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Pulling a Rabbit Out of the GRAT Hat: Some of the Most Creative Structural GRAT Planning Ideas We See Out There

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Private Wealth Management

Pulling the Rabbit Out of the GRAT Hat: Some of the Most Creative Structural GRAT Planning Ideas We See Out There

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The information herein is provided solely to educate on a variety of topics, including wealth planning, tax considerations, estate, gift and philanthropic planning.

What is a Traditional Grantor Retained Annuity Trust ("GRAT") and What Is This Presentation All About?

(See Pages 1 – 11 of the Paper)

- What is a GRAT?
  - A GRAT is an irrevocable trust to which the grantor transfers an asset in exchange for the right to receive a guaranteed annuity for a fixed number of fiscal years (the "Annuity Period").
  - When the trust term expires, any GRAT balance remaining is transferred tax free to a designated remainder beneficiary (e.g., a "defective grantor trust" for the benefit of the grantor's spouse and issue).
  - IRC Sec. 2702 provides that for a gift of the remainder of a GRAT in which the grantor retains a "qualified interest," defined to include a guaranteed annuity, the taxable gift will be reduced by the present value of the qualified interest, as determined pursuant to a statutory rate determined under IRC Sec. 7520(a)(2) (the "Statutory Rate").
  - In general, Statutory Rate requires an actuarial valuation under prescribed tables using an interest rate equal to 120 percent of the Federal midterm rate in effect for the month of the valuation.
  - A grantor's ability to determine the size of the guaranteed annuity and the annuity period at the outset allows the GRAT to be constructed so that the present value of the grantor's retained interest approximately equals the value of the property placed in the GRAT, resulting in a "zeroed out" GRAT.
  - If the grantor survives the GRAT term and the GRAT earns a yield or otherwise appreciates at a rate that exceeds the Statutory Rate, the amount of such excess value should pass to the GRAT's designated beneficiaries free of transfer tax.

What is a Traditional Grantor Retained Annuity Trust (“GRAT”) and What Is This Presentation All About? (Continued)

- Advantages of a traditional GRAT:
  - Valuation advantage of a GRAT.
    - Under the regulations, the grantor’s retained annuity rights may be defined in the trust instrument as a percentage of the fair market value of the property contributed by the grantor to the trust, *as such value is finally determined for federal tax purposes*.
    - *This valuation advantage may be the most important advantage of the GRAT in comparison to other estate planning techniques. The IRS is not going to argue their own regulations are against public policy like they have with other defined value assignments. The IRS served notice in its 2015-2016 Priority Guidance Plan that they are taking dead aim with perhaps a regulations project against other forms of defined value assignments.*
  - Ability of grantor to pay for income taxes associated with GRAT gift tax-free and substitute assets of the GRAT income tax-free.
  - Synergy with other techniques.
  - Comparatively low hurdle rate.
  - High leverage.
  - Non-recourse risk to remaindermen.

What is a Traditional Grantor Retained Annuity Trust ("GRAT") and What Is This Presentation All About? (Continued)

- Considerations of a traditional GRAT:
  - There are 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 U.S. Court of Appeals for the Eleventh Circuit (*see Atkinson*, 309 F.3rd 1290 (11th Cir. 2002), cert denied, 540 U.S. 945 (2003)), has held that an inter vivos charitable remainder annuity trust's (CRAT's) failure to comply with the required annual payment regulations during the donor's lifetime resulted in complete loss of the charitable deduction. Even though the subject CRAT prohibited the offending acts of administration, the Court held that the CRAT fails.
      - In a similar fashion, the Internal Revenue Service could take the position that if the regulations under IRC Sec. 2702 are violated by the trustee of the GRAT's administrative practices, then the interest retained by the grantor will not be a qualified interest. Just as in the *Atkinson* case, it may not matter if appropriate savings language is in the document.
    - The annuity amount must be paid annually.

What is a Traditional Grantor Retained Annuity Trust (“GRAT”) and What Is This Presentation All About? (Continued)

- 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 clients stewardship goals because the investments of the GRAT may have been too successful.

– The GST tax exemption may be difficult to leverage through the use of a traditional GRAT structure.

- This is because of the estate tax inclusion period (“ETIP”) rule found in IRC Sec. 2642(f)(3), which provides as follows:

> Any period after the transfer described in paragraph (1) during which the value of the property involved in such transfer would be includible in the gross estate of the transferor under Chapter 11 if he died. The transferor’s exemption for generation-skipping tax purposes cannot be allocated until after the ETIP period.

– 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.

- Some of the goals of this presentation:
  - There is no question that the GRAT is one of the most popular estate planning tools that the practitioner utilizes. While it is a very popular estate planning tool, it is probably a fair statement, as noted above, that it is not always an effective estate planning tool. Critical administrative issues exist with a GRAT that can lead to its failure.
  - The purpose of this presentation is to offer the reader some suggested solutions, which should ameliorate or eliminate the above concerns and make the GRAT a more effective estate planning tool.
  - In addition to discussing suggested solutions to the considerations of using a traditional GRAT, this paper will discuss the synergy of designing structures to be used with a GRAT that address the following additional goals:
    - Designing a GRAT structure to save transfer taxes and income taxes by using basis enhancing strategies in the administration of the GRAT;
    - Designing a GRAT structure to work well for an art owner who wishes to possess his art until his death;
    - Designing a GRAT structure to be a better alternative to a QPRT for a personal residence owner who wishes to use that property until his death;
    - Designing a GRAT structure to simulate a sale to a grantor trust without the considerations of a sale to a grantor trust;

What is a Traditional Grantor Retained Annuity Trust ("GRAT") and What Is This Presentation All About? (Continued)

- Designing a GRAT structure to protect the taxpayer from any new regulations under IRC Sec. 2704(b)(4);
- Designing a GRAT structure to facilitate charitable planning;
- Designing a GRAT structure to be the last GRAT the grantor ever creates (i.e., a legal structure eliminates the need for cascading GRATs);
- Designing a GRAT structure so that the grantor never runs out of money;
- Designing a GRAT structure to work well for equity fund or hedge fund managers and avoid IRC Sec. 2701 rules;
- Designing a GRAT structure to allow the grantor to have investment control and some distribution control over the GRAT assets when the GRAT terminates; and
- Designing a GRAT structure to own and pay for life insurance.

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

(See Pages 11 – 13 of the Paper)

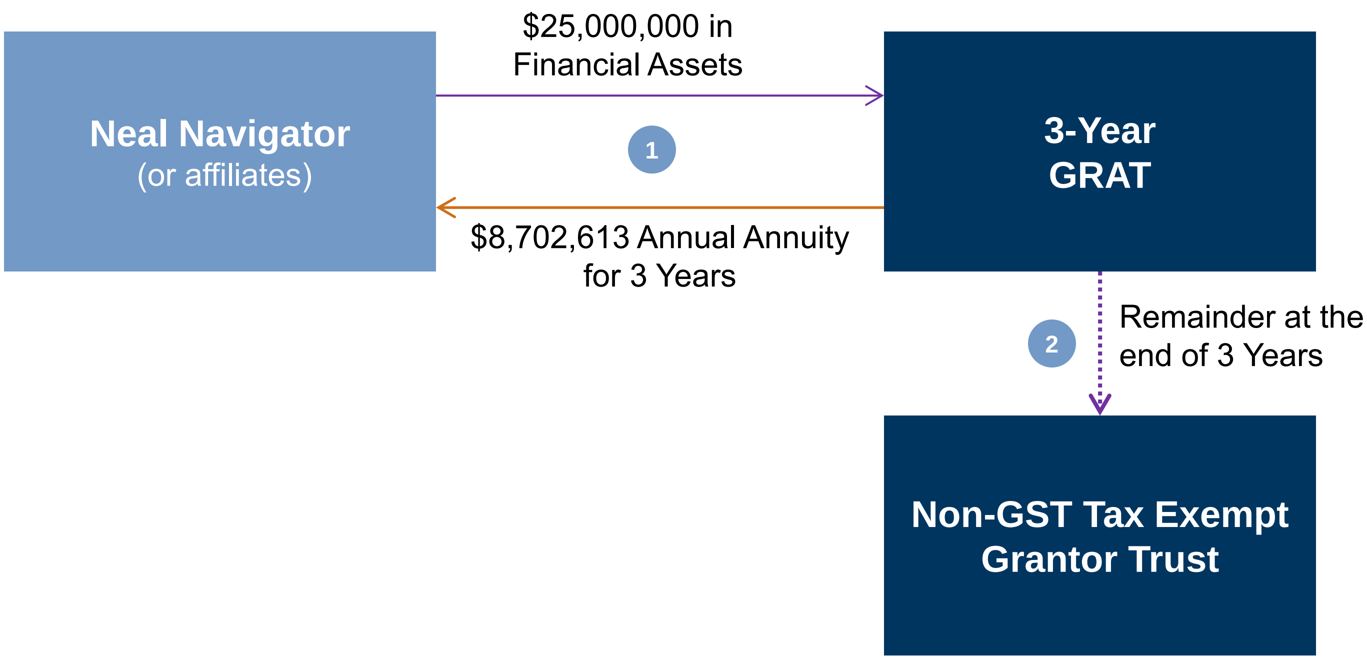
- Structural solutions to prevent the inadvertent additional contribution of assets to a GRAT.
  - When creating the GRAT, the grantor may wish to consider a provision that prohibits any additional contributions to the GRAT and if any additional contribution is made, a new GRAT must be created specifically 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.

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

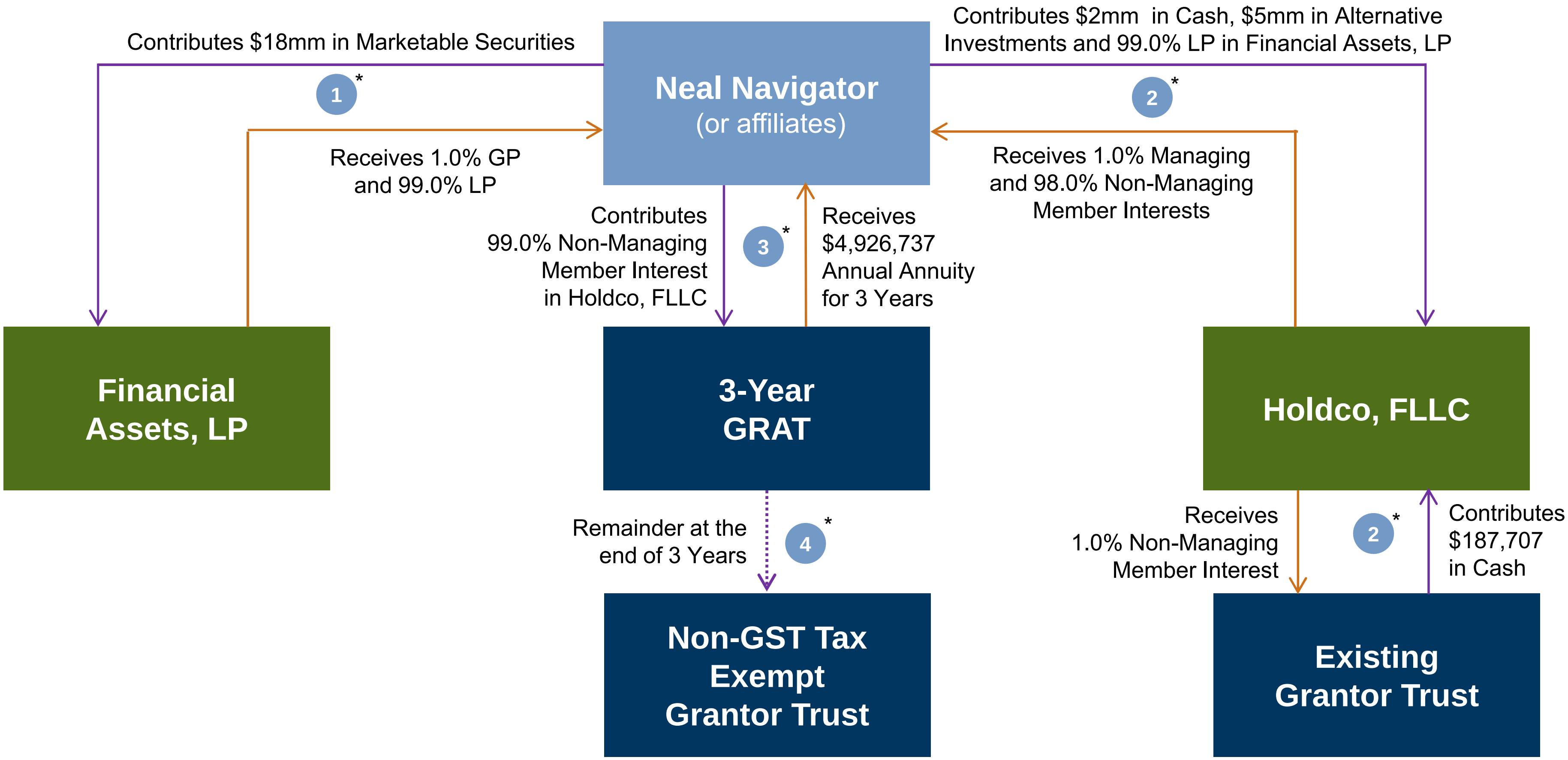
- Structural solutions to limit the amount that is received by the remainderman of the GRAT.
  - A structural solution is to put a cap on the amount left in the trust for the benefit of his descendants at the end of the annuity term.
  - To the extent that the value of the assets of the GRAT on its termination exceeds that cap, there could be a provision that requires that excess to revert back to the donor.
- 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 two strategies: a member interest in a leveraged family limited liability company ("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.

Marrying the Best Characteristics of a Discounted Sale to a Grantor Trust With a GRAT: The Advantages and Considerations of Contributing a Proportionate Interest, a Preferred Interest, and/or a Growth Interest in a Leveraged FLLC to a GRAT (See Pages 13 – 49 of the Paper)

Hypothetical Technique A
Traditional GRAT

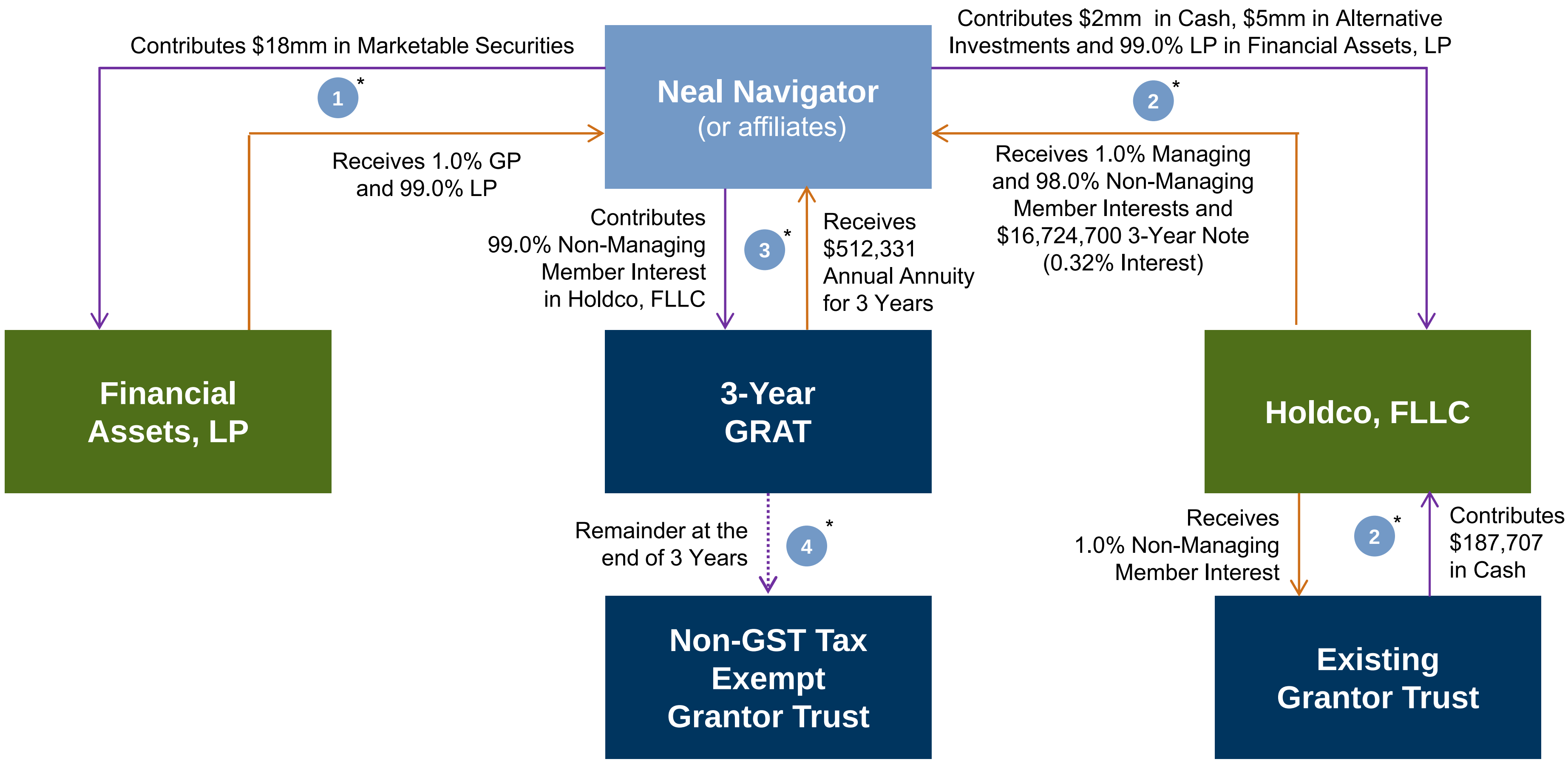


Hypothetical Technique B
Contribution of Non-Leveraged Entities to a GRAT



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

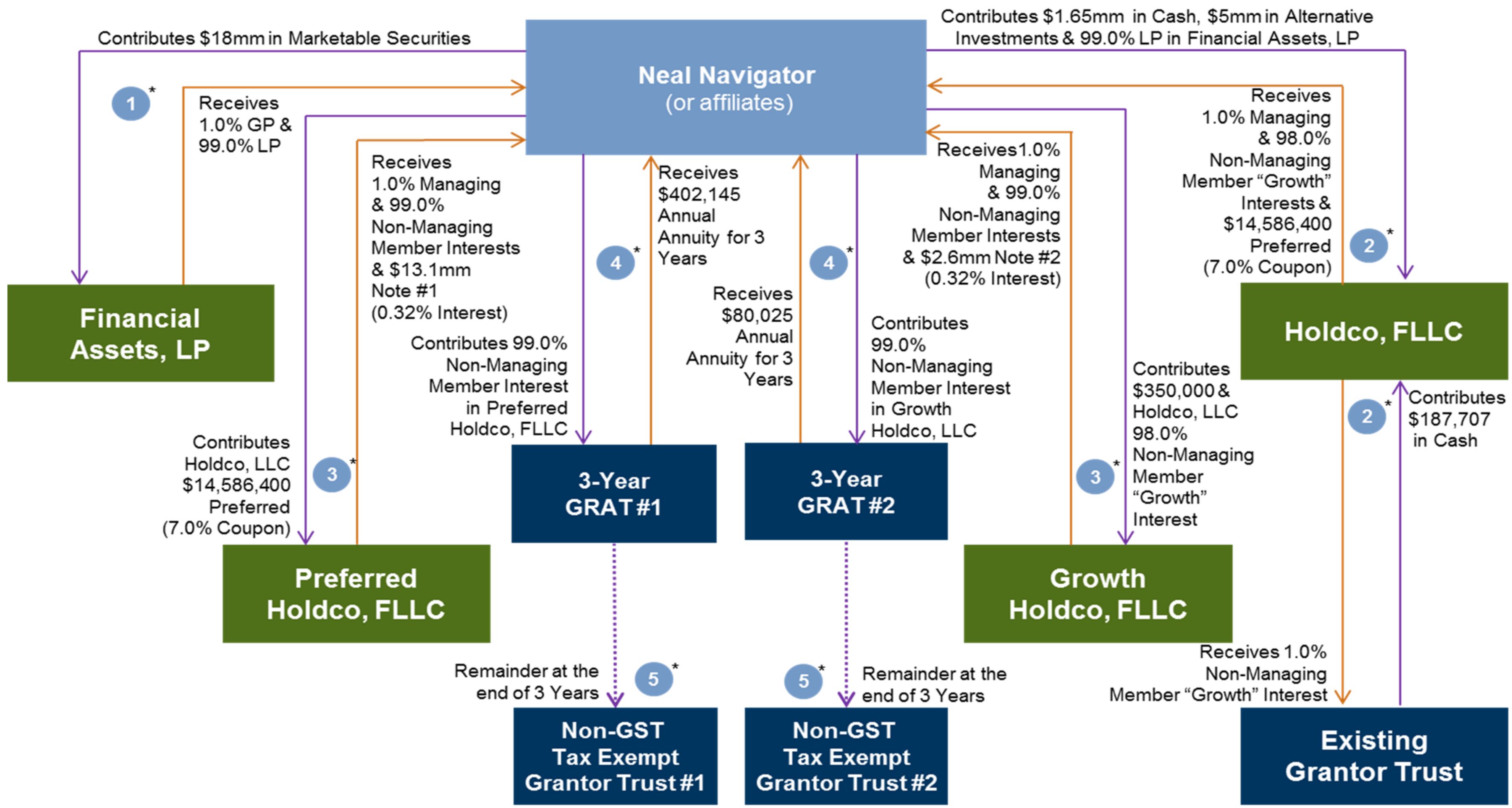
Hypothetical Technique C
Leveraged FLLC Assets Contributed to a GRAT



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

Hypothetical Technique D

Assets Contributed to Two GRATs with Different Provisions



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

Hypothetical Results – Scenario 1

Hypothetical Techniques Scenario 1: Assets Earn 2.20% Annually, IRS 7520 Rate of 2.20%	Neal Navigator	Navigator Children	% Improvement Over Technique #1	% Improvement Over Technique #2	% Improvement Over Technique #3
No Further Planning	$26,553,039	$0	N/A	N/A	N/A
Technique A: Contributing Assets That Are Not in Entities to a GRAT	$26,552,894	$144	N/A	N/A	N/A
Technique B: Contribution of Non-Leveraged Entities to a GRAT	$24,217,863	$2,335,176	1619182.15%	N/A	N/A
Technique C: Leveraged FLLC Asset Contributed to a GRAT	$18,781,789	$7,771,250	5388721.91%	232.79%	N/A
Technique D: Two Leveraged FLLCs (Preferred and Growth) Assets Contributed to Two Different GRATs	$17,455,005	$9,098,034	6308754.37%	289.61%	17.07%

Hypothetical Results – Scenario 2

Hypothetical Techniques Scenario 2: Assets Earn 7.40% Annually, IRS 7520 Rate of 2.20%	Neal Navigator	Navigator Children	% Improvement Over Technique #1	% Improvement Over Technique #2	% Improvement Over Technique #3
No Further Planning	$30,292,932	$0	N/A	N/A	N/A
Technique A: Contributing Assets That Are Not in Entities to a GRAT	$27,409,575	$2,883,358	N/A	N/A	N/A
Technique B: Contribution of Non-Leveraged Entities to a GRAT	$24,501,833	$5,791,099	100.85%	N/A	N/A
Technique C: Leveraged FLLC Asset Contributed to a GRAT	$18,401,811	$11,891,122	312.41%	105.33%	N/A
Technique D: Two Leveraged FLLCs (Preferred and Growth) Assets Contributed to Two Different GRATs	$17,080,466	$13,212,466	358.23%	128.15%	11.11%

Hypothetical Results – Scenario 3

Hypothetical Techniques Scenario 3: Assets Earn 10.00% Annually, IRS 7520 Rate of 2.20%	Neal Navigator	Navigator Children	% Improvement Over Technique #1	% Improvement Over Technique #2	% Improvement Over Technique #3
No Further Planning	$32,295,905	$0	N/A	N/A	N/A
Technique A: Contributing Assets That Are Not in Entities to a GRAT	$27,826,552	$4,469,353	N/A	N/A	N/A
Technique B: Contribution of Non-Leveraged Entities to a GRAT	$24,569,260	$7,726,645	72.88%	N/A	N/A
Technique C: Leveraged FLLC Asset Contributed to a GRAT	$18,186,732	$14,109,173	215.69%	82.60%	N/A
Technique D: Two Leveraged FLLCs (Preferred and Growth) Assets Contributed to Two Different GRATs	$16,784,233	$15,511,672	247.07%	100.76%	9.94%

Advantages of a Leveraged FLLC Asset GRAT 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 Leveraged FLLC Asset GRAT avoids the necessity of continually creating GRATs using the so–called "cascading GRATs" technique
- The Leveraged FLLC Asset GRAT locks in today's low interest rate
- The Leveraged FLLC Asset GRAT has a lower "hurdle rate" than a GRAT

Advantages of a Leveraged FLLC Asset GRAT in Comparison to a Defined Value Sale to a Grantor Trust With the Excess Above the Defined Value Passing to GRAT

- 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
- If there is an adjustment with respect to the value of the transferred asset, because of an IRS audit, there will be an additional transfer to the GRAT pursuant to the defined value formula. The trust document creating the GRAT needs to be carefully drafted in order to avoid deemed contribution issues under that circumstance
- Less chance of an audit of a transfer to a GRAT than a sale (even a defined sale) to a grantor trust
- Less chance that the retained note will be recharacterized as deemed retained interest in the donee trust under equitable tax principles

Advantages of Funding a Leveraged FLLC Asset GRAT With a Guaranteed Preferred Partnership Interest and Funding Another Leveraged FLLC Asset GRAT With Slightly Different Beneficiaries With a Growth Partnership Interest

- The legal structure transfers more wealth than both a conventional GRAT and a Leveraged FLLC Asset GRAT in bear, flat and bull markets
- The technique has the other advantages that a Leveraged FLLC Asset GRAT enjoys
- Many of the gift tax valuation rules under 2701 do not apply because of the exception for guaranteed return preferred interests

Post Creation Strategies

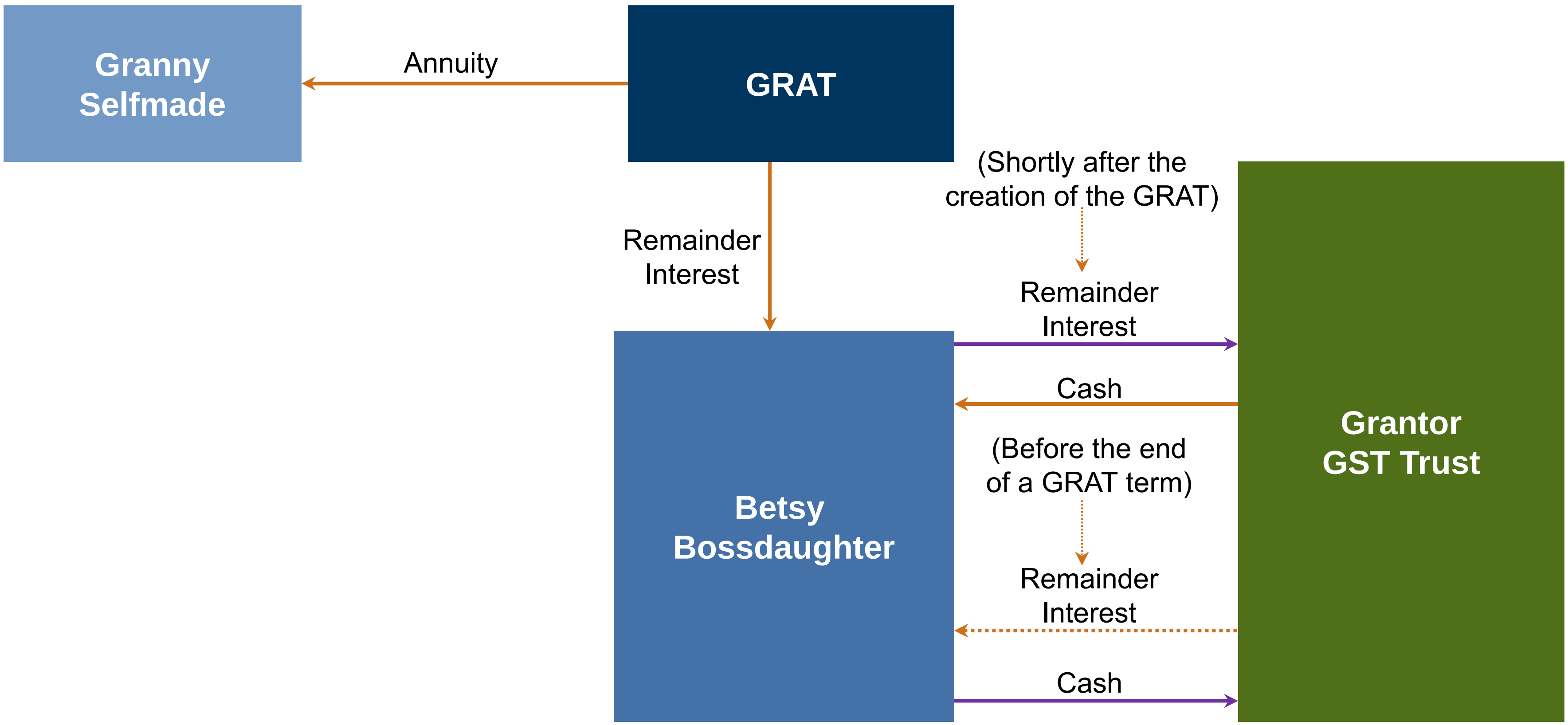
- Sell GRAT annuity to IDGT for cash/note
  - Removes mortality risk
- Convert note receivable from leveraged entity to private annuity
  - Removes gain at death issue
- Contribute note to a preferred partnership in exchange for preferred interest
  - Removes gain at death issue and also serves as a basis enhancing strategy
- Purchase remainder for cash or note
  - Removes mortality risk
- Exercise power of substitution over GRAT to either lock in gain or lock in loss and re-GRAT
  - Increases probability that GRAT will succeed
- Remainder beneficiary sells or gifts remainder to a GST exempt dynasty trust
  - Leverages GST tax exemption

Possible Structural Solutions to Allow the Allocation of the GST Exemption Upon the Creation of a GRAT

(See Pages 49 – 65 of the Paper)

- If there is a 5% or less probability that estate tax inclusion will occur because of the death of the grantor, is there an exception to the ETIP rules applying under Treas. Reg. § 26.2632-1(c)(2), which allows an upfront allocation of a GST exemption?
  - A conservative taxpayer should assume in allocating the GST exemption on the creation of the GRAT, if an inclusion ratio of "0" is desired, that he should allocate a GST exemption amount that is equal to the amount of the property transferred, without netting out the retained GRAT annuity.
  - Allocating a GST exemption to a Leveraged FLLC Asset GRAT on its creation could still work very well for generation-skipping transfer tax purposes.
  - The reason why there is not much of a penalty with that structural technique is because the retained GRAT annuity is a relatively modest part of the leverage being employed in the transfer to the GST exempt trust.
  - For instance, consider the Neal Navigator example above.
  - Because of the leverage embedded in the contributed FLLC member interest to a GRAT and the assumed valuation discounts, the taxpayer would only have to allocate $1,471,774 of his GST exemption to make the GRAT and the remainder trust exempt from the generation-skipping transfer tax because those trusts will have a zero inclusion ratio.
  - At the end of three years, because of the arbitrage of discounted assets going into the GRAT and a relatively modest amount of cash being used to pay the GRAT annuities, even if the assets grow at the modest IRC Sec. 7520 rate of 2.2%, the GST trust would, upon termination of the GRAT in three years, have a value of $7,771,229, if the valuation discounts are ignored in valuing the GST assets at that time.

- Is there a technique that uses the leverage of the GRAT to indirectly profit a GST trust in which a skip person is not the remainderman of the GRAT at the beginning or end of the ETIP (and does the technique work)?
  - The technique is illustrated below:

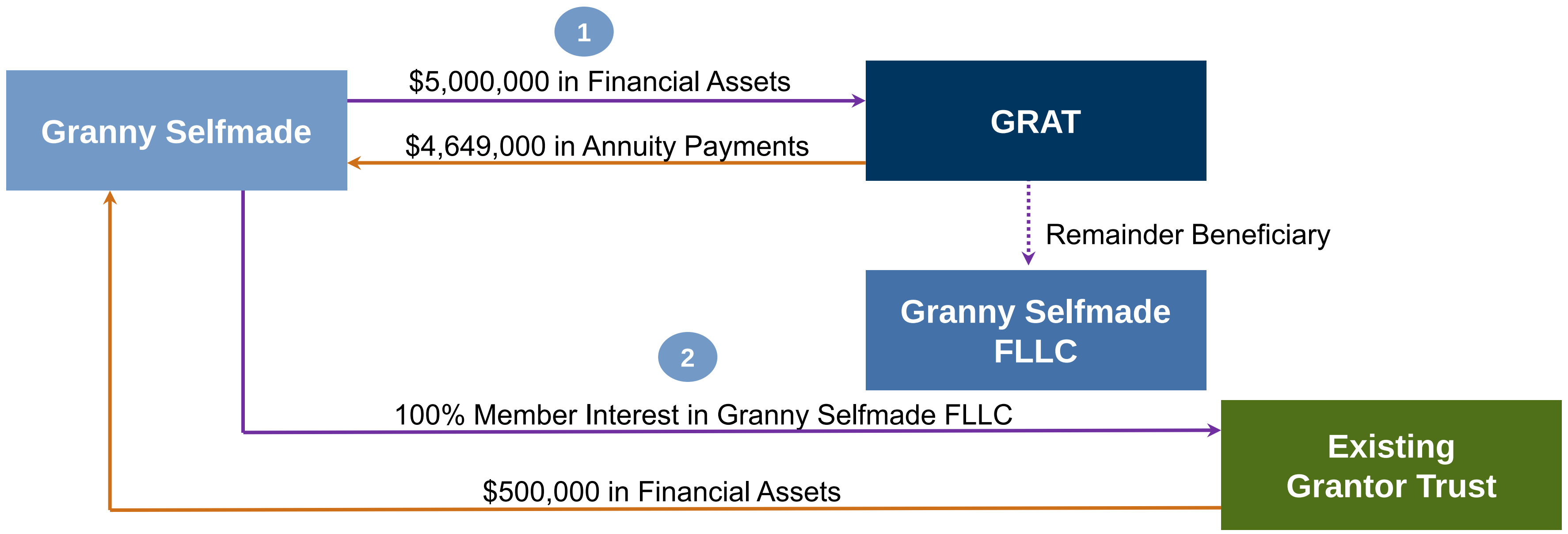


Possible Structural Solutions to Allow the Allocation of the GST Exemption Upon the Creation of a GRAT (Continued)

- The remainder interest in a GRAT that is indirectly held by the grantor of the GRAT is sold for full and adequate consideration to an old exempt GST.

Granny Transfers a Remainder Interest in a GRAT For Full and
Adequate Consideration to a Pre-Existing Generation-Skipping Transfer Trust

Granny Selfmade transfers cash and near cash equal to $5,000,000 to a two-year GRAT. The GRAT pays an annuity equal to 46.49% at the end of each year at a time when the IRS Sec. 7520 rate is 2.2%. The remainder beneficiary is Granny FLLC. Shortly after the creation of the GRAT, Granny transfers, for full and adequate consideration, all of her interest in Granny FLLC to an existing generation-skipping trust that is also a grantor trust. The technique is illustrated as follows:



Possible Structural Solutions to Allow the Allocation of the GST Exemption Upon the Creation of a GRAT
(Continued)

- Advantages of the technique:
  - The technique should avoid gift taxes.
  - Assuming the grantor of the GRAT receives full consideration, the technique should avoid all estate taxes and generation-skipping transfer taxes, even if the grantor dies during the term of the GRAT annuity.
  - When the GRAT terminates and the existing GST grantor trust receives Granny's FLLC interest, that should not be treated as an addition for purposes of requiring an adjustment to the existing GST grantor trusts inclusion ratio, assuming the existing GST grantor trust pays full consideration for Granny's interest.

Possible Structural Solutions to Allow the Allocation of the GST Exemption Upon the Creation of a GRAT
(Continued)

- Considerations of the technique:
  - There is no authority that explicitly supports the advantage outlined above, other than the analysis offered in the paper.
  - It is crucial for the grantor to have received full consideration in above transaction 2.
    - In order to make sure the sale of the remainder FLLC is for full consideration, the grantor may wish to consider entering in a defined value allocation assignment when selling to the existing grantor trust.
  - Other than the GST consideration, this technique has the same considerations that GRATs have.
  - It may be crucial that the remainder interest of the GRAT that is sold has substance and is not a de minimis amount.

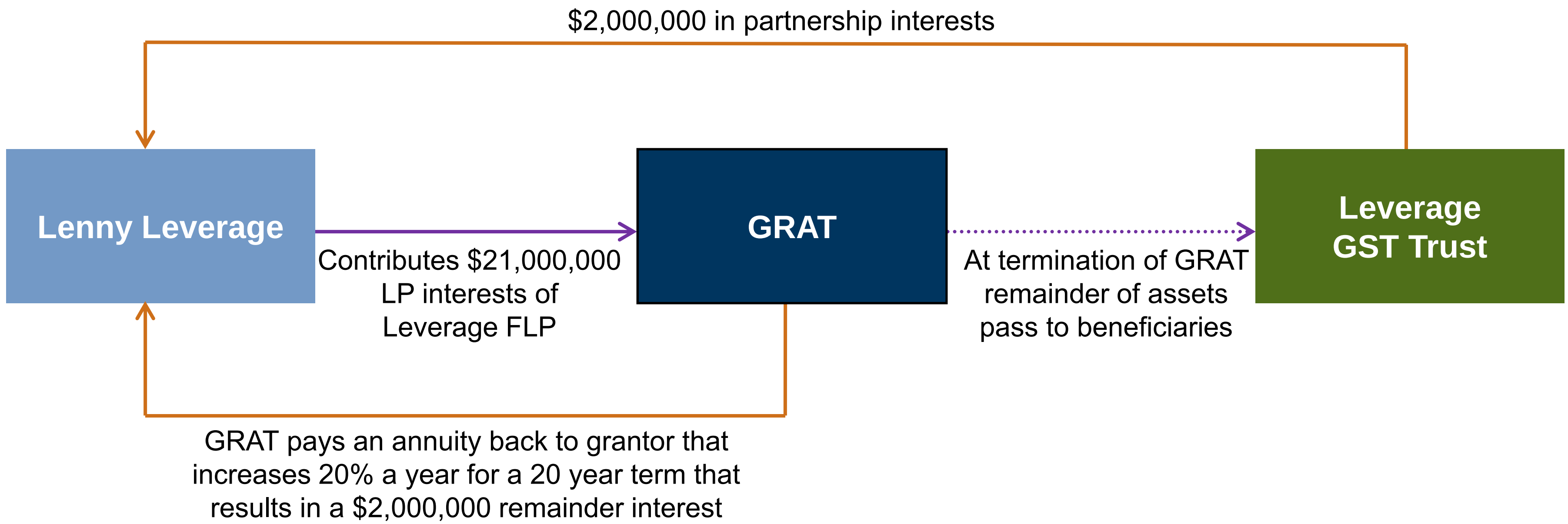
- The creation of a GRAT for full and adequate consideration.

Lenny Leverage Enters Into a GRAT With the Remainderman Being an Existing Grantor Trust That is a Generation-Skipping Transfer Trust, With the Existing <u>Generation-Skipping Transfer Trust Purchasing the Remainder Interest For Full Consideration</u>

Several years ago, Lenny Leverage created a generation-skipping transfer trust that is also a grantor trust. The GST trust and Lenny contributed certain assets to a family limited partnership ("FLP"). Lenny's interest in the partnership, after considering valuation discounts, is worth $21 million and the GST trust's interest in the partnership is worth $2,000,000. The GST trust transfers that $2,000,000 partnership interest to Lenny Leverage in full consideration for Lenny Leverage contributing his $21 million interest in the FLP to a GRAT that is designed with a defined value formula annuity which increases 20% a year. The formula produces a remainder value of $2 million under IRC Sec. 7520. The liquidation value of the partnership interest that is transferred to the GRAT is $30 million and the appraised fair market value of the transferred partnership interest is $21 million (30% discount). The partnership, at that time, has 15 years to operate before it terminates. Lenny has $1,500,000 outside the partnership. Lenny is 50 years old.

Possible Structural Solutions to Allow the Allocation of the GST Exemption Upon the Creation of a GRAT
(Continued)

- The technique is illustrated below:

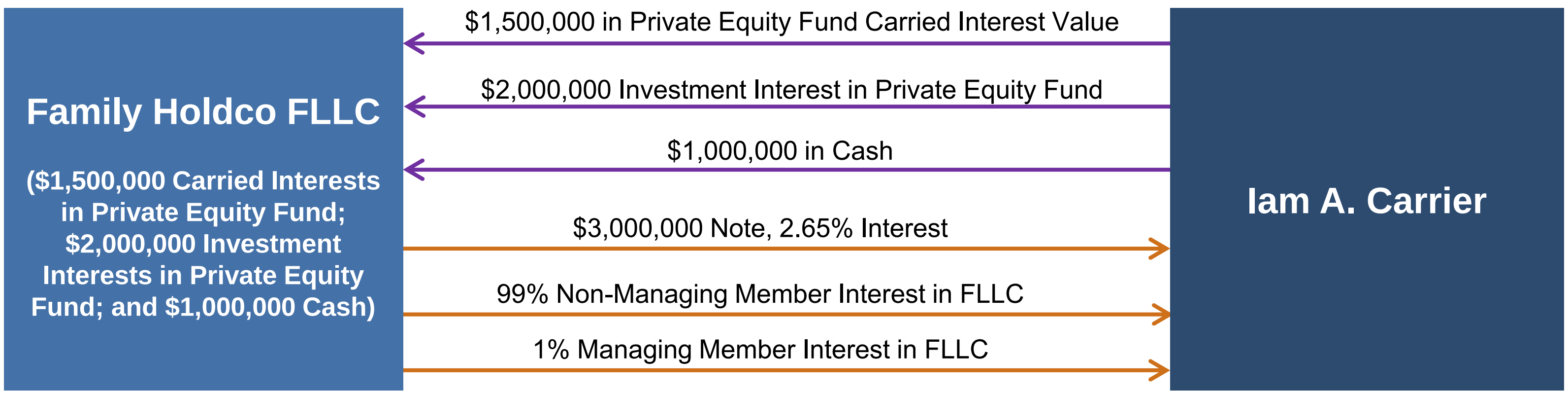


  – It is crucial to avoid valuation issues with this technique. The purchase price for the remainder interest must be consistent with the valuation assumptions of the GRAT. Thus, using "apples to apples", such as partnership units in the same partnership, will facilitate adequate and full consideration being paid for the remainder interest in the GRAT.

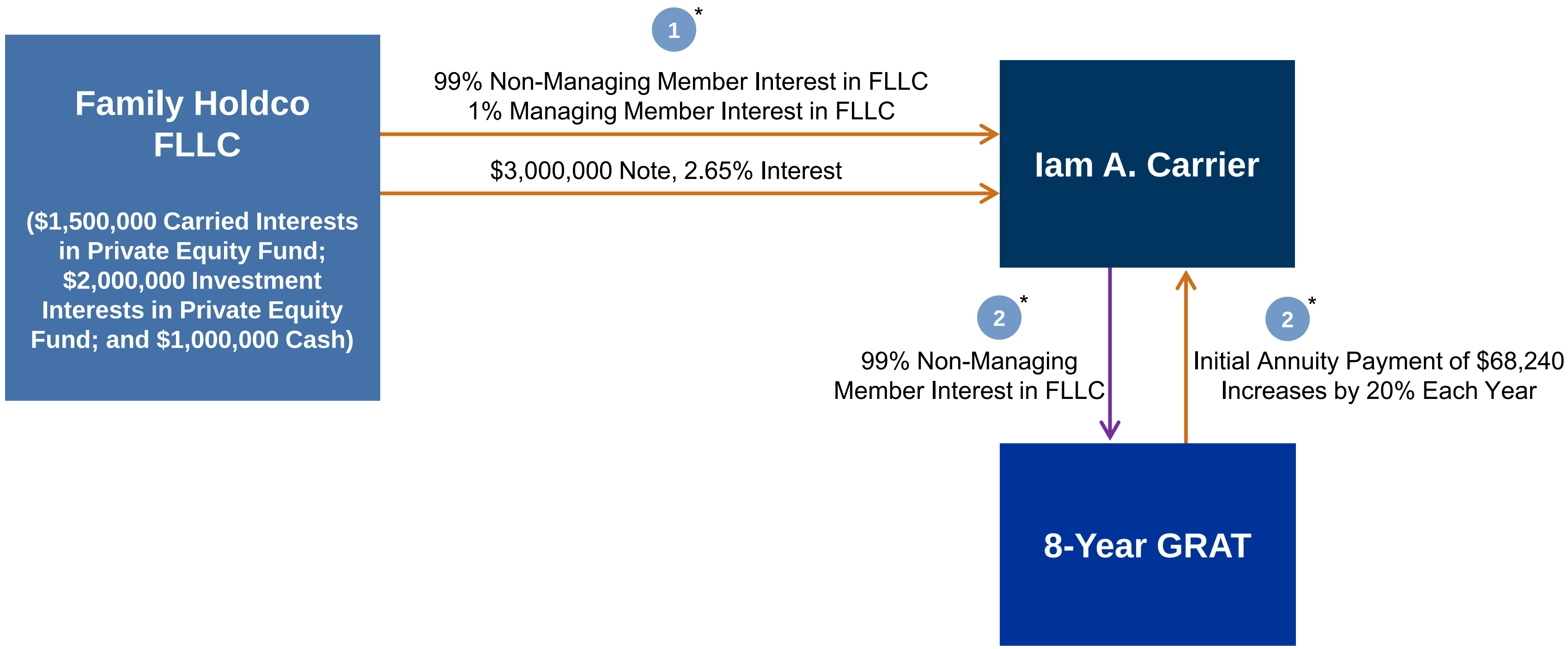
  – There could be abusive situations where the remainder interest is very small and the logic of the *Wheeler, D'Ambrosio* and *Magnin* cases would not be applied. However, under the facts assumed under this example, the remainder interest is significant and would seem to be analogous to the remainderman values considered in the Circuit Court cases referred to above and cited in footnote 46 the paper.

Using a 20% Annual Increasing Annuity GRAT, and Using "Proportionality" and "Debt" Exceptions to IRC Sec. 2701 to Plan For Private Equity Fund Managers and Hedge Fund Managers (See Pages 65 – 71 of the Paper)

- Scenario 1: Hypothetical Technique:



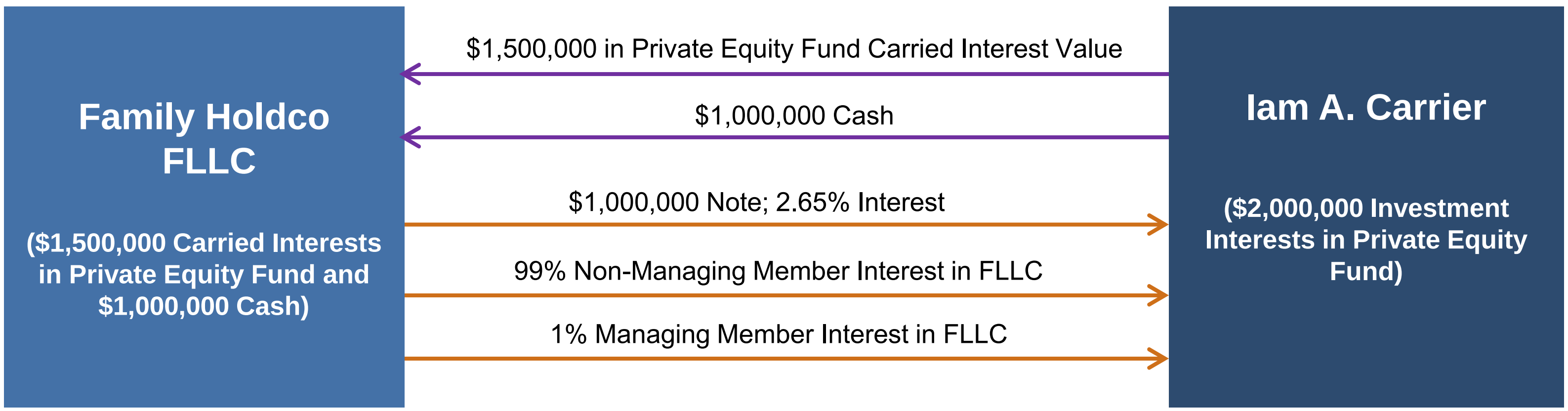
– Because of certain income tax considerations it may be prudent to use a GRAT instead of a sale to an intentionally defective grantor trust or some other estate planning technique that could be considered as involving a disposition of the carried interest. The taxpayer may also wish to eliminate from his planning any carried interest that has been awarded in the last two years, because of those income tax considerations, or if recently awarded profits interests are to be used, use a preferred interest instead of a note. Thus, Iam A. Carrier transfers his 99% non-managing member interest in Holdco to an eight year near "zeroed out" GRAT in which the annuity increases 20% a year.



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

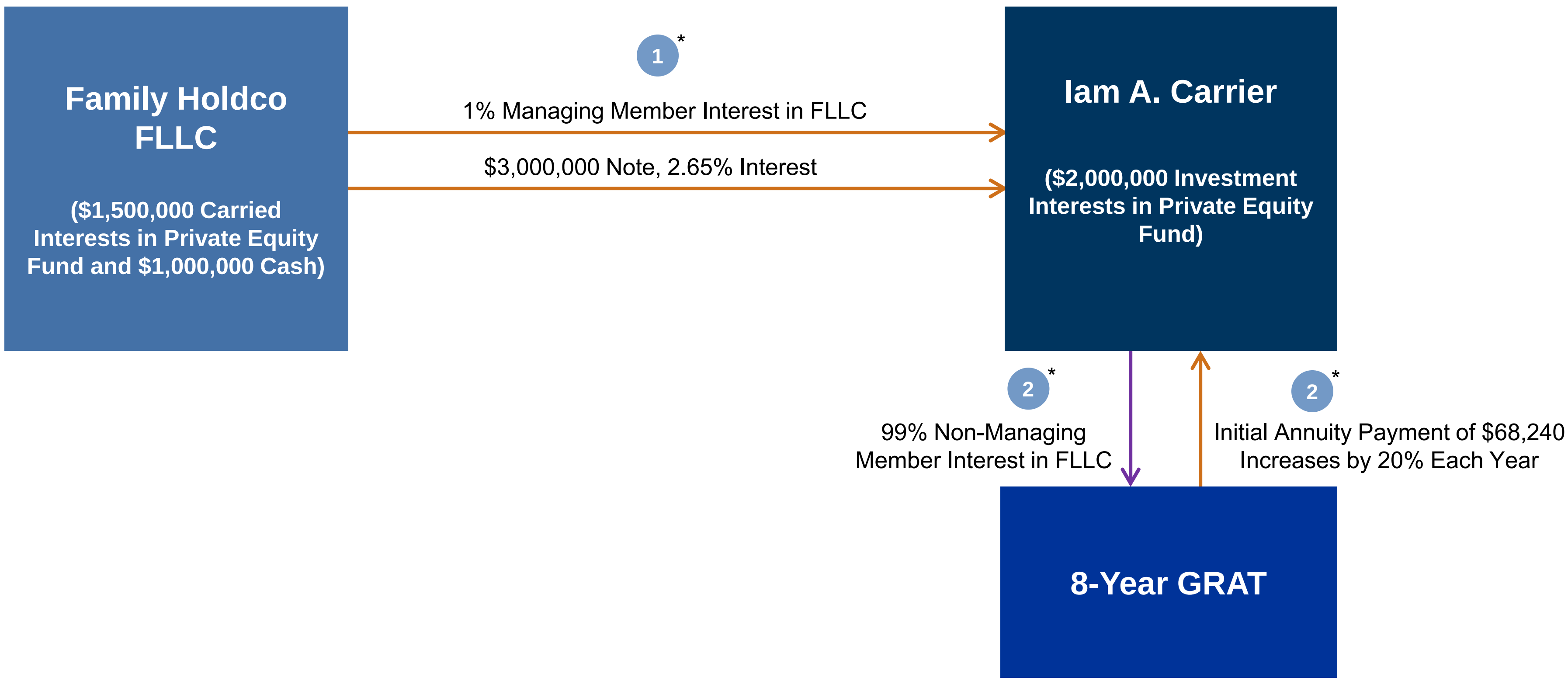
Using a 20% Annual Increasing Annuity GRAT, and Using "Proportionality" and "Debt" Exceptions to IRC Sec. 2701 to Plan For Private Equity Fund Managers and Hedge Fund Managers (Continued)

– *An alternative structure, which may be subject to the valuation rules under IRC Sec. 2701*, would be for Iam Carrier to contribute $1,000,000 along with the carried interest to Holdco. Iam A. Carrier would continue to individually own the investment interest in the private equity fund. The structure would be similar to the illustration below:



Using a 20% Annual Increasing Annuity GRAT, and Using "Proportionality" and "Debt" Exceptions to IRC Sec. 2701 to Plan For Private Equity Fund Managers and Hedge Fund Managers (Continued)

– Iam A. Carrier could transfer his 99% non-managing member interest in Holdco to an eight year near "zeroed out" GRAT in which the annuity increases 20% a year. The estate planning structure is illustrated below:



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

Using a 20% Annual Increasing Annuity GRAT, and Using "Proportionality" and "Debt" Exceptions to IRC Sec. 2701 to Plan For Private Equity Fund Managers and Hedge Fund Managers (Continued)

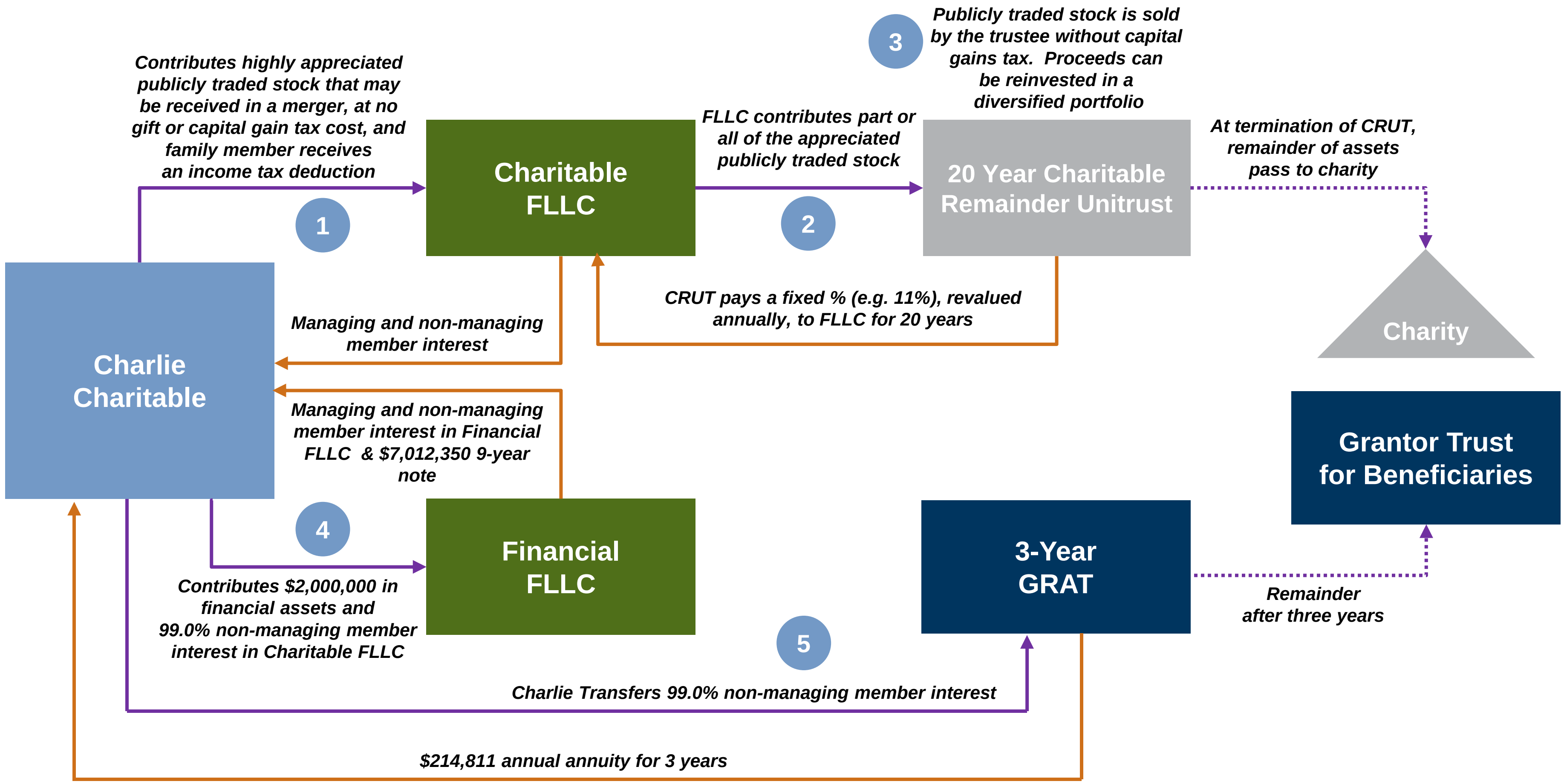
– Under the assumptions of this example, the estate planning results of scenario one and scenario two in comparison to each other and in comparison to no further planning are delineated below:

Technique	Carrier Family	IRS - Income Tax	IRS - Investment Opportunity Cost	IRS - Gift Tax (at 45%)	Total
No Further Planning; Transfers Estate to Family at the End of 8 Years	14,092,544	3,755,759	68,598	11,530,263	29,447,164
Planning Scenario #1: Leveraged FLLC Asset GRAT Technique That Includes Carried Interests, Cash and the Investment Interests in the Private Equity Fund	24,886,627	3,769,157	68,598	722,783	29,447,164
*Planning Scenario #2: Leveraged FLLC Asset GRAT Technique That Includes Only the carried Interest and Cash	24,447,268	3,497,229	68,598	1,434,069 *	29,447,164

* This scenario may also be subject to additional gift taxes because of the valuation rules under IRC Section 2701.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (See Pages 71 – 96 of the Paper)

- Use of a Leveraged FLLC Asset GRAT when one of the assets of the FLLC is a non-charitable interest in a charitable remainder unitrust ("CRUT"). The technique is illustrated below:



– Key CRUT rules:

- The FLLC, as the noncharitable beneficiary, must receive an annual unitrust payment.

- The unitrust payment must be at least 5%, but not more than 50%, of the fair market value of the trust's assets, determined annually.

- The CRUT does not pay income taxes. The CRUT distributions carry out income tax consequences to the noncharitable beneficiary in a specific order: First, as ordinary income to the extent of the trust's current and past undistributed ordinary income (dividends that are taxed at 15% are included in this tier); second, as capital gains to the extent of the trust's current and past capital gains; third, as tax-exempt income to the extent of the trust's current and past tax exempt income; and finally, as a nontaxable return of capital.

- The trustees of the CRUT do not have unlimited investment flexibility. There is a 100% excise tax on unrelated business taxable income (UBTI) generated in a CRUT. Broadly defined, UBTI is income derived from any trade or business. UBTI includes debt-financed income, so certain investment strategies that use borrowing might be off limits. Also, the self-dealing rules that apply to charitable trusts prohibit Charlie from transacting with the CRUT, even if the transaction is completely fair.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- Advantages of the technique:
  - The same tax advantages as creating a Leveraged FLLC Asset GRAT discussed above.
  - The 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 tax advantage of lowering opportunity costs by delaying taxes on the portion of the original gain that is not allocated to charity.
  - The tax advantage of a charitable deduction in year one for the actuarial value of the remainder interest of the CRUT passing to charity.
  - The tax advantage of integration, which produces advantageous comparative results (see the table below):

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

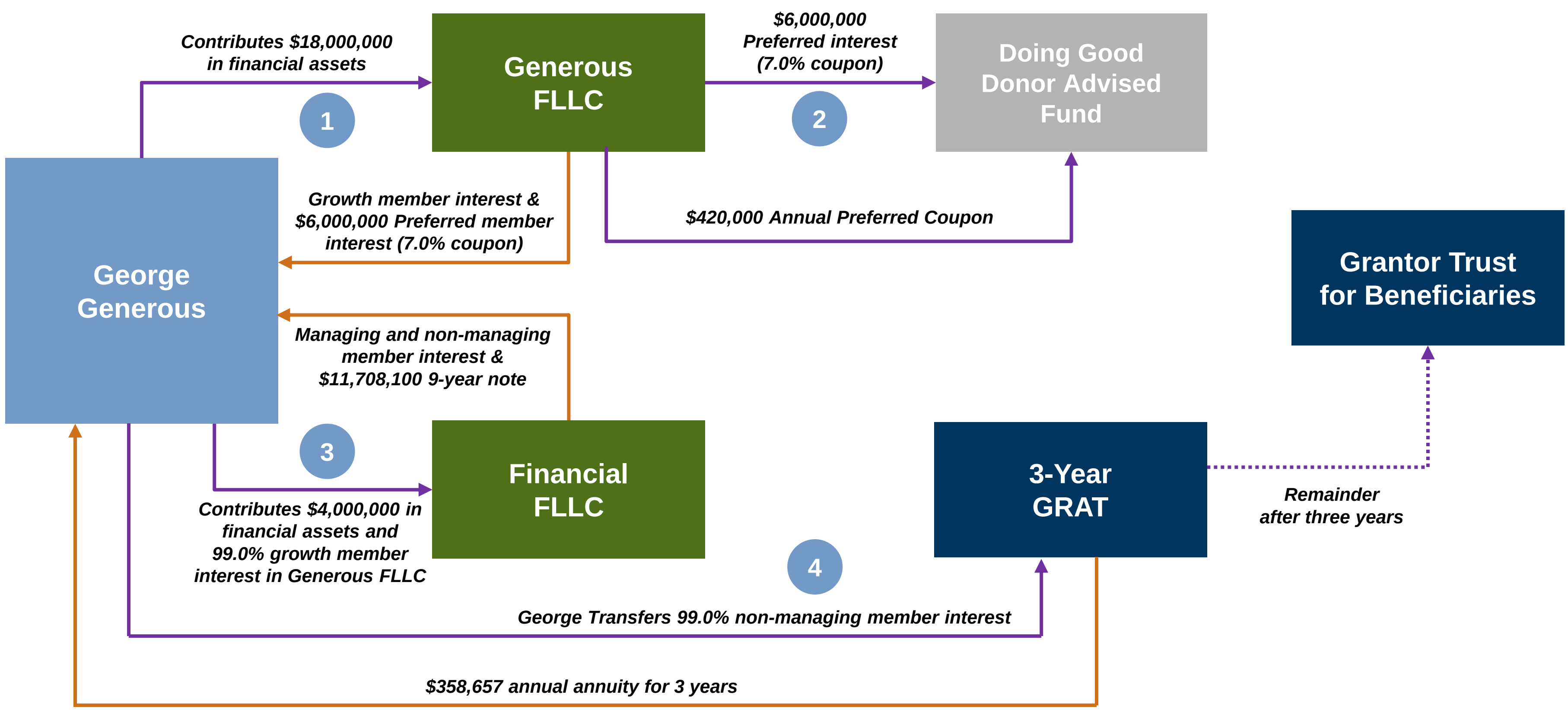
Hypothetical Technique (Assumes $9.83mm Estate Tax Exemption Available)	Charlie's Descendants	Charity	Charlie's Consumption Direct Costs	Consumption Investment Opportunity Costs	IRS Taxes on Investment Income	IRS Investment Opportunity Costs	IRS Estate Taxes (@40.0%)	Total
Future Values at the end of 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

Lifetime Charitable Giving Strategies That Also Benefit Client’s Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- Considerations of the technique:
  - Generally, for 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 Leveraged FLLC Asset GRAT.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- Creating a FLP or FLLC with preferred and growth interests, transferring the preferred interest to a public charity, and transferring the growth interests to a Leveraged FLLC Asset GRAT. The technique is illustrated below:



Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- Advantages of the technique:
  - 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 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 (see the table below).

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

Description	Tax Efficiency Ratio of Charitable Gifts (Present Value of Total Net Tax Savings ÷ Present Value of Total Out of Pocket Cash)
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%**

– Valuation advantage: The gift tax valuation rules under IRC Sec. 2701 do not apply to any future gifts, or sales, of the growth member interests to family members, or trusts for family members.

– Under the facts of this example, in addition to saving significant income and healthcare taxes, significant transfer taxes could be saved in transferring the growth interests to a grantor trust.

- If George was able to obtain a 35% valuation discount for the growth interest in Generous FLLC and a 20% discount for Financial FLLC, Pam projects that in addition to saving income and healthcare taxes, George could save over $15,000,000 in estate taxes.

	George's Descendants	Charity	IRS Income Tax	IRS Income Tax Investment Opportunity Cost	IRS Estate Tax (at 40%)	Total
20-Year Future Values						
No Further Planning	$35,000,264	$23,989,144	$14,640,259	$15,513,858	$17,540,176	$106,683,701
Hypothetical Technique #1	$55,436,988	$23,989,144	$15,426,212	$9,896,673	$1,934,685	$106,683,701
Present Values (Discounted at 2.5%)						
No Further Planning	$21,359,644	$14,639,877	$8,934,525	$9,467,657	$10,704,260	$65,105,963
Hypothetical Technique #1	$33,831,583	$14,639,877	$9,414,169	$6,039,652	$1,180,682	$65,105,963

- Income tax valuation advantage: IRS concedes preferred partnership interests should have a high coupon.
- IRC Sec. 2036 advantage, if George gives or sells the growth interests to his family.
  - There is a substantial investment purpose (i.e., non-tax purpose) with having preferred and common interests that 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.
  - The enactment of IRC Sec. 2036(c) and its subsequent repeal demonstrate 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. Thus, even if the transfer of the growth interests occurs at the taxpayer's death, because of that strong legislative intent, IRC Sec. 2036 should not apply.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

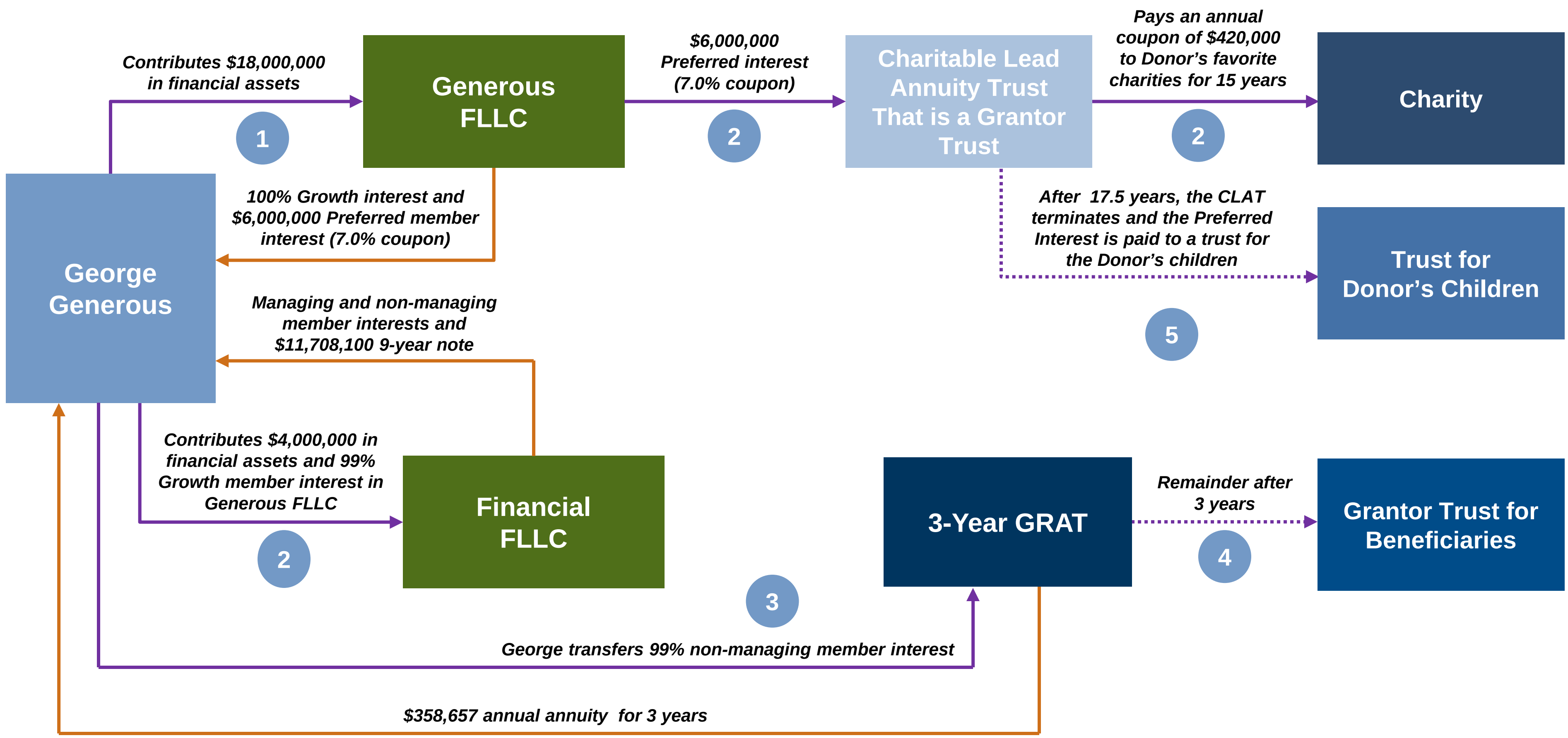
- Considerations of the technique:
  - Despite state property law, the IRS may take the position that the gift of the preferred interest of an FLLC should be considered a non-deductible partial gift of the underlying assets of the FLLC.
  - If the gift of the preferred interest is to a donor advised 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.
    - Among the reporting requirements are:
      1. The taxpayer must get and keep a contemporaneous written acknowledgment of the contribution from the charity. See IRC Sec. 170(f)(8)(A).
      2. The taxpayer must also keep records that include how the taxpayer acquired the property and the basis information for the donated preferred interest. See Treas. Reg. §§ 1.170A-13(b)(3)(i)(A), (B).
      3. The taxpayer must also obtain a qualified written appraisal of the donated property from a qualified appraiser, if the preferred interest is worth more than $500,000 attach the qualified appraisal to the taxpayer's return. See IRC Sec. 170(f)(11)(D).
  - 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.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- The use of a high-yield preferred partnership or membership interest with a charitable lead annuity trust ("CLAT").
  - What is a CLAT?
    - A CLAT is a trust in which the lead interest is payable to a charity and is in the form of an annuity amount for the term of the lead interest.
    - In the CLAT, the annual payment is not based on the income of the trust. Since the annuity amount is not based on the income of the trust, that amount must be paid to the charity even if the trust has no income.
    - The lead interest in a CLAT can be for a fixed term of years.
    - CLATs are not subject to the minimum payout requirements associated with charitable remainder trusts. Thus, there is no 5% minimum pay out for CLATs.
    - The CLAT is not a tax-exempt entity, unless the CLAT is a grantor trust. If the CLAT is a non-grantor trust and if taxable income is accumulated in the trust it will be subject to income taxes. The CLAT will receive a charitable income tax deduction when it makes the distribution to the charity. If the CLAT is a grantor trust, the grantor will receive an income tax deduction for the actuarial value of the charitable gift of the annuity amounts upon creation of the CLAT. If the CLAT is a grantor trust, there will not be any future income tax deductions for distributions to charities.
    - CLATs are characterized as private foundations for purposes of certain restrictions placed on such organizations.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

– The technique



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Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- Advantages of the technique:
  - Because of the difference in the yield of a preferred coupon of a preferred interest in a FLLC that is compliant with Revenue Ruling 83-120 and the IRC Sec. 7520 rate, the transfer tax success of a CLAT is virtually assured.
  - IRC Sec. 2701 valuation rules will not apply to a gift of the "growth" interests in a FLLC if the preferred interests are owned by a CLAT. This could lead to significant transfer tax benefits.

	George's Descendants	Charity	IRS Income Tax	IRS Income Tax Investment Opportunity Cost	IRS Estate Tax (at 40%)	IRS Estate Tax (at 40.0%)
20-Year Future Values						
No Further Planning	$35,000,264	$23,989,144	$14,640,259	$15,513,858	$17,540,176	$106,683,701
Hypothetical Technique #2	$62,717,877	$16,373,449	$15,934,675	$9,946,218	$1,711,482	$106,683,701
Present Values (Discounted at 2.5%)						
No Further Planning	$21,359,644	$14,639,877	$8,934,525	$9,467,657	$10,704,260	$65,105,963
Hypothetical Technique #2	$38,274,898	$9,992,240	$9,724,469	$6,069,888	$1,044,468	$65,105,963

  - 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.

Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants if Used With a Leveraged FLLC Asset GRAT (Continued)

- Considerations of the technique:
  - 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.

- The possible form of the IRS regulations that may be issued under IRC Sec. 2704(b)(4).
  - On May 5, 2015, BNA reported that in an ABA Tax Section meeting a representative of the IRS Office of Tax Policy, stated that regulations will be issued in the near future under IRC Sec. 2704(b)(4). It was reported that she said the form of the regulations will be similar to the Greenbook Proposal, even though that enabling legislation has not been passed by Congress and it is unlikely it will ever be passed by Congress.
  - The Greenbook Proposal would have expanded the scope of IRC Sec. 2704(b) as follows:

    This proposal would create an additional category of restrictions ("disregarded restrictions") that would be ignored in valuing an interest in a family-controlled entity transferred to a member of the family if, after the transfer, the restriction will lapse or may be removed by the transferor and/or the transfer's family. Specifically, the transferred interest would be valued *by substituting for the disregarded restrictions certain assumptions* to be specified in regulations. Disregarded restrictions would *include limitations on a holder's right to liquidate that holder's interest* that are more restrictive than a standard to be identified in regulations. *A disregarded restriction also would include any limitation on a transferee's ability to be admitted as a full partner* or to hold an equity interest in the entity. For purposes of determining whether a restriction may be removed by member(s) of the family after the transfer, certain interests (to be identified in regulations) held by charities or others who are not family members of the transferor would be deemed to be held by the family. Regulatory authority would be granted, including the ability to create safe harbors to permit taxpayers to draft the governing documents of a family-controlled entity so as to avoid the application of section 2704 if certain standards are met. This proposal would make conforming clarifications with regard to the interaction of this proposal with the transfer tax marital and charitable deductions. (Emphasis added.)

  - It seems unlikely that the Obama Administration dropped the Greenbook Proposal because it abandoned the goals of the proposal. Rather, it seems to have decided that those goals can be attained by regulations promulgated under IRC Sec. 2704(b)(4), which provides:

    (4) OTHER RESTRICTIONS – The Secretary may by regulations provide that *other restrictions shall be disregarded* in determining the value of the transfer of any interest in a corporation or partnership to a member of the transferor's family, *if such restriction has the effect of reducing the value of the transferred interest* for purposes of this subtitle but does not ultimately reduce the value of such interest to the transferee. (Emphasis added.)

- The taxpayer must demonstrate that a regulation under IRC Sec. 2704(b)(4) is an unreasonable and an invalid extension of IRC Sec. 2704(b)(4), because it is manifestly contrary to that statute, in order to have that regulation ignored in transferring an interest in a closely held family enterprise.
  - See the *Walton* case, *Audrey Walton v. Commissioner*, 115 T.C. 589 (2000).
  - See the Chevron case, *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* supra at 843-844.
  - See the *Mayo* case, *Mayo Foundation v. United State*s, 107 AFTR2d 2011-341, 131 Sup. Ct. 704 (2011).
  - The burden inherent in determining if a legislative regulation is valid may now be the standard for both interpretative and legislative regulations. If the burden is the burden for a legislative regulation, the burden for the taxpayer is for a court to find that the regulation is "manifestly contrary to the statute."

- Arguments that if the treasury regulations under IRC Sec. 2704(b)(4) take the form of the Greenbook Proposal, the regulations will be an unreasonable and invalid extension of IRC Sec. 2704(b)(4).
  - If the regulation takes the form of the Greenbook Proposal it may violate the origin and purpose of IRC Sec. 2704(b).
    - Prior to the passage of Chapter 14 in 1990, case law for valuing proportionately held family enterprises generally held as follows:
      - (i) That the legal rights and interests inherent in that property must first be determined under state law and after that determination is made is federal tax law then applied to determine how such rights and interests will be taxed;
      - (ii) That transfers of non-controlling interests in family enterprises are to be valued the same way non-controlling interests in non-family enterprises are valued; and
      - (iii) There are no special valuation premiums because of family attribution for closely held family enterprises.
    - For purposes of determining the fair market value of the gifts of closely held interest in a family enterprise, case law holds the identity and intentions of the recipient of that interest are irrelevant. “The standard is an objective test using hypothetical buyers and sellers in the marketplace, and is not a personalized one which envisions a particular buyer and seller.” Thus, family relationships are ignored, and the ownership of a controlling interest among a family’s members when each ownership interest is attributed to the others is also ignored.

- In determining the value for gift and estate tax purposes of any asset that is transferred, case law holds the legal rights and interests inherent in that property must first be determined under state law. After that determination is made, the federal tax law then takes over to determine how such rights and interests will be taxed.

- Congress has never supported a change in the above case law and made it clear when it passed Chapter 14 (including IRC Sec. 2704(b)(4)) in 1990 that Chapter 14 was to be interpreted in a manner consistent with existing case law.
  - In the fall of 1987, the House of Representatives, in its Revenue Bill of 1987, passed legislation that would have overturned the above case law and eliminated minority and other discounts then established by case law for purposes of valuing closely held corporations and partnerships. The Senate rejected that legislation, and it did not become the law.
  - The legislative history in 1990 in enacting Chapter 14 made it clear that Congress, once again, was comfortable with existing case law treating proportionately held (pro rata stock ownership or partnership ownership) closely held businesses owned by family members the same way as closely held businesses not owned by family members with respect to ignoring family attribution for valuation purposes.

– The Senate Report on the bill made it clear that the bill was not to affect the discounts associated with creating an entity, including pro rata partnerships or corporations that do not have a senior equity interest:

The value of property transferred by gift or includable in the decedent's gross estate generally is its fair market value at the time of the gift or death. Fair market value is the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. sec. 20.2031-1(b)). This standard looks to the value of the property to a hypothetical seller and buyer, not the actual parties to the transfer. Accordingly, courts generally have refused to consider familiar relationships among co-owners in valuing property. For example, courts allow corporate stock to be discounted to reflect minority ownership even when related persons together own most or all of the underlying stock.

. . . .

The bill does not affect minority discounts or other discounts available under present law.

. . . .

. . . the bill does not affect the valuation of a gift of a partnership interest if all interests in the partnership share equally in all items of income, deduction, loss and gain in the same proportion *(i.e.*, straight-up allocations).

- What Congress was concerned about when it replaced IRC Sec. 2036(c) with Chapter 14 were provisions that could be placed in the organizational documents of a family enterprise that would lower the value of a transferred interest in a family enterprise that would typically not be found in either non-family enterprise organizational documents or under default state property law provisions.

  - The remedy Congress employed was to disregard, for valuation purposes, the provisions in organizational documents that would generally not be found in non-family business organizational documents.

  - Congress did not provide for substitute provisions for the disregarded provisions in either the statutes of Chapter 14 (including IRC Sec. 2704(b)) or in its documented legislative history. Nor did Congress give the IRS the power to substitute provisions for the disregarded provisions.

  - The origin and intent of IRC Sec. 2704(b) was only to disregard liquidation provisions and other provisions of the organizational documents that lowered the value of interests in a family business for transfer tax purposes below what would occur under state law if those provisions were not in the documents.

- Shortly after the passage of Chapter 14, including IRC Sec. 2704(b)(4), when the IRS institutional memory of the origin and purpose of these statutes was fresh, the IRS consistently recognized that Chapter 14 did not affect the above case law.
  - The regulations originally proposed under IRC Sec. 2704(b) in 1992 protected traditional valuation discounts. The regulations made the statute meaningful by referring a "limitation on the ability to liquidate the entity" rather than a restriction "which effectively limits the ability of the corporation or partnership to liquidate." Secondly, the regulations made the statute consistent with legislative history by disregarding only those restrictions that were more restrictive than state law.
  - Within one year of the issuance of the final regulations under Chapter 14 (January 26, 1993) the IRS issued Revenue Ruling 93-12 (1993-1 C.B. 202) revoking Revenue Ruling 81-253 (1981-1 C.B. 187) and giving an acquiescence to Estate of Lee v. Commissioner, 69 T.C. 860 (1978).
  - In 1994 Treasury finalized certain anti-abuse income tax regulations and took extraordinary steps to comply with Chapter 14 legislative history to confirm investment partnerships should be treated the same as active business partnerships.
  - See also the discussion of the Valuation Training for Appeals Officers, issued by the IRS National Office in 1994. Based on that publication, the IRS National Office in 1994 agreed that even after passage of Chapter 14 and IRC Sec. 2704(b) family attribution was irrelevant for determining value under transfer tax law, and that valuation discounts for lack of control and lack of marketability are to be applied in valuing an interest in a closely held family enterprise.

- Also, in a technical advice memorandum issued in 1994, the IRS held that the value of a donor's gift of 100% of corporate stock in equal shares to each of his 11 children was determined by considering each gift separately and not by aggregating all of the donor's holdings in the corporation immediately prior to the gift.

- Not only would regulations under IRC Sec. 2704(b)(4) that take the form of the Greenbook Proposal violate the origin and purpose of IRC Sec. 2704(b), those regulations would also be manifestly contrary to the language of IRC Sec. 2704(b)(4).
  - Certain of the regulations, if they take the form of the Greenbook Proposal, will apply to a liquidation restriction already described in other parts of IRC Sec. 2704(b).
    - The Greenbook Proposal states that the IRS may disregard restrictions on "a holder's right to liquidate." However, certain liquidation restrictions are already clearly described in IRS Sec. 2704(b)(1), (2) and (3) and are, thus, not to be covered by IRC Sec. 2704(b)(4) because that statute only applies to "other restrictions."
    - For instance, any regulation under IRC Sec. 2704(b)(4) may not cover any restriction "which effectively limits the ability of the corporation or partnership to liquidate, and . . . the transferor or any member of the transferor's family, either alone or collectively, has the right to remove, in whole or in part the restriction." See IRC Sec. 2704(b)(2).

– The IRS only has the power to disregard certain restrictions in family entity organizational documents under IRC Sec. 2704(b)(4); it does not have the power to replace or substitute alternative provisions for the disregarded provisions.

- IRC Sec. 2704(b)(1) and Sec. 2704(b)(4) have identical operative language: each provides that a restriction "shall be disregarded." Neither section gives the IRS the power to "substitute" alternative language to take the place of disregarded restriction.

- The contemporaneous regulation written under Treas. Reg. § 25.2704-2(c) on January 28, 1992 uses that remedy:

> *(c) Effect of disregarding an applicable restriction.*—If an applicable restriction is disregarded under this section, the transferred interest is valued as if the restriction does not exist and as if the rights of the transferor are determined under the State law that would apply but for the restriction.

- If the new regulations take the form of the Greenbook Proposal stated below, the IRS will have the power under those regulations to substitute provisions for the disregarded provisions of the organizational documents that may not be found in the default state property law:

> Specifically, the transferred interest would be valued by substituting for the disregarded restrictions certain assumptions to be specified in regulations. Disregarded restrictions would include limitations on a holder's right to liquidate that holder's interest that are more restrictive than a standard to be identified in regulations.

- It would appear that the substituted assumptions or standards will be different than state statutory or common law. It also appears there is not any statutory authority under IRC Sec. 2704(b)(4) to make that substitution.

- Under IRC Sec. 2704(b)(4) the only restrictions that may be disregarded are those restrictions that have the "effect of reducing the value of the transferred interest" below what the transferred interest value would be even if the restriction was not in the organizational documents.
  - If regulations under IRC Sec. 2704(b)(4) are consistent with the Greenbook Proposal certain of those regulations will disregard restrictions, even if the value is not reduced because of those restrictions, which is contrary to the express statutory provision of IRC Sec. 2704(b)(4). Certain restrictions may exist under state statutory and common law that are consistent with the written liquidation restrictions in an organizational document. Their removal from the organizational document would not reduce the value of the transferred interest, because of the operation of state property law.
- Regulations under IRC Sec. 2704(b) that track the Greenbook Proposal would redefine family for purposes of IRC Sec. 2704(b), which it cannot do.

▪ Even if certain restrictions are disregarded in an organizational document, and even if other provisions are substituted for the disregarded provisions, the valuation of transferred interests in a family holding company may not change, if the courts apply the Non-marketable Investment Company Evaluation Method.

- Because of the uncertainty about the enforceability of regulations under IRC Sec. 2704(b)(4), and even if the regulations are held to be valid, the uncertainty of the application of the lack of liquidity valuation discount, the taxpayer should consider using the "*Kerr*" strategy, or a similar strategy, to protect against a significant gift tax if the courts uphold the regulations and if the courts also do not apply the lack of liquidity discount. What are the facts of the *Kerr* case and what is the strategy?
  - As noted above, fresh from the legislative history associated with Chapter 14, the IRS initially took the view that Chapter 14 did not affect the value of closely held FLPs and FLLCs that were held in pro rata form of ownership. However, beginning in early 1997, the IRS embarked on a frontal assault on the use of FLPs and other closely held entities for estate planning purposes through the issuance of technical advice memoranda and private letter rulings. In these pronouncements, the National Office of the IRS took the position that an interest in a closely held entity can be valued for transfer tax purposes based on the pro rata net asset value of the interest in the entity transferred, essentially disregarding the existence of the entity. One of the arguments raised by the IRS in each of these pronouncements was that under IRC Sec. 2704(b), transferred partnership interests can be valued without regard to restrictions on liquidation or withdrawal contained in the partnership agreement.
  - The IRS position on the application of IRC Sec. 2704(b) was repudiated by the full Tax Court in Kerr v. Commissioner.
  - The Court's analysis focused on whether the partnership agreements imposed greater restrictions on the liquidation of the partnerships than the limitations that generally would apply under Texas law.

- Comparing the liquidation provisions in § 10.01 of the partnership agreements with § 8.01 of the Texas Revised Limited Partnership Act (TRLPA), the Court concluded that § 10.01 did not contain restrictions on liquidation that constitute "applicable restrictions" within the meaning of IRC Sec. 2704(b). The Court reasoned that Texas law provided for the dissolution and liquidation of a limited partnership pursuant to the occurrence of events specified in the partnership agreement or upon the written consent of the partners. As such, the restrictions contained in the partnership agreements were no more restrictive than the limitations that generally would apply to the partnerships under Texas law.

- However, even if the IRS had won the Kerr case, because the operation of a GRAT provides that the annuities retained by Mr. and Mrs. Kerr would equal a certain percentage of the assets transferred to the GRATs as finally determined for gift tax purposes, the Kerr's would not incur a gift tax surprise. Their disappointment would be that the GRATs would owe them more money.

- In a similar fashion, a taxpayer could first contribute and/or sell his interests in family entities and other assets to a single member FLLC. The taxpayer could then contribute his interests in the single member FLLC to a GRAT.

Private Wealth Management

Strategic Wealth Advisory Team - Biographies

Strategic Wealth Advisory Team

Biographies

Stacy Eastland – Managing Director	Houston	Tel: (713) 654 – 8484

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 The Best Lawyers in America (Woodward/White). He has also 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® (2004). 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.

Jeff Daly – Managing Director	Los Angeles	Tel: (310) 407 – 5828

Jeff joined Goldman Sachs in October 2000, after spending nine years with Arthur Andersen in Houston in the Private Client Services group as a Senior Tax Manager. Jeff's experience includes developing and implementing innovative strategies to assist his clients in meeting their income tax, estate tax, and financial planning goals. He has co-written or assisted with published articles addressing issues of estate planning, income tax planning, single stock risk management and stock option planning. He has been a past speaker at various tax conferences sponsored by state bar associations and law schools. 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. He earned his B.S. in Economics with honors from the WDozoretzon School of the University of Pennsylvania.

Strategic Wealth Advisory Team (continued)

Biographies

Clifford D. Schlesinger – Managing Director | **Philadelphia** | **Tel: (215) 656 – 7886**

Cliff is a member of the Goldman Sachs Strategic Wealth Advisory Team. He works with the firm's private clients and their own advisors to develop appropriate wealth management plans that often combine a variety of income tax, gifting and estate planning techniques. Prior to joining Goldman Sachs, Cliff was a partner with the law firm of Wolf Block Schorr and Solis-Cohen LLP. Cliff served on WolfBlock's Executive Committee and was Chairman of WolfBlock's Private Client Services Group. Cliff graduated, magna cum laude, with a B.S. in Economics from the WDozoretzon School of the University of Pennsylvania. He received his J.D., cum laude, from the University of Pennsylvania Law School. Cliff was admitted to the practice of law in Pennsylvania and New York and he also received his C.P.A. license from New York. Cliff is a Fellow of the American College of Trust and Estate Counsel. He is a past President of the Philadelphia Estate Planning Council (PEPC). He was the PEPC's 1998 recipient of the Mordecai Gerson Meritorious Service Award. Cliff currently serves as the Treasurer and as a member of the Board of Trustees of the National Museum of American Jewish History. Cliff also serves on the Board of Overseers for the Einstein Healthcare Network. Cliff previously served as President of the Endowment Corporation and on the Board of Trustees of the Jewish Federation of Greater Philadelphia. Cliff was the 2008 recipient of the Edward N. Polisher Award in recognition of his distinguished service to the Philadelphia Jewish Community. Cliff was also the 2003 recipient of the Myer and Rosaline Feinstein Young Leadership Award presented for exceptional service to the Philadelphia Jewish Community. Cliff has been a frequent author and lecturer on estate planning and transfer tax related topics.

Karey Dubiel Dye – Managing Director | **Houston** | **Tel: (713) 654 – 8486**

Karey joined Goldman Sachs in October 2000, after practicing law at the law firm of Vinson & Elkins L.L.P. in Houston, Texas. While in private practice, Karey specialized in trusts and estates and tax exempt organization matters. Currently, Karey works with private clients and their own advisors on estate planning and family wealth transfer matters as well as with institutional clients served by Goldman Sachs Private Wealth Management (foundations, endowments, and other charitable organizations). Karey also assists donors and their advisors in developing efficient charitable giving strategies, including the creation and administration of non-profit family charitable vehicles such as private foundations, donor advised funds, and supporting organizations. Karey also serves as the President of the Goldman Sachs Philanthropy Fund, a donor advised fund which is a public charity established to encourage and promote philanthropy and charitable giving across the United States by receiving charitable contributions, by providing support and assistance to encourage charitable giving, and by making grants to other public charities and governmental units. Karey graduated from Middlebury College, B.A., cum laude, and the University of Virginia School of Law, J.D. She was admitted to the practice of law in Texas. In Houston, she serves on the board of the Foundation for DePelchin Children's Center, on the endowment board at St. Martin's Episcopal Church where she is Past President, and on the board of Episcopal High School where she chairs the Advancement Committee.

Strategic Wealth Advisory Team (continued)

Biographies

Melinda M. Kleehamer – Managing Director	**Chicago**	**Tel: (312) 655 – 5363**

Melinda M. Kleehamer has worked exclusively with ultra-high net worth families for over twenty-five years. As a member of SWAT, Melinda helps PWM clients and their advisors with sophisticated income, gift and estate planning techniques. Melinda spent the first fifteen years of her career practicing gift and estate planning law with national and international law firms, most recently as a capital partner in McDermott Will & Emery's Private Client Department. At McDermott, Melinda focused on pre-transaction planning, family business issues, family wealth education, complex gift planning and valuation methodologies. After leaving the practice of law, Melinda maintained a private client practice focused on communication, decision-making and conflict resolution workshops specifically tailored to her clients' individual, family and philanthropic goals. She also led a sales and advisory team at Bank of America that managed investment, trust, deposit and credit services for her clients. Melinda is a summa cum laude graduate of the State University of New York at Brockport, an honors graduate of the University of Chicago Law School and a member of the Order of the Coif. She is a member of the Distribution Committee of a family foundation and deeply involved in charitable activities intended to alleviate suffering of all kinds.

Adam Clark – Managing Director	**New York**	**Tel: (212) 357 – 5177**

Adam Clark serves as Chairman, CEO and President of the Goldman Sachs Trust Company, N.A. and is a member of the Strategic Wealth Advisory Team, where he provides tax and wealth planning education focused on gift and estate tax planning, income tax planning and philanthropic planning. Adam also has extensive experience in the international tax area, having advised high net worth clients with multi-jurisdictional tax and financial interests, including non-U.S. investments and families of multiple citizenship and residence. He has also helped many families to satisfy their U.S. tax reporting obligations with respect to interests in non-US structures, such as offshore trusts and foreign investment vehicles. Prior to joining as a member of the Strategic Wealth Advisory Team in the Goldman Sachs' New York office, Adam was a managing director at WTAS LLC, where he led the international private client group, helping domestic and international families with their tax, financial planning and business interests. Adam holds an LL.B in English law and German law from the University of Liverpool and achieved the BGB (German civil law) from the University of Würzburg. Adam also serves on the board of Fiver Children's Foundation, an organization that provides youth development programs to underserved communities throughout New York City and Central New York.

Strategic Wealth Advisory Team (continued)

Biographies

Michael L. Duffy – Vice President	**Atlanta**	**Tel: (404) 846 – 7224**

Michael L. Duffy serves two roles at Goldman Sachs: (i) Southeast Trust Strategist for the Goldman Sachs Trust Companies and (ii) Southeast representative of the Strategic Wealth Advisory Team (SWAT). Prior to joining Goldman Sachs in May 2007, Michael was a Senior Director of New Business Development with Mellon Financial. Before joining Mellon, Michael served as a Vice President and Wealth Advisor in the JPMorgan Private Bank, where he provided counseling and planning services to ultra-high net worth families. Preceding his tenure at JPMorgan Private Bank, Michael practiced law in Palm Beach, Florida with Alley, Maass, Rogers & Lindsay, P.A. where he was central to the firm's income tax, transfer tax and sales tax practices. Michael started his career after law school as an in-house research associate for Coopers & Lybrand. Michael was awarded his B.A. from Flagler College, his J.D. from Ohio Northern University and his LL.M. in Taxation from the Georgetown University Law Center. Although he does not currently practice law, he is a member of the American Bar Association and the Florida, North Carolina, South Carolina and Atlanta Bar Associations. Michael is currently serving a two-year term as Treasurer on the Board of the Atlanta Estate Planning Council.

Cathy Bell – Vice President	**Houston**	**Tel: (713) 654 – 8462**

Cathy joined the Strategic Wealth Advisory Team (SWAT) in May 2009, after spending 17 years with Stewart Title in Houston, Texas working in their property information technology division. Cathy received her B.B.A. in Finance from the University of Texas and her M.B.A. from the University of Houston. Cathy is a current board member of a local chapter of the National Charity League.

Jason Danziger – Vice President	**Dallas**	**Tel: (214) 855 – 1134**

Jason is a member of the Goldman Sachs Strategic Wealth Advisory Team. He works with Private Wealth Management clients and their own advisors to help achieve long-term goals using a variety of income tax, gifting and estate planning techniques. Prior to his current role, he assisted Private Wealth Management clients in the Texas region with the construction of comprehensive financial plans and general income tax and estate planning advice. Before joining Goldman Sachs, he was a Financial Planner and Assistant Vice President for a regional trust company in Houston. Jason began his career in public accounting, specializing in tax compliance for flow-through entities and oil and gas companies. Jason received his B.S. in Finance and Accounting from Washington University in St. Louis and a Master's in Public Accounting focusing in Tax from the University of Texas at Austin. He is a Certified Public Accountant (CPA) and a Certified Financial Planner (CFP).

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