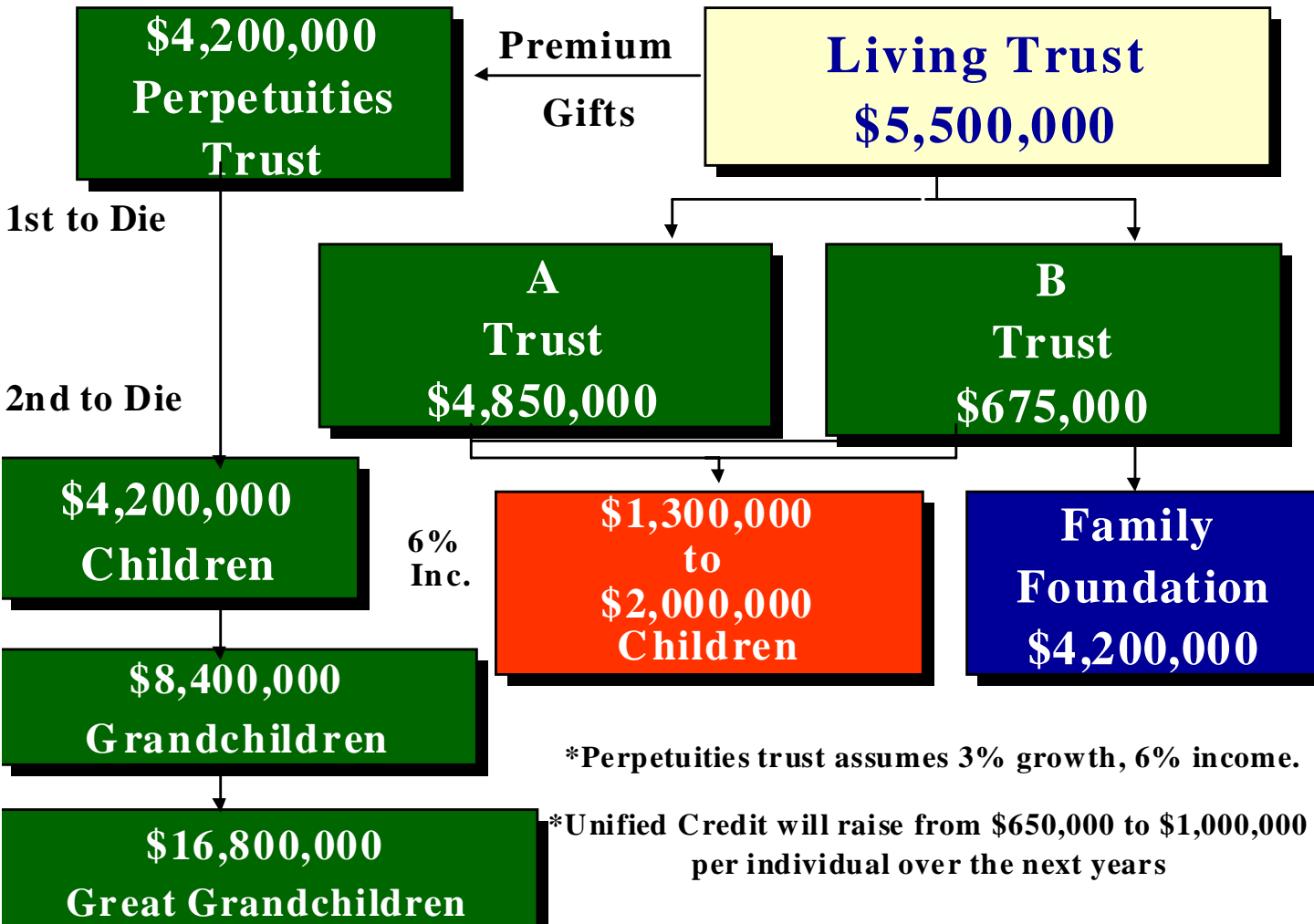


A and B Marital Estate Plan



*Perpetuities trust assumes 3% growth, 6% income.

*Unified Credit will raise from \$650,000 to \$1,000,000 per individual over the next years



High Net Worth Individual

- Worth \$5 million plus
- Hates taxes/wants to act
- Willing to pay substantial setup costs (\$30,000 - \$50,000) to save taxes
- Has transferable assets
 - Real estate
 - Family business
 - Liquid investments

BUT

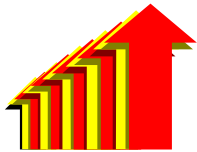
- Uninsurable
- Hates life insurance
- Insurance is too expensive
- Wants to retain income/control from assets

AND

- Wants to retain income/control from assets

Estate Planning with Defective Trusts, Private Annuities, Installment Sales and Family FLPs/LLCs

AGENDA



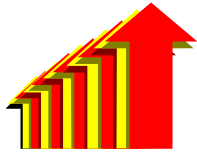
Goals



Tools



Example-equity strip



Goals

- ✓ **Maximize Transfer of Assets at Lowest Tax Cost**
Avoid Estate, Gift, GST and Income Taxes
- ✓ **Retain Income Stream from Transferred Assets**
- ✓ **Retain Control of Transferred Assets**



Tools

- ✓ **Family limited liability company or family limited partnership**
- ✓ **Intentionally defective irrevocable trust**
- ✓ **Private annuity**
- ✓ **Installment sale**

Family LLC or Family LP

- ✓ **Pass through entity for income tax purposes**
LLC advantage is no unlimited liability for anyone
FLP - General partner has unlimited liability
- ✓ **Assets transferred to LLC or FLP in exchange for ownership interests or units = non-taxable event**
Some units can have restrictions (such as control or marketability) and therefore be entitled to valuation discount
- ✓ **The Valuation Discount**

Allows LLC interests (units) to be gifted or sold for much less (35 to 50%) than the value of the underlying assets represented by the units; marketability, control, illiquidity

✓ **Retained Interests**

Maintain operating control

Assure the discount for the transferred interests

Intentionally Defective Irrevocable Trust

✓ **Assets transferred are not included in grantor's estate**

✓ **All income from trust assets is taxed to the grantor**

Example: right to replace trust property

IRC Sections 671-678, Rev Ruling 85-13

✓ **Advantage** - Trust assets grow more and grantor's estate is depleted because grantor is paying income taxes. The same effect as a "gift" from grantor, but the grantor is "only following" the tax code and there is no gift. The IRS hates this, but has stopped challenging it.

Private Annuity

✓ **Device to Transfer Assets**

Usually between family members

Recognized by IRS

✓ **Grantor transfers assets in exchange for an unsecured promise to pay income**

Usually for life (term of years possible)

Amount required to be paid is determined by IRS tables

✓ **Upon grantor's death the payments stop**

✓ **The transferred interest is not included in the grantor's taxable estate**

Compare to a GRAT

✓ **Most effective when:**

Grantor dies soon after the transfer

Transferred assets grow at a rate that exceed the payments back to the grantor

- ✓ **Not new, but especially useful now**
 Low interest rates mean smaller required payment
 - Lower Applicable Federal Rates
 The availability of discounting vehicles
 - LLC, FLP
- ✓ **Strong case law support**
 Estate of McClendon (5th Circuit, 1998)
 Estate of D'Ambrosio (3rd Circuit, 1996) Delaware covered

Installment sale

- ✓ **Device to transfer assets**
 Usually between family members
 Recognized by IRS, but less certain than P.A.
- ✓ **Grantor transfers assets in exchange for a promissory note**
 Note must bear interest at least equal to 7872 rate (e.g. May, 1999)

Short term (less than 3 years)	4.84%
Mid-term (3 years to 9 years)	5.15%
Long term (greater than 9 years)	5.58%
- ✓ **Term of years is flexible**
- ✓ **Note can be interest only, amortized or balloon**
- ✓ **Note can be self canceling but rate is much higher based on the seller's age**
- ✓ **Upon grantor's death any unpaid balance will be included and taxed in the seller's estate.**
- ✓ **IRS may treat gain on the unpaid portion of the note as taxable income**
- ✓ **Most effective when:**
 - Note is paid off before seller dies
 - Transferred assets grow at a rate that exceeds the payments back to the seller

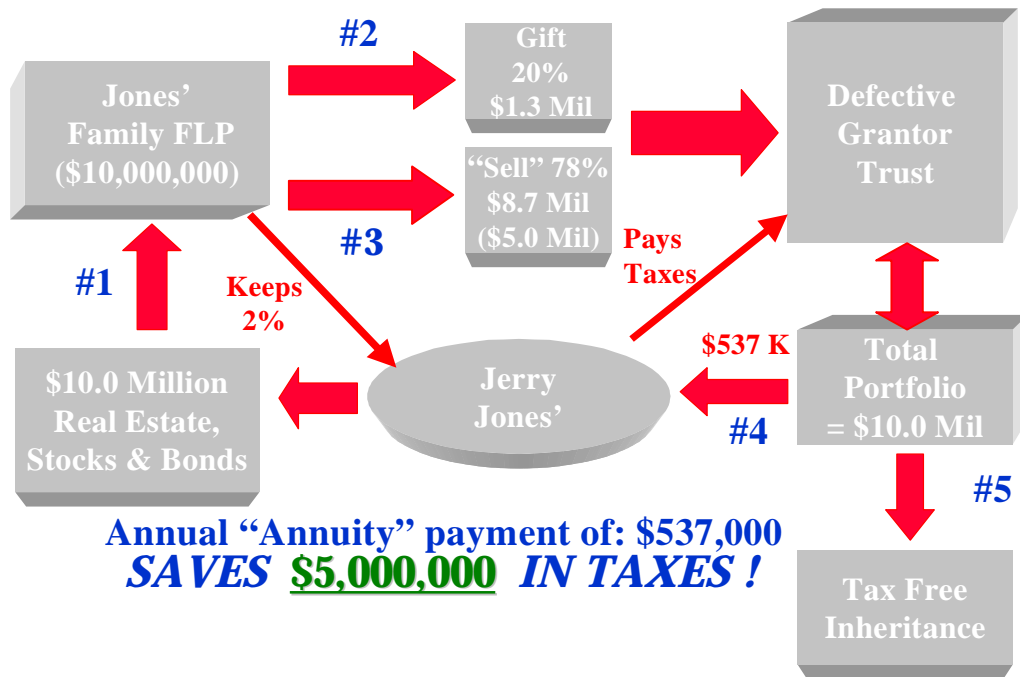
Example

- ✓ **70 year old donor/seller**
- ✓ **\$11.1 million in assets to be transferred**
 - Gift of \$1,166,667 discounted to \$700,000
 - LLC shares discounted from \$9,936,333 to \$7,131,800
- ✓ **LLC shares sold to trust in exchange for promissory note bearing interest at 5.58% for 15 years**
 - If fully amortized payments = \$798,104/year
 - If interest only, payments = \$397,954/year
 - If SCIN, payments = \$992,000/year
 - Compare to P.A. payments of \$844,000/year

Comparison: Private annuity v. Installment sale

Income taxes	By grantor No IRD	By grantor IRD
Transfer taxes	No gift tax No estate tax	No gift tax May be estate tax
Payment amount	Set by tables Generally higher	Flexibility on terms Usually lower
Payment term	Life, term of years	Note period
IRS Risk	Less	More

The Family Limited Partnership with a Family Private Annuity



Example-equity strip

The Client

- 70 year old widow
- Uninsurable
- 2 children and 3 grandchildren
- Estate of \$20,000,000-wants to minimize estate and gift taxes
- Willing to pay fees
- Wants income from transferred assets
- Wants control of transferred assets

The Client's Estate

Residences and Personal Property	\$1,500,000
Investment Assets	\$3,500,000
Commercial Real Estate	<u>\$15,000,000</u>
TOTAL ESTATE	\$20,000,000

The Real Estate

High Grade, Triple Net Leased, No Debt
Cash Flow of 8% or \$1,200,000/year
Appreciating at 4% annually on average
GOAL - to get RE transferred at lowest cost

✓ **If Client does nothing and dies in 5 years**

Estate grows to \$24,008,078
Tax is \$13,204,443
To Heirs \$10,803,635

✓ **If Client Gifts the Real Estate today**

Gift tax of \$7,929,500

✓ **Client needs another solution**