Goldman Sachs

Private Wealth Management

The History and Future of Valuation Discount Planning

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Selected History of Valuation Discount Planning From 1978 to 2000
(See Pages 1 – 13 of the Paper)

- The tax context of family entity valuation discount planning in 1978 was that a very high marginal estate tax rate existed and a carryover basis tax regime also existed.
- First big breakthrough: Family attribution is ignored by the courts in the valuation of transferred interests in a family entity.
  - Initial IRS position was that family attribution applied. See the IRS position in Rev. Rul. 81-253, 1981-1 C.B. 187. That ruling also states that the IRS could not follow the Bright case discussed below.
  - Estate of Bright v. United States, 658 F.2d 999 (5th Cir. 1981). In Bright the decedent's undivided community property interest in shares of stock, together with the corresponding undivided community property interest of the decedent's surviving spouse, constituted a control block of 55% of the shares of a corporation. The Fifth Circuit held that, because the community-held shares were subject to a right of partition, the decedent's own interest was equivalent to 27.5% of the outstanding shares and, therefore, should be valued as a minority interest, even though the shares were to be held by the decedent's surviving spouse as trustee of a testamentary trust.
  - Other cases were consistent with Bright: Propstra v. United States, 680 F.2d 1248 (9th Cir. 1982) accords with the result in Bright. In addition, Estate of Andrews v. Commissioner, 79 T.C. 938 (1982), and Estate of Lee v. Commissioner, 69 T.C. 860 (1978), nonacq., 1980-2 C.B. 2, held that corporate shares owned by other family members cannot be attributed to an individual family member for purposes of determining whether the individual family member's shares should be valued as a controlling interest in the corporation.

Selected History of Valuation Discount Planning From 1978 to 2000 (Continued)

– On January 6, 1987 the landmark case of Estate of Daniel J. Harrison v. Commissioner, 52 T.C.M. 1306 (1987), was decided by Judge Shields.

  • The Harrison opinion did not discuss a family attribution issue that the government could have, but did not, raise: that the ability of either son, via his general partnership interest, to liquidate the partnership, which did not terminate with the elder Harrison's death, should be attributed to the decedent under Rev. Rul. 81-253 because held by a family member.

▪ Second big breakthrough: In 1987 Congress considered legislation to impose family attribution for valuation purposes, but rejected that legislation in favor of legislation to limit estate freezes.

▪ Third big breakthrough: In 1990 Congress repealed IRC Sec. 2036(c) and added new valuation rules under Chapter 14 of the Internal Revenue Code.

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

> The value of property transferred by gift or includable in the decedent's gross estate generally is its fair market value at the time of the gift or death. Fair market value is the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. § 20.2031 1(b)). This standard looks to the value of the property to a hypothetical seller and buyer, not the actual parties to the transfer. Accordingly, courts generally have refused to consider familiar relationships among co owners in valuing property. For example, courts allow corporate stock to be discounted to reflect minority ownership even when related persons together own most or all of the underlying stock.
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Selected History of Valuation Discount Planning From 1978 to 2000 (Continued)

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

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

– Thus, Chapter 14 did not enact a general family attribution rule. Of course, that is not to say that it did not have a distinctive impact on certain family transactions. The new rules applied specifically to transfers to, and interests retained by, family members, with the latter term given specific (and sometimes differing) definitions. But those rules targeted specific transfers defined in the statute; they did not enact a general rule of family attribution.

- Fourth big breakthrough: On January 28, 1992 final regulations were published with respect to new Chapter 14.

  – Under Treas. Reg. § 25.2704-2 valuation of a family entity is determined without family attribution unless a liquidation restriction exists that is more onerous than the default state law provisions. If the restriction is more onerous than the state law restriction, then the state law restriction applies.

Selected History of Valuation Discount Planning From 1978 to 2000 (Continued)

- Fifth big breakthrough: Within one year of the issuance of the final regulations under Chapter 14 (January 26, 1993) the IRS issued Revenue Ruling 93-12 (1993-1 C.B. 202) revoking Revenue Ruling 81-253 (1981-1 C.B. 187) and giving an acquiescence to *Estate of Lee v. Commissioner*, 69 T.C. 860 (1978).
  - The key holdings of Revenue Ruling 93-12 are as follows:

    If a donor transfers shares in a corporation to each of the donor's children, the factor of corporate control in the family is not considered in valuing each transferred interest for purposes of IRC Section 2512. For estate and gift tax valuation purposes, the IRS will follow *Bright*, *Propstra*, *Andrews*, and *Lee* in not assuming that all voting power held by family members may be aggregated for purposes of determining whether the transferred shares should be valued as part of a controlling interest. Consequently, a minority discount will not be disallowed solely because a transferred interest, when aggregated with interests held by family members, would be a part of a controlling interest. This would be the case whether the donor held 100% or some lesser percentage of the stock immediately before the gift.

The 2000 Perspective of This Author as to Selected Transfer Tax Fundamentals that Affected the Creation and Transfer of Interests in Family Entities

(See Pages 13 – 42 of the Paper)

- First fundamental: The achilles' heel of the federal estate and gift tax system is that, constitutionally, the tax must be an excise tax on the privilege of transferring property that takes into account all logical transformations of the property on its transfer.

- Second fundamental: If a transfer has occurred, the fact that the transferor and transferee are related to each other is irrelevant to valuation.

- Third fundamental: If a transfer of partnership interest has occurred, the identity of the remaining partners is a relevant fact in measuring the value of that transfer; however, assuming the remaining owners are a cohesive family that relevant fact affects the value of the transfer *negatively*.

- Fourth fundamental: Generally, unless federal law supersedes state law, the property rights inherent in a transferred partnership interest or corporate stock are determined under state law, and, under state law, a transferred partnership interest or a transferred minority position in a corporation does not have any management rights or withdrawal rights and has only limited information rights.

- Fifth fundamental: Federal tax law has a more liberal standard than state law in recognizing a partnership apart from its owners for estate, gift and generation-skipping tax purposes. Under federal tax law (including federal transfer tax law), a partnership is considered to be created and recognized independent of its owners if that group of owners agrees to divide profits and carries on any financial operation.

- IRC Sec. 7701(a)(2) provides that for estate, gift and generation skipping tax purposes, where not otherwise distinctly expressed or manifestly incompatible with the intent of other provisions of the Internal Revenue Code:

  The term partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or joint venture is carried on, and which is not within the meaning of this title, a trust, estate or corporation; and the term partner includes a member in such a syndicate, group, pool, joint venture, or organization. (Emphasis added.)

- Sixth fundamental: In measuring what a hypothetical willing buyer would pay a hypothetical willing seller of a family limited partnership ("FLP") interest, valuation experts generally conclude that significant discounts are appropriate because the transferred assignee interest lacks management control and is not readily marketable.

- Case law has rejected the potential IRS argument that creating a pro rata partnership or corporation (that does not have a senior equity interest) should be subject to gift taxes. (See pages 42 – 56 of the paper).
  - The IRS argued in TAM 9842003 (issued October 19, 1998) that the creation of a pro rata limited partnership constituted a gift to the partner who received a 99% limited partnership interest because the value of the limited partnership interest to a hypothetical willing buyer was worth less than the value of the consideration contributed to the partnership. This argument (so far) has been rejected by the courts.
  - The IRS's gift tax on formation argument was rejected in *Estate of Albert Strangi v. Commissioner*.
  - It is hard to improve upon Justice Phillips' articulation in *Commissioner v. Hogle* of what elements are necessary for a transfer to be subject to gift taxes:

    But the tax cannot be sustained unless there was a transferor, a transferee, and an effective transfer of title or other economic interest or benefit in property having the quality of a gift.

- Stated differently, there are three requirements of a taxable transfer, all of which must exist before any transfer tax can be imposed: (i) the transferor did not enter into a transaction that is bona fide, at arm's length and free from donative intent (i.e., in the language of Justice Phillips, you need a "transferor"); (ii) the transferor entered into a transaction that has the quality of a gift (i.e., in the language of Justice Phillips, you need "an effective transfer of title or other economic interest or benefit in property having the quality of a gift"); and (iii) a transferee's net worth increased as a result of the transaction (i.e., in the language of Justice Phillips, you need a "transferee").

- The creation of a pro rata partnership (which does not have a senior equity interest) does not meet the first requirement of a taxable transaction: the transferor did not enter into a transaction that is bona fide, at arm's length and free from donative intent.

- The creation of a pro rata partnership does not meet the second requirement of a taxable transaction: the transfer must enter into a transaction that has the quality of a gift.

  - The second requirement of a taxable transfer is that the transfer must have the quality of a gift. Even if a decedent or donor (i) receives less than full and adequate consideration in a transaction and (ii) a transferee receives a benefit in that transaction, *there is no gift if the transaction does not have the quality of a gift*.

  - The simplest example of why this element must be present for a transfer to be taxable is theft. If a victim ("the transferor") is burglarized, his or her net worth certainly decreases, and the crook's ("the transferee") net worth surely increases. No taxable gift or transfer results because the transfer does not have the quality of a gift.

– The creation of a pro rata partnership, without a senior equity interest, does not meet the third requirement of a taxable transaction: there is no net worth increase in any of the only possible transferees to the transaction (the other partners) as a result of the transaction (stated differently, a mere change in value of a transferor's net worth does not constitute a transfer unless it shifts or splits to another person).

  - *Thus, unless the creation of a partnership results in an increase of the net worth of a partner in a greater proportion than the other partners, that creation will be treated as a "changing value" transaction instead of a "split value" transaction, and no gift tax will be assessed.*

– The only possible transferees, under the Treasury Regulation, are the other partners. Assuming the other partners' net worth does not increase because of the partnership creation, no gift occurs on partnership creation.

– Some of the best arguments and planning methods to defend against the potential IRS position that the partnership agreement (or articles of incorporation and other related documents), certain terms of the partnership agreement (or articles of incorporation and other related documents), and/or the retained interest in the partnership (or corporation) should be ignored in valuing a gift of a partnership interest because of the operation of Chapter 14 of the Internal Revenue Code. (See pages 58 – 95 of the paper).

  - Legislative Perspective: As noted above, when Congress passed Chapter 14, it was comfortable with the fundamentals discussed above and, in particular, Congress did not wish to affect valuation discounts inherent in the use of pro rata partnerships or corporations that do not have a senior equity interest. Chapter 14 was added by the Omnibus Budget Reconciliation Act of 1990 (sometimes referred to as "the bill" below).

  - It is inconceivable, and would violate all normal rules of interpretation of legislative history, to assume that Congress was targeting "entity discounts," and, in particular, pro rata partnerships, with any part of the bill in light of the above legislative intent as recorded in the Congressional Record.

– Some of the best arguments and planning methods to defend against the potential IRS position that the retained interest in the partnership by the transferor is ignored in valuing a gift of a pro rata partnership interest because of IRC Sec. 2701.

- IRC Sec. 2701 under Chapter 14 contains special rules for gift tax valuation purposes. These rules only apply to entities with junior and senior equity interests. In determining the value of any partnership interests that are transferred, if the partnership has junior and senior equity interests, distribution rights on the retained partnership interest by the transferor will be valued at zero unless they take the form of a “qualified payment,” which is defined under IRC Sec. 2701(a)(3)(A) generally as a distribution that is cumulative and is payable on a periodic basis at a fixed rate. There are three key exceptions to valuing the distribution right at zero: (i) a distribution right does not include the right to receive a guaranteed payment under IRC Sec. 707(c); (ii) the distribution right does not include “liquidation, put, call, or conversion rights”; and (iii) the distribution does not include a right to distributions with respect to any interest which is junior to the rights of the transferred interest.

- Additionally, any “liquidation, put, call, or conversion right” in a retained partnership interest (when there is a transfer of a partnership interest) will be valued at zero for purposes of determining the value of a transferred partnership interest unless either (i) the exercise or non-exercise does not affect the value of a transferred interest or (ii) the liquidation, put, call, or conversion right is to be exercised at a specific time in a specific amount.

- If IRC Sec. 2701 applies, the value of the transferred interest is determined by using a subtraction method described under Treas. Reg. § 25.2701-3. Under many circumstances, the effect of the subtraction method is not only to increase the gift by the distribution rights that are valued at zero, but also to increase the gift by denying discounts that would normally apply to the transferred interest.

- Congress passed IRC Sec. 2701 because it was concerned with certain valuation abuses that would not be possible with its companion repeal of IRC Sec. 2036(c) that could occur through the potential shift of value from one class of equity to another by the reason of the non-exercise of certain retained rights. As a consequence, if the potential for that abuse does not exist, Congress provided for exceptions to the application of IRC Sec. 2701 valuation rules. For instance, if a senior equity interest is transferred and a junior equity interest is retained, Congress did not feel that a potential valuation abuse could occur.

- Some of the best arguments and planning methods to defend against the potential IRS position that the partnership or corporate form of doing business should be ignored in valuing a transfer because of the operation of IRC Sec. 2703.

  - The IRS should not be able to ignore the partnership under IRC Secs. 2033, 2031 and 2703.

    - Whether the IRS can use IRC Sec. 2703 to ignore the partnership involves the construction of the term "property" as it is used in IRC Sec. 2033, Treas. Reg. § 20.2031-1(b), and IRC Sec. 2703. The question of law is summarized as follows:

      Whether the term "property," as it is used in IRC Sec. 2033, Treas. Reg. § 20.2031 1(b), and IRC Sec. 2703, refers to the property owned and transferred by the taxpayer as a result of his death (an interest in a partnership validly created and existing under state law and federal tax law) or, as to what the IRS claimed in this time period, to property that was not owned or transferred by the taxpayer as a result of his death (the property owned by the Partnership)?

    - To determine this issue, a court would need to determine (1) whether the term "property," as it is used in IRC Sec. 2033 and Treas. Reg. § 20.2031-1(b), means Sam Selfmade's Partnership Interest; and (2) whether the term "property," as it is used in IRC Sec. 2703, has the same meaning as the term "property" as it is used in IRC Sec. 2033 and Treas. Reg. § 20.2031-1(b).

– At the time Congress passed Chapter 14, courts had allowed significant discounts in measuring the fair market value of interests transferred in a closely held corporation or partnership between family members because the relationship between transferor and transferee was irrelevant for transfer tax purposes under the hypothetical willing buyer willing seller test. Stated differently, for purposes of determining the fair market value of a transfer of a partnership interest, the identity and intentions of the recipient of that interest are irrelevant. "The standard is an objective test using hypothetical buyers and sellers in the marketplace, and is not a personalized one which envisions a particular buyer and seller." This point has also been emphasized in the updated edition of Valuation Training for Appeals Officers (1994) (issued by the IRS National Office), which stresses the hypothetical willing buyer and seller, and states unequivocally that "it is irrelevant who are the real seller and buyer."

– In light of this clear, consistent expression of intent from Congress, it would violate all normal rules of interpretation of legislative history to assume that Congress was targeting "entity valuation discounts," in particular pro rata partnerships, with any part of the 1990 Act (including IRC Sec. 2703).

– Where federal law has not superseded state law, the nature of the property being transferred that is subject to estate taxation is determined by and must be consistent with state law property rights the "property" being transferred by Sam Selfmade as a result of his death, and thus, referred to in IRC Sec. 2033, Treas. Reg. § 20.2031-1(b), and IRC Sec. 2703, is an interest in the partnership under state law.

- Federal law has not superseded state law; it is clear that under federal law the partnership is a partnership which cannot be ignored apart from its owners.
- The IRS's use of IRC Sec. 2703(a) in the 1990's to disregard the existence of the partnership ignores the clear wording of IRC Sec. 2033, Treas. Reg. § 20.2031-1(b), and IRC Sec. 2703.
- The IRS's use of IRC Sec. 2703(a) in the 1990's to disregard the partnership ignores the assumption in the Treasury Regulations that IRC Sec. 2703(a) only deals with restrictions in agreements that affect a decedent's ability to transfer her interest in the capital structure of the entity.
- The IRS's use of IRC Sec. 2703(a) in the 1990's to disregard the partnership entity ignores legislative intent.
- The reported cases rejected the IRS's position. For example see *Church*, and *Strangi*.

– Some of the best arguments and planning methods to defend against the potential IRS position that certain provisions of the partnership agreement that affect the transfer of a partnership interest (or stock) should be ignored because of the operation of IRC Sec. 2703. (See pages 74 – 79 of the paper).

- For purposes of this discussion, because of the operation of IRC Sec. 2703(a), it is assumed that all requirements restricting a limited partnership withdrawal are ignored because of IRC Sec. 2703(a)(2) (hereinafter the partnership agreement, as so modified, will be referred to as the "Modified Partnership Agreement," and the partnership existing there under will be referred to as the "Modified Partnership"). It should be noted that in many partnerships those provisions should not be ignored because those provisions meet the safe harbor discussed below. Furthermore, even if those provisions are ignored, it will not affect valuation. The remaining provisions of the Modified Partnership Agreement, including its provision requiring a transferee to be treated as an assignee having no withdrawal rights, should not be ignored because of the safe harbor exception under IRC Sec. 2703(b). This exception provides that the Modified Partnership Agreement will not be disregarded for valuation purposes if the following three requirements are met:

  (i) The right or restriction is a bona fide business arrangement ("bona fide arrangement" test);

  (ii) The right or restriction is not a device to transfer property to members of the family for less than full and adequate consideration in money or money's worth ("device" test); and

  (iii) At the time the right or restriction is created, the terms of the right or restriction are comparable to similar arrangements entered into by persons in an arm's length transaction ("comparables" test).

- If it is determined that IRC Sec. 2703(a) requires certain restrictions imposed by the partnership agreement to be disregarded (e.g., restrictions against limited partners withdrawing before the end of the term of the partnership), an examination of the inherent nature of what could be transferred by the taxpayer to a hypothetical transferee (an assignee interest) indicates that the value of the transfer at the taxpayer's death does not change:

  (i) Even if the limited partner withdrawal restrictions imposed by the partnership agreement are inapplicable because of the operation of IRC Sec. 2703(a)(2), it will still be the case that the inherent nature of partnerships under state law prohibits the transfer of a partnership interest to a person as a partner without the consent of the remaining partners. Applying the state law default rules should not change the determination of the value. Chapter 14 of the IRC did not repeal the willing buyer willing seller standard of Treas. Reg. § 20.2031-1(b). The inherent nature of an assignee interest in a limited partnership is that a holder of an assignee interest would not be entitled to become, or to exercise the rights or powers of, a partner without the consent of the other partners. Under state law, an assignee does not have the right to withdraw from a partnership.

  (ii) If the partnership agreement were silent as to the duration of the partnership, such that the 50-year term is eradicated, then there would be no requirement, as well as no assurance to the partners, that the partnership must terminate at any time. Under state law, the Modified Partnership could continue as long as the general partners desire to continue the partnership. Life expectancies could exceed 50 years. Therefore, a willing buyer of an assignee interest in the Modified Partnership must take into account that the partnership could be continued for a term in excess of 50 years.

– Some of the best arguments and planning methods to defend against the potential IRS position that lapsed voting or liquidation rights with respect to a transferred partnership interest affect the transfer value of the partnership interest because of the operation of IRC Sec. 2704(a). (See pages 80 – 87 of the paper).

- One important misunderstood fact about *Harrison* is that no liquidation or voting rights inherent with Mr. Harrison's limited partnership interests lapsed on Mr. Harrison's death. Even after Mr. Harrison's death, Mr. Harrison's general partnership interest continued to exist. If there was any valuation abuse in *Harrison*, it was a buy sell valuation abuse that now is prohibited by IRC Sec. 2703.

- The following summarizes the operation of IRC Sec. 2704(a):

  (i) There is a lapse of a voting right or liquidation right in a corporation or partnership (the Treasury may expand this requirement to include other rights similar to voting rights and liquidation rights).

  (ii) The "individual" (significantly, the statute does not use the word "transferor") holding such a right immediately before the lapse and members of his or her family control the entity both before and after the lapse.

  (iii) If the elements described in paragraphs (a) and (b) above are present, the lapse will be treated as a transfer.

(iv) The measure of that "deemed transfer" is the excess, if any, of (i) the price that a hypothetical willing buyer would pay for all interests in the entity held by the individual before the lapse (determined immediately after the lapse as if the lapsed right was nonlapsing), over (ii) the price that a hypothetical willing buyer would pay for such interests immediately after the lapse (determined as if all such interests were held by one individual).

- What is a lapse?

- A lapse of a voting right or liquidation right is defined as follows:

  A lapse of a [voting right or] liquidation right occurs at the time a presently exercisable right is restricted or eliminated. [Generally], a transfer of an interest that results in the lapse of a liquidation right is not [a lapse of that right] if the rights with respect to the transferred interest are not restricted or eliminated.

- Has the Harrison result even been changed by IRC Sec. 2704(a)? Remember that no rights inherent in Mr. Harrison's general partnership interest lapsed in Harrison: Mr. Harrison's general partnership interest stayed intact; it was purchased by his sons for its fair market value (which was its liquidation value) pursuant to a buy sell agreement. Therefore, there was no measurable lapse, if the measure of the lapse is a comparison of values as if one person owned all of the transferred interests. However, the result of Harrison is probably changed by IRC Sec. 2703 because it would be difficult for the taxpayer to demonstrate comparables to the Harrison buy sell agreement and certain other covenants of that partnership agreement.

- The contractual exception to IRC Sec. 2704(a): there is no lapse of a liquidation right, if under the terms of the partnership agreement, a partner or assignee never has a liquidation right.
- The IRC Sec. 2704(b) exception to IRC Sec. 2704(a): there is no deemed lapse of a liquidation right, if that lapse involves a restriction described in IRC Sec. 2704(b), because such restrictions are to be disregarded after the lapse.
- The measurable lapse exception to IRC Sec. 2704(a).

– Some of the best arguments and planning methods to defend against the potential IRS position that, for purposes of determining the value of the transferred partnership interest, certain provisions of the partnership agreement restricting liquidation should be ignored because of the operation of IRC Sec. 2704(b). (See pages 87 – 95 of the paper).

- Components of IRC Sec. 2704(b).

  − Under IRC Sec. 2704(b), certain "applicable restrictions" must be disregarded in determining the value of a transferred ownership interest if:

    (i) The transfer is made to a member of the transferor's family;

    (ii) The transferor's family controls the entity; and

    (iii) There is an "applicable restriction" which either:

      1) Lapses after the transfer; or

      2) May be removed wholly or partially after the transfer by the transferor or any member of his or her family, individually or jointly.

- If an applicable restriction is disregarded, the transferred interest that formerly was subject to the restriction is valued as if the restriction does not exist and as if the rights of the transferor are determined under state law.

- The Treasury regulations define "applicable restriction" as a restriction which:

  (a) Is a limitation on the ability to liquidate the entity (in whole or in part); and

  (b) "Is more restrictive than the limitations that would apply under the state law generally applicable to the entity in the absence of the restriction."

- Even if an applicable restriction exists, that restriction will not be affected by IRC Sec. 2704(b) if:

  (i) It arises as part of any financing or equity participation entered into by the corporation or partnership with a person who is unrelated, as long as the restriction is commercially reasonable;

  (ii) It is imposed or required to be imposed by any federal or state law; or

  (iii) It is a restriction that is also subject to IRC Sec. 2703.

- When there is a restriction against a limited partnership's continuing beyond either a certain point in time or the accomplishment of a particular undertaking, is that an "applicable restriction" under IRC Sec. 2704(b)? If it is an "applicable restriction" does its absence affect what a hypothetical willing buyer will pay a hypothetical willing seller for the partnership interest?

- Beginning in early 1997, the IRS embarked on a frontal assault on the use of FLPs and other closely held entities for estate planning purposes through the issuance of technical advice memoranda and private letter rulings. In these pronouncements, the National Office of the IRS took the position that an interest in a closely held entity can be valued for transfer tax purposes based on the pro rata net asset value of the interest in the entity transferred, essentially disregarding the existence of the entity. One of the arguments raised by the IRS in each of these pronouncements was that under IRC Sec. 2704(b) , transferred partnership interests can be valued without regard to restrictions on liquidation or withdrawal contained in the partnership agreement which are more restrictive than state law.
- A fixed term is a restriction on not liquidating (i.e., continuing), thus, it cannot be an “applicable restriction”.
- IRC Sec. 2703 applies to provisions limiting the continuance of a partnership agreement and, thus, they cannot be considered an “applicable restriction”.
- Even if a limited partner can withdraw after six months’ notice, it does not mean a hypothetical willing buyer who becomes an assignee can so withdraw.
- Even if provisions limiting the continuance of a limited partnership are “applicable restrictions,” and even if a hypothetical willing buyer believes he can become a limited partner, a limited partner may receive only “fair value” on withdrawal.
- Legislative history contemplates normal discounting.

The 2000 Perspective of This Author as to the Best Arguments and Planning Methods to Defend Against Potential IRS Positions That Would Affect the Transfer Tax Value of a Transferred Interest in a Family Entity (Continued)

- *Kerr v. Commissioner* held IRC Sec. 2704(b) does not apply.
- Drafting to avoid IRC Sec. 2704(b):
  - A FLP should be designed to terminate after a fixed term of years or after a specific undertaking is accomplished. Under the default state law rules, if a partnership agreement is so worded, a limited partner cannot withdraw until the partnership terminates.
  - There should be more than one general partner. If there is only one general partner, however, the general partner's estate should not be given the power to liquidate the partnership or the decedent's interest in the partnership.
  - The transfer of a partnership interest should give the recipient only the rights of an "assignee" under state law.

– Some of the best arguments and planning methods to defend against the potential IRS position that a partnership is a sham that lacks "substance" and should be ignored for transfer tax purposes. (See pages 95 – 98 of the paper).

- In order to facilitate the substance of the partnership formation being recognized, obviously, the partners need to act like partners. Partnership bank accounts should maintained, which only pay partnership expenses and do not pay personal expenses. When partnership distributions are made, they should follow the partnership agreement. For instance, if the partnership is a pro rata partnership, all distributions should be made on a pro rata basis. The partnership agreement should make it clear that all partners are subject to normal partnership fiduciary duties. The partnership agreement should also make it clear that an "ascertainable" standard exists for making distributions based on a standard of reasonableness.

– Some of the best arguments and planning methods to defend against the potential IRS position that a non-operating, investment partnership lacks "substance" and the partnership "form" should be ignored for transfer tax purposes. (See pages 98 – 100 of the paper).
  - It does not matter if a principal purpose for utilizing a partnership structure is to reduce aggregate tax liability as long as there a business, investment, or financial reason exists for using that form of organization. Long established judicial authority holds that the IRS cannot disregard the existence of a partnership if the partnership was formed for a business, financial, or investment reason or in fact did engage in a business, financial, or investment activity.
  - Most of these non-transfer tax advantages apply not only to operating businesses but also to non-operating businesses (i.e., a partnership holding only passive investments). Owners of stocks and bonds, who are unrelated, frequently pool their assets with other owners of stocks and bonds to form partnerships for the same reasons that owners of operating businesses wish to pool their assets.
  - Congress and the Treasury have recognized that it is common and proper for groups to use partnerships to hold only passive securities:
    – The IRS, because of IRC Sec. 7701(a)(2), has always recognized that "passive investment clubs," through which investors engage in passive investment activities, may be conducted in the partnership form of ownership for all federal tax purposes.
    – The IRC liberally defines the term "partnership" in Secs. 761(a), 6231(a), and 7701(a). Under the IRC, Congress clearly provides that unless it is "manifestly incompatible" with Congress' intent, a group or syndicate that carries on business or financial operations and is neither a corporation, nor a trust, nor an estate is a partnership for purposes of Chapters 1, 11, 12, 13, and 14.

– Specific rules that apply only to partnerships holding passive investment assets appear in IRC and the Treasury Regulations:

(1) Under IRC Sec. 721, taxpayers contributing assets to a partnership that is deemed an "investment company" (generally, one made up of over 80% marketable stocks or securities, or interests in regulated investment companies or real estate investment trusts).

(2) IRC Sec. 731(c)(3)(A)(iii) addresses the favorable tax treatment of distributions of marketable securities made to partners of "investment" partnerships (which is defined under IRC Sec. 731(c)(3)(C)(i) as a partnership which has never engaged in a trade or business and substantially all of its assets are passive securities).

(3) Treas. Reg. § 1.704-3(e)(3) contains a special aggregation rule for "securities" partnerships (at least 90% of the partnership's non-cash assets consist of stocks, securities and similar instruments tradable on an established securities market).

(4) Treas. Reg. § 1.761-2(a) expressly confirms that investment partnerships are to be treated as partnerships under subchapter K (unless a contrary election is made).

(5) The final anti-abuse regulation acknowledges that the "business" activity of a partnership may be investing assets: "Subchapter K is intended to permit taxpayers to conduct joint business (including investment) activities through a flexible economic arrangement without incurring an entity-level tax."

The 2000 Perspective of This Author as to the Best Arguments and Planning Methods to Defend Against Potential IRS Positions That Would Affect the Transfer Tax Value of a Transferred Interest in a Family Entity (Continued)

- Some of the best arguments and planning methods to defend against the potential IRS position that, because of the operation of the step transaction doctrine, the creation of the entity should be ignored for valuation purposes. (See pages 100 – 103 of the paper).

  - The step transaction analysis requires the presence of three steps, not two steps: the first step is the creation of the entity, the second step is the transfer of the interest in the entity, and the third step is the termination of the entity so that the transferee obtains the underlying assets. Many taxpayers will be able to argue the third step clearly has not taken place (nor will it take place).

  - If income tax law principles are going to be used in the estate tax arena, then we should follow income tax case law. Income tax cases indicate that if the first step of creating the entity is not subject to IRS scrutiny as a sham or illusory, has independent economic significance, and is undertaken to merely “minimize” and not “avoid” taxes, then the steps cannot be collapsed. This is true, according to case law and IRS rulings, even if the steps are part of an overall plan.

- Some of the best arguments and planning methods to defend against the potential IRS position that a partnership agreement or operating agreement of a FLLC should be ignored because a hypothetical willing buyer of the estate's interest in the partnership would assume the partnership would not continue after the death of the partner (or other withdrawal event). (See pages 103 – 104 of the paper).

  - It is crucial to demonstrate to the IRS that the remaining partners wish to continue the partnership and, in fact, do continue the partnership. The partnership could be structured in a manner that avoids the dissolution of the partnership on the death of an individual general partner by placing his general partnership interest in an entity that does not dissolve on that partner's death.

– Some of the best arguments and planning methods to defend against the potential IRS position that, because a general partner (or majority shareholder) controls partnership (or corporate) distributions, a transferred partnership interest (or stock) by that partner (or majority shareholder) should be taxed in that partner's (or shareholder's) estate or shareholder's because of the operation of IRC Sec. 2036(a)(2). (See pages 107 – 108 and 111 – 119 of the paper).

  - See *U.S. v. Byrum* and the *Cohen* case.
  - Rev. Rul. 1973-143.
  - Rev. Rul. 95-58.
  - Rev. Rul. 81-15.

– Some of the best arguments and planning methods to defend against the potential IRS position that, because of the operation of IRC Sec. 2036(b), a transferred partnership interest in a partnership that owns a closely held corporation (or transferred stock, in a closely held family corporation) should be taxed in the transferor's estate.

  - Congress, in response to Byrum, changed some of the results of Byrum with respect to corporations, but not partnerships. Congress provided that if a transferor transfers stock in a closely held corporation (any corporation which the decedent and his family, after the application of IRC Sec. 318, control 20% of the voting stock) and directly or indirectly retains the right to vote that stock, then that stock will be included in the transferor's estate under IRC Sec. 2036(a).
  - IRC Sec. 2036(b) should not apply because of state law considerations. Only the partnership has the right to vote that stock. Stated differently, IRC Sec. 2036(b) should not apply to the transfer of partnership interests, irrespective of what the partnership may own, assuming state law property rights are to be respected in the interpretation of IRC Sec. 2036(b).
  - It is clear that if a transferor owns voting and nonvoting stock, and transfers the nonvoting stock, that nonvoting stock of the corporation will not be included in his estate under IRC Sec. 2036(b). A similar result should be obtained if a transferor transfers a nonvoting partnership interest, whether that partnership interest is a limited partnership interest or an assignee interest.
  - Finally, if a general partner shares the power with other general partners to determine the management of the partnership, it would appear that IRC Sec. 2036(b) would have no applicability because it is a power he or she has in conjunction with another person, and a power shared with another person is not covered by IRC Sec. 2036(a).

– Avoiding the potential IRS argument that, because of the operation of IRC Sec. 2038, a transferred partnership interest, or transferred stock, should be included in the transferor's estate. (See pages 109 – 110 of the paper).

  - It should be made clear under the partnership agreement, or corporate buy-sell agreement, that it cannot be amended except by the unanimous consent of all partners or shareholders. No partner should have the unilateral right through his ownership interest to amend any partnership provision, or certainly no key partnership provisions. Otherwise, IRC Sec. 2038 could be argued to bring any transferred partnership interest by that partner back into that partner's estate.

What follows are excerpts from this writer's December 27, 2012 paper, "Some of the Best Synergistic Family Limited Partnership or Family Limited Liability Company Estate Planning Ideas We See Out There."

- Tax Rates From 2000 to 2012:
  - In 2000 the basic exclusion amount was $675,000 and the GST exemption was $1,030,000. By 2011 the basic exclusion amount was $5,000,000 and the GST exemption was $5,000,000. In 2000 the maximum estate, gift and generation-skipping transfer tax rate was 55%. By 2011 the maximum estate, gift and generation-skipping transfer tax rate was 35%. The maximum long-term capital gains rates during that period were as follows:

Capital Gains Tax Rates From 2000 to 2012	
Years	**Top Rate**
2000 – 2002	21.2%
2003 – 2005	16.10%
2006 – 2007	15.7%
2008 – 2009	15.4%
2010 – 2012	15%

- The IRC Sec. 2036(a)(1) problem for decedents who retain a significant family limited partnership interest. (See pages 119 – 166 of the paper).
  - If the taxpayer does not transfer the partnership interests during her lifetime (whether by sale or gift), the courts may ignore the valuation discount at death, assuming the following factors are present:
    - (i) Either the taxpayer fails to demonstrate that there is at least one substantial non tax reason to establish the partnership, or the capital accounts of the partnership do not reflect interests proportionate to the contributed property; and
    - (ii) The taxpayer and the partnership have practices that demonstrate an implied or actual agreement to retain possession or enjoyment of the income of the contributed assets to the partnership back to the taxpayer.
- The IRC Sec. 2036(a)(1) problem does not exist if there is a substantive non tax reason for the creation of the family limited partnership.
  - The first investment reason certain trusts are benefitted by the creation of family limited partnerships: Closely held family limited partnerships may facilitate the ability of smaller trusts to hold alternative investments and follow modern portfolio theory.
  - The second investment reason certain trusts are benefitted by the creation of family limited partnerships: Closely held family limited partnerships facilitate income only (so called simple) trusts to be fully diversified, as modern portfolio theory seems to require.

- The third investment reason certain trusts are benefitted by family limited partnerships: the closely held family limited partnership has the management capacity to carry out the partnership's capital gains income to the income-only beneficiary for income tax purposes.
- Other non-transfer tax reasons why families form family limited partnerships or family limited liability companies.
  - A taxpayer, by using the partnership vehicle, has the ability to transfer capital without killing the transferee's productivity and initiative, because the taxpayer may have some indirect control over distributions, which may not be possible with the trust vehicle.
  - The partnership vehicle simplifies annual giving for private equity investments.
  - The difficulties associated with the *Hackl* and *Price* cases may be avoided if the donor gives the done in the assignment document the right to "put" the partnership units back to the donor for cash equal to the fair market value of the units (with fair market value of the units determined as if the "put" right does not exist) for a period of time.
  - Partnership vehicle facilitates keeping assets that are important to be kept in the family.
  - Partnership vehicle provides some protection against a taxpayer's future unforeseeable creditors, which cannot be provided to that taxpayer under most state's law by using trusts.
  - The partnership vehicle provides greater protection of gifted assets against failed marriages.

- Unlike irrevocable, non-amendable trust agreements, partnership agreements are comparatively flexible.
- Business Judgment Rule of partnership law offers greater flexibility in investment management than trust law.
- Partnership agreements could be drafted to mandate arbitration of family disputes and circumvent court litigation, which is generally not possible under most state laws with respect to trusts.
- Partnership agreements could be drafted to mandate the "English" rule for disputes (loser pays); that is generally not possible under most state laws with respect to trusts.
- Partnership arrangements facilitate and institutionalize family communication and education on financial matters.
- Partnerships eliminate or lower out-of-state probate costs for real estate investments.
- A partnership is advantageous compared to a "C" corporation because it has one level of income tax and is advantageous compared to an "S" corporation because it allows a greater variety of ownership structures.
- A partnership is advantageous compared to a corporate structure because in many jurisdictions there is no franchise tax or intangibles tax to pay with the use of partnerships.

– If a sale of a partnership interest occurs during a client's lifetime, the gift tax equivalent of IRC Sec. 2036 does not exist (i.e., there is no IRC Sec. 2536 under Chapter 12 of the Code).

– Advantages of the technique:

- Tax advantage if the interest in the family entity is sold to a grantor trust.
- The appreciation of the assets of the trust above the interest of the note used in any sale to a grantor trust for the grantor's spouse will not be taxable in the grantor/seller's estate.
- Flexibility advantages of gifting and selling non-managing interests in family entities to a grantor trust in which the grantor's spouse is a beneficiary.
  – Flexibility could also be achieved by refinancing the note to a note with a different interest rate, a private annuity, purchasing assets owned by the trust and/or renouncing the powers that make the trust a grantor trust.

– Considerations of the technique:

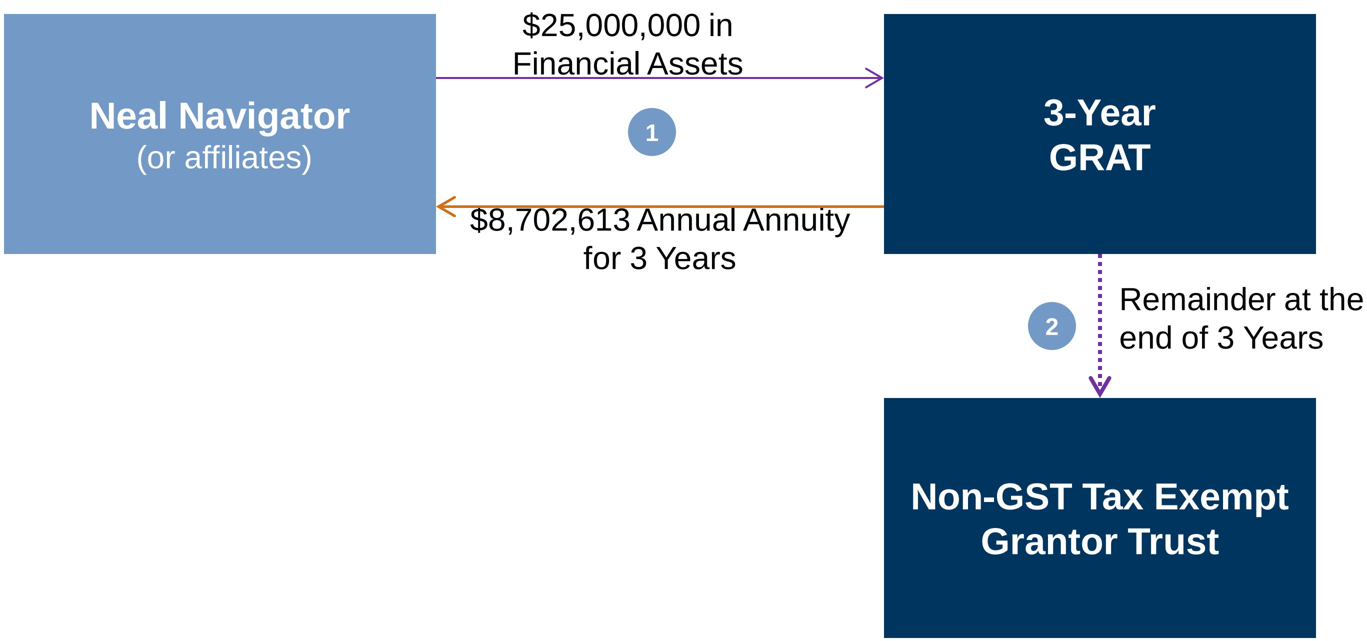
  - There may need to be substantive equity in the trust from prior gifts (is 10% equity enough?) before the sale is made.
  - State income tax considerations.
  - The IRS could be successful in the argument, that because of the step transaction doctrine, a valuation discount is not appropriate in valuing 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.

Selected History of Valuation Planning From 2000-2012 (Defending the IRC Sec. 2036 Position and the Advent of Techniques to Limit a "Valuation Surprise" From Valuation Planning) (Continued)

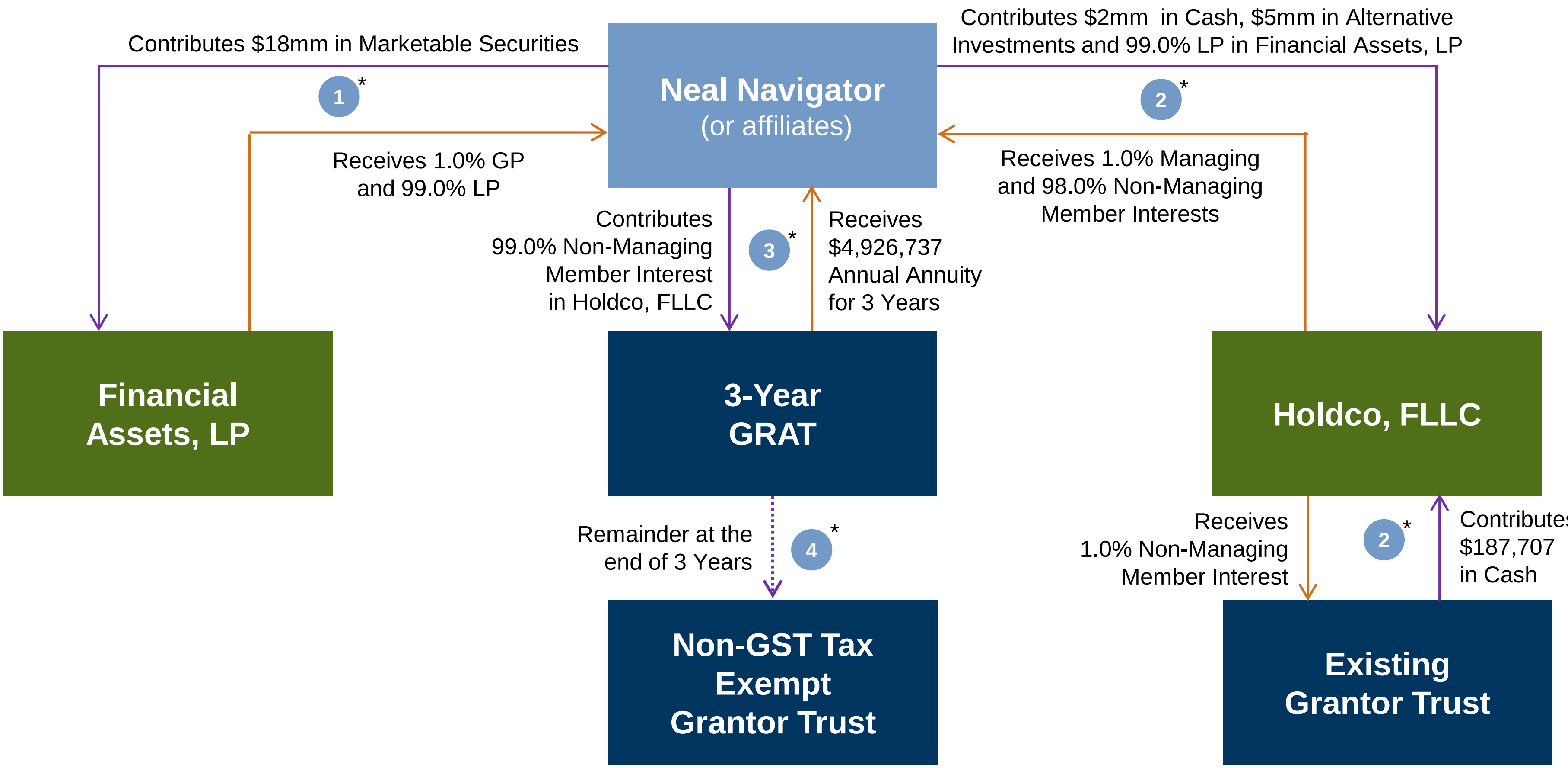
- Techniques to defend against or mitigate a "valuation surprise" from valuation planning. (See pages 166 – 186 of the paper).
  - Defined value allocation clauses involving a charity.
  - Defined value allocation clauses involving a residual gift to a marital deduction trust.
  - Defined value allocation clauses involving gifts to a grantor trust and a grantor retained annuity trust ("GRAT").
  - Defined value allocation clauses involving a defined dollar transfer by the donor.

- The new tax environment and a new reason to consider valuation techniques. Many of the techniques can be used to lower income taxes.
- Marrying the best characteristics of a discounted sale to a grantor trust with a GRAT: The advantages and considerations of contributing an proportionate interest, a preferred interest, and/or a growth interest in a leveraged FLLC to a GRAT (see pages 185 – 205 of the paper):

Hypothetical Technique A
Traditional GRAT



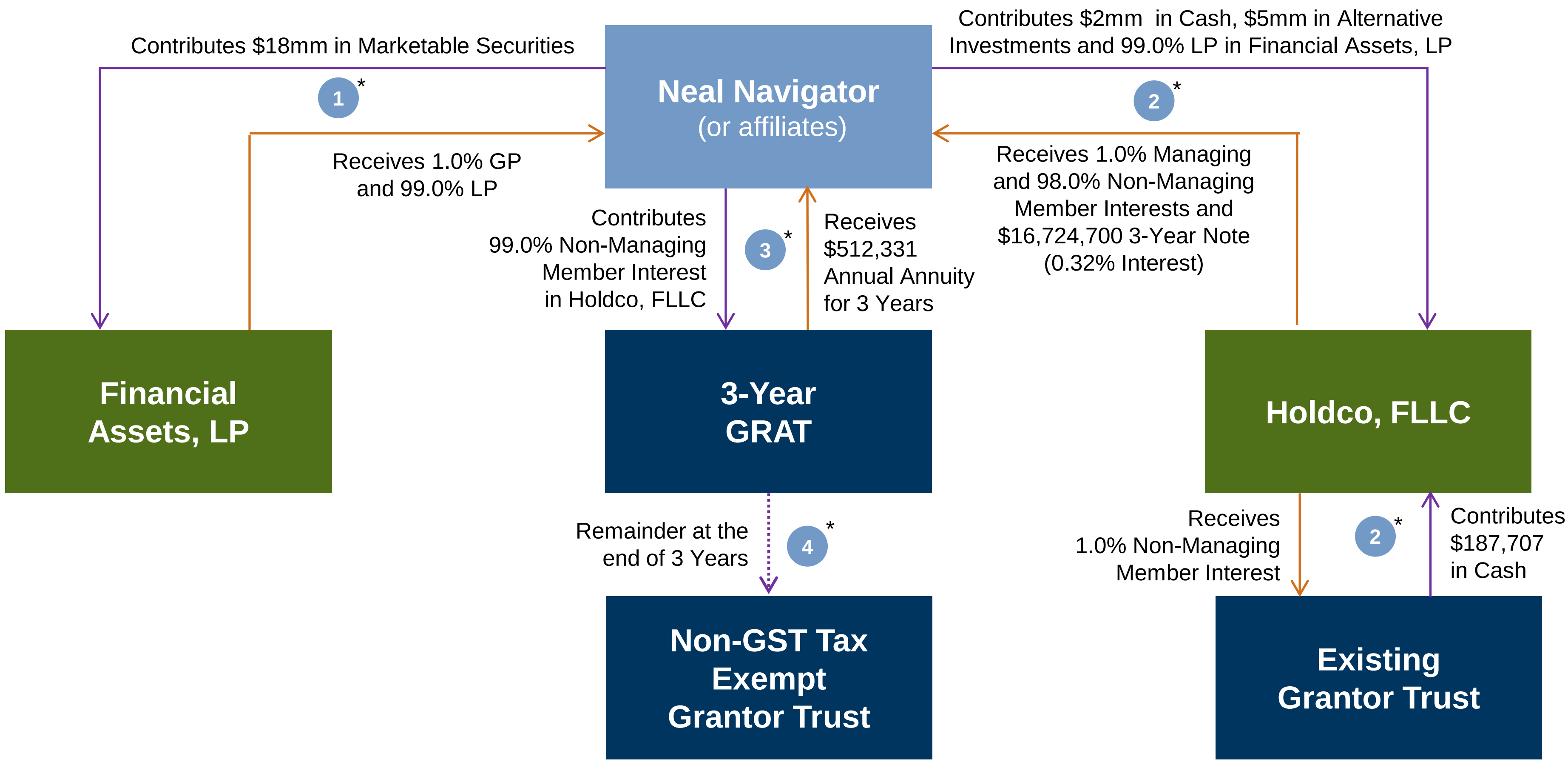
Hypothetical Technique B
Contribution of Non-Leveraged Entities to a GRAT



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

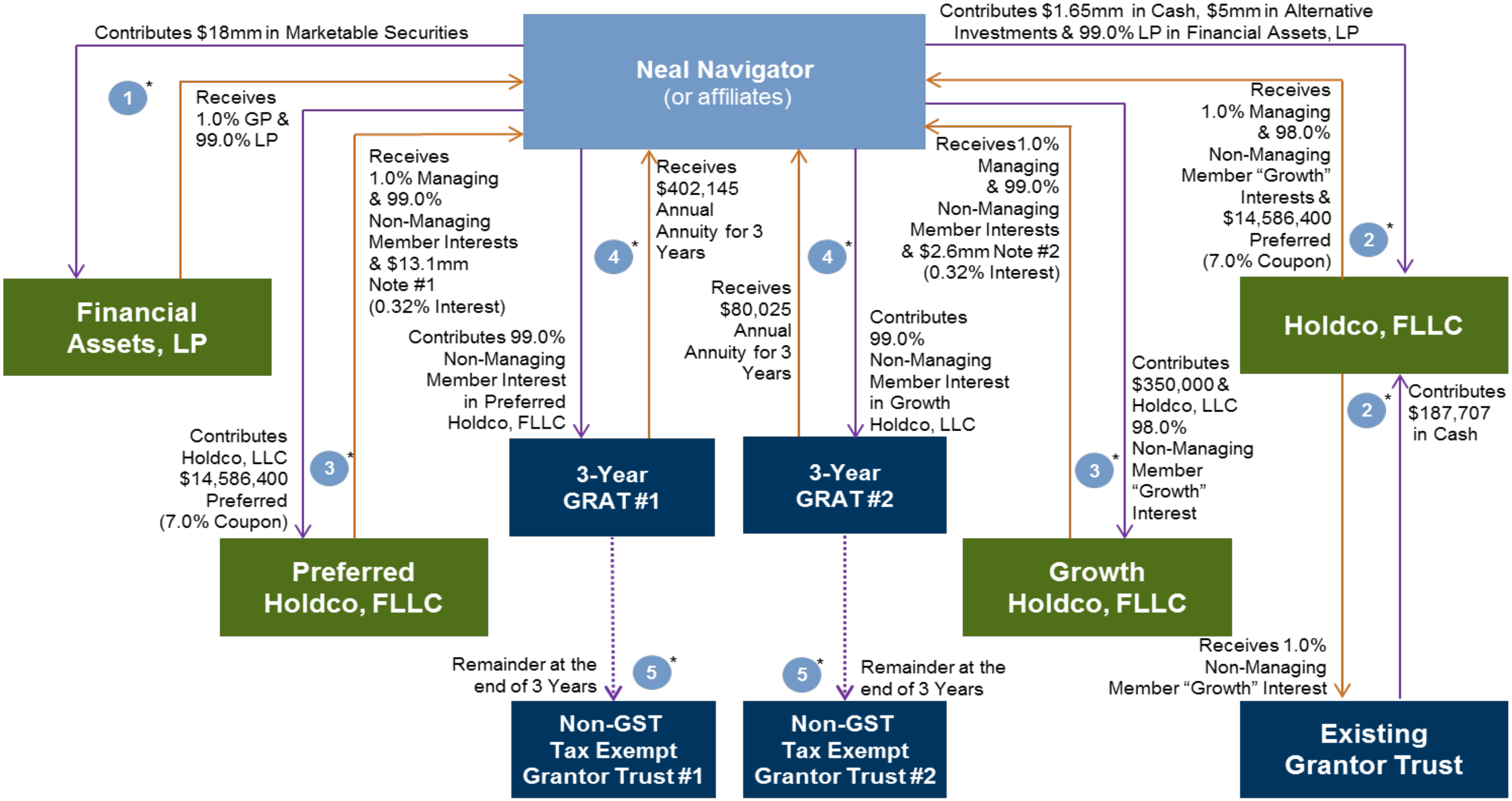
Marrying the Best Characteristics of a Discounted Sale to a Grantor Trust With a GRAT: The Advantages and Considerations of Contributing a Proportionate Interest, a Preferred Interest, and/or a Growth Interest in a Leveraged FLLC to a GRAT (Continued)

Hypothetical Technique C
Leveraged FLLC Assets Contributed to a GRAT



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

Hypothetical Technique D
Assets Contributed to Two GRATs with Different Provisions



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

Hypothetical Results – Scenario 1

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

Hypothetical Results – Scenario 2

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

Hypothetical Results – Scenario 3

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

Advantages of a Leveraged FLLC Asset GRAT in Comparison to a Traditional GRAT

- Performs much better in bear, flat and bull markets
- The "*Atkinson*" worry about paying a GRAT annuity with a hard-to-value asset may be eliminated
- Has many of the same advantages that a sale to a grantor trust has in comparison to a GRAT. For example, a retained note is much more flexible than a retained annuity
- The Leveraged FLLC Asset GRAT avoids the necessity of continually creating GRATs using the so–called "cascading GRATs" technique
- The Leveraged FLLC Asset GRAT locks in today's low interest rate
- The Leveraged FLLC Asset GRAT has a lower "hurdle rate" than a GRAT

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

- Does not require a significant use of gift tax exemption, which may be wasted if markets deteriorate
- In the future the IRS may be able to ignore defined value sales by changing its regulations
- Better authority that sales to single member FLLC's should be ignored by the IRS for income tax purposes
- If there is an adjustment with respect to the value of the transferred asset, because of an IRS audit, there will be an additional transfer to the GRAT pursuant to the defined value formula. The trust document creating the GRAT needs to be carefully drafted in order to avoid deemed contribution issues under that circumstance
- Less chance of an audit of a transfer to a GRAT than a sale (even a defined sale) to a grantor trust
- Less chance that the retained note will be recharacterized as deemed retained interest in the donee trust under equitable tax principles

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

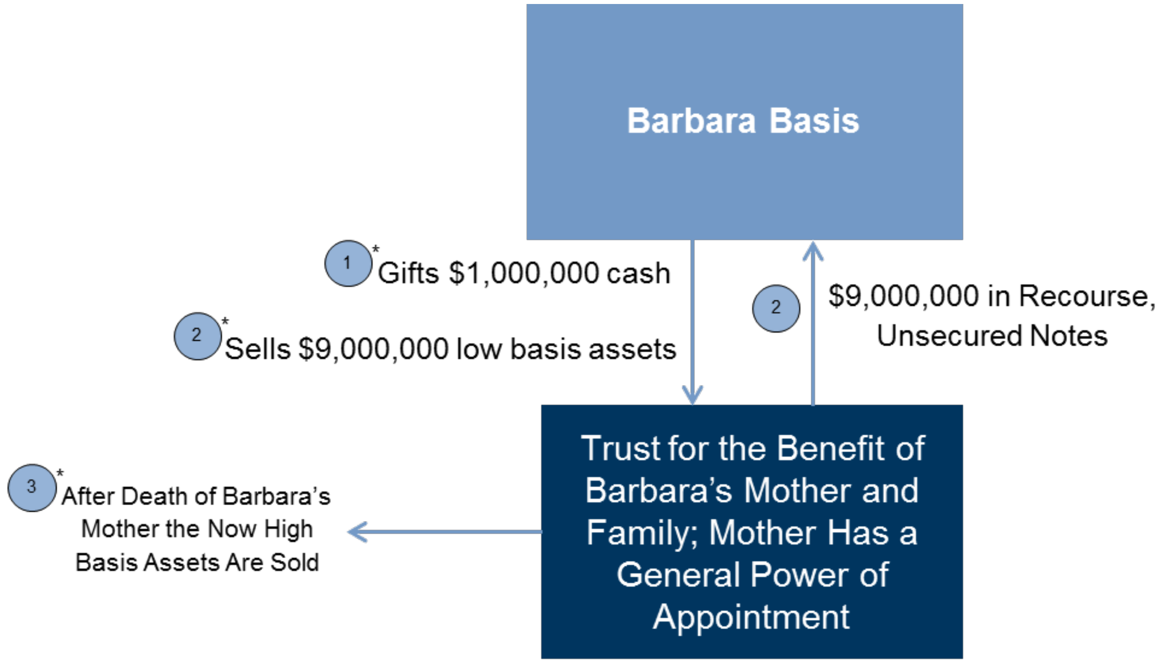
- The legal structure transfers more wealth than both a conventional GRAT and a Leveraged FLLC Asset GRAT in bear, flat and bull markets
- The technique has the other advantages that a Leveraged FLLC Asset GRAT enjoys
- Many of the gift tax valuation rules under 2701 do not apply because of the exception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

Post Creation Strategies

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

The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

- Gifting and selling low basis asset to a grantor trust that is subject to an older generation's general power of appointment and estate taxes. The technique is illustrated below (see pages 205 – 210 of the paper):



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

– 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. § 20.2053-7 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.

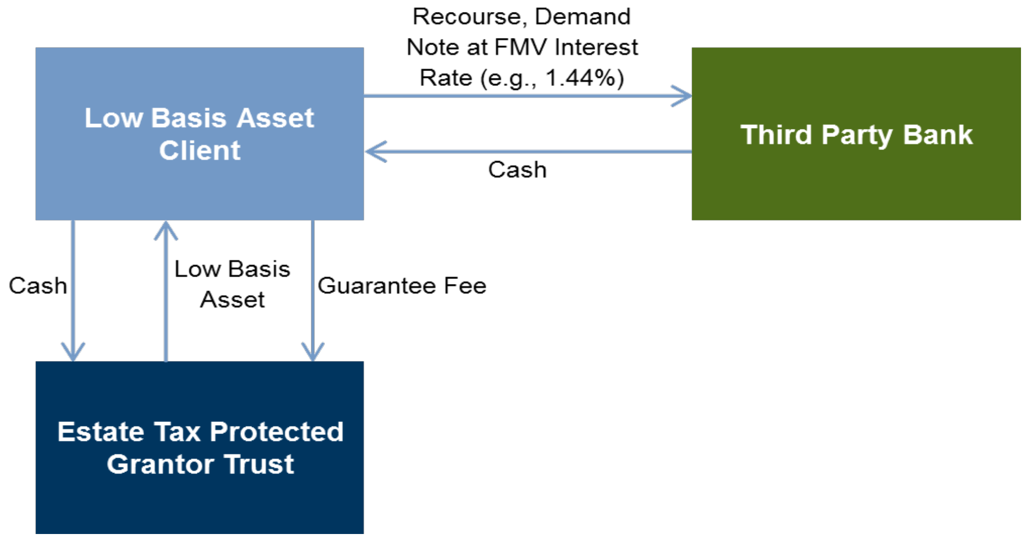
– Considerations of the technique:

- The grantor of the trust will still have a low basis in his or her note upon the death of the older generation beneficiary.
- 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?

- Managing a grantor trust, or a spousal grantor trust, by making it a "reverse grantor trust." The grantor could purchase low basis assets from a grantor trust by using a loan from a third party bank. (See pages 210 – 212 of the paper).
  - Similar to the technique illustrated by Revenue Ruling 85-13 a grantor could purchase low basis assets from a successful grantor trust. Consider the following example:

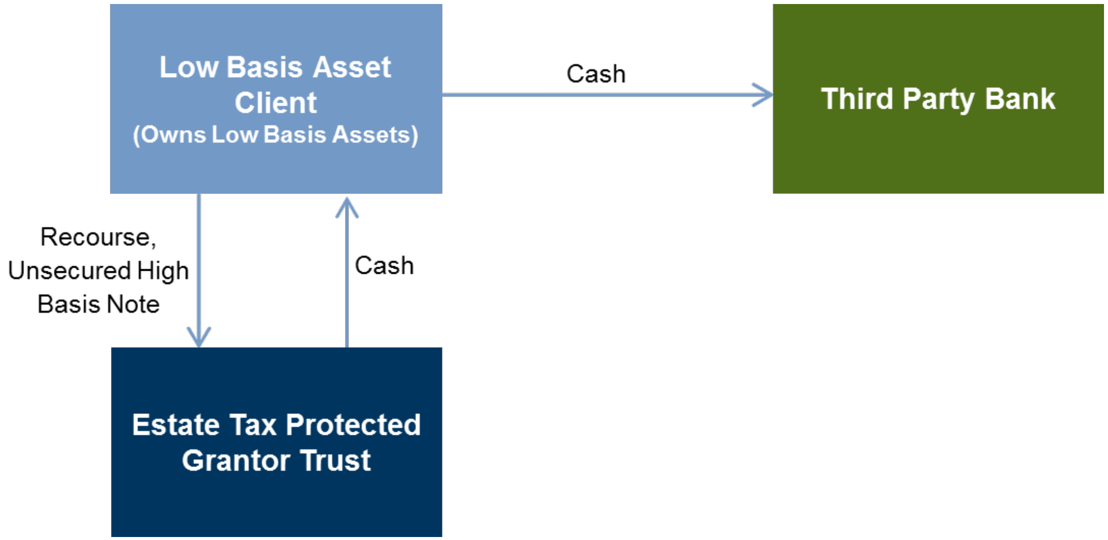
    Hypothetical Transaction #1:

    Low Basis Asset Client borrows cash from Third Party Bank and uses that cash to purchase low basis assets from the Estate Tax Protected Grantor Trust. The Low Basis Asset Client will be personally liable on the bank loan. The trust could guarantee the bank's loan to the client. Hypothetical Transaction #1 is illustrated below:



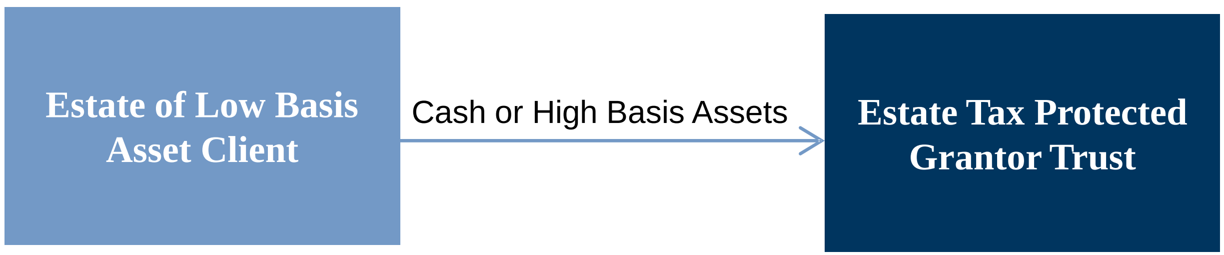
Hypothetical Transaction #2:

Low Basis Asset Client could continue to borrow from Third Party Bank. Or, in a few years, because Low Basis Asset Client would like the flexibility of a recourse, unsecured long-term note, or because interest rates have moved, or because of some other financial reason, Low Basis Asset Client could borrow cash from the grantor trust to help pay the Third Party Bank note. The recourse, unsecured long-term note with the grantor trust will be at a fair market interest rate that is much higher than the AFR. The Low Basis Asset Client will be personally liable on the note owed to the trust. The Estate Tax Protected Grantor Trust's basis in the new recourse, unsecured note may be equal to the cash that is loaned. Hypothetical Transaction #2 is illustrated below:

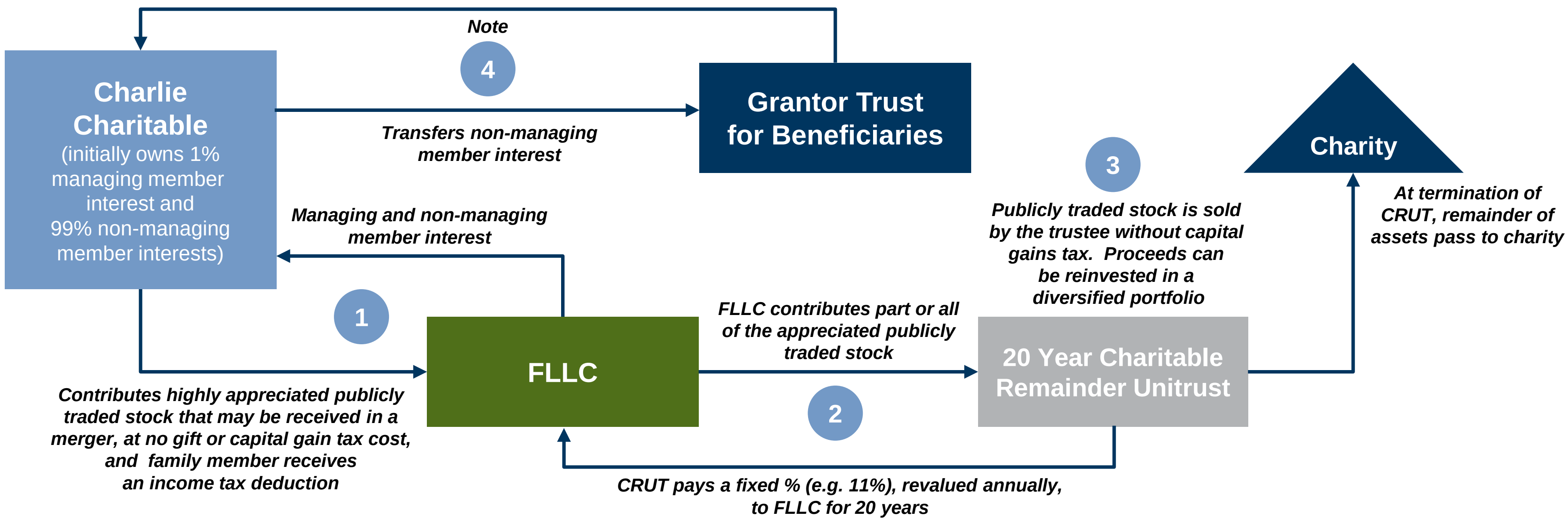


Hypothetical Transaction #3:

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). Hypothetical Transaction #3 is illustrated below:



- Lifetime charitable giving strategies that also benefit client's descendants by reducing the family's total income tax and transfer tax. (See pages 212 – 234 of the paper).
  - Use of a discounted sale of the non-charitable interest in a charitable remainder unitrust ("CRUT") to a grantor trust. The technique is illustrated below (see pages 212 – 221 of the paper):



- Advantages of the technique:
  - The tax advantages of creating a grantor trust and a sale to a grantor trust.
  - The tax advantage of eliminating the capital gains tax on that part of the gains that will be allocated to the charity under the tiered income tax rules.
  - The tax advantage of lowering opportunity costs by delaying taxes on the portion of the original gain that is not allocated to charity.
  - The tax advantage of a charitable deduction in year one for the actuarial value of the remainder interest of the CRUT passing to charity.
  - FLLCs offer many non-tax advantages. Among them, FLLCs:
  - The tax advantage of integration, which produces advantageous comparative results. See the table on the next slide:

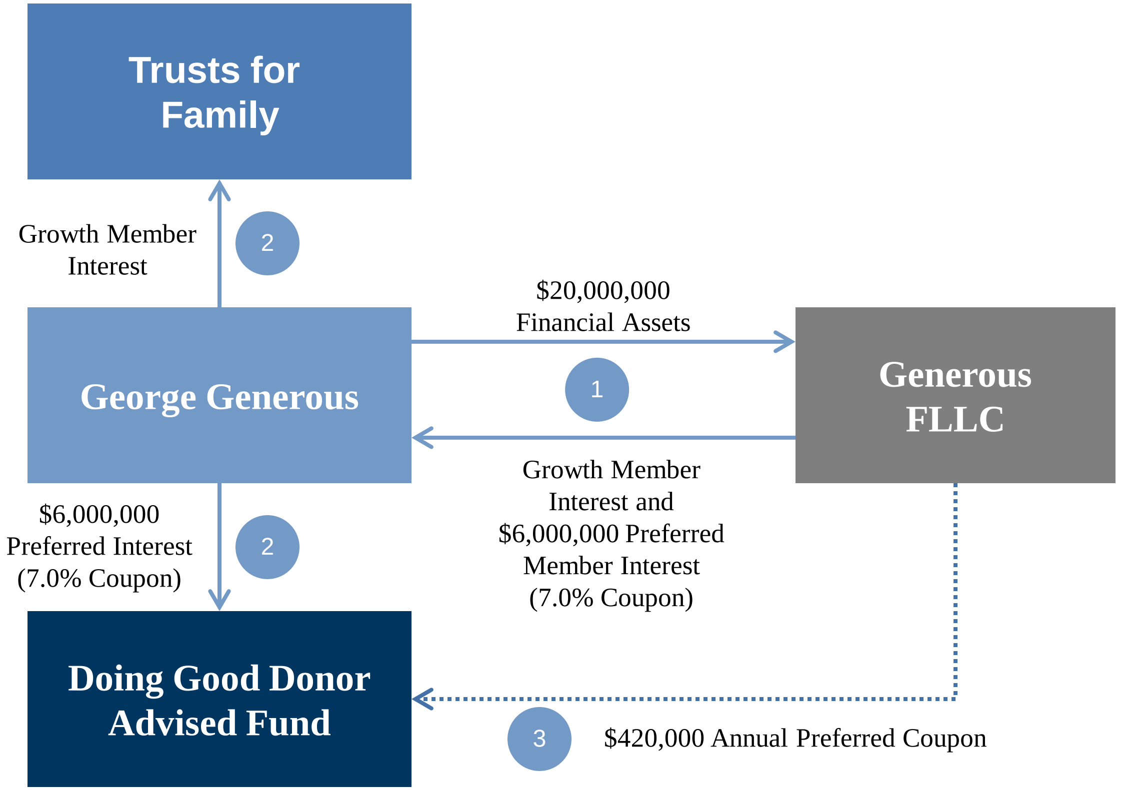
The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

Hypothetical Technique (Assumes $9.65mm Estate Tax Exemption Available)	Charlie's Children	Charlie's Descendants (GST Exempt)	Charity	Charlie's Consumption Direct Costs	Consumption Investment Opportunity Costs	IRS Taxes on Investment Income	IRS Investment Opportunity Costs	IRS Estate Taxes (@40.0%)	Total
Future Values at the end of 25 Years Assuming an Annual Compounded Rate of Return at 7.4%									
Stock Sale, No Planning	$10,023,860	$9,650,000	$0	$5,123,665	$7,440,046	$11,792,247	$23,763,728	$6,682,574	$74,476,121
Simulated Tax Holiday (No Initial Capital Gains Tax and No Estate Tax) 76% - 24% Split Between Family and Charity	$0	$26,583,325	$8,207,700	$5,123,665	$7,440,046	$11,817,313	$15,304,071	$0	$74,476,121
FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity	$0	$24,472,697	$8,207,700	$5,123,665	$7,440,046	$12,516,445	$16,715,568	$0	$74,476,121
FLP/Grantor Trust Sale, Charlie gives remaining estate to family	$0	$25,621,226	$0	$5,123,665	$7,440,046	$12,527,456	$23,763,729	$0	$74,476,121

– Considerations of the technique:

- The technique will have the same considerations as a sale to a grantor trust

– Creating a FLP or FLLC with preferred and growth interests, transferring the preferred interest to a public charity, and transferring the growth interests to family members. The technique is illustrated below (see pages 221 – 231 of the paper):



– Advantages of the technique:

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

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

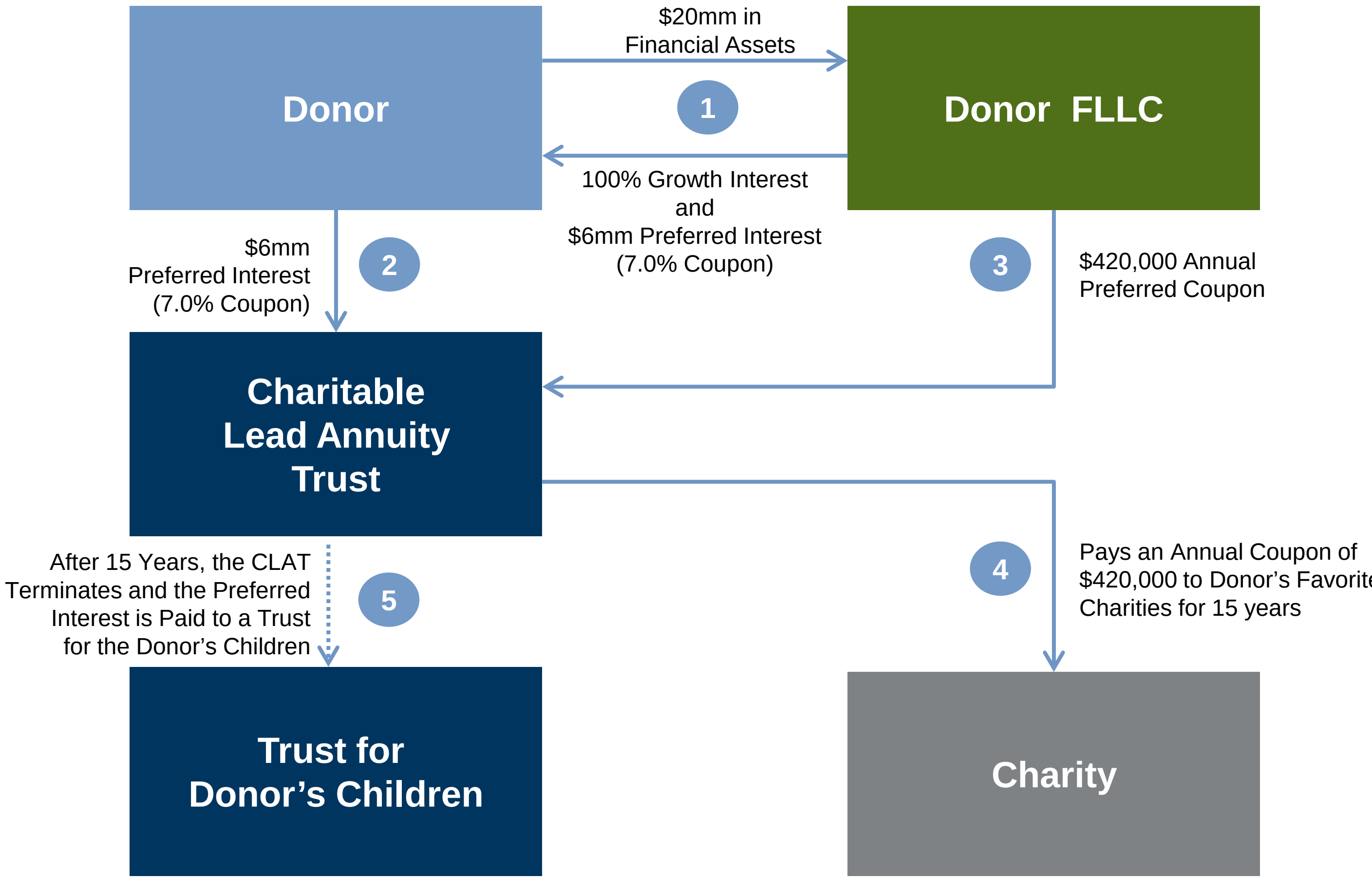
- Valuation advantage: The gift tax valuation rules under IRC Sec. 2701 do not apply to any future gifts, or sales, of the growth member interests to family members, or trusts for family members.
- Under the facts of this example, in addition to saving significant income and healthcare taxes, significant transfer taxes could be saved in transferring the growth interests to a grantor trust.
- Income tax valuation advantage: IRS concedes preferred partnership interests should have a high coupon.
- IRC Sec. 2036 advantage, if George gives or sells the growth interests to his family.

– Considerations of the technique:

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

The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

– The use of a high-yield preferred partnership or membership interest with charitable lead annuity trust ("CLAT"). The technique is illustrated below (see pages 231 – 236 of the paper):



– Advantages of the technique:

- Because of the difference in the yield of a preferred coupon of a preferred interest in a FLLC that is compliant with Revenue Ruling 83-120 and the IRC Sec. 7520 rate, the transfer tax success of a CLAT is virtually assured.

- IRC Sec. 2701 valuation rules will not apply to a gift of the "growth" interests in a FLLC if the preferred interests are owned by a CLAT.

	Total Present Value Received by Family Net of Taxes	Total Present Value Received by Charity	Total Present Value for Family and Charity
	Assuming a 7.0% Present Value Discount		
Description			
No Further Planning: Makes $420,000 Annual Contribution to Charity; Bequeaths $6mm to Charity at Death	$6,850,593	$6,199,251	$13,049,844
Hypothetical Technique: Creation of an FLLC with Growth and Preferred Interests; Gift of Preferred to Charity; Gift and Sale of Growth Interest to a GST Tax Exempt Grantor Trust; Bequeaths Estate to Family	$13,848,307	$6,199,251	$20,047,558

- The donor will not pay income taxes or health care taxes on income that is allocated to the CLAT.

– Considerations of the technique:

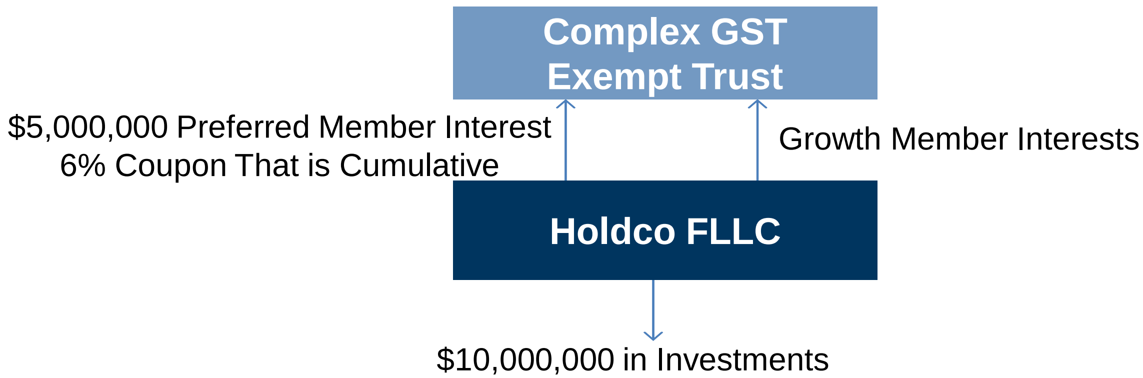
  - The partial interest rule should not apply for gift tax purposes or income tax purposes (if a grantor CLAT is used), but the IRS may make the argument.

  - Care should be taken to make sure there is not a tax on excess business holdings under IRC Sec. 4943.

- Strategies that may lower the income and health care taxes of trusts without making cash distributions to the beneficiaries of the trusts. (See pages 236 – 247 of the paper).
  - The trustee of a complex trust could consider creating a two class (one class is a preferred interest and one class is a growth interest) single member FLLC and the trustee could distribute part or all of the preferred class to the current beneficiary. Consider the following example:

    Hypothetical Transaction #1:

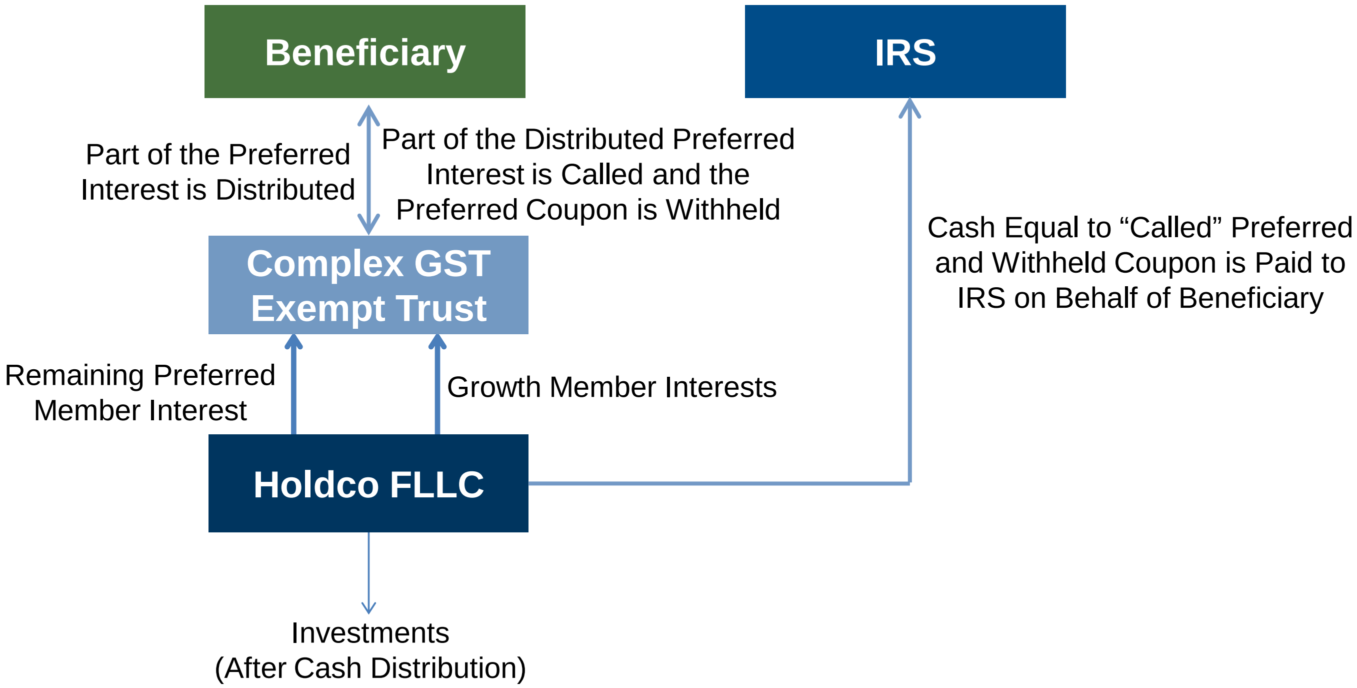
    Trustee of Complex GST Exempt Trust, which has $10,000,000 in assets, forms a single member FLLC with preferred and growth member interests as illustrated below:



Holdco, FLLC has the right to “call” or “redeem” any portion of the preferred for cash and/or withhold any portion of a preferred coupon that is to be paid to its owner. The trustee of the Complex GST Exempt Trust could pay cash for that portion of “called” preferred that is owed and/or any portion of the coupon that is withheld, to the IRS for the benefit of the owner of the preferred.

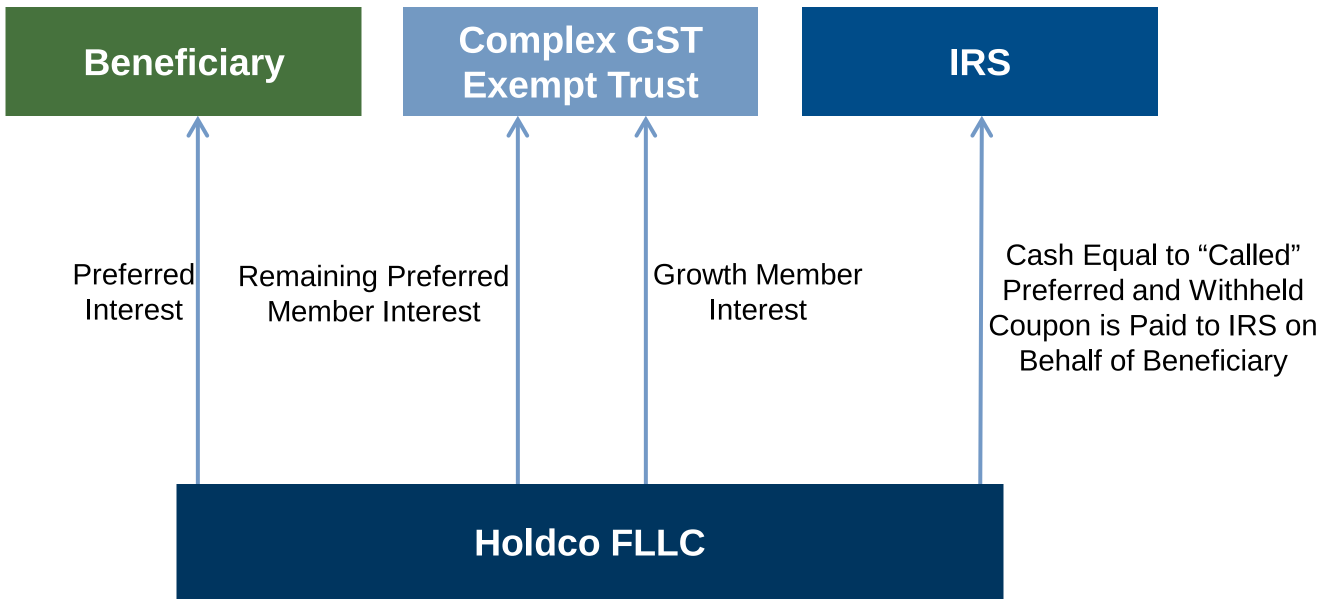
Hypothetical Transaction(s) #2

Trustee of the Complex GST Exempt Trust could distribute part of its preferred interest to beneficiary. The par value of the distributed preferred is equal to the trust's adjusted gross income, as defined in IRC Sec. 67(e) over the dollar at which the highest bracket in IRC Sec. 1(e) begins for such taxable year. The trustee withholds the coupon payout that is due and "calls" or redeems part of the preferred. A cash amount equal to the "withheld" coupon and the "called" preferred interest is paid to the IRS on behalf of the beneficiary to be applied to the beneficiary's income taxes. The transaction is illustrated below:



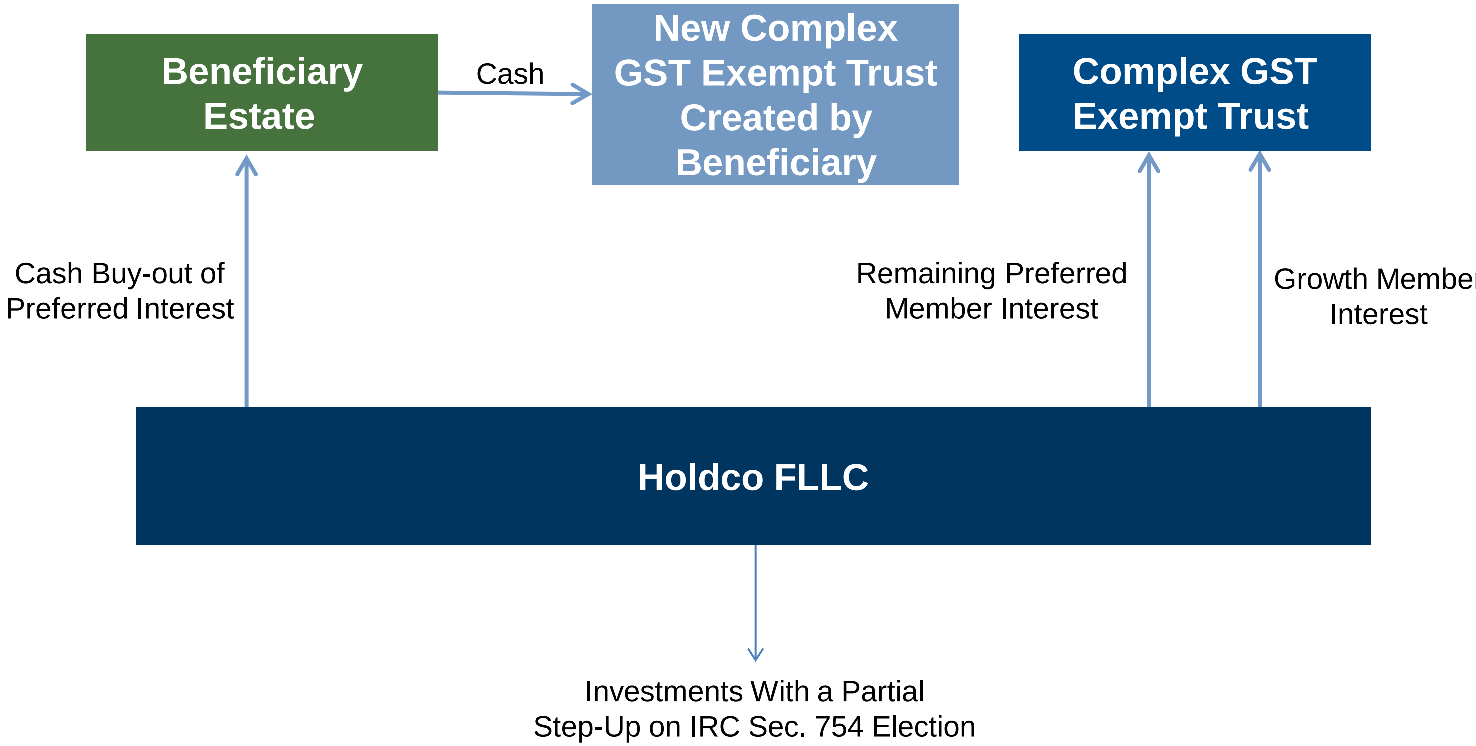
Hypothetical Transaction(s) #3

In the later years, the trustee of the Complex GST Exempt Trust no longer distributes preferred partnership interests to the beneficiary. The trustee of the Complex GST Exempt Trust is not taxed on the net income allocated to the preferred interest owned by the beneficiary. Holdco, FLLC "calls" or withholds part of the cash coupon owed to the beneficiary and pays that cash to the IRS on behalf of the beneficiary:



Hypothetical Transaction(s) #4

Upon the beneficiary's death, the trustee may wish to redeem or "call" all of the preferred interest then held by the beneficiary's estate. If the beneficiary does not have a taxable estate and bequeaths the proceeds of the "called" preferred interest to a similar Complex GST Exempt Trust, that cash, upon redemption, will then pass according to the terms of the new trust. If an IRC Sec. 754 election is made, some of the low basis assets of Holdco, FLLC may receive a step-up in basis:



– Advantages of the technique:

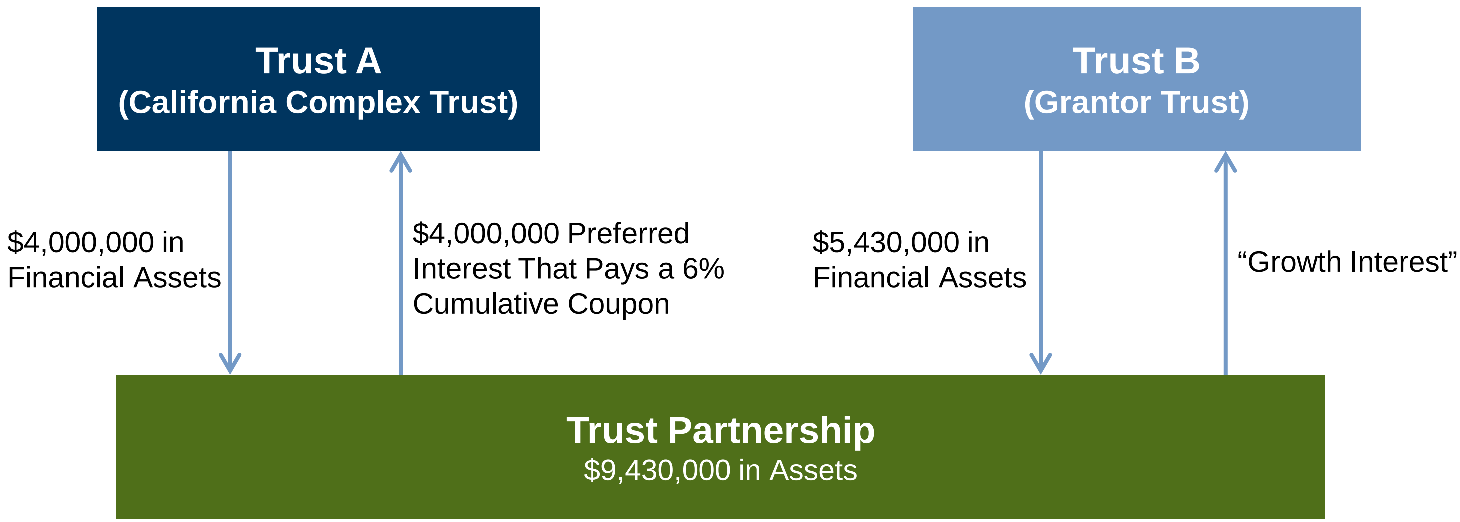
- Taxable income of the trust allocated to the beneficiary, either directly to the beneficiary because of the in-kind distributions of the preferred interest, or indirectly because of the payment of the preferred coupon, will not be taxable to the trust, which could save significant income taxes and health care taxes.
- If the trust contributes low basis assets to Holdco in exchange for the preferred, then distributes the preferred to the beneficiary, and if there is a later sale of those low basis assets by Holdco, significant future capital gains taxes could be saved.
- On the death of the beneficiary additional income tax and health care tax savings could accrue, if the stepped-up outside basis of the preferred interest owned by the beneficiary exceeds the proportionate inside basis of the FLLC assets.
- Unlike a trustee distribution of cash, a trustee distribution of a preferred interest in a closely held FLLC is not marketable, which could partially address spendthrift concerns.
- Unlike a distribution of cash, in which the trust loses its ability to return the earning potential of that cash for the benefit of future beneficiaries, the trust will indirectly retain the earning potential of the assets owned by the single member FLLC subject to the preferred coupon payment requirements.
- The valuation rules of IRC Sec. 2701 probably do not apply to these illustrated transactions.

– Considerations of the technique:

- It adds a layer of complexity to the administration of the trust.
- The beneficiary may not bequeath the preferred interest in a manner consistent with the remainderman provisions of the complex trust.
- Creditors of the beneficiary, including divorced spouses, may be able to attach the preferred interest.

– A complex trust contributes in 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. The proposed transaction is illustrated below:

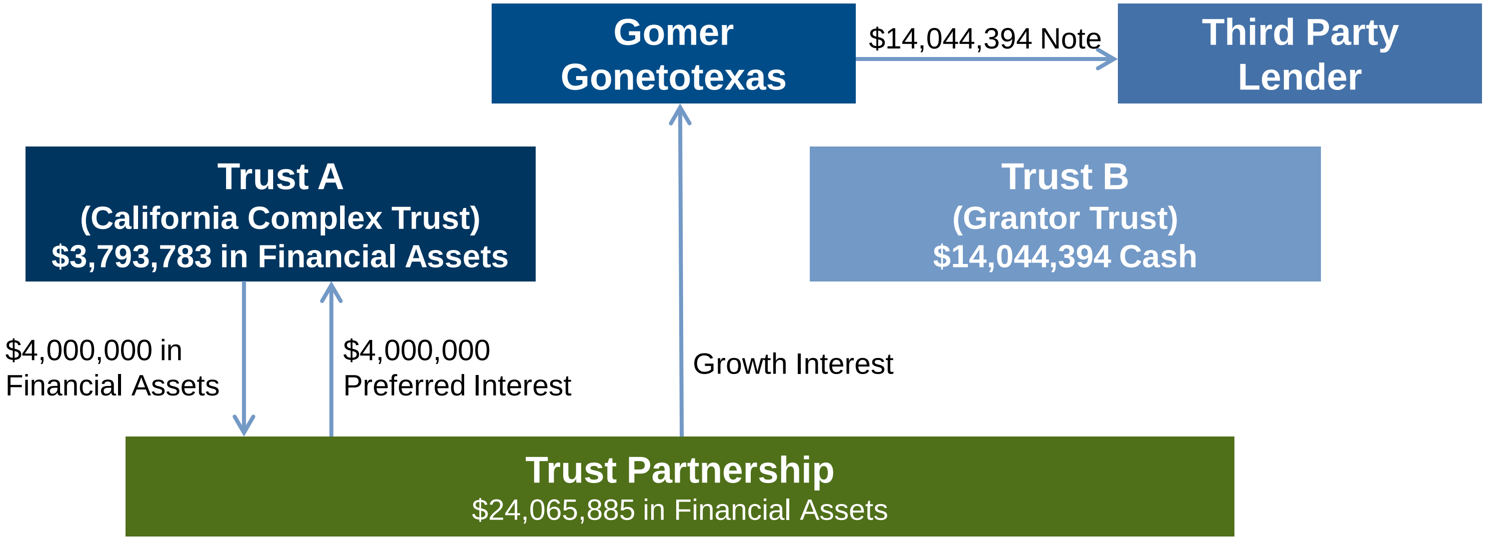
Transaction One:



Transaction Two:

Assume Gomer two years before he dies (and eighteen years after the original transaction) manages the contingent income capital gains taxes associated with Trust B's ownership of the growth interest by purchasing the growth interest with cash obtained by borrowing from a third party. That transaction is illustrated below:

Eighteen Years After Transaction One, Gomer Borrows Cash From Third Party
Lender and Buys Trust B's Growth Interest in the Trust Partnership For its Fair Market Value

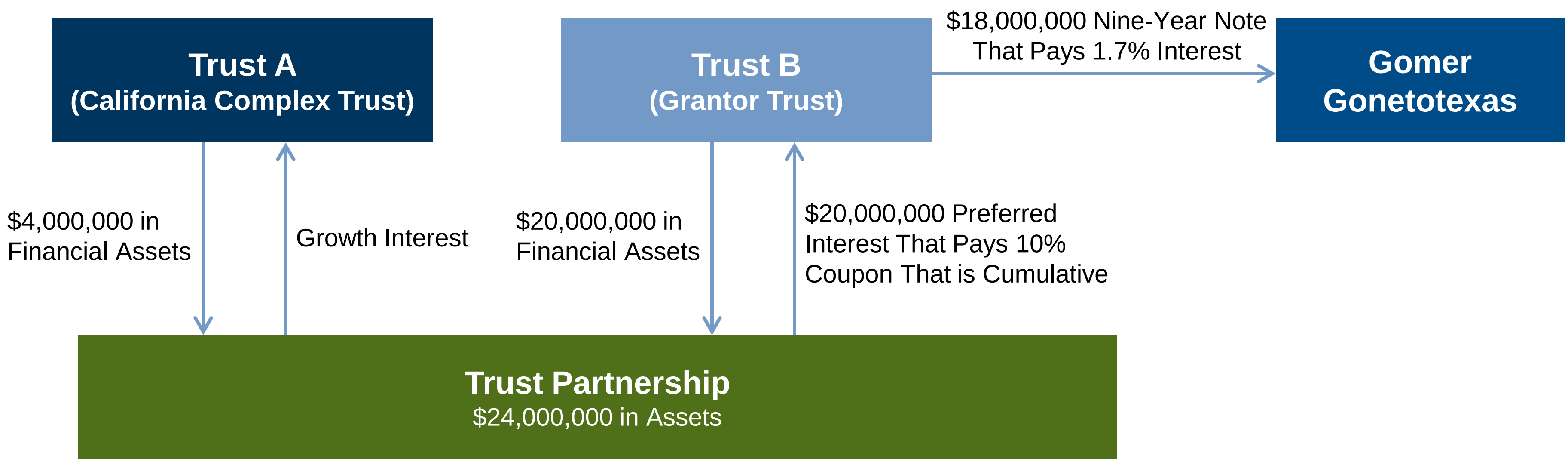


It is assumed that the partnership is terminated shortly before Gomer's death and the third party lender is paid.

- 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.
  - 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.
    - As noted above, there may be fiduciary concerns if distributions are made to a beneficiary solely to save income taxes. This technique eliminates that risk.
  - 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.

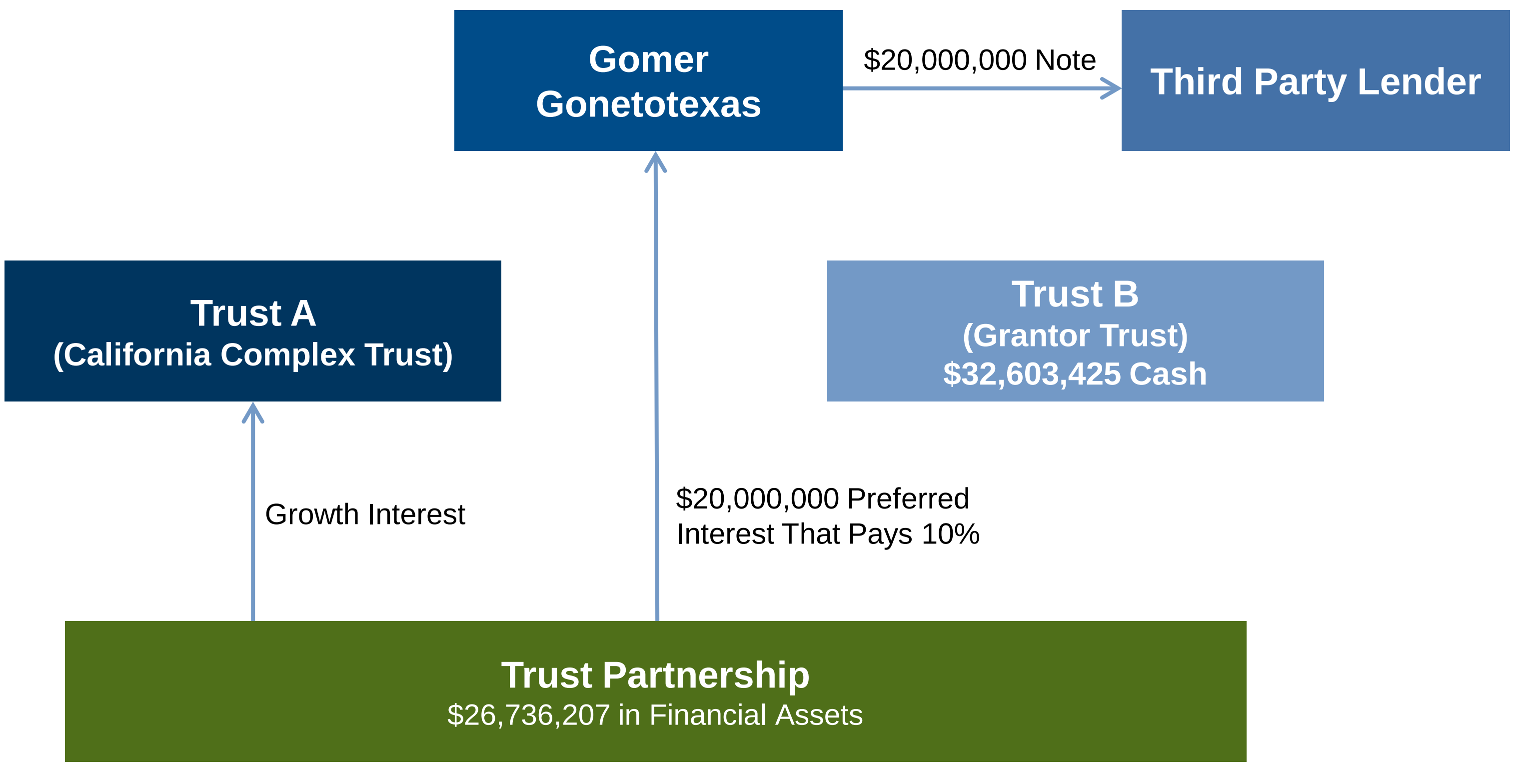
– The use of a leveraged reverse freeze to shift trust taxable income from a high income tax state to a low income tax state. The example is illustrated below:

Transaction One:



Transaction Two:

Seventeen Years After Transaction One, Gomer Borrows Cash From Third Party Lender and Buys Trust B's Growth Interest in the Trust Partnership For its Fair Market Value

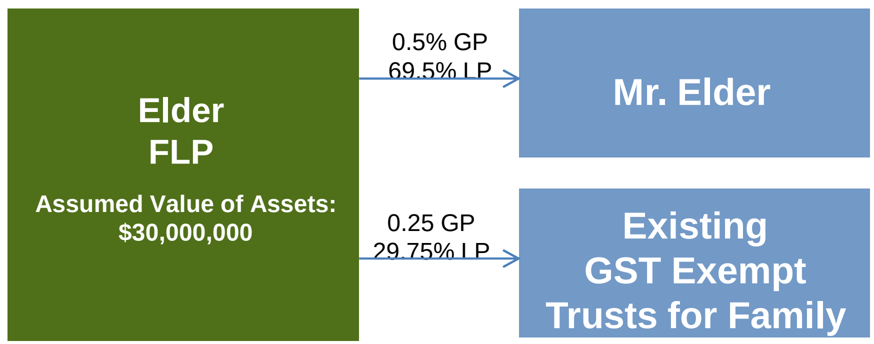


- Advantages of the technique:
  - Significant state income taxes and the investment opportunity costs associated with those state income taxes can be saved with this technique.
  - Significant transfer taxes will be saved under this technique.
  - The trustee of Trust B may wish to use some of its positive cash flow from the transaction to purchase life insurance on the life of Gomer Gonetotexas, at least to the extent there may be estate taxes associated with Gomer's note.

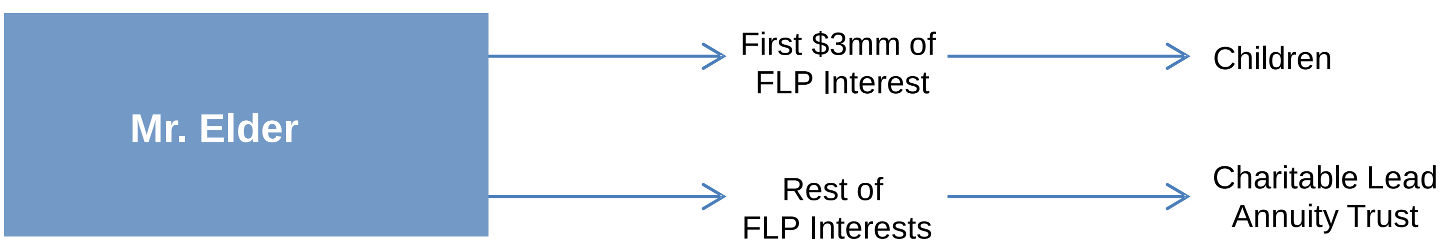
The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

- Post-mortem strategies that lower the net total income tax and transfer tax. (See pages 247 – 264 of the paper).
  - Use of a leveraged buy-out of a testamentary charitable lead annuity trust ("CLAT"). The technique is illustrated below:

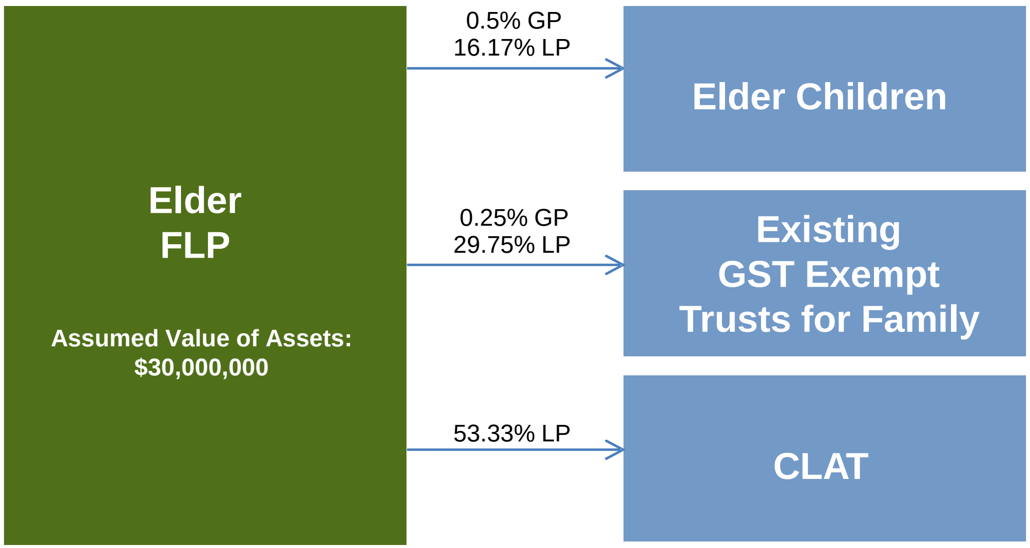
During Ed's lifetime he creates a FLP with his family:



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

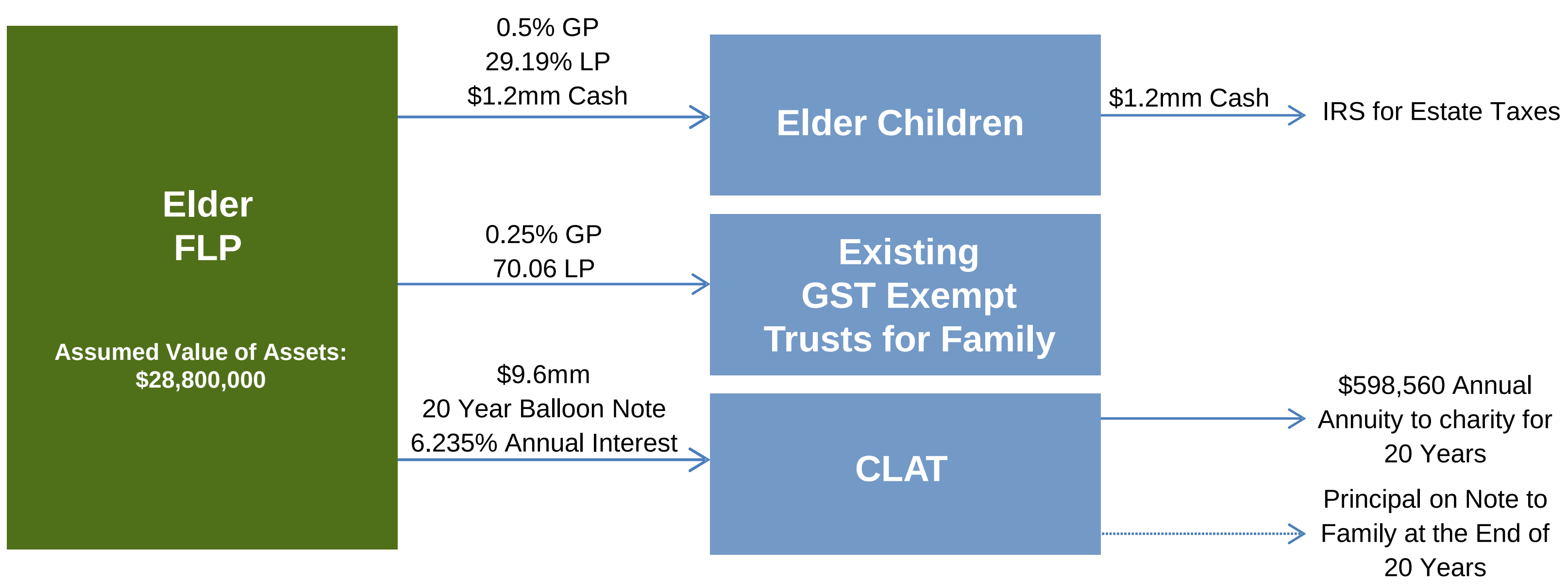


The percentage ownership of Elder Family Limited Partnership before any redemption pursuant to a probate court hearing is as follows:



The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

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



– Advantages of the technique:

- Significant improvement in the after tax net worth for both the family of the decedent and the decedent's favorite charitable causes will accrue because of this technique. See the tables below:

Summary of Results For $30 Million of Assets Growing at 3% Per Year (Pre Tax) – No Further Planning vs. 20 Year Testamentary CLAT Technique; 20 Year Future Values; Post-Death Scenarios (assuming Mr. Elder dies in year 1)

Technique	Elder Children	Elder GST Exempt Trust	Charity	IRS Taxes on Investment Income	IRS Investment Opportunity Cost	IRS Estate Tax	Total
No Further Planning - No Charitable Gift No Discount Allowed	$18,333,733	$15,073,672	$0	$5,253,849	$7,522,083	$8,000,000	$54,183,337
No Further Planning - No Charitable Gift Discount Allowed	$23,059,178	$15,073,672	$0	$5,956,415	$5,294,072	$4,800,000	$54,183,337
Hypothetical Technique - CLAT Redemption Discount Allowed - $3mm to Family	$16,818,670	$17,096,849	$16,083,531	$1,747,005	$1,237,281	$1,200,000	$54,183,337
Hypothetical Technique - CLAT Redemption Discount Allowed - $10mm to Family	$22,778,999	$14,337,710	$4,355,956	$4,501,200	$4,209,472	$4,000,000	$54,183,337

Summary of Results For $30 Million of Assets Growing at 7.5% Per Year (Pre Tax) – No Further Planning vs. 20 Year Testamentary CLAT Technique; 20 Year Future Values; Post-Death Scenarios (assuming Mr. Elder dies in year 1)

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

Summary of Results For $30 Million of Assets Growing at 10% Per Year (Pre Tax) – No Further Planning vs. 20 Year Testamentary CLAT Technique; 20 Year Future Values; Post-Death Scenarios (assuming Mr. Elder dies in year 1)

Technique	Elder Children	Elder GST Exempt Trust	Charity	IRS Taxes on Investment Income	IRS Investment Opportunity Cost	IRS Estate Tax	Total
No Further Planning - No Discount Allowed	$49,533,164	$39,520,097	$0	$29,956,665	$74,815,071	$8,000,000	$201,824,998
No Further Planning - Discount Allowed	$61,335,976	$39,520,097	$0	$33,800,051	$62,368,873	$4,800,000	$201,824,998
Hypothetical Technique - CLAT Redemption Discount Allowed - $3mm to Family	$36,556,659	$63,844,719	$34,282,524	$29,612,351	$36,328,746	$1,200,000	$201,824,998
Hypothetical Technique - CLAT Redemption Discount Allowed - $10mm to Family	$59,592,669	$40,494,791	$9,284,850	$32,455,697	$55,996,990	$4,000,000	$201,824,998

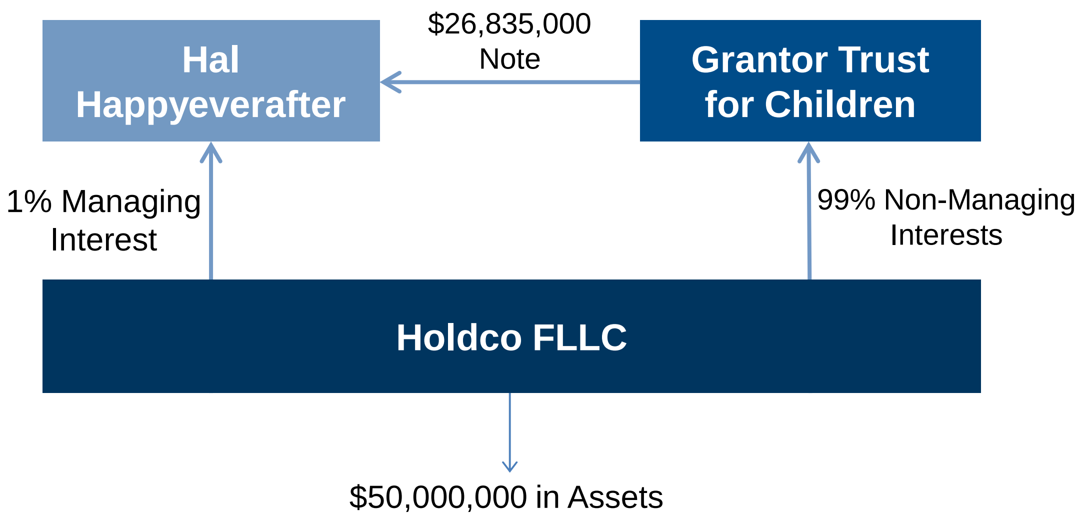
- The family does not have to wait 20 years to access the investments, if the investments are successful.

– Considerations of the technique:

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

– The use of the deceased spouse's unused exemption amount ("DSUE amount") to take advantage of the grantor trust rules to save future estate taxes and to simulate the tax and creditor protection advantage that a significant credit shelter trust would give a surviving spouse.

- 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. See IRC Sec. 2010. 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:



The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

- Ima's calculations indicate that 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:

	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 FLLC 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 FLLC 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 than 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.

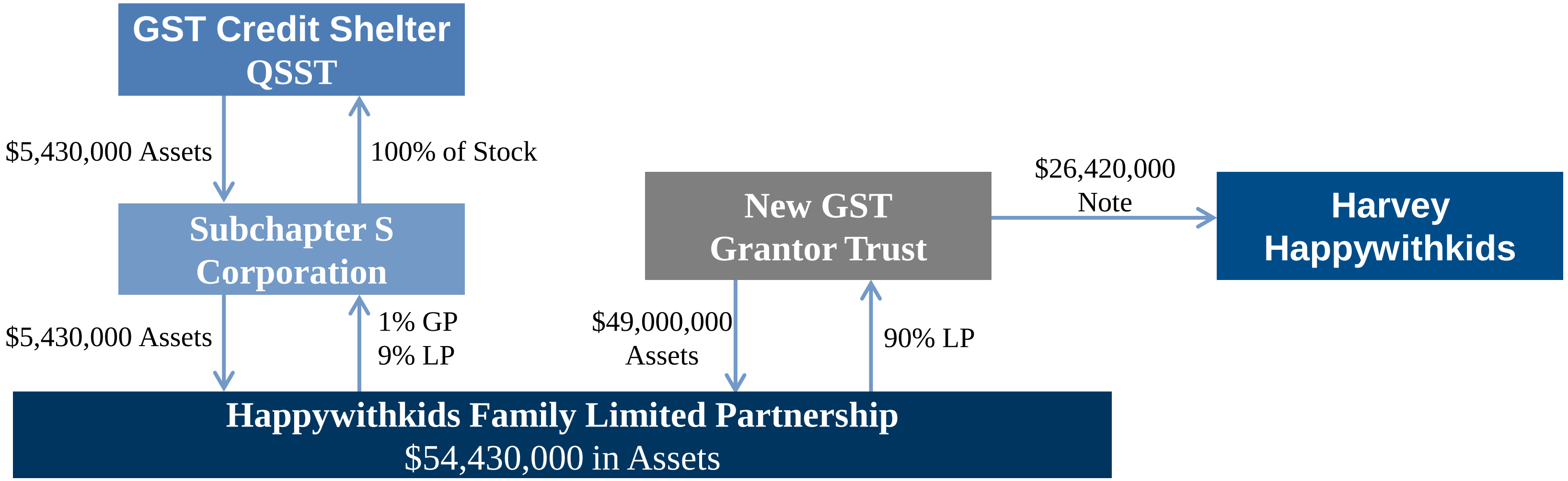
– Considerations of the technique:

- 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 Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

– 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.

- The technique: A deceased spouse bequeaths her entire estate under a formula marital deduction plan. An amount equal to her remaining unified credit, assumed to be $5,430,000, passes to a credit shelter trust that pays all of its income to her husband. The remainder of her estate passes to her husband.
- Consider the following example in which the credit shelter trust and the surviving spouse form a FLP together. The credit shelter trust then contributes its share of the partnership to a subchapter S corporation and the credit shelter trust becomes a QSST. The surviving spouse could use the unified credit to create a new grantor GST trust and could sell his remaining partnership interest to the new grantor trust.



– Advantages of the technique:

- Significant estate taxes can be saved with this technique.

  – 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.

	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.
- It has all of the advantages of converting a complex trust to a QSST:
  - 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.
- 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 in comparison to techniques in which there is a sale to a trust in which the seller is a beneficiary.

- 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.
    - 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 under normal subchapter J rules.
    - State income tax considerations.
  - 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 264 – 275 of the paper).

  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.

– Advantages of the technique:

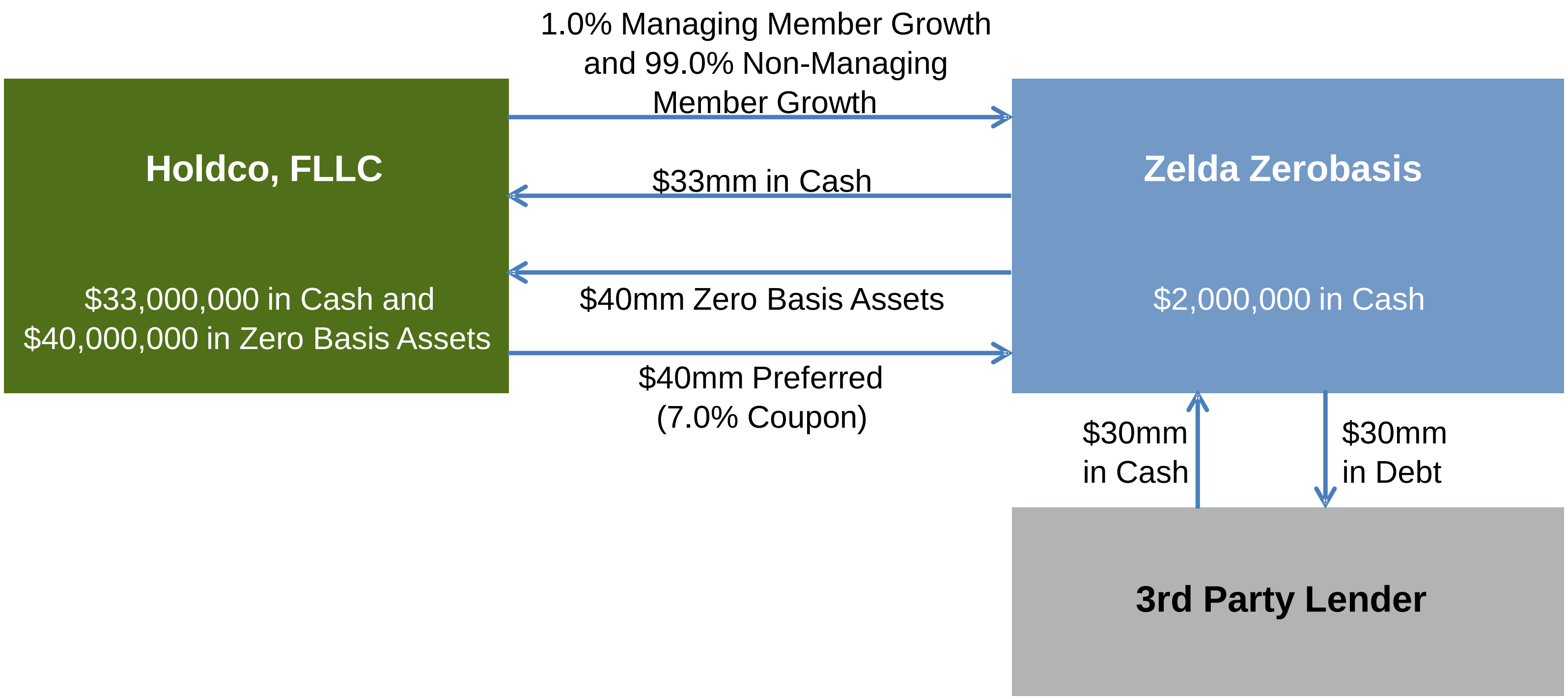
- The income tax benefit of the withdrawal: the illustrated "family structure" opportunity can provide the family an ability to manage the position through an appropriate controlled legal entity, while offering the potential for a long-term exit strategy that can be accomplished on a deferred tax basis.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

– Considerations of the technique:

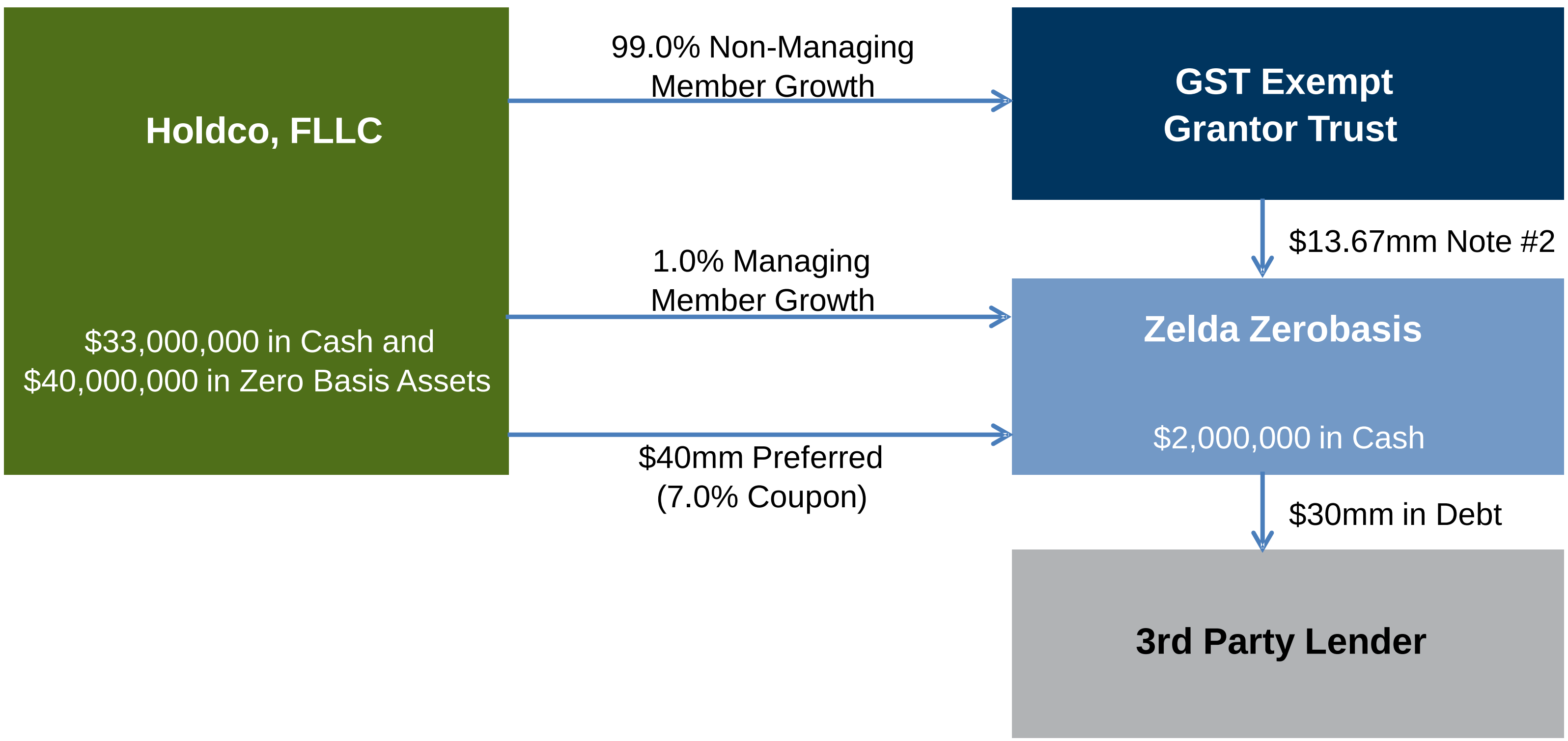
- Are there any tax consequences on formation of the partnership?
- Are there any tax consequences when Sam redeems his interest?
- There is exposure that Congress could change the law, by the time a partner withdraws (e.g., IRC Secs. 732 or 752 of the Code could be amended) and that the favorable liquidation 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 Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

- The use of a retained preferred partnership interest and third party leverage to generate effective estate planning and basis planning. The technique is illustrated below:

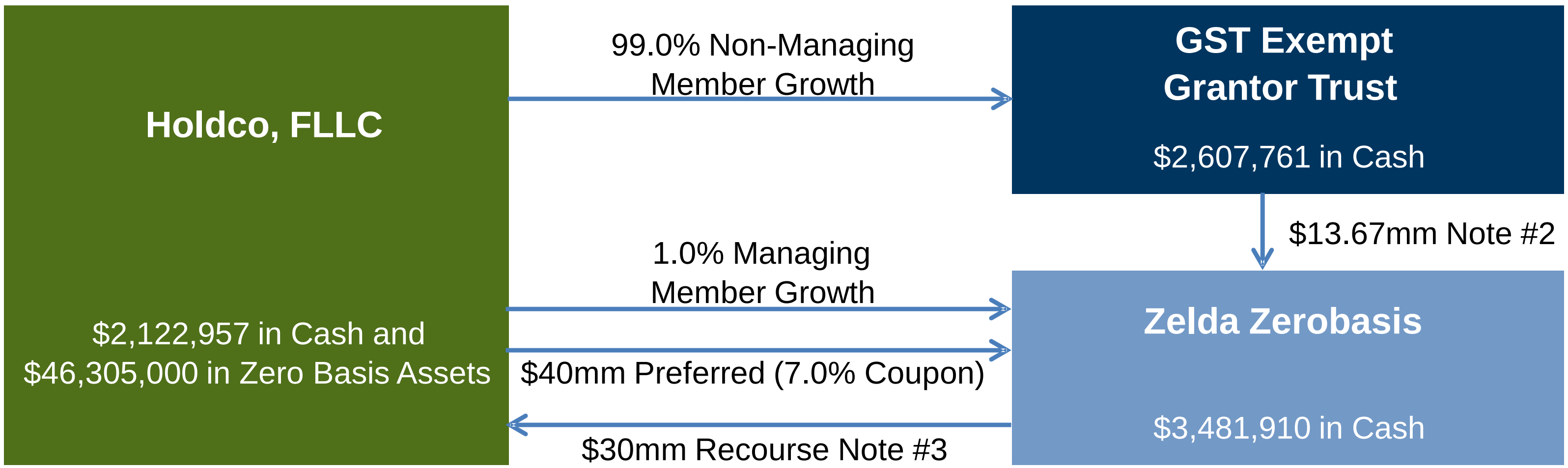


– Pam suggests that Zelda could then gift (using her $5,430,000 gift tax exemption) the non-managing member growth interests and sell the remaining non-managing member growth interests to a GST exempt grantor trust in separate independent transactions.



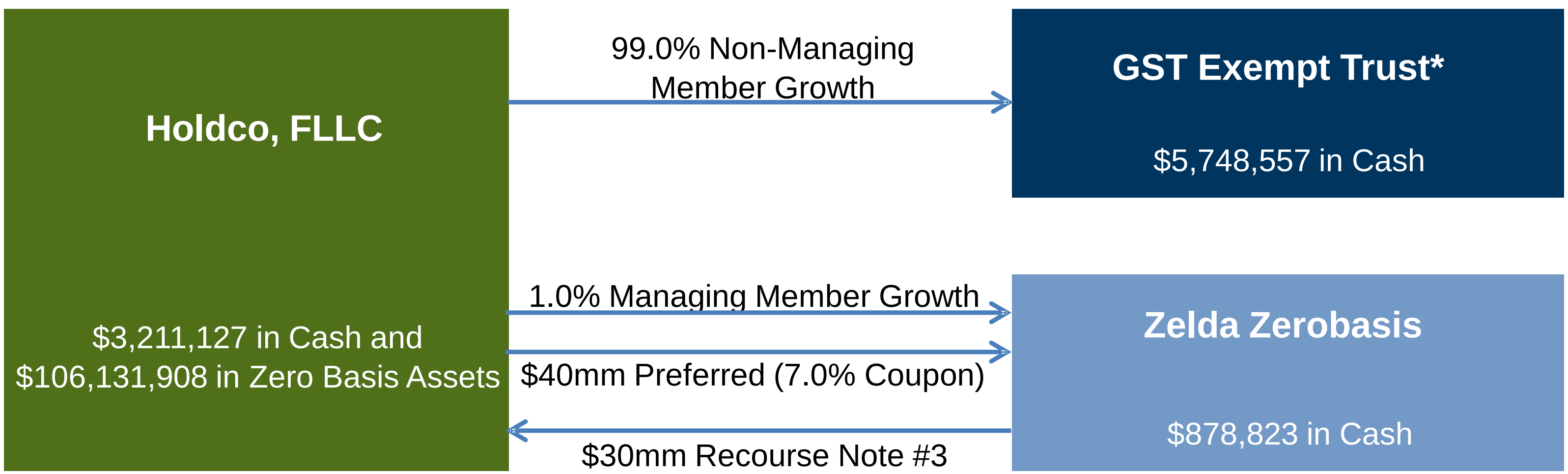
The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

– After three years Zelda may wish to borrow cash from Holdco, FLLC on a long-term recourse, unsecured basis to pay her recourse loan from the third party lender. After the payment of the loan to the third party lender the structure will be as shown below:



The Use of Valuation Techniques From 2012 to the Present and Future: Using the Techniques to Lower Both Income Taxes and Transfer Taxes (Continued)

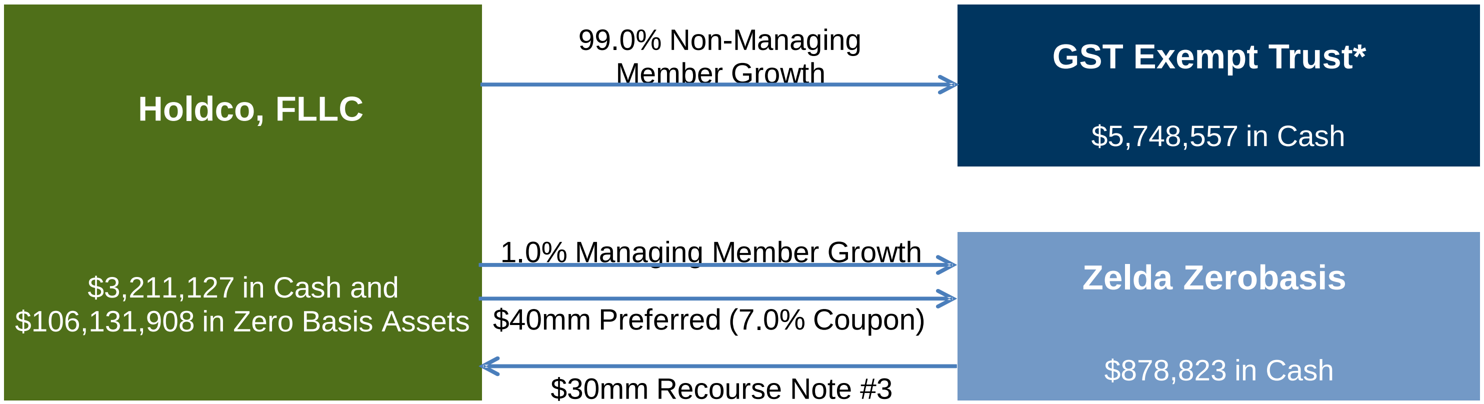
– The moment before Zelda's death in 20 years the structure under the above assumptions may be as follows:



*Grantor Trust status removed in year 18.

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 FLLC could terminate and her estate would pay the note owed to the single member FLLC. Her estate would receive a step-up in basis for the preferred interest in Holdco. Holdco, FLLC 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:

*Grantor Trust status removed in year 18.

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

- 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.

- Valuation planning, if the IRS issues regulations under IRC Sec. 2704(b)(4) that are consistent with the Greenbook Proposal. (See pages 275 – 284 of the paper).

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

  – The Greenbook Proposal would have expanded the scope of IRC Sec. 2704(b) as follows:

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

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

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

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

- Arguments that if the treasury regulations under IRC Sec. 2704(b)(4) take the form of the Greenbook Proposal, the regulations will be an unreasonable and invalid extension of IRC Sec. 2704(b)(4).
  - If the regulation takes the form of the Greenbook Proposal it may violate the origin and purpose of IRC Sec. 2704(b).
    - Prior to the passage of Chapter 14 in 1990, case law for valuing proportionately held family enterprises generally held as follows:

      (i) That the legal rights and interests inherent in that property must first be determined under state law and after that determination is made is federal tax law then applied to determine how such rights and interests will be taxed;

      (ii) That transfers of non-controlling interests in family enterprises are to be valued the same way non-controlling interests in non-family enterprises are valued; and

      (iii) There are no special valuation premiums because of family attribution for closely held family enterprises.

    - For purposes of determining the fair market value of the gifts of closely held interest in a family enterprise, case law holds the identity and intentions of the recipient of that interest are irrelevant. “The standard is an objective test using hypothetical buyers and sellers in the marketplace, and is not a personalized one which envisions a particular buyer and seller.” Thus, family relationships are ignored, and the ownership of a controlling interest among a family’s members when each ownership interest is attributed to the others is also ignored.

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

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

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

> The value of property transferred by gift or includable in the decedent's gross estate generally is its fair market value at the time of the gift or death. Fair market value is the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. sec. 20.2031-1(b)). This standard looks to the value of the property to a hypothetical seller and buyer, not the actual parties to the transfer. Accordingly, courts generally have refused to consider familiar relationships among co-owners in valuing property. For example, courts allow corporate stock to be discounted to reflect minority ownership even when related persons together own most or all of the underlying stock.
>
> . . . .
>
> *The bill does not affect minority discounts or other discounts available under present law.*
>
> . . . .
>
> *. . . the bill does not affect the valuation of a gift of a partnership interest if all interests in the partnership share equally* in all items of income, deduction, loss and gain in the same proportion *(i.e.*, straight-up allocations).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Private Wealth Management

Strategic Wealth Advisory Team - Biographies

Strategic Wealth Advisory Team

Biographies

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

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

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

Jeff joined Goldman Sachs in October 2000, after spending nine years with Arthur Andersen in Houston in the Private Client Services group as a Senior Tax Manager. Jeff's experience includes developing and implementing innovative strategies to assist his clients in meeting their income tax, estate tax, and financial planning goals. He has co-written or assisted with published articles addressing issues of estate planning, income tax planning, single stock risk management and stock option planning. He has been a past speaker at various tax conferences sponsored by state bar associations and law schools. He was recently named one of the "Top 100 Wealth Advisors" to ultra-high net worth individual clients in the United States by Citywealth magazine. He earned his B.S. in Economics with honors from the WDozoretzon School of the University of Pennsylvania.

Strategic Wealth Advisory Team (continued)

Biographies

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

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

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

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

Strategic Wealth Advisory Team (continued)

Biographies

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

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

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

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

Strategic Wealth Advisory Team (continued)

Biographies

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

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

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

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

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

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

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