Goldman Sachs

Private Wealth Management

The Financial and Estate Planning Council
Detroit, MI
February 10, 2015

Putting it All Together: Some of the Best Estate Planning Strategies We See in the New Frontier That Reduce Both Income and Estate Taxes (With a Focus on Income Tax Issues)

Important Information

Goldman Sachs does not provide legal, tax or accounting advice. Clients of Goldman Sachs should obtain their own independent tax and legal advice based on their particular circumstances.

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

Organizational Pattern of a Purpose-Based Estate Plan
(See pages 1-3 of the Paper)

- A hierarchical organizational pattern for a purpose-based estate plan is:

Purpose

The declared principles for the family's capital which determine the plan's essential characteristics

(having priority over)

Strategies

The alternative game plans for implementing the essential characteristics

(having priority over)

Legal Structures

The legal documents which embody and implement the essential characteristics

Once the Purpose and Use of the Family's Capital Has Been Determined, Strategies Should Be Developed to Maximize the Investment Risk-Adjusted, After-Tax Wealth That May be Applied to Those Purposes and Uses (See Pages 4-15 of the Paper)

- Almost all of the US population (estimates are 99.8%) do not have to worry about strategies that reduce transfer taxes. However, around 50% of the US population welcomes strategies that reduce income taxes on investments.
- There are strategies that reduce both the income taxes on capital and the transfer taxes on capital. Planning for those two taxes does not have to be, and should not be, an "either, or" exercise.
- The purpose of this talk is to discuss some of the strategies that reduce both taxes, with an emphasis on income taxes.

If Lifetime Basis Enhancing Strategies Are Not Used, From a Tax Perspective, at What Assumed Growth Rate is it Better to Use a Lifetime Transfer Strategy With a Low Basis Asset in Comparison to Retaining the Asset Until Death?

- Simplistically, if an asset will be sold immediately after a taxpayer's death if the tax result is the only factor (of course, it is rare that the tax result is the only factor), and if lifetime basis enhancing strategies are not used, the decision to subject a low basis asset to a lifetime transfer strategy to a non-grantor trust, in order to save future estate taxes, or to hold the asset in order to receive a step-up in basis, is determined by a taxpayer's assumption of how fast a low basis asset will increase in value in the future.
- There is not an exemption protecting the assessment of a capital gains tax on the sale of an asset. There are substantial exemptions protecting the assessment of a transfer tax.
- The amount of tax that you would pay by gifting the asset now is the gift tax paid now (if any) plus the capital gains tax paid upon a sale at death. The amount of tax that you would pay by bequeathing the low basis asset at death is the estate tax paid at death. There is a growth rate where the taxpayer will pay the same taxes whether the taxpayer gives the asset now, or at the taxpayer's death.
- If the taxpayer assumes a growth rate will be higher than that breakeven growth rate, then it is more tax efficient to gift the asset now. If the taxpayer assumes a growth rate is lower than that breakeven growth rate, then it is more tax efficient to bequeath the asset at death and receive the stepped-up basis. The assumed growth rate is a function of the taxpayer's assumed life expectancy times the assumed annual growth rate of the asset.
- The determination of the breakeven growth rate can be expressed by the following formula:

Breakeven Growth Rate During the Taxpayer's Life Expectancy =

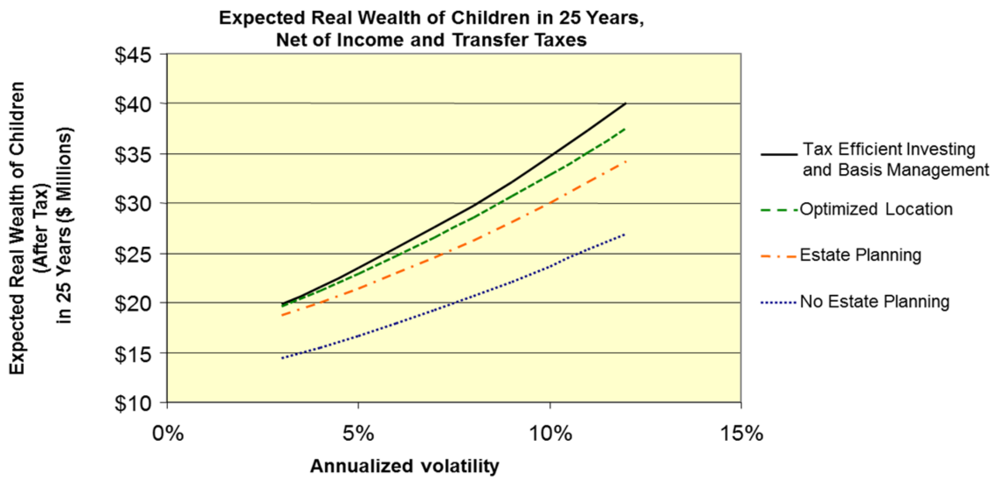
$$\frac{\text{Capital Gain Rate(Gift Value} - \text{Basis)} + \text{Gift Tax Rate(Gift Value} - \text{Remaining Gift Tax Exemption)} - \text{Estate Tax Rate(Gift Value} - \text{Estate Tax Exemption at Death)}}{\text{Value of Gift (Estate Tax Rate} - \text{Capital Gains Rate)}}$$

Taking All of the Above Factors Into Account, When Should a Gifting Strategy for a Low Basis Asset Be Considered?

- Gift planning should be considered for a low basis asset for a client who is projected to have a taxable estate unless **all** of the following factors exist:
  - The above formula indicates gift planning should not be utilized;
  - The taxpayer thinks it will be unlikely he will ever wish to sell that asset because of its investment risk;
  - Non-tax considerations such as asset protection planning, planning for future stewardship and cash flow planning for retirement do not exist;
  - The taxpayer is convinced that his family will sell that asset immediately after his death; and
  - If it is unlikely a lifetime basis enhancing strategy will be used.
- Those assets and situations do exist, but it is respectfully submitted that those assets and situations are rare (e.g., negative basis real estate that is well positioned to keep its value and the taxpayer's family will sell it immediately after his death.)
- While it may be rare that transfer planning for a wealthy client's low basis assets should not be considered, it is rarer still that a client would also not wish to consider lifetime income tax planning and basis enhancing strategies that are consistent with transfer tax saving strategies.

- Congress gives the private investor significant after tax subsidies for his equity investments in comparison to his fixed income investments.
  - A key income tax factor that affects wealth management strategy of a private investor's portfolio, in comparison to construction of an institutional investor's portfolio, is the significant degree Congress subsidizes an equity investment (which may have a low basis in comparison to value) in comparison to a fixed income investment (which generally has a high basis in comparison to value):
    - Substantially lower rates of taxation;
    - The private investor, under the tax laws, may choose when he realizes taxable income on any equity investment (turnover rate), but cannot when he owns a taxable bond investment; and
    - The private investor may determine how much of an equity investment's unrealized income is ever taxed (e.g., the private investor could bequeath the equity investment to a charity).

- What is the efficient investment frontier for the private investor? (hint: it is probably not what you learned in finance class.)
  - The traditional efficient frontier will not work for the private investor, who pays taxes, like it does for the institutional investor that does not pay taxes. This is because gross return does not equal wealth for the taxable private investor due to income taxes, health care taxes and transfer taxes.
  - A wealth management strategy for a private investor involves much more than constructing an investment strategy. A wealth management strategy involves estate and income tax planning that is consistent with the private investor's stewardship goals, optimized location of asset classes in the tax-advantaged entities the private investor has created, and the use of income tax efficient investing and basis enhancing strategies when possible. A sample efficient frontier for the private investor, as a steward of wealth, is illustrated below.



For illustrative purposes only

*Chart reproduced from *Modern Investment Management* by Bob Litterman and the Quantitative Resources Group of Goldman Sachs Asset Management (2003)

Wealth Management Strategies That Use Grantor Trusts to Lower a Taxpayer’s Total Net Income and Transfer Taxes (See Pages 15-40 of the Paper)

- The technique:
  - Contributing and/or selling assets to a grantor trust:
    - A taxpayer could contribute a low basis asset to an intentionally defective grantor trust that does not pay income taxes or health care taxes.
    - The taxpayer will pay the income taxes and health care taxes associated with the trust.
    - If the grantor trust sells a low basis asset, the taxpayer will pay less estate tax, because his estate is liable for the income taxes and health care taxes associated with that sale. A trust that does not pay income taxes and health care taxes will grow much faster than a trust that does pay income taxes and health care taxes. Any growth by the grantor trust’s assets will escape future estate taxes.
    - Stated differently, depending on one’s tax perspective, when a taxpayer uses grantor trusts, that taxpayer is using income taxes and health care taxes to subsidize the payment of transfer taxes or vice versa.

- The advantage of locating income tax inefficient asset classes inside a grantor trust that is not subject to estate taxes.
  - The technique of asset class location in order to improve the after-tax, after-risk adjusted rate of return for an investment portfolio.
    - In order to optimize after-tax risk-adjusted returns, wealth management for the private taxable investor involves: (i) the creation of tax advantaged entities; (ii) the investment in asset classes that produce an optimal after-tax risk-adjusted return; and (iii) asset class location in different tax advantaged entities.
    - Stated differently, not every asset class that an investor and the investor's family would desire in their collective investment portfolios in order to reduce the portfolio's risk, or volatility, lends itself to investment via a tax efficient low turnover fund (i.e., a broad based passive equity fund). For instance, asset classes such as high yield bonds, hedge funds, master limited partnerships, emerging market debt and various forms of private equity are not available in a passive, low turnover (tax efficient) product. An investor and his family may have all of those asset classes in their collective portfolios.
  - Location of tax inefficient investment classes in a grantor trust significantly ameliorates the income income tax inefficiencies of those classes, because transfer taxes are saved when the grantor pays the income taxes of the trust.
    - Engaging in an asset class location strategy of locating income tax inefficient asset classes in grantor trusts, and other family planning vehicles, may greatly ameliorate those tax inefficiencies and lead to an optimal after tax risk adjusted return for the private investor.
    - There exist various techniques for the investor to have direct, or indirect, access to these tax efficient entities.
    - There exist various techniques for the investor to create these tax efficient entities without paying gift taxes.

- The table below illustrates the annual growth required for an equity fund to double (after both income taxes and transfer taxes) for an investor’s beneficiaries, if the investor dies in 10 years, depending upon how a fund is located:

	Annual Growth Rate Required on a $1mm Equity Fund Which Has a 2% Dividend Rate to Achieve $2.06mm (After Tax) for Investor's Beneficiaries for an Investor Who Dies in 10 Years(1), Depending Upon How a Fund is Located, and Percentage Improvement to Equal Equity Fund with 5% Turnover(2) or 50% Turnover(3)																	
	No Estate Planning Fund Owned by Investor						Estate Planning Techniques (Fund is Not Subject to Estate Taxes)											
Equity Fund's Annual Turnover of Assets	Fund is Owned by Investor and Investor's Estate is Not Subject to Estate Tax Because of Existing Exemptions and/or Charitable Bequests			Fund is Owned by Investor and is Fully Taxable in the Investor's Estate			Fund is in a Grantor Trust and Grantor Buys the Assets from the Grantor Trust for Cash Shortly Before Grantor's Death			Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years <u>Before</u> Grantor Dies			Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years <u>After</u> Grantor Dies			Fund is Held in a Non-Grantor Trust and Remaining Unrealized Income is Taxed in 10 Years		
	A			B			C			D			E			F		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
Equity Fund with 5% Annual Turnover (4)	6.34%	N/A	N/A	12.21%	N/A	N/A	6.00%	N/A	N/A	6.59%	N/A	N/A	7.06%	N/A	N/A	7.49%	N/A	N/A
Equity Fund with 50% Annual Turnover (5)	8.16%	28.75%	N/A	15.62%	27.99%	N/A	6.91%	15.10%	N/A	7.05%	6.88%	N/A	7.37%	4.42%	N/A	8.48%	13.28%	N/A
Equity Fund with 200% Annual Turnover (6)	10.86%	71.39%	33.12%	21.03%	72.34%	34.65%	7.94%	32.40%	15.03%	7.94%	20.50%	12.75%	7.94%	12.49%	7.73%	10.86%	45.10%	28.09%

(1) These calculations ignore the effect of investment management fees, state income taxes and investment friction costs. These calculations assume the estate planning vehicles are created without paying gift taxes. An equity fund owned by a tax exempt entity would need 5.52% annual growth rate of return over 10 years, assuming a 2% dividend rate, to achieve $2.06mm.
(2) % improvement necessary to equal fund with 5% annual turnover.
(3) % improvement necessary to equal fund with 50% annual turnover.
(4) 100% short-term realized gains in year 1, 0% short-term realized gains in years 2-10; 100% long-term realized gains in years 2-10.
(5) 100% short-tern realized gains in year 1; 25% short-term realized gains and 75% long-term realized gains in years 2-10.
(6) 100% short-term realized gains in years 1-10.

Wealth Management Strategies That Use Grantor Trusts to Lower a Taxpayer's Total Net Income and Transfer Taxes (Continued)

- The asset location of a tax inefficient investment is particularly important. There is a much more modest differential on what is needed to earn pre-tax for a tax inefficient investment, in comparison to a tax efficient investment, in order to double the investment over a 10-year period, if the investment is located in an estate tax protected grantor trust, as opposed to being taxed in the taxpayer's estate.

- For instance, if a fund is located in an estate tax protected grantor trust, a 200% turnover fund (e.g., certain hedge funds) needs to earn 7.94% before taxes to double the value of the investment after taxes in 10 years and a 5% turnover fund (e.g., S&P 500 index fund) needs to earn 7.06% before taxes to double the investment after taxes in 10 years.

- Stated differently, a 12.49% improvement in annual pre-tax return is necessary for a 200% turnover fund to equal a 5% annual turnover fund, if the fund is located in a grantor trust and sold after the grantor's death (see column E(2)). Contrast this result with those same funds being held in the taxpayer's estate, if the two different types of funds are subject to estate taxes. If the funds are subject to estate taxes, a 5% turnover will need to earn 12.21% before taxes to double the investment after taxes in 10 years, and the high 200% turnover fund will need to earn 21.03% before taxes to double the investment after taxes in 10 years. A 72.34% annual pre-tax improvement in return is necessary for a 200% turnover fund to equal a 5% annual turnover fund, if the fund is fully taxable in the investor's estate.

- The difference between 12.49% annual pre-tax needed improvement and 72.34% annual pre-tax needed improvement is obviously significant.

- Considerations of the technique:
  - There may need to be substantive equity in the trust from prior gifts (is 10% equity enough?) before the sale is made.
  - State income tax considerations.
  - The IRS could be successful in the argument, that because of the step transaction doctrine, a valuation discount is not appropriate in valuing the transferred entity interest.
  - If the assets decrease in value, the gift tax exemption equivalent may not be recoverable.
  - There may be capital gains consequences with respect to the note receivables and/or note payables that may exist at death.
  - The IRS may contest the valuation of any assets that are hard to value that are donated to a grantor trust or are sold to such a trust.
    - The problem and the probable solution: defined allocation transfers.
    - Defined value allocation clauses involving a defined dollar transfer by the donor.
    - Defined value allocation clauses involving both a defined dollar transfer by the donor and a parallel formula qualified disclaimer by the donee.

- The technique:
  - All wealthy taxpayers should consider an estate freeze estate planning technique that does not use any of their unified credit, even those taxpayers who have low basis assets. In all states, the marginal transfer tax rate is higher than the marginal federal and state capital gains rate. Thus, removing future growth of a taxpayer's assets, while preserving the taxpayer's unified credit to be used at the taxpayer's death, always results in lower net transfer and capital gains taxes, even for zero basis assets that are not sold during the taxpayer's lifetime.
- Consider the following example:

Contribution of a Leveraged FLLC Member Interest to a GRAT

Neal Navigator approaches his attorney, Lenny Leverage, and tells him that he would like to transfer, through the use of a GRAT, the maximum amount that he can transfer using a three-year GRAT that will terminate in favor of a grantor trust for his wife and children. Neal tells Lenny that he has around $32,000,000 in financial and private equity assets. Neal is willing to have a significant portion of his assets subject to a three-year GRAT.

Lenny likes many of the aspects of a GRAT, including its built-in revaluation clause. Lenny also likes using FLPs, or FLLCs, because of the substantive non-tax investment and transfer tax advantages that are sometimes associated with these entities (e.g., they may effectively deal with qualified purchasers and accredited investor requirements for alternative investments and because of the possibility of valuation discounts with FLLCs).

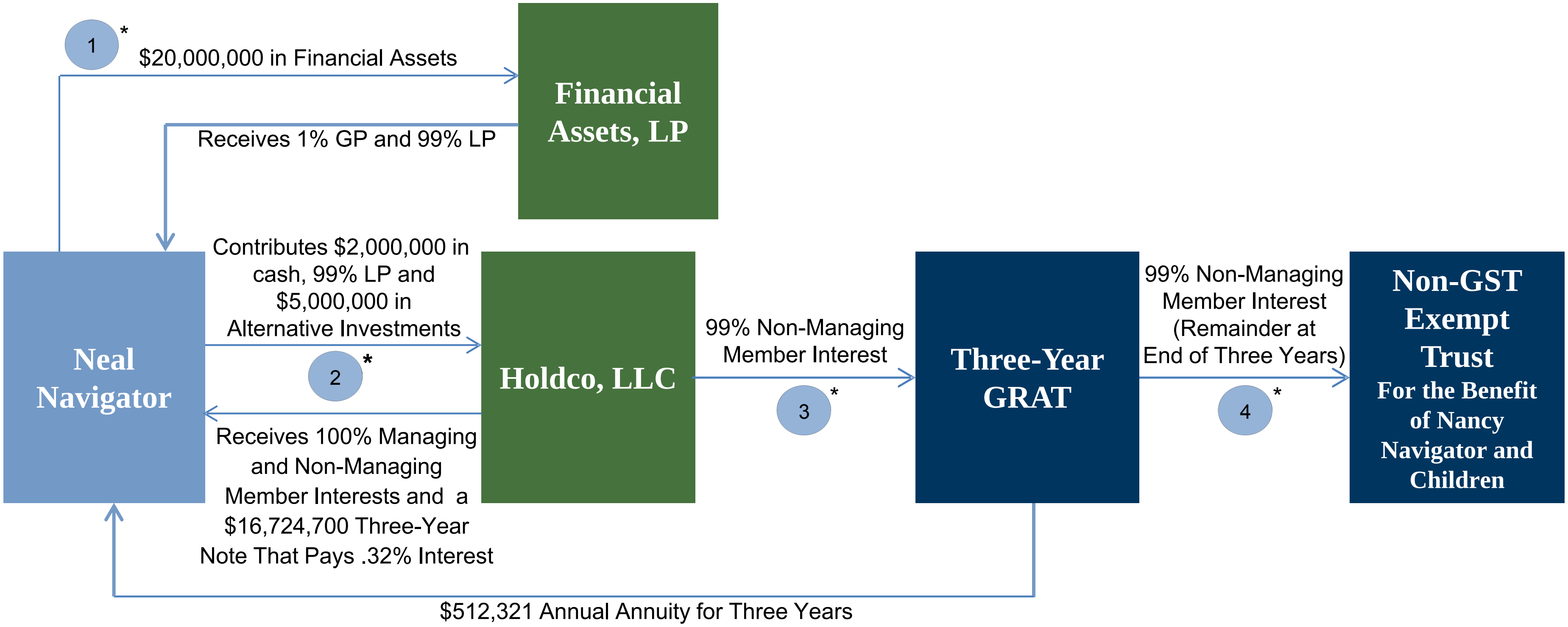
Despite the advantages of GRATs and the possibility of valuation discounts of FLPs and FLLC's, Lenny, feels that there are certain disadvantages with contributing FLP interests and FLLC member interests to a GRAT in comparison to a sale of partnership interests to a grantor trust, including the disadvantage of the higher Statutory Rate and the potential difficulties in paying the retained annuity amounts in a GRAT with hard to value FLP or FLLC interests.

Lenny assumes Neal's limited partnership interest will have a 35% valuation discount and Neal's non-managing member interest in Holdco will have a 20% valuation discount.

Lenny proposes to eliminate those disadvantages by having a part sale/part contribution of Neal's assets to a single member FLLC in exchange for a note equal to $16,724,700 (which is 90% of the assumed value of $2,000,000 cash, the limited partnership interest and the alternative investments that are contributed to the single member LLC).

The Advantages and Considerations for a Taxpayer to Contribute and Sell the Taxpayer's Investments to a Single Member FLLC and Then Contributing Non-Managing Member Interests in That FLLC to a GRAT (Continued)

- Lenny's proposed technique is illustrated below:



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

The Advantages and Considerations for a Taxpayer to Contribute and Sell the Taxpayer's Investments to a Single Member FLLC and Then Contributing Non-Managing Member Interests in That FLLC to a GRAT (Continued)

- Advantages of the technique:
  - If leverage is used in creating the FLLC that is contributed to the GRAT, much more wealth will be transferred to the remainderman of the GRAT than through the use of a conventional GRAT.
    - The calculations below assume different rates of returns, as noted. The assumed IRC Sec. 7520 rate is 2.2%:

Hypothetical Techniques: Assets Earn 2.20% Annually	Neal Navigator	Navigator Children	% Improvement Over Hypothetical Technique #1a	% Improvement Over Hypothetical Technique #2a
Holdco, FLLC Distributes about 2% of the value of assets it owns directly and indirectly.				
No Further Planning	$33,987,889	$0	N/A	N/A
Hypothetical Technique #1a (Conventional GRAT): Contribution of Assets to a Three-Year GRAT that Does Not Use Discounted Entities or Leverage; Remaindermen of GRAT is a Non-GST Grantor Trust	$33,987,745	$144	N/A	N/A
Hypothetical Technique #2a (Contributing Non-Leveraged Family Entities to a Conventional GRAT): Formation of Discounted Entities Without Leverage, Contribution to a Three-Year GRAT	$32,512,758	$1,475,131	1022800.97%	N/A
Hypothetical Technique #3a (Contributing Leveraged Family Entities to a Conventional GRAT): Formation of a Leveraged Entity that Can be Discounted; Contribution to a Three-Year GRAT	$26,216,640	$7,771,249	5388721.62%	426.82%

The Advantages and Considerations for a Taxpayer to Contribute and Sell the Taxpayer's Investments to a Single Member FLLC and Then Contributing Non-Managing Member Interests in That FLLC to a GRAT (Continued)

Hypothetical Techniques: Assets Earn 7.40% Annually	Neal Navigator	Navigator Children	% Improvement Over Hypothetical Technique #1b	% Improvement Over Hypothetical Technique #2b
Holdco, FLLC Distributes about 2% of the value of assets it owns directly and indirectly.				
No Further Planning	$38,774,953	$0	N/A	N/A
Hypothetical Technique #1b (Conventional GRAT): Contribution of Assets to a Three-Year GRAT that Does Not Use Discounted Entities or Leverage; Remaindermen of GRAT is a Non-GST Grantor Trust	$35,891,596	$2,883,358	N/A	N/A
Hypothetical Technique #2b (Contributing Non-Leveraged Family Entities to a Conventional GRAT): Formation of Discounted Entities Without Leverage, Contribution to a Three-Year GRAT	$33,985,022	$4,789,931	66.12%	N/A
Hypothetical Technique #3b (Contributing Leveraged Family Entities to a Conventional GRAT): Formation of a Leveraged Entity that Can be Discounted; Contribution to a Three-Year GRAT	$26,883,832	$11,891,122	312.41%	148.25%

- Under all rates of return, the leveraged GRAT substantially outperforms the other techniques.
- The reason for the improved performance with the contribution of member interests in a leveraged FLLC is (i) the average hurdle rate is lower with leverage and (ii) the GRAT annuity amount is paid with the normal distributable cash flow of the FLLC instead of discounted FLLC member interests. The chief reason for the outperformance is the second reason. A significant arbitrage is created when a heavily discounted asset is contributed to a GRAT and undiscounted cash is used to pay the annuity.

- Other advantages of the technique:
  - The technique has many of the same advantages as the sale to the grantor trust.
  - Valuation advantage of a GRAT.
  - Ability of grantor to pay for income taxes associated with Holdco, the GRAT and remainder grantor trust gift tax-free and substitute assets of Holdco, the GRAT and remainder grantor trust income tax-free.
  - Synergy with other techniques.
  - Comparatively low hurdle rate.
  - High leverage.
  - Non-recourse risk to remaindermen.
  - The "Atkinson" worry about paying a GRAT annuity with a hard-to-value asset may be eliminated.
  - The taxpayer's unified credit does not have to be used with this technique as it would with most other freeze techniques, which could save capital gains taxes on the death of the taxpayer.
  - There may be less danger that the retained note will be recharacterized as a deemed retained interest in a trust with this technique than with a sale to a grantor trust.

The Advantages and Considerations for a Taxpayer to Contribute and Sell the Taxpayer's Investments to a Single Member FLLC and Then Contributing Non-Managing Member Interests in That FLLC to a GRAT (Continued)

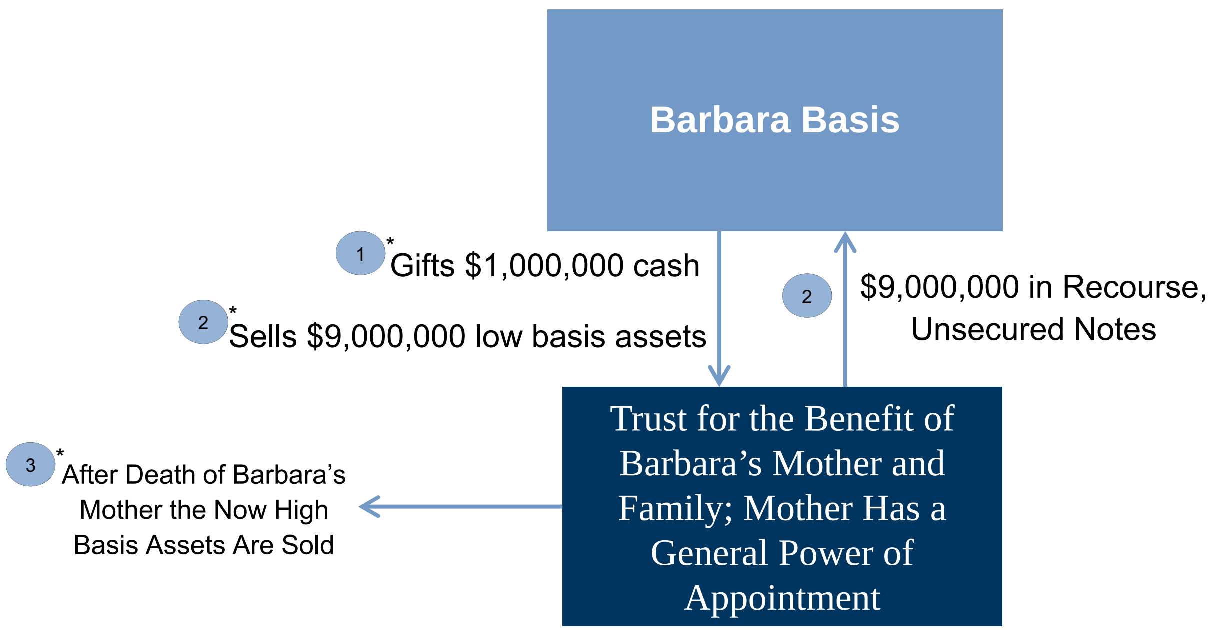
- Considerations of the technique:
  - Part (but not all) of the FLLC interests could be taxable in the grantor's estate if the grantor does not survive the term of the GRAT.
  - It is more complex than the other GRAT techniques.
  - Care must be taken if the underlying asset that is sold or contributed to the single member LLC is stock in a Subchapter S corporation.

Swapping Assets Inside a Grantor Trust, or a Disregarded Single Member LLC, Before the Death of the Grantor (See Pages 54-55 of the Paper)

- Advantages of the Technique:
  - The low basis assets, if retained by the grantor, will receive a basis step-up on the grantor's death.
  - If the low basis assets are sold by the grantor before his or her death the cost of the capital gains taxes will be borne by the grantor (just as they would have been if the assets had been sold by the grantor trust or a disregarded single member LLC.)
- Considerations of the Technique:
  - The grantor may not have any high basis assets, or cash, to swap.
  - To the extent, after the swap of assets, "swapped" low basis assets grow more than the "swapped" high basis assets in the grantor trust, the grantor's estate taxes will increase.

The Gift and Sale of Low Basis Assets to a Grantor Trust That is Subject to an Older Generation's General Power of Appointment and Estate Taxes (See Pages 55-58 of the Paper)

- The technique:
  - A taxpayer could gift cash and then later sell some of his low basis assets (for adequate and full consideration) to a grantor trust in independent transactions. The beneficiaries of the trust could be the taxpayer's descendants and an older generation beneficiary, such as a parent. The older generation beneficiary could be given a general power of appointment that will be structured to include those trust assets in his or her estate. If the grantor first gifts high basis cash to the trust, IRC Sec. 1014(e) should not apply to that gift of cash because it is not a low basis asset.
  - The technique is illustrated below:



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

The Gift and Sale of Low Basis Assets to a Grantor Trust That is Subject to an Older Generation's General Power of Appointment and Estate Taxes (Continued)

- Advantages of the technique:
  - This technique has the same advantages as a sale to a grantor trust.
  - The assets of the trust will receive a step-up in basis on the older generation beneficiary's death equal to the fair market value of the assets, if net value rule of Treas. Reg. §2053-7 does not apply.
  - The assets of the trust may be generation skipping tax protected
  - The older generation beneficiary may not have to pay estate taxes because of her general power of appointment, if her then available unified credit exceeds the net value of the trust.
- Considerations of the technique:
  - The grantor of the trust will still have a low basis in his or her note upon the death of the older generation beneficiary.
    - Under the logic of Revenue Ruling 85-13, the note does not exist as long as the grantor status of the trust is maintained.
    - The note may be satisfied before the grantor's death without tax consequences.
    - There is an absence of authority, and a split among certain commentators, as to whether satisfaction of the note after the grantor's death will cause capital gains consequences
  - The older generation beneficiary could exercise his or her general power of appointment in an unanticipated way.
  - Many of the same considerations for the use of a grantor trust and a sale to a grantor trust would also be present for this technique.

- The effect of IRC Sec. 1014(e) must be considered, if cash is not given and low basis assets are used to capitalize the trust.

- The effect of Treas. Reg. §20.2053-7 needs to be considered.

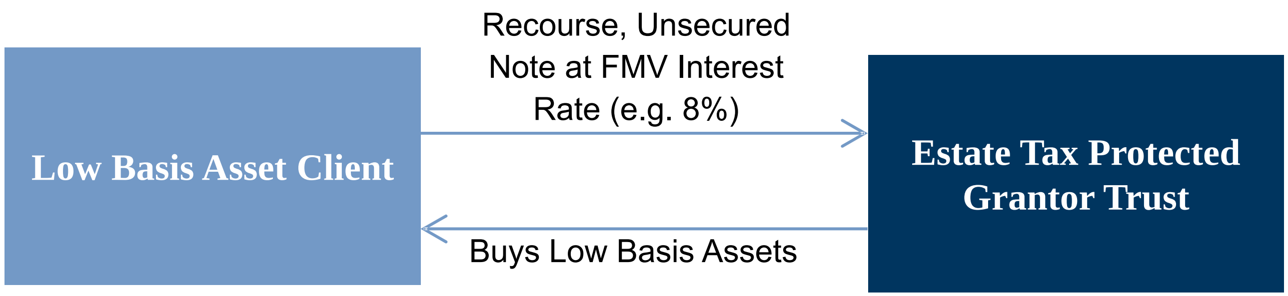
- Is grantor trust status lost for the original grantor when the older generation beneficiary dies and the trust assets are included in the beneficiary's estate?

  - Treas. Reg. §1.671-2(e)(6) contains an example that would seem to indicate that the grantor trust status would not change, if the older generation does not exercise his or her general power of appointment:

    > Example 8. G creates and funds a trust, T1, for the benefit of B. G retains a power to revest the assets of T1 in G within the meaning of section 676. Under the trust agreement, B is given a general power of appointment over the assets of T1. B exercises the general power of appointment with respect to one-half of the corpus of T1 in favor of a trust, T2, that is for the benefit of C, B's child. Under paragraph (e)(1) of this section, G is the grantor of T1, and under paragraphs (e)(1) and (5) of this section, B is the grantor of T2.

Borrowing Strategies That Lower the Net Total Income Tax and Transfer Tax (See Pages 66-74 of the Paper)

- The technique:



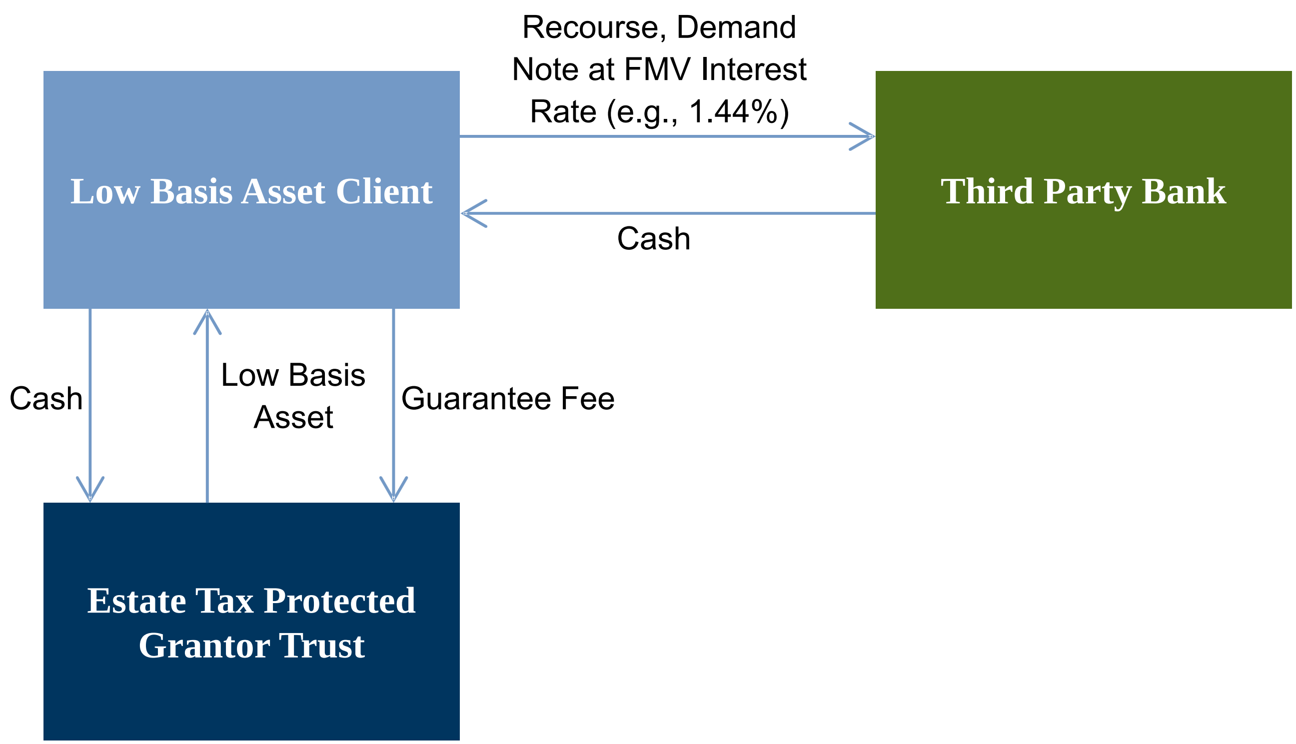
- Advantages of the technique:
  - The low basis asset will receive a step-up in basis on the grantor’s death.
  - Estate taxes will be saved if the interest carry on the note owed to the grantor trust exceeds the growth of the purchased low basis note.
  - As long as the trust is a grantor trust, the interest payments on the note could be made in-kind without any income tax consequences.

Borrowing Strategies That Lower the Net Total Income Tax and Transfer Tax (Continued)

- Considerations of the technique:
  - An independent appraisal will be necessary to determine that the interest rate on the recourse, unsecured note is a fair market value interest rate. If the interest rate is too high, there may be gift tax consequences.
  - If the note is paid back after the grantor's death, there may be capital gains consequences to the trust. Stated differently, the trust's basis in the note may be equal to the basis of the low basis asset that is exchanged for the note. That result may not change on the death of the grantor, when the trust becomes a complex trust.
    - One way to remove this consideration may be to borrow cash from an independent third party bank. Consider the following additional hypothetical transactions.

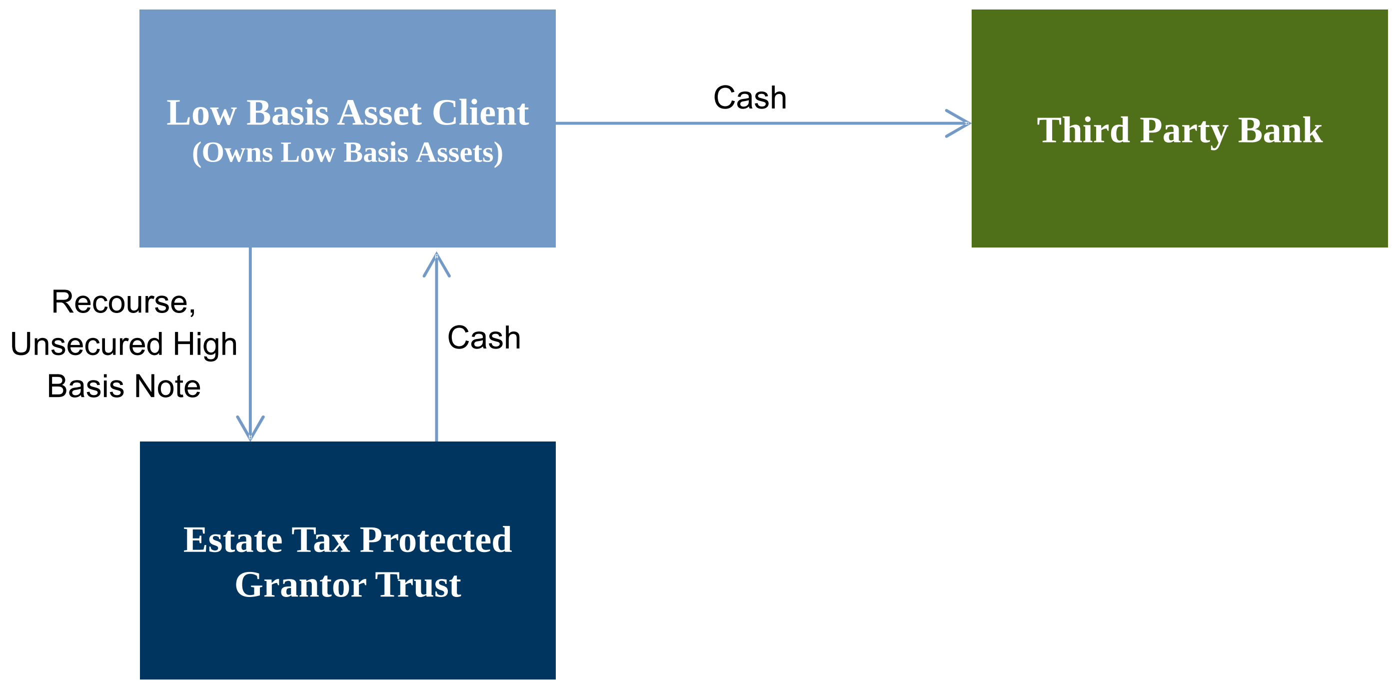
Involvement of a Third Party Lender May Ameliorate the Capital Gains at Death Question

- Hypothetical Transaction #1:



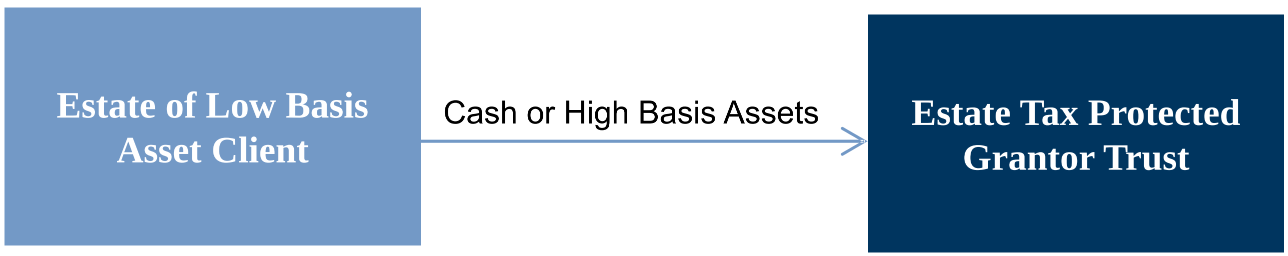
Involvement of a Third Party Lender May Ameliorate the Capital Gains at Death Question (Continued)

- Hypothetical Transaction #2:



Involvement of a Third Party Lender May Ameliorate the Capital Gains at Death Question (Continued)

- Hypothetical Transaction #3:
  - Upon the death of Low Basis Asset Client, the estate satisfies the note to the Estate Tax Protected Grantor Trust with the now high basis assets or cash (if the high basis assets are sold after the death of Low Basis Asset Client):



  - Is the basis of the note received for cash loaned by the Estate Tax Protected Grantor Trust equal to the cash's fair market value?
  - It is difficult to imagine that when the Estate Tax Protected Grantor Trust loans cash its basis in the resulting note is anything less than the value of the cash. Stated differently, may cash ever have a basis lower that the amount of that cash? Perhaps in the different world of grantor trusts it may.
  - If that is a concern, consider converting the grantor trust to a complex trust before the loan of the cash is made. If the conversion is made before the trust makes a loan to the grantor there would not appear to be any tax consequences to that conversion (because there are not any outstanding loans owed to or by the grantor). The loan of cash from the now, complex trust, should be treated like any loan of cash from a complex trust.

Grantor creates a complex trust under which the beneficiary has a lapsing limited income right of withdrawal.

- The technique:
  - A donor could create a complex trust that provides annual lapsing withdrawal rights to the beneficiary of a limited amount of trust income and the beneficiary only withdraws that amount necessary to pay the income taxes caused by that withdrawal right
  - Consider the following withdrawal power (hereinafter sometimes referred to as a "limited income withdrawal power"):

    Upon the end of each calendar year if the beneficiary is living immediately before the end of the year, the Trustee shall pay to the beneficiary, or his representative, that fractional share of the trust's net income that is not exempt from federal income tax, as the beneficiary, or his representative, last directs in writing before the end of the year, whether or not that net income is allocable to corpus, that does not exceed the lesser of the following:

    (a) that fractional share of the trust's net income that is equal to the trust's net investment income, as defined in IRC Section 1411;

    (b) that fractional share of the trust's net income that is equal to the trust's adjusted gross income, as defined in IRC Section 67(e) in excess of the dollar amount at which the highest tax bracket in IRC Section (1)(e) begins for such taxable year; or

    (c) that fractional share of the trust's net income that is equal to 5% of the trust estate determined at the end of the year of the trust.

Strategies That May Lower the Income and Health Care Taxes of Trusts Without Making Cash Distributions to the Beneficiaries of the Trusts (Continued)

- Advantages of the technique:
  - Assuming, on the beneficiary's death, the annual lapse of the withdrawal powers did not exceed in value 5% of the trust properties in any calendar year, there should not be any estate taxes on the beneficiary's estate associated with those lapses.
  - The annual failure to exercise the withdrawal power should not be considered a taxable gift by the beneficiary.
  - Annually, that part of the taxable income of the trust that the beneficiary has the power to vest in himself will be taxable to the beneficiary and will not be taxable to the trust.
  - The trust assets may grow much faster during the beneficiary's lifetime than would be the case if the limited income withdrawal right did not exist.
  - If the trust owns an interest in a closely held entity that is taxed under the LLC or Subchapter S rules, and if the beneficiary materially participates in the business, there may be health care tax advantages if the beneficiary has the limited income withdrawal power.
  - The limited income withdrawal power may cause less fiduciary problems for an independent trustee of the trust.
- Considerations of the technique:
  - The power holder may exercise the limited income withdrawal power in a manner that was not anticipated by the settlor.
  - Beneficiary creditor concerns.
    - However, if an independent trust protector, or an independent trustee, has the power in future years to terminate, or temporarily terminate, the beneficiary's limited income withdrawal power, that may ameliorate the concern.

The trustee of a complex trust, from time to time, in the exercise of his discretionary authority, gives the beneficiary a lapsing limited income right of withdrawal.

- The technique:
  - The trustee of a complex trust that, in the exercise of his discretionary authority, from time to time, gives an annual lapsing withdrawal rights to the beneficiary of a limited amount of trust income and the beneficiary only withdraws that amount necessary to pay the income taxes caused by that withdrawal right
  - The trustee could, from time to time, give a beneficiary the following withdrawal power (hereinafter sometimes referred to as a "limited income withdrawal power"):

    Upon the end of each calendar year if the beneficiary is living immediately before the end of the year, the Trustee shall pay to the beneficiary, or his representative, that fractional share of the trust's net income that is not exempt from federal income tax, as the beneficiary, or his representative, last directs in writing before the end of the year, whether or not that net income is allocable to corpus, that does not exceed the lesser of the following:

    (a) that fractional share of the trust's net income that is equal to the trust's net investment income, as defined in IRC Section 1411;

    (b) that fractional share of the trust's net income that is equal to the trust's adjusted gross income, as defined in IRC Section 67(e) in excess of the dollar amount at which the highest tax bracket in IRC Section (1)(e) begins for such taxable year; or

    (c) that fractional share of the trust's net income that is equal to 5% of the trust estate determined at the end of the year of the trust.

Strategies That May Lower the Income and Health Care Taxes of Trusts Without Making Cash Distributions to the Beneficiaries of the Trusts (Continued)

- Advantages of the technique:
  - Assuming, on the beneficiary's death, the annual lapse of the withdrawal powers did not exceed in value 5% of the trust properties in any calendar year, there should not be any estate taxes on the beneficiary's estate associated with those lapses.
  - The annual failure to exercise the withdrawal power should not be considered a taxable gift by the beneficiary.
  - In any year in which the beneficiary has that withdrawal power, that part of the taxable income of the trust that the beneficiary has the power to vest in himself will be taxable to the beneficiary and will not be taxable to the trust.
  - The trust assets may grow much faster during the beneficiary's lifetime than would be the case if the limited income withdrawal right did not exist.
  - If the trust owns an interest in a closely held entity that is taxed under the LLC or Subchapter S rules, and if the beneficiary materially participates in the business, there may be health care tax advantages in any year that the beneficiary has the limited income withdrawal power.
  - The grantor of a limited income withdrawal power may, from time to time, cause less fiduciary problems for an independent trustee of the trust.
  - The trustee does not have to grant the power in any year that the beneficiary has creditor problems or the trustee feels the beneficiary may act irresponsibly.

- The technique:
  - Consider the following example:

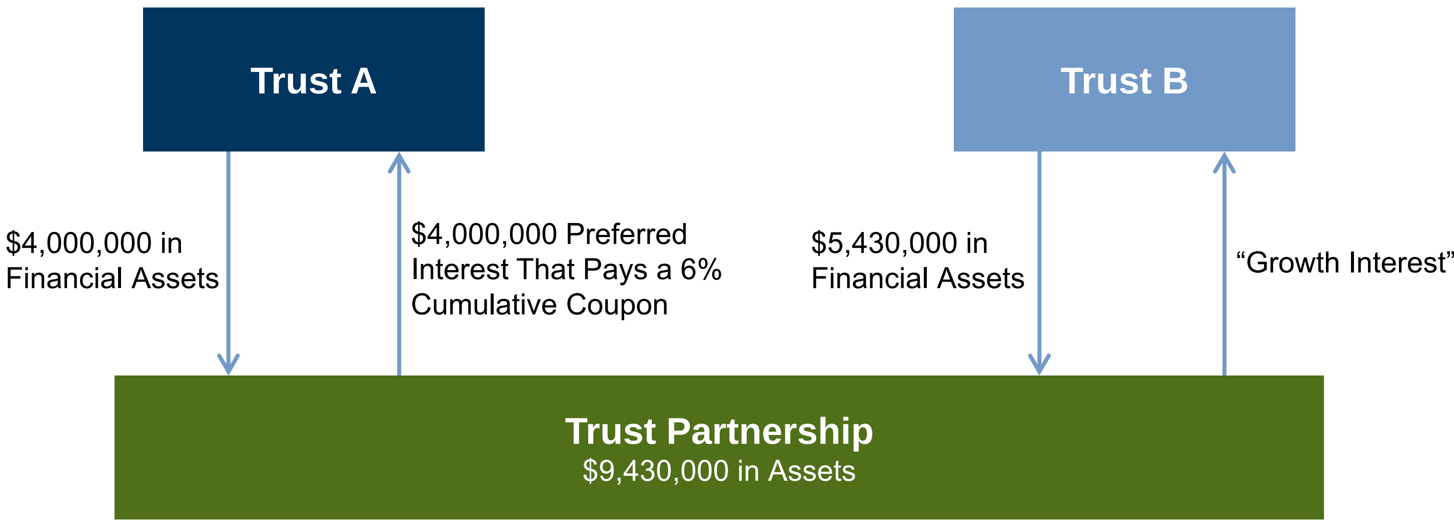
Old Complex Trust Enters Into a
<u>Two-Class Partnership With a New Grantor GST Trust</u>

Gomer Gonetotexas is a discretionary beneficiary of a GST Complex trust that was created in California and is subject to California state income tax law ("Trust A"). Gomer now lives in Texas. Gomer has a $20,000,000 estate and does not need or want any distributions from Trust A. The beneficiaries of Gomer's estate are the same as the beneficiaries of the California complex trust. Gomer desires to lower the California state income taxes of Trust A and lower his estate taxes. Gomer does not want to pay any gift taxes. Gomer's living expenses are $500,000 a year. Gomer develops the following plan:

Trust A invests its $4,000,000 in financial assets for a $4,000,000 preferred interest in a FLP that pays a 6% cumulative return. Gomer creates Trust B with $5,430,000 in assets. Trust B is a grantor trust that is also a GST trust with similar beneficial interests to Trust A. Trust B contributes its assets for a growth interest in the FLP that is entitled to all of the income and growth of the partnership that is not allocated to the preferred interest. During the term of the partnership there are no distributions to the Trust A beneficiaries. Assume the partnership assets earn 7.4% before taxes a year with 3.4% of the return being taxed at ordinary rates and 4% of the return being earned at long-term rates with a 30% turnover.

A Complex Trust Contributes its Assets For a "Preferred" Interest in a FLP or FLLC and a Grantor Trust, With the Same Beneficial Interests as the Complex Trust, Contributes its Assets For a "Growth" Interest in That FLP or FLLC (Continued)

- A diagram of the transaction is below:



A Complex Trust Contributes its Assets For a “Preferred” Interest in a FLP or FLLC and a Grantor Trust, With the Same Beneficial Interests as the Complex Trust, Contributes its Assets For a “Growth” Interest in That FLP or FLLC (Continued)

- Advantages of the technique:
  - Under this arrangement, the complex trust’s income taxes will be significantly reduced and a significantly greater amount will pass to Gomer’s descendants. Under Scenario A below a 6% cumulative return is used on the preferred interest. Under Scenario B below a 3% cumulative return is used on the preferred interest.

	Gonetotexas Beneficiaries			Consumption		IRS Income Taxes		CA Income Taxes		IRS Estate Tax (at 40.0%)	Total
		Children & Grandchildren									
	Children	California Complex Trust	Texas Grantor Trust	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost		
20-Year Future Values											
No Further Planning	$15,428,576	$9,901,125	$8,690,000	$12,772,329	$13,053,175	$14,096,596	$13,698,567	$1,146,501	$995,794	$10,285,717	$100,068,380
Hypothetical Technique Scenario A	$4,519,199	$8,438,250	$28,299,023	$12,772,329	$13,053,175	$14,400,963	$13,745,501	$939,759	$887,382	$3,012,799	$100,068,380
Hypothetical Technique Scenario B	$3,026,201	$6,216,830	$33,438,779	$12,772,329	$13,053,175	$14,674,976	$13,955,262	$469,735	$443,626	$2,017,467	$100,068,380
Present Values (discounted at 2.5%)											
No Further Planning	$9,415,611	$6,042,369	$5,303,254	$7,794,581	$7,965,974	$8,602,743	$8,359,837	$699,676	$607,704	$6,277,074	$61,068,825
Hypothetical Technique Scenario A	$2,757,936	$5,149,619	$17,270,072	$7,794,581	$7,965,974	$8,788,489	$8,388,480	$573,508	$541,543	$1,838,624	$61,068,825
Hypothetical Technique Scenario B	$1,846,802	$3,793,951	$20,406,715	$7,794,581	$7,965,974	$8,955,711	$8,516,491	$286,666	$270,732	$1,231,202	$61,068,825

  - The trustee of the complex trust does not have to distribute assets or cash to a beneficiary, or give a withdrawal right to a beneficiary, in order to save income taxes or health care taxes.
  - This technique may be easier to manage than some of the other trust income tax savings techniques.
  - If the two trusts have identical provisions the valuation rules under IRC Sec. 2701 may not apply.

A Complex Trust Contributes its Assets For a "Preferred" Interest in a FLP or FLLC and a Grantor Trust, With the Same Beneficial Interests as the Complex Trust, Contributes its Assets For a "Growth" Interest in That FLP or FLLC (Continued)

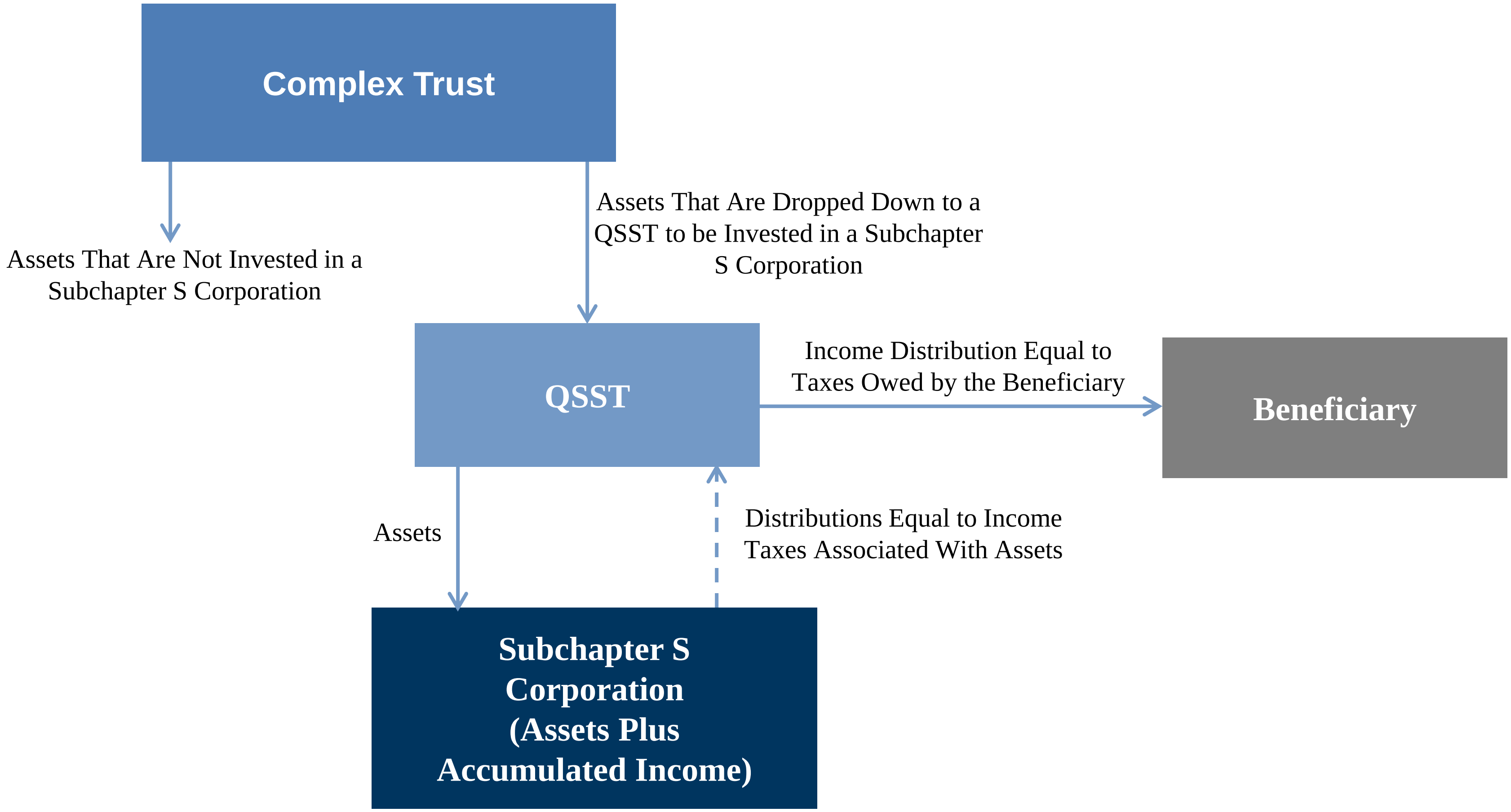
- Considerations of the technique:
  - A party may not exist that could create a grantor trust that could invest and receive a preferred partnership interest.
  - The technique is complex.
  - In certain circumstances it may be better for the new grantor trust to own the preferred interest if a high coupon is warranted (e.g., 11% – 12%) because the new grantor trust is contributing 80% – 90% of the assets of the partnership.
  - In certain circumstances it may be more profitable for the old trust to sell the high basis assets to the new trust for a low interest (AFR rate) note to the new trust.

The Complex Trust Could in Effect Convert Part of Its Assets Into an IRC Sec. 678 Grantor Trust in Which the Income is Taxed to the Beneficiary of the Trust By Having the Trust Invest in a Subchapter S Corporation and that Part of the Trust is Converted Into a Qualified Subchapter S trust ("QSST")

- The technique:
  - Many trust documents creating complex trusts provide that if any investment is made in a Subchapter S corporation that part of the trust will convert into a QSST. Or, in appropriate circumstances, a complex trust could be modified by court order to allow a Subchapter S investment by a QSST conversion for that investment. In order to ameliorate fiduciary concerns, assume the amount of distributions to the QSST beneficiary is taken into account by the trustee in determining the amount of the distributions, if any, to the beneficiary out of the assets of the complex trust that are not held in the QSST.

The Complex Trust Could in Effect Convert Part of Its Assets Into an IRC Sec. 678 Grantor Trust in Which the Income is Taxed to the Beneficiary of the Trust By Having the Trust Invest in a Subchapter S Corporation and that Part of the Trust is Converted Into a Qualified Subchapter S trust ("QSST") (Continued)

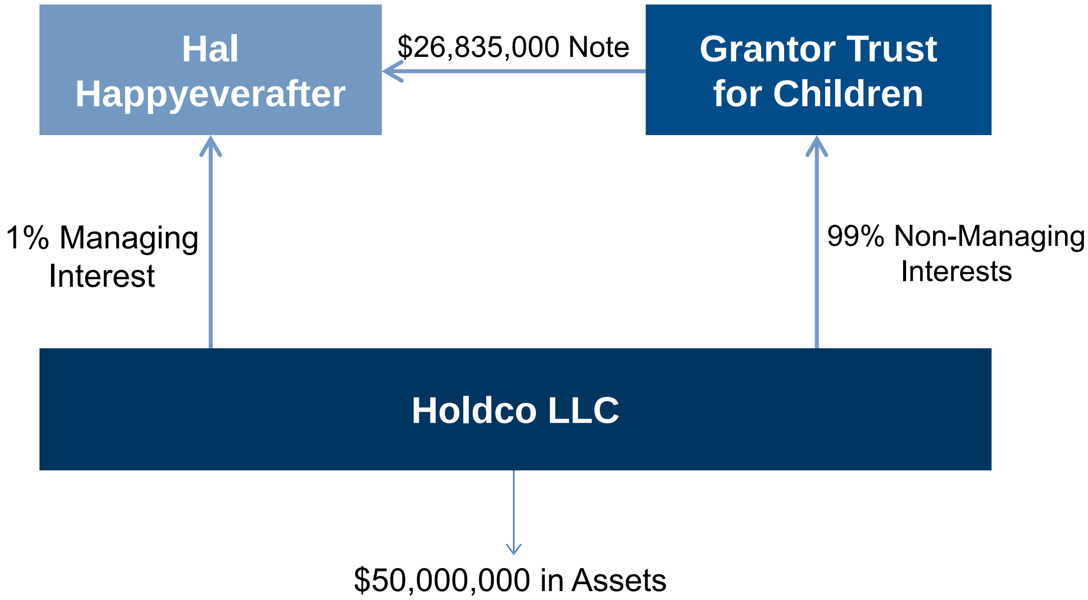
- The technique is illustrated below:



- Advantages of the technique:
  - The beneficiary may be in a lower tax bracket than the trust.
  - There is not any concern about the effect of any lapse of withdrawal rights.
  - If the Subchapter S corporation participates in a trade or business, and if the current beneficiary of the QSST materially participates in that trade or business, or is in a lower marginal bracket, significant health care taxes may be saved with the technique.
  - The beneficiary of the QSST will have access to the cash flow distributed to the trust.
  - The trust is much more flexible than a simple income only trust and may be administered to simulate a complex trust without the income tax and health care tax disadvantages of a complex trust.

- Considerations of the technique:
  - The federal income tax considerations with utilizing a Subchapter S corporation.
  - Any assets of the QSST that are not Subchapter S stock will be taxed trust under normal Subchapter J rules.
  - State income tax considerations.

- The technique:
  - Portability permits the estate of the first spouse to die of a married couple to elect to transfer the DSUE amount to the surviving spouse who could use it for making gifts and sales to a grantor trust.
  - A surviving spouse's gift of non-managing interests in a family entity to a grantor trust using the DSUE amount, and sales by the surviving spouse of non-managing interests in a family entity to the grantor trust, may be designed to simulate, from the perspective of the surviving spouse and the surviving spouse's descendants, the same result that would accrue if the first spouse to die had created a much larger credit shelter trust through the use of a much larger unified credit.
  - Consider the following example:



– For a credit shelter trust to duplicate the estate tax savings of the above DSUE amount planning the trust would have to be funded with $46,189,085 on Harriett's death, or around nine times the then assumed available unified credit amount. See the table below:

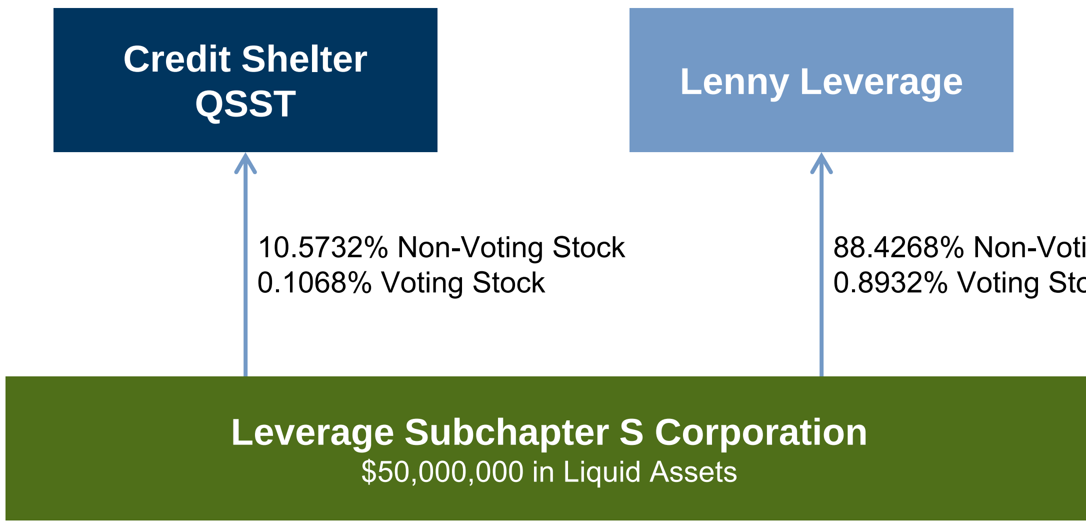
	Happyeverafter Children (1)	Consumption (2)	Consumption Investment Opportunity Cost (3)	IRS Income Tax (4)	IRS Income Tax Investment Opportunity Costs (5)	IRS Estate Taxes at 40% (6)	Total (7)
10-Year Future Values							
Simulated Credit Shelter Trust: Hal Happyeverafter's deceased spouse created a $46,189,085 credit shelter trust for Hal and family and bequeaths the rest of her estate to Hal	$77,713,665	$6,722,029	$2,606,804	$8,285,914	$2,225,962	$4,542,587	$102,096,962
Hap Happyeverafter's deceased spouse bequeaths her estate to Hal; Hal creates a single member LLC and gifts the DSUE amount to a grantor trust; Hal sells the remaining non-managing member interests to the grantor trust	$77,713,665	$6,722,029	$2,606,804	$8,732,917	$2,225,962	$4,095,584	$102,096,962
Present Values (Discounted at 2.5%)							
Simulated Credit Shelter Trust: Hal Happyeverafter's deceased spouse created a $46,189,085 credit shelter trust for Hal and family and bequeaths the rest of her estate to Hal	$60,709,791	$5,251,238	$2,036,431	$6,472,943	$1,738,918	$3,548,662	$79,757,983
Hap Happyeverafter's deceased spouse bequeaths her estate to Hal; Hal creates a single member LLC and gifts the DSUE amount to a grantor trust; Hal sells the remaining non-managing member interests to the grantor trust	$60,709,791	$5,251,238	$2,036,431	$6,822,141	$1,738,918	$3,199,464	$79,757,983

- Advantages of the technique:
  - Significantly more assets may be passed to the next generation by using this technique than using the exemption to fund a credit shelter trust.
  - There is a step-up in basis of the deceased spouse's assets at her death.
  - There is an opportunity through using borrowing strategies from third party lenders for the surviving spouse to increase the basis of the transferred assets during his lifetime.
  - Significantly more assets may receive protection from creditors by using sales to grantor trusts with the use of the DSUE amount then using the exemption to fund a credit shelter trust.
  - The surviving spouse's rights with respect to assets owned by the grantor trust, and cash flows produced by those assets, are pursuant to a flexible contract, rather than discretionary distributions by a trustee who is subject to fiduciary considerations.
  - All of the advantages of creating a grantor trust and selling assets to a grantor trust are present with this technique.

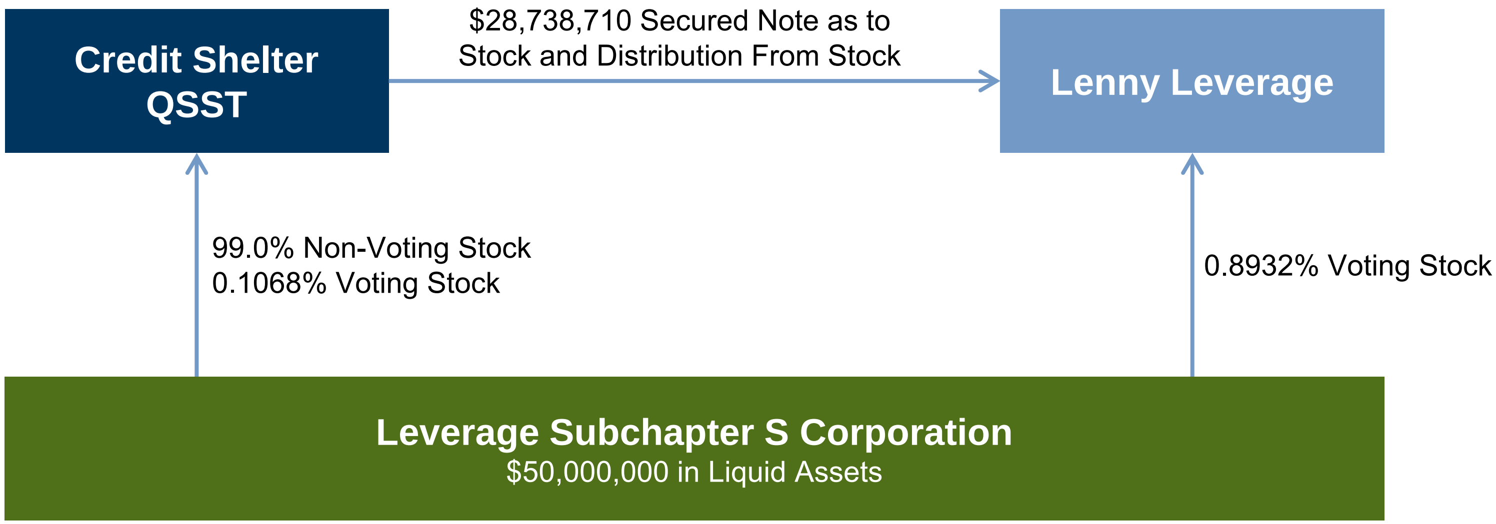
- Considerations of the technique:
  - The surviving spouse may not transfer the DSUE amount in the manner that the deceased spouse anticipated.
  - If the surviving spouse has creditor issues at the time of the first spouse's death, creating a family trust with the deceased spouse's unified credit will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

The Conversion of a Credit Shelter Trust to a Qualified Subchapter S Trust ("QSST"), the Investment by the Credit Shelter QSST in a Subchapter S Corporation and the Sale of Subchapter S Stock owned by the Surviving Spouse to the Credit Shelter QSST (See pages 127-135 of the Paper)

- The technique:
  - A deceased spouse ("Lucy Leverage") bequeaths her entire estate ($45,000,000) under a formula marital deduction plan. An amount equal to her remaining unified credit, assumed to be $5,340,000, passes to a credit shelter trust that pays all of its income to her husband. The remainder of her estate passes to her husband ("Lenny Leverage:"). Lenny owns $5,000,000 assets in his name.
  - Consider the following example, in which by investing in a Subchapter S corporation, making a QSST election with the credit shelter trust, and the beneficiary of the QSST selling non-voting stock in a Subchapter S corporation, a leveraged sale to a credit shelter trust that is a grantor trust to the surviving spouse is simulated:



– Lenny could sell for a note that pays an AFR rate, his non-voting stock to the credit shelter trust that is also a QSST. Assuming a 35% valuation discount, those transactions are illustrated below:



– Under IRC Sec. 1361(d)(1)(B), the transferor (as a beneficiary of the QSST) will be treated as the owner of the Subchapter S stock held in trust under IRC Sec. 678(a). Under IRC Sec. 678(a) the trust is ignored for income tax purposes, at least with respect to any Subchapter S stock that is held in the trust.

– The note should be secured by both the stock and distributions from the stock. However, if the note is so secured any principal of the note that is reduced from the income of the trust must be reimbursed to the income beneficiary of the trust.

- Advantages of the technique:
  - May provide better defenses to the bona fide sale considerations of IRC Secs. 2036 and 2038 than certain other IRC Section 678 beneficiary grantor trust techniques in which the trust is only funded with $5,000.
  - Circumvents federal capital gains tax treatment on a QSST beneficiary's sale of his Subchapter S stock to the QSST.
  - There is not any concern about the effect of any lapse of withdrawal rights.
  - It has the advantage of allowing the seller to be a beneficiary of the trust and have a power of appointment over the trust.
  - If the current beneficiary of the QSST materially participates in the business of the Subchapter S corporation or is in a lower marginal bracket, significant health care taxes may be saved with the technique.
  - It has the potential of mitigating gift tax surprises.
  - Appreciation will be out of the seller's estate.
  - The beneficiary of the QSST will have access to the cash flow distributed to the trust.
  - The trust is much more flexible than a simple income only trust and may be administered to simulate a complex trust without the income tax and health care tax disadvantages of a complex trust.
  - Because of the safe harbor provided by Revenue Ruling 81-15, IRC Sec. 2036(a)(2) may not be a concern for transfer planning with Subchapter S stock.
  - This technique does not have to be entered into until after the death of the first spouse to die.
  - A full step-up on the appreciated assets that accrued from the first spouse to die's estate will be achieved.

– A significantly greater amount will pass to the remainder beneficiaries of the credit shelter trust under this technique, in comparison to no further planning, as the table below demonstrate:

– As the above table demonstrates, under the assumed facts of this example, the technique simulates the same results a $36,032,212 credit shelter trust would have produced, which is almost nine times the size of the credit shelter trust that could be created. Once again, the synergistic power of using discounted sales to grantor trusts is illustrated.

	Leverage Children and Grandchildren (1)	Consumption Direct Cost (2)	Consumption Investment Opportunity Cost (3)	IRS Income Tax (4)	IRS Income tax Investment Opportunity Costs (5)	IRS Estate Tax (at 40%) (6)	Total (7)
10-Year Future Values							
No Further Planning other than funding a $5,340,000 credit shelter trust: Lenny bequeaths estate to family (assumes $6.7mm inflation adjusted estate tax exemption available at death)	$56,160,243	$6,722,029	$2,606,804	$6,416,457	$2,225,962	$27,965,466	$102,096,962
Simulated $36,032,212 Credit Shelter Trust: Lenny Leverage's deceased spouse created a credit shelter trust for Lenny and family and bequeaths the rest of her estate to Lenny (assumes $6.7mm inflation adjusted estate tax exemption available at death)	$72,342,706	$6,722,029	$2,606,804	$7,820,059	$2,225,962	$10,379,401	$102,096,962
Hypothetical Technique: Lenny bequeaths estate to family (assumes $6.7mm inflation adjusted estate tax exemption available at death)	$72,342,706	$6,722,029	$2,606,804	$8,734,934	$2,225,962	$9,464,526	$102,096,962

– As the above table demonstrates, under the assumed facts of this example, the technique simulates the same results a $36,032,212 credit shelter trust would have produced, which is almost seven times the size of the credit shelter trust that could be created. Once again, the synergistic power of using discounted sales to grantor trusts is illustrated.

- Other advantages of the technique:
  - This technique has the same advantages as the third party created QSST discussed in Section VII E of this paper.
  - This technique does not have to be entered into until after the death of the first spouse to die.
  - A full step-up on the appreciated assets that accrued from the first spouse to die's estate will be achieved.
  - May circumvent federal capital gains tax treatment on a QSST beneficiary's sale of his Subchapter S stock to the QSST on any gain, if any, on the appreciation of the sold Subchapter S stock after the death of the first spouse.
  - There is not any concern about the effect of any lapse of withdrawal rights.
  - It has the advantage of allowing the seller to be a beneficiary of the trust and have a power of appointment over the trust.
  - If the current beneficiary of the QSST materially participates in the business of the Subchapter S corporation, or is in a lower marginal bracket, significant health care taxes may be saved with the technique.
  - It has the potential of mitigating gift tax surprises.
  - It has all of the other advantages noted in a sale to a spousal grantor trust.
  - The trust is much more flexible than a simple income only trust and may be administered to simulate a complex trust without the income tax and health care tax disadvantages of a complex trust.
  - Because of the safe harbor provided by Revenue Ruling 81-15, IRC Sec. 2036(a)(2) may not be a concern for transfer planning with Subchapter S stock.

- Considerations of the technique:
  - There may need to be substantive equity in the trust (is 10% equity enough?) before the sale is made.
  - The federal income tax considerations with utilizing a Subchapter S corporation.
  - Federal income tax considerations with respect to the interest on the seller/beneficiary's note.
  - Any assets of the trust that are not Subchapter S stock will be taxed trust under normal Subchapter J rules.
  - State income tax considerations.
  - The Step Transaction Doctrine needs to be considered.
  - The transferor is the only beneficiary of the trust.
  - Like all leverage techniques, if the underlying assets stay flat or decline there is not any advantage to the technique and to the extent a gift tax exemption is used, the technique operates at a disadvantage.
  - Additional estate tax considerations.
    - It is important that any sale by a beneficiary of a trust be for "fair and adequate consideration" and also be considered a "bona fide sale". If the sale is not for "adequate and full consideration," or if the sale is not considered to be a "bona fide sale," the value of the assets of the trust at the time of the beneficiary's death will be brought back into the beneficiary's estate under IRC Secs. 2036 and/or 2038 because the seller obviously has a retained interest in the trust (unlike a conventional sale to a grantor trust in which the seller does not have a retained interest in the trust). (In determining the estate tax under IRC Secs. 2036 and 2038, there will be a consideration offset allowed under IRC Sec. 2043 for the value of the note at the time of the sale.) The beneficiary—seller should consider a defined value assignment and the filing of a gift tax return which discloses the sale.

The Conversion of a Credit Shelter Trust to a Qualified Subchapter S Trust ("QSST"), the Investment by the Credit Shelter QSST in a Subchapter S Corporation and the Sale of Subchapter S Stock owned by the Surviving Spouse to the Credit Shelter QSST (Continued)

- A trust must meet the requirements of a QSST, which may mean converting an existing trust's provisions.
- Income distributed by the Subchapter S must be distributed to the beneficiary of the QSST and cannot be accumulated.
- If the current beneficiary of the QSST has multiple children, and if the Subchapter S corporation is not conducting a trade or business, the Subchapter S corporation cannot be easily divided if the children wish to go their separate ways after the death of the current beneficiary.
- The amount of principal paid on the note from distributions from the income interest of the QSST needs to be reimbursed from the principal of the trust to the income beneficiary, or to the income beneficiary's estate.

- Consider the following example:

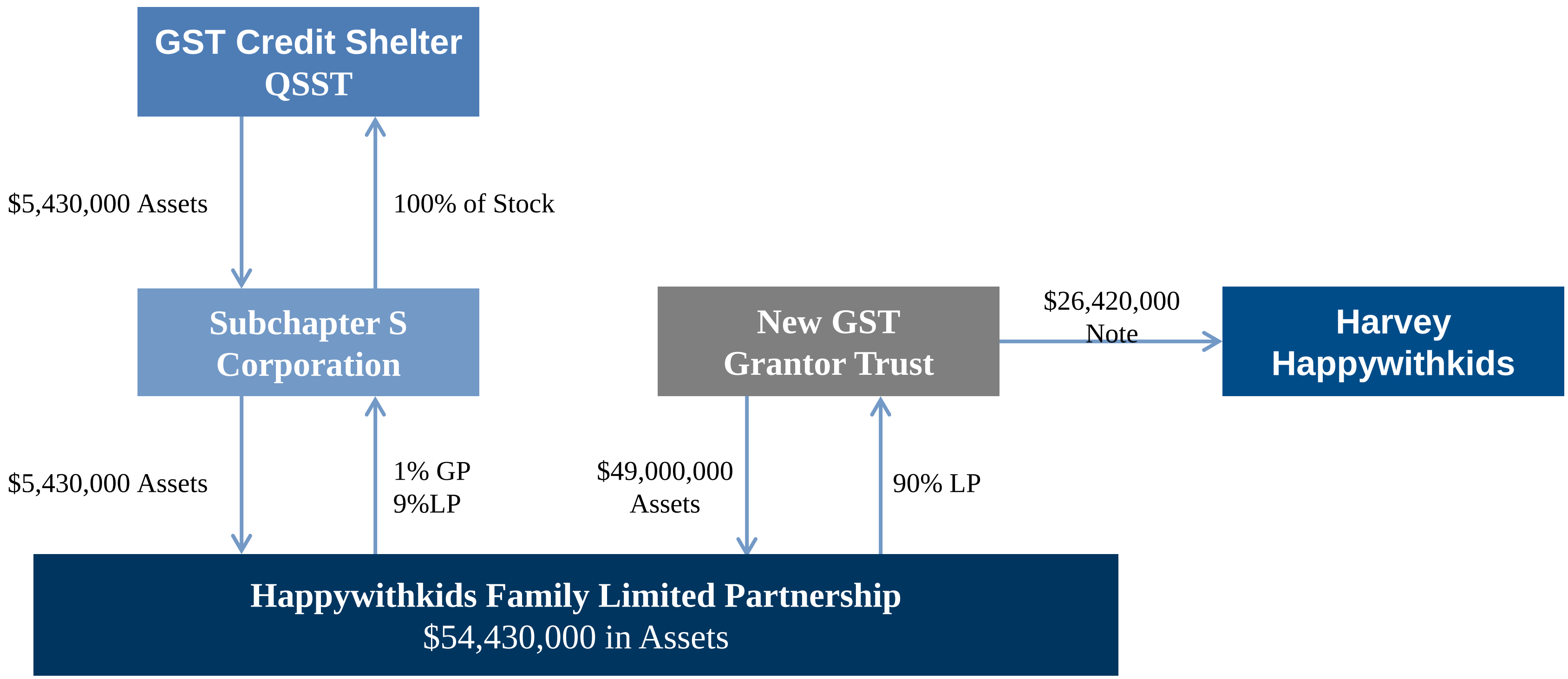
Harvey Happywithkids and a Credit Shelter Trust
Create a FLP, the Credit Shelter Trust Contributes its Partnership Interest
to a Subchapter S Corporation, the Credit Shelter Trust Becomes a QSST,
<u>and Harvey Gifts and Sells His Partnership Interest to a New Grantor Trust</u>

Helen Happywithkids dies with a substantial $54,430,000 estate that is largely liquid, but has a low basis. Her husband, Harvey, has $1,000,000 in liquid assets. Helen's will bequeaths $5,430,000 to a GST credit shelter trust and the rest of her estate to Harvey. Harvey is the trustee of the credit shelter trust that distributes all of its income to Harvey and has a special power of appointment.

Harvey asks his attorney, Susie Cue, if she has any ideas on how to eliminate the future estate tax after his death. Harvey is very happy with his descendants and the ability to change the objects of his bounty is not important to him. Harvey asks Susie to assume he will live 10 years. Harvey also tells Susie that the liquid assets will annually earn a 7.4% pre-tax return during that 10-year period with 0.6% of the return being taxed at ordinary rates, 2.4% of the return being tax-free and 4.4% of the return being taxed at long-term capital gains rates with a 30% turnover. Harvey tells Susie that he will need around $1,200,000 a year (inflation adjusted) for his consumption needs. Susie assumes a 35% valuation discount is appropriate in valuing the limited partnership interest.

The Synergies of a Credit Shelter Trust Becoming a QSST, a Surviving Spouse Creating a FLP and a Surviving Spouse Giving and Selling Interests in the FLP to a New Grantor Trust (Continued)

- Susie Cue does have a plan:
  - Susie suggests that the credit shelter trust and Harvey contribute their collective assets to a FLP. Harvey will then gift (using his unified credit) and sell his limited partnership interests to a grantor trust that is also a GST trust pursuant to a defined value allocation assignment. The credit shelter trust will contribute its partnership interest to a Subchapter S corporation and the credit shelter trust will become a QSST. The technique is illustrated below:



- Advantages of the technique:
  - Significant estate taxes can be saved with this technique. Under the assumptions of this example over $24,000,000 in estate taxes can be saved with this technique in comparison to the first spouse to die creating a conventional credit shelter trust with no further planning. This technique, under the assumptions of this example, simulates the same result that would have been obtained if Harriett Happywithkids had a $45,000,000 unified credit that she used to create a credit shelter trust. See the table below:

	Children (1)	Trust for Children & Grandchildren (2)	Children & Grandchildren (3)	Consumption (4)	Consumption Investment Opportunity Cost (5)	IRS Income Tax (6)	IRS Income Tax Investment Opportunity Costs (7)	IRS Estate Tax (at 40.0%) (8)	Total (9)
10-Year Future Values									
No Further Planning	$36,235,140	$8,878,625	$6,790,000	$13,444,058	$5,213,608	$13,482,783	$4,983,718	$24,156,760	$113,184,692
$45,172,758 Simulated Credit Shelter Trust	$0	$73,862,244	$153,997	$13,444,058	$5,213,608	$15,527,067	$4,983,718	$0	$113,184,692
Hypothetical Technique	$19,926	$11,087,730	$62,754,589	$13,444,058	$5,213,608	$15,667,780	$4,983,718	$13,284	$113,184,692
Present Values (discounted at 2.5%)									
No Further Planning	$28,306,833	$6,935,968	$5,304,337	$10,502,477	$4,072,862	$10,532,728	$3,893,272	$18,871,222	$88,419,700
$45,172,758 Simulated Credit Shelter Trust	$0	$57,701,067	$120,302	$10,502,477	$4,072,862	$12,129,720	$3,893,272	$0	$88,419,700
Hypothetical Technique	$15,566	$8,661,717	$49,023,784	$10,502,477	$4,072,862	$12,239,645	$3,893,272	$10,377	$88,419,700

- Under this example, Harvey Happywithkids has a considerable safety net of being a beneficiary of the GST credit shelter trust QSST, if he ever needs those resources.
- Under this example, Harvey Happywithkids does not have to be paid back an equitable adjustment equal to the principal of the note.
- It has all of the advantages of converting a complex trust to a QSST.
- It has all of the advantages of a sale to a grantor trust.
- Since under this technique, there is not a sale to a trust in which the seller is a beneficiary, there is much less IRC Secs. 2036 and 2038 pressure on the technique.

- Considerations of the technique:
  - The surviving spouse only has flexibility to change the beneficiaries of the GST credit shelter QSST (assuming the surviving spouse has a power of appointment over the trust) and any assets the surviving spouse owns (which may be significantly depleted by the time of his death).
  - This technique has the same considerations of converting a complex trust to a QSST. Some of the income tax considerations of having a Subchapter S corporation could be mitigated if the Subchapter S corporation owned a preferred interest in the partnership.
  - This technique has the same considerations as sales of limited partnership interests to a grantor trust.

Using Partnership Structures to Achieve Diversification While Delaying the Tax on That Diversification (See Pages 138-149 of the Paper)

- Certain key partnership income tax and basis accounting rules:
  - Generally, the contribution of low basis property to a partnership does not trigger gain, but it could.
    - The primary purpose of IRC Sec. 721 is to allow the formation of a partnership without the recognition of a taxable gain, thus encouraging the growth of new businesses.
    - Subchapter K of the Internal Revenue Code indicates, that, in general, no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.
    - The Treasury Regulations further detail the definition of an investment company to include entities where the formation results, directly or indirectly, in diversification of the transferors' interests, and more than 80 percent of its value in assets (excluding cash and nonconvertible debt obligations from consideration) that are held for investment and are readily marketable stocks or securities, or interests in regulated investment companies or real estate investment trusts.
  - Certain partnership tax accounting rules must be navigated to make sure a partnership is not being used as a vehicle for a disguised sale.
    - In an effort to preclude such disguised sale planning opportunities IRC Secs. 704(c), 737 and 707 were included in subchapter K.
    - IRC Secs. 704(c) and 737 prevent the distribution of an appreciated asset to one partner that was originally contributed by another partner during a seven year period. Another way to view the section is that if a partnership exists for more than seven years then the IRS probably will view the partnership as having a business purpose other than the disguised sale of an asset.

Using Partnership Structures to Achieve Diversification While Delaying the Tax on That Diversification (Continued)

  - Besides the seven year rule of IRC Secs. 704(c) and 737, there is the so called two year rule under the regulations of IRC Sec. 707. If a partner transfers property to a partnership and receives money or other consideration, the transfers are presumed to be a sale. Due to the specificity of the two-year rule, a properly structured partnership could avoid the application of a disguised sale if the assets remain within the partnership for an appropriate length of time.

– Certain partnership income tax accounting rules exist to determine if a tax is imposed on a partner who liquidates his or her partnership interest.

  - At some point in the future, the partners may wish to realize the economic benefits of their investment through the distribution of partnership assets or the liquidation of their interest in the partnership. IRC Secs. 731 and 732 address the taxation of such transactions.
  - Generally, gain will not be recognized to a partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution.
  - Because of the ease of liquidity related to marketable securities, the IRS has increasingly viewed such instruments as cash. In effect, marketable securities, if deemed to be money, can cause taxable gain, if the fair market value of the distributed securities exceeds the withdrawing partner’s tax basis in the partnership.
  - The receipt of marketable securities will not be considered cash, if the partnership is an investment partnership.
  - The general rule for qualifying as an investment partnership is the ownership of marketable investments and never engaging in an actual trade or business other than investing.

– Certain partnership tax accounting rules exist to determine a partner's basis in non-cash assets he or she receives.

  • The basis in the asset distributions or distributions in liquidation of a partner's interest is subject to the tax rules outlined in IRC Sec. 732.

  • Under IRC Sec. 732, if a partner receives an asset distribution from a partnership, the partner receives the asset subject to a carryover of the partnership's cost basis, and if the partner receives an asset distribution in liquidation of his interest, then the partner will attach his partnership interest cost basis to the assets received in liquidation. The regulations highlight an example illustrating the result.

– Existing anti-abuse tax accounting rules.

  • Regardless of the form of a transaction, the IRS added regulations under IRC Sec. 701 (Anti Abuse Rules) that address the substance of a partnership and could cause a tax result derived from a partnership transaction to be negated, if the IRS views the structure as a mechanism to reduce the overall tax burden of the participating partners.

– If there is a change in the outside basis of a partnership interest, because of a sale or a death of a partner, that could effect the inside basis of the partnership assets.

Use of Closely Held Family Partnerships

- The technique:
  - Consider the following example:

Diversification Planning With a Closely Held Family Partnership While
Preserving the Transfer Tax Advantage of a Closely Held Family Partnership

In 2005, Sam Singlestock contributed $850,000 worth of marketable stock (Marketable Stock, Inc.), with a cost basis of $0 to Growing Interests, Ltd. for an 85% limited partnership interest. His daughter, Betsy Bossdaughter, contributed $75,000 worth of Marketable Stock, Inc., with a cost basis of $0 and his son, Sonny Singlestock, contributed $75,000 worth of Marketable Stock, Inc., with a cost basis of $0 to the partnership and each received a .5% general partnership interest and a 7% limited partnership interest. The initial sharing ratios of the partners are Sam 85%, Betsy 7.5%, and Sonny 7.5%. In 2011, using a financial engineering technique, the Marketable Stock, Inc. stock owned by the partnership is hedged, and the partnership is able to obtain $595,000 in cash, in the form of a cash loan from Investment Bank, Inc. Betsy and Sonny also agree to personally guarantee the note. The partnership invests the loan proceeds in a nonmarketable $595,000 real estate investment.

A few years later (2013), for family reasons and because the partners have significantly different views about the future investment philosophy of the partnership, Sam Singlestock wishes to withdraw from the partnership. There has been no growth in the partnership assets. A professional, independent appraiser determines that because of marketability and minority control discounts, Sam's limited partnership interest is worth $595,000. The partnership distributes the real estate investment worth ($595,000) in liquidation of his limited partnership interest. The partnership makes an IRC Sec. 754 election.

One year later (2014) the partnership sells enough of Marketable Stock to liquidate the loan with the proceeds of the $595,000 sale. After the 754 election the partnership's basis in the $1,000,000 Marketable Stock, Inc. is equal to $595,000. Thus, if all of the $1,000,000 in marketable stock is then sold to retire the $595,000 debt and diversify into other investments there will be $101,250 in capital gains taxes (assuming a 25% rate). After the sale, the partnership and the remaining owners of the partnership, Betsy and Sonny, are left with $303,750.

Use of Closely Held Family Partnerships (Continued)

- Advantages of the technique:
  - The income tax benefit of the withdrawal: the illustrated “family structure” opportunity can provide the family an ability to manage the position through an appropriate controlled legal entity, while offering the potential for a long-term exit strategy that can be accomplished on a deferred tax basis.
    - The real estate investment will retain its zero basis without the imposition of a capital gains tax until it is sold, at which time Sam will recognize capital gains taxes.
    - If Sam chooses to operate the real estate until his death, then IRC Sec. 1014 would apply upon his death and the real estate will receive a step-up in basis to its then fair market value.
  - In comparison to the exchange fund, the illustrated mixing bowl technique provides the retention of upside in the original appreciated position, albeit without diversification until the stock is sold, and without the lack of control and the outside management fees associated with exchange funds.
  - Transfer tax benefit of a withdrawal from a long-term partnership structure.
  - The total potential transfer tax and capital gains tax savings may be significant.
    - The net result of these transactions is that Betsy and Sonny’s collective net worth (assuming a 25% capital gains rate) after capital gains taxes and/or contingent capital gains taxes will increase by 170%, as calculated below:

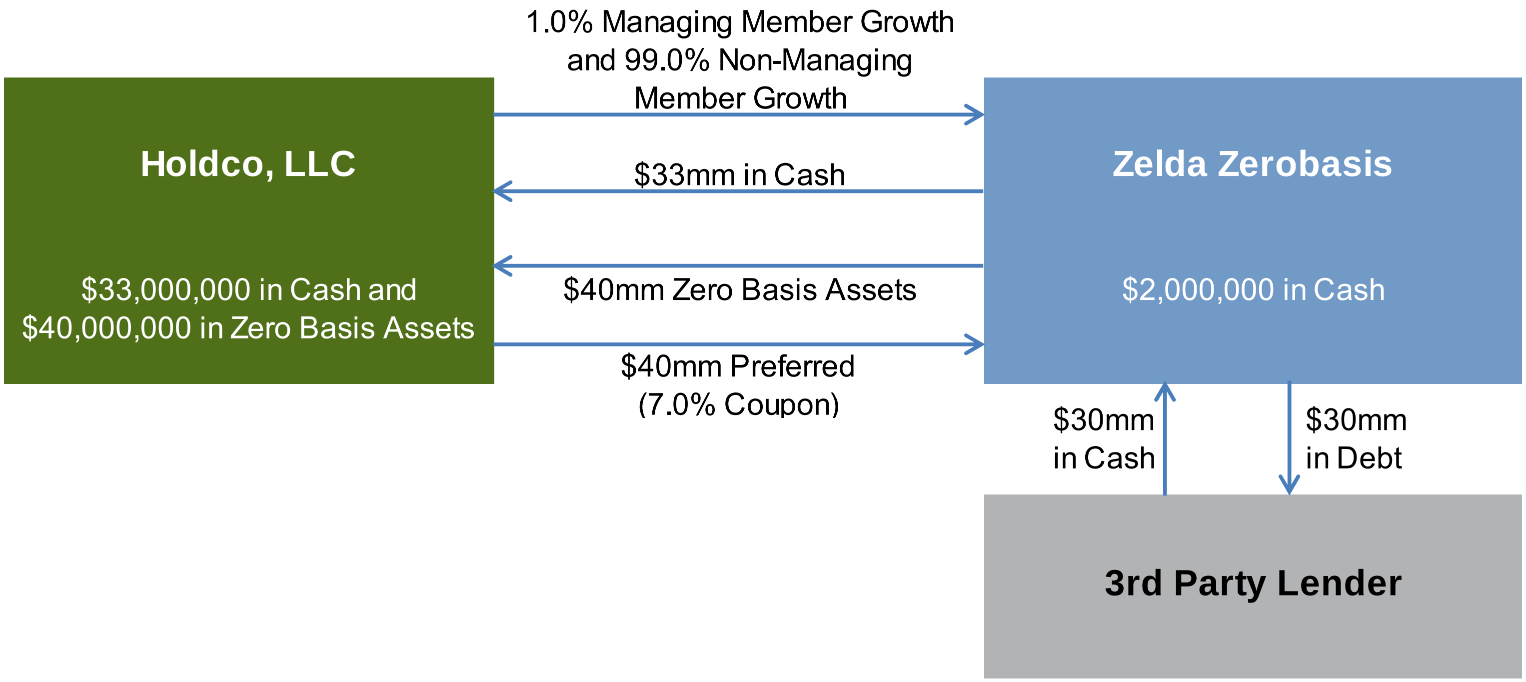
      (($1,000,000-$595,000-$101,250)-($150,000-$37,500)), or ($303,750-$112,500), or $191,250, or a 170% improvement ($191,250÷$112,500) after taxes.

Use of Closely Held Family Partnerships (Continued)

- Considerations of the technique:
  - Are there any tax consequences on formation of the partnership?
  - Are there any tax consequences when Sam redeems his interest?
    - If the partnership redeems Sam's interest for cash, Sam will be subject to capital gain recognition under IRC Sec. 731(a).
    - If Sam's interest is redeemed with the non-marketable real estate, applying the rules of IRC Secs. 732 and 752, Sam would have a "0" basis in the non-marketable real estate, Sam would pay no immediate capital gains tax and the partnership, because of the application of IRC Sec. 734(b), would have a $595,000 basis in its remaining assets (the hedged Marketable Stock, Inc. stock).
  - The partnership portfolio is still subject to the $595,000 note payable that must be repaid at some time in the future. The partnership could make a Section 754 election after the redemption of Sam's interest, and because of IRC Sec. 734(b) the remaining marketable stock would receive a proportionate basis adjustment.
  - There is exposure that Congress could change the law, by the time a partner withdraws (e.g., IRC Secs. 732 or 752 of the Code could be amended) and that the favorable liquidation rules would no longer be available. There is also exposure in that the IRS could change its regulations.
  - Like all leverage techniques, if the underlying assets stay flat or decline there is not any advantage to the technique and to the extent a gift tax exemption is used, the technique operates at a disadvantage.

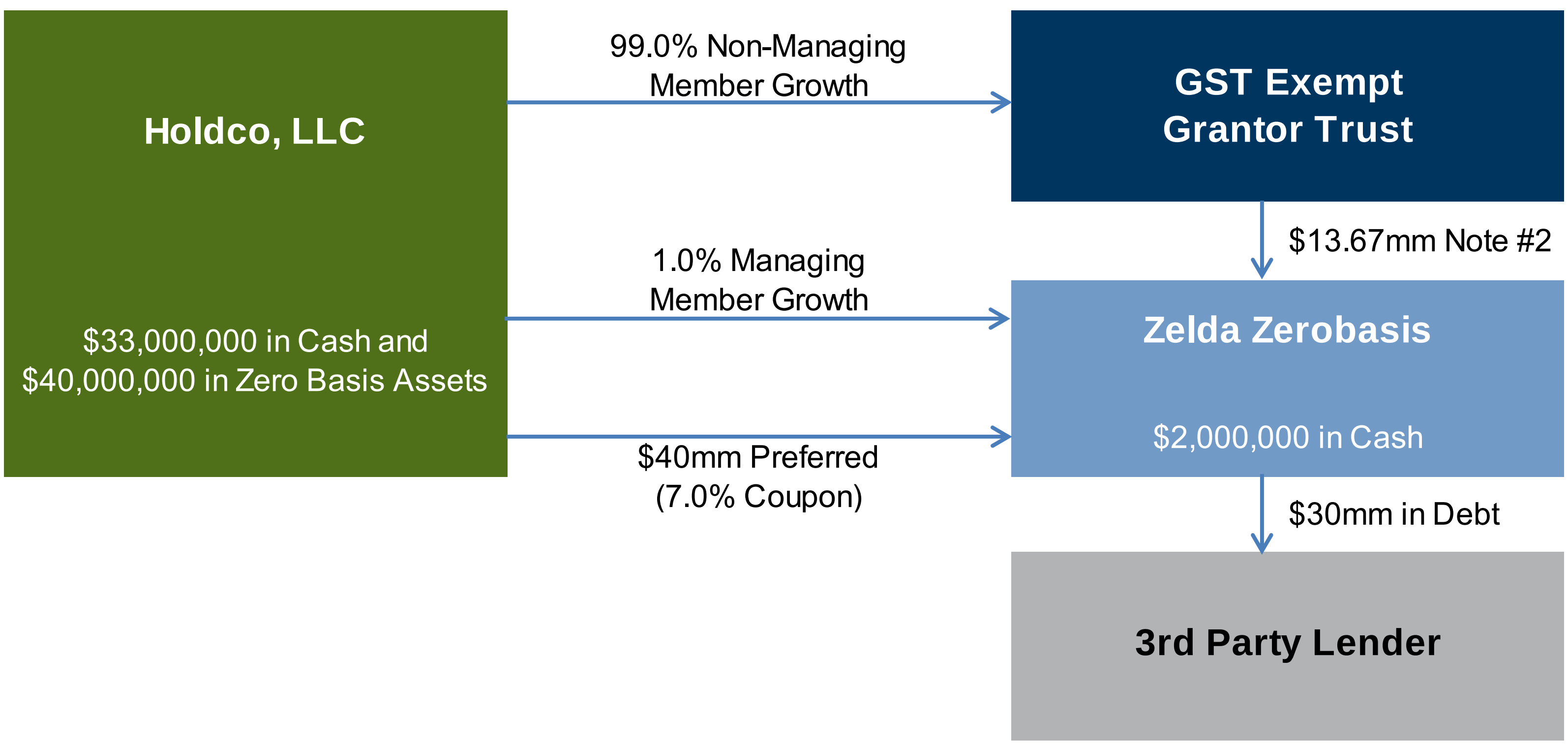
The Use of a Retained Preferred Partnership Interest and Third Party Leverage to Generate Effective Estate Planning and Basis Planning

- The technique:
  - A technique for a taxpayer who owns assets that are highly appreciated (e.g., depreciated real estate), wishes to engage in estate planning, and would like to preserve the possibility of a step-up in basis at death, is to consider creating a single member limited liability company with preferred and growth member interests. The taxpayer could contribute the zero basis asset to the single member limited liability company in exchange for a preferred interest. The taxpayer could contribute cash that the taxpayer owns, or borrows, to the single member limited liability company in exchange for the "growth" interests. The taxpayer could then engage in advanced gifting techniques to remove the growth interests from her estate. Consider the following illustration:



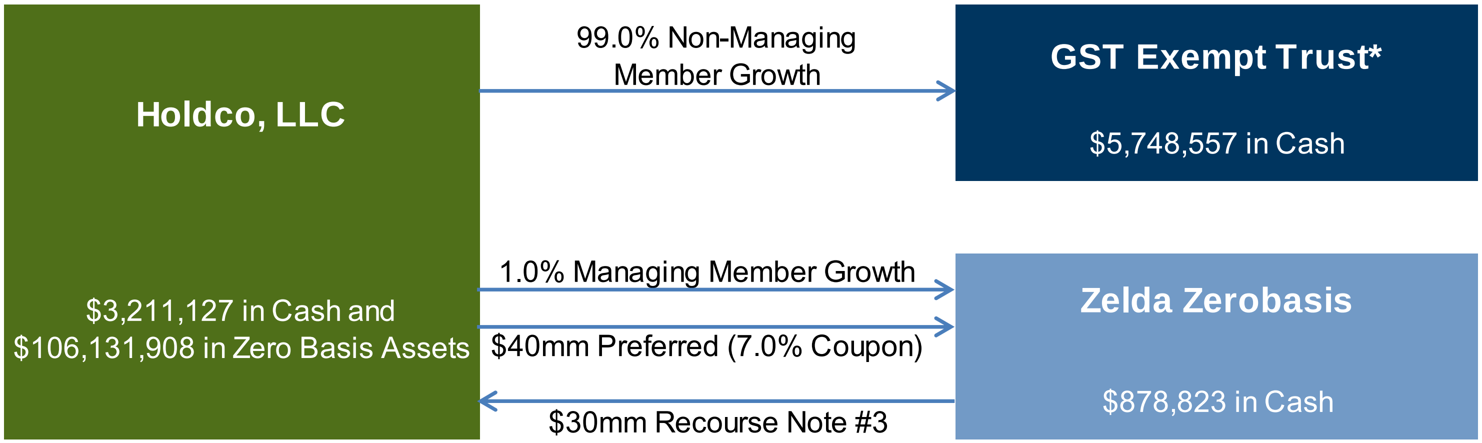
The Use of a Retained Preferred Partnership Interest and Third Party Leverage to Generate Effective Estate Planning and Basis Planning (Continued)

– Zelda could then gift (using her $5,340,000 gift tax exemption) the non-managing member growth interests and sell the remaining non-managing member growth interests to a GST exempt grantor trust in separate independent transactions. Assuming a 40% valuation discount is appropriate because of the liquidation preference and income preference of the retained preferred interest, these transactions could be represented by the following diagram:



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

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



*Grantor Trust status removed in year 18.

– At Zelda's death the single member LLC could terminate and her estate would pay the note owed to the single member LLC. Her estate would receive a step-up in basis for the preferred interest in Holdco.

– Holdco, LLC could sell the zero basis assets after an IRC Section 754 election is made.

*Grantor Trust status removed in year 18.

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

– At Zelda's death the single member LLC could terminate and her estate would pay the note owed to the single member LLC. Her estate would receive a step-up in basis for the preferred interest in Holdco. Holdco, LLC could sell the zero basis assets after an IRC Section 754 election is made. The balance in Zelda's estate and the GST exempt trust, after capitals gains taxes, but before estate taxes, would be as follows:

Zelda Zerobasis	GST Exempt Trust*
$10,878,823 in Cash	$105,091,592 in Cash

*Grantor Trust status removed in year 18.

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

- Advantages of the technique:
  - The net after tax savings to Zelda are projected to be substantial. See the table below:

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

  - Unlike a traditional gift planning technique, that eliminates estate taxes by removing an asset from the taxpayer's estate, there will be a significant step-up in basis on the death Zelda.
  - This technique has the same advantages as a sale to a grantor trust.
  - This technique has the same advantages as using borrowing with a grantor trust to achieve basis adjustment in low basis assets.

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

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

Enhancing the Basis of an Asset Through Marital Planning
(See Pages 159-163 of the Paper)

- Creating community property interests:
  - If property is community property, the surviving spouse’s half interest in the community property will have a basis adjustment equal to the fair market value as reported in the deceased spouse’s estate tax return.
  - There are currently nine community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Generally, when a couple moves into one of these states, their separate property may be converted into community property by agreement.
- Advantages of the technique:
  - There is a clear statutory authority that if property is community property, the basis of the surviving spouse’s interest in the community property is adjusted on the deceased spouse’s death.
  - If a couple moves to Texas or Nevada, there are also other advantages. Neither state has a state income tax nor a state inheritance tax.
- Considerations of the technique:
  - The couple needs to establish that they are domiciled in the community property state.
  - Community property states could create creditor considerations, and marital property rights on the divorce of the spouses, that otherwise would not exist.
  - Arizona, California, Idaho, Louisiana, New Mexico, Washington and Wisconsin either have a state income tax or a state inheritance tax.
  - A couple may later move from a community property state to a separate property state and the community property status of their property may be lost.

Enhancing the Basis of an Asset Through Marital Planning (Continued)

- The technique of a non-resident couple electing to treat their property as community property under the state statutes of Alaska and Tennessee:
  - Non-residents could name a trustee who resides in Alaska or Tennessee as trustee and have the trust subject to either state's trust and property laws. Both states allow non-residents to convert their property to community property, if the trust document expresses that intent.
- Advantages of the technique:
  - If the technique is successful, it has the potential basis advantages of community property.
  - Both Alaska and Tennessee have favorable state tax laws.
- Considerations of the technique:
  - There is not any reported tax case confirming the technique.
  - Requires the cost of creating the trust and having a trustee in that state.
  - Under the conflict law rules of the taxpayer's domicile, it is unclear whether the non-residents' creation of a trust in Alaska or Tennessee, which changes the martial property rights of the non-residents, will be recognized by the non-residents' sale of domicile.

Enhancing the Basis of an Asset Through Marital Planning (Continued)

- Using joint revocable trusts to get a basis adjustment on the low basis assets jointly owned by a couple on first spouse to die's death:
  - A married couple jointly creates a revocable trust and transfers assets to the trust. Either spouse, during their joint lifetimes may revoke the trust with 50% of the assets in the trust passing to each spouse.
  - On the death of either spouse, the trust becomes irrevocable and, the decedent spouse will have a general power of appointment over the entire trust, which causes a basis adjustment under IRC Sec. 1014.
    - Under the trust document, or by exercise of the general power of appointment, it is assumed an amount no greater than the deceased spouse's exemption amount, but no greater than the deceased spouse's contribution to the JEST, will first fund a bypass trust with the surviving spouse being a lifetime beneficiary.
    - If the decedent spouse's 50% share is less than the exemption amount, that remaining exemption amount may perhaps be funded by the surviving spouse's share of the trust in a bypass trust in which the surviving spouse is not a beneficiary.
    - If the deceased spouse's 50% share exceeds the estate exemption amount, that excess could pass to a QTIP for the benefit of the surviving spouse.
- Advantages of the technique.
  - If IRC Sec. 1014(e) does not apply, all or part of the marital property subject to the JEST will get a basis adjustment upon the death of the first to die.
  - A simple estate freeze could occur during the surviving spouse's lifetime to reduce the estate taxes on the surviving spouse's death.
    - The trustee of the QTIP trust could sell or loan its assets to the trustee of the by-pass trust after the death of the first spouse to die.

Enhancing the Basis of an Asset Through Marital Planning (Continued)

- Considerations of the technique.
  - This technique may lead to undesirable results in second marriage situations when there is a desire to protect a spouse's children from a different marriage.
  - IRC Sec. 1014(e) may prevent some or all of the basis adjustment that exceeds what would have happened if the JEST had not been created.
    - The IRS takes the position that an incomplete gift is made by the surviving spouse to the deceased spouse (because of the surviving spouse's revocation power) that does not become complete until the moment of death (which, of course, is within one year of the deceased spouse's death) and IRC Sec. 1014(e) applies to deny a step-up of that part of the JEST that accrues from the surviving spouse's contribution to the JEST
    - The advocates of this technique suggest that the IRC Sec. 1014(e) portion could be segregated and put into the bypass trust in which the surviving spouse is not a beneficiary, which some believe may defeat the reason for the creation of the JEST.
  - The surviving spouse may not be a beneficiary of the by-pass trust in which the surviving spouse is considered the grantor.

Enhancing the Basis of an Asset Through Marital Planning (Continued)

- IRC Sec. 2038 Estate Marital Trust:
  - A spouse (the "funding spouse") will contribute a low basis asset to a trust in which the trust assets will be held for the benefit of the other spouse (the "beneficiary spouse") and will pass to the beneficiary spouse's estate on the beneficiary spouse's death.
  - The funding spouse will retain the right to terminate the trust at any time prior to the beneficiary spouse's death.
  - If the trust is terminated the trust assets must be distributed to the beneficiary spouse.
  - The funding spouse will retain the right in a non-fiduciary capacity to swap assets with the trust.
- Advantages of the technique.
  - If the funding spouse dies first, the trust assets should be taxable in the funding spouse's estate and there should be a basis adjustment of the trust's assets upon that death.
    - The funding spouse's power to terminate the trust will be treated as an IRC Sec. 2038 power.
  - If the beneficiary spouse dies first, the trust assets should be taxable in the beneficiary spouse's estate under IRC Sec. 2031.
  - The funding spouse's transfer should qualify for the gift tax marital deduction under IRC Sec. 2523(b) and should be a completed gift for gift tax purposes (since the beneficiary spouse is the lifetime beneficiary and the remaining trust properties on the beneficiary spouse's death pass to the beneficiary spouse's estate).
  - For smaller estates, unlike the JEST described above, the surviving spouse could be a beneficiary of all trusts that may be created.
  - The remaining high basis assets of the marriage could be left out of the technique.

Enhancing the Basis of an Asset Through Marital Planning (Continued)

- Considerations of the technique.
  - The possibility exists that the beneficiary spouse's may bequeath the properties accruing from the trust in an unanticipated manner (from the funding spouse's perspective).
  - If the beneficiary spouse dies first and if the death occurs within one year of the funding of the trust, IRC Sec. 1014(e) will prevent the desired basis adjustment, if the property is bequeathed back to the funding spouse.

Goldman Sachs

Private Wealth Management

Strategic Wealth Advisory Team - Biographies

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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