Some of the Best Family Limited Partnership Planning Ideas We See Out There (That Also Have the Merit of Playing Havoc With Certain "Conventional Wisdom")

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Best Non-Tax Family Limited Partnership Planning Ideas – Or Why Investment Professionals Love Limited Liability Companies and/or Limited Partnerships
(Pages 2 through 32 of the Paper)

Conventional Wisdom:

- "For the passive trustee investor, there does not exist any substantive non-tax investment reason to invest in a family limited partnership;" or
- You cannot allocate capital gains taxable income to the income beneficiary of an income only trust."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

Best Non-Tax Planning Idea – or Why Investment Professionals Have Limited Liability Companies and/or Limited Partnerships (Continued)

Marvin and Maggie Modern wish to give $300,000 to separate trusts for each of their grandchildren. Marvin and Maggie understand modern portfolio theory and the importance of diversification. They want the grandchildren's trusts to invest for the greatest risk-adjusted return and are concerned that the trusts will not be large enough to meet SEC limitations on who may invest in certain alternative asset classes.

In addition to current gift planning, Marvin and Maggie want to provide a qualified terminal interest marital deduction trust ("QTIP") for the surviving spouse under their estate plans. Many of their personal alternative asset investments are held in private equity partnerships now. Marvin and Maggie worry that these investments could cause income tax fairness issues for the QTIP trust – that is, they worry that the surviving spouse, as income beneficiary, may bear a disproportionate amount of income tax liability on the alternative investments - but still feel strongly that the QTIP trust should have exposure to alternative asset classes.

Marvin and Maggie ask their attorney, Pam Planner, how to structure their investment portfolio so the trustees for their grandchildren's individual trusts and the survivor's QTIP trust can invest in the broad array of asset classes necessary to maximize risk-adjusted return under modern portfolio theory.

This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Best Non-Tax Planning Idea – Or Why Investment Professionals Love Limited Liability Companies and/or Limited Partnerships (Continued)

- The first investment reason certain trusts are benefited by the creation of family limited partnerships: closely held family limited partnerships may facilitate a trust holding alternative investments and the trust's ability to follow modern portfolio theory.
  - Certain exceptions to the registration requirements under the Securities Exchange Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940 are important to many issuers of alternative investments (e.g., investments such as oil and gas, real estate and other private equity investment funds).
  - It is important that those alternative investment funds be held by "accredited investors" and/or "qualified purchasers".
  - If the Moderns first create a family limited partnership, and then give family limited partnership units to the trusts for the grandchildren, then the accredited investor and qualified purchaser exceptions may apply. In that manner the trust investments would follow modern portfolio theory.

Best Non-Tax Planning Idea – Or Why Investment Professionals Love Limited Liability Companies and/or Limited Partnerships (Continued)

- The second investment reason certain trusts are benefited by the creation of family limited partnerships: closely held family limited partnerships facilitate income only (so-called simple) trusts to be fully diversified, as modern portfolio theory seems to require.
  - Closely held family limited partnerships could be a tool to manage distribution fairness issues for income only trusts associated with distributions (or lack of distributions) from alternative investments that could be superior to using a unitrust conversion.
    - Unitrust conversion does not help because of valuation issues with hedge funds and private equity investments.
    - Distributions of private equity and fund investment units cannot be made because of securities concerns.
    - If other assets are distributed it could potentially distort the overall asset allocation.
  - Closely held family limited partnerships could be a tool to manage income tax fairness issues associated with alternative investments for income only trusts.
    - One cash distribution could be made from a family limited partnership to an income only trust and designated as trust accounting income.
    - A second cash distribution could be made from a family limited partnership to an income only trust and designated as corpus to pay trust income taxes.

Best Non-Tax Planning Idea – Or Why Investment Professionals Love Limited Liability Companies and/or Limited Partnerships (Continued)

- The third investment reason certain trusts are benefits by family limited partnerships: the closely held family limited partnership has the management capacity to carry out the partnership's capital gains income to the income only beneficiary for income tax purposes.
  - Under UPIA Section 401, a distribution of cash from an entity to a trust may be deemed to have carried out capital gain income as trust accounting income, if a trustee does not have distribution control over a family limited partnership.
  - A trustee can only allocate receipts from the entity between income and principal according to the trust agreement or UPIA Section 401.

One of the Best Family Limited Partnership Planning Ideas – Sell It (Pages 32 through 36 of the Paper)

Conventional Wisdom:

- "Do not engage in family limited partnership planning unless it can be demonstrated that the partnership uniquely solves a substantive non-tax problem;" or
- "Discounting a client's assets is a much better estate planning tool than grantor trusts or freezing a client's estate."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

One of the Best Family Limited Partnership Planning Ideas – Sell It (Continued)

Example: The Sweet Deal

Cal Client is in his office when Dan Deal knocks on his door and tells Cal that he has "a heck of a deal for him." Dan states that he would like to sell most of his assets to Cal for 65¢ on the dollar. Cal tells Dan that he likes the price, but he does not want to buy any of the assets for cash. Cal wonders if Dan would still be willing to sell his assets for 65¢ on the dollar, if it was all for a seller financed note from Cal. Dan tells Cal that because he likes him so much he will be happy to accept a note from Cal. Cal then informs Dan that while he likes the 65¢ on the dollar, he likes the fact that he can buy all the assets for a seller financed note, he does not like to pay much interest on the note and wonders if Dan will still offer that deal if the interest rates are comparable to US Treasury interest rates. Again, Dan tells Cal that because he likes him so much he will be happy to do that deal. Cal then informs Dan that while he likes the price of 65¢ on the dollar, and he also likes the fact that he can purchase the assets for a seller financed note at US Treasury interest rates, he will only buy the assets if he will have no personal liability on the note (i.e., the note will be non-recourse). Dan, once again agrees to Cal demands. An increasingly impatient Dan asks Cal if there are any other deal points. Cal says there is just one more. Cal tells Dan that he does not like paying income taxes. Cal will only do the deal if Dan will agree to pay all of the income taxes associated with the assets he is purchasing from Dan. Dan agrees.

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If a Sale of a Partnership Interest Occurs During a Client's Lifetime, the Gift Tax Equivalent of I.R.C. Section 2036 Does Not Exist (i.e., There is No I.R.C. Section 2536 Under Chapter 12 of the Code)

Example: Lacy Lucky Sells Her Partnership Interest During Her Lifetime

Lacy Lucky lives in the great state of Nirvana. In the state of Nirvana, plaintiff's lawyers have been banned. In this enlightened state, wealthier spouses always receive all of the marital assets, if there is a failed marriage. Because this state is so enlightened, the SEC is very impressed and has waived its qualified purchaser and accredited investor rules with respect to trusts created under this state's laws. Because of all of these reasons (and because all children in this state are born with above average intelligence), Lacy Lucky is worried that a substantive non-tax reason may not exist for the creation of her family limited partnership. After the creation of the partnership, Lacy will own a 1% general partnership interest and a 98% limited partnership interest. Lacy asks her attorney, Tom Taxadvisor, what she could do to avoid the application of I.R.C. Section 2036(a)(1) other than avoiding behavior that might constitute an implied agreement to use the partnership asset income?

- Tom may advise Lacy to sell all of her limited partnership interest for adequate and full consideration.
- Even if the sale is not for adequate and full consideration (e.g. part sale, part gift or all a gift), if Lacy lives longer than three years after the transfer, then I.R.C. Section 2036(a)(1) should not apply to the resulting note (assuming the note is a note for state law property purposes) and/or cash she receives from that sale.

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Best Family Limited Partnership Idea – Sell It (Continued)

- If a sale of a partnership interest occurs during a client's lifetime the gift tax equivalent of IRC Section 2036 may not exist.
- The valuation principles of Revenue Ruling 93-12 apply to lifetime transfers, but they do not apply to transfers at death.
- Growth of the underlying assets of the partnership, if a transfer occurs during the lifetime of a taxpayer, will not be subject to estate tax.
- A future Congress could change the current law with respect to valuation discounts associated with family limited partnerships.
- The taxpayer may have the ability to indirectly access all of the partnership distributable cash flow for consumption needs.
- Generally, the sale of a family limited partnership interest to a trust, is a flexible arrangement that can be modified to changed circumstances.
- The sale of a limited partnership interest for a note facilitates testamentary charitable planning, because the note is a more attractive asset for a charity to receive than family limited partnerships interests.
- There is a significant transfer tax advantage for the taxpayer who transfers his partnership interests during his lifetime to a grantor trust in exchange for a note.

Best Family Limited Partnership Idea – Sell It (Continued)

Example: Mimi Minimum Wonders What Additional Transfer Tax Benefit Accrues From a Partnership Valuation Discount Over Her Life Expectancy

Mimi Minimum is a very healthy 50 year old female. Both of her parents are still alive and she has only recently buried her grandparents. Her doctor assures her that she easily has a 30 year life expectancy. Mimi likes the relative simplicity of making a $2,000,000 gift of some of her highly appreciated stock to fund a grantor trust and then selling her highly appreciated stock worth $18,000,000 to that grantor trust for a low interest note after the sale for the note is completed, the grantor trust would then sell all $20,000,000 of its stock ("Technique One" below). Mimi asks her estate planner, Les Rates what is gained by transferring a family limited partnership (which holds $18,000,000 of her stock) to a grantor trust from a transfer tax standpoint, assuming she does live a 30 year period ("Technique Two" below). Mimi is concerned about the costs of creating a family limited partnership (legal costs, accounting costs, administrative costs and valuation expert costs). Mimi tells Les Rates to assume that she will earn 8% pretax return with respect to the proceeds of the sale of the appreciated stock (with 2% being taxed at ordinary income rates and 6% being taxed at capital gains rates with a 30% turnover) and that her consumption needs will be $350,000 a year before inflation. What does Les Rates' analysis demonstrate?

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Summary of Results For $20 Million of Asset With "0" Basis Growing at 8% Per Year (Pre-Tax) – No Further Planning vs. Two Hypothetical Integrated Income and Estate Tax Plans; 30 Year Future Values; Post-Death Scenarios (assuming client dies in 30 years)

Technique	Minimum Family	Consumption– Direct Cost	Consumption– Investment Opportunity Cost	IRS– Income Tax	IRS– Investment Opportunity Cost	IRS– Estate Tax (at 45%)	Total
No Further Planning; Bequeaths Estate To Family (Without Discount)	$38,798,412	$16,651,395	$36,796,365	$19,551,445	$57,711,366	$31,744,155	$201,253,138
No Further Planning; Bequeaths Estate To Family (With Discount)	$49,908,866	$16,651,395	$36,796,365	$19,551,445	$57,711,366	$20,633,701	$201,253,138
Technique #1: Hypothetical Integrated Income and Estate Tax Plan With a Gift/Sale to a GST; Bequeaths Estate To Family	$68,269,192	$16,651,395	$36,796,365	$21,308,079	$57,711,366	$516,740	$201,253,138
Technique #2: Hypothetical Integrated Income and Estate Tax Plan With a Partnership and With a Gift/Sale to a GST; Bequeaths Estate To Family	$68,399,886	$16,651,395	$36,796,365	$21,796,365	$57,711,366	$298,954	$201,253,138

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Summary of Results For $20 Million of Asset With "0" Basis Growing at 8% Per Year (Pre-Tax) – No Further Planning vs. Two Hypothetical Integrated Income and Estate Tax Plans; 10 Year Future Values; Post-Death Scenarios (assuming client dies in 10 years)

Technique	Minimum Family	Consumption – Direct Cost	Consumption – Investment Opportunity Cost	IRS – Income Tax	IRS – Investment Opportunity Cost	IRS – Estate Tax (at 45%)	Total
No Further Planning; Bequeaths Estate To Family (Without Discount)	$14,857,342	$4,012,358	$1,692,703	$6,076,989	$4,383,101	$12,156,007	$43,178,500
No Further Planning; Bequeaths Estate To Family (With Discount)	$19,111,945	$4,012,358	$1,692,703	$6,076,989	$4,383,101	$7,901,405	$43,178,500
Technique #1: Hypothetical Integrated Income and Estate Tax Plan With a Gift/Sale to a GST; Bequeaths Estate To Family	$20,869,217	$4,012,358	$1,692,703	$6,780,213	$4,383,101	$5,440,909	$43,178,500
Technique #2: Hypothetical Integrated Income and Estate Tax Plan With a Partnership and With a Gift/Sale to a GST; Bequeaths Estate To Family	$23,931,861	$4,012,358	$1,692,703	$6,635,610	$4,383,101	$2,522,868	$43,178,500

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Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Pages 62 through 107 of the Paper)

Conventional Wisdom:

- “The IRS will always contest the valuation of a family limited partnership interest because the IRS could increase the transfer taxes, if they can demonstrate that the valuation discount is too high;” or
- “All valuation clauses in an assignment document are against public policy.”

This “conventional wisdom,” under the circumstances discussed below, is incorrect.

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

Certain conclusions that may be drawn from the *Petter*, *Christainsen* and *McCord* cases:

- These cases strongly suggests that the Tax Court would be prepared to allow defined value allocation formula clauses, with a gift over to entities or trusts other than charities, which incorporated the phrase "as finally determined for federal gift tax purposes" and in which an independent fiduciary exists to enforce the allocation.
- The addition of the phrase "as finally determined for federal gift tax purposes" was obviously found to be an unnecessary addition by the Fifth Circuit. There may be key reasons why a donor, in his assignment document, would not wish to add that phrase. One reason is a practical one: over ten years is too long to wait to find out the result of whom own what in assignment of a closely enterprise (the facts of *McCord*). Another reason may be a tactical one: an arms-length transaction is the best evidence of value.
- It should be noted that in *King v. United States*, 545 F.2d 700 (10th Cir. 1976), the Tenth Circuit also found that *Proctor* did not apply where the transaction did not contain "contingencies which, upon fruition, alter, change or destroy the nature of the transaction."

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

- Besides a public charity, the recipient of the "give over" in the defined value allocation formula could be a spouse, marital deduction trust or grantor retained annuity trust (GRAT).

- Defined value allocation formula clauses could cause practical problems as to the administration of the transferred property before a final determination has been made as to the portion of the property that has actually been transferred. For instance, issues may arise as to the distribution of income earned on the transferred property, the exercise of ownership rights and the reporting of the income for income tax purposes.

- Generally, these issues could be avoided by using a trustee as the transferee of the legal title to the property. The defined value allocation formula clause could be a clause internal to the trust document creating the trust and could direct that the trustee is to allocate the interest in the hard to value asset between two trusts in which the trustee is the trustee. One trust could be held for the benefit of the client's family and the other trust is held in a manner that is not subject to gift tax. In a similar fashion perhaps an escrow agent could also be utilized.

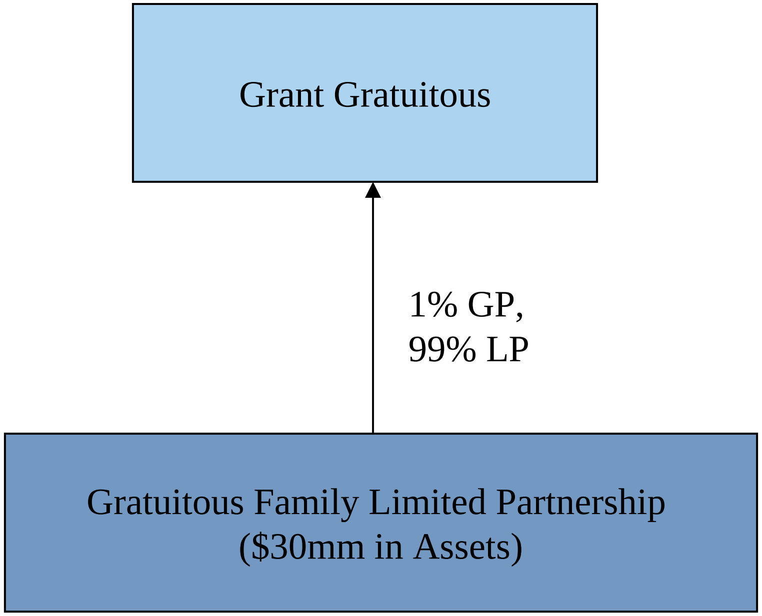
- In order to avoid certain income tax reporting uncertainties it is recommended that all of the "transferee" trusts be considered potentially defective grantor trust.

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

- Transfer to a 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*. For example, the trust agreement might provide for payments of 53% per year for two years, where the 53% annual payment amount is derived from the initial value. This type of language operates as a built-in revaluation clause, mitigating the risk of a surprise gift on revaluation of the transferred property by the Service.

Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

- The attorney for Grant Gratuitous, Lenny Leverage, would like to use a technique that combines a sale of a limited partnership interest to a grantor trust that is protected with a "GRAT" wrapper. Grant tells Lenny that he has $30,000,000 in assets that are appropriate for a partnership. Grant would like to consider planning for one-third of his partnership units if a three year GRAT is involved and plan for all of his partnership units if a 10 year GRAT is involved. See the illustration below:



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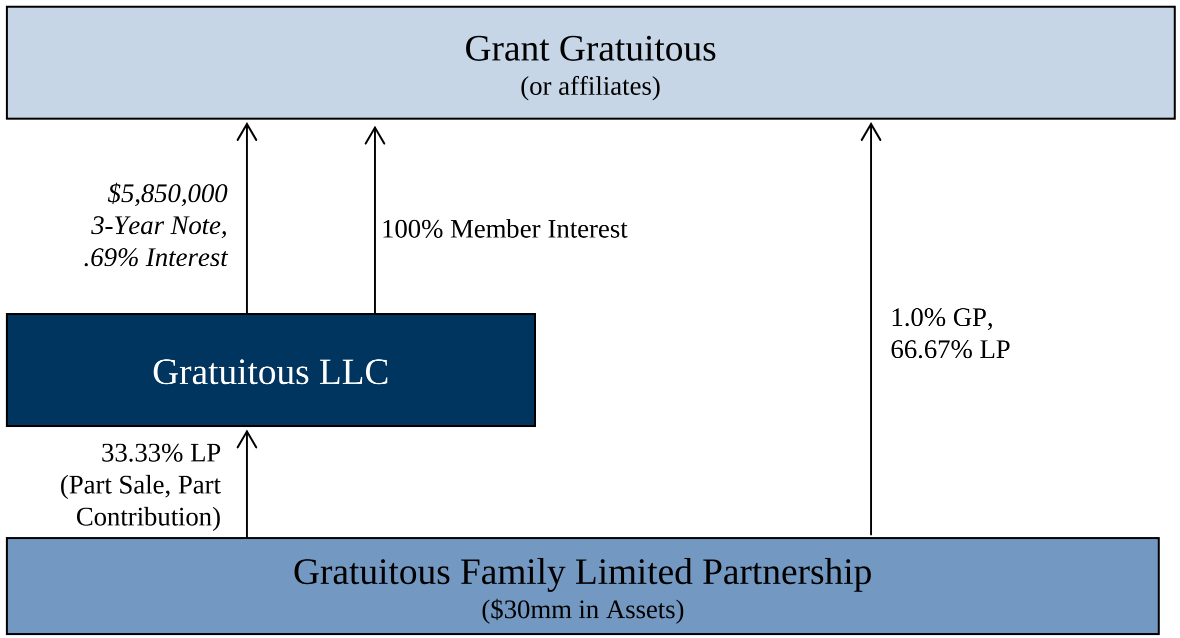
Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

- Grant could contribute and sell a 33.33% LP interest to a single member LLC. Assuming a 35% discount, the transaction is illustrated below:



- Though it is not required by any statute or regulation, many advisors believe that it is desirable for the LLC to have at least 10% greater than the amount of the trust's note to support treatment of the note as true debt. Advisors differ as to the extent of any required cushion and how the requirement can be satisfied.
- It is assumed that the short-term AFR is .69%.

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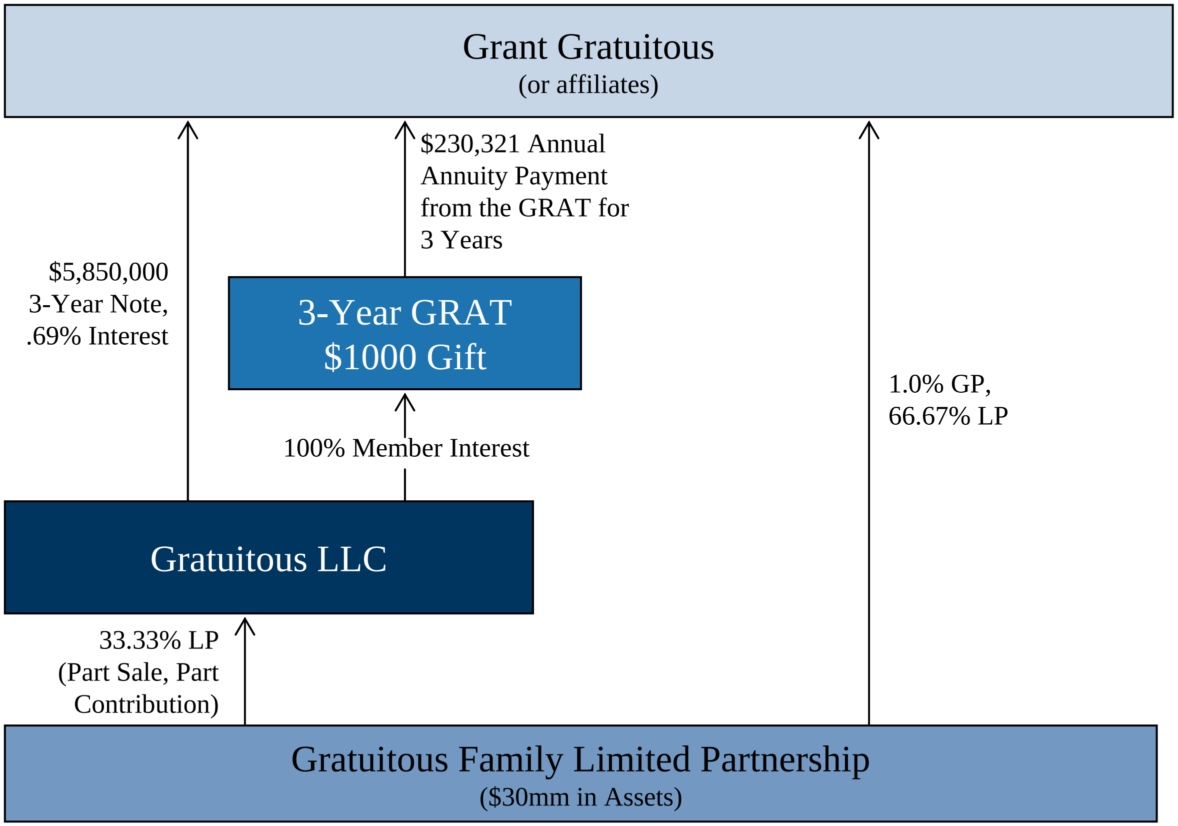
- Grant could contribute the LLC units to an irrevocable three year GRAT that is a near zeroed out GRAT. It is assumed the IRC Section 7520 rate is 3.2%. The transaction is illustrated below:



- Grant Gratuitous may wish to only contribute a 99% non-voting membership interest to the GRAT.

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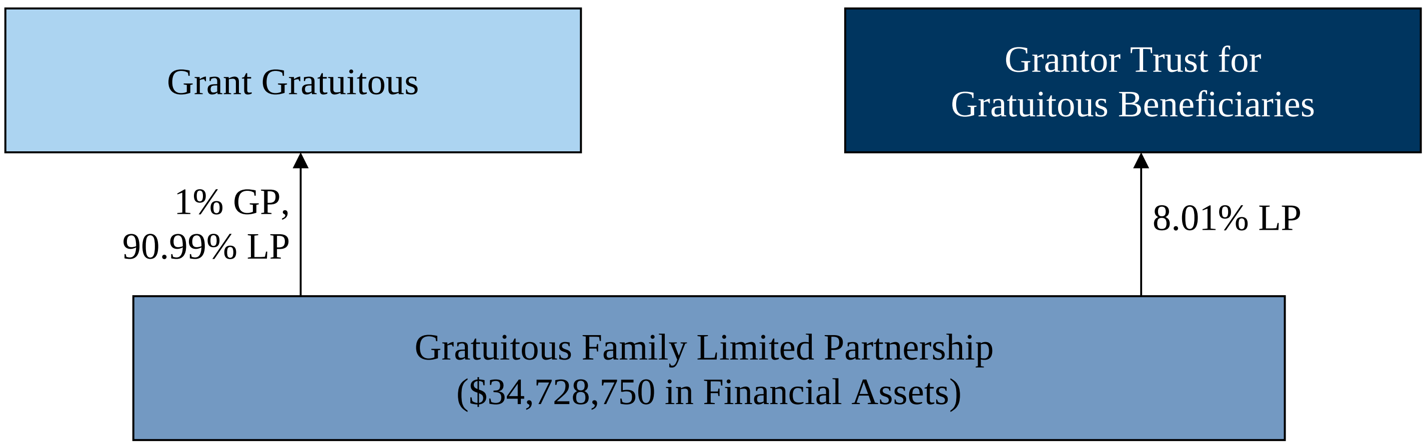
Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

- Three years later, under the assumptions noted above, if both the GRAT and LLC terminate and the note balance is paid by the remainder beneficiary (the Grantor Trust) with partnership units, 8.01% of the limited partnership interest will be owned by the remainder beneficiaries, as illustrated below:



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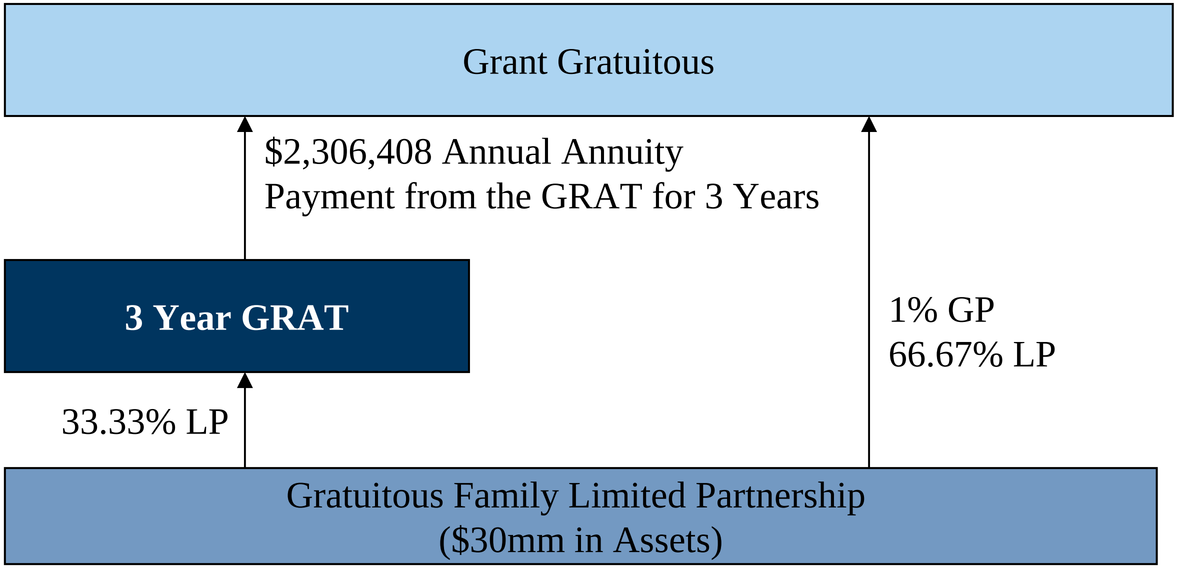
- For comparison purposes, Lenny wishes to illustrate to Grant what the transaction would be like without any leverage. Thus, a 33.33% pro rata limited partnership interest is contributed to a GRAT in a transaction similar to the illustration below:



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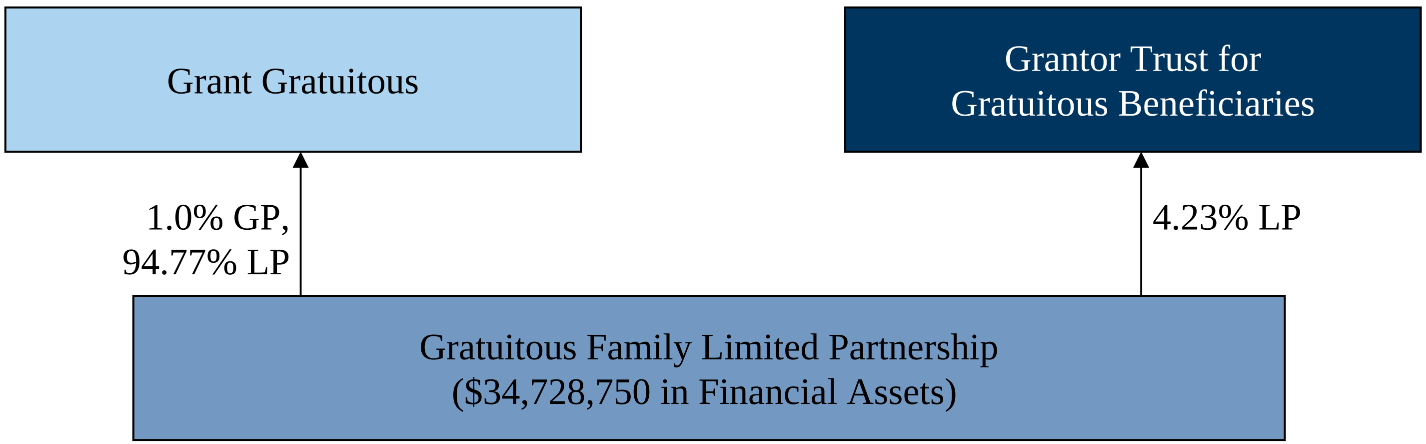
Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

- At the end of three years, under the above assumptions, 4.23% of the limited partnership interest will be transferred to the remainderman beneficiaries of the trust as illustrated below:



- Obviously, the use of leverage substantially improves the result of the GRAT technique and also avoids having to pay the annuity with hard to value assets. Paying the annuity with hard to value assets may create deemed contribution or commutation issues.

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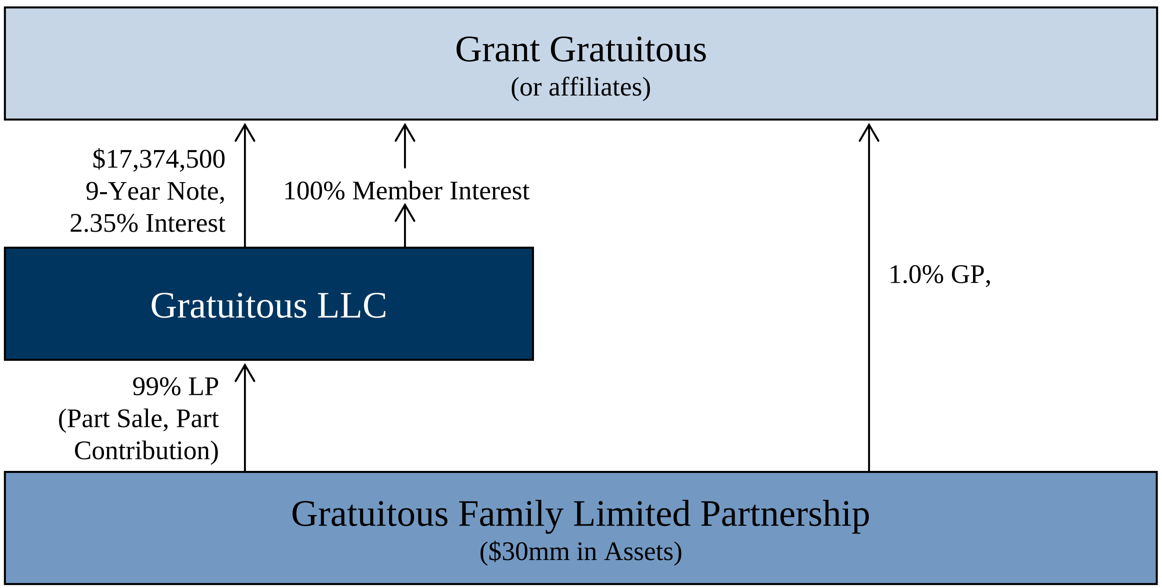
Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

- Use of a mortgaged partnership interest with a ten year GRAT. It is assumed the mid-term AFR is 2.35%



- Grant Gratuitous could contribute and/or sell a 99% limited partnership interest to a single member LLC. It is assumed that the limited partnership interests will be valued at a 35% discount, as illustrated above.
- Because Grant Gratuitous owns all of the LLC, there is no gift tax owed even though the note is equal to only 90% of the value of the assets that are sold. There should not be any income taxes associated with the sale because the LLC is ignored for income tax purposes.
- Though it is not required by any statute or regulation, many advisors believe that it is desirable to have a value at least 10% greater than the amount of the trust's note in order to support treatment of the note as true debt.

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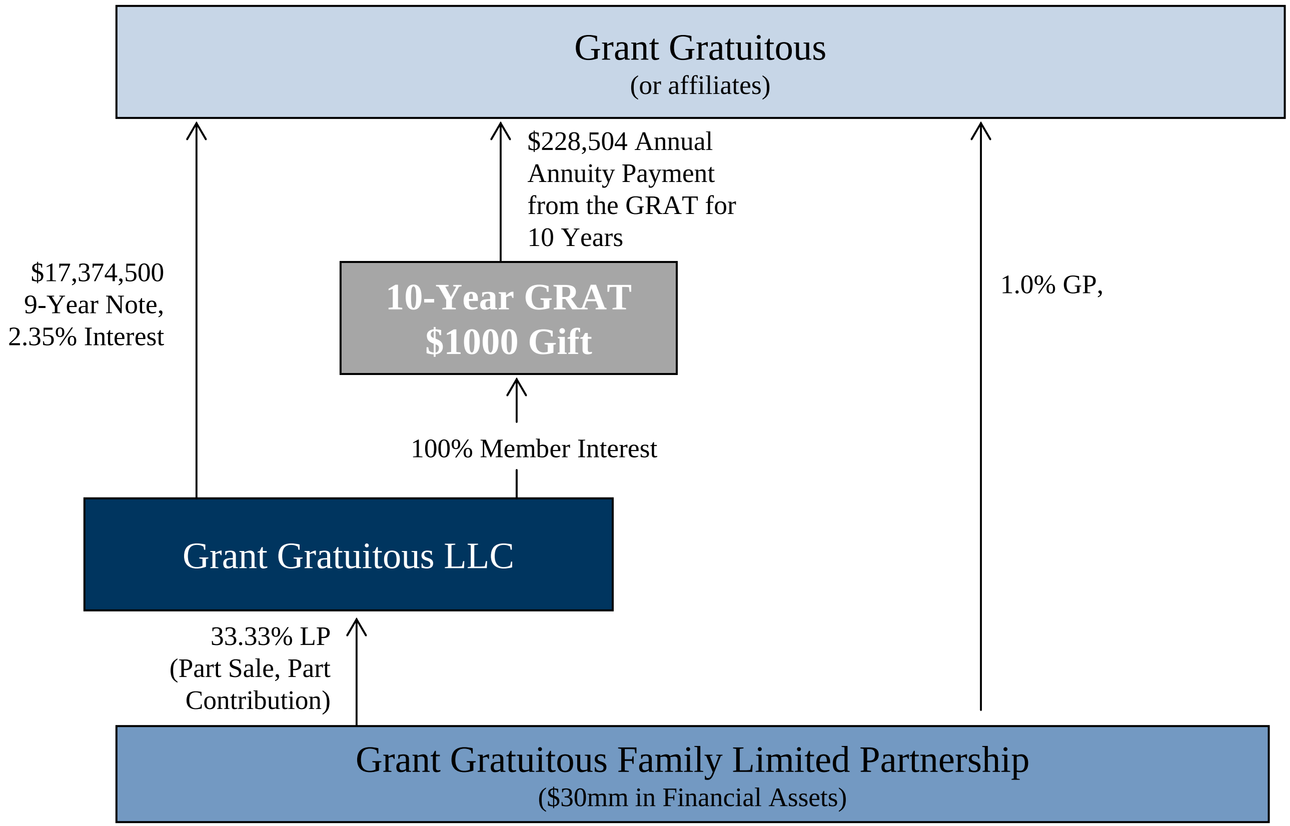
- Grant Gratuitous could contribute the LLC member units to an irrevocable 10-year GRAT. It is assumed the IRC Section 7520 rate is 3.2%.



- Grant Gratuitous may wish to only contribute a 99% non-voting membership interest to the GRAT.

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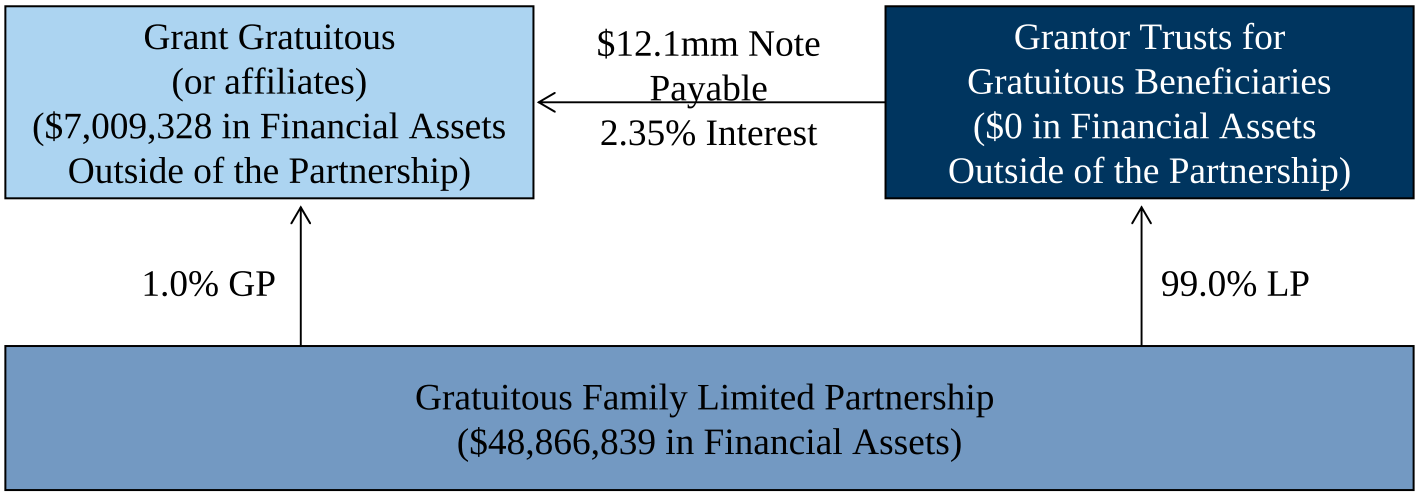
- After ten years, both the LLC and GRAT terminate, and the remaining GRAT assets and liabilities are paid to the remainder beneficiary, which is assumed to be a grantor trust.



- It is assumed that the assets of the partnership will grow at 8.0% annual rate before income taxes.

- It is assumed that the notes will be re-financed in year 9, perhaps with a short-term note, at the same interest rate.

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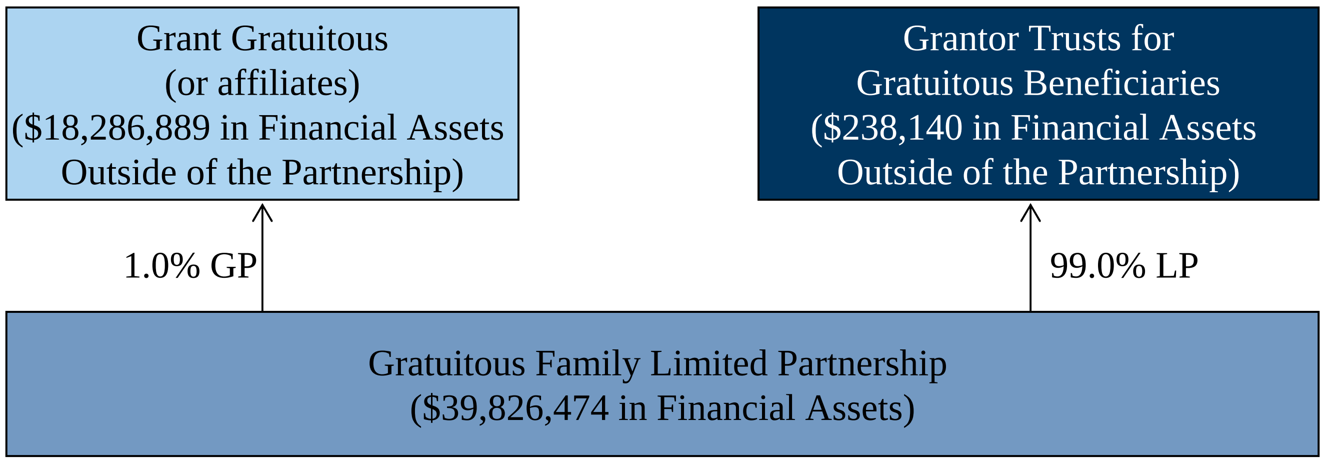
- The partnership agreement could mandate in the 11th year that a special pro-rata distribution of 23.0% (in addition to the 3% annual distribution) of the partnership assets be made, or the partners could unanimously agree to that distribution in the 11th year.



- The Grantor Trusts for the Gratuitous Beneficiaries could use its share of the special distribution to pay the note they owe to Grant Gratuitous. There should be enough cash in the trust from distributions in prior years to completely pay the note obligations.

- Alternatively, the notes could be paid over time by the grantor trust for the Gratuitous Beneficiaries with the trust's share of the partnership distributions.

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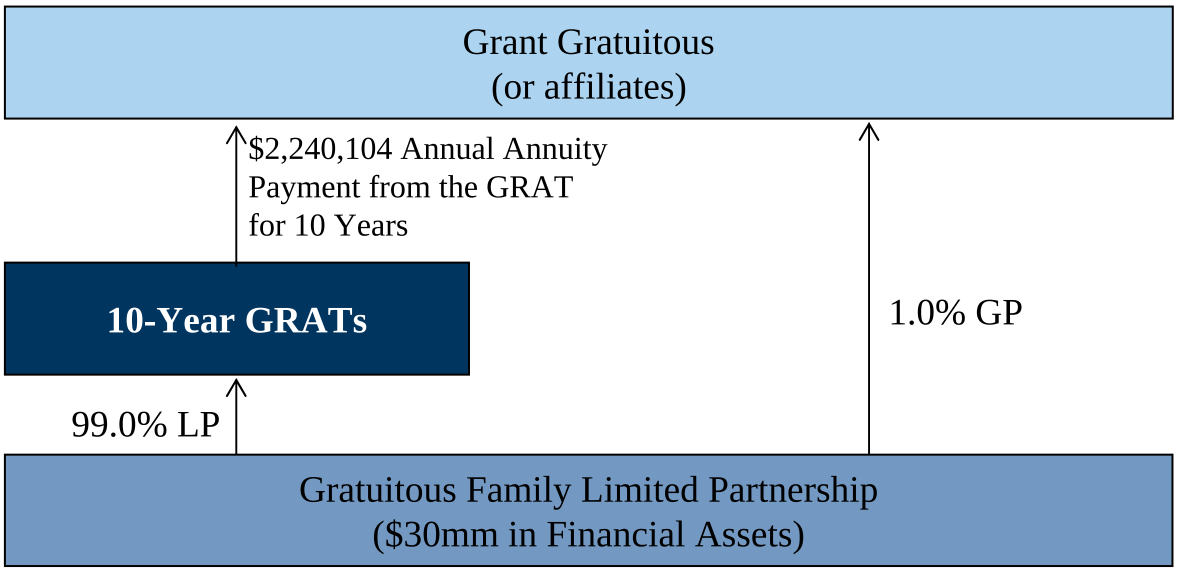
- Grant Gratuitous could contribute his limited partnership interests to 10-year GRATs without first leveraging the interests.

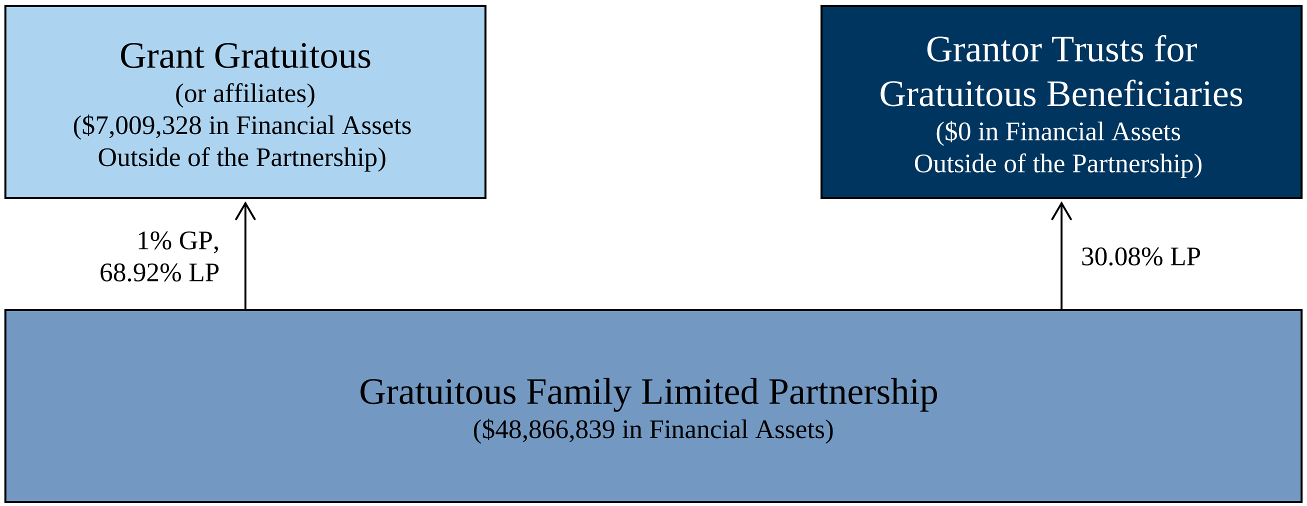


- A consideration of paying GRAT annuities with partnership units is that they are hard to value. If the units are not valued correctly when they are used to pay the annuities, the payments could disqualify the GRAT and significant gift taxes could be owed.
- A consideration of a GRAT paying higher annuity amounts, when not using leverage, is that more of the assets of the GRAT could be included in the GRAT creator's estate, if the creator dies before the GRAT terminates.

This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

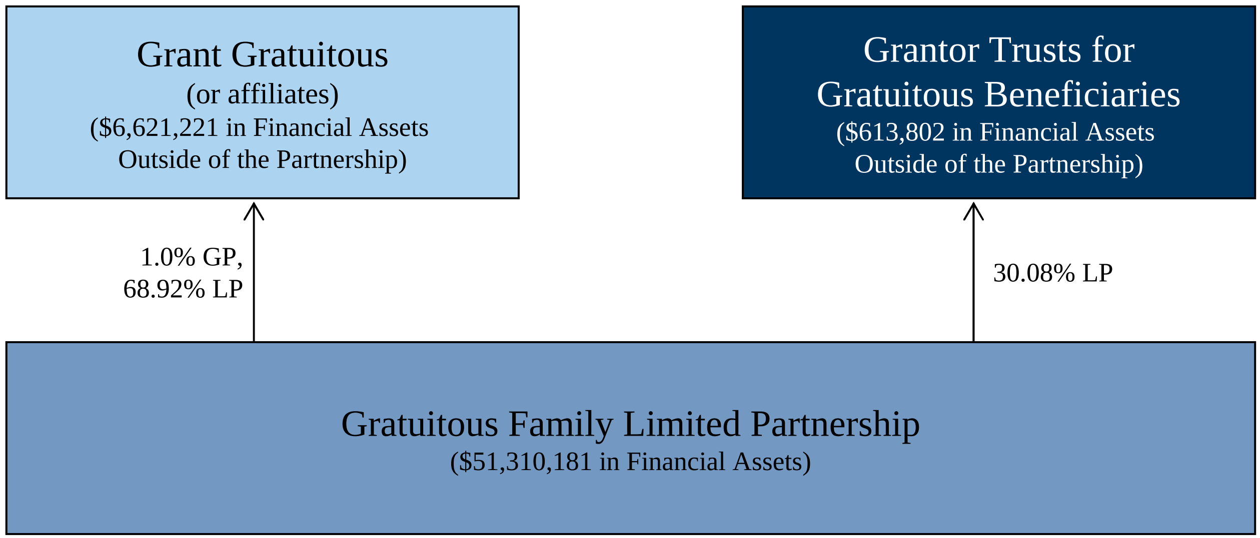
- After ten years, the GRAT terminates and the remaining GRAT assets are paid to grantor trusts.



- It is assumed that the assets of the partnership will grow at 8.0% annual rate before income taxes.

This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)



- One year later, at the end of 11 years, under the assumption of this example, the values would be as described above.

- Obviously, the use of leverage substantially improves the result of the GRAT technique and also avoids having to pay the annuity with hard to value assets.

This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Possible Structural Planning Solution to Lower the Leverage Cost of a GRAT; Avoid Paying the Retained Annuity With Hard to Value Assets; Assure the Contribution of Assets to a GRAT is Made at the Exact Point of the Creation of the GRAT and Minimize the Amount That Would Be Included in the Grantor's Estate if the Grantor Died Before the End of the Term of the GRAT (Continued)

- Certain observations:
- The use of mortgaged partnership units improves the estate planning results, under the above assumptions for the 3-year GRAT, by around 70%. It improves the result for the 10-year GRAT by over 157%. The reason for the improvement is that the annuity is always paid with undiscounted cash and the "hurdle rate" is considerably lower.
- When mortgaged LLC units are contributed to a GRAT, under the assumptions above, there is enough cash flow coming out of the LLC, whether it is pro rata partnership units or a preferred interests that are owned by the LLC to pay all of the GRAT the annuity amounts during the Annuity Period in cash. This eliminates the problems associated with satisfying the GRAT annuity with hard to value assets.
- The notes associated with the sale to the LLC before the GRAT is created may be finally satisfied with hard to value assets after the GRAT terminates by the remainder beneficiary. However, the use of payments in kind to satisfy the loan by the remainder beneficiary after the GRAT terminates does not run the "deemed contribution" danger that may be inherent in satisfying GRAT annuity payments with hard to value assets.
- If the grantor of the GRAT dies before the end of the annuity period, using the mortgaged technique, particularly with long term GRATs, may produce a much better result under IRC Section 2036.

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

- Sales to incomplete gift trusts. Consider the following example :

Example: Ann and Aaron Appointment Wish to Make Transfers of Family Limited Partnership Interests and Maintain Maximum Flexibility

Ann and Aaron Appointment approach their attorney, Ray Reciprocal, and tell him they would like to transfer their family limited partnership interests in a manner that maintains maximum future flexibility and ensures that there will be no gift tax surprises.

Ray suggests they consider creating trusts for each other as discretionary beneficiaries (with different provisions) that will not be considered reciprocal trusts and under which each would have a testamentary power of appointment (also with different provisions). The trusts will be grantor trusts to the spouse who creates the trust.

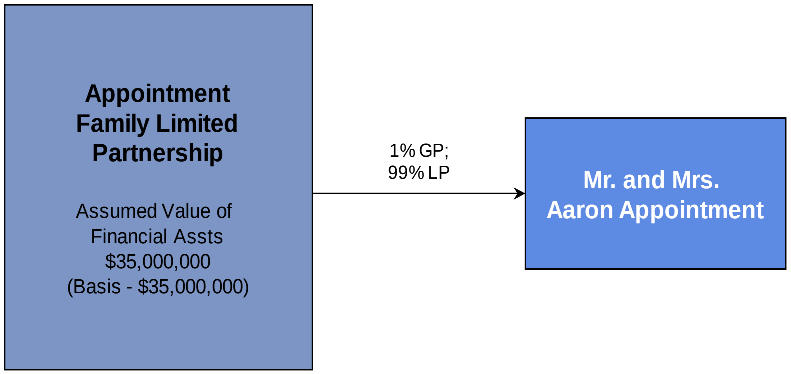
Ann and Aaron Appointment have $5,000,000 in financial assets outside the partnership. The partnership owns $35,000,000 in financial assets. Ann and Aaron ask Ray to assume the following: (i) Ann and Aaron will have a joint life expectancy of 25 years; (ii) the annual pre-tax rate of return of their assets will be 7% (with 3% being taxed at ordinary rates and 4% taxed at capital gain rates with a 30% turnover); (iii) the distribution policy of the partnership will be 4% of the value of the assets; and (iv) the assumed valuation discount from their appraiser will be 35%.

Ray suggests that after the trusts are created that Ann sell her limited partnership interests to the trust Aaron created for her benefit and Aaron sell his limited partnership interests to the trust Ann created for his benefit.

This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

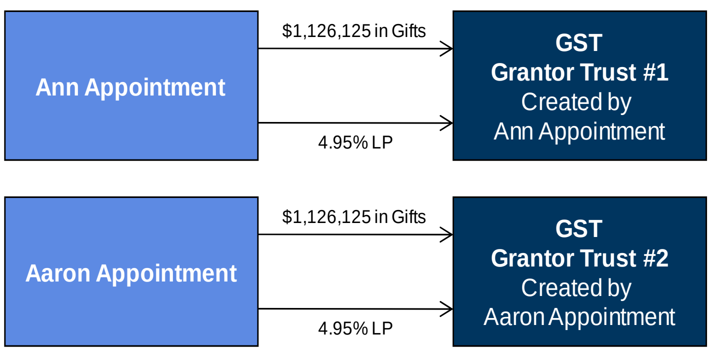
Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

The ownership of the partnership is illustrated below:



Partner	Ownership (%)
Ann and Aaron Appointment	1% GP: 99% LP

The proposed gift to create the proposed trusts is illustrated below:

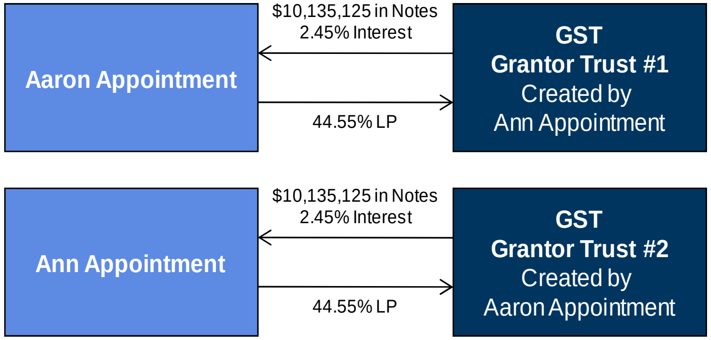


Partner	Ownership (%)
Ann and Aaron Appointment	1.0% GP; 89.1% LP
GST Grantor Trust #1 Created by Ann Appointment	4.95% LP
GST Grantor Trust #2 Created by Aaron Appointment	4.95% LP

The trusts will be designed so that they are not “reciprocal” of each other for tax purposes.

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

The proposed sale of partnership interests is illustrated below:



Partner	Ownership (%)
Ann and Aaron Appointment	1% GP; $20.27mm Notes Receivable
GST Grantor Trust #1 Created by Ann Appointment	49.5% LP $10.135mm Note Payable
GST Grantor Trust #2 Created by Aaron Appointment	49.5% LP $10.135mm Note Payable

- A sale by a grantor’s spouse to the grantor’s trust should not be recognized for income tax purposes because of IRC Sections 1041 and 671. However, interest on the notes will be recognized for income tax purposes.
- Generally, the interest will produce an offsetting deduction and income to the spouses. The principal and income of the notes can be paid with cash flow that is naturally distributed to the partners in order to pay their income taxes.

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

- Because of the presence of the testamentary power of appointment, if the IRS determines the notes received by Aaron is inadequate consideration, there will not be any gift taxes owed because the gift will be incomplete for gift tax purposes. *See* Treas. Reg. Section 25.2511-2(b). Instead, Aaron will be considered the grantor of that portion of the trust consisting of the excess value. If the IRS does finally determine Aaron has made a gift, under state law or the trust agreement, the trust may be able to be divided into two trusts.

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Best Valuation Idea For Family Limited Partnership Interests – The Defined Value Allocation Formula Gift (Continued)

- Assuming the terms of the sale are accepted by the IRS as providing adequate consideration, the estate planning results of such a structure under the above assumptions are impressive:

Future Values	Appointment Children (1)	Appointment Children and Grandchildren (2)	Consumption Direct Cost (3)	Consumption - Investment Opportunity Cost (4)	IRS - Income Tax (5)	IRS - Investment Opportunity Costs (6)	IRS - Estate Tax (at 45%) (7)	Total: (8)
No Further Planning; Bequeaths Estate to Family	$45,516,984	$0	$36,459,264	$46,882,103	$22,464,953	$28,532,833	$37,241,169	$217,097,306
Hypothetical Integrated Income & Estate Tax Plan	$724,802	$79,991,794	$36,459,264	$46,882,103	$23,913,489	$28,532,833	$593,020	$217,097,306
Present Values (discounted at 3%)								
No Further Planning; Bequeaths Estate to Family	$21,739,165	$0	$17,413,148	$22,391,154	$10,729,387	$13,627,440	$17,786,590	$103,686,882
Hypothetical Integrated Income & Estate Tax Plan	$346,169	$38,204,526	$17,413,148	$22,391,154	$11,421,216	$13,627,440	$283,230	$103,686,882

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Best Legal Argument Against Application of IRC Section 2036 to a Decedent's Family Limited Partnership – IRC Section 2033 Inclusion Supersedes IRC Section 2036 Inclusion (Pages 107 through 121 of the Paper)

Conventional Wisdom:

- "The courts could apply both IRC Sections 2033 and 2036 to a decedent's partnership interest resulting in an over 100% estate tax inclusion;" or
- "The courts will apply IRC Section 2036 to the exclusion of IRC Section 2033 with respect to a decedent's partnership interest, because IRC Section 2036 inclusion will include more in the decedent's estate"; and
- "Application of IRC Section 2043 solves the double inclusion problem of applying both IRC Sections 2033 and 2036 to a decedent's partnership interest."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

Best Legal Argument Against Application of IRC Section 2036 to a Decedent's Family Limited Partnership – IRC Section 2033 Inclusion Supersedes IRC Section 2036 Inclusion (Continued)

- Except for a brief period (1987 to 1990) IRC Section 2033 has always superseded IRC 2036 for estate tax inclusion purposes.
  - You cannot have double inclusion when two sections of Chapter 11 apply.
  - The power and interest section of Chapter 11 (IRC Section 2033) inclusion in prior cases and rulings has superseded the power sections of Chapter 11 (IRC Sections 2036, 2038 and 2042), even when less estate tax revenue resulted from that IRC Section 2033 inclusion.
    - *See Tully v. U.S.*, 528 F2d 1401 (Ct. Cl. 1976); see also the discussion of the forerunner of IRC Section 2033 in *Helvering v. Safe Deposit Co. of Baltimore*, 316 U.S. 56 (1942).
    - *See Estate of Knipp v. Comm.*, 25 T.C. 153 (1933); *Estate of Tompkins v. Comm.*, 13 T.C. 1054 (1949); *Watson v. Comm.*, 36 T.C.M. (CCH) 1084 (1977); *Infante v. Comm.*, 29 T.C.M. (CCH) 903 (1970); Rev. Rul. 83-147, 1983-2 CB 158; and G.C.M. 39,034 (Sept. 21, 1983), which received Rev. Rul. 83-147.
  - From 1987 to 1990, IRC Section 2036(c)(5), before it was repealed in 1990, provided that IRC Section 2036 inclusion superseded IRC Section 2033 inclusion; the presumed reason for that provision is that, without the statutory presumption, IRC Section 2033 inclusion would have superseded IRC Section 2036 inclusion.
- The Courts may be directed by Section 7701(a)(2) of the Code to prioritize that estate tax inclusion section (i.e., IRC Section 2033), which recognizes the existence of the partnership apart from its owners for estate tax inclusion purposes.

Best Legal Argument Against Application of IRC Section 2036 to a Decedent's Family Limited Partnership – IRC Section 2033 Inclusion Supersedes IRC Section 2036 Inclusion (Continued)

- Congress intends for a consistent treatment of transfer of assets (including family limited partnership interests) during a taxpayer's lifetime and at a death under Chapters 11 and 12. The application of IRC Section 2036 inclusion instead of IRC Section 2033 inclusion generates inconsistent treatment.

- In 1990, the legislative history makes it clear that congress believed that the application of IRC Section 2036(a) inclusion instead of Section 2033 inclusion to family limited partnerships was poor tax policy and reaffirmed the priority of IRC Section 2033 inclusion over IRC Section 2036(a) inclusion.

Best GST Family Limited Partnership Planning Idea – The Possible Use of a Leveraged GRAT (Pages 121 through 135 of the Paper)

Conventional Wisdom:

- "The remainderman of a GRAT cannot be a generation-skipping trust;" or
- "You can use the leverage of a GRAT for gift tax purposes, but you cannot use that leverage for generation-skipping purposes."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

Possible Solutions to Allow a GRAT to Leverage a GST Exemption: Is There a 5% Exception?

- Treas. Reg. Section 26.2632-1(c)(2) contains the regulatory definition of ETIP and then provides an exception, as follows:

  For purposes of paragraph (c)(2) of this section, the value of transferred property is not considered as being subject to inclusion in the gross estate of the transferor or the spouse of the transferor if the possibility that the property will be included is too remote as to be negligible. A possibility is so remote as to be negligible if it can be ascertained by actuarial standards that there is less than a 5 percent probability that the property will be included in the gross estate.

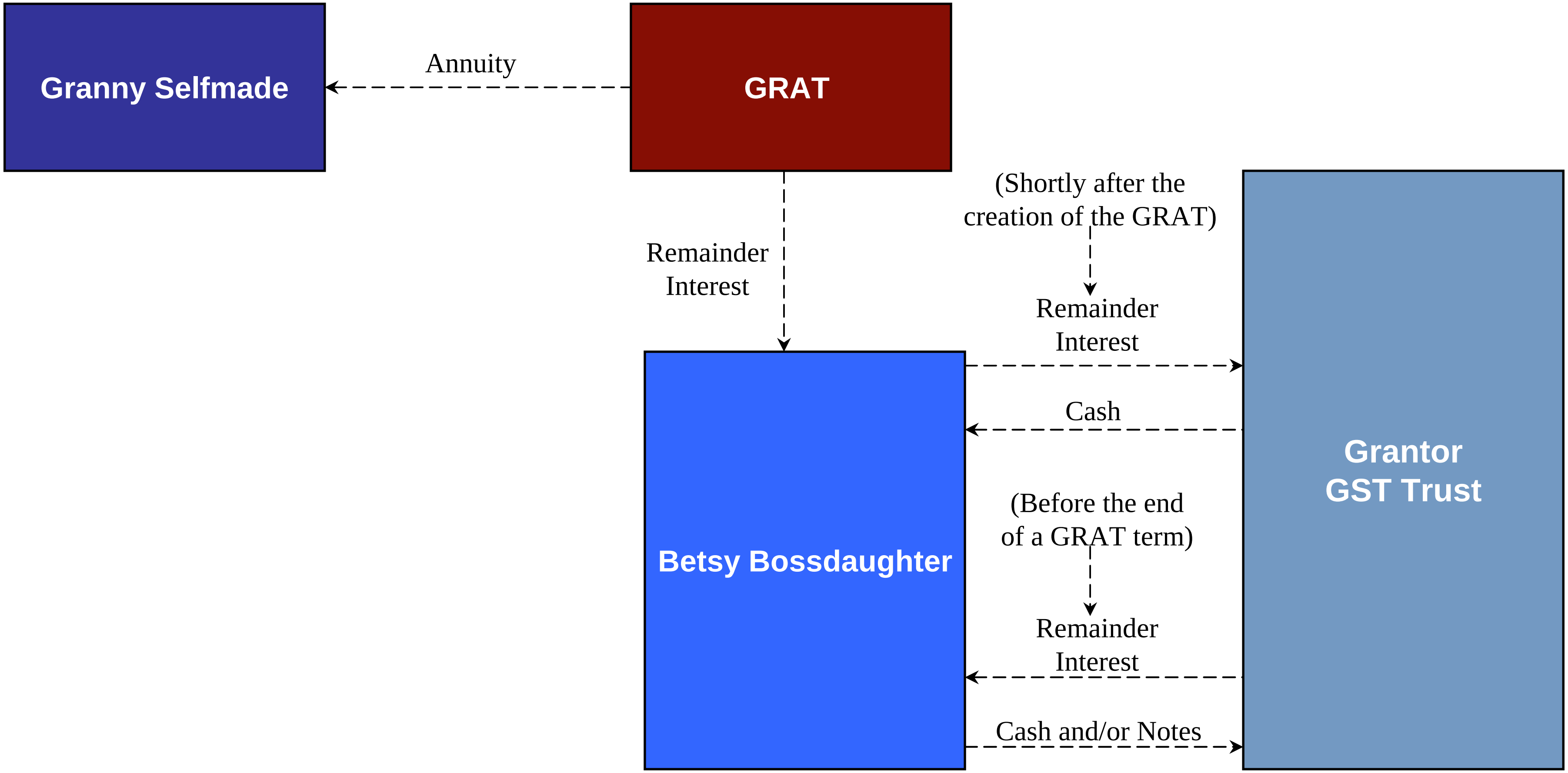
- For a short term GRAT (e.g., two years), except for a grantor who is above 70 years of age, the 5% exception noted above would apply.

- At least one way of reading the exception for a short term GRAT is that the ETIP rules will not apply to an allocation of GST exemption, because there is less than a 5% chance that the grantor will die during the GRAT term.

- Thus, can a grantor, age 70 or younger create a GRAT in which the remainderman is GST trust, if the exception applies, make an allocation of the GST exemption that is equal to the amount of the taxable gift of the GRAT remainder, and produce a zero inclusion ratio for generation skipping tax purposes?

- There is not any definitive authority on this subject, but most commentators believe the IRS will resist this result.

Example: Using the Leverage of a GRAT to Indirectly Profit a GST Trust – Non-Skip Person Exception



Using the Leverage of a GRAT to Indirectly Profit a GST Trust – Non-Skip Person Exception

- See private letter ruling 20010705. The private letter ruling's basic holding can be viewed as uniquely applicable to the charitable lead annuity trust. However, it is clear that the IRS will look for other opportunities to apply equitable doctrines in similar contexts. Stated differently, the ruling's reasoning could apply just as easily to a GRAT, if the reader substituted the phrase "ETIP rules" for "I.R.C. Section 2642(e)."

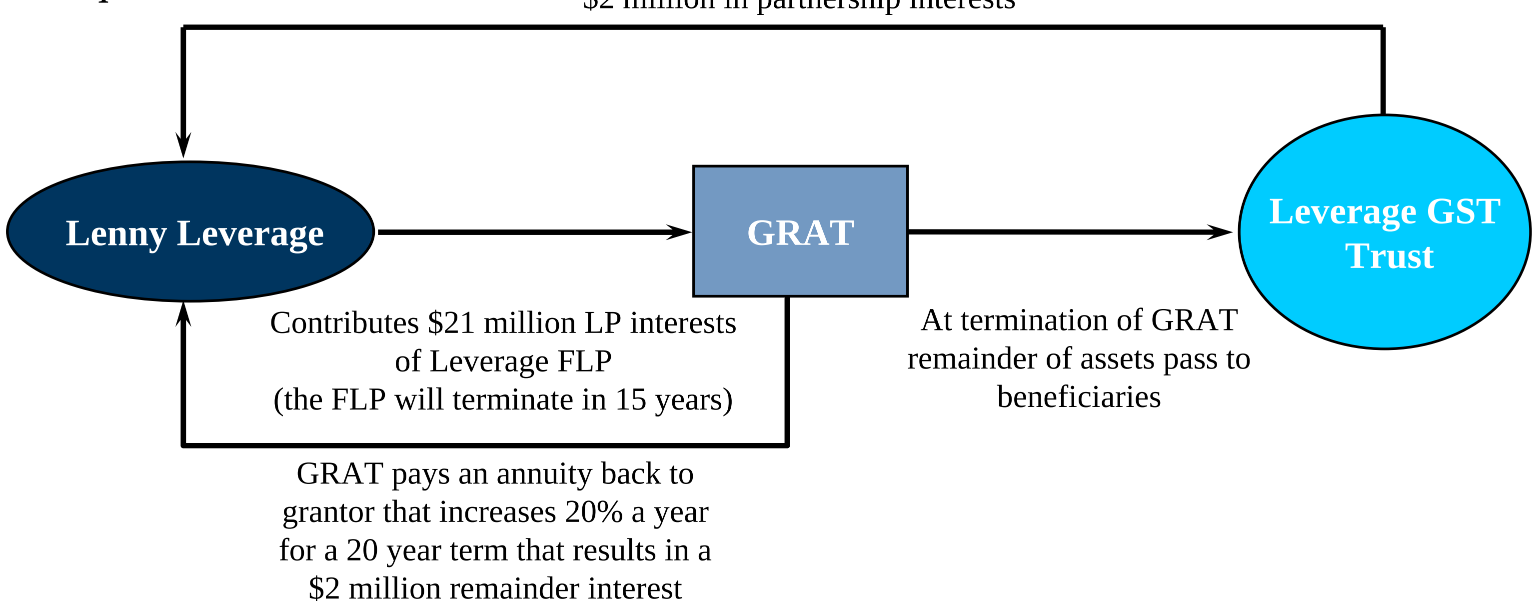
- Using the same logic, the Service could find that a *gift* by a GRAT remainderman is avoidance of the Congressional intent in enacting the ETIP rules. However, would the equitable doctrines inherent in the ruling apply to a *sale* by Betsy? It would appear that the answer should be *no*.

- In using a sale for full and adequate consideration, the issue is not whether Granny or Betsy is the transferor of the property that moves from the GRAT to the dynasty trust. The issue is whether there is an addition to the dynasty trust for GST purposes. There should not be an addition to the dynasty trust for GST purposes when Betsy transfers the remainder interest to the GST trust for full and adequate consideration and when Betsy buys the remainder interest back for full and adequate consideration.

Possible Solutions to Allow a GRAT to Leverage the GST Exemption (Continued)

- Consider a GRAT that is created with a substantial remainder interest, however, because of a purchase of a remainder interest of the GRAT, there is not a gift. That is, instead of making a gift of the remainder interest, what if the grantor of a GRAT sold it for full and adequate consideration to a pre-existing trust? IRC Section 2036 inclusion does not apply if the grantor dies before the GRAT term ends, and as a consequence, the ETIP limitation may also not apply and the creation of the GRAT may not constitute a transfer to the GST trust.

The technique is illustrated below:



Possible Solutions to Allow a GRAT to Leverage the GST Exemption (Continued)

Please note the table below, which delineates the amount that is projected to be transferred to Lenny's children, grandchildren and great grandchildren pursuant to this technique in comparison to not doing any further planning with respect to the partnership. The table assumes Lenny's death at the end of year 20, Lenny consumes $100,000 a year with a 3% inflation rate, an 8% pre-tax rate of return with 2% being taxed at ordinary income rates (35%) and 6% at capital gains rates (15%, with a 30% turnover). The table assumes Lenny has $1,500,000 of assets outside the partnership. Assume that the partnership, at the time of the creation of the split purchase GRAT, has only 15 years remaining and that the valuation discount is 30%.

Technique	Leverage Children	Leverage GST Trust	Consumption – Direct Cost	Consumption – Investment Opportunity Cost	IRS – Income Tax	IRS – Investment Opportunity Cost	IRS – Estate Tax (at 45%)	Total
No Further Planning; Bequeaths Estate To Family	$55,282,583	$13,317,021	$2,687,037	$3,022,654	$20,916,430	$19,680,241	$45,231,204	$160,137,171
Hypothetical Integrated Income and Estate Tax Plan With a Partnership and GRAT; Bequeaths Estate To Family	$9,687,257	$98,772,116	$2,687,037	$3,022,654	$20,778,989	$17,263,179	$7,925,938	$160,137,171

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Possible Solutions to Allow a GRAT to Leverage the GST Exemption (Continued)

- The results are obviously very significant. Will this work? An argument can certainly be made that the creation of the split purchase GRAT is not subject to the ETIP rules and the creation of the GRAT does not constitute a transfer to the GST trust. If Lenny died during the 20 year term of the GRAT, the GRAT property will not be includible in his gross estate, only the value of the remaining annuity payments would be included. Alternatively, the GRAT annuity period could be set for the shorter of 20 years or the death of Lenny. Obviously, the GRAT annuity payment would have to be set at a higher amount in order to provide adequate and full consideration to Lenny. If Lenny died earlier than 20 years there would be significant income tax and estate tax advantages in structuring the GRAT term in that manner.
- 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 case, the remainder interest is significant and would seem to be analogous to the remainderman values considered in the above Circuit Court cases.

Best Post Mortem Family Limited Partnership Planning Idea (and a Good Insurance Planning Idea) – The Note "Freeze" Partnership (Pages 135 through 137 of the Paper)

Conventional Wisdom:

- "Using a family limited partnership always creates administration problems, it does not solve them;" or
- "Life insurance will be included in an insured's estate if the insurance is owned by a partnership in which he is a partner."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

Best Post Mortem Family Limited Partnership Planning Idea (and a Good Insurance Planning Idea) – The Note "Freeze" Partnership (Continued)

Please consider the following example:

Connie Confused Wishes to Simplify Her Post-Mortem Administrative Life and Also Accomplish Some Estate Planning Goals

Carl Confused dies in a year in which the estate tax exemption and the GST exemption are $2,000,000. Carl and Connie live in a community property state. The financial assets of their community property estate equal $12,000,000. Carl and Connie, at Carl's death, have not created a family limited partnership. Connie is 70 years of age and is in very good health. Connie is the lifetime beneficiary of the by-pass trust, which is also a generation-skipping trust that Carl created under his will. Connie also wishes to create a generation-skipping trust using her $1,000,000 gift tax exemption. In order to help defray the cost of paying estate taxes, Connie is contemplating purchasing a $2,500,000 life insurance policy on her life that is a guaranteed universal life policy.

Connie asks her estate planner, Pam Planner, if there is any way to organize the multiple trusts and her financial assets where there is a simplified structure that consolidates the community estate assets and saves future estate taxes. She asks Pam to assume that she will spend $250,000 a year, after income taxes, with a 3% inflation adjustment.

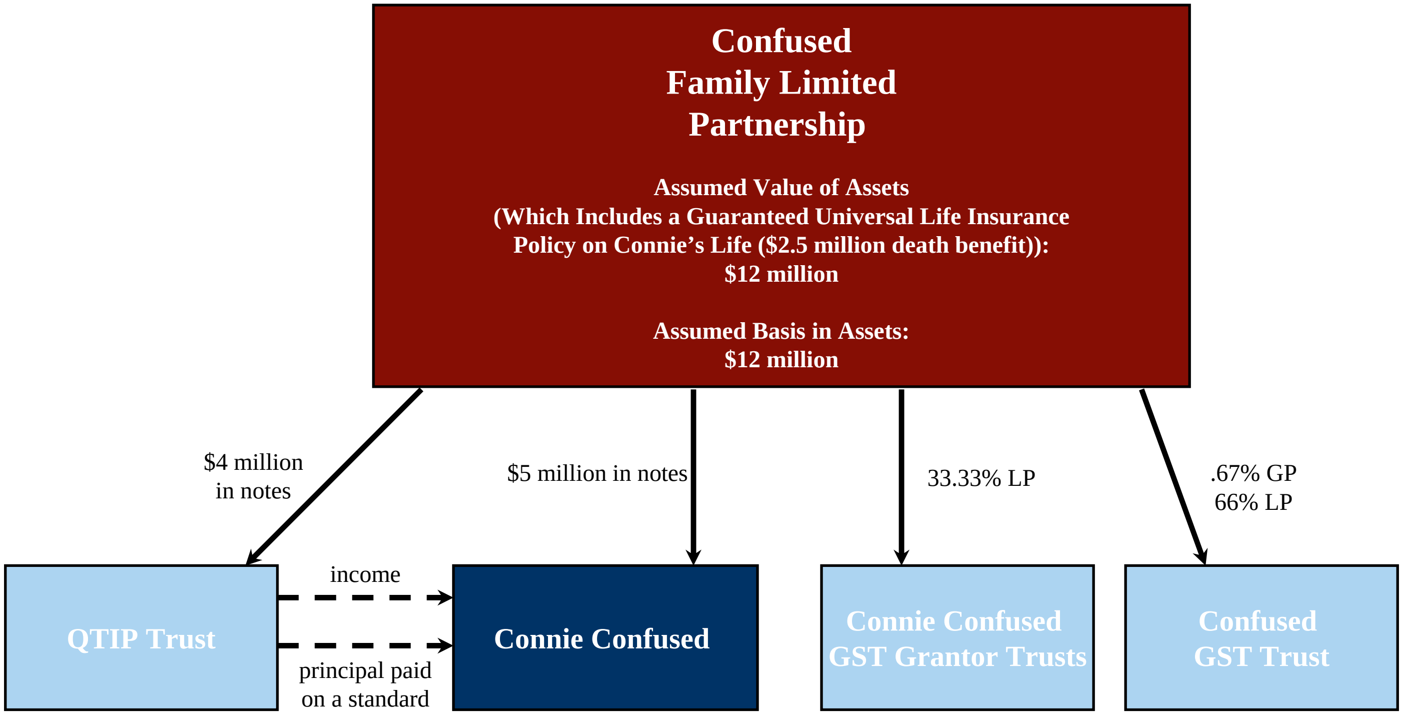
This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Best Post Mortem Family Limited Partnership Planning Idea (and a Good Insurance Planning Idea) – The Note "Freeze" Partnership (Continued)

- Pam suggests that Connie and the various trusts form a partnership with the various parties either receiving a note for their contribution to the partnership or receiving partnership interests for their contribution to the partnership.
- The $2,000,000 GST trust, in which Connie is a lifetime beneficiary, receives a partnership interest for its $2,000,000 contribution. The $1,000,000 GST trust that Connie creates will receive a partnership interest for its $1,000,000 contribution. Connie receives a note for the contribution of her assets. The various QTIP trusts receive notes for their contribution to the partnership. The notes pay the AFR interest rate.

Best Post Mortem Family Limited Partnership Planning Idea (and a Good Insurance Planning Idea) – The Note "Freeze" Partnership (Continued)

The diagram below illustrates the concept:



Non-Tax Reasons For the Creation of a Note Freeze Partnership

- Simplifies the administration of the estate.
- Takes advantage of the step-up in basis of estate assets.
- Life insurance proceeds will not be subject to I.R.C. Section 2042.
- Note freeze partnership is not subject to valuation rules of I.R.C. Section 2701.
- The historic low yields on treasuries accentuate the result of note freeze partnership.

Comparative Result of the Note Freeze Partnership

Please note the following table, which compares the result that would have accrued had Connie not done any further planning with the hypothetical plan (assuming she lives 20 years, consumes $250,000 a year, after inflation) the family assets earn 8% before taxes, with 2% being taxed as ordinary income and 6% being taxed as capital gains rates with an assumed 30% turnover.

Technique	Confused Children	Confused GST Trust	Consumption – Direct Cost	Consumption – Investment Opportunity Cost	Investment Opportunity Cost/(Benefit) of Buying Life Insurance	IRS – Income Tax	IRS – Investment Opportunity Cost	IRS – Estate Tax (at 45%)	Total
No Further Planning; Bequeaths Estate To Family	**$14,538,178**	**$7,041,630**	**$6,717,594**	**$7,556,636**	**$0**	**$5,569,070**	**$5,477,142**	**$9,031,236**	**$55,931,486**
Hypothetical Integrated Income and Estate Tax Plan With a Partnership; Bequeaths Estate To Family	**$3,701,671**	**$25,629,169**	**$6,717,594**	**$7,556,636**	**$377,325**	**$5,777,962**	**$5,187,944**	**$983,185**	**$55,931,486**

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Comparative Result of the Note Freeze Partnership (Continued)

Not only does the proposed structure greatly simplify the administration problems for Connie, but it also has the potential of saving considerable transfer taxes. If Connie should die early (e.g., in 5 years) the life insurance policy forms a substantial "hedge" against an early death.

Best Lifetime Charitable Planning Idea – Partnership, or a Limited Liability Company, Creates a Charitable Remainder Trust With the Partnership Units Eventually Being Sold to a Grantor Trust (Pages 149 through 161 of the Paper)

Conventional Wisdom:

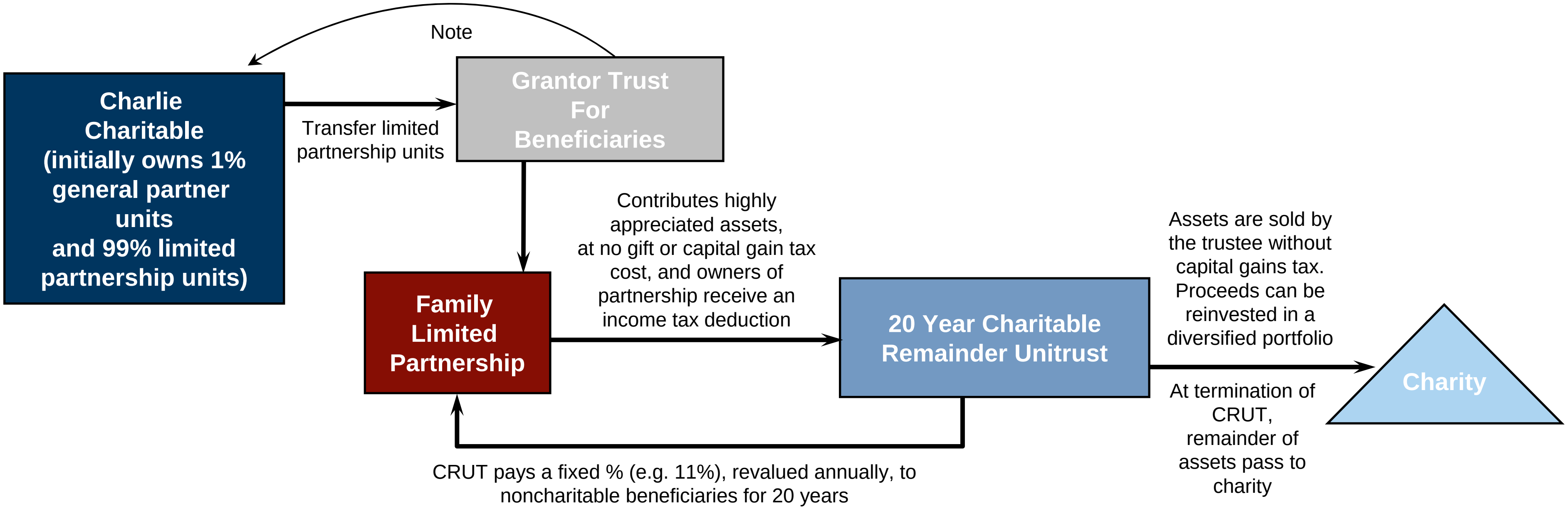
- "You can no longer use the CRUT technique and benefit your family;" or
- "The problem with charitable planning is that it will greatly decrease what a client's family will receive."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

Best Lifetime Charitable Planning Idea – Partnership, or a Limited Liability Company, Creates a Charitable Remainder Trust With the Partnership Units Eventually Being Sold to a Grantor Trust (Continued)

- Charitable remainder trusts, particularly charitable remainder unitrusts ("CRUTs") are a very popular planning technique for the charitably inclined client. While the technique has significant benefits to the client and his favorite charitable causes, one downside is the perception that it is difficult to benefit a client's family with the technique. Perhaps that is not true, if the technique is used synergistically with certain other estate planning techniques, that is, sale of limited liability company or limited partnership units to a grantor trust. What if that synergistic planning simulated a capital gains tax and estate tax holiday for the client and his family with the client's family charity receiving 23% of his death on his death?

Best Lifetime Charitable Planning Idea – Partnership, or a Limited Liability Company, Creates a Charitable Remainder Trust With the Partnership Units Eventually Being Sold to a Grantor Trust (Continued)



Advantages

- Generation of current income tax deduction (10% or more of value placed in CRUT)
- Depending on investment performance, approximately 40% to 60% of inherent capital gains in the asset contributed to the CRUT will not be subject to capital gains tax
- The remaining inherent capital gains will be subject to tax, but is tax-deferred (over 20 years)
- Production of relatively steady cash flow over time
- Tax-efficient satisfaction of charitable desires
- Economic participation in growth of assets

Considerations

- Limit on certain investment alternatives
- Certain prohibited related-party transactions (even if fair)
- In the early years, access to capital is limited
- Capital gains tax rates may increase in the future
- Administrative costs in connection with formation of partnership

The Comparative Results

To show Charlie the difference that taxes play in accumulating family wealth over time, Pam projects what would happen if there were no initial capital gains taxes when Charlie sells his stock and no estate taxes She also projects what would happen if Charlie sold partnership interests to a grantor trust without including the CRUT component. If the investment plan produced smooth returns until Charlie's death (which the group agrees to project twenty-five into the future), the results would look like this:

Scenario	Charlie's Children	Charlie's Descendants (GST Exempt)	Charity	Charlie's Consumption Direct Costs	Consumption Investment Opportunity Costs	IRS – Income Taxes	IRS – Investment Opportunity Costs	IRS – Estate Taxes	Total
Stock Sale, No Planning	14,795,841	2,000,000	-	5,468,890	8,795,202	7,413,154	16,269,613	13,742,052	68,484,752
Simulated Tax Holiday (No Initial Capital Gains Tax and No Estate Tax) 72% - 28% Split Between Family and Charity	-	28,053,477	8,510,849	5,468,890	8,795,202	8,008,304	9,648,029	-	68,484,752
FLP/CRUT/ Grantor Trust Sale, Charlie gives remaining estate to charity	-	27,731,762	8,510,849	5,468,890	8,795,202	7,685,158	10,292,890	-	68,484,752
FLP/ Grantor Trust Sale, Charlie gives remaining estate to family	-	29,698,713	-	5,468,890	8,795,202	8,117,016	16,269,613	135,318	68,484,752

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Best Testamentary Charitable Planning Idea For the Family Limited Partnership – The Leveraged Buy-Out Charitable Lead Annuity Trust (Pages 161 through 167 of the Paper)

Conventional Wisdom:

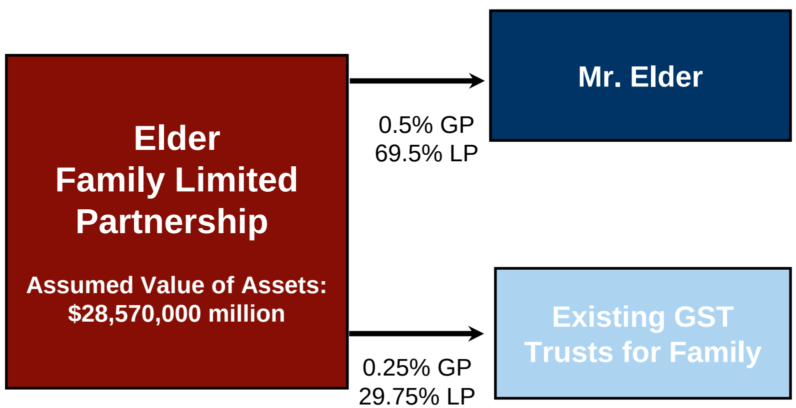
- "One can never self-deal, even on a fair basis, with a foundation or a CLAT;"
- "The problem with testamentary gifts to charity is that the decedent's family always ends up with substantially less;" or
- "The problem with testamentary CLATs is that the decedent's family has to wait a long time to have access to the decedent's assets."

This "conventional wisdom," under the circumstances discussed below, is incorrect.

Best Testamentary Charitable Planning Idea For the Family Limited Partnership – The Leveraged Buy-Out Charitable Lead Annuity Trust (Continued)

- Assume a client, at his death, wishes for part of his estate to go to his family and the rest to his favorite charitable causes. One technique that is generally considered under those circumstances is the testamentary charitable lead annuity trust ("CLAT"):

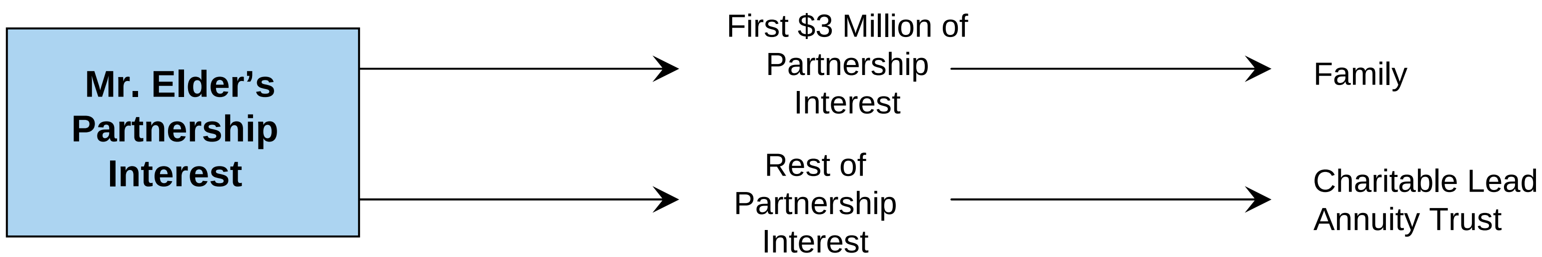
During Ed's lifetime he creates a partnership with his family:



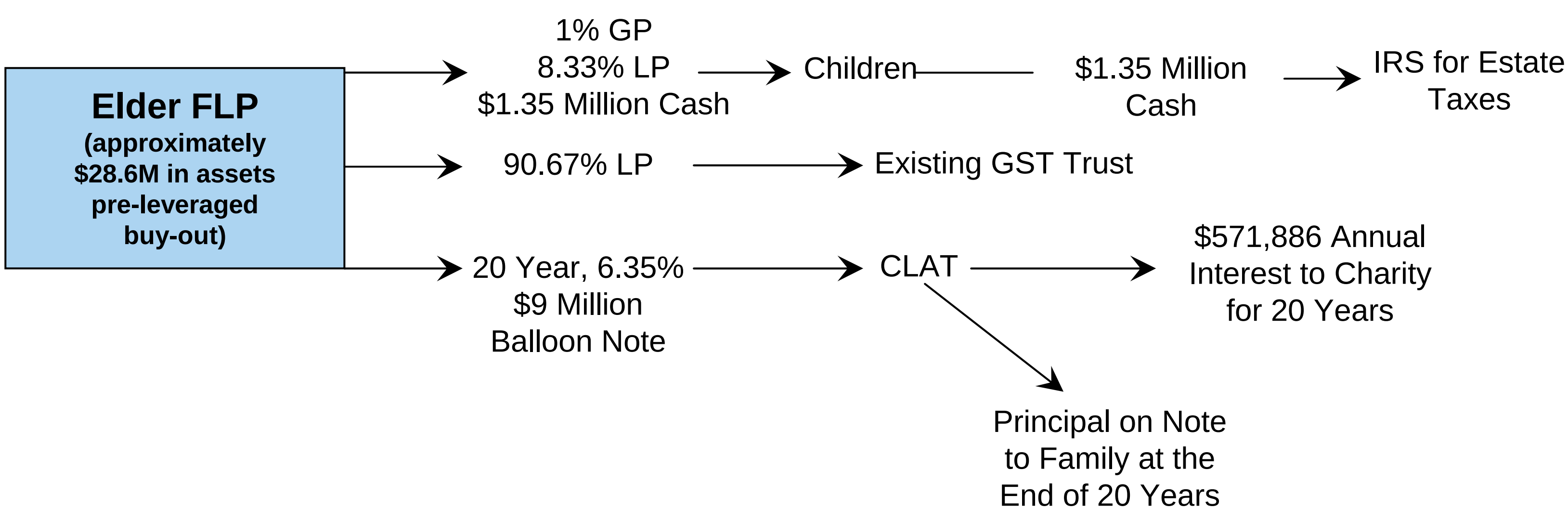
Partner	Ownership (%)
Mr. Elder	0.5% GP; 69.5% LP
Existing GST Trusts for Family	0.25% GP; 29.75% LP

Best Testamentary Charitable Planning Idea For the Family Limited Partnership – The Leveraged Buy-Out Charitable Lead Annuity Trust (Continued)

After Ed's death his will conveys his partnership interest as follows:



After a probate hearing Ed's testamentary CLAT is redeemed as follows:



What Are the Comparative Results of the Leveraged Buy-Out CLAT?

Summary of Results For $28.57 Million of Assets Growing at 8% Per Year (Pre Tax) – No Further Planning vs. 20 Year Testamentary CLAT Technique; 30 Year Future Values; Post-Death Scenarios (assuming Mr. Elder dies in year 1)

Technique	Elder Children	Elder GST Trust	Charity	IRS – Income Tax	IRS – Investment Opportunity Cost	IRS – Estate Taxes	Total
No Further Planning Without a Discount 8%, 30 Years	74,723,823	55,481,827	-	29,497,788	118,801,049	9,000,000	287,504,487
No Further Planning With a Discount 8%, 30 Years	84,904,303	55,481,827	-	33,691,823	108,026,533	5,400,000	287,504,487
CLAT Redemption With a Discount and $3 Million to Family 8%, 30 Years	46,374,710	92,379,335	56,500,420	30,013,402	60,886,619	1,350,000	287,504,487
CLAT Redemption With a Discount and $10 Million to Family 8%, 30 Years	74,166,232	65,866,823	12,555,671	32,874,812	97,540,948	4,500,000	287,504,487

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

What Are the Comparative Results of the Leveraged Buy-Out CLAT? (Continued)

- The primary reason the leveraged buy out CLAT technique has a good result for both the client's family and the client's favorite charities, is that, in effect, the client's family is getting two tax deductions for the interest payments that they are making on the note. There is an estate tax deduction (i.e., the zeroed out CLAT annuity payments) and the family owners of the partnership are also receiving an income tax deduction on the interest payments.
- The secondary reason the technique has a good result for the family is that they are not out-of-pocket cash to pay the principal of the note to a third party.
- From the family's perspective, the principal of the note is, in effect, paid to themselves.
- From the family's perspective, they have the assets now subject to the interest obligations of the note held by the CLAT (which could be satisfied with a sinking fund of laddered bonds).

Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Pages 167 through 182 of the Paper)

Conventional Wisdom:

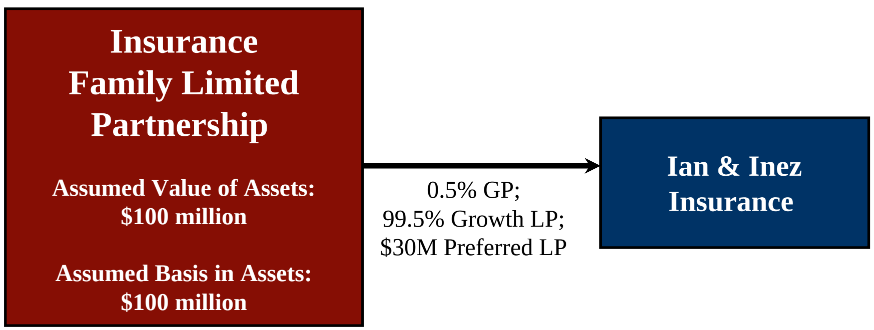
- "Using a preferred partnership interest is dead after the passage of IRC Section 2701;" or
- "It is impossible, after split dollar reform, without paying significant gift taxes, for a trust to have the means to pay for premiums on a significant life insurance policy."

This "conventional wisdom," under the circumstances discussed below, may be incorrect.

Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Continued)

- One of the somewhat unexplored areas of estate planning is the utilization of what some practitioners call "reverse freeze" planning. This planning takes advantage of the truism that investors have the potential of making a successful investment, if they engage in a leveraged purchase of a high yield preferred interest. The following idea exploits the current differentiation in yields between high yield fixed income and treasuries.

- Consider the following example, which illustrates the potential of combining a leveraged sale of a high yielding preferred to a grantor trust with the trust using its excess cash flow to purchase life insurance and make cascading purchases of the growth partnership interests:



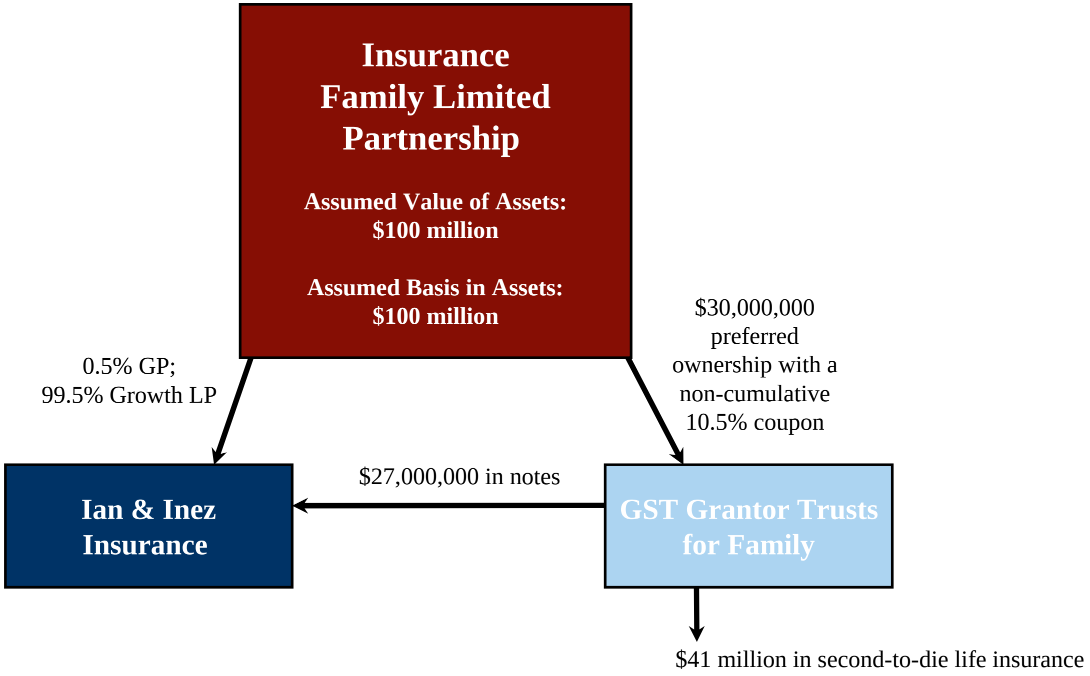
Partner	Ownership (%)
Ian & Inez Insurance	0.5% GP; 99.5% Growth LP; $30M Preferred LP

- After the partnership has been created Ian and Inez Insurance transfers, by gift, a $3,000,000 preferred partnership interest with a non-cumulative 10.5% coupon to some generation-skipping transfer trusts for the benefit of their children, grandchildren and future descendants.

Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Continued)

- Ian and Inez also sell the remaining $27,000,000 preferred interests to those trusts in exchange for notes that will pay a blended AFR rate of 2.06%.

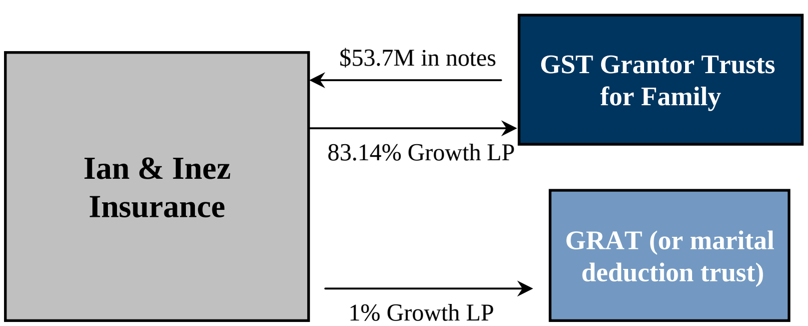
See the illustration below:



Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Continued)

- Approximately three years after the transfer of the preferred partnership interests, the GST grantor trust could purchase from Ian and Inez their remaining growth interests that have not been sold in prior years in exchange for notes (on which, it is again assumed there will be a blended 2.06% interest rate).
- During the interim three year period, it is assumed that around 16% of the growth limited partnership units will have been purchased. The purchase of the remaining growth interests could occur in a manner in which there is a defined value sale and in which a stated dollar amount (around $54M) of the value of the transferred growth limited partnership interest, as finally determined for federal gift tax purposes, passes to the generation-skipping trusts and any excess in value passes to a near zero GRAT or a marital deduction trust.

See the illustration below:



Owner	Ownership (%)
Ian & Inez Insurance	0.5% GP; $80.7 M note receivable
GST Grantor Trusts for Family	98.5% Growth LP; $80.7M note payable; $30M Preferred LP
GRAT (or marital deduction trust)	1% Growth LP

Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Continued)

Advantages:

- With the use of life insurance, there is a hedge against early deaths.
- In Revenue Ruling 83-120 the IRS concedes preferred partnership interests in a closely held partnership should have a high coupon.
- Currently, there exists a significant arbitrage between high yielding private preferred partnership interests in a closely held partnership and treasury interest rates.
- Strong legislative history suggests I.R.C. Section 2036 should not apply to partnerships with significant preferred interests.
- The valuation rules of I.R.C. Section 2701 should not apply if one generation transfers its ownership of preferred partnership interests to the second generation.
- A later transfer of the growth partnership interests will not be affected by the valuation rules of I.R.C. Section 2701.

Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Continued)

The tables below indicate the results that could accrue under the assumptions given to Pam Planner by Ian and Inez and also assuming a $400,000 a year premium and a 40% discount on the growth partnership interests (because of the effect of the preferred partnership interests). The results are extremely powerful. Assuming that Ian and Inez die in 10 years, the 30 year future values of the hypothetical integrated plan in comparison to not doing any further planning is as follows:

30 Year Future Values (Death in 10 Years)

Technique	Insurance Children	Insurance Children & Grandchildren	Consumption – Direct Cost	Consumption – Investment Opportunity Cost	IRS– Income Tax	IRS– Investment Opportunity Cost	IRS– Estate Tax (at 45%)	Investment Opportunity Cost/(Benefit) of Buying Life Insurance	Total
No Further Planning; Bequeaths Estate To Family	$417,679,967	$0	$22,927,759	$168,266,209	$94,874,217	$580,465,509	$82,357,221	$0	$1,366,570,882
Hypothetical Integrated Income and Estate Tax Plan With a Partnership; Bequeaths Estate To Family	$173,319,917	$572,273,337	$22,927,759	$168,266,209	$159,136,543	$432,194,150	$34,174,842	($195,721,874)	$1,366,570,882

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Best Family Limited Partnership Insurance Planning Idea (and a Very Good Estate Planning Idea) – The Leveraged Reverse Freeze With a Cascading Sale of Growth Partnership Interests (Continued)

If the survivor of Ian and Inez Insurance dies in 30 years, the future value in 30 years of what their descendants will receive under the hypothetical plan in comparison to no further planning is as follows:

Future Value (Death in 30 Years)

Technique	Insurance Children	Insurance Children & Grandchildren	Consumption-Direct Cost	Consumption – Investment Opportunity Cost	IRS – Income Tax	IRS – Investment Opportunity Cost	IRS – Estate Tax (at 45%)	Investment Opportunity Cost/(Benefit) of Buying Life Insurance	Total
No Further Planning; Bequeaths Estate To Family	$337,941,016	$0	$95,150,831	$266,196,369	$124,662,541	$266,122,930	$276,497,195	$0	$1,366,570,882
Hypothetical Integrated Income and Estate Tax Plan With a Partnership; Bequeaths Estate To Family	$7,205,005	$586,008,373	$95,150,831	$266,196,369	$133,704,220	$258,888,064	$5,895,004	$13,523,015	$1,366,570,882

This table is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Leveraged Reverse Freeze With a GRAT

What would be the comparative outcome under the proposed structure if long term GRATs were used?

- If Mr. and Mrs. Insurance create GRATs that last 10 years and if an 11% preferred coupon (instead of 10.5%) supports "par value" for the preferred, the gift will be $2,135,460, assuming the IRC Section 7520 rate is 3.2%, even though trusts for their children will receive $30,000,000 of preferred partnership interests at the end of 10 years.
- If the term of the GRAT is 11 years, assuming the IRC Section 7520 rate is 3.2%, the gift will be zero.

This example is for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Leveraged Reverse Freeze With a GRAT (Continued)

- If the appraisers find that the rate of return on the preferred interests should be equal to 11.843% in order to support par value of the preferred interests, and the 10 year GRATs are created with $30,000,000 of preferred interest paying all of that coupon in satisfaction of the retained annuity, the GRATs will be near zeroed out GRATs.

- Thus, in each of these scenarios, Mr. and Mrs. Insurance could be in the position to receive substantial cash flows for a 10 year or 11 year period, and assuming the gift tax exemption that they each have is $1,000,000, they will each transfer preferred interests that are equal in value to over $30,000,000 to trusts for the benefit of their children by paying little or no gift taxes.

- All of this is accomplished, even though their investment portfolio could earn 4% to 5% annually, after taxes.

Best Ideas for Allowing a Client to Be in Control of a Family Limited Partnership in the Context of Section 2036(a)(2) – Rev. Rul. 73-143, 95-58 and 81-15
(Pages 182 through 193 of the Paper)

Conventional Wisdom:

- "A partner, who is a donor of partnership interests, should never retain any management control of a family limited partnership;" or
- "A partner, who is a donor of partnership interests, may not have any input, directly or indirectly, on the distribution policy of a family limited partnership."

This "conventional wisdom," under the circumstances discussed below, may be incorrect.

Best Ideas for Allowing a Client to Be in Control of a Family Limited Partnership in the Context of Section 2036(a)(2) – Rev. Rul. 73-143, 95-58 and 81-15 (Continued)

- In the *Strangi* case, some commentators believe Judge Cohen's reliance on *O'Malley* is misplaced.
- Sell the partnership interests for full consideration.
- Use the same fiduciary constraints in the partnership as *Byrum*.
- Follow Rev. Rul. 73-143; See sample language.
- Follow Rev. Rul. 95-58.
- Follow Rev.Rul. 81-15.

Additional Information

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