6,455,494	$4,030,373	$4,050,605	$2,514,747	$3,262,864	$33,108,378
	$12,794,296							
Creation of a FLLC; Gift of Growth Non-Managing Member Interests to a GST Exempt Grantor Trust; Bequeaths Estate to Family; $9.9mm Non-Managing Member Non-Cumulative Preferred Not Taxed in Estate (assumes $12.20mm estate tax exemption equivalent available at death which includes an additional $9.9mm mitigation of preferred)	$8,746,123	$6,866,132	$6,455,494	$4,030,373	$4,495,510	$2,514,747	$0	$33,108,378
	$15,612,254							
Present Value (discounted at 3%)								
No Further Planning: Bequeaths Estate to Family (assumes $7.9mm estate tax exemption available at death)	$3,141,462	$5,070,709	$4,143,536	$2,586,943	$2,599,929	$1,614,120	$2,094,308	$21,251,008
	$8,212,172							
Creation of a FLLC; Gift of Growth Non-Managing Member Interests to a GST Exempt Grantor Trust; Bequeaths Estate to Family; $9.9mm Non-Managing Member Non-Cumulative Preferred Not Taxed in Estate (assumes $12.20mm estate tax exemption equivalent available at death which includes an additional $9.9mm mitigation of preferred)	$5,613,803	$4,407,109	$4,143,536	$2,586,943	$2,885,497	$1,614,120	$0	$21,251,008
	$10,020,912							

Advantages of the IDPIP Technique (Continued)

- Tax advantages similar to creating a LAIDGT and tax advantages similar to a sale to a LAIDGT.
- The near term death of the grantor of a grantor trust generally does not affect the technique like the death of a grantor of a GRAT.
- The appreciation of the assets of the trust, above the preferred coupon that is paid, will not be taxable in the grantor's estate.
- IRC Sec. 2036 advantage.
  - The purpose of having preferred and common interests is to divide the economic return of the FLP or FLLC between the owners of the interests in a different way than would result without the two interests. This is a substantive investment reason for the creation of the FLP or FLLC. As such, it should constitute a significant nontax purpose, one that is inherent in the preferred/common structure.
  - The enactment of IRC Sec. 2036(c) (in 1988) and its subsequent repeal (in 1990) demonstrates that going forward Congress intended to address the preferred/common structure solely by means of the gift tax rules of Chapter 14 (IRC Sec. 2701) and *not* by including the transferred common interest in the transferor's gross estate under IRC Sec. 2036. The legislative history of the repeal of IRC Sec. 2036(c) unmistakably manifests this Congressional intent.
- Flexibility advantages.
  - Since the preferred coupon is noncumulative, this technique has the advantage of flexibility. If in a particular tax year the enterprise investments do not produce enough cash flow to pay the preferred coupon, the taxpayer's estate does not grow because of the cumulative feature.

Advantages of the IDPIP Technique (Continued)

- Basis advantages.
  - The taxpayer's estate will get a step up in basis for the fair market value of the preferred, which can be transported to the assets of the FLLC or FLP under IRC Sec. 754.
- The capital gains consequences that may exist for existing note receivables and/or payables with the sale to a grantor trust technique does not exist at death with this technique.
- The technique could work in much larger situations through the use of convertible debt. For example, the creator of an IDPIP could create a leveraged single member LLC with $100,000,000 in assets. The leverage could be a $90,000,000 convertible note. See the discussion of the LAIDGT technique. The equity in the LLC could be funded with $10,000,000 in exchange for a $9,000,000 defective preferred member interest and a $1,000,000 "growth" interest. The client could transfer the growth interest to a grantor trust and keep the $90,000,000 in convertible debt and the $9,000,000 defective preferred member interest.

Considerations of the IDPIP Technique (Pages 226-227 of the Paper)

- There needs to be enough substantive equity in the growth interest in the entity.
- The IRS could be successful in applying the step transaction doctrine to the technique to eliminate the inherent valuation discounts.
- If the assets of the entity decrease in value, the gift tax exemption equivalent may not be recoverable.
- The IRS may contest the valuation of the growth interests that are donated to the grantor trust.

Biography

Biographies

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Stacy joined the firm to expand the advisory team working with Private Wealth Management clients. He currently works with private clients and their own advisors with their strategic wealth management plans, combining a variety of income tax, estate planning and gifting techniques. Prior to joining Goldman Sachs in October 2000, Stacy was a senior partner with Baker Botts, L.L.P. in Houston, Texas. Stacy received his B.S. (with Honors) from Washington and Lee and his J.D. from The University of Texas (with Honors). Stacy's professional associations include: Member of the International Academy of Estate and Trust Law; Fellow of the American College of Trust and Estate Counsel (Regent for 1992/1998 term); Member of the American Bar Association (Supervisory Council Member of the Real Property, Probate and Trust Law Section from 1990-1998); Member of the Texas Bar Association (Texas Bar Foundation Fellow); Member of the Houston Bar Association (Houston Bar Foundation Fellow). Stacy is listed in Who's Who in America and was selected to receive the Marquis Who's Who Lifetime Achievement award in 2017. Stacy is also listed in The Best Lawyers in America (Woodward/White). He has been listed in Town & Country and in Bloomberg Personal Finance as one of the top trust and estate lawyers in the U.S. Stacy was selected as one of the ten initial recipients of the Accredited Estate Planner® award of the Estate Planning Hall of Fame® of the National Association of Estate Planners and Councils (2004). He was chosen as the 2018 Hartman Axley Lifetime Service Award recipient of the National Association of Estate Planners and Councils. He was recently named one of the "Top 100 Wealth Advisors" to ultra-high net worth individual clients in the United States by Citywealth magazine. Articles about Stacy's estate planning ideas have also been featured in Forbes and Fortune magazines. Stacy is a prominent lecturer throughout the country.

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