THE HISTORY AND FUTURE OF VALUATION DISCOUNT PLANNING©

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S. Stacy Eastland
Houston, Texas

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THE HISTORY AND FUTURE OF VALUATION DISCOUNT PLANNING©

I. SELECTED HISTORY OF VALUATION DISCOUNT PLANNING FROM 1978 TO 2000.

A. 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.

In 1978 the highest marginal estate tax rate was 70%, which meant that for every dollar a beneficiary of an estate received the IRS received over $2.00. If the estate consisted of zero basis or low basis assets, the estate was also subject to capital gains taxes under the carryover basis tax. The long-term capital gains rate under the 1976 Act for the tax year 1978 was 39.875%. Thus, for a zero basis asset the assumed combination rate for both taxes at the top marginal bracket was 82% (after the permitted adjustment to basis for the estate tax). Stated differently, if such an asset was sold by the executor, for every dollar a decedent's heirs received, the IRS received over $5.55. In 1980 the carryover basis tax was retroactively repealed. The top marginal estate tax rate from 1984 through 2001 was 55%. The long-term capital gains rate from 1978 to 2000 was as follows:

Capital Gains Tax Rates From 1978 to 2000	
Year(s)	**Top Rate**
1978	**39.875%**
1979 – 1980	**28%**
1981	**23.7%**
1982 - 1986	**20%**
1987 – 1990	**28%**
1991 – 1992	**28.9%**
1993 – 1996	**29.2%**
1997 - 2000	**21.2%**

B. First Big Breakthrough: Family Attribution is Ignored by the Courts in the Valuation of Transferred Interests in a Family Entity.

1. Initial IRS Position.

Valuation planning with family entities would not have been possible if the courts had agreed with the IRS position that no minority shareholder discount is allowed with respect to transfers of stock between family members if, based upon a composite of the family members' interests at the time of the transfer, control (either majority voting control or de facto control through family relationships) of the corporation exists in the family unit. 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.

2. *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.

3. 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.

4. 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.

In 1975, Daniel J. Harrison, Jr. empowered his son, Daniel J. Harrison, III, (Dan) to manage his assets, including his ranching properties, other real estate, and oil and gas interests. In 1979, Dan and Bruce F. Harrison, Dan's brother, organized Harrison Interests, Ltd., a Texas limited partnership, and contributed the elder Harrison's interests to the partnership in return for a one percent general partnership interest and a 77.8% limited partnership interest. Bruce and Dan also contributed property of their own in return for separate 10.6% general partnership interests. The properties contributed by the sons were not given to them by the elder Harrison. The value of the father's contribution to the partnership upon formation was $59,476,523, while his sons each contributed property valued at $7,981,351. Under the partnership agreement, any general partner had an absolute right to force dissolution of the partnership; however, this right did not pass to a partner's estate.

In 1980, the elder Harrison died, and Bruce and Dan exercised an option they had to purchase their father's general partnership interest for $757,116. In the estate tax return, the executor included in the gross estate Harrison's limited partnership interest which passed at death and which the IRS stipulated had a fair market value of $33,000,000. The difference between the value stipulated for the limited partnership interest and the value of the property that the elder Harrison contributed in return for his limited partnership interest was attributable entirely to the expiration at death of the decedent's right as a general partner to force dissolution of the partnership. The IRS argued that the limited partnership interest had a value equal to the value of the property contributed to the partnership, $59,000,000, i.e. that the expiration of the right to dissolve should be disregarded.

Tax Court Judge Shields held that the estate was not liable for the additional taxes and found that the value of the partnership interest at Harrison's death was the stipulated value of $33,000,000. The court agreed with the estate that the right to dissolve the partnership accounted for the difference between the stipulated value and the value of the property contributed, but since the right to dissolve the partnership expired at Harrison's death, the stipulated value controlled for estate tax purposes.

The court found that the formation of the partnership had a valid business purpose of providing a vehicle through which to manage the decedent's interests. The court also found that the agreement was not a substitute for a testamentary disposition because it applied to all the partners, because the decedent received consideration for his partnership interest, and because it was not proved that the partnership was not formed for business purposes. Key parts of Judge Shields' opinion holding for the taxpayer are as follows:

> …
>
> Respondent relies on sections 2033, 2035, 2036, 2037, 2038, and 2041 in support of his argument that the value of decedent's limited partnership interest for estate tax purposes is $59,555,020, the amount at which he could have forced its liquidation immediately before his death.
>
> Respondent's reliance upon section 2033 is inapposite, however, as is well illustrated by the reasoning in United States v. Land, 303 F.2d 170, 171-173 (5th Cir. 1962), cert. denied 371 U.S. 862 (1962).
>
> …
>
> Having determined that the property interest to be valued is that which passed to the decedent's estate, we must now decide how to value it. As stated in United States v. Land, supra, we must pinpoint our valuation at the instant of death, "the moment of truth, when the ownership of the decedent ends and the ownership of the successor begins." 303 F.2d at 172. The value thus pinpointed is to be determined by reference to the classical fair market value, the amount at which the limited partnership interest would have changed hands between a willing seller and a willing buyer with neither being under any compulsion and both having reasonable knowledge of the relevant circumstances. Section 2031; section 20.2031(b), Estate Tax Regs. As also noted in Land, a potential buyer of the partnership interest would focus on the value of such interest in the present or the future, not the past. Thus decedent's right during life to liquidate the partnership would no longer be available to enhance the value of the partnership interest after his death. Put simply, the only purchase available to such a potential buyer in this case would be the limited partnership interest without any right to liquidate the partnership. As previously indicated, the parties have stipulated that the value of such interest is $33,000,000.
>
> Respondent next contends that under section 2035 the gross estate includes the right to liquidate the partnership as property transferred by the decedent without adequate and consideration during the three-year period ending on his death. In this connection, respondent argues that when the decedent originally transferred his assets to the partnership he failed to retain for his estate the right to liquidate the partnership while the other partners retained such right for their estates. Thus,

> according to respondent, decedent transferred without adequate consideration and in contemplation of death something of value to the other partners when the partnership was created. We disagree because we find that Dan and Bruce did not retain a liquidation right for their estates since, in this respect, the partnership agreement treats all three partners equally. Furthermore, as stipulated to by respondent, the decedent received partnership interests equal in value to the assets he contributed to the partnership; thus, there was adequate and full consideration for his transfer. Moreover, no transfer was made by decedent to Dan and Bruce since they received partnership interests having stipulated values equal to the assets they contributed to the partnership.
>
> Respondent also contends that under section 2036 the gross estate includes the right to liquidate the partnership as property transferred by the decedent without adequate consideration and over which he retained for his life the right to possession, enjoyment, or the income therefrom. As noted above, decedent's transfer to the partnership was for a full and adequate consideration. In addition, he retained no rights in the transferred property, but instead acquired partnership interests having equal value.
>
> We are also unable to agree with respondent's contention that the decedent's estate includes the right to liquidate the partnership under section 2037 as property transferred by the decedent without adequate consideration where he retained reversionary interest in the property and the enjoyment of the property could be obtained only by surviving the decedent. Here again, this section is not applicable because there was adequate and full consideration given for decedent's transfer. Furthermore, he did not retain a reversionary interest in the assets, and the enjoyment of the other partners of their interest in the assets contributed by him to the partnership was not postponed until the death of decedent.
>
> Section 2038 is equally inapplicable because there was no gratuitous transfer by the decedent and he retained no right to alter or terminate the transfer to the partnership.
>
> Section 2041 is inapplicable because decedent did not retain a general power of appointment over the property transferred to the partnership.
>
> In conclusion, given the facts stipulated to by respondent and the absence of any proof putting into question the purpose of the partnership, we hold that for estate tax purposes the value of the decedent's limited partnership interest was $33,000,000.

The Shields 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.

C. 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.

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.[1] The Senate rejected that legislation, and it did not become the law. However, the Revenue Act of 1987 did add IRC Sec. 2036(c), which targeted so-called "estate freezes." (Congress repealed IRC Sec. 2036(c) when it enacted Chapter 14 in 1990.[2]) The legislative history with respect to IRC Sec. 2036(c) made it clear that Congress was not targeting entity discounts with the passage of IRC Sec. 2036(c).[3] For instance, the House Report made it clear that IRC Sec. 2036(c) did not change the law with respect to the valuation of pro rata corporations and partnerships: "[t]hus, section 2036(c) does not apply if the transferor retains an undivided interest in property, *i.e.*, a fractional or percentage share of each and every interest in the property."[4]

Thus, in 1987 Congress rejected legislation that would have overturned the above case law by eliminating minority and other discounts. (See also Section II C of this paper.)[5]

However, Congress did add new IRC Sec. 2036(c) to limit estate freezes and that change was heavily criticized. Consider what this author wrote in 1989:[6]

> The House of Representatives Ways and Means Committee Conference Report accompanying TAMRA[7] stated that there were two reasons why Congress

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[1] H.R. REP. NO. 100-3545, at 1041-1044 (1987).

[2] Omnibus Budget Reconciliation Act of 1990, P. L. 101–508, 104 Stat. 1388.

[3] H. R. REP. NO. 100-495, at 995 (1987).

[4] H.R. REP. NO. 100-795, at 423 (1988).

[5] Similarly, as already referenced (see Section II D of this paper), the Senate Report in 1990 made it clear that the 1990 Act (referred to in the Senate Report as "the bill") was not intended to affect the fundamentals of estate and gift tax valuation discussed above or the discounts involved in the valuation of an interest in an entity, including a pro rata partnership.

[6] "The Legacy of IRC Section 2036(c): Saving The Closely Held Business After Congress Made 'Enterprise' A Dirty Word." S. Stacy Eastland, Real Property Probate and Trust Journal, Volume 24, Number 3, Fall 1989.

[7] *See* H.R. Rep. No. 100-795, 100th Cong., 2nd Sess. 418-419 (1988) (hereinafter cited as 1988 House Report). The six primary sources establishing and explaining the new section 2036(c) transaction tax are the statute itself, the 1987 joint Committee of Taxation Conference Report on the Omnibus Budget Reconciliation Act, H.R. Rep. No. 100-495, 100th Cong., 1st Sess. 995 (1987) (hereafter cited as 1987 Conference Committee Report), the 1988 House Report, the Senate Report issued in conjunction with RAMRA, S. Rep. No. 100-445, 100th Cong., 2nd Sess. 522 (1988) (hereafter cited as 1988 Senate Report), the Statement of Managers, issued by the Joint Committee on Taxation in conjunction with TAMRA, TAMRA 1988 Stand. Fed. Tax Rep. (CCH No. 53, 92 (Oct. 24, 1988) (hereafter cited as 1988 Managers' Report), and Notice 89-99, 1989-39 I.R.B. 4 (hereafter cited as Notice). The key

> decided to punitively tax estate freezes. The first stated reason was inherent difficulties exist in valuing common stock that is sold or given away by a transferor in conjunction with an estate freeze transaction. According to the 1988 House Report, the Internal Revenue Service did not have the resources to either adequately value the common stock or, in some cases, even to detect that a gift had been made.[8] The second stated reason for penalizing estate freeze transactions was that essentially these transactions are testamentary in nature, because the transferor retains income in the enterprise and, thus, retains enjoyment of the whole enterprise until the moment of death. If a transferor creates a trust and retains the right to receive income from the trust for life, the trust corpus will be includible in the transferor's gross estate for federal estate tax purposes under Section 2036(a)(1). Courts have refused, however, to treat preferred stock in an enterprise as if it were a retained life estate for purposes of including the value of the enterprise in the decedent's estate under Section 2036(a)(1) [and have applied Section 2033 to the exclusion of Section 2036].[9] According to the 1988 House Report, it was necessary for Congress to remedy that refusal by adopting Section 2036(c).

By 1990, it became apparent to many commentators[10], including this one, that IRC Sec. 2036(a) inclusion, in lieu of IRC Sec. 2033 inclusion, with respect to ownership in partnerships and other "enterprises" should be repealed because of numerous problems. Those problems included the following:

> Sometimes the transfer tax system is abused by estate freeze planning but the abuse does not lie in the retention of preferred stock or a preferred partnership interest by the transferor. There is nothing sinister or improper about owning preferred stock or a preferred partnership interest. The economic rights associated with preferred ownership interests serve an extremely useful purpose in the capital market. Many capital investors find an equity interest that bestows a preferred income stream, preferred voting rights, and preferred liquidation preferences suitable for their investment goals. In the closely held family business context, preferred interests are an extremely useful capital concept because it is extremely rare to find a family whose members have equal abilities to run the business, or

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source at this time is the Notice, however, because of the tremendous power that has been delegated by Congress to the Treasury Department under Section 2036(c)(8):

> The secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purpose of this subsection, including such regulations as may be necessary or appropriate to prevent avoidance of the purposes of this subsection through distributions or otherwise.

[8] 1988 House Report at 418-419 (cited in note 4).

[9] Courts have reasoned that the receipt of income from the retained preferred stock is only a retention of income from the preferred stock, not from the assets of the entire enterprise and accordingly should be included under Section 2033, not Section 2036(a). See Estate of Boykin v. Commissioner, 53 T.C.M. (CCH) 345 (1987).

[10] *See* Dees, Section 2036(c): The Monster That Ate Estate Planning And Installment Sales, Buy-Sells, Options Employment Contacts and Leases, 66 Taxes 876 1988).

who all have a desire to participate as employees in the family business. Preferred ownership interests fairly compensate those family members who are not receiving compensation as employees of the business. Occasionally, family owners reach retirement and no longer are employed by the family business. In those circumstances, preferred ownership interests are extremely useful capital structures that allow a portion of the income stream of the business to be directed to that family owner.

Congress implicitly recognized that there is nothing inherently evil in the ownership of preferred interests for enterprises that are not closely held. For example, an individual of significant wealth may convert that wealth into ownership of preferred stock and common stock of General Motors. That individual could convey the common stock to a child without Section 2036(c) applying to bring the future value of that common stock into the individual's gross estate.

The clear discrimination against closely held businesses under Section 2036(c) is justified, according to the legislative history, because the common stock or growth partnership interest of a closely held enterprise is more difficult to value than the common stock of General Motors. Because Section 2036(c) did not eliminate the need to value the transferred common stock or growth partnership interest, the way to attack the valuation problem would be to aid the Internal Revenue Service in valuing transferred common stock or growth partnership interests.

* * *

A second criticism of Section 2036(a) inclusion is that it is based on a flawed analogy and concept. Besides the valuation problems noted by Congress, the other reason given for adoption of Section 2036(c) was that a transferor's retention of preferred stock after a conveyance of common stock is analogous to creation of a trust in which the settler retains only an income interest, in which case Section 2036(a)(1) would include the entire value of the trust in the transferor's gross estate. Transferred common stock is not includible in a deceased transferor's estate by operation of Section 2036(a)(1), operating without Section 2036(c), because the transferor has not retained rights in the transferred common stock. Thus, the asserted analogy is not appropriate.

To illustrate this, assume a transferor (T) creates two trusts. One trust will be includible in T's estate under Section 2036(a)(1) because T retains an income interest, but the other trust will not be includible in T's estate because T is not a beneficiary of the trust (assume T's children are the sole beneficiaries of the trust.) Finally, assume that T transfers General Motors preferred stock into the retained income trust and transfers General Motors common stock into the trust created for the children. General Motors will allocate a disproportionate amount of the income generated by its assets to the retained income trust and a disproportionate amount of the appreciation of its assets to the trust created for T's children. Under Section 2036(a)(1) the only trust that will be included in T's estate is the retained income trust because T retained no interest in the General Motors common stock that was transferred to the children's trust. T did not retain the right to income, either directly or indirectly, of that common stock. If the facts were changed to assume stock in Family Co. Ranching Operations, the common stock would be includible in T's estate, not under Section 2036(a)(1) but, instead, under Section 2036(c), which ignores the fact that T has not retained an income interest in the common stock.

Even if the analogy to Section 2036(a) were appropriate, and if Congress wished to reform the transfer tax system to make the treatment of trusts consistent with the treatment of family enterprises, the solution would not be to create Section 2036(c) to bring enterprises within the fold of Section 2036(a). Instead, the solution would be to eliminate Section 2036(a) in its present form. The estate taxation of trusts because of retained income interests, particularly in light of the unified transfer tax system that has existed since 1976, is unfair and unnecessary. [See Treasury I]

* * *

The third principal flaw [in application of IRC Sec. 2036(c) for IRC Sec. 2036(a) inclusion] is that, while it discourages the utilization of preferred ownership interests, it does not eliminate "freezes" or solve valuation problems. Taxpayers may pay a heavy tax cost under Section 2036(c) if they convert a growth interest in a family business to a preferred ownership interest, which discourages taxpayers from using an equity tool that can solve many family business ownership problems. Meanwhile, Section 2036(c) has compounded the valuation problems inherent in determining the value of transferred growth interests and has not eliminated numerous freezes in family businesses, some of which have been endorsed specifically by Congress. Having failed in its two objectives, Section 2036(c) should not be left also to dissuade legitimate nontax planning in family businesses.

Because the language of Section 2036(c) abandons traditional property law concepts, and applies to transfers that have no inherent gift element, a fourth criticism of it is that application of the tax cannot be predicted with certainty, which is always bad in a voluntary compliance system. Moreover, Section 2036(c) encourages investment in self-gratification assets instead of job-producing enterprises, which also is a poor policy result. Indeed, because of the Service's interpretation that personal use assets are not subject to Section 2036(c), Congress appears to have passed an estate tax statute that opposes the Section 162 and 212 income tax policy of encouraging investment in enterprises.

D. Third Big Breakthrough: In 1990 Congress Repealed IRC Sec. 2036(c) and Added New Valuation Rules Under Chapter 14 of the Internal Revenue Code.

Commentators were not the only persons who had concluded by 1990 that IRC Sec. 2036(c) exemplified poor tax policy, and that estate tax inclusion under IRC Sec. 2036 was not the right solution to the estate freeze problem. Several prominent Republican Senators felt this way. What is perhaps noteworthy is that several powerful Democrat Senators felt the same way. Thus, the repeal of IRC Sec. 2036(c) enjoyed rare bi-partisan consensus. Consider the following statements before the Senate on October 17, 1990:[11]

> MR. BENTSEN. Mr. President, I am introducing legislation today that will repeal section 2036(c) of the Internal Revenue Code and provide new rules to limit evasion of Federal estate and gift taxes by means of estate freezes.
>
> The Omnibus Reconciliation Act of 1987 contained section 2036(c). . . . Unfortunately, the cure 3 years ago turned out to be worse than the disease. The complexity, breadth and vagueness of the new rules have posed an unreasonable impediment to the transfer of family businesses.
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> . . .
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> Senators Boren and Daschle, in particular, have labored long and hard on this issue. I commend them on their efforts, as this bill would not have been possible without their assistance. Earlier this year, they chaired a joint hearing of the Subcommittee on Taxation and Debt Management and the Subcommittee on Energy and Agricultural Taxation. At that hearing the subcommittee members reviewed proposals from the American Bar Association and American College of Probate [*sic*, Counsel], the Tax Section of the D.C. Bar, the U.S. Chamber of Commerce, and the American Institute of Certified Public Accountants. In addition, they heard from a wide range of estate planners, small business representatives and the Treasury Department. All witnesses agreed that the current rules should be repealed. Most witnesses testified that these rules should be replaced with a rule that is targeted to valuation abuses. That is exactly what this bill does.
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> We have worked hard to balance taxpayers concerns with our concerns about transfer tax abuses. I'm convinced that this proposal is a reasonable approach to the problem.
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> * * *
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> MR. BOREN. Mr. President, I am pleased today to join with my colleagues Senator Bentsen and Senator Daschle in introducing this legislation that will repeal section 2036(c) of the Internal Revenue Code. At a time when we should be doing all that we can to help keep small family owned businesses afloat section 2036(c), known as the estate freeze provision, poses a real treat to their survival.
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> . . .
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> The legislation we are introducing today repeals section 2036(c) and instead provides for special valuation rules for estate freezes. The current law is overly broad and unintelligible to even the most sophisticated counsel, let alone

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[11] Congressional Record, 101st Congress S. 3113: pg. 1-4 (October 17, 1990).

counsel representing many small family owned business or farms throughout the United States. It is worth nothing that even supporters of 2036(c), few though they may be, concede that the 1987 law was clumsily fashioned. What they really mean is that virtually every knowledgeable observer has concluded that the new rules are simply unadministrable and not at all subject to a patch-up job of revision. While Treasury and other academics have suggested modifications, very few have come forward with hard and fast revisions. Given the tremendous burdens this rule places upon family owned small business the only fair and meaningful course is to cleanly and clearly start over with repeal.

. . .

I believe the most efficient way to solve this problem is to repeal section 2036(c) and start over. We should begin with a clean slate, only then can we begin to consider a much more narrow, focused and equitable alternative to the current section 2036(c). I believe the legislation we are introducing today is such an alternative. I urge my colleagues to join us in supporting this legislation.

* * *

MR. DASCHLE. Mr. President, I am pleased to join my distinguished colleagues, Senator Lloyd Bentsen, chairman of the Finance Committee, and Senator David Boren, in introducing legislation to repeal section 2036(c) of the Internal Revenue Code and replace it with a significantly more limited measure that is fairer to family businesses.

Last year, I introduced a bill, S. 349, that would repeal section 2036(c). At that time, I indicated that I would be open to consideration of a more limited substitute – one that was targeted strictly at the estate tax abuses that allegedly were occurring prior to the enactment of section 2036(c). I also expressed an interest in working with Senator Bentsen in this endeavor.

After extensive review of alternative options, including meetings with small business groups and hearings on this issue in the Finance Committee, Senator Bentsen and I have what we believe is a reasonable alternative to current law section 2036(c).

Our bill addresses three major concerns I have about current law. First, current law takes an approach that throws the baby out with the bathwater. Consequently, a wide rage of otherwise legitimate transactions are suspect under its provisions. The bill we are introducing today takes the opposite approach. It says, 'These specifically identified abuses are impermissible.' Period. In this way, family business owners who wish to pass the business on to their children gradually during their lifetimes can do so with a clear understanding of those means which are permissible.

Second, under [application of Section 2036(a) in lieu of Section 2033], *the IRS can find a transaction unenforceable for estate tax purposes years, perhaps decades, after the transaction occurs. Like a number of other substitute proposals that have been advanced, our bill addresses potential abuses at the time the transaction occurs. This ensures that the appropriate amount of gift tax is paid at* *that time, leaving owners of businesses with confidence that the transaction will not be found invalid years later when they die and it is too late to do anything about it.*

Finally, section 2036(c) is simply too ambiguous and confusing. Senator Bentsen and I have sought to make our bill much simpler and straightforward. [Emphasis added.]

* * *

Congress did retroactively repeal the application of IRC Sec. 2036(a) inclusion to business and other financial enterprises in lieu of IRC Sec. 2033 inclusion. Among the reasons cited by the Senate in its legislative history were the following:

> The [Senate Finance] committee believes that an across-the-board inclusion rule [application of Section 2036(a)] is an inappropriate and unnecessary approach to the valuation problems associated with estate freezes. The committee believes that the amount of any tax on a gift should be determined at the time of the transfer and not upon the death of the transferor . . . . In developing a replacement for current section 2036(c) the committee sought to accomplish several goals: (1) to provide a well defined and administrable set of rules; (2) to allow business owners who are not abusing the transfer tax system to freely engage in standard intra-family transactions without being subject to severe transfer tax consequences; and (3) to deter abuse by making unfavorable assumptions regarding certain retained rights.[12]

Congress adopted the suggestion of numerous commentators and approached the reform with respect to inclusion of partnership interest and corporate interest as a valuation problem. It reaffirmed the traditional inclusion and taxation of partnership interests, in which part of the partnership is held in preferred form, under IRC Secs. 2511 and 2033. Those sections were modified, however, through the passage of new valuation rules under Chapter 14.

The legislative history in enacting the new valuation rules made it clear that Congress, once again, was comfortable with existing case law 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

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[12] Informal Senate report accompanying the Revenue Reconciliation Bill of 1990 (S. 3209) as printed in the Oct. 18, 1990, Congressional Record, vol. 136, s. 15679 (Daily Edition) (emphasis added).

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).[13]

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.

E. 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.

F. 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 Sec. 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.

[13] 136 CONG. REC. § 15679, 15681 (October 18, 1990) (emphasis added).

See also the discussion of the Valuation Training for Appeals Officers, issued by the IRS National Office in 1994 in Section III B 3 (b) (4) of this paper. Based on that publication, the IRS National Office in 1994 agreed that even after passage of Chapter 14 family attribution was irrelevant for determining value under transfer tax law.

II. THE 2000 PERSPECTIVE OF THIS AUTHOR AS TO SELECTED TRANSFER TAX FUNDAMENTALS THAT AFFECTED THE CREATION AND TRANSFER OF INTERESTS IN FAMILY ENTITIES.

What follows is an excerpt from this writer's paper, "The Art of Making Uncle Sam Your Assignee Instead of Your Senior Partner: The Use of Partnerships in Estate Planning," which was prepared on January 16, 2001:

* * *

Consider the following example as an illustration of the gift and estate tax consequences of a typical FLP.

Example 1: Pro Rata Partnership

Sam Selfmade owns an undivided 80% interest and each of his two children, Sonny Selfmade and Betsy Bossdaughter, own an undivided 10% interest in some undeveloped land outside of a thriving metropolitan area. The land is worth $1,500,000. Sam, Sonny, and Betsy decide to contribute the land to a FLP ("Selfmade Interests, Ltd."). Sam receives a 1% general partnership interest and a 79% limited partnership interest, and each of his children receives a .5% general partnership interest and a 9.5% limited partnership interest.

The partnership agreement gives each partner the same pro rata rights to income and loss allocations and cash distributions, and the dissolution and liquidation provisions mirror state law. There will be a 50-year term, unless all of the partners agree to terminate the partnership sooner. The limited partners are prohibited from withdrawing before the partnership dissolves and liquidates, and if any general partner tries to withdraw before the end of the term, his or her general partnership interest will be converted to a limited partnership interest. No partner may transfer a partnership interest outside of the family without first giving the other partners the right to buy that partnership interest at its fair market value, defined in the agreement by reference to the distributable cash flow method of valuation, although there is an exception to the buy-sell provisions which applies at the death of a general partner and allows a general partner's personal representative to continue as a general partner. Any transferee of a partnership interest, unless admitted to the partnership as a partner by the unanimous consent of the existing partners, has no rights other than succeeding to the distributive share of the transferring partner; in other words, assuming that the transferee is not admitted as a partner, he or she will be a mere "assignee" with no management rights or withdrawal rights. At the time the partnership is created in 1998, its prospects and the restrictive terms of the partnership agreement make Sam's partnership interests worth only $480,000 (60% discount) to a hypothetical willing buyer.

After the partnership is created, Sam, Sonny, and Betsy develop a shopping center on the property. Although the shopping center is successful, virtually all of the cash flow is retained by the partnership to develop new opportunities, and the average distributable yield to the partners is approximately 3% of the underlying asset value of the partnership.

When Sam dies in 2005 leaving his interests to Sonny and Betsy, the partnership net assets are worth $30,000,000. However, if Sam's executor were to sell Sam's general and limited partnership interests, he would receive only $9,600,000 from a hypothetical willing buyer, reflecting a 60% discount from the underlying $24,000,000 asset value attributable to Sam's total interest. This discount results from the low distributable yield on Sam's partnership interests and the fact that any buyer would be a mere assignee of a partnership interest with no management rights and no liquidation rights (at least for another 40 years). Contrast a scenario in which Sam's executor has the right to liquidate the partnership, in which case the estate's interests in the partnership would be worth $24,000,000.

Is the difference between the value of Sam's contribution ($1,200,000) to Selfmade Interests, Ltd. and the value of his partnership interest ($480,000) subject to gift taxes? When Sam dies, is the difference between what a hypothetical buyer will pay ($9,600,000) and the liquidation value ($24,000,000) subject to estate taxes? Assuming the partnership agreement is drafted and administered in a manner that avoids the potential IRS positions delineated in Section III of this paper, the answer to those questions is "no" because of the key fundamentals discussed below.

A. 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.

The valuation of an interest in a limited partnership must be based on the value of that interest when transferred from one person to another, not the value when held by the transferor, because of the Constitution. The Constitution provides that "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."[14] In plain terms, therefore, all *direct* taxes are unconstitutional unless levied across the country in proportion to the states' populations. This clear constitutional prohibition against direct taxes raises two questions: (i) what is meant by a direct tax; and (ii) under what circumstances will a gift, estate, or generation-skipping tax not be considered a direct tax?

1. What Constitutes a Direct Tax.

The definition of direct taxes is found in *Pollock v. Farmers' Loan & Trust Co.*[15] The issue before the Supreme Court in *Pollock* was the constitutionality of a federal income tax. The taxpayer argued that a tax on the income from property is the same thing as a direct tax on the property itself.[16] In agreement, the Supreme Court held clearly and conclusively as follows:

> *First.* We adhere to the opinion already announced, that, taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes.

[14] U.S. CONST. art. I, § 9, cl. 4.

[15] 157 U.S. 429, *reh'g granted*, 158 U.S. 601 (1895).

[16] *Pollock*, 157 U.S. at 555.

> *Second.* We are of opinion that taxes on personal property, or on the income of personal property, are likewise direct taxes.[17]

The Court's lengthy analysis rests heavily on the substance-over-form rationale advanced by the taxpayer that a tax on the income from property simply cannot be distinguished from a tax on the property itself.[18] After *Pollock*, therefore, there could be no federal income tax without an amendment to the Constitution, and the Supreme Court's decision in *Pollock* in fact led to the Sixteenth Amendment.

It is quite clear since Pollock that a tax on the value of either real or personal property is a direct tax. Further, a tax merely on the income from either type of property is a direct tax, but one that is permitted by the Sixteenth Amendment. *Therefore, the gift tax, estate tax and generation-skipping tax cannot be valid unless it is a tax on something other than the value of the decedent's property per se.*

2. The Gift, Estate, and Generation-skipping Taxes Will Avoid Being Considered a Direct Tax Only to the Extent They Operate as an Excise Tax on the Transfer of Property.

The Supreme Court often has held or stated that succession taxes, inheritance taxes, estate taxes, and other death taxes will not be considered direct taxes on property if they are applied in a manner that is merely an excise tax on the transfer of property at death.[19]

The seminal case on the matter is *Knowlton v. Moore*, in which the Court stated as follows:

> Taxes of this general character are universally deemed to relate, not to property *eo nomine*, but to its passage by will or by descent in cases of intestacy, as distinguished from taxes imposed on property, real or personal, as such, because of its ownership and possession. In other words, the public contribution which death duties exact is predicated on the passage of property as a result of death, as distinct from a tax on property disassociated from its transmission or receipt by will, or as the result of intestacy.[20]

After considering the approach used in other nations and colonies, the Court in *Knowlton* concluded that the "tax laws of this nature in all countries rest in their essence upon the principle

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[17] *Pollock*, 158 U.S. at 637.

[18] *Pollock*, 157 U.S. at 580-83.

[19] *See, e.g.*, *Scholey v. Rew*, 90 U.S. (23 Wall.) 331 (1874); *Knowlton v. Moore*, 178 U.S. 41 (1900); *Murdock v. Ward*, 178 U.S. 139 (1900); *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921); *Greiner v. Lewellyn*, 258 U.S. 384 (1922); *Young Men's Christian Ass'n v. Davis*, 264 U.S. 47 (1924); *Chase Nat'l Bank v. United States*, 278 U.S. 327 (1929); *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929); *Tyler v. United States*, 281 U.S. 497 (1930); *United States v. Jacobs*, 306 U.S. 363 (1939); *United States Trust Co. v. Helvering*, 307 U.S. 57 (1939); *Fernandez v. Wiener*, 326 U.S. 340 (1946); *United States v. Manufacturers Nat'l Bank of Detroit*, 363 U.S. 194 (1960); *United States v. Wells Fargo Bank*, 485 U.S. 351 (1988).

[20] *Knowlton*, 178 U.S. at 47.

that death is the generating source from which the particular taxing power takes its being, and that it is the power to transmit, or the transmission from the dead to the living, on which such taxes are more immediately rested."[21]

In *United States v. Wells Fargo Bank,*[22] Justice Brennan's opinion recognizes that the estate tax, unlike the income tax, is not a direct tax but rather is an excise tax that may be levied only upon the use or transfer of property. That opinion states:

> Of course, we begin our analysis of § 5(e) with the statutory language itself. This section states that "[Project Notes], including interest thereon, . . . shall be exempt from all taxation now or hereafter imposed by the United States." Well before the Housing Act was passed, an exemption of property from all taxation had an understood meaning: the property was exempt from *direct* taxation, but certain privileges of ownership, such as the right to transfer the property, could be taxed. Underlying this doctrine is the distinction between an excise tax, which is levied upon the use or transfer of property even though it might be measured by the property's value, and a tax levied upon the property itself. The former has historically been permitted even where the latter has been constitutionally or statutorily forbidden. The estate tax is a form of excise tax.[23]

In *United States v. Manufacturers Nat'l Bank*,[24] the Supreme Court observed that "[f]rom its inception, the estate tax has been a tax on a class of events which Congress has chosen to label, in the provision which actually imposes the tax, 'the *transfer* of the net estate of every decedent.'"[25] In that case, the Court sought to find a transfer, reflecting the critical threshold test of every case in which an estate tax is to be assessed: identify the transfer.

If Congress wanted to tax all property interests owned by a decedent, irrespective of the taxes associated with any transfer that may have occurred as a result of the decedent's death, it could do so simply by amending IRC Sec. 102 to make bequests, devises, and inheritances subject to the income tax. This is true because the federal income tax is a permissible direct tax on property under the Sixteenth Amendment to the Constitution. However, until a similar constitutional amendment is adopted with respect to estate and gift taxes, it is unconstitutional to assess estate and gift tax in a manner that constitutes an unapportioned direct tax.

Therefore, only that property which is *transferred* as a result of a taxpayer's death or by gift during the taxpayer's life can be subjected to taxation under the federal estate and gift tax system. The tax cannot be a "wealth tax" or "property tax" on the intrinsic value of an asset to the decedent or donor at the time the transfer occurs; rather, it must be a tax only on the value transferred.

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[21] *Id*. at 56.

[22] 485 U.S. 351 (1988).

[23] *Id*. at 355.

[24] 363 U.S. 194 (1960).

[25] *Id*. at 198.

IRC Sec. 2033 expansively defines a decedent's gross estate to include all assets owned by the decedent at the time of his death for purposes of calculating the decedent's estate tax, irrespective of whether all or part of those assets are to be transferred to the decedent's heirs. Specifically, IRC Sec. 2033 provides that "the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death."[26]

Although the IRC expansively defines a decedent's gross estate to include all assets owned by the decedent at the moment of his death, the U.S. Treasury through its own regulations recognizes that in certain instances such inclusion would be unconstitutional. The decedent's property must not only be owned by the decedent at the moment of his death, but must also be transferable. The Treasury Regulations provide that "the estate tax . . . is an excise tax on the transfer of property at death and is not a tax on the property transferred."[27] The Regulations add the following helpful example of an asset of the decedent that in many cases has significant value at the moment of death, but very little transferable value (and, thus, very little value for estate tax purposes):

> [A] cemetery lot owned by the decedent is part of his gross estate, but its value is limited to the salable value of that part of the lot which is not designed for the interment of the decedent and the members of his family.[28]

A cemetery lot could be sold for considerable value at the moment of death. However, under the regulations that part of a cemetery lot in which the decedent is buried is not included in the gross estate and is not subject to tax because it is not transferred to the decedent's heirs at death; rather, it is taken or encumbered by the decedent's remains. The logic of the cemetery lot exception in the Treasury Regulations is a tangible example showing that the estate tax is an excise tax on the transfer of property at death and not a tax on the property transferred.

The following example may be even more indicative of the constitutional limitation on the estate tax than the Treasury's example of the cemetery lot: what would be the estate tax result if a decedent died owning the Coca-Cola formula and directed in her will that her executor was to retrieve the formula from her safe deposit box and burn it? What would be the value of that formula for estate tax purposes if the executor burned the formula six months after the decedent's death? Is the value of the transfer equal to what a hypothetical willing buyer would pay for the Coca-Cola formula at the moment of death or what a hypothetical willing buyer would pay for the ashes? The answer is well stated in the Court's opinion in *Ahmanson Found. v. United States*,[29] in which the Ninth Circuit opined:

> [T]he valuation of property in the gross estate must take into account any changes in value brought about by the fact of the distribution itself. *It is undisputed that the valuation must take into account changes brought about by the death of the testator*. Ordinarily death itself does not alter the value of property

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[26] IRC Sec. 2033.

[27] Treas. Reg. § 20.2033-1(a).

[28] Treas. Reg. § 20.2033-1(b).

[29] 674 F.2d 761 (9th Cir. 1981) (emphasis added).

owned by the decedent. However, in a few instances such as when a small business loses the services of a valuable partner, death does change the value of property. *See United States v. Land, supra*, 303 F.2d at 172. *The valuation should also take into account transformations brought about by those aspects of the estate plan, which go into effect logically prior to the distribution of property in the gross estate to the beneficiaries*. Thus, for example, if a public figure ordered his executor to shred and burn his papers, and then to turn the ashes over to a newspaper, the value to be counted would be the value of the ashes, rather than the papers. Similarly, if a will provides that prior to the distribution of the estate a close corporation owned by the testator is to be recapitalized, with one class of stock in the gross estate exchanged for another, the value of the gross estate would be based on the shares resulting from the recapitalization. *Provident Nat'l Bank v. United States, supra*, 581 F.2d at 1086-87.

. . . The estate tax is a tax upon a transfer. . . . [I]t is a tax on the privilege of passing on property not a tax on the privilege of receiving property.[30]

It is clear that the valuation of what is transferred and subject to estate tax, in the words of *Ahmanson*, takes "into account transformations. . . which go into effect logically prior to the distribution of property in the gross estate to the beneficiaries."[31]

In another Ninth Circuit case, *Estate of McClatchy v. Commissioner*, 147 F.3d 1089 (9th Cir. 1998*)* the court also analyzed the affect changing transfer restrictions had on valuation of stock. The decedent, prior to his death, owned two classes of common stock of a corporation, one class of which was subject to federal securities law transfer restrictions on sales as an affiliate of the corporation. Upon the decedent's death, the restricted stock passed to the executor of his estate. The executor, which was not an affiliate of the decedent, was not subject to the securities law restrictions applicable to the decedent.

The court held that the restricted stock should be valued in the hands of the decedent and should reflect the discount applicable to the restriction on transfer of the stock. The court ruled that death alone in this instance, did not *logically* alter the value of the stock. Instead, the change in value was occasioned by the identity of the transferee (i.e., the executor) and not by death. Thus, according to the court, the property was not transformed prior to the distribution to the heirs of the estate by the lapsing security law restrictions.

Constitutionally, all logical transformations of the decedent's estate must be taken into account, whether those transformations are caused by a burial, the executor's burning of valuable papers or a state law which provides that a decedent cannot transfer a partnership interest--only an assignee interest.

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[30] *Id*. at 768.

[31] *Id*.

B. Second Fundamental: If a Transfer Has Occurred, the Fact That the Transferor and Transferee Are Related to Each Other is Irrelevant to Valuation.

Fair market value of property that has been transferred has long been defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.[32] "All relevant facts and elements of value as of the applicable valuation date shall be considered."[33] Determining what a willing buyer would pay for the property is a question of fact, with the trier of fact having the duty to weigh all relevant evidence of value and to draw appropriate inferences.[34]

For purposes of determining the fair market value of the gifts of 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."[35] 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.

For many years the IRS fought the non-attribution concept with regard to family-controlled businesses; however, the IRS finally reversed its course due to the success of several taxpayers in court. In a 1993 Revenue Ruling, the IRS considered a situation in which a father gave all of his stock in a closely held corporation in equal shares to his five children (20% each) and determined that each 20% interest transferred by the father was entitled to a minority interest discount for valuation purposes. This determination reversed the IRS's prior approach, which required the aggregation of interests held by family members. In other words, the IRS finally admitted that only 20% was *transferred* in each case.[36]

In a technical advice memorandum,[37] 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. Whether the donor owned a controlling interest prior to the transfer and whether the donees were family members or various third parties were not determining factors in valuing

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[32] *Id.* at § 20.2031-1(b).

[33] *Id*.

[34] *Hamm v. Commissioner*, 325 F.2d 934, 938 (Eighth Cir. 1963).

[35] *LeFrak v. Commissioner*, 66 T.C.M. (CCH) 1297, 1299 (1993). *See also Estate of Bonner v. United States*, 84 F.3d 196, 198 (5th Cir. 1996) ("We are precluded from considering evidence submitted by the government regarding who actually received the assets."). This point has also been emphasized in the updated edition of *Valuation Training for Appeals Officers* (1994) (issued by the Service National Office), which stresses the hypothetical willing buyer and seller, and states unequivocally that "it is irrelevant who are the real seller and buyer." *See also Propstra v. United States*, 680 F.2d 1248 (9th Cir. 1982); *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981) (en banc); *Estate of Lee v. Commissioner*, 69 T.C. 860 (1978); *Minahan v. Commissioner*, 88 T.C. 492 (1987) (ordering litigation costs assessed against the IRS for continuing to litigate this issue).

[36] Rev. Rul. 93-12, 1993-1 C.B. 202.

[37] Tech. Adv. Mem. 94-49-001 (Mar. 11, 1994).

each block of stock transferred to a donee or in deciding whether a separate gift was subject to a minority interest discount.

C. Third Fundamental: If a Transfer of a 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 Transfer N*egatively*.

As noted above, it is clear under the law that in determining the fair market value of the partnership interest transferred at death by Sam Selfmade, the identity of the recipients of that interest is not a relevant fact. However, the IRS has taken the position (with case law support) that the identity of the remaining partners at the time of the transfer is a relevant fact in determining what this "outsider," who is the hypothetical willing buyer, would pay for the transferred partnership interest. If upon a transfer of a partnership interest, only one remaining partner objects to the potential purchaser becoming a partner, that person will only be an assignee. That obviously may be a fact that convinces a hypothetical willing buyer that he or she will only become an assignee and will not be admitted as a partner. The IRS has stated that if a willing buyer would acquire a "swing vote," the "minority" or "marketability" discount may not be appropriate.[38] The theory of the "swing vote" is that, even though a single block of stock which is transferred by gift or bequest, by itself, does not represent majority ownership of a corporation, it should not be fully discounted as a minority interest for its lack of control if it is big enough that it could be pooled with the stock held by other large shareholders so that they can obtain control jointly. For example, in *Estate of Winkler v. Commissioner,*[39] the court considered a 10% block of stock in a closely held corporation in which two families held 40% and 50%, respectively. The court determined that a premium should be added to the otherwise fully discounted value of the stock because the "10 percent block . . . could become pivotal."[40] In other words, the court took away a portion of the minority interest discount. The concept also has been discussed in *Estate of Bright v. United States*[41] and *Estate of Davis v. Commissioner*.[42]

By its very nature, however, the "swing vote" argument is a double-edged sword for the IRS. For instance, see *A. D. Davis v. Commissioner,*[43] a case argued for the taxpayer by Baker Botts, LLP (my former firm).

In *Davis*, the decedent, prior to his death, transferred two blocks of common stock of a closely held corporation to two sons. Each son received a block of stock that constituted 25.77% of the issue and outstanding common stock of the corporation. The court rejected valuation based upon swing block potential of each block. The IRS contended that the blocks of stock could enable the sons to influence management and represented a swing block that would lessen the

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[38] *See* Tech. Adv. Mem. 94-36-005 (May 26, 1994); Tech. Adv. Mem. 94-49-001 (Mar. 11, 1994).

[39] 57 T.C.M. (CCH) 373 (1989).

[40] *Id.* at 383.

[41] 658 F.2d 999 (5th Cir. 1981).

[42] 37 T.C.M. (CCH) 341 (1978).

[43] 110 T.C. No. 35 (1998).

discount for lack of marketability. The court agreed with the taxpayer's argument that the value of the block in question had to be determined by considering the actual owners of any remaining stock of the corporation. Since the remaining owners were in each case a cohesive family (i.e., father and son), each block was to be valued separately without any premium for a "swing vote".

The Tax Court in *Furman v. Commissioner*, T.C. Memo. 1998-157 (1998) also ruled that swing vote potential did not exist in the case of an individual who received separate gifts of stock from his parents. Prior to the gifts, the individual owned 40 of the 100 issued and outstanding shares of a family owned corporation. The individual's parents each gifted the individual 6 shares of the stock of the corporation. As a result, the individual owned 52% of the corporation. The IRS argued that the stock gifted should be valued based upon its swing vote potential. The court refuted this argument. The court stated that it is "required to value the shares as if they were transferred to a hypothetical buyer and are not permitted to take into account the circumstances of the actual transferee in valuing the shares."

Estate of Richard R. Simplot, 112 T.C. 130 (1999), is an important valuation case involving voting (Class A) and nonvoting stock (Class B) of a closely held company, J. R. Simplot & Co. (Simplot), a Nevada corporation. The Court valued the company, on a freely traded minority discount basis, at $867 million. At the decedent's death on June 24, 1993, he owned 18 of the 76.445 outstanding shares of voting stock and 3,942.048 of the 141,288.584 outstanding shares of nonvoting stock. The decedent's percentage interest in the voting shares (about 23) was much higher than in the nonvoting shares (about 2.8). The ratio of voting shares to nonvoting shares was 1 to 1,848. The nonvoting shares were owned by descendants of J. R. Simplot (the father of the decedent) and an ESOP. The remaining voting stock was owned by the decedent's three siblings as follows:

Don	18 shares;
Gay	18 shares; and
Scott	22.445 shares.

One of the IRS experts asserted that the voting premium should be 10 percent of Simplot's equity value, and the other proposed a 3 percent premium. The court used the lower voting premium, which resulted in a $5.863 million value for the minority vote in stock, which represents a significant premium above the value for nonvoting stock per share.

Certain observations should be made about the *Simplot* decision. First of all, the Court did recognize that a hypothetical willing buyer would consider the identity of the remaining Class A shareholders. The Court theorized that these remaining shareholders, after 20 or 30 years, would no longer be united as a cohesive family (as there were) and that a hypothetical willing buyer who owned approximately 23% of the voting stock would then be in a position to exert significant control. One may question the Court's judgment on that point, but it is consistent with the proposition that the Court did consider relevant who the remaining shareholders were.

The second observation, Nevada is probably the worst state in the Union, as far as protecting nonvoting shareholder's rights. In many states (and the documents can certainly be drafted this way in Nevada in the Articles of Incorporation) key matters such as mergers and liquidations must be approved, not only by the voting shareholders, but also by the nonvoting shareholders, as a class.

Third observation, the Court's math seems questionable. If the Simplot family fell apart after 20 years, as the Court implied, an investor who paid $6 million for less than 1/100% of 1% of the stock of the subject corporation would need to be paid approximately $167 million (for a 867 million dollar company), 20 years later to equal the "opportunity cost" of his $6 million investment (*i.e.* $6 million compounded by 18% over 20 years). Even if the holder of 23% of the voting stock was then in a position to force a merger or liquidation, since a purchase price on a merger or liquidation has to be shared equally with the nonvoting owners, at that future time, the Court's conclusion seems problematic, at best.

As discussed above, the identity of other owners of a business, exclusive of the transferor and transferee, and their expected actions in the face of a transferee, can have a negative impact on the valuation of a transferred ownership interest just as well as it can have a positive impact. If the transferee of the partnership interest is considered to be a hypothetical willing buyer and, by definition, must be an outsider as discussed above, how can it be expected that the outsider would form a coalition with *all* of the remaining partners who are presumably family members? It is well settled that there is no family attribution in gift and estate tax valuation (as discussed above), so there can be no assumption that a coalition would be formed. Furthermore, it seems more likely that at least one of the family partners would exclude an outsider from voting decisions (*i.e.*, the outsider would not become a partner and would remain an assignee), thus entrenching the minority interest discount even further.

D. 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.

In determining the value for gift and estate tax purposes of any asset that is transferred, the legal rights and interests inherent in that property must first be determined under state law (unless federal law supersedes state law).[44] After that determination is made, the federal tax law then takes over to determine how such rights and interests will be taxed.[45] In its legislative history to various revenue acts, Congress has endorsed these principles, which had been developed under case law. For instance, the reports to the 1948 changes in the estate taxation of community property provide that those changes restore the rule by which estate and gift tax liabilities are to depend upon the ownership of property under state law.[46]

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[44] Occasionally, federal law does supersede state law in this context. For instance, federal law determines what is charity for purposes of IRC Sec. 2055, not state property law.

[45] *See United States v. Bess*, 357 U.S. 51 (1958); *Morgan v. Commissioner*, 309 U.S. 78 (1940).

[46] *See* H. REP. NO. 2543, 83rd Cong. 2nd Sess., 58-67 (1954); H.R. REP. NO. 1274, 80th Cong. 2nd Sess., 4 (1948-1 C.B. 241, 243); S. REP. NO. 1013, 80th Cong., 2nd Sess., 5 (1948-1 C.B. 285, 288) where the Committee Reports on the 1948 changes in the estate taxation of community property states: "Generally, this restores the rule by which estate and gift tax liabilities are dependent upon the ownership of property under state law." *See also* the reports of the Revenue Act of 1932 that define "property" to include "every species of right or interest protected by law and having an exchangeable value." H.R. REP. NO. 708, 72nd Cong., 1st Sess., 27-28 (1932); S. REP. NO. 665, 72nd Cong., 1st Sess., 39 (1932).

In a recent federal district court case in New Hampshire, *Hilco Property Services, Inc. v. United States*,[47] District Judge Joseph A. Di Clerico, Jr. found that the estate tax lien statutes were not applicable to the assets of the partnership and would only apply to the partnership interest in a case where an individual, through a gift deed, conveyed property to an oral partnership on her death bed and was incoherent at the time of that conveyance. The Court found that under the laws of New Hampshire, a valid partnership existed with respect to that property (because of estoppel theories) and that the IRS would be bound by the state law property rights and encumbrances with respect to that property. The court delineated an excellent synopsis of the controlling authorities:

> [The Government argues] that although the taxpayer's property rights are defined by state law, the extent of the IRS interest, including the priority of the lien, are determined by federal law.
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> Federal law governs issues of federal tax lien priority. *E.g., Progressive Consumers Federal Credit Union v. United States*, 79 F.3d 1228, 1234-35 (1st Cir. 1996) (listing authorities); *Gardner v. United States*, 34 F.3d 985, 987 (10th Cir. 1994); *In re Adler*, 869 F. Supp. 1021, 1026-27 (E.D.N.Y. 1994). However, "it is equally well-settled that in the application of a federal revenue act, state law controls in determining the nature of the legal interest . . . in the property to be reached by the statute." *Progressive Consumers Federal Credit Union*, 79 F.3d at 1235 (*quoting Aquilino v. United States*, 363 U.S. 509, 513, 80 S. Ct. 1277, 1280, 4 L. Ed. 2d 1365 (1960)); *accord Avco Delta Corp., Canada Ltd. v. United States*, 459 F.2d 436, 440 (7th Cir. 1972) ("federal court must look to state law to determine the nature of the legal interest which the taxpayer had in the property sought to be reached.") (*citing Aquilino*, 363 U.S. at 512-13, 80 S. Ct. at 1280). This is because "state law created legal interests and rights in property [while] federal law determined whether and to what extent those interests will be taxed." *United States v. Irvine*, 511 U.S. 242, —, 114 S. Ct. 1473, 1481, 128 L. Ed. 2d 168 (1994); *accord United States v. Bess*, 357 U.S. 51, 55, 78 S. Ct. 1054, 1057, 2 L. Ed. 2d 1135 (1958) (federal tax laws "creat[e] no property rights but merely atta[ch] consequences, federally defined, to rights created under state law"). Finally, in the federal tax lien context, it makes no difference whether the state law principles used to determine the relevant property interest arise under statute or common law, *e.g., Gardner v. United States*, 814 F. Supp. 982, 984-85 (D. Kan. 1993), or arise through equitable doctrines of estoppel, *e.g., Avco Delta Corp. Canada, Ltd.*, 459 F.2d at 440-41.[48]

Another excellent synopsis of the relevant case law and authorities for the proposition that state law controls in determining the nature of the legal interest that is transferred for estate tax purposes and, in particular, a partnership interest is found in a brief filed by the government in a Fifth Circuit Court of Appeals Case.[49] The case concerned the estate taxation of a Louisiana

[47] 929 F. Supp. 526 (D. N.H. 1996).

[48] *Id*. at 547-48.

[49] *Aldrich v. United States*, 346 F.2d. 37 (5th Cir. 1965).

partnership interest. The Justice Department, in one of its briefs in that case, provided that synopsis, which the Court quoted in its opinion:

> It is now well established that state law is determinative of the rights and interests in property subject to federal estate taxation. In *Morgan v. Commissioner*, 309 U.S. 78 [626], 60 S. Ct. 424, 84 L. Ed. 585 (1940), the Supreme Court said (p. 80): 'State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.' *Estate of Rogers v. Commissioner*, 320 U.S. 410, 414, 64 S. Ct. 172, 88 L. Ed. 134 (1943); *United States v. Dallas Nat. Bank*, 152 F.2d 582 (C.A. 5th 1945); *Smith's Estate v. Commissioner*, 140 F.2d 759 (C.A. 3d 1944). *See Aquilino v. United States*, 363 U.S. 509, 513, 80 S. Ct. 1277, 4 L. Ed. 2d 1365 (1960); *Commissioner v. Chase Manhattan Bank*, *supra* [259 F.2d 231 (5th Cir. 1958)], p. 249; *United States v. Hils* (C.A. 5th 1963) [318 F.2d 56]. * * *
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> The courts must determine the substance of the state property law provisions and apply the estate tax provisions to the property interests so determined.[50]

Thus, among the relevant considerations in connection with determining the gift or estate tax value of a transferred partnership interest, or minority position in a corporation, are the liquidation restrictions and voting restrictions that are inherent under the default state law rules.

As noted above, a very relevant fact for consideration by a hypothetical willing buyer of a general partnership interest or a limited partnership interest is that hypothetical willing buyer's assessment of whether the other partners would admit the buyer into the partnership as a partner or an assignee. *It is clearly more relevant to consider the "assignee" rules under the applicable state's partnership law because only very rarely would a hypothetical willing buyer consider it likely that all of the other partners would admit the buyer into the partnership as a partner*.

The IRS has argued in the past that dissolution and withdrawal rights possessed by a general partner would or could be transferred by that general partner's estate and, thus, would be a key relevant fact considered by a hypothetical willing buyer. That argument has been rejected by the courts.

In *Estate of Watts v. Commissioner*,[51] both the Tax Court and the Eleventh Circuit allowed an 85% discount to liquidation value even though the decedent was a general partner who enjoyed, under applicable Oregon law, full dissolution rights during her life. Both courts reasoned that the *transfer* value of the partnership interest was what a hypothetical willing buyer would pay based upon his expectations as to whether or not the family would want the partnership to continue to exist after his purchase. However, the Eleventh Circuit reasoned that this was because the hypothetical willing buyer would only be an assignee. The key parts of the Eleventh Circuit's opinion are as follows:

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[50] *Id*. at 38, 39.

[51] 823 F.2d 483 (11th Cir. 1987), *aff'g* 51 T.C.M. 60.

However, this error does not require a reversal, because the tax court's decision to value decedent's interest as part of a going concern is amply supported by the law governing Oregon partnerships, and the contractual restrictions placed upon Ms. Watts' partnership interest by the partnership agreement governing Rosboro Lumber Company.

First, we note that, 'because the estate tax is a tax on the privilege of transferring property upon one's death, the property to be valued for estate tax purposes is that which the decedent actually transfers at his death, rather than the interest held by the decedent before death, or that held by the legatee after death.' *Propstra*, 680 F.2d at 1250. [Additional citations omitted]. The Commissioner's argument rests entirely on the notion that the interest transferred at the time of Martha Watt's death was an interest that entitled its holder to dissolve the partnership, and liquidate the company [*i.e.*, the rights inherent with a general partnership interest]. This is not the case.

. . . .

. . . . No dissolution occurred here. Thus, the interest held by Ms. Watts' estate did not carry with it the liquidation right of Ore. Rev. Stat. §68.600. We therefore conclude that the tax court was correct, as a matter of law, in determining that the value of Ms. Watts's interest in Rosboro could not be ascertained by reference to the value of that interest upon the lumber company's liquidation. This is true not because of the partner's current intent, but because of the legal restrictions placed upon the partner's interest by contract, fully commensurate with Oregon law. *Cf. Hunter v. Straube*, 273 Or. 720, 543 P.2d 278 (1975) (suit to dissolve a three-man partnership by two partners did not entitle them to dissolution where partnership agreement expressly provided that the retirement of any partner would not dissolve the partnership of the remaining partners).

The Commissioner's argument seems to rest on the additional assumption that once the hypothetical purchaser has bought the interest, he can then act to dissolve the partnership, and subsequently require liquidation. However, this contravenes the rule that the interest being valued is that interest passed by the estate, not the subsequent value of that interest in the hands of the purchaser. *See Bright,* 658 F.2d at 1002. Moreover, a conveyance or assignment of an interest in a partnership does not cause dissolution. Ore. Rev. Stat. § 68.440.[52]

Similarly, in *Estate of Lucile Marie McCormick v. Commissioner*,[53] the Tax Court recently valued general partnership interests which were transferred by gift and upon the death of the general partner at substantial discounts from their pro rata share of the partnership's liquidation value. As it had argued in *Watts*, the IRS argued that, since a general partner under North Dakota law could withdraw from a partnership and force a dissolution, the value of the general partnership interests should be equal to a pro rata share of the partnership's liquidation

[52] *Id*. at 486, 487, n.1.

[53] 70 T.C.M. (CCH) 318 (1995).

value. The taxpayer chose not to make the above "willing buyer, assignee" argument to rebut the IRS. The taxpayer argued, however, that a hypothetical willing buyer/assignee, even if admitted as a full general partner, would not be purchasing that general partnership interest to liquidate that partnership interest. The Tax Court ruled that even if a hypothetical willing buyer would buy the partnership interest with that intent, it would be many years before it could be completely wound up and as a consequence would pay an amount substantially below a pro rata share of the partnership's liquidation value. With respect to the four transfers of general partnership interests in question, the Tax Court allowed combined marketability and minority interest discounts of 46%, 38%, 44%, and 54%. The key parts of the Tax Court's opinion are as follows:

> Respondent contends that the minority discount for a general partnership would be less than a minority interest in a similar corporation. The basic premise for respondent's contention is that, under North Dakota law, a small percentage general partner could cause the dissolution of the partnership, and, thus, have access to some form of liquidation value based on his percentage interest.
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> Petitioners do not contest respondent's contention that a partner may have the ability to cause dissolution, but they do contend that dissolution would not necessarily result in partition of the realty or the immediate receipt of partnership property in kind. Instead, petitioners argue that the dissolution procedure merely causes the partnership to go into a "winding-up mode" which would not enhance the value of a general partner's minority interest.
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> . . . .
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> Petitioners argue that, as a practical matter, dissolution, winding up, and liquidation of the assets of the MP and MP2 partnerships would be a lengthy process because of the nature of the businesses and the underlying assets. As a result, to the extent that any difference exists between a partner's and a shareholder's ability to obtain the net value of his interest, petitioners argue that it would have relatively little effect on the minority discount to be used in this case.
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> We tend to agree with petitioners on this point because liquidation value in the setting of this case would not be readily available to the holder of a small percentage of these family partnerships. In that connection, it is less likely that a willing buyer would purchase any of the interests under consideration for the purpose of liquidating the underlying assets. It is more likely that a willing buyer would seek to invest in what appears to be a profit-making and ongoing business. The availability of assets in the event of a dissolution and/or liquidation, however, may indicate less overall risk, and support a higher value for an entity.[54]

A recent Fifth Circuit opinion, *Estate of McLendon v. Commissioner*,[55] also emphasizes that the value to a willing buyer of a limited partnership interest is its "assignee" value:

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[54] *Id*. at 328-29.

[55] 77 F.3d 477 (5th Cir. 1995) *rev'g* 66 T.C.M. (CCH) 946. (The court designated this opinion as not for publication because, according to the Court, it had no precedential value and merely decided a particular case on the basis of well-settled principles of law.)

> Both the gift tax and estate tax issues turn on categorization of partnership interests Gordon transferred. *The Estate suggests that the interests transferred could only be remainders in 'assignees' interests' in the partnerships, not the actual partnership interests themselves. Texas law, relied on by the Estate, prohibits the transfer of partnership interests without agreement by the other partners. See, e.g.,* Tex. Rev. Civ. Stat. Ann. Art. 6132b, §§ 18(g) and 27(1) (Vernon 1970).
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> . . . . *Viewing the transaction at face value, it is evident that the Tax Court's neglect of Texas law was unfortunate. The Tax Court does not sit to create its own rules of business organization governance. Where the Code has not superseded state law, the tax consequences of a transaction must depend on the nature of the deal under state law*. Accordingly, we look to Texas law as well as the various agreements to evaluate the transactions executed among Gordon, Bart and the Trust.
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> . . . . First, neither partnership agreement permitted sale or transfer of partnership interests without consent of the partners. No person could demand admission to the partnership unless consent was granted by all the partners, in the case of Tri-State, § 7.04 of the partnership agreement, or by the partners of the McLendon Company, § 6. Texas law reinforced this right of exclusivity, born of the intimate nature of the partnership relationship and the apparent authority of each partner to conduct partnership business. *Thomas v. American Nat'l Bank,* 704 S.W.2d 321, 323 (Tex. 1966). The Commissioner agrees that if, under Texas law, a partner attempts to transfer a general partnership interest without the other partners' consent, the transferred interest is an assignee interest, limited to the non-control right to receive distributions from the partnership. Service Brief at 17, n.16, and 29-30 citing *Thomas, supra*; Tex. Rev. Civ. Stat. Ann. art 6132b § 27(1); Art. 6132a § 2(c).[56] (*Emphasis added.*)

In *Estate of James Barudin v. Commissioner,*[57] the tax court rejected a valuation challenge by the IRS, although it stopped short of supporting the taxpayer's valuation. The decedent in that case owned <u>one</u> of 95 units in a New York general partnership that owned and operated commercial real estate in Manhattan. The managing general partner owned or controlled 54 of the 95 units, giving him majority control. The Tax Court accepted the taxpayer's valuation of the underlying assets of the partnership (and rejected the IRS's expert). The taxpayer's expert argued for a combined discount to liquidation value of 67.5% (for minority interest and lack of marketability), and the IRS expert argued for a combined discount of only 28%. The Tax Court stated that the IRS's "expert erroneously assumes that an owner of each general partnership unit could participate meaningfully in management," noting that the managing partner had "practical control" over management and that the holders of minority interests "would have only limited

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[56] *Id*.

[57] 72 T.C.M. (CCH) 488 (1996).

veto power" over certain issues requiring a super-majority vote.[58] Most interestingly, the court found that a general partner's right to dissolve the partnership was not important, as follows:

> Although, under New York State law, any general partner . . . arguably had the legal authority to dissolve the partnership . . . , we believe that such authority would have little impact on [the managing partner's] effective control . . . . We note that neither expert considered this arguable authority in determining a minority interest discount.[59]

By implication, this language recognizes, as apparently the IRS expert recognized, that if a general partner who has a right to dissolve a partnership passes his or her interest in the partnership at death, that interest must be valued as an assignee's interest. The court in this case ultimately allowed an overall discount to liquidation value of 45%.

In a recent case, *Estate of Ethel S. Nowell v. Commissioner*[60], Chief Judge Cohen held that, as a matter of law, in granting the taxpayer's notion for summary judgment, a hypothetical willing buyer would only assume that he could purchase an assignee interest and not a limited partnership (because of the limitations of state property law):

> The second issue for decision is whether the interests in the two partnerships passing at death should be valued for Federal estate tax purposes as "assignee" interests or as partnership interests.
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> The Federal estate tax is a tax on the privilege of transferring property upon one's death. United States v. Manufacturers Natl. Bank of Detroit, 363 U.S. 194, 198, 80 S.Ct. 1103, 4 L.Ed.2d 1158 (1960). "[T]he property to be valued for estate tax purposes is that which the decedent actually transfers at his death rather than the interest held by the decedent before death, or that held by the legatee after death." Propstra v. United States, 680 F.2d 1248, 1250 (9th Cir. 1982); see also Ahmanson Found. v. United States, 674 F.2d 761, 769 (9th Cir. 1981).
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> . . .
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> In determining the value of an asset for Federal estate tax purposes, State law first determines precisely what property is transferred. Morgan v. Commissioner, 309 U.S. 78, 80, 60 S.Ct. 424, 84 L.Ed. 585 (1940); Estate of Bright v. United States, 658 F.2d 999, 1001 (5th Cir. 1981). After that determination is made, the Federal tax law takes over to determine how such rights and interests will be taxed. United States v. Bess, 357 U.S. 51, 55, 78 S.Ct. 1054, 2 L.Ed.2d 1135 (1958). Thus, State law must be consulted to determine what property interests were transferred at a decedent's death.
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> Under the Arizona Limited Partnership Act, "An assignment entitles the assignee to receive, to the extent assigned, only the distribution to which the

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[58] *Id.* at 494.

[59] *Id*.

[60] TC Memo 1999-15 (Jan. 26, 1999).

> assignor would be entitled." Ariz.Rev.Stat. sec. 29-340 (1991). A partner in an Arizona limited partnership cannot, however, confer to an assignee the rights to exercise the powers of a partner, unless provided otherwise in the partnership agreement. Id. ... Accordingly, limited partners status in PFLP and ESNGLP is conferred on Mr. Prechel and Ms. Prechel only if the general partners consent.
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> . . .
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> Applying the Federal estate tax valuation principles to the interests described above, the limited partnership interests must be valued as "assignee" interests, and the general partnership interest in PFLP distributed to Mr. Prechel must be valued as a general partnership interest. Determination of whether Mr. Prechel and MS. Prechel will be treated as limited partners of the respective partnerships can be made only by taking into consideration whether the remaining general partners will consent to their admission as limited partners, subjective factors that cannot be taken into consideration under the objective standard of the hypothetical seller/buyer analysis. See Propstra v. United States, supra at 1252; Estate of Andrews v. Commissioner, supra at 956; Kolom v. Commissioner, supra at 244. Thus, the limited partnership interests received by Mr. Prechel and Ms. Prechel must be valued as assignee interests.

What follows is a review of Texas law as pertains to the valuation of transferred interests in limited partnerships, including both general partnership interests and limited partnership interests. Although Texas law and the laws of the other states are similar on most key matters, it should be emphasized that state laws vary and should be analyzed accordingly.

The place to begin is an analysis of the rights of assignees under state law. Assignees have no management rights, withdrawal rights, dissolution rights, and only limited information rights.[61] Assignees merely have the right to receive partnership distributions. Thus, for valuation purposes, if a hypothetical willing buyer of a partnership interest would assume that any one of the remaining partners in a partnership would not admit that buyer into the partnership as a partner, then that willing buyer clearly would pay a purchase price equal only to the present value of the expected future cash distributions from the partnership.

It is almost unthinkable that an outsider buying into a family-owned partnership would assume that all of the other partners gratuitously would admit that outsider into the partnership as a partner. Even if somewhere in this world this gratuitous partnership exists, as the discussion below demonstrates, a hypothetical willing buyer would not pay an amount equal to a pro rata share of liquidation value because, in general, neither limited partners nor general partners have the immediate right to receive a pro rata share of a partnership's liquidation value.

Limited partners have limited rights. In Texas, a limited partner may withdraw only as provided in the partnership agreement; if the agreement is silent, there is no withdrawal right.[62] In the event of such a withdrawal, except as provided in the partnership agreement, the limited

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[61] *See* Section 7.02 of the Texas Revised Limited Partnership Act ("TRLPA").

[62] TRLPA § 6.03.

partner would be paid the "fair value" of his interest in the partnership at the date of withdrawal, within a reasonable period of time after the withdrawal.[63] By contrast, under the Revised Uniform Limited Partnership Act (1975) with the 1985 Amendments, a limited partner may withdraw if allowed by the partnership agreement or if the agreement does not provide a date on which the partnership must terminate (a fixed term partnership rather than a partnership "at will") or if the agreement is silent, in which events a limited partner may withdraw upon six months' notice and be paid as provided in the agreement or, if the agreement is silent as to such payments, be paid the "fair value" of his interest in the partnership as of the date of withdrawal based on the partner's right to share in distributions.[64] "Fair value" does not appear to be the same thing as liquidation value. Following the uniform act, most states provide that fair value is determined by computing the present value of the forecasted cash distributions from the partnership. In addition to Texas, California, Georgia, and Delaware provide that a limited partner may not withdraw except as provided in the partnership agreement.

General partners have more rights than limited partners, but a general partner does not have the unilateral ability to liquidate an entire partnership nor to partially liquidate a partnership with respect to his or her general partnership interest. Under Texas law, when a general partner withdraws from a partnership, each of the other partners (excluding that withdrawing partner) may elect to convert the withdrawing general partner's interest into a limited partnership interest (no other state has this provision).[65] In addition, any general partner in a fixed-term partnership who withdraws before the end of the term may be assessed damages for breach of the partnership agreement.[66] If a withdrawing general partner also holds limited partnership interests, those limited partnership interests need not be redeemed upon his or her withdrawal.[67] Furthermore, if there is more than one general partner, and if the partnership agreement so provides, all of the remaining general partners (without the acquiescence of the limited partners) may continue the partnership (without there being any dissolution of the partnership entity).[68] Moreover, if the partnership agreement does not expressly permit the partnership to continue upon the withdrawal of a general partner, the partnership will still continue (without there being any dissolution of the partnership entity) if all of the other general and limited partners express their desire to continue the partnership in writing within 90 days of the general partner's withdrawal (assignees, including estates who are assignees, do not have a vote).[69] It should be noted that upon the withdrawal of a general partner, his or her interest as a limited partner, if any, is not entitled to vote on the admission and compensation of any replacement general partner (nor, by implication, the continuation of the partnership). In other words, and in the words of the statute itself, "if the

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[63] TRLPA § 6.04.

[64] Revised Uniform Limited Partnership Act (1975) with the 1985 Amendments, §§ 603-604.

[65] TRLPA § 6.02(b)(1).

[66] TRLPA § 6.02(a) and (b).

[67] TRLPA § 6.03.

[68] TRLPA § 8.01(3)(A).

[69] TRLPA § 8.01(3)(B).

general partner's withdrawal violates the partnership agreement, the general partner has *no* voting rights."[70]

E. 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 Operations.

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.[71] *(Emphasis added.)*

Clearly, Congress has provided for a very liberal definition for determining when a partnership has been created and recognized for its purposes. It is not necessary for a group to conduct an operating business to have a partnership. By the explicit terms of IRC Sec. 7701(a)(2), any financial operation (*e.g.*, investment in stocks and bonds) by a group which is not conducting its affairs as a trust, an estate, or a corporation will be a partnership under all provisions of Chapters 11, 12, 13 and 14 of the IRC.[72]

A key question which is addressed by the new "check the box" regulations under IRC Sec. 7701(a)(2) is whether an arrangement or undertaking constitutes a separate entity (*e.g.*, a partnership or a corporation) recognized apart from the owners. Treas. Reg. § 301.7701-1(a) (effective January 1, 1997) retains the existing concept that undertakings, arrangements, or entities that do not have a joint profit motive would not be treated as separate entities for federal income tax purposes.[73] The new regulations retain the examples found in the old regulations. *However, it is clear that if a joint profit motive does exist, the entity will be recognized for federal tax purposes apart from its owners.*

The new regulations define "business entity" as an entity recognized for federal tax purposes that is not a trust under Treas. Reg. § 301.7701-4 or otherwise subject to special treatment under the IRC A business entity with two or more owners is classified as either a corporation or a partnership for all federal tax purposes (including federal estate, gift or

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[70] TRLPA § 6.02(c).

[71] IRC Sec. 7701(a)(2) (emphasis added).

[72] *Id*.

[73] Treas. Reg. § 301.7701-1(a).

generation-skipping tax purposes). Any business entity having two or more members that is not a *per se* corporation, as defined in the Regulations, is defined to be a partnership.[74]

The IRS has not only provided in its regulations for a liberal definition of when a partnership is created and recognized, but has also taken that position in its revenue rulings. For instance, 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.[75]

Case law has also taken a very liberal view of when a partnership is created and recognized for federal tax purposes apart from its owners.[76]

The *Winkler*[77] case is very instructive as to how liberal the courts have been in upholding the creation and recognition of partnerships for estate and gift tax purposes. The Tax Court upheld the recognition of a partnership (and denied the IRS gift tax and estate tax deficiencies), even though: (i) the only assets of the partnership were lottery tickets; (ii) the partnership was initially an oral partnership where many of the provisions were undefined; (iii) the accountants for the Winklers initially reported the cash consideration involved in the lottery tickets as a gift; (iv) the patriarch was in poor health and died shortly after the creation of the partnership; (v) the division of the profits did not follow state law; (vi) all of the consideration for the winning Lotto ticket was provided by the matriarch; and (vii) the descendants of the patriarch and matriarch were 50% owners of the partnership.[78]

The Tax Court found that the Winklers engaged in an activity that constitutes permissible partnership activity for federal gift, and estate tax purposes: the activity of pooling their money to purchase family Lotto tickets. Thus, the Court found that the Winklers, in good faith and acting with business purpose, intended to join together in the present conduct of a partnership enterprise.[79] As a consequence, the Court found that there were no gift tax or estate tax deficiencies.

The *70-Acre Recognition Equipment Partnership*[80] case is another case that is instructive as to the liberal standard the courts are applying in determining whether a partnership is created

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[74] Treas. Reg. § 301.7701-2(c)(1).

[75] *See*, Rev. Rul. 75-523, 1975-2 C.B. 257 (because of IRC Sec. 7701(a)(2), a partnership was recognized for all federal tax purposes even though the only purpose of the partnership was to invest in certificates of deposit); Rev. Rul. 75-525, 1975-2 C.B. 350 (because of IRC Sec. 7701(a)(2), a partnership form of ownership was recognized for tax purposes even though the only purpose of the partnership was to invest in marketable stocks and bonds).

[76] *See Commissioner v. Culbertson*, 337 U.S. 733 (1949); *Lusthaus v. Commissioner*, 327 U.S. 293 (1946); *Commissioner v. Tower*, 327 U.S. 280 (1945); *Evans v. Commissioner*, 447 F.2d 547, 550 (7th Cir. 1971); *Winkler v. Commissioner*, 73 T.C.M. (CCH) 1657 (1997); *70 Acre Recognition Equip. Partnership v. Commissioner*, 72 T.C.M. (CCH) 1508 (1996); *Frazell v. Commissioner*, 88 T.C. 1405, 1412 (1987); *Wheeler v. Commissioner*, 37 T.C.M. (CCH) 883 (1978).

[77] *Winkler*, 73 T.C.M. (CCH) 1657.

[78] *Id.*

[79] *Id*. at 1663.

[80] *70 Acre Recognition Equip. Partnership*, 72 T.C.M. (CCH) 1508.

and recognized for federal tax purposes. The Court found in this case that a partnership was created and recognized for federal tax purposes independent of the two owners (Booth Creek Investment, Inc. and State Savings & Loan Association of Lubbock) even though: (i) the owner's accounting firm had admitted the nonexistence of a valid partnership in a letter to the IRS; (ii) there was no written partnership agreement; (iii) State Savings did not contribute capital services except for a promise to extend credit; (iv) State Savings had no right to jointly manage the subject real estate; and (v) State Savings did not agree to share in the losses.[81]

F. 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.

Most ownership interests in FLPs are worth less than liquidation value when valued by the income approach or net asset value approach. The primary reasons are that most of the cash flow generated within a limited partnership is reinvested instead of being distributed to the partners and that a buyer generally does not obtain management control, much less liquidation control. A buyer who obtains liquidation control would pay a higher price for access to the retained cash than a buyer who does not acquire liquidation control would pay for the low distributable yield.

Tax case law supports a potentially substantial difference between liquidation value and the value obtained by the income approach or net asset value approach. The valuation of an ownership interest in a business entity for tax purposes generally is determined by reference to the price a hypothetical willing buyer would pay a hypothetical willing seller, assuming that neither is under a compulsion to enter into the transaction and that both are fully apprized of all relevant facts. In situations where a taxpayer does not have unilateral liquidation control of a family partnership, depending on the partnership's distributable cash flow, courts have found that the taxpayer's interest in the partnership may have a value as much as 40% to 85% lower than if a hypothetical willing buyer had liquidation control.[82]

The income approach to valuation generally entails the capitalization of current earnings or the discounting of future earnings. In either case, the valuation expert selects the appropriate measure of earnings power (net income, gross cash flow, net cash flow, operating cash flow, or some other measure) to capitalize or to discount to present value. Generally, a capitalization of earnings method is used when there is no expected growth in earnings or the expected growth is consistent. A discounted cash flow method is used when future growth is predictable and varies significantly over the predicting period.

The net asset value approach generally is used for valuing partnerships or corporations that own financial securities or passive investments in oil, gas, timber or real estate. Under this approach, the valuation expert computes the fair market value of the assets owned by the

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[81] *Id.*

[82] For a more complete analysis of the valuation factors relevant for partnership interests, *see* Service Valuation Guide for Income, Estate and Gift Taxes - Valuation Training for Appeals Officers, at 9-1 to 9-51 (CCH Federal Estate and Gift Tax Reports, Number 239, January 28, 1994).

partnership or corporate entity and subtracts the value of the entity's liabilities, after which he or she applies two discounts: (i) a minority interest discount or lack of liquidation control discount; and (ii) a marketability discount.

The magnitude of the minority interest discount depends on, among other things, the level of distributions from the entity to the partners or shareholders, the financial risk associated with the entity's assets, and the terms of the partnership agreement or articles of incorporation. Because control premiums have been studied in the corporate takeover context, the inverse relationship of a minority interest discount to a control premium gives experts an accurate base from which to determine a minority interest discount. A minority interest discount for an assignee's rights attributable to a partnership interest typically is in the range of 20% to 40%.

The magnitude of the marketability discount often is determined by reference to sales of restricted stock of publicly traded companies. Because of several independent studies, experts confirm a range of restricted stock discounts from 30% to 45%. Another source of reference for experts is the comparison of the sale of a minority block of stock in a closely held corporation to the value of the same block of stock after the corporation "goes public." Such studies have revealed discounts ranging from 42% to 74%.

Substantial discounts are appropriate even if the only assets of the entity are passive investments such as undeveloped real estate, stocks, bonds, and cash. As to such assets, in general, valuation experts and courts allow for a minority interest discount in the range of 10% to 20% (similar to closed-end investment funds) while still allowing for the normal range of marketability discounts.[83]

There are a number of studies and an increasing amount of empirical data that support the theoretical discounts to liquidation value. Three of the more complete and better known of these studies are those performed in 1992, 1993, and 1994 by Partnership Profiles.[84] In those studies,

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[83] *See Estate of Luton v. Commissioner,* 68 T.C.M. (CCH) 1044 (1994) (finding that decedent owned 78% of a passive real estate corporation and the court still allowed a 20% marketability discount; the decedent also owned 33% of the stock of a corporation that owned a duck hunting preserve, and the court allowed a combined 35% minority interest and marketability discount; the court also understandably allowed only a 10% marketability discount for an interest in an IRC Sec. 337 liquidating trust which was required to distribute the proceeds of its only asset, a note paying 10% from a credit worth corporation, 30 days after receiving the cash proceeds); *Estate of Simpson v. Commissioner*, 67 T.C.M. (CCH) 2938 (1994) (finding that the decedent owned 100% of an investment holding corporation and the court allowed a 30% marketability discount); *Dougherty v. Commissioner*, 59 T.C.M. (CCH) 772 (1990) (finding that decedent owned 100% of the stock of a personal holding corporation with assets consisting of notes receivable, marketable securities, and passive real estate partnership interests, and the court allowed a 35% marketability discount); *Estate of Gillet v. Commissioner*, 50 T.C.M. (CCH) 636 (1985) (finding that decedent owned 26.4% of the stock of a corporation with assets consisting largely of passive investments, yet the court allowed a 20% minority interest discount and a 15% marketability discount); *Estate of Mundy v. Commissioner*, 35 T.C.M. (CCH) 1778 (1976) (finding that all of the assets of the personal holding corporation were stocks, bonds, and treasury securities, yet the court allowed a combined 40% minority interest and marketability discount); *Estate of Thalhermer v. Commissioner,* 33 T.C.M. (CCH) 877 (1974) (finding that decedent owned 8.29% of a corporation's Class A voting stock and 5.31% of its Class B non-voting stock, and the corporation owned substantial common stock investments, yet the court allowed a combined 34% discount for the voting stock and a 37% discount for the non-voting stock).

[84] Partnership Profiles, Inc., *LP Secondary Market Discounts: How Much?*, THE PERSPECTIVE, May/June 1992, at 1-2; and Partnership Profiles, Inc., *LP Secondary Market Discounts: An Update?*, THE PERSPECTIVE,

the actual trading prices of investment units on the secondary market were compared to valuations of those units by the general partners or by independent appraisers. The 1992 studies found that secondary market discounting averaged 44%, the 1993 studies concluded that this figure increased to 46%, and the 1994 studies found that this figure increased to 48%. Another study that was commissioned by the Investment Program Association in 1992 found an average discount from estimated values of 48%.[85]

The studies mentioned above involved publicly offered partnerships that were not publicly traded. Clearly, the discounts would be greater for the typical FLP because there does not exist any secondary market and because the cash distributions tend to be extremely low. According to a recent article in *THE APPRAISAL JOURNAL*, in a no-cash flow or low cash flow situation, a careful analysis of the 1992 and 1993 studies by Partnership Profiles would indicate that discounts are as high as 70% to 90%:

> An important finding of the 1992 and 1993 studies by Partnership Profiles is the importance of cash distributions to investors in the pricing of these investment units; that is, the greater the annual cash flow to the holders of the units as a percentage of net asset value, the less the discount applied in the marketplace. For partnerships with no cash flow, discounts have averaged nearly 70% and have, at times, risen to as high as 90%. For some partnerships, no buyers could be found at any price--suggesting that the discount was 100%. These latter partnerships were excluded from the 1993 study.[86]

In connection with his presentation to the AICPA business valuation practitioners on November 16, 1998, Charlie Elliott of Howard Frazier Barker Elliott, Inc. in Houston shared the following information regarding the discounts from net asset values ("NAV") recently observed in various public markets which his firm uses for reference points in arriving at discount factors to apply to securities and real estate partnerships. As Mr. Elliott states, "The investment company discount and the secondary market discount (derived from the secondary market for limited partnership interests) are basically proxies for the minority interest discount which is appropriate to apply to assignee/non-controlling/non-marketable, limited partnership interests, matching the appropriate asset categories represented in a partnership's asset mix."

May/June 1993, at 1-4; and Partnership Profiles, Inc., *The Low-Down on Secondary Market Discounts*, THE PERSPECTIVE, May/June 1994, at _____.

[85] Mark S. Thompson, Ph.D. and Eggert Dagbjartsson, *Market Discounting of Partial Ownership Interests*, 62 THE APPRAISAL JOURNAL 535 (1994).

[86] *Id*. at 536.

What follows is an excerpt from Mr. Elliott's outline:

* * *

1. Asset Categories

   a. Securities

      (1) Draw analogies with closed-end investment companies (stock and bond closed-end funds, both corporate and municipal).

      (2) At August 7, 1998, the range of discounts/premiums applied to the net asset values ("NAVs") among representative groups of closed-end funds was as follows:

         (a) Stock funds [range – a 21.6 percent discount to a 5.8 percent premium. The middle 50 percent of the ranked range of discounts/premiums (the 75th through the 25th percentile) was a 16.2 percent discount to an 8.2 percent discount]. Discount figures are parenthesized below:

75th percentile	(16.2)%
Median	(9.5)
25th percentile	(8.2)

         (b) Corporate bond funds (range - 12.1 percent discount to a 2.6 percent premium):

75th percentile	(4.3)%
Median	(3.2)
25th percentile	(0.2)

         (c) Municipal bond funds (range - 13.8 percent discount to a 7.3 percent premium):

75th percentile	(4.5)%
Median	(3.3)
25th percentile	0.7 premium

         (d) Government bonds (range – a 13.2 percent discount to a 1.8 percent discount; median 5.8 percent discount).

   b. Limited partnership interests

      (1) The Partnership Spectrum, published bi-monthly by Partnership Profiles, Inc., is an important source of fundamental and valuation information regarding limited partnership interests trading in the secondary market for limited partnership interests. The analogy to privately owned partnership interests is directly akin to the analogies drawn by valuation experts between publicly traded securities and similar securities of closely held corporations.

      (2) Below are enumerated various valuation benchmarks derived from information compiled from recent issues of The Partnership

Spectrum for a large number of partnerships whose units trade in the secondary market.

(a) Overview as provided in the May/June 1998 issue of The Partnership Spectrum.

	# of Partnership	Average Discount	Average Yield
Equity partnerships			
Distributing			
Low or no debt	33	27%	8.0%
Moderate to high debt	29	36%	6.7%
Non-distributing	21	43%	0.0%
Triple-net-lease (all distributing)	20	17%	9.7%
Insured mortgage programs (all distributing)	10	12%	9.8%

(b) Equity real estate partnerships that are making distributions to their partners.

Discounts from NAV

75th percentile	(37.6)%
Median	(33.0)
25th percentile	(23.2)

Price to cash flow

75th percentile	11.3x
Median	9.4
25th percentile	7.0

Yield

75th percentile	9.0%
Median	6.5
25th percentile	4.0

Percentage of cash flow distributed

75th percentile	90.4%
Median	65.0
25th percentile	36.8

Leverage

75th percentile	48.0%
Median	33.0
25th percentile	0.0

(c) Equity real estate partnerships that are not making distributions to their partners.

Discounts from NAV

75th percentile	(51.4)%
Median	(42.0)
25th percentile	(35.9)

Price to cash flow

75th percentile	9.7x
Median	7.4
25th percentile	6.4

Leverage

75th percentile	68%
Median	54
25th percentile	49

* * *

Another article analyzing The Partnership Spectrum data points out that family partnerships should be much less valuable than the syndicated partnerships that are part of the study in the Partnership Profiles data and concluded as follows:

> The first fundamental difference between syndicated partnerships and FLPs involves the experience of the general partner in operating and administering such a business entity. FLPs generally do not designate professional managers as the general partner, but rather the current owner of the assets who is forming the FLP. Therefore, the management risks are more pronounced for the FLP and consequently greater for the limited partners of the FLP than for their syndicated partnership counterparts.
>
> The second significant fundamental difference is an asset risk. Syndicated partnerships usually hold many assets, with a broad geographic diversification. This numerical and geographic diversity of assets, even of a single type provides some spreading of risk of the partnership compared to one with few assets and limited geographic dispersion. The reduced portfolio risk of the syndicated partnership is typically not enjoyed by the interests of the FLP, which are usually structured with one significant asset such as an apartment house, shopping center or building and several lesser properties. The extremes in geographic and market risks found in a FLP typically are absent in the syndicated partnerships.
>
> The third significant fundamental difference is the distribution of cash prior to the partnership's liquidation. An investor in a syndicated partnership usually has an expectation for current income of cash distributions based on some formula relative to the partnership's operations satisfying certain criteria or financial hurdles, as provided in the limited partnership agreement. Income derived from the operating surplus or gains from the sale of assets are sources of cash that provide the limited partner with an economic benefit that the secondary

market can use as a basis for pricing the security. In contrast, an investor in a FLP is aware that current income, if any, could well be (and typically is) only enough to cover their portion of the tax liability allocable from the partnership's taxable income. The general partner of the FLP in all likelihood has less motivation or requirement to sell assets and generate a return of capital to a third party investor, than does the general partner of a syndicated partnership. Therefore, the expected return on an investment in an FLP is even more remote than it is for a syndicated partnership.

The fourth significant difference is the relative lack of any organized secondary market for FLP interests. The conventional measures used in pricing LPS severely punish those that do not provide a track record for distributing cash from current income or return of capital. If the FLP was tradable, investors could expect to get hammered for the absence of these economic benefits. Removing the most obvious vehicle for liquidity from a security with relatively undesirable investment attributes is virtually unforgivable because the holding period for this economic bust would be perceived as indefinite. A third party buyer of an interest in the FLP would invest because he expects an unusually large gain on the sale of the partnership's asset(s), and is prepared to wait perhaps indefinitely for this blessed event to occur.

. . . .

Separately, we have initiated a study of private partnerships that have traded in the secondary market. We have observed that discounts for private LPS are substantially larger than discounts required for the syndicated partnerships. Investors in private LPS demand current returns on their investments in the range of 20 percent for a typical non-syndicated partnership interest as compared to 10-14 percent for the syndicated LPS. This is because of 1) lack of competitive bidders for these partnerships resulting in an attendant greater illiquidity in comparison to the syndicated LPS, 2) non-mandated distributions, 3) the lack of professional management, 4) a greater disregard for the limited partners by the general partners, 5) a limited partnership agreement which is often prejudiced in favor of the general partners, and 6) the assets in the partnership are typically either of one class or only one property, thereby depriving potential investors of any diversification or risk avoidance possibilities. The results of this study of private partnerships will be available shortly.[87]

In an outline prepared by Business Valuation Services, Inc. for the Continuing Professional Education for the Service Federal Estate and Gift Tax Attorneys of the Midstates Region, the following observations were made:

Family Limited Partnership Discounts: Studies are rare, and reliable data is limited. Data is available by talking to experienced brokers of such interests.

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[87] Kern, Schroeder and Smith, *The Market Pricing of Syndicated LPS and the Valuation of FLPs*, TRUST AND ESTATES JOURNAL, at 35 (February 1996).

> Some published articles discuss typical discounts observed by brokers. Theoretical calculations, using published required return differentials, can be used to supplement and test the observed discounts. Discounts can be very large for non-income producing investments with substantial risk to the underlying basis of the investments over time and with little prospect for liquidity in the near future. Discounts can be relatively small or modest if the investments produce healthy income streams to shareholders and have little risk of losing value over time. Discounts are almost always calculated off of net asset value as determined by valuing the underlying investments at their control values.[88]

My old law firm (Baker Botts L.L.P.) requested the IRS to admit that certain factors that the IRS utilized in a partnership valuation case (*Robertson v. Commissioner*, Tax Court Docket Nos. 26090-95, 26091-95, and 12782-96) were appropriate for determining the amount of a discount in determining the value of a limited partnership interest in another tax court valuation case (both of those cases were before Tax Court Judge Gayle). *See* Petitioner's Request, *Estate of Ruth C. Brown* (Tax Court Docket Nos. 7492-95 and 14899-96). In the *Robertson* case, the IRS used a 70% discount in valuing a limited partnership interest that was purchased by two parents from one of their children. The primary asset of the partnership was some ranch land in California. With respect to the valuation of the limited partnership interest in *Robertson*, a letter dated August 15, 1996 from the District Counsel of the Service Midstates Region stated that:

> Respondent admits that a discount of 70% was used in valuing the 6% limited partnership interest. Respondent believes that there are many considerations that enter into evaluation of a partnership interest. Those consideration (sic) include lack of lack of (sic) marketability and minority interest. Respondent also believes that in valuing interest in family limited partnerships, such as the 6% interest in [Robertson family partnership], considerations must be given to other additional factors, including, but not limited to: management risk, asset risk that arise due to concentration of asset in one class/or geographic region, limited cash distributions to partners, limited liquid assets for making distributions, expected returns, lack of an active organized secondary market for interest, restrictions on the transfer of interest by partners, concentration of control over the partnership, the economic outlook for the business or geographic area the partnership operates in, the partnership's position in the industry, the partnership's historical profitability, and expectation of future profitability, values of comparable interest traded on secondary markets and restrictions on transferability.[89]

The taxpayer in *Brown* requested the IRS to admit that the considerations set forth above were proper factors for an appraiser to consider in determining the fair market value of the partnership interest in Brown Interests, Ltd. owned by Ruth C. Brown at the time of her death. The IRS in *Brown* responded as follows:

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[88] "*Valuation: Common Battleground Issues and Anecdotal War Stories*", BUSINESS VALUATION SERVICES, INC. (August 15, 1995).

[89] *Robertson v. Commissioner*, T.C. Docket Nos. 26090-95, 26091-95 and 12782-96 (March 7, 1997).

> Admits, but denies any application that such a listing encompasses the universe of appropriate factors to consider.

If the IRS remains consistent in the positions that it took in *Brown* and *Robertson*, there is no question that substantial discounts from the liquidation value of a partnership are warranted.

In *Estate of Etta H. Weinberg, et al. v. Commissioner*,[90] Judge Whalen determined that the fair market value of a decedent's interest in a limited partnership was equal to approximately 50% of the underlying liquidation value of the said partnership interest. Etta Weinberg owned a 25.235% limited partnership interest in Hill House Limited Partnership. The chief asset of the partnership was a high cash flowing apartment complex. The Court valued the partnership interest by using a capitalization approach and a net asset value approach. The Court put a 75% weight on the capitalization approach and a 25% weight on the net asset value approach. The Court looked at comparable partnerships under the Partnership Profile studies and determined that a 53% discount was comparable to the subject partnerships of those studies. The Court then added an additional 20% marketability discount, because the subject FLP, did not enjoy a secondary market (the partnerships subject to the Partnership Profile studies do have a secondary market). With respect to the capitalization approach, the Court utilized a capitalization rate of approximately 10%, and then applied the same 20% marketability discount.

It is the writer's belief that appraisers should use both approaches (the capitalization approach and the net asset value approach) and then weigh both approaches. Under different circumstances there should be given a higher or lower weight to the capitalization approach in comparison to the net asset value approach. It is, obviously, helpful to the appraiser, if the partnership is organized in a manner that allows consideration of the capitalization approach.

Another interesting valuation case is *Knight v. Commissioner*.[91] On December 28, 1994, the taxpayers established a trust in which interests in a FLP were transferred. The assets of the partnership consisted of a small ranch and residential properties and bond funds and/or treasury notes. Approximately 85 % of the assets were represented by bond funds or treasury notes. The court allowed a minority discount based on the average discounts for closed-end bond funds of approximately 10% and an additional small discount for lack of marketability, which put the total minority and marketability discount at 15%. The court found the taxpayer's expert, Robert K. Conklin persuasive on the 10% minority discount based on the closed-end bond funds, but generally found his arguments on marketability discounts to be nonobjective:

> We conclude that Conklin was acting as an advocate and that his testimony was not objective. However, despite the flaws in petitioners' expert's testimony, we believe that some discount is proper, in part to take into account material in the record relating to closed-end bond funds. We hold that the fair market value of an interest in the Knight family partnership is the pro rata net asset value of the partnership less a discount totaling 15 percent for minority interest and lack of marketability. Thus, on December 28, 1994, each petitioner made taxable gifts of $789,030 (44.6 percent of $2,081,323, reduced by 15 percent).

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[90] T.C. Memo 2000-51 (February 15, 2000).

[91] 115 T.C. 36, Docket Nos. 11955-98, 12032-98 (Filed November 30, 2000).

This case is a good illustration that the taxpayer's expert needs to be able to demonstrate objective comparables that are persuasive. Perhaps the most persuasive comparables are real transactions between real hypothetical willing buyers and real willing sellers with respect to publicly offered, but not publicly traded, partnerships, whose major assets are cash or near cash assets (as demonstrated by the Partnership Profile studies). An expert needs to be able to demonstrate how those studies relate to the partnership that is before the court and how to objectively differentiate any differences.

G. Seventh Fundamental: Liquidation Costs (Including Capital Gains Taxes) Should Be Considered in Valuing an Asset Holding Partnership.

Assume a hypothetical willing buyer has two choices for a potential partnership investment: (i) partnership #1: has low basis assets and it is almost a certainty that the managing partner will not make an IRC Sec. 754 election, if that buyer purchases an assignee interest in the partnership and (ii) partnership #2: owns the same exact assets as partnership #1, but those assets have a high basis. Obviously, partnership #1 is much less marketable than partnership #2.

If the managing partner of partnership #1 sell assets of partnership #1, and if an IRC Sec. 754 election is not made, that buyer will pay capital gains taxes, even though his outside basis is proportionately greater that the partnership's inside basis on those partnership assets. When the buyer eventually sells his assignee interest, or if the partnership liquidates, the buyer will receive a capital loss. However, the buyer may not be able to use all of the loss. Even if the buyer can use all of the loss, the "timing" loss of the early capital gains tax payments could be significant. Thus, a significant marketability discount associated with "754 problem" should exist for partnership #1, under the logic of *Estate of Artemus D. Davis v. Commissioner*, 110 T.C. 530 (1998) and *Eisenberg v. Commissioner*, 155 F.3d 50 (2nd Cir. 1998).

* * *

III. THE 2000 PERSPECTIVE OF THIS AUTHOR AS TO THE BEST ARGUMENTS AND PLANNING METHODS TO DEFEND AGAINST POTENTIAL IRS ATTACKS THAT WOULD AFFECT THE TRANSFER TAX VALUE OF A TRANSFERRED INTEREST IN A FAMILY ENTITY.

What follows is an excerpt from this writer's paper, "The Art of Making Uncle Sam Your Assignee Instead of Your Senior Partner: The Use of Partnerships in Estate Planning," which was prepared on January 16, 2001:

* * *

A. Some of the Best Arguments and Planning Methods to Defend Against the Potential IRS Position That Creating a Pro Rata Partnership or Corporation (That Does Not Have a Senior Equity Interest) Should Be Subject to Gift Taxes.

The IRS recently argued in TAM 9842003 (issued October 19, 1998) that the creator 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.

On January 18, 2000 Judge Garcia, in the *Church*[92] Case, rejected the theory of the above TAM:

> Initially, the Government's contention confuses the market value of the assignee interest passing at death with the value of the Partnership interest Mrs. Church received in return for her contribution. The two interests are not comparable. More importantly, the Government ignores the fact that this was a pro rata partnership that did not confer a financial benefit on, or increase the wealth of, any partner. Implicit in the Government's argument is the notion that since the value of Mrs. Church's partnership interest was less than the assets she contributed, someone must have received a gratuitous transfer of the difference. This was not the case, and never could be in the formation of a business entity in which each investor's interest is proportional to the capital contributed.
>
> A gift can be made in many guises, and it is the intention of IRC § 2501, et. seq. to tax them whatever their form. Nevertheless, a taxable gift must involve a gratuitous transfer, which by definition requires a donee. Dickman v. Commissioner, 465 U.S. 330, 334, 104 S.Ct. 1086 (1984). There was none in this case. Kincaid v. United States, 682 F.2d 1220 (5th Cir. 1982) and the other cases cited by the Government reinforce this point rather than contradict it. Each involved an attempt to donatively pass property to others through the formation of business entities in which the donor did not receive an interest proportionate to his or her capital contribution.

The IRS's gift tax on formation argument has also been rejected in the recent case *Estate of Albert Strangi v. Commissioner*.[93] The *Strangi* case involved a family partnership that was created through a power of attorney. The partnership consisted of approximately $10 million in assets, of which $7.5 million consisted of cash and securities. The partnership was created shortly before the death of Albert Strangi. Stranco, was the corporate general partner. It issued 47% of the stock to Mr. Strangi with the remainder of the stock being owned by Mr. Strangi's children from his first marriage. Also, there was a very small position of the stock that was owned by McClendon Community College Foundation.

After Mr. Strangi's death (two months after the partnership was created), Mr. Strangi's four children essentially managed the partnership in a manner that was inconsistent with the terms of the partnership. Instead of the corporate general partner managing the partnership, the children entered into an arrangement where one-fourth of the assets were managed by each of the children pursuant to a separate account that they had with Merrill Lynch. Secondly, very liberal cash distributions were made to the Strangi children and very liberal lines of credit were opened up for the Strangi children. The family partnership also loaned the Strangi estate cash.

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[92] *Church et al v. the United States of America*, United States District Court for the Western District of Texas, San Antonio Division (January 18, 2000, Cause No. SA-97-CA-0774-OG)

[93] *Strangi v. Commissioner*, 15 T.C. 135, Docket 2000-31014, 2000 TNT 230-12 (2000)

The IRS argued that the partnership should be ignored because of operation of IRC Sec. 2703, because it lacked economic substance or because the step transaction doctrine is applicable. The IRS lost all of those arguments. In the alternative, the IRS argued that if the partnership was not to be ignored for estate tax purposes, then a gift was made when the partnership was created, because the fair market value of the retained partnership interest was less than the assets that Mr. Strangi contributed to the partnership. Judge Mary Cohen, writing for the majority of the full Tax Court, concluded that the IRS's argument had no merit:

> We do not believe the decedent gave up control over the assets, his beneficial interest in them exceeded 99%, and his contribution was allocated to his own capital account. . . .. The instinctive reaction that there was a gift at the inception of the partnership does not lead to a determination of gift tax liability."

It should be noted that the court in this case did not examine Treas. Reg. 25.2511(h)(1). As noted below, under that analysis the only possible gift when one makes a contribution to a partnership that is subject to gift taxes (since only gifts can be made to individuals) are the partners in proportion to their partnership interest. Since Mr. Strangi owned, either directly or indirectly, over 99% interest in the partnership and since the small percentage interest that he did not own was paid for by full fair market dollars, that were not discounted, the math of the transaction under the regulations would say that there is no gift.

See also, the recent *Knight*[94] case discussed above. The IRS argued in *Knight* that the partnership should be disregarded on economic substance reasons. Over 75% of the assets of the partnership were bonds with 25% of the assets of the partnership being a small ranch and several rent houses. Certain children of the Knights lived in the rent houses, but did not pay the proper amount of rent to the partnership. A majority of the Court rejected the IRS's economic substance arguments so that the partnership would be recognized for gift tax purposes and that there was a gift on formation of the partnership:

> In this case, the estate claims that the assets were transferred to SFLP for the business purpose discussed above. Following the formation of SFLP, decedent owned a 99-percent limited partnership interest in SFLP and 47 percent of the corporate general partner, Stranco. Even assuming arguendo that decedent's asserted business purposes were real, we do not believe that decedent would give up over $3 million in value to achieve those business purposes.
>
> Nonetheless, in this case, because we do not believe that decedent gave up control over the assets, his beneficial interest in them exceeded 99 percent, and his contribution was allocated to his own capital account, the instinctive reaction that there was a gift at the inception of the partnership does not lead to a determination of gift tax liability. In a situation such as that in *Kinkaid*, where other shareholders or partners have a significant interest in an entity that is enhanced as a result of a transfer to the entity, or in a situation such as *Shepherd v. Commissioner*, 115 T.C. ___, ___ (2000) (slip. op. at 21), where contributions of a taxpayer are allocated to the capital accounts of other partners, there is a gift. However, in view of

[94] See Footnote 81.

decedent's continuing interest in SFLP and the reflection of the contributions in his own capital account, he did not transfer more than a minuscule proportion of the value that would be "lost" on the conveyance of his assets to the partnership in exchange for a partnership interest. See *Kinkaid v. United States*, *supra* at 1224. Realistically, in this case, the disparity between the value of the assets in the hands of decedent and the alleged value of his partnership interest reflects on the credibility of the claimed discount applicable to the partnership interest. It does not reflect a taxable gift.

It is hard to improve upon Justice Phillips' articulation 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.[95]

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").

(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").

If any one of those elements is missing, a taxable transfer does not occur. However, under this analysis, a traditional gift, bequest, or devise would be a taxable transfer, as would be a bargain sale. However, it would appear that all three elements are missing with the creation of a pro rata partnership.

1. 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 a Bona Fide, at Arm's Length and Free From Donative Intent.

The first requirement of a taxable transfer is that a person must, in fact, act like a transferor. Thus, if a person enters into an investment that is bona fide, at arm's length, and free from donative intent, there is no taxable gift, even if (i) he is in control of what the hypothetical willing buyer would receive from the transferor in the transaction and (ii) another party (including the objects of his bounty) receives a benefit.

Whether this requirement exists is determined by IRC Sec. 2512(b). That statute provides that "[w]here property is transferred for less than an adequate and full consideration in money or

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[95] *Commissioner v. Hogle*, 165 F.2d 352, 353 (10th Cir. 1947).

money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift."[96] Likewise, Treas. Reg. § 25.2512-8 provides as follows:

> Transfers reached by the gift tax are not confined to those only which contravene without a valuable consideration, in accordance with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth.[97]

Assume a partner could only sell his partnership interest to a hypothetical willing buyer for 50% of the value of his partnership contribution. Has that partner or shareholder made a gift to the other partners or shareholders of the entity when he participates in its creation because he did not receive "adequate and full consideration" under IRC Sec. 2512(b)? The "ordinary course of business" provision under Treas. Reg. § 25.2512-8 defines certain business transactions as being deemed to meet the "adequate and full consideration" standard under IRC Sec. 2512(b). A transfer made for less than adequate and full consideration, even though ordinarily subject to tax, is not taxed if made "in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from donative intent)."[98] In *Stern v. United States*,[99] the Fifth Circuit, holding that political campaign contributions were not gifts, stated as follows:

> In a very real sense, then, [the contributor] was making an economic investment that she believed would have a direct and favorable effect upon her property holdings in New Orleans and Louisiana. These factors, in conjunction with the undisputed findings of the lower court that the expenditures were bona fide, at arm's length and free from donative intent, lead us, in light of what we have said above, to the conclusion that the expenditures satisfy the spirit of the Regulations and are considered as made for an adequate and full consideration.[100]

In other contexts, Treas. Reg. § 25.2512-8 has been interpreted in the same way.[101] In *Rosenthal v. Commissioner*,[102] the Second Circuit concluded that "even a family transaction may

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[96] IRC Sec. 2512(b).

[97] Treas. Reg. § 25.2512-8.

[98] Treas. Reg. § 25.2512-8.

[99] 436 F.2d 1327 (5th Cir. 1971).

[100] *Id.* at 1330.

[101] *See, e.g., Shelton v. Lockhart*, 154 F. Supp. 244 (W.D. Mo. 1957); *Messing v. Commissioner,* 48 T.C. 502 (1967); *Beveridge v. Commissioner,* 10 T.C. 915 (1948).

[102] 205 F.2d 505 (2nd Cir. 1953).

for gift tax purposes be treated as one 'in the ordinary course of business' as defined in this Regulation [25.2512-8] if each of the parenthetical criteria is fully met."[103]

Generally, a pro rata partnership is a bona fide arrangement. Numerous bona fide reasons exist for creating a partnership in the family context. Assuming the terms of the partnership or corporation are substantially similar to the default state law provisions of the relevant state, those terms should also be considered to be terms under which arm's-length parties would agree to do business. Similarly, if the terms of the agreement or documents creating its corporation apply to all partners or shareholders, then those terms that apply restrictions to the original partners of a partnership should be free from donative intent.

Thus, the creation of a pro rata partnership should not be considered a gift, even if a hypothetical willing buyer would not pay the same consideration to an original partner that the partner contributed to the partnership, because that original partner would not be considered a transferor under the "ordinary course of business" exception under Treas. Reg. § 25.2512-8.

* * *

In a different content, this first requirement of the need for a transferor could also be at issue when one family member purchases a partnership interest or minority stock from another family member. For example, consider a parent who buys a partnership interest in the family business from a child.

Example 2: The IRS Wants a 70% Discount

Sam and Sally Selfmade are partners in a limited partnership, Selfmade Interests, Ltd., that includes their children as limited partners. Sam and Sally are the only general partners. Unlike Example 1, the general partners under this partnership agreement have the unilateral ability to liquidate Selfmade Interests, Ltd. at any time. Sam and Sally want to buy their daughter's limited partnership interest. They pay a price that is equal to the liquidation value of Selfmade Interests, Ltd. allocable to their daughter's interest. In other words, they apply no discounts to the purchase price for the lack of voting control or the lack of marketability of the interest transferred. The IRS argues that the Selfmades have made a gift to their daughter because a hypothetical willing buyer would apply a discount of 70% to liquidation value.[104]

The Selfmades' lawyer should argue that no taxable transfer has been made because the parents have total control over the partnership and, thus, are paying what the partnership interest is worth to them. In other words, their net worth does not decrease as a result of the transaction and, even though the transaction could have been prevented by them and even though the child's net worth may have increased, the fact that this first requirement of a taxable transfer is lacking prevents imposition of the gift tax.

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[103] *Id.* at 509.

[104] This was the original Service position in *Robertson v. Commissioner,* T.C. Docket Nos. 26090-95, 26091-95, and 12782-96 (March 7, 1997). However, after trial the IRS conceded that, under the facts of *Robertson*, adequate and full consideration existed and, thus, that there was no gift (even though the purchase price was greater than what a hypothetical willing buyer would pay).

As discussed above, the gift tax is an excise tax upon a donor's act of making a transfer. As a general rule, the gift tax is measured by the fair market value of the property passing from a donor to a donee. However, a transfer is not a gift if it is made "in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from donative intent)" or if the donor receives full and adequate consideration in exchange for the transferred property.

In the Selfmades' example, the IRS can be expected to argue that, in making the determination of whether a gift results from the parents' acquisition of the partnership interest from their child, the partnership interest should be valued under the hypothetical "willing buyer-willing seller" test of Treas. Reg. § 25.2512-1; that is, "the price such property would change hands between a hypothetical willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts."[105] The IRS's position, however, fails to recognize that the question is not what the value is of the partnership interest for gift tax purposes, but whether the parents even made a gift when they purchased the partnership interest from their child -- in other words, whether they made a taxable transfer.

Although the "willing buyer-willing seller" test normally applies in determining the *value* of a gift, it does not apply under IRC Sec. 2512(b) or Treas. Reg. § 25.2512-8 in determining whether a gift has been made. Rather, the test under IRC Sec. 2512(b) and Treas. Reg. § 25.2512-8 is whether (i) the purchase of the limited partnership interest was "in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent)," or (ii) the partnership interest represented "adequate and full consideration" to the parents as strategically unique (not hypothetical) buyers of the partnership interest in exchange for their sizeable payment. If either test is met, there is no gift.[106]

In *Commissioner v. Wemyss,*[107] the Supreme Court analyzed the "adequate and full consideration" provisions of IRC Sec. 2512(b). The Court stated that "[t]he section taxing as gifts transfers that are not made for 'adequate and full [money] consideration' aims to reach those transfers which are *withdrawn from the donor's estate*" (emphasis added).[108] In other words, the tax depends on a decrease in net worth. Based on this analysis, the question to be answered in the Selfmades' example is as follows: what is the value to the parents, in money's worth, of the limited partnership interest they received from their daughter? If the parents' estate was enriched by the same amount as the price they paid, but no more, they received full and adequate consideration.[109]

The "adequate and full" consideration test under IRC Sec. 2512(b) has been used on numerous occasions to determine whether a gift was made in connection with a purported sale

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[105] Treas. Reg. § 25.2512-1.

[106] *See Commissioner v. Wemyss*, 324 U.S. 303, 307 (1945).

[107] 324 U.S. 303 (1945).

[108] *Id*. at 307.

[109] *See also* CHARLES L.B. LOWNDES, ROBERT KRAMER, AND JOHN H. MCCORD, FEDERAL ESTATE AND GIFT TAXES at 779-80 (3d ed. 1974).

between family members. In each of these cases, the courts examined all factors unique to the transaction to determine whether the consideration received by the transferor is "adequate and full." In *Wilson v. Commissioner,*[110] the taxpayer sold real estate to her children in exchange for a promissory note. The IRS argued that the taxpayer made a gift equal to the fair market value of the real estate transferred because the fair market value of the note the taxpayer received from her children was zero. The Tax Court disagreed, despite the fact that the taxpayer's expert valued the note under the hypothetical "willing buyer-willing seller" test at significantly less than the property transferred. The particular facts of that case, including the fact that the note was secured and the testimony establishing that the children intended to sell the property and pay the note with the proceeds of the sale, demonstrated that the children provided full consideration. The court stated, "[i]f we were to adopt [the Service]'s rationale, many seller-financed transactions and loans would have gift element since the discounted value of the note will often be less than the value of the property transferred. This is especially true when the transactions or loans were intrafamily."[111]

In *Becker v. United States,*[112] the taxpayer transferred ranch land and capital stock to a family-owned company in exchange for preferred stock and debentures in the company. The IRS argued that the taxpayer made a gift as a result of the transaction because the liquidation value of the preferred stock and the face value of the debentures were less than the value of the ranch land and capital stock. In valuing the preferred stock and debentures, however, the Court properly took into consideration other factors, including the fact that the remaining shares of the company were owned by members of the taxpayer's family who regularly deferred to his decisions concerning the operation of the company. The Eighth Circuit stated as follows:

> The jury had before it, *inter alia,* the fair market value of LCC assets immediately after the transfer, the fact that Fred Lowe's block of preferred stock constituted an overwhelming majority of the voting shares, the fact that his shares had the potential to realize dividends, and the fact that the remaining LCC stock was owned by members of Fred Lowe's family, who, according to the record, regularly deferred to his decisions concerning the operations of LCC Having reviewed the evidence, we are satisfied that it provides a sufficient basis for the jury's finding that the value of the preferred stock and debentures acquired by Fred Lowe pursuant to the Recapitalization Agreement was at least equal to the value of the ranch land and capital stock that he transferred to LCC . . . . Accordingly, as Fred Lowe did not transfer property that was worth more than the property he received, the transfer necessarily was not a gift.[113]

Similarly, the Tax Court has held that transfers made in exchange for a transferee's agreement to release claims against the transferor are made for adequate and full consideration in

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[110] 64 T.C.M. (CCH) 583 (1992).

[111] *Id.* at 585.

[112] 968 F.2d 691 (8th Cir. 1992).

[113] *Id.* at 694-95.

money or money's worth, even though the release has no market value to hypothetical third parties. The release has significant value in money's worth to one strategically unique person--the transferor.[114] The Tax Court and the Fifth Circuit have also recognized on numerous occasions that a wife's transfer of a remainder interest in property in exchange for her husband's agreement to leave her an income interest in trust is adequate and full consideration. This is true even though (i) the value of the interest received has value <u>only</u> to the surviving spouse, (ii) the transfer by the surviving spouse was motivated by donative intent, (iii) the interest received by the surviving spouse is not assignable to any hypothetical willing buyer because of the trust's spendthrift clause, and (iv) the interest received by the surviving spouse is entirely unmarketable.[115]

The IRS's position regarding the valuation of consideration in Example 2 is inconsistent with ordinary business practices. In valuing an interest in a closely held business, the degree of control attributable to an interest held by a particular owner has always affected the valuation of that owner's other interests that lack "control" attributes.[116] For example, it is common for buyers who are uniquely situated to benefit from the property being offered to pay consideration above what a hypothetical "willing buyer" would pay for the same property. Those sales do not result in gifts. In *Estate of Curry v. United States*,[117] the IRS argued that the decedent's nonvoting shares in a family corporation had the same value as his voting shares because the decedent controlled the corporation. The court agreed, and stated that "both the law and common sense compel the conclusion that the fair market value of the non-voting stock in the hands of an estate with sufficient shares of voting stock to ensure that estate's control of a corporation cannot be less than the value of the estate's voting stock."[118]

In the Selfmades' case, the parents' control over the partnership directly bears on the value of the limited partnership interest that they purchased from their child. They were the only general partners of the Partnership. Under the partnership agreement, the parents, as general partners, had the power to dissolve the partnership by withdrawing. Their withdrawal was even allowed under the partnership agreement and, as a result, both would have received full liquidation value of any interest they owned. Accordingly, under those circumstances, paying approximately the liquidation value for an interest in the partnership does not constitute a gift because the Selfmades' net worth does not decrease as a result of the transaction.

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[114] *See Estate of Noland v. Commissioner,* 47 T.C.M. (CCH) 1640 (1984); *Estate of Friedman v. Commissioner*, 40 T.C. 714 (1963).

[115] *See Commissioner v. Chase Manhattan Bank,* 259 F.2d 231 (5th Cir. 1958), *cert. denied,* 359 U.S. 913 (1959); *United States v. Gordon*, 406 F.2d 332 (5th Cir. 1969); *Turner v. Commissioner,* 35 T.C. 1123 (1961); *Estate of Vardell v. Commissioner*, 307 F.2d 688 (5th Cir. 1962); *Estate of Bressani v. Commissioner*, 45 T.C. 373 (1966).

[116] *See* Treas. Reg. § 25.2512-2(f).

[117] 706 F.2d 1424 (7th Cir. 1983).

[118] *Id.* at 1427. *See also Estate of Chenoweth v. Commissioner,* 88 T.C. 1577, 1589 (1987) (holding that "the block of the company's stock passing under decedent's will to his surviving widow was the controlling interest in the company and was entitled to be valued . . . to include an additional element of value because of that control.").

2. 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.

Another example is the estate tax treatment of "death benefit only" ("DBO") plans. Under these employee benefit plans, death benefits are paid to family members as designated by the plan itself, not the employee. The employee has no power to change the beneficiary of the plan and no right to receive anything himself under the plan--it is a predetermined death benefit only, nothing else. Case law holds that a DBO plan benefit is not taxable in the decedent's estate if it is a "pure" DBO plan.[119]

Consider the treatment of successful DBO plans in light of the three requirements of a taxable transfer discussed above. The first requirement of a taxable transfer is present: clearly, there was a decrease in the decedent's net worth because he received no benefit himself from the plan, but otherwise could have received more salary or other forms of compensation. In fact, the IRS has argued, albeit unsuccessfully, that the donative transfer was made when the employment contract was signed.[120] The third requirement of the presence of a transferee also is present: someone else's net worth clearly increases (the beneficiary of the plan). The only reason why there is no estate tax is that the plan participant (*i.e.* the transferor) did not enter into a transaction that has the quality of a "gift" transfer.

Another example of a situation in which an economic benefit is perhaps transferred from a transferor to a transferee but does not constitute a gift are defective grantor trusts in which a grantor has to pay income taxes on the income of the trust. Clearly, the payment of those income taxes, and, in fact, the accruing of the income for the benefit of the beneficiaries of the trust are tangible benefits that accrue to identifiable transferees. However, neither the payment of those taxes nor the annual accrual of that income constitutes a gift by the grantor. The taxes constitute a legal obligation that the grantor must pay (*i.e.*, it is an involuntary transfer to the federal government). Moreover, the grantor is not in control of the income that accrues to the beneficiary -- that happens as a matter of a right under the trust document. The leading case on

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[119] *See Estate of Van Wye v. United States*, 686 F.2d 425 (6th Cir. 1982); *Estate of Schelberg v. Commissioner*, 612 F.2d 25 (2nd Cir. 1979), *rev'g* 70 T.C. 690 (1978); *Estate of Porter v. Commissioner*, 442 F.2d 915 (1st Cir. 1971); *Estate of DiMarco v. Commissioner*, 87 T.C. 653 (1986), *acq*. 1990-2 C.B. 1; *Kramer v. United States*, 406 F.2d 1363 (Ct. Cl. 1969); *Estate of Fusz v. Commissioner*, 46 T.C. 214 (1966), *acq*. 1967-2 C.B. 2. *See also* Rev. Rul. 76-380, 1976-2 C.B. 270.

[120] *See* Rev. Rul. 81-31, 1981-1 C.B. 475; *Estate of DiMarco*, 87 T.C. at 659.

this matter is *Commissioner v. Hogle*.[121] The Tenth Circuit held in *Hogle* that a grantor of a defective grantor trust does not make a transfer to the beneficiaries of the trust when income is accumulated or paid to the beneficiaries of the trust:

> But the tax court 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.
>
> . . . .
>
> He could not withhold from the trusts any of the income accruing from trading on margin. How could he give what he could not withhold? There was no transfer directly or indirectly from Hogle to the trusts of title to, or other economic interests in, the income from trading on margin, having the quality of a gift. In short, there was no transfer directly or indirectly by Hogle to the trusts of property or property rights.[122]

A similar situation exists if a partner wishes to transfer his or her assets in exchange for a partnership interest. That partner is not in control of receiving liquidation value prior to that point in time specified in the agreement--that determination is made by the remaining partners. Thus, the difference in value (if any) between the value of the partnership interest and liquidation value is a difference which the alleged transferor is not in a position to control and does not have the quality of a gift (and, thus, is a difference that is not subject to transfer taxes).

3. 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).

Even if (i) a purported transferor does not receive adequate and full consideration in a transaction and (ii) the purported transferor has the quality of a gift, a taxable transfer still does not exist unless the transferee's net worth increases as a result of the transaction.

As noted above, certain IRS estate and gift tax attorneys take the position that the gift tax applies to a family's formation of pro rata partnership or a corporation with a single class of stock. The argument generally goes as follows: a "transferor" places assets into a corporation or partnership with other owners (family members) and receives an ownership interest in return, but, since his ownership interest would be valued by a hypothetical willing buyer at a discount to his share of the underlying asset value, there must be a taxable transfer equal to that difference in value. As is developed below, even assuming there is a transferor who did not engage in a bona fide, arm's-length transaction, the flaw in this argument is its inability to identify a shareholder or partner who received a transfer (*i.e.*, there is no transferee). Under the Treasury Regulations, the

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[121] 165 F.2d 352 (10th Cir. 1947).

[122] *Id*. at 353, 354.

transfer, if there is a transfer, can only be to other partners and not to the partnership or some other person or entity. See Treas. Reg. § 25.2511-1(h)(1). No other partner's net worth increases as a result of such a transaction.

a. The fact that there is a decrease in value does not mean the deemed transferee (the other partners) received that decrease.

Much of what follows has been adapted from briefs filed in past and present tax court cases by Baker Botts, LLP, including *Estate of Harrison v. Commissioner*.[123]

Value really does appear and disappear, and that fact does not mean that a transfer has occurred from one person to another. For example, suppose A, B, and C contributes $100 each to form a corporation, each receiving one share. With only one share, none of them alone can force a liquidation so as to get his $100 back. Under the willing buyer-willing seller test, what is the value of A's share? The value has decreased from the $100 contributed to something much smaller, perhaps $45, because he has no right to liquidate. Does this diminution in value mean that a taxable transfer has occurred if B and C are A's children? No. Where did the lost $55 go? It did not go to B or C, for each of them has suffered the same $55 "loss." Such a "loss" may continue indefinitely as the corporation does business. We can see that readily by noting that the stocks of hundreds of corporations sell on exchanges at substantial discounts below liquidation values. Just as value can disappear, however, it can reappear. We can see that readily by noting what happens to the prices of those discounted stocks just mentioned when a tender offer is made for a controlling block that would include a power to liquidate. Value reappears suddenly, as the price moves up to the tender offer amount, which is usually near the liquidation value.

The key to determining that no taxable transfer has taken place is to be careful when examining the many available examples of decreasing value so as to distinguish between those cases where value truly changes or disappears ("changing value cases") and those cases where value splits off and passes elsewhere, producing no decrease in value on the whole, although the particular asset in question might have decreased in value ("split value cases"). In changing value cases (*e.g.*, value of a business interest decreases because of changing economic conditions or because a key employee dies), the diminution in value is never taxed, because it is not transferred to anyone. An attempt to do so would violate the Constitution, as explained above. In split value cases, the diminution in value may or may not be taxed.

The example above is a changing value case. Now, consider the following example of a split value case in order to emphasize the difference. Suppose a corporation has three shareholders, A, B, and C, who have agreed that any of them can, during life, sell his stock to the corporation for $100, but that, upon death, the stock must be redeemed at $50. The stock of a shareholder thus would drop in value at his death from $100 to $50, but the stock of B and C would increase in value. Value would have split off A's stock and transferred to B and C. The estate tax value of A's stock would be $100, not $50. All of the elements of a taxable split value case are present in this example:

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[123] 52 T.C.M. (CCH) 1306 (1987).

(i) The value of the decedent's stock decreased at his death.

(ii) The decedent was in control of preventing that decrease in value during his life.

(iii) There is at the decedent's death a corresponding increase in value of the stock of other shareholders.

A change in value is not subject to transfer taxes, because a change, as compared to a shift or split, does not constitute a transfer. There are a number of estate tax cases involving assets that change in value as a consequence of a person's death -- either because of the operation of law or because of the contract provisions governing those assets. In each of these cases, the death of a decedent caused the change to occur, but there is no transfer. The same is true on formation of an entity--value may change for all parties, but there is no transfer.

United States v. Land[124] is a changing value case that considers the importance of the three elements mentioned above. In *Land*, the value increased instead of decreasing, and that increase was caused by the death of a partner. The taxpayers in *Land* argued, unsuccessfully, that the value for estate tax purposes was the value of the partnership interest at the moment before death. On the facts of that case, if a partner were to withdraw from the partnership during his lifetime, the other partners could purchase his interest at two-thirds of its calculated value. At the death of a partner, the surviving partners could purchase his interest at its full value; and if they did not do so, the partnership would be dissolved and liquidated. The value having increased at the moment of death to the full value, the court held that the estate tax value was the value at the moment of death.

The court in *Land* began its analysis with the constitutional limitations as follows:

> The statute applicable here is the general provision, section 2033 of the Internal Revenue Code of 1954, 26 U.S.C.A. section 2033. This provides that "the gross estate shall include the value of all property . . . to the extent of the interest therein of the decedent at the time of his death." The Regulations reiterate the truism that the tax is "an excise tax on the transfer of property at death and is not a tax on the property transferred." Treas. Reg. 20.2033-1(a). It is of course imperative that the tax be imposed on the *transfer* of the property in order to avoid the constitutional prohibition against unapportioned direct taxes. From this, it seems to us, it follows that the valuation of the estate should be made at the time of the transfer. The time of transfer is the time of death. Treas. Reg. 20.2031-1(b).[125]

The court then turned to how the estate tax is to be applied when value changes at death:

> Brief as is the instant of death, the court must pinpoint its valuation at this instant--the moment of truth, when the ownership of the decedent ends and the ownership of the successors begins. It is a fallacy, therefore, to argue value before or after death on the notion that valuation must be determined by the value either

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[124] 303 F.2d 170 (5th Cir.), *cert. denied,* 371 U.S. 862 (1962).

[125] *Id*. at 171-72.

> of the interest that ceases or of the interest that begins. Instead, the valuation is determined by *the interest that passes*, and the value of the interest before or after death is pertinent only as it serves to indicate the value *at* death. In the usual case death brings no change in the value of the property. It is only in the few cases where death alters value, as well as ownership, that it is necessary to determine whether the value at the time of death reflects the change caused by death, for example, loss of services of a valuable partner to a small business.[126]

The court then tested its analysis against a provision of the estate tax regulations. In doing so, it developed the distinction between changing value cases and split value cases and used terms along those lines:

> It might be argued that the Regulations abandon this approach and look to the past rather than the future in certain cases. Section 20.2031-2(h) provides that when stock is held subject to an option that is to take effect at death but leaves the decedent free to dispose of the property during his life, the option or contract price will not control the evaluation for estate tax purposes. See *Estate of Giannini*, 1943, 2 T.C. 1160, 1176-80, *aff'd without discussion of this point*, 9th Cir. 1945, 148 F.2d 285, *cert. denied*, 326 U.S. 730, 66 S. Ct. 38, 90 L. Ed. 434. This rule is based, however, on an entirely different foundation: when a decedent retains complete freedom to prevent the property being subjected to a restriction or contingency his inaction constitutes a passive transfer of an interest in the property to the person who stands to benefit by the limitation on the value of the property passing to the decedent's heir or legatee. The rule applies the same principle that underlies IRC §§ 2038 and 2041, which include within a decedent's estate property over which he held a power of disposition or appointment. Under this analysis such a case does not present a problem of changing value; the interest simply is split and passes to different persons, but its total value is unaltered, and that is the value included in the estate.[127]

In 1984, the Treasury issued a Report to the President entitled *Tax Reform for Fairness, Simplicity, and Economic Growth*.[128] In the Report at Chapter 19.03, the Treasury recognized that under applicable law, the measure of a transfer from a transferor to a transferee does not involve measuring the decrease in the transferor's estate. That is the very point of this discussion of the changing value phenomenon and the three elements of a transfer. The following language is excerpted from that Report.

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[126] *Id.* at 172.

[127] *Id.* at 173-74. *See also Estate of Bright v. United States,* 658 F.2d 999 (5th Cir. 1981); *Winkle v. United States*, 160 F. Supp. 348 (W.D. Pa. 1958); *Ahmanson Found. v. United States*, 674 F.2d 761 (9th Cir. 1981).

[128] TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH, Vol. 2, Ch. 19.03.

Current Law

Property transferred by gift is valued for Federal gift tax purposes at its fair market value, in general the price it would bring in a transaction between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all relevant facts. Thus, property transferred by gift is not valued by reference to the amount by which it increases the value of the donee's estate, *nor is it valued by reference to the amount by which it decreases the value of the donor's estate*.

Reasons for Change

In most instances, the value of property transferred by gift will be the same regardless of whether such value is determined by reference to the separate value of the property, the diminution in value of the transferor's estate, or the enhancement in value of the transferee's estate. In other instances, however, these measures of value can vary greatly. This is particularly true in the case of transfers of minority interests in closely held businesses and undivided interests in assets such as real estate. These interests are often valued, for transfer tax purposes, at significant discounts from their pro rata share of the value of the underlying business or asset.[129]

In 1987, the Joint Committee on Taxation recommended the enactment of a special valuation rule eliminating minority or fractional share discounts for transfer tax purposes if the donor retains an interest in the subject property after the gift or has previously made a gift of a fractional interest in that property.[130] This proposal was included in HR 3545, but was rejected in the conference considering the final version of the Revenue Act of 1987.

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.

b. 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.

From the gift tax regulations (Treas. Reg. § 25.2511-1(h)(1)) one can conclude that there is no gift under Example 1. Under this part of the regulations, Sam's investment in Example 1 would be considered a transfer to the other partners, but only to the extent the other partners receive more proportionate value than Sam does.

[129] *Id*. at 386 (emphasis added).

[130] JOINT COMMITTEE ON TAXATION, DESCRIPTION OF POSSIBLE OPTIONS TO INCREASE REVENUES PREPARED FOR THE COMMITTEE ON WAYS & MEANS (JCS-17-87) (June 1987).

Stated differently, if there is a transfer when one participates in the creation of an entity, or has dealings with that entity, that transfer, under the Treasury Regulations can only be to other partners (or shareholders) and not to the partnership (or corporation) or some other person or entity. The IRS cannot claim the transfer goes to some unidentified transferee -- the Treasury Regulations, with respect to transfers to entities, specifies the identity of that transferee. To determine if a taxable transfer has occurred one must examine the effect that the transaction has on each partner. If any partner's net worth has increased, a taxable transfer has occurred (if it has not increased, no taxable transfer has occurred).

The tax court has recently held in *Estate of Bosca, Deceased v. Commissioner*, T.C. Memo. 1998-251 (1998) that the determination of whether or not any dealings that a potential donor has with a corporation constitute a gift, are to be determined based on the effect those dealings individually have on the only potential transferees - the other shareholders of the corporation. *Bosca* involved valuation issues relating to the recapitalization of closely held stock held by the decedent prior to his death. Under the recapitalization plan, the decedent exchanged shares of voting stock in the return for shares of non-voting stock. The decedent's sons, subsequent to the recapitalization, each held a greater portion of the voting stock of the corporation. The court examined whether the recapitalization plan resulted in a gift and whether the voting common stock that the decedent transferred should be valued as a single block of 50% of the stock of the corporation or as two blocks of 25% of the stock. The court held that the recapitalization plan did result in a gift. It also ruled that the two blocks of stock should not be combined because such gifts were made separately to each shareholder transferee (i.e., to each son). The court stated that "the decedent did not convey 50% of the voting stock of the corporation to either of the donees or to both of them jointly." Therefore, the gifts were to be valued as separate (25%) gifts of stock to each son (resulting in a much lower gift tax liability).

The value of the partnership interest received by Sam in example 1, which is less than the value of his contribution to the partnership ($720,000), could be considered a transfer to other partners, if certain transfer offsets were not considered. Because Sam is an 80% partner of the partnership, 80% of that potential transfer ($576,000) is made to himself and, thus, is not subject to gift taxes. The $72,000 potential gifts to each of Sonny and Betsy must be offset by the simultaneous "transfers" of the same amount that Sonny and Betsy made to Sam.[131] Consequently, after subtracting the transfer Sam made to himself and the simultaneous transfers that Sonny and Betsy made to Sam, on a net basis there is no transfer by Sam on which to assess the gift tax.

The above offset approach was followed by the Court of Claims in *Chanin v. United States.*[132] In this case, the shareholders of the corporation made gifts to the corporation. The Court ruled against the IRS's position that the value of what each donor got back (the shareholders' stock value increased) was less than what the value of the donor transferred and therefore a gift resulted:

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[131] *United States v. Gordon*, 406 F.2d 332 (5th Cir. 1969).

[132] 393 F.2d 972 (Ct. Cls. 1968). *See also Heringer v. Commissioner*, 235 F.2d 149 (9th Cir. 1956); *Georgia Ketteman Trust v. Commissioner*, 86 T.C. 91 (1986).

> *Certainly when the gifts to the donee stockholders are to be evaluated on this basis, it is fair and reasonable to determine the related interests in the same manner*. At the least that is true, as here, in the absence of any real fair market value, adequately ascertained. *The whole is thus made equal to the sum of its parts. Otherwise, different standards would be applied on the "transferred" and "received" sides of the equation. The donors were in a sense also donees*, *except that it is illogical to say that a person can give property to himself*. But in lieu of being a donee, the donor has "received" in the same sense that he had retained his proportionate share of the overall gifts.[133]

B. 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.

1. Legislative Perspective.

As noted above, (see Section I D of this paper) 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.

2. 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

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[133] *Chanin*, 393 F.2d at 980 (*emphasis added*).

(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.[134] 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 the 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.[135]

This potential valuation abuse also would not exist if the distribution rights of the transferred and retained interests were identical or proportional, even if there is a difference between the transferred and retained interests with respect to voting, management rights, or liability rights (in the case of partnerships).[136] The differences with respect to management and liability must be non-lapsing unless the lapse is caused by state or federal law. Thus, in a pro rata partnership (or corporations that do not have a senior equity interest), transfers by a general partner of a limited partnership interest (or by a shareholder of his stock) will not be affected by the valuation rules of IRC Sec. 2701, even when there may be slightly different economic interests because of the application of IRC Sec. 704(b), as long as the partnership is a pro rata partnership.[137] Thus, only in those cases where the practice or operation of a pro rata partnership is not pro rata (*e.g.*, the partnership continually distributes cash to only one partner, even though the terms of the partnership call for pro rata distributions) does the potential for this IRS position exist for the pro rata partnership.

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[134] Treas. Reg. § 25.2701-3.

[135] *See* IRC §§ 2701(c)(1)(B)(i); 2701(c)(2)(A).

[136] *See* IRC §§ 2701(a)(2)(B); 2701(a)(2)(C).

[137] *See* P.L.R. 94-15-007 (Jan. 12, 1994); P.L.R. 94-27-023 (Apr. 11, 1994).

3. 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.

Example 3: Is the Creation of a Pro Rata Partnership
or the Transfer of a Partnership Interest a
<u>"Device" to Receive Property Contributed to a Partnership?</u>

The facts are exactly like Example 1, except certain trusts for the benefit of the Selfmade family are partners and the initial assets of the partnership are 75% in stocks, 10% in bonds and 15% in unimproved real estate. Like Example 1, the Partnership assets grow in value and are worth $30 million by the time of Sam's death.

Sam Selfmade's estate is audited by Susan Service. Susan claims that the creation of the partnership (the "Partnership") was nothing more than a "device to transfer Sam's contribution to the partnership to members of Sam's family for less than full and adequate consideration in money or money's worth." Susan has been reading THE WALL STREET JOURNAL *and claims that Sam's long-term investment strategy would have been better served by investing in mutual funds instead of a partnership.*

Susan serves Sam's executor with a 30-day letter claiming "no discount," instead of the 45% discount claimed by Sam's executor on the estate tax return. Susan (the "Examining Agent") claims the creation of the partnership should be ignored because of IRC Sec. 2703(a) and that the safe harbor under IRC Sec. 2703(b) is not available because the partnership is a "device".

Is Susan Service right?

a. The IRS pronouncements regarding FLPs and other closely held entities.

Beginning in early 1997, the IRS, through the issuance of technical advice memoranda and private letter rulings, embarked on a frontal assault on the use of FLPs and other closely held entities for estate planning purposes. In these pronouncements, the National Office of the IRS took the position that an entity should be completely disregarded for estate and gift tax purposes under IRC Sec. 2703[138] and the IRS's interpretation of the Tax Court's memorandum decision in *Estate of Murphy v. Commissioner.*[139]

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[138] IRC Sec. 2703 provides as follows:

(a) GENERAL RULE.—For purposes of this subtitle, the value of any property shall be determined without regard to—

(1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property without regard to such option, agreement, or right, or

(2) any restriction on the right to sell or use such property.

(b) EXCEPTIONS.—Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:

(1) It is a bona fide business arrangement.

What follows has been largely extracted by the memorandum that was filed by Baker Botts, LLP in the Estate of *White v. Commissioner*.[140] Part of what follows repeats the analyses in Section III of this outline.

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

Whether Susan Service 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 Sam Selfmade as a result of his death (an interest in a partnership validly created and existing under state law and federal tax law) or, as Susan Service contends, to property that was not owned or transferred by Sam Selfmade 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).

(1) Relevant Perspective: The statutory and case law history with respect to IRC Secs. 2031, 2033 and 2703

IRC Sec. 2703 was added to the IRC by the Omnibus Budget Reconciliation Act of 1990 (sometimes referred to as "the 1990 Act" below). Congress, by adding IRC Sec. 2703 to the IRC, essentially put into statutory form what had been in Treasury Regulations under IRC Sec. 2031 for many years:

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(2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.

(3) Its terms are comparable to similar arrangements entered into by persons in an arm's length transaction.

IRC Sec. 2703(a)-(b).

[139] 60 T.C.M. (CCH) 645. *See, e.g.,* P.L.R. 97-36-004 (June 6, 1997); P.L.R. 97-35-043 (June 3, 1997); P.L.R. 97-35-003 (May 8, 1997); P.L.R. 97-35-004 (April 3, 1997); P.L.R. 97-25-018 (March 20, 1997); P.L.R. 97-25-002 (March 3, 1997); and P.L.R. 97-23-009 (February 24, 1997). In each of these pronouncements, the IRS took the position that IRC Sec. 2703 allowed it to completely disregard the existence of the applicable entity -- whether or not that entity was validly created and existing under state law. In other words, the IRS claims that because, in its opinion, the entity at issue was formed primarily for estate planning purposes, the IRS could completely disregard for federal estate and gift tax purposes the existence of a legal entity in determining the fair market value of the assets subject to the transfer taxes -- regardless of the fact that the asset transferred was an interest in a closely held entity validly created and existing under state law.

[140] *Estate of White v. Commissioner*, T.C. Docket No. 14412-97.

> Another person may hold an option or a contract to purchase securities owned by a decedent at the time of his death. The effect, if any, that is given to the option or contract price in determining the value of the securities for estate tax purposes depends upon the circumstances of the particular case. . . . Even if the decedent is not free to dispose of the underlying securities at other than the option or contract price, such price will be disregarded in determining the value of the securities unless it is determined under the circumstances of the particular case that the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth.[141]

However, Congress did add a third "safe harbor" provision: that the terms are similar to arm's length transactions.[142]

The IRS has attempted to use Treas. Reg. § 20.2031-2(h), in conjunction with IRC Sec. 2033, in three reported cases to argue (i) the effect of restrictions against transferring partnership interests in a family partnership agreement or (ii) the creation of the partnership, in order to deny discounts in valuing a partnership interest.[143] The Tax Court rejected the IRS attempted application of Treas. Reg. § 20.2031-2(h) in all three cases.

At the time Congress passed the 1990 Act, 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.[144] 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."[145] This point has also been emphasized in the updated edition of *Valuation Training for Appeals Officers* (1994) (issued by

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[141] Treas. Reg. § 2031-2(h).

[142] *See* IRC Sec. 2703(b)(3) that was added by the 1990 Act, which did not exist in the Treasury Regulations.

[143] *See Estate of Bischoff v. Commissioner*, 69 T.C. 32 (1977); *Estate of Harrison v. Commissioner*, 52 T.C.M. (CCH) 1306 (1987) (finding that the partnership agreement was created 5½ months before the decedent died and the decedent was incompetent at the time of its creation); *Estate of McLendon v. Commissioner*, 66 T.C.M. (CCH) 946 (1993), *rev'd on other grounds*, 77 F.3d 477 (5th Cir. 1995) (finding that the partnership agreement was amended shortly after the decedent was diagnosed with terminal cancer and shortly before the decedent attempted to commit suicide).

[144] *See* Treas. Reg. §§ 20.2031-1(b); 20.2512-1.

[145] *LeFrak v. Commissioner*, 66 T.C.M. (CCH) 1297, 1299 (1993). *See also Estate of Bonner v. United States*, 84 F.3d 196, 198 (5th Cir. 1996) ("We are precluded from considering evidence submitted by the government regarding who actually received the assets.").

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."[146]

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).

(2) 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.

See the discussion in Section II D of this paper.

(3) 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

See the discussion in Section II E of this paper.

(4) Susan Service's use of IRC Sec. 2703(a) 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 Partnership Interest is included in Sam Selfmade's estate for estate tax purposes because of IRC Sec. 2033. Under that section, "[t]he value of the gross estate shall include the value of all *property to extent of the interest therein of the decedent* at the time of his death."[147] As a general rule, "the value of *every item of property* includable in a decedent's gross estate under IRC Secs. 2031 through 2044 is its fair market value at the time of a decedent's death. . . . The fair market value is the price at which *the property* would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[148] IRC Sec. 2703 addresses the value of certain property included in a decedent's estate under IRC Sec. 2033; it does not attempt to change the property interest being included. In certain instances, however, IRC Sec. 2703 can exclude from consideration for valuation purposes what would otherwise be relevant facts under the "willing buyer-willing seller" test for valuing that property by allowing certain restrictions against the

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[146] *See also Propstra v. United States*, 680 F.2d 1248 (9th Cir. 1982); *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981); *Estate of Lee v. Commissioner,* 69 T.C. 860 (1978)*; Minahan v. Commissioner*, 88 T.C. 492 (1987) (ordering litigation costs assessed against the IRS for continuing to litigate this issue).

[147] IRC Sec. 2033 (emphasis added).

[148] Treas. Reg. § 20.2031-1(b) (emphasis added).

transfer or use of that property, facts which a hypothetical buyer and seller would otherwise take into account in valuing that property. In no event does IRC Sec. 2703 permit Susan Service to completely ignore what property is being transferred by the decedent under IRC Sec. 2033.

Susan Service reads the word "property" in IRC Sec. 2033, Treas. Reg. § 2031-1(b), and IRC Sec. 2703 to mean the proportionate share of the property owned by the Partnership that an owner of Sam Selfmade's Partnership Interest would receive if the Partnership liquidated. Susan Service's interpretation ignores not only all terms of the Partnership agreement, but the very existence of the Partnership under state and federal tax law. Susan Service's interpretation is incorrect, for under state law Sam Selfmade had no right to property of the Partnership and no ability to transfer property owned by the Partnership.[149] In other words, the "property" being transferred by Sam Selfmade as a result of his death is not and cannot be the property of the Partnership; rather, the property being transferred as a result of Sam Selfmade's death is Sam Selfmade's Partnership Interest.[150] Accordingly, the "property" to be valued in Sam Selfmade's gross estate is his interest in the Partnership.[151]

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[149] TRLPA, art. 6132a-1 § 7.01 (Vernon Supp. 1997) ("A partner has no interest in specific limited partnership property.").

[150] *Id.*

[151] Thus, substituting "the partnership interest" for the word "property," IRC Sec. 2033, Treas. Reg. § 20.2031-1(b) and IRC Sec. 2703 would read as follows:

> **Sec. 2033. [The Partnership Interest] in Which the Decedent Had an Interest.**
>
> The value of the gross estate shall include the value of [the partnership interest] to the extent of the interest therein of the decedent at the time of [her] death.
>
> * * * * *
>
> **Treas. Reg. § 20.2031-1. Definition of gross estate; valuation of [the partnership interest].**
>
> . . . .
>
> (b) **Valuation of [the partnership interest] in general**. The value of every item of property includable in the decedent's gross estate under §§ 2031 through 2044 is its fair market value at the time of the decedent's death. . . . The fair market value is the price at which [the partnership interest] would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.
>
> * * * * *
>
> **Sec. 2703. Certain Rights and Restrictions Disregarded.**
>
> (a) GENERAL RULE --For purposes of this subtitle, the value of [the partnership interest] shall be determined without regard to--
>
> (1) any option, agreement, or other right to acquire or use [the partnership interest] at a price less than the fair market value of [the partnership interest] (without regard to such option, agreement, or right), or

Accordingly, IRC Sec. 2703 permits Susan Service under certain circumstances, for the purpose of determining the value of the Partnership Interest included in Sam Selfmade's estate under IRC Sec. 2033, to disregard certain provisions in a partnership agreement which restrict the transfer or use of the Partnership Interest-- but it does not permit Susan Service to disregard the existence of the Partnership or the fact that a partnership interest was transferred.[152]

(5) Susan Service's use of IRC Sec. 2703(a) 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 Treasury Regulations under IRC Sec. 2703 also support the interpretation by the executor of Sam Selfmade's estate of IRC Sec. 2703. For example, Treas. Reg. § 25.2703-1(a)(3) provides:

> (3) *Agreements, etc., containing rights or restrictions.* A right or restriction may be contained in a partnership agreement, articles of incorporation, corporate bylaws, a shareholders' agreement, or any other agreement. A right or restriction may be implicit in the capital structure of an entity.[153]

> (2) any restriction on the right to sell or use [the partnership interest].
>
> (b) EXCEPTIONS--Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:
>
> (1) It is a bona fide business arrangement.
>
> (2) It is not a device to transfer [the partnership interest] to members of the decedent's family for less than full and adequate consideration in money or money's worth.
>
> (3) Its terms are comparable to similar arrangements entered into by persons in an arm's length transaction.

IRC Sec. 2033; Treas. Reg. § 20.2031-1(b); IRC Sec. 2703.

[152] An examination of the other estate tax "inclusion" provisions of the IRC also demonstrates that the term "property" as used in IRC Sec. 2703 means the property owned by the decedent. *See, e.g.,* IRC Sec. 2034 ("The value of the gross estate shall include the value of all property to the extent of any interest therein of the surviving spouse . . . ."); IRC Sec. 2035 ("[t]he value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has made a transfer . . . ."); IRC Sec. 2036(a) ("The value of the gross estate shall include the value of all property . . . .[t]o the extent of any interest therein of which the decedent has at any time made a transfer. . . ,"); IRC Sec. 2038(a) ("The value of the gross estate shall include the value of all property . . . [t]he extent of any interest therein of which the decedent has . . . made a transfer. . . ."); IRC Sec. 2040(a) ("The value of the gross estate shall include the value of all property to the extent of the interest therein held as joint tenants with rights of survivorship . . . ."); IRC Sec. 2044 ("The value of the gross estate shall include the value of any property to which this section applies in which the decedent had a qualifying income interest for life.").

[153] Treas. Reg. § 25.2703-1(a)(3).

Similarly, Treas. Reg. § 25.2703-1(b)(5) indicates that the standards of the statute are to be independently applied to each right or restriction in an agreement governing or creating the property:

> (5) *Multiple rights or restrictions.* If property is subject to more than one right or restriction described in [IRC Sec. 2703(a)(2)], the failure of a right or restriction to satisfy the requirements of [IRC Sec. 2703(b)(1)] does not cause any other right or restriction to fail to satisfy those requirements if the right or restriction otherwise meets those requirements. Whether separate provisions are separate rights or restrictions, or are integral parts of a single right or restriction, depends on all the facts and circumstances.[154]

Under Susan Service's expanded view of IRC Sec. 2703, Treas. Reg. § 25.2703-1(b)(5) has to be incorrect. If the decedent's interest in the partnership entity is completely disregarded, every right or restriction in the partnership agreement, or which otherwise apply under state law, would have no application, even any "right or restriction [that] otherwise meets those requirements."[155] However, Treas. Reg. § 25.2703-1(b)(5) is correct: only those provisions of a partnership agreement which affect the transfer of a partnership interest are subject to IRC Sec. 2703, and the other provisions of the partnership agreement are not to be disregarded under IRC Sec. 2703.

(6) Susan Service's use of IRC Sec. 2703(a) to disregard the partnership entity ignores legislative intent.

Not only does the general legislative history of Chapter 14 support the Selfmade position, but the specific legislative history of IRC Sec. 2703 also supports the Selfmade interpretation of IRC Sec. 2703. The heading of the Senate Committee Report discussing IRC Sec. 2703 is entitled "Options and buy-sell agreements."[156] The heading of the Conference Committee Report dealing with IRC Sec. 2703 is entitled "Buy-sell agreements and options."[157] If Congress had intended to provide Susan Service with a radical new way of treating the valuation of interests in closely held entities, it does not stand to reason that Congress would have hidden the authority for doing so within the language of a statute clearly designed to police buy-sell agreements and similar provisions.

The legislative history demonstrates that by enacting IRC Sec. 2703, Congress intended to focus on the restrictions in an agreement regarding the transfer of an interest in an entity, and not

[154] Treas. Reg. § 25.2703-1(b)(5).

[155] *Id.*

[156] 1990 Senate Report on Proposed Revisions of Estate Freeze Rules, 136 CONG. REC. S15683 ("Senate Report").

[157] H. R. REP. NO. 5835, the Omnibus Budget Reconciliations Act of 1990, 101st Cong., P.L. 101-508, 2nd Sess. at 1131 ("Conference Report").

restrictions in agreements concerning liquidation[158] or the creation of an entity (even if the creation of an entity leads to minority discounts or other discounts). The Senate Report summarizing the reasoning underlying IRC Sec. 2703 states:

> *Options and buy-sell agreements*
>
> The committee believes that buy-sell agreements are common business planning arrangements and that buy-sell agreements generally are entered into for legitimate business reasons that are not related to transfer tax consequences . . . . However, the committee is aware of the potential of buy-sell agreements for distorting transfer tax value. Therefore, the committee establishes rules that attempt to distinguish between agreements designed to avoid estate taxes and those with legitimate business agreements. These rules generally disregard a buy-sell agreement that would not have been entered into by unrelated parties acting at arm's length.
>
> . . . .
>
> The bill does not affect minority discounts or other discounts available under present law.[159]

Likewise, in the "Explanation of Provisions" accompanying the Act in the Senate Report, the discussion relating to the changes brought by IRC Sec. 2703 are presented under the heading "Buy-sell agreements." The Senate thus implied that the *property* discussed in the following explanation is that property which is the subject of the buy-sell agreement *(i.e.,* the interest in the entity to which the restrictions apply), to wit:

> The bill provides that the value of *property* for transfer tax purposes is determined without regard to any option, agreement or other right to acquire or use the property at less than fair market value or any restriction on the right to sell or use such *property*, unless the option, agreement, right or restriction meets three requirements.[160]

The Conference Report also summarizes congressional reasoning underlying IRC Sec. 2703 as follows:

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[158] As discussed later in this outline, restrictions in an agreement concerning liquidation are addressed in IRC Sec. 2704.

[159] 136 CONG. REC. § 515, 629-04, at 15,681 (1990).

[160] *Id.* at 15,683 (emphasis added).

Options and buy-sell agreements

Some courts have held that the price contained in a buy-sell agreement limits fair market value for estate tax purposes if the price is fixed or determinable, the estate is obligated to sell, the agreement contains restrictions on lifetime transfers, and there is a valid business purpose for the agreement.[161]

Buy-sell agreements and options

The conferees do not intend *the provision governing buy-sell agreements* to disregard such an agreement merely because its terms differ from those used by another similarly situated [entity].[162]

Buy-sell agreements

The Senate amendment provides that the value of *property* is determined without regard to any option, agreement, right or restriction, unless (1) the option, agreement, right or restriction is a bona fide business arrangement, (2) the option, agreement, right or restriction is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration, and (3) the terms of the option, agreement, right or restriction are comparable to those obtained in similar arrangements entered into by persons in an arm's length transaction.[163]

That the statute is intended only to address objectionable transfer provisions in agreements creating entities (and not the creation or existence of an entity) is further supported by the Senate Report statement that, apart from the restrictions concerning acquisition or use of the property addressed in the bill, "[t]he bill does not otherwise alter the requirements for giving weight to a buy-sell agreement. For example, it leaves intact present law rules requiring that an agreement have lifetime restrictions in order to be binding on death."[164]

Susan Service's interpretation of IRC Sec. 2703 is also inconsistent with the statutory structure of Chapter 14. Susan Service's view of IRC Sec. 2703 would totally supplant the need for IRC Sec. 2704 (which provides that certain restrictions in an agreement with respect to liquidation may be disregarded). If IRC Sec. 2703 was intended by Congress to allow Susan Service to completely ignore the creation and existence of an entity for transfer tax purposes, there would have been no need to enact IRC Sec. 2704.[165] Stated differently, the natural conclusion of Susan Service's position is that Congress passed a meaningless statute when it

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[161] H. R. REP. NO. 964, 101st Cong., 2nd Sess. 1137, at 1133 (1990).

[162] *Id*. at 1137 (emphasis added).

[163] *Id*. at 1133 (emphasis added). The Conferee's discussion under the heading "Buy-sell agreements" is almost identical to the language of IRC Sec. 2703 and Treas. Reg. § 25. 2703-1(a).

[164] 136 CONG. REC. § 515, 629-04, at 15,683 (1990).

[165] *See* H. R. REP. NO. 964, at 1137-38.

enacted IRC Sec. 2704. On the other hand, the Selfmade position that one should read IRC Secs. 7701(a)(2), 2033 and 2703 literally would *not* make IRC Sec. 2704 meaningless and *would* make it a necessary part of what Congress was trying to accomplish when it passed Chapter 14.

In addition, the Conference Report indicates that IRC Sec. 2704 (specifically, IRC Sec. 2704(b)) was adopted so that "any restriction that effectively limits the ability of a corporation or partnership to liquidate is ignored in valuing a transfer among family members. . . ."[166] Congress, however, carefully crafted IRC Sec. 2704 so that it would not ignore entire liquidation restrictions of entities normally found under state law. Consequently, the legislative history demonstrates that IRC Sec. 2704 "does not apply to . . . a restriction required under *State* or *Federal law*."[167] The adoption of a measure that would have completely ignored an entity validly created under state law was not an activity that Congress (or any other Congress) was ready or willing to undertake.

Professor Jerry A. Kasner has pointed out the fallacy in Susan Service's broad interpretation of IRC Sec. 2703 as determining that "the property" which is subject to the restrictions of IRC Sec. 2703 is the partnership's property, and not the assignee's rights in a partnership interest. Professor Kasner states:

> How would the opponents of the valuation discounts seek to use section 2703 to deny them? As I understand it, the argument is that any restriction that affects the rights of limited partners to force a liquidation of the entity or to sell their interests to purchasers who could force liquidation of the entity is a restriction that must be ignored under section 2703, *i.e.*, the transfer is always of an undivided interest in the underlying assets of the entity. Of course, if this statement is true, there was never any reason for Congress to adopt section 2704(a) or (b). I believe it is clearly not true.
>
> The basic fallacy here is in defining the "property" that is subject to the restrictions. In the typical FLP (or corporation, or family limited liability company ("FLLC")), the senior family member transfers assets to the partnership in exchange for general and limited partnership interests. At this point in time, there is of course no taxable event. (I have seen one commentator suggest there is!) Assume senior then transfers limited partnership interests to family members. The property being transferred is the partnership interests, *not* the underlying partnership assets. *The possible application of sections 2703 and 2704 will depend on restrictions placed on the rights of the donees in the partnership interests.* The donees never own the partnership assets.
>
> If section 2703 applied this broadly, then it would apply any time property is transferred to a FLP, corporation, or FLLC, and interests in those entities are then transferred to family members. In other words, the existence of the entity would always be ignored. I do not find anything in the language of the code,

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[166] *Id*. at 1138.

[167] *Id*. (emphasis added).

> regulations, or legislative history of sections 2703 and 2704 to suggest that result, although the Service might like it.
>
> Even if the scope of section 2703 were that broad, the argument of the proponents of the section would come into play--it obviously makes good business sense in the case of a variety of both active businesses and passive investments to operate and manage property through a separate business entity, whether or not family-owned. This is not to say some of these transactions could be treated as shams, or lacking substance. However, to broadly nullify the existence of all family business or investment entities goes too far.[168]

(7) The reported cases.

On January 18, 2000 in the *Church* case (see footnote 82), Judge Garcia held that the creation of a partnership two days before a decedent dies should be recognized for Federal estate tax purposes under IRC Sec. 2703(a). On October 22, 1993 Mrs. Church and her two children signed a partnership agreement and a certificate for a Texas partnership. Mrs. Church died two days later on October 24, 1993. The assets of the partnership, an undivided interest in a ranch and one million dollars of securities, had not been transferred to the partnership at the time of Mrs. Church's death. The general partner of the partnership, a FLLC, had also not been formed at the time of Mrs. Church's death. Mrs. Church had breast cancer at the time that she died. The doctors had stopped any medical treatment with respect to that cancer. It was the doctor's best belief that she was in temporary clinical remission at the time of her death. Mrs. Church died suddenly and unexpectedly of cardiopulmonary collapse.

The court held that IRC Sec. 2703 did not apply, as a matter of law, and factually. That is, the court ruled that all of the elements of 2703(b) were present. The court also held, as a matter of law, that 2703(a) did not apply:

> The Government makes two contentions with respect to the application of IRC Sec. 2703 to this case. It first suggests that the term "property" refers to the assets Mrs. Church contributed to the Partnership prior to death, rather than her Partnership interest. There is no statutory basis for this contention. Mrs. Church did not own the assets she contributed to the Partnership on the date of her death; she owned a Partnership interest. The estate tax is imposed on that which a decedent transfers at death without regard to the nature of the property interest before or after death. IRC Sec. 2033; Estate of Bright v. United States, 658 F.2d 999,1001 (5th Cir. 1981) (en banc). IRC Sec. 2033 provides that the gross estate shall include any partnership interest owned by a decedent as defined by IRC§ 7701 (a)(2). Lusthaus v. Commissioner, 327 U.S. 293, 66 S.Ct. 539 (1946); Estate of Winkler v. Commissioner, 73 T.C.M. (CCH) 1657 (1997). IRC Sec. 2703 does not define the term "property" in any matter inconsistent with these provisions, or indeed at all, and cannot have a meaning attributed to it without Congressional authorization that would make it unique in the estate tax provisions of the Code.

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[168] Jerry A. Kasner, *Family Partnerships: Focus Shifts to Section 2703, Tax Notes,* July 31, 1995, at 610-11 (emphasis added).

> The Government alternatively contends that if IRC Sec. 2703 does require taxation of Mrs. Church's Partnership interest, it may nonetheless disregard the term restriction, and restrictions on sale in the Partnership Agreement that serve to reduce its market value. No case supports the Government's position, and nothing in the legislative history, or the regulations adopted by the IRS itself, convince this Court to read into Section 2703 something that is not there. By its very nature, a partnership is voluntary association of those who wish to engage in business together and upon whom the law imposes fiduciary duties. Term restrictions, or those on the sale or assignment of a partnership interest that preclude partnership status for a buyer, are part and parcel of the property interest created by state law. These are not the agreements or restrictions Congress intended to reach in passing IRC Sec. 2703. Reviewing the legislative history, and construing IRC Sec. 2703 with its companion statute, IRC Sec. 2704, it is clear that the former was intended to deal with below-market buy-sell agreements and options that artificially depress the fair market value of property subject to tax, and are not inherent components of the property interest itself.

The IRS also argued the applicability of IRC Sec. 2703(a) in the *Strangi* [169] case. Rejection of the IRS's IRC Sec. 2703(a) argument is one of the few matters upon which all of the judges of the Tax Court agreed. That is, under the facts of *Strangi*, IRC Sec. 2703 has no applicability, even though the partnership consisted of largely marketable securities, it was created shortly before the decedent died and was created for the benefit of an individual who was incompetent.

> Respondent next argues that the term "property" in section 2703(a)(2) means the underlying assets in the partnership and that the partnership form is the restriction that must be disregarded. Unfortunately for respondent's position, neither the language of the statute nor the language of the regulation supports respondent's interpretation. Absent application of some other provision, the property included in decedent's estate is the limited partnership interest and decedent's interest in Stranco.
>
> In *Kerr v. Commissioner*, 113 T.C. 449 (1999), the Court dealt with a similar issue with respect to interpretation of section 2704(b). Sections 2703 and 2704 were enacted as part of chapter 14, IRC, in 1990. See Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, 104 Stat. 1388. However as we indicated in *Kerr v. Commissioner*, *supra* at 470-471, and as respondent acknowledges in the portion of his brief quoted above, the new statute was intended to be a targeted substitute for the complexity, breadth, and vagueness of prior section 2036(c)); and Congress "wanted to value property interests more accurately when they were transferred, instead of including previously transferred property in the transferor's gross estate." Treating the partnership assets, rather than the decedent's interest in the partnership, as the "property" to which section 2703(a) applies in this case would raise anew the difficulties that Congress sought

[169] See Footnote 83.

to avoid by repealing section 2036(c) and replacing it with Chapter 14. We conclude that Congress did not intend, by the enactment of section 2703, to treat partnership assets as if they were assets of the estate where the legal interest owned by the decedent at the time of death was a limited partnership or corporate interest. See also *Estate of Church v. United States*, 85 AFTR 2d 2000-804, 2000-1 USTC par. 60,369 (W.D. Tex. 2000). Thus, we need not address whether the partnership agreement satisfies the safe harbor provisions of section 2703(b). Respondent did not argue separately that the Stranco shareholders' agreement should be disregarded for lack of economic substance or under section 2703(a).

(8) My old law firm's experience with IRC Sec. 2703(a).

The above arguments were made by John Porter and me when I was at Baker Botts L.L.P., in a summary judgment motion on behalf of our client in the case styled *Estate of White v. Commissioner*[170] (sometimes described as the "Petitioners" below).

On November 8, 1985, Mrs. White's son, acting on Mrs. White's behalf and as her attorney-in-fact under a valid power of attorney, executed a trust agreement with "Bank," as Trustee, effective as of November 1, 1985, creating a trust (the "ESW Trust") for Mrs. White's benefit. Upon execution of the trust agreement, substantially all of Mrs. White's assets were transferred to Bank to be held in trust.

The Partnership was established by an Agreement and Articles of Partnership dated April 15, 1992. "Bank," as Trustee of the ESW Trust, contributed substantially all of the assets of the ESW Trust to the partnership in exchange for a 33.792991% Class B limited partnership interest. A certificate of limited partnership was filed for the partnership on April 15, 1992. At the time the partnership was created, Mrs. White was not fully capable of managing her own affairs.

With the exception of two very small preferred interests, the partnership was a pro rata partnership. The pro rata percentage interest in the partnership allocated to each party was equal to the fair market value of the properties contributed by each partner, as determined by appraisal or other verified means. The assets of the partnership included mineral interests, real estate, stocks and bonds and cash. More than two-thirds of the properties of the partnership were marketable securities (80% of the properties of the partnership were marketable securities, bonds and cash).

Mrs. White died on July 31, 1993. Under the ESW Trust, a 33.792991% Class B limited partnership interest in the Partnership was transferred to the personal representative of her estate upon her death. In the estate tax examination, the examining agent took the position that the partnership agreement was entered into primarily for estate tax purposes and that, under IRC Sec. 2703, the fair market value of the interest transferred by Mrs. White was equal to 33.792991% of the assets of the partnership--thus completely disregarding what the IRS acknowledged was a validly created and existing partnership under **state** law. The IRS's Notice of Deficiency, which was issued on June 26, 1997, was simple and straightforward, and stated as follows:

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[170] *Estate of White v. Commissioner*, T.C. Docket No. 14412-97.

> It is determined that the value of the decedent's 33.792991% partnership interest in [the Partnership] is **** as of the date of death, under § 2703 rather than **** as reported on the estate tax return. Accordingly, the taxable estate is increased ****.

After filing its answer to the petition, the IRS forwarded to us an extensive request for documents. The requests called for information clearly subject to the attorney-client privilege, including a substantial amount of information from the estate planner's files. We responded with a detailed request for information, specifically seeking each provision of the partnership agreement that the IRS sought to disregard under IRC Sec. 2703 and the facts supporting such claim. The IRS responded by stating:

> Preliminarily, I cannot respond to your informal discovery request because you have assumed that the "property" is the partnership interest. As you already know, we do not agree that "property" can be so narrowly construed. In the event that "property" refers only to Mrs. White's partnership interest, then I would respond to your question by citing to *every conceivable restriction found in the partnership agreement, most notably the restrictions on transfer, withdrawal, and dissolution.*

We filed a motion for partial summary judgment at the earliest possible date. The arguments discussed above in this outline were incorporated in that motion. In the motion, we sought a determination as to 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 limited partnership interest owned and transferred by Mrs. White as a result of her death or, instead, as the IRS claimed, property owned by the limited partnership. In other words, we asked the Court to determine that IRC Sec. 2703 cannot be used by the IRS to completely disregard an entity validly created and existing under state law.

Our motion for partial summary judgment provided the IRS the opportunity to obtain a judicial ruling concerning its assertion, as set forth in its private letter rulings and technical advice memorandum, that IRC Sec. 2703 allows the IRS to disregard the existence of an entity validly created and existing under state law for federal estate and gift tax purposes. In fact, the IRS asked for additional time to coordinate is response with the National Office on the grounds that:

> The issue posed by Petitioner is one of first impression. Respondent knows of no case law that interprets the term "property" in this context. As such, Respondent's trial counsel had to coordinate a response with Chief Counsel National Office to assure a correct and complete response. . . . Indeed, the whole of Chapter 14 (IRC Secs. 2701 through 2704) is relatively new and untested. *Chief Counsel as a whole perceives that it has a responsibility to interpret new statutes properly as they affect the greatest number of cases, not simply the case currently under scrutiny.* For that reason alone, extra time is warranted to consider the ramifications of a drafted response as it might affect other cases or situations likely to arise." (Emphasis added)

The case was pending before the Honorable Maurice Foley, who, through his prior service on the Joint Committee on Taxation, had significant experience with the legislative history. It is my understanding that he was consulted in connection with drafting the regulations under IRC Sec. 2703 by the Treasury Department.

After being granted additional time to consider the ramifications of its response regarding this, using the IRS's own words, "new and untested statute" on "other cases or situations likely to arise," the IRS filed a notice with the Court two days before its response was due, conceding "the issue relating to the value of the decedent's interest in the Partnership." Obviously, the "issue related to the value" of the decedent's partnership interest was the question of whether the IRS can use IRC Sec. 2703 to completely disregard a limited partnership validly created and existing under applicable state law. We believe the IRS concession is thus equivalent to a concession of the issue raised in the motion for partial summary judgment -- that IRC Sec. 2703 does not, nor was it ever intended to, allow the IRS to completely disregard an entity validly created and existing under state law. However, the IRS's carefully worded concession of "the issue related to the value" of the decedent's partnership interest, coupled with the fact that the IRS has not taken a public position different from its pronouncements, leads us to conclude that the IRS will continue to argue that IRC Sec. 2703 can be used to completely disregard the existence of a partnership or closely held corporation validly created and existing under applicable state law.

The IRS also initially raised the above IRC Sec. 2703(a) argument, but abandoned it, in another case handled by John Porter and me: *Estate of Brown v. Commissioner*, Docket Nos. 7492-95; 14899-96, United States Tax Court. Approximately 70% of the assets of the partnerships were marketable securities, bonds and cash. In its pleadings, the IRS abandoned the IRC Sec. 2703 arguments that it had originally argued. The taxpayer and the IRS, after the IRS's abandonment of its IRC Sec. 2703 arguments, were able to compromise the valuation argument at a 50% discount.

The IRS also used the above IRC 2703(a) argument in *Morris v. Commissioner*, Docket No. 19620-97, United States Tax Court. Over 80% of the assets of the partnership were marketable securities, bonds and cash. John Porter and I also handled this matter. The IRS and the taxpayer were able to settle this matter on the basis that IRC Sec. 2703(a) did not apply to the partnership and that a substantial discount similar to *Brown* and *White* was warranted.

The IRS has also abandoned its 2703 argument in 2 other recent cases handled by Baker Botts, LLP: *Estate of Isabelle Hagen v. Commissioner* (Docket No. 14304-99) and *Agnes Kung v. Commissioner* (Docket No. 12338-99).

4. 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.

Assume the same facts as Example 3. 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").[171] It should be noted that

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[171] Many taxpayers may *not* consider that these restrictions should be disregarded because they fail to satisfy the safe harbor provided in IRC Sec. 2703(b). However, for purposes of the argument in this subparagraph b and the argument below these "restrictions" are ignored. The remaining partnership provisions do not fail under IRC Sec. 2703 because these "restrictions" may fail. *See* Treas. Reg. § 25.2703-1(b)(5).

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. See subparagraph d of this subparagraph 4.

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).

According to Treas. Reg. § 25.2703-1(b)(2), each of these three requirements must be independently satisfied before a right or restriction will meet this exception.[172]

a. Bona Fide Arrangement Test.

Sam Selfmade's investment under the Modified Partnership Agreement should meet the "bona fide arrangement" test. If a group or syndicate wishes to conduct a trade or business or a nonbusiness financial operation, Congress assumes that the most prevalent (and logical) way to conduct the group's affairs would be to use the partnership form of ownership; indeed, it provided that the partnership form of doing business would be the default rule for the investment business.[173] Assuming a group's pooling of resources makes financial sense, using a partnership to pool those resources is almost always the most advantageous arrangement for that "pooling." The flexibility advantage and income tax advantage of the partnership "arrangement" clearly make it the preferred form of ownership for many business and/or financial transactions. Thus, using the partnership form of ownership for business or financial assets is bona fide and common.

In light of the property management and family considerations of the Selfmade family, it is clear that at the time of the formation of the Modified Partnership there existed a number of compelling business and financial reasons (other than reduction of transfer taxes) which supported the Modified Partnership as an advantageous vehicle for, and as being in the best interests of, the members of the Selfmade family. *See* Section II.

Provisions that provide for the lack of free transferability are bona fide. Partnerships, particularly family partnerships, are entities where personal relationships are crucial. Sam may

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[172] Treas. Reg. § 25.2703-1(b)(2).

[173] *See* IRC §§ 7701(a)(2) and 761.

wish to be a partner with members of his family, but he may not wish to be a partner with a cult group. The good news is that if his son or daughter transfers his or her interest in the partnership to a cult group, Sam does not have to be a partner with the cult group. That is a bona fide arrangement. Indeed, this lack of free transferability is one of the key four tests under the old regulations under IRC Sec. 7701(a)(2) for distinguishing partnerships from corporations, reflecting the long history of that bona fide partnership characteristic.

There is no shortage of business and financial reasons for the Selfmade family to have considered the formation of the Modified Partnership, with its prohibition against new owners automatically having partner status. See Section IV C 3 of this paper.

b. Device Test.

The prohibition in the Modified Partnership against granting new owners partner status (unless all of the partners agree) is not a "device" for Sam Selfmade to transfer the property he contributed to the Modified Partnership to his family for less than full and adequate consideration. For the IRS to win on this "test," with respect to the provisions of the Modified Partnership which establish a lack of free transferability, the IRS has to establish that the taxpayer has not met its burden as to *both*[174] of the following: (i) the drafting of those partnership provisions is a "device"; and (ii) Sam Selfmade's family received the assets Sam contributed to the partnership.

Sam Selfmade clearly meets his burden with the second part of the device test. Under the Modified Partnership Agreement and state law, members of Sam Selfmade's family have *no* rights to receive, possess or use those contributed partnership properties, either before his death or after his death. After his death, members of his family have rights only to use and enjoy his partnership interest. Whether during his life or after his death, Sam Selfmade's family does *not* have the right to receive or use the assets Sam Selfmade contributed to the Modified Partnership.

The fact that Sam Selfmade's family cannot possess or use the property of the Modified Partnership and can only possess or use his partnership interest *clearly* means that the Modified Partnership is not a device to transfer to them the property Sam Selfmade originally contributed to the Modified Partnership. For instance, a shareholder of General Motors does not have the right to use a General Motors factory in Detroit--that shareholder has the right only to current and future General Motors dividends and other rights consistent with the use and ownership of corporate stock. If Sam Selfmade had transferred General Motor's stock to his family, they would not have the right to receive or use any factory (even if he had contributed that factory to General Motors, Inc. in exchange for the stock). In this instance, partnership law is exactly like corporate law.[175] Thus, the Modified Partnership cannot be a "device" to transfer contributed partnership properties to Sam Selfmade's family, because those contributed properties are not and cannot be transferred to Sam Selfmade's family under partnership law.[176]

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[174] If the taxpayer meets its burden on *either* part of the test, it would appear that the taxpayer's burden with respect to IRC Sec. 2703(b)(2) is met.

[175] TRLPA § 7.01 ("A partner has no interest in specific limited partnership property.").

[176] *See* the above discussion in Section III F of this paper.

Although it is not necessary for the taxpayer to meet its burden on the first part of the "device" test since the second part is clearly not applicable, the first part of the "device" test also should not apply to provisions of the Modified Partnership. What does the term "device" mean? Does it mean that any agreement that is primarily "tax" motivated that affects the use of property is a "device." Clearly not. Otherwise, "Crummey" clauses in trusts, bypass or credit shelter trusts, and grantor retained annuity trusts would all be prohibited by IRC Sec. 2703. Each is an agreement that is clearly tax-motivated that affects the use of property. Alternatives clearly exist for each of those agreements that do not save taxes.

If it is assumed that Congress, through the use of the term "device", is not targeting agreements that affect the use of property and save taxes, what is it targeting? What Congress has indicated in its legislative history is that if the terms of agreements affecting the use of the property are ignored by the parties and/or are not "normal" provisions, those terms will constitute a "device," as discussed in *St. Louis County Bank v. United States.*[177] The Senate Finance Committee Report on IRC Sec. 2703 makes it clear that the "device" test follows the reasoning of the Eighth Circuit in *St. Louis County Bank.*[178] That case led the Eighth Circuit to conclude that while a valid business purpose may exist for buy-sell agreements, certain provisions of the buy-sell agreement under the facts of *St. Louis County Bank* may constitute an estate tax-avoidance device because those terms were not followed and were totally inappropriate for the business arrangement described in the case. The Court overturned the District Court's summary judgment stating as follows:

> We have no problem with the District Court's findings that the stock-purchase agreement provided for a reasonable price at the time of its adoption, and that the agreement had a bona fide business purpose--the maintenance of family ownership and control of the business. Courts have recognized the validity of such a purpose. See *Estate of Bischoff v. Commissioner*, 69 T.C. 32 (1977); *Estate of Reynolds v. Commissioner*, 55 T.C. 172 (1970); *Slocum v. United States*, 256 F. Supp. 753 (S.D.N.Y. 1966). Here the District Court concluded that the existence of a valid business purpose necessarily excluded the possibility that the agreement was a tax-avoidance testamentary device. 511 F. Supp. at 654-55. We disagree. *The fact of a valid business purpose could, in some circumstances, completely negate the alleged existence of a tax-avoidance testamentary device as a matter of law, but those circumstances are not necessarily presented here*."[179]

Clearly, a case can be made that the valid financial and business purposes of prohibiting any new owners from obtaining partner status, unless all of the partners agree, are so overwhelming that in the words of the *St. Louis County Bank* opinion, those purposes "completely negate the alleged existence of a tax-avoidance testamentary device" (*see also* the

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[177] 674 F.2d 1207 (Eighth Cir. 1982).

[178] *See* 136 CONG. REC. § 515, 629-04 at 15,679 (1990).

[179] 674 F.2d 1209, 1210 (emphasis added).

above discussion of the "bona fide arrangement" test). Even if not, the facts that led the Eighth Circuit to conclude that tax-motivated testamentary purposes were not necessarily excluded as a matter of law are in sharp contrast to the provisions of the Modified Partnership establishing that a transferee would expect to be a mere assignee:

(i) In *St. Louis County Bank*, the buy-sell agreement restrictions were ignored by the taxpayer's family with respect to transfers to family members. The partners of the Modified Partnership carried out its activities as partners, followed the provisions of the agreement, and did not treat the Modified Partnership as an alter ego in contrast to the *St. Louis County Bank* buy-sell agreement. All transferees, to become partners instead of mere assignees, had to be admitted into the partnership by all of the remaining partners.

(ii) The buy-sell agreement formula in *St. Louis County Bank* resulted in a value of "0" and was not the normal formula for an asset-holding corporation (the formula was based on a multiple of earnings approach). In clear contrast, the provisions of the Modified Partnership Agreement establishing that a transferee would expect to be a mere assignee are a "normal" way for unrelated parties who are partners in a partnership to hold business and nonbusiness financial assets (*see* the discussion below under the "comparables" test).

Finally, case law precedent establishes that the "device" test should not apply to the provisions of the Modified Partnership Agreement that restrict transferability. This was the chief argument the IRS used in *Estate of Bischoff*,[180] *Estate of Harrison*,[181] and *Estate of McLendon*[182] in connection with the "device" test under IRC Sec. 2031. In all three cases, the Tax Court rejected the IRS's argument, because it found unrelated parties in similar circumstances would create a limited partnership that would restrict the rights of transferees.

c. *Comparables Test*.

The terms applicable to Sam Selfmade's interest in the Modified Partnership at his death are comparable to similar arrangements entered into by persons in arm's-length transactions. Treasury Regulations define a similar arrangement as one that could have been obtained at a fair bargain among unrelated parties in the same business dealing with each other at arm's-length. A right or restriction is considered a fair bargain if it conforms with the general practice of unrelated parties under negotiated agreements in the same business.

The provisions of the Modified Agreement that require the agreement of all of the partners before a transferee can be promoted from assignee status to partner status are the default rule, not only under every state statute governing partnerships, but under the Treasury Regulations applicable to IRC Sec. 7701(a)(2) prior to January 1, 1997. Thus, it is clear that almost all partnerships between unrelated individuals have those provisions.

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180 *Estate of Bischoff v. Commissioner*, 69 T.C. 32, 40-42 (1977).

181 *Estate of Harrison v. Commissioner*, 52 T.C.M. (CCH) 1306, 1309 (1987).

182 *Estate of McLendon v. Commissioner*, 66 T.C.M. (CCH) 946, 962, 963 (1993).

d. *Valuation in connection with the Modified Agreement.*

If it is determined that IRC Sec. 2703(a) requires certain restrictions imposed by the Selfmade 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 Sam Selfmade to a hypothetical transferee (an assignee interest) indicates that the value of the transfer at Sam Selfmade'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. Thus, Sam Selfmade would be limited to only being able to transfer an assignee interest. 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).[183] 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.[184] 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. Although state law and the Modified Partnership Agreement would permit a limited partner to withdraw from the partnership upon some reasonable notice, this withdrawal right is not extended to an assignee holder of Sam Selfmade's partnership interest. Therefore, although the partnership agreement would at least guarantee the assignee holder of Sam Selfmade's partnership interest the right to withdraw from the partnership at the end of its 50-year term, under the Modified Partnership Agreement, Sam Selfmade's transferee, as an assignee, must expect to hold his or her interest indefinitely.

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[183] Treas. Reg. § 20.2031-1(b) ("The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.").

[184] The IRS has indicated through its own regulations that it issued prior to January 1, 1997 that this lack of free transferability is inherent in transferred partnership interests and is a key factor in distinguishing an entity as a limited partnership as opposed to a corporation. *See* Treas. Regs. § 301.7701-2(e) prior to January 1, 1997.

5. 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).

a. The *Harrison* case: Genesis of IRC Sec. 2704(a).

The ability to structure an owner's interest in a business entity so that he or she retains liquidation control yet can value the interest under the income approach or the net asset approach for transfer tax purposes has been affected by the passage of IRC Sec. 2704. IRC Sec. 2704 targets what Congress perceived to be valuation abuses associated with certain unusual partnership agreement terms, as illustrated by the *Harrison* case.[185] (See also the discussion of *Harrison* in I B 4 of this paper.) In the interests of full disclosure, it should be noted I was one of the drafters of the partnership agreement involved in *Harrison* and was one of the attorneys representing the taxpayer in *Harrison*, along with others in my old law firm (Baker Botts L.L.P.).

The Tax Court in *Harrison* recognized that there may be a significant decrease in the value of a person's interest in a partnership at the time of his death and that the decreased value is the amount subject to estate tax rather than the higher value existing just before his death.[186] The unusual provisions in the Harrison partnership allowed a general partner to withdraw at full liquidation value with respect to *both* his general partnership interest and his limited partnership interest. A limited partner who was not a general partner did not have that right.

Less than six months before his death, Mr. Harrison contributed properties worth $59,476,523 to a limited partnership in exchange for a 1% general partnership interest and a 77.8% limited partnership interest. His two sons each contributed $7,981,351 for the remaining 21.2% general partnership interests. Shortly after Mr. Harrison died, his sons exercised an option to purchase his 1% general partnership interest and agreed to continue the partnership as allowed under the partnership agreement, but they did not purchase his limited partnership interest.

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 IRS disagreed about the value of Mr. Harrison's 77.8% limited partnership interest, alleging that it was worth $59,555,020, the pro rata value of the partnership's assets attributable to the interest as if the partnership had been dissolved and liquidated immediately before Mr. Harrison's death. Mr. Harrison's executors contended that the *transfer* value of the interest was only $33,000,000, representing the value a hypothetical willing buyer would pay for the limited partnership interest the moment after it passed from Mr. Harrison to his estate, reflecting the effect of the buy-sell provisions. The $26,555,020 difference was attributable entirely to Mr. Harrison's right as a general partner to dissolve and liquidate his partnership interests *before his*

[185] *Estate of Harrison v. Commissioner*, 52 T.C.M. (CCH) 1306 (1987).

[186] *Id.* at 1309.

death. The parties agreed that this right could not pass to a hypothetical willing buyer purchasing the limited partnership interest from Mr. Harrison's estate because of the partnership agreement and applicable state law.

The Tax Court ruled in favor of Mr. Harrison's executors, meaning that over $26 million in value disappeared for estate tax purposes because Mr. Harrison's liquidation right as a general partner could not be transferred to an assignee of the limited partnership interest when he died. Thus, Mr. Harrison was able to maintain liquidation control during his life, yet have the transfer tax value of his limited partnership interest discounted at his death.

The IRS turned to Congress, which enacted two general prohibitions related to what was "deemed" to be unusual partnership agreement terms: lapsing rights, which reduce the transfer tax value of a partnership interest, and unusual restrictions on liquidation rights or withdrawal rights. IRC Sec. 2704(a) treats the lapse of an assignee's voting or liquidation rights in a family- controlled partnership as a transfer subject to gift or estate tax. However, if a lapse does not occur, or if a lapse does not affect the *transfer* value of the partnership interest, then IRC Sec. 2704(a) does not apply.

As discussed below in this outline, only in extremely rare circumstances will IRC Sec. 2704(a) be a concern to a transferor of an interest in a limited partnership because assignees of a general partnership interest or a limited partnership interest never have voting or liquidation rights, whether the interest is received from a living partner or an estate. As a consequence, unless there is an unusual provision in the partnership agreement, the *transfer* value of a general or limited partnership interest is the same both before death and after death.

IRC Sec. 2704(b) requires that the devaluation effect of certain restrictions on liquidation rights and withdrawal rights that may exist in a partnership agreement be disregarded. However, not all restrictions are ignored. As discussed below, if the restrictions in a partnership agreement are no more restrictive than the default state laws or are restrictions for which unrelated parties normally would bargain, then IRC Sec. 2704(b) does not apply (the provisions also would satisfy IRC Sec. 2703).

As discussed below, a partnership agreement with provisions like those described in Example 1 clearly meets the prerequisites of IRC Sec. 2704(a).

(1) Detailed review of IRC Sec. 2704(a).

The following example illustrates the techniques that Congress was trying to prohibit by passing IRC Sec. 2704(a):

Example 4: The Taxation of a Lapsing Partnership
<u>Liquidation Right Under Pre-IRC Sec. 2704 Law</u>

Sam Selfmade forms a partnership with Betsy Bossdaughter and Sonny Selfmade. Sam has an 80% interest in the partnership consisting of a 1% general partnership interest and a 79% limited partnership interest. Betsy and Sonny each have a 10% general partnership interest. At any time, any general partner can force a partial liquidation of the partnership and thus receive the liquidation value of his or her interest, both general and limited. Also, the partnership agreement, unlike most, give Sam the right to assign his general partnership interest to anyone before he dies and to have that person admitted to the partnership as a general partner. Therefore, Sam and any assignee of his choice unilaterally could withdraw full liquidation value in exchange for his or her interest in the partnership. However, if any general partner dies, that general partner would be paid the liquidation value of his or her general partnership interest, but that partner's limited partnership interest would not be redeemable nor have the right to force a dissolution and liquidation. Furthermore, Sam's estate would not have the right (as Sam did) to insist that any assignee be admitted as a partner. Sam's limited partnership interest is worth $X if the partnership is valued by the net asset value or income approach. However, if the partnership liquidates, his limited partnership interest is worth $2X. Under the law prior to passage of IRC Sec. 2704(a), what value is taxed in Sam's estate for his limited partnership interest that passes to Sonny and Betsy under his will?

The answer is $X. Before the passage of IRC Sec. 2704(a), the difference between $X and $2X would not be subject to estate tax because nothing reflecting that difference is transferred to Sonny and Betsy as a result of Sam's death. Since the passage of IRC Sec. 2704(a), however, the answer probably is $2X. The reason for my use of the word "probably" is that IRC Sec. 2704(a) leads to that result, but the courts may invalidate IRC Sec. 2704(a) as being unconstitutional (it depends on how much latitude the courts give Congress in defining when there is a transfer, as distinguished from defining how to value a transfer). The reason why the result was $X before the passage of IRC Sec. 2704(a) is that no estate tax can apply unless there is a transfer, and there is none in this example. Other than receiving Sam's interest worth $X, Sonny's and Betsy's interests in the partnership do not increase in value as a result of Sam's death. If the decrease in value in Sam's estate had "shifted" to either Sonny or Betsy, that amount would be subject to estate tax even under the old law, but in this example no such shift takes place.

(2) Components of IRC Sec. 2704(a).

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).[187]

Has a lapse occurred for purposes of IRC Sec. 2704(a) if a transferor who is a limited partner can transfer only the rights of an assignee instead of the rights of a limited partner? The answer under the regulations to IRC Sec. 2704(a) should be "no" under most circumstances.

(a) 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.[188]

Therefore, the transfer of a minority interest in a corporation or partnership by the controlling shareholder or partner does not involve a lapse of voting rights. Even though the transferor's liquidation control may have disappeared, the IRS recognizes that the dominant Congressional intent was to preserve fractionalization discounts.

* * *

Has the *Harrison*[189] 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.

(b) 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 clearest way to avoid an IRC Sec. 2704(a) lapse of liquidation right is never to have one. If one does not have a right it cannot lapse. Unlike IRC Sec. 2704(b), where certain contractual provisions in a partnership agreement are to be ignored, contractual restrictions are not ignored for purposes of IRC Sec. 2704(a).

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[187] *See* Treas. Reg. § 25.2704-1(d).

[188] Treas. Reg. § 25.2704-1(c)(1).

[189] 52 T.C.M. (CCH) 1306.

(c) The contractual exception to IRC Sec. 2704(a): there is no lapse of a voting right, if under the terms of the partnership agreement, the partner's successor has the same voting rights.

The clearest way to avoid an IRC Sec. 2704(a) lapse of voting right is for the partner's successor to have the same right to vote. If a managing partner's successor is also a managing partner, then there is no lapse of a voting right.

(d) 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.

For purposes of IRC Sec. 2704(a), certain liquidation restrictions are deemed never to lapse (even if they do lapse). Under the Treasury Regulations, all liquidation restrictions in the partnership agreement which are disregarded under IRC Sec. 2704(b) are *also* disregarded under IRC Sec. 2704(a):

> (2) Exceptions. Section 2704(a) does not apply to the lapse of a liquidation right under the following circumstances . . . .
>
> > (B) Ability to liquidate. Whether an interest can be liquidated immediately after the lapse is determined under the State law generally applicable to the entity, as modified by the governing instruments of the entity, *but without regard to any restriction described in section 2704(b).*[190]

Thus, for purposes of determining whether an interest can be liquidated after a lapse under IRC Sec. 2704(a), if IRC Sec. 2704(b) applies to a liquidation restriction, the owner of a partnership interest is deemed not to have any disqualified IRC Sec. 2704(b) liquidation restrictions on his or her interest after the lapse. For example, assume a partnership agreement provides that if a general partner withdraws from the partnership, that withdrawal will cause the partnership to dissolve unless the remaining general partners can reconstitute and continue the partnership. Those reconstitution and continuance provisions will be "applicable restrictions" under IRC Sec. 2704(b) if they are not the "default" state law provisions. See the discussion below under Section IV.B.6. *If those provisions are applicable restrictions described in IRC Sec. 2704(b), they are to be ignored for purposes of IRC Sec. 2704(a) after the lapse*. After the lapse event (withdrawal of the general partner), because of this IRC Sec. 2704(b) exception to IRC Sec. 2704(a), *the owners of the transferor's interest are deemed for purposes of IRC Sec. 2704(a) to have the same or greater ability to liquidate the partnership as what existed before the lapse*. Thus, under the example, for purposes of IRC Sec. 2704(a), the other general partners have the ability to reconstitute the partnership before the lapse event (which would prevent a liquidation), but not after the lapse event (which increases the likelihood of liquidation).

[190] *See* Treas. Reg. § 25.2704-1(c)(2)(i)(B) (emphasis added).

Experience shows that most partnership agreements have reconstitution or continuance provisions which are "applicable restrictions" under IRC Sec. 2704(b) (*i.e.*, more restrictive than default state law). As a consequence, for purposes of IRC Sec. 2704(a), since those provisions are deemed to exist *before* the lapse, but not *after* the lapse, those partnership agreements give the owners of the partnership interests greater (or the same) liquidation rights after the lapse, such that IRC Sec. 2704(a) should not apply with respect to the transferor's liquidation rights. In other words, there is no lapsed right given the assumption of IRC Sec. 2704(a).

(e) The measurable lapse exception to IRC Sec. 2704(a).

In connection with a partner's interest being converted to an assignee interest, support for the proposition that a *measurable* lapse of liquidation and voting rights will not occur in most circumstances is found in Treas. Reg. § 25.2704-1(d).[191] As noted in above, a general partner or limited partner cannot unilaterally transfer the withdrawal and voting rights of a partner to a third party. If a partner attempted to transfer all of his rights as a partner to an assignee, the assignee would not have the same rights as a partner unless the remaining partners were to consent to the assignee's being admitted to the partnership as a partner. Therefore, a lapse of limited partner voting rights and liquidation rights (to the extent that limited partner is deemed to have liquidation rights) under IRC Sec. 2704(a) almost always occurs when a partnership interest is transferred. However, what is the measure of the lapse of those voting rights or liquidation rights?

Remember that a hypothetical willing buyer of a partnership interest would take into account the likely behavior of the other partners with respect to allowing the assignee to have the rights of a partner.[192] Therefore, if an IRC Sec. 2704(a) lapse of voting or liquidation rights occurs with a transfer of a general partnership interest or limited partnership interest, whether by reason of the death of a partner or otherwise, that lapse generally is not a *measurable* lapse because the willing buyer - willing seller test under Treas. Reg. § 20.2031-1(b) must be used in determining the value of a transferred general partnership or limited partnership interest before and after the lapse.[193]

In comparing the value of a person's ownership interests before and after a lapse, the test is what a hypothetical willing buyer would pay a hypothetical willing seller for those respective interests. At each point in time, a hypothetical willing buyer probably would not assume that the remaining partners in the partnership would be willing to admit the willing buyer into the partnership as a partner. Alternatively, if a hypothetical willing buyer somehow would assume that the remaining partners would admit that buyer into the partnership as a partner before the lapse, it would also be logical for that buyer to assume that he would be admitted into the partnership as a partner after the lapse. What is illogical is an assumption that the hypothetical

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[191] *See* Treas. Reg. § 25.2704-1(d).

[192] *See U.S. v. Land*, 303 F.2d at 171-72, *supra* and Tech. Adv. Mem. 94-36-005 (May 26, 1994) (finding that a hypothetical willing buyer of an interest in an enterprise will consider the likely behavior of the other owners of the business and whether that buyer will have or not have management rights because of their behavior).

[193] *See* Treas. Reg. § 20.2031-1(b) and Treas. Reg. § 2704-1(d).

willing buyer would be admitted into the partnership as a partner before the lapse but not after the lapse.

Except in cases with a partnership agreement under which the partners have waived their right to approve future partners, a hypothetical willing buyer most likely would pay only for the rights of an assignee, whether or not the willing seller is a living partner or an estate. The measure of a "transfer" for purposes of IRC Sec. 2704(a) under the method described in Treas. Reg. § 25.2704-1(d) (*see* subparagraph (1)(d) above), therefore, almost always should be zero because a hypothetical willing buyer would pay a price based solely upon the assumption that he or she would be an assignee rather than a partner.

(f) Other exceptions to IRC Sec. 2704(a).

If enough owners of a partnership or corporation are not members of the same family so that the nonfamily owners can block a liquidation effort by the family owners, then, even if the family wanted to liquidate the corporation or partnership, IRC Sec. 2704(a) should not apply.[194]

Example 5: Lapsing Liquidation Rights
in a Non-Family Limited Liability Partnership

Sam Selfmade and Betsy Bossdaughter are general and limited partners in a 40-year term partnership, which is a limited liability partnership. The partnership agreement provides that, upon a general partner's death, his general partnership interest is subject to a "must buy - must sell" buy-sell agreement, but his limited partnership interest will continue (as in the Harrison case). Unlike Harrison, however, a 10% limited and general partnership interest is owned by an unrelated party. The partnership agreement provides that after the death of Sam Selfmade, the acquiescence of all partners is required before any partnership interest may be withdrawn or before the partnership may liquidate completely. If a general partnership interest is withdrawn in defiance of the partnership agreement, that general partner will receive only a limited partnership interest. Does IRC Sec. 2704(a) apply to this transaction on Sam's death?

The answer is no, because Sam's two children do not have the unilateral power to liquidate Sam's limited partnership interest (it requires the acquiescence of a nonfamily member). However, IRC Sec. 2704(a) will apply if, under state law, the concurrence of 90% of the limited partners could result in the liquidation of the term partnership before the end of its term. The Treasury may have added this exception (which significantly expands on the "control" prerequisite found in the statute) in an effort to ameliorate the constitutional concerns expressed above. It should be noted that under *both* the Uniform Limited Partnership Act and the Revised Limited Partnership Act, the consent of *all of* the partners is required to terminate a partnership before the end of its term.

IRC Sec. 2704(a) does not apply to the lapse of a voting right or liquidation right previously valued under IRC Sec. 2701(a) to the extent necessary to prevent double taxation.[195]

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[194] *See* Treas. Reg. §§ 25.2704-1(c)(2)(i); 25.2704-1(f), Example 2.

[195] *See* Treas. Reg. §§ 25.2704-1(c)(2)(ii); 25.2704-1(f), Example 9.

If there is a change in the default state law that causes the lapse (not the partnership agreement), IRC Sec. 2704(a) does not apply.[196]

(g) Drafting to avoid IRC Sec. 2704(a):

At no time should any partner have the unilateral right to directly or indirectly liquidate the partnership or his partnership interest. There cannot be a lapse of a liquidation right, if the partner never had one.

A partner's general partnership interest may be passed to a permitted assignee (at least by will). There cannot be a lapse of a voting right if it does not lapse. Secondly, having such a provision gives flexibility to the agreement to allow Sam Selfmade to determine who his successor will be as managing partner.

The general partners (or managing partner) should not have the power to distribute any asset other than cash to the partners, and then only that amount of cash that exceeds the reasonable working reserves needed for the partnership's affairs. Even if management rights are deemed to lapse, they cannot have much value if the holder of those rights is held to a tight fiduciary standard. Secondly, that standard should assume the applicability of *United States v. Byrum*, 408 U.S. 125 (1972) in avoiding IRC Sec. 2036(a)(2) treatment for any transfers of limited partnership interests during the managing partner's lifetime.

If these provisions are in a partnership agreement, there should not be an IRC Sec. 2704(a). Unlike IRC Sec. 2704(b), a partnership contract can be drafted to avoid IRC Sec. 2704(a), even if it is inconsistent with state law.

6. 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).

a. 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:

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[196] *See* Treas. Reg. § 25.2704-1(c)(2)(iii).

(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*."[197]

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.[198]

b. 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.[199] 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)[200], transferred partnership interests can be

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[197] Treas. Reg. § 25.2704-2(b).

[198] *See* IRC Sec. 2704(b)(3); Treas. Reg. § 25.2704-2(b).

[199] *See, e.g.,* PLR 9736004 (June 6, 1997); PLR 9735043 (June 3, 1997); PLR 9735003 (May 8, 1997); PLR 973004 (April 3, 1997); PLR 9725018 (March 20, 1997); PLR 9725002 (March 3, 1997); PLR 9723009 (February 24, 1997); PLR 98-30803 (October 16, 1998).

[200] References to IRC or § are to the Internal Revenue Code of 1986, as amended.

valued without regard to restrictions on liquidation or withdrawal contained in the partnership agreement which are more restrictive than state law.

Recall that the limited partnership from Example 1 is a fixed-term partnership that will dissolve by its terms 50 years after its inception (unless it is continued as provided in the agreement and under state law). If the partnership instead were required to be treated as a partnership at will because its required termination after 50 years is disregarded as a restriction on the partnership's liquidation (and, thus, an applicable restriction), then a limited partner would be deemed under state law in some states to have a right to withdraw and be paid "fair value" after some reasonable notice period. As noted above, in certain states a limited partner cannot withdraw except as specifically provided in the partnership agreement, even if there is no fixed term, so that a fixed term in the partnership agreement could not be deemed to be an applicable restriction under any circumstance. Furthermore, mentioned throughout this outline, the estate tax and gift tax are excise taxes on the privilege of *transferring* property, not direct taxes on what Sam himself could have derived from his interest in the partnership. Given that principle, there are five separate methods of analyzing IRC Sec. 2704(b) under which it is clear that a substantial "discount" from liquidation value is appropriate in measuring the transfer value of Sam's limited partnership interest.

(1) A fixed term is a restriction on not liquidating (i.e., continuing), thus, it cannot be an "applicable restriction".

Some of the prerequisites of IRC Sec. 2704(b) are present in Example 1. Sam, Sonny, and Betsy, as general partners, are deemed to be in control of the partnership. Sam cannot force a liquidation of the partnership without the consent of all partners, who are family members. The limited partners, who are family members, may not withdraw before the end of the term of the partnership. However, restrictions which require the consent of all partners before the limited partnership may terminate before the end of its 50-year term and prohibiting an assignee's or limited partner's withdrawal before the definite time for dissolution are consistent with the restrictions that exist under the Uniform Revised Limited Partnership Act.[201] Thus, these restrictions are not "applicable restrictions" since they are no more restrictive than default state law. Of course, the restriction on the partnership continuing beyond its fixed term is not an "applicable restriction," and cannot be disregarded, because it is only a restriction on *not* liquidating.

Stated differently, what would be the result if the partnership agreement had only the following terms?

(i) Sam and Betsy are general partners and Sam, Betsy, and Sonny are limited partners;

(ii) The partnership may not continue longer than 50 years; and

(iii) Each partner's rights, powers, and duties will be determined under the Uniform Revised Limited Partnership Act.

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[201] *See* Unif. Revised Ltd. Partnership Act, §§ 6.03, 8.01.

If that were the agreement between the Selfmades, and if a purchaser bought a limited partnership interest owned by any of the Selfmades, that purchaser would find under the Uniform Revised Limited Partnership Act that his or her assigned interest could not be withdrawn/liquidated for 50 years. Is the second section of the partnership agreement, which provides that the partnership may not continue after 50 years, considered to be an "applicable restriction" which must be ignored? If so, the partnership would be considered a perpetual partnership or a partnership at will. The default rule for such partnerships under the Uniform Revised Limited Partnership Act is that a limited partner may withdraw after six months' notice; however, it can hardly be stated that a restriction on a partnership's ability *not* to liquidate (which is clearly what the second section of the agreement does) is a restriction on the partnership's ability to liquidate! The second section of the hypothetical agreement insures that the partnership *does* liquidate at a predetermined point in the future. It is not a restriction on the partnership's ability to liquidate; rather, it is a restriction on the partnership's ability to continue. Thus, the second section of the above agreement cannot be ignored under IRC Sec. 2704(b) because it does not meet the definition of an "applicable restriction" and will be given effect for transfer tax valuation purposes.

(2) IRC Sec. 2703 applies to provisions limiting the continuance of a partnership agreement and, thus, they cannot be considered an "applicable restriction".

Even assuming that a requirement for a partnership to dissolve at a set point in the future could be interpreted to be an "applicable restriction" (and, thus, disregarded), if the partnership agreement also contains specific covenants that a limited partner or assignee may not withdraw from the partnership until the partnership dissolves and liquidates, and that an assignee cannot be admitted to the partnership unless all of the partners agree, significant discounts still would be appropriate in valuing a partnership interest because those covenants are subject to IRC Sec. 2703. Those covenants clearly would be a restriction on the right to acquire or use a partnership interest and, thus, would be subject to IRC Sec. 2703.[202] If a covenant in an agreement is subject to IRC Sec. 2703, then it cannot be an applicable restriction.[203] However, for the covenant to be recognized for valuation purposes, the statutory prerequisites of IRC Sec. 2703 must be satisfied.

It could be argued that the reference in the Treasury Regulations to being "subject to 2703" is unclear. The Report of the American College of Trust and Estate Counsel Business Planning Committee on Family Limited Partnerships in 1996 concludes as follows:

> Some meaning should be given to the exception, and meaning can best be given by applying the language to a restriction that meets the bona fide business arrangement test. Such a result is not only consistent with principles of interpretation but also makes good policy. Section 2703 deals with restrictions on sales and Section 2704 with restrictions on liquidation. It is reasonable for the

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[202] *See* Treas. Reg. §§ 25.2703-1(a)(2)(ii); 25.2703-1(a)(3).

[203] *See* Treas. Reg. § 25.2704-2(b).

rules to have a similar purpose and such a result would be more consistent with the legislative history permitting minority discounts.

(3) 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 IRC Sec. 2704(b) applies to these restrictions with respect to a limited partnership interest, it does not cause the *assigned* limited partnership interest to be valued at its liquidation value. Under Revenue Ruling 93-12,[204] *fair market value is determined by examining the rights transferred to the assignee, not the rights formerly held by the assignor*. In other words, even if the partnership agreement's restrictions on a limited partner's ability to liquidate his limited partnership interest did not exist, any person buying the transferred limited partnership interest would purchase it at a price based on the income value approach or net asset value approach, not its liquidation value, because that person would only be an assignee, not a partner. If the partnership agreement were silent on these matters, a hypothetical buyer still would be concerned with the restrictions on an assignee under default state law. The mechanics of IRC Sec. 2704(b) do not require that the valuation be determined as if the transferee's interest has a "put" right. The statute only requires that the valuation be determined as if the applicable partnership agreement is silent with respect to liquidation restrictions.[205] If the governing instrument is silent as to liquidation rights, one then must look to state law to determine the result. Under state law, assignees do not have the right to force a liquidation of the partnership or even the right to petition a court to force liquidation.

(4) 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.

Section 6.04 of the Texas Revised Limited Partnership Act makes it clear that under Texas law, even if IRC Sec. 2704(b) applies, a limited partner on withdrawal receives in cash only "the *fair value* of that limited partner's interest in the limited partnership as of the date of withdrawal." (Emphasis added.) The Act does not define "fair value," but the use of that particular terminology is significant, especially when contrasted to the language used to define what a limited partner receives when the partnership is wound up and liquidated.

What is the *fair value* of a limited partnership interest on the date of a limited partner's death under state law? It should be what a willing buyer would pay to assume the rights inherent in that limited partnership interest. The meaning a state legislature gives to the term "fair value"

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[204] Rev. Rul. 93-12, 1993-1 C.B. 202.

[205] IRC Sec. 2704(b).

may be well developed because of its use under the Model Business Corporation Act.[206] It is clear under relevant case law that "fair value" is *not* liquidation value.[207]

(5) Legislative history contemplates normal discounting.

The legislative history of IRC Sec. 2704(b) makes it clear that normal minority interest discounts and other discounts are not to be disregarded. The general discussion portion of the Conference Committee Report dealing with IRC Sec. 2704 states as follows: "These rules do not affect minority discounts or other discounts available under present law." Thus, if the transferee owns only a minority interest in a corporation, or owns only a limited partnership interest as in the above example, and if under state law the minority corporate or limited partnership interest does not have a "put" right or automatic liquidation right, then fractionalization discounts will be applied. In other words, as the legislative history makes clear, if a minority interest in a corporation or a limited partnership interest normally is valued on an income approach or net asset value approach basis, then IRC Sec. 2704(b) will not affect that result. Stated differently, if an entity having a limited term is interpreted as *per se* containing an "applicable restriction," then the only entities that are not subject to IRC Sec. 2704(b) would be perpetual corporations. No one can argue seriously that such a proposition represents Congressional intent.

c. *Kerr* case:

On the last day it issued opinions before the Christmas holiday, the Tax Court, on a case my old law firm (Baker Botts L.L.P.) handled, issued its opinion in *Kerr v. Commissioner* [208], the first opinion addressing the IRS's broad interpretation of the provisions of Chapter 14 of the Internal Revenue Code and Congress' intent with respect to those statutes.[209] In an early Christmas present for taxpayers, the Court held that IRC Sec. 2704(b) did not affect the valuation of limited partnership interests transferred by the taxpayers because the restrictions on liquidation in the partnership agreements at issue were not "applicable restrictions" under IRC Sec. 2704(b).

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[206] *See* TEX. BUS. CORP. ACT art. 5.12 (Vernon Supp. 1994).

[207] *See In Re Glosser Bros*., 555 A.2d 129 (Pa. Super. 1989) (finding that a court may consider any method of stock valuation generally considered acceptable in the financial community); *Independence Tube Corp. v. Levine*, 535 N.E.2d 927 (1st Dist. Ill. 1988) (finding that, in determining fair value, the court is allowed to exercise its judgment after considering all relevant factors such as investment value, dividend history, projected dividend policy, selling prices of stock of like character, and the minority or illiquidity of the stock), and *Blake v. Blake Agency, Inc.*, 486 N.Y.S.2d 341 (2d Dept. 1985) (finding that the trier of fact may use three principal methods of stock valuation to determine fair value, including: (1) net asset value; (2) investment value; or (3) market value. The value should be determined on the basis of what a willing purchaser, in an arm's-length transaction, would offer for an interest in an operating, rather than liquidating, business.).

[208] 113 T.C. No. 30 (December 23, 1999). *See also Kerr v. Commissioner*, 292 F.3d 490 (5th Cir. 2002), which held IRC Sec. 2704(b) did not apply to the transferred interests on different grounds.

[209] In *Estate of White v. Commissioner*, Docket No. 14412-97, the Court had the opportunity to address whether or not IRC §2703 could be used to completely disregard the existence of a legally created and existing limited partnership created under Texas law. However, in the face of a motion for partial summary judgment on the issue, the IRS conceded all valuation questions in the case. Therefore, the Court could not address the issue.

In 1993, the taxpayers and their children formed two FLPs in 1993 (KIL and KFLP). Mr. and Mrs. Kerr simultaneously, with the creation of KFLP, transferred part of their general partnership in KFLP to their four children. The assignment document by Mr. and Mrs. Kerr, as the then only general partners, approved the children's admission as general partners. The partnership agreement creating KFLP and certificate of limited partnership for KFLP provided that the children were admitted as general partners. Each document was signed by all six general partners.

Each partnership is to last until December 1, 2043 or until all partners agree to terminate the partnership. No limited partner has the right to withdraw from the partnership during its term.

In June, 1994, the taxpayers transferred Class A partnership interests in both partnerships to the University of Texas. The assignment documents by Mr. and Mrs. Kerr approved the University of Texas' admission as a Class A limited partner. The children did not approve of the admission of the University of Texas, at that time. On December 30, 1994, the First Amendment of KIL was executed and all of the KIL partners agreed to admit the University of Texas as a Class A limited partner.

On December 28, 1994, the taxpayers created separate grantor retained annuity trusts ("GRATs"), and each transferred 44.535% Class B interests in KFLP to the GRATs. The remainder interests in the GRATs passed to generation skipping trusts pursuant to a formula. The trustees of the GRATs were not formally admitted as limited partners -- no general partner other than the taxpayers consented to the admission of the GRAT trustees as limited partners. The taxpayers also made gifts of interests in KIL to their children. However, under the KIL partnership agreement, the children automatically received partnership interests because they were already partners in the partnership.

In filing their federal gift tax returns for 1994 and 1995, the taxpayers computed the fair market value of the interests transferred by applying valuation adjustments for minority interest and lack of marketability. The IRS, however, determined that IRC Sec. 2704(b) barred any adjustment for minority interest and lack of marketability in computing the fair market value of the partnership interests. The IRS claimed that the provisions of the partnership agreements that restricted the right of a limited partner to liquidate his limited partnership interest were "applicable restrictions" which should be disregarded in determining the fair market value of the interests transferred.

> The IRS's argument had two components. First, the IRS claimed that the provisions of the partnership agreements which stated that the partnership shall liquidate upon the earlier of December 31, 2043, or the consent of all the partners, were restrictions on the liquidation of the partnerships that constitute "applicable restrictions" within the meaning of § 2704(b) which must be disregarded in valuing the interests transferred. Second, the IRS claimed that the provisions of the partnership that restricted a limited partner's right to withdraw from the entity were "applicable restrictions" which must be disregarded in valuing the interests transferred. The IRS thus claimed that because a limited partner in a partnership that did not have a fixed term (i.e., December 31, 2043) had the right to withdraw his interest under state law upon six months notice, that the fair market value of the interest is equal to the proportionate pro rata net asset value of the partnership interest transferred.

After the case was put at issue in the Tax Court, the taxpayers filed a motion for partial summary judgment arguing that IRC Sec. 2704(b) did not apply to the valuation of the transferred interests because (1) the taxpayers could only unilaterally transfer assignee interests in KFLP, as opposed to limited partnership interests (the IRS conceded in its brief that if the assigned interest was an assignee interest IRC Sec. 2704(b) did not apply); (2) the restrictions on liquidation and withdrawal in the partnership agreements are not "applicable restrictions" within the meaning of IRC Sec. 2704(b) because a limited partner under Texas law cannot withdraw until the end of a fixed term; (3) the restrictions on withdrawal in the partnership agreements are not "applicable restrictions" because under Texas law a limited partner can only withdraw in accordance with the terms of the partnership agreement; and (4) the family did not have the unilateral right to remove any restriction on liquidation or withdrawal because the University of Texas, as either a limited partner or as an assignee under the terms of each of the partnership agreements, had the right to block that withdrawal or the removal of any such restriction.[210]

As an initial matter, the Court found that the transferred interests transferred to the GRAT trustees were limited partnership interests, and not assignee interests (regardless of the fact that no general partner of KFLP other than the taxpayers consented to the trustees admission as limited partners). Despite this finding, the Court held that IRC Sec. 2704(b) did not apply to the valuation of the transferred interests. 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), [211] 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. Stated differently, providing for a fixed term when the partnership must liquidate, according to the Court, is not an "applicable restriction".

Importantly, the Court rejected the IRS's argument that the restrictions in the partnership agreements on withdrawal of a limited partner should be compared with § 6.03 of the TRPLA, which deals with a limited partner's right of withdrawal.[212] The Court found the IRS's reliance on

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[210] These were the grounds that the Fifth Circuit held IRC Sec. 2704(b) did not apply. *See Baine v. Comm.*, 292 F.3d 490 (5th Cir., 2002).

[211] Under § 8.01 of the TRLPA, a partnership shall be dissolved on the earlier of: (1) the currents of events specified in the partnership agreement to cause dissolution; (2) the written consent of all partners to dissolution; (3) the withdrawal of a general partner; or (4) the entry of a decree of judicial dissolution.

[212] Under § 6.03 of the TRLPA which was in existence in 1994 and 1995, a limited partner could "withdraw from a limited partnership at the time or on the occurrence of events specified in a written partnership agreement and in accordance with that written partnership agreement. ***If the partnership agreement does not specify such a time*** or event or define a time for the dissolution and winding up of the limited partnership, a limited partner may withdraw

TRPLA § 6.03 was erroneous, stating that TRLPA § 6.03 sets forth limitations on a limited partner's withdrawal from a partnership. The Court noted, however, that "a limited partner may withdraw from a partnership without requiring the dissolution and liquidation of the partnership. In this regard, the Court concluded that TRLPA § 6.03 is not a 'limitation on the ability to liquidate the entity' within the meaning of Treas. Reg. § 25.2704-2(b)."

The primary importance of this case is the Court's holding that the IRS's broad interpretation of "applicable restrictions" under IRC Sec. 2704(b) cannot be applied to withdrawal provisions of a partnership agreement. That argument is the thrust of the IRS's IRC Sec. 2704(b) position in its pronouncements issued over the last few years. The *Kerr* decision is hopefully just the first of a number of decisions to be issued in the next year that will clarify the issues in this area for both taxpayers and the IRS.

d. 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.

C. 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.

Under the facts of Example 3, the partnership was created and was operated as a valid, independent legal entity at all times, in accordance with all state and tax law requirements. No allegations or suggestions were made to the contrary by Susan Service.[213] It is very important that the partnership be operated as a partnership and not as the alter ego of Sam Selfmade. Therefore, the facts of Example 3 do not support that the creation or operation of the partnership is a sham in any respect.

The IRS argued in *Church* (see footnote 82) there was no "substance" to the form of the partnership since the certificate had not been filed with the Secretary of State at the time of Mrs. Church's death, that FLLC which was to be general partner had not been formed at the time of Mrs. Church's death and that the assets of the partnership had not been conveyed into the partnership at the time of Mrs. Church's death. The Court found that for state law purposes and federal estate tax purposes the partnership is a valid partnership, despite those facts:

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on giving written notice not less than six months before the date of withdrawal to each general partner." (Emphasis added.)

[213] Unlike *Schauerhamer*, T.C. Memo 1997-242, in which Dorothy Schauerhamer routed partnership income directly into her personal account.

> The Government contends that prior to her death, Mrs. Church did not effectively convey to the partnership legal title to the securities in her Paine Webber account. Based on the undisputed facts, the Court concludes this contention is without merit. Mrs. Church did not hold legal title to these securities; hers was an equitable beneficial interest and legal title was held by Paine Webber. It would make no difference even if this were not the case because neither Texas law nor the federal law of estate taxation concern themselves with legal title in determining ownership of partnership property. Under well-established principles of Texas law, ownership of property intended to be a partnership property is not determined by legal title, but rather by the intention of the parties. Logan v. Logan 156 S.W. 2d 507, 512 (Tex. 1941); Foust v. Old Am. County Mut. Fire Ins. Co., 977 S.W. 2d 783, 786 (Tex. App.– Forth Worth 1998, no writ). Mrs. Church's intention to relinquish her beneficial interest in the securities held by Paine Webber was clearly expressed by her executions of the Partnership Agreement in which these securities are specifically described. This intention governs without regard to legal title to the securities and the securities were the property and assets of the Partnership.

The IRS was more successful in their "substance" arguments in the *Estate of Charles E. Reichardt v. Commissioner*.[214] Judge Colvin agreed with the IRS that the substance of the partnership transaction was that Mr. Reichardt and his children had an implied agreement to allow Mr. Reichardt to continue to substantively enjoy the property contributed to the partnership and retain the right to income from the partnership assets during his lifetime in the same manner he had before the creation of the partnership. The Court found that the transfers to the partnership did not affect Mr. Reichardt's enjoyment of the property. Mr. Reichardt also continued to manage the property in the same fashion that he had before. The Court also found that Mr. Reichardt commingled partnership and personal funds, enjoyed the use of the personal residence, which was contributed to the partnership, without paying rent, and that Mr. Reichardt was solely responsible for the partnership's business activities.

The IRS received a double barrel blow in the *Strangi*[215] case and in the *Knight*[216] case on its common law doctrine of economic substance. The IRS used the common law doctrine of economic substance in order to ignore a partnership. Under both of these cases, significant facts existed to ignore the partnership (*e.g.*, failure to pay proper rental income, the creation of the partnership for the benefit of the incompetent, the creation of the partnership shortly before a partner was to die, the major assets being nothing but marketable securities and/or bonds, the partners not following the management provisions of the partnership agreement, the partners not following the distribution provisions of the partnership, etc.). Despite the fact that the partners entered into numerous "due diligence" errors, both partnerships were held to be valid partnerships under state law and that the economic substance doctrine did not apply.

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[214] 114 T.C. No. 9 (March 1, 2000).

[215] *See* Footnote 83.

[216] *See* Footnote 81.

The majority opinion in *Knight v. Commissioner*[217], *supra*, rejected the IRS "substance" argument based on the following reasoning:

> ***Petitioners contend that their rights and legal relationships and those of their children changed significantly when petitioners formed the partnership, transferred assets to it, and transferred interests in the partnership to their children's trusts, and that we must recognize the partnership for Federal gift tax valuation purposes. We agree with petitioners.
>
> State law determines the nature of property rights, and Federal law determines the appropriate tax treatment of those rights. See *United States v. National Bank of Commerce*, 472 U.S. 713, 722 (1985); *United States v. Rodgers*, 461 U.S. 677, 683 (1983); *Aquilino v. United States*, 363 U.S. 509, 513 (1960). The parties stipulated that the steps followed in the creation of the partnership satisfied all requirements under Texas law, and that the partnership has been a limited partnership under Texas law since it was created. Thus, the transferred interests are interests in a partnership under Texas law. Petitioners have burdened the partnership with restrictions that apparently are valid and enforceable under Texas law. ... We apply the willing buyer, willing seller test to value the interests in the partnership because we have no reason to conclude from this record that a hypothetical buyer or seller would disregard it.
>
> Respondent relies on several income tax economic substance cases. See, e.g., *Frank Lyon Co. v. United States*, 435 U.S. 561, 583-584 (1978); *Knetsch v. United States*, 364 U.S. 361, 366 (1960); *ASA Investerings Partnership v. Commissioner*, 201 F.3d 505, 511-516 (D.C. Cir. 2000); affg. T.C. Memo. 1998-305; *ACM Partnership v. Commissioner*, 157 F.3d 231, 248 (3d Cir. 1998); affg. in part and regv. in part T.C. Memo. 1997-115; *Merryman v. Commissioner, supra; Winn-Dixie Stores, Inc. v. Commissioner*, 113 T.C. 254, 278 (1999). We disagree that those cases require that we disregard the partnership here because the issue here is what is the value of the gift. See secs. 2501, 2503; sec. 20.2031-1(b), Estate Tax Regs.; sec. 25.2512-1, Gift Tax Regs.
>
> Respondent points out that in several transfer tax cases we and other courts have valued a transfer based on its substance instead of its form. See. e.g., *Heyen v. United States*, 945 F.2d 359, 363 (10th Cir. 1991); *Schultz v. United States*, 493 F.2d 1225 (4th Cir. 1974); *Estate of Murphy v. Commissioner*, T.C. Memo 1990-472; *Griffin v. United States*, 42 F.Supp. 2d 700, 704 (W.D. Tex. 1998). Our holding is in accord with those cases because we believe the form of the transaction here (the creation of the partnership) would be taken into account by a willing buyer; thus the substance and form of the transaction are not at odds for gift tax valuation purposes. Respondent agrees that petitioners created and operated a partnership as required under Texas law and gave interests in that partnership to their children's trusts. Those rights are apparently enforceable under Texas law.

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[217] 115 T.C. 506 (2000).

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.

D. 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.

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.[218] Where either of these tests has been met, the courts have not ignored the effect of partnership agreements on valuation, even when valuation discounts approach 85%.[219] There is no shortage of business, financial, or investment reasons for creating a family partnership.

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.[220]

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[218] *See Frank G. Lyon Co. v. U.S.,* 435 U.S. 561, 583-584 (1978); *Estate of McLendon v. Commissioner,* 66 T.C.M. (CCH) 946, 962 (1993); *Sparks Farm, Inc. v. Commissioner,* 56 T.C.M. (CCH) 464, 472-473 (1988); *Estate of Harrison v. Commissioner,* 52 T.C.M. (CCH) 1306, 1309 (1987); *Estate of Bischoff v. Commissioner*, 69 T.C. 32, 39-41 (1977).

[219] *See Estate of Watts v. Commissioner*, 51 T.C.M. (CCH) 60 (1985), *aff'd*, 823 F.2d 483 (11 Cir. 1987); *John R. Moore v. Commissioner*, 62 T.C.M. (CCH) 1128 (1991); *Estate of Harrison v. Commissioner*, 52 T.C.M. (CCH) 1306 (1987); *Harwood v. Comm.*, 82 United States Tax Court Reports 239 (1984).

[220] *See New York Times,* Section 3, Page 1, *Our Portfolio, Ourselves* (October 15, 1995) Referencing 17,004 Investment Clubs belong to the National Association of Investor's Corporation ("NAIC"). In 1997, the number had increased to 31,800. *See* New York Times, Section 13LI, Page 3, *Helping Women with a World of Finances* (September 21, 1997); referencing that 31,800 investment clubs belong to NAIC. As of November 1997, there are 33, 549 investment clubs with over 670,000 members. (Source: Internet Website for NAIC, Background and History.) Of course, many more investment clubs are created than register with NAIC. The official guide from NAIC recommends that a limited partnership be utilized to create an investment club and that limited partnership interest be non-transferrable except with the agreement of all partners. *See Starting and Running a Profitable Investment Club*, O'Hara and Janke (1996) p. 188.

Congress and the Treasury have recognized that it is common and proper for groups to use partnerships to hold only passive securities:

(i) 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.[221]

(ii) The IRC liberally defines the term "partnership" in sections 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.* Congress clearly intended that an individual would always be treated as a partner of a partnership for purposes of Chapters 1, 11, 12, 13, and 14 of the Code if that individual is a member of a group that conducts any financial operation, including investing in stocks and bonds, unless that group is a trust, an estate, or a corporation. See the discussion of *Winkler* in Section III E.

(iii) Specific rules that apply only to partnerships holding passive investment assets appear in the 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) will recognize gain or loss on contribution unless each partner's contributed stock portfolio is substantially diversified (see the new regulations under section 368 and the discussion in Section IV.B).

 (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).

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[221] *See* Rev. Rul. 75-523, 1975-1 C.B. 257 (because of IRC Sec. 7701(a)(2), a partnership was recognized for tax purposes even though the only purpose of the partnership was to invest in certificates of deposit) and Rev. Rul. 75-525, 1975-1 C.B. 350 (because of IRC Sec. 7701(a)(2), a partnership form of ownership was recognized for tax purposes even though the only purpose of the partnership was to invest in marketable stocks and bonds).

(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."[222]

E. 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.

The IRS may argue as it did in TAM 9842003 (issued October 19, 1998) that the step transaction analysis applies to collapse step one, the creation of the partnership (or corporation), with step two, the transfer of the partnership interest (or transfer of corporate stock). Assuming the collapse is appropriate, the IRS could argue that IRC Sec. 2703(a) would then become applicable and the creation of the partnership should be ignored. Under this theory, the restrictions in the partnership agreement (or corporate form of business) would affect the value of the contributed partnership property and therefore should be disregarded for valuation purposes.

One of the major arguments that the IRS made in the *Strangi* case (see Footnote 83) was that the step transaction doctrine should apply. The application of the step transaction doctrine, according to the IRS, would lead to the conclusion that the partnership agreement should be completely disregarded. The three steps were (i) the creation of the partnership shortly before death; (ii) the transfer of the partnership interest at death; and (iii) the, in effect, termination of the partnership at the moment of death. The IRS argued that the partnership was deemed not to exist at death because the partners essentially disregarded the partnership agreement after the death of Mr. Strangi. The majority of the court agreed that the partnership agreement was largely not followed by the partners after Mr. Strangi's death, but still existed as a matter of state law and should be recognized for estate tax purposes. At least some of the judges, Judge Foley and Judge Wells, felt that this common law doctrine, along with other common law doctrines, had no place in the transfer tax arena.

J. C. *Shepherd v. Commissioner*,[223] involved J.C. Shepherd's 1991 gift tax liability from his transfer of land and stock of three rural Alabama banks to a *general* partnership in which he had a 50 percent interest and each of his two sons had a 25 percent interest. The partnership was formed on August 2, 1991. On August 1, 1991, Mr. Shepherd and his wife executed two deeds to the Partnership, each one transferring an undivided 50 percent interest. The deeds were recorded on August 30, 1991. The bank stock was transferred to the partnership on September 9, 1991.

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[222] Treas. Reg. § 1.701-2(a) (emphasis added). The parenthetical language referring to investment as a business activity was added after the release of the proposed regulation. *Compare* Prop. Reg. § 1.701-2(a).

[223] *J. C. Shepherd v. Commissioner*, 115 T.C. 30 (2000).

The majority opinion described the issues as follows:

> (1) The characterization, for gift tax purposes, of petitioner's transfers of certain real estate and stock into a family partnership of which petitioner is 50-percent owner and his two sons are each 25-percent percent owners; (2) the fair market value of the transferred real estate interests; and (3) the amount, if any, of discounts for fractional or minority interests and lack of marketability that should be recognized in valuing the transferred interests in the real estate and stock.

The opinion rejected the taxpayer's contention that his gift was an enhanced partnership interest:

> The gift tax is imposed on the transfer of property. See sec. 2501. Here the property that petitioner possessed and transferred was his interests in the leased land and bank stock. How petitioner's transfers of the leased land and bank stock may have enhanced the sons' partnership interest is immaterial, for the gift tax is imposed on the value of what the donor transfers, not what the donee receives. See Robinette v. Helvering, 318 U.S. 184, 186 (1943) (the gift tax is "measured by the value of the property passing from the donor"); Stinson Estate v. United States, 214 F.3d 846, 849 (7th Cir. 2000); Citizens Bank& Trust Co. v. Commissioner, 839 F.2d 1249 (7th Cir. 1988) (for gift and estate tax purposes, value of stock transferred to trusts was determined without regard to terms or existence of trust); Goodman v. Commissioner, 156 F.2d 218, 219 (2d Cir. 1946), affg. 4 T.C. 191 (1944); Ward v. Commissioner, 87 TC 78, 100-101 (1986); LeFrak v. Commissioner, supra [T.C. Memo 1993-526]; sec. 25.2511-2(a), Gift Tax Regs.; cf. Estate of Bright v. United States, 658 F.2d 999, 1001 (5th Cir. 1981) (for estate tax purposes, "the property to be valued is the property which is actually transferred, as contrasted with the interest held by the decedent before death or the interest held by the legatee after death")....
>
> A gift may be direct or indirect. See Sec. 25.2511-1(a), Gift Tax Regs. The regulations provide the following example of a transfer that results in an indirect taxable gift, assuming that the transfer is not made for adequate and full consideration: "A transfer of property by B to a corporation generally represents gifts by B to the other individual shareholders of the corporation to the extent of their proportionate interests in the corporation." Sec. 25.2511-(h)(1), Gift Tax Regs.

Does *Shepherd* have any adverse taxpayer effect in the FLP area? The answer should be no because, if the transaction is correctly handled, the gift being valued is not property added to the partnership but rather a partnership interest itself. The donor should transfer the property to the partnership when the donees' interests in the partnership are small (or nonexistent), and then make gifts of interests in the partnership to them.

The step transaction doctrine should not be an appropriate analysis for transfer tax law (it is only appropriate as an income tax doctrine). If the creation of the partnership is not voidable under applicable state law, then Sam Selfmade's transfer of a partnership interest is a transfer of a valid partnership interest under state law and, thus, transfer tax law. [224]

Even if the step transaction analysis is appropriate for transfer tax law, it should have no application under the facts of Example 3. First of all, 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. 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. Under the facts of Example 3, valid business and financial reasons existed to support the creation of the Partnership (*see* discussion above), and there has been no suggestion or allegation that the creation of the Partnership was a sham.[225] There is therefore no basis for claiming that what Sam Selfmade transferred was any asset at the time of his death other than an interest in the Partnership.

Finally, in each of the cases cited by the IRS in TAM 9842003, *Estate of Cidulka v. Comm.* (T. C. Memo 1996-149), *Estate of Murphy v. Comm.* (T.C. Memo 1990-472), and *Griffin v. United States*, No. A96-CA-760 SS (W.D. Texas June 2, 1998) the transferee after the collapse of the "steps" had voting control of a corporation. Even if the steps are collapsed, in a typical partnership transaction, the transferee does not have voting control, indeed the transferee of a partnership interest has the same amount of "control" and "management" rights (or lack of rights) if he or she has an 80% interest or a 1% interest in a partnership.

[224] Estate and gift tax consequences are to be determined solely by applying state law to determine ownership rights and encumbrances, not federal income tax law. *See* the above discussion in Section III.D. of this outline.

[225] *See* Rev. Rul. 79-250, 1979-1 C.B. 156; GCM 37652 ("The Service has indicated on several occasions that threshold steps, even when undertaken to tailor transactions so as to generate favorable tax results with respect to the transaction as a whole, will not be disregarded under a step transaction analysis when such preliminary activity demonstrates independent economic significance"); *Penrod v. Comm.*, 88 TC 1415, 1429-1430 (1987).

F. 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).

Even in those partnership agreements that are silent on the continuation of a partnership by the remaining partners after the death of a general partner (or other withdrawal event) (which may be deemed for estate tax purposes to always be the case because of operation of IRC Sec. 2704(b)), the remaining partners under state law can agree to continue the partnership.[226]

At the moment of death, the decedent's interest in the partnership passes to his heirs subject to estate administration. However, what passes is not a "voting" partnership interest for purposes of determining whether the partnership continues. That vote is with the remaining partners and not with the estate (unless the partnership agreement supersedes default state law).[227]

Thus, if a willing buyer would assume at the moment of death the partnership would continue because the remaining partners are a cohesive family that would wish to continue the partnership for the non-transfer tax reasons that led to its creation, the dissolution of the partnership which is caused by a partner's death would not affect the price a willing buyer would pay for the partnership interest. A willing buyer always looks forward to the assumed facts after his purchase of the estate's partnership interest.[228] If, however, under the facts of Example 1 a hypothetical willing buyer would assume one or more of the remaining partners would not want to continue the partnership, then that willing buyer would ignore the partnership agreement. Thus, it is crucial to demonstrate to the IRS that the remaining partners wish to continue the partnership and, in fact, do continue the partnership. Alternatively, 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.

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[226] *See* T.R.L.P.A. § 8.01(3)(B).

[227] *See* T.R.L.P.A. § 6.03(b), § 7.05, and § 8.01(3)(B).

[228] *See U.S. v. Land*, 303 F2d *supra* 171-172.

G. 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).

Even if a general partner controls partnership distributions, IRC Sec. 2036(a)(2) should not include any previously transferred limited partnership interests or assignee interests in his estate. The Supreme Court's analysis in *United States v. Byrum*[229] provides authority that IRC Sec. 2036(a)(2) should not apply to the facts of Example 1.

United States v. Byrum involved a case in which the IRS determined that stock of certain corporations was included in a decedent's estate under IRC Sec. 2036(a)(2). The decedent had transferred stock to a trust and retained the rights to vote the stock and also retained the power to disapprove the transfer of any trust assets, investments and reinvestments, and to remove the trustee and designate a corporate trustee. The decedent's right to vote the stock of the trust corpus, together with his right to vote the stock he owned individually, gave him the right to vote 71% of the stock.

The IRS argued that under IRC Sec. 2036(a)(2), Mr. Byrum, the decedent, retained the right to designate the persons who had enjoyed the income from the transferred property. The IRS argued that he had this right because he had control over the corporate dividend policy. By increasing, decreasing, or stopping the dividends completely, Byrum could indirectly "regulate the flow of the income to the trust" and thereby shift or defer the beneficial enjoyment of the trust income between the beneficiaries.

The Supreme Court rejected the IRS's reasoning based on three different theories. The first theory was that the power to manage assets that affect the income of a transferee, including assets directly or indirectly transferred to a transferee, is not a power that is subject to IRC Sec. 2036(a)(2):

> At the outset we observe that this Court has never held that trust property must be included in a settlor's gross estate solely because the settlor retained the power to manage trust assets. On the contrary, since our decision in *Reinecke v Northern Trust Co.*, 278 U.S. 339, 73 L Ed 410, 49 S. Ct. 123, 66 ALR 397 (1929), it has been recognized that a settlor's retention of broad powers of management does not necessarily subject an inter vivos trust to the federal estate tax. Although there was no statutory analogue to § 2036(a)(2) when Northern Trust was decided, several lower court decisions decided after the enactment of the predecessor of § 2036(a)(2) have upheld the settlor's right to exercise managerial powers without incurring estate tax liability. In *Estate of King v. Commissioner*, 37 T.C. 973 (1962), a settlor reserved the power to direct the trustee in the management and investment of trust assets. The Government argued that the settlor was thereby empowered to cause investments to be made in such a manner as to control

229 408 U.S. 125 (1972).

significantly the flow of income into the trust. The Tax Court rejected this argument, and held for the taxpayer. Although the court recognized that the settlor had reserved "wide latitude in the exercise of his discretion as to the types of investments to be made," id. at 980, it did not find this control over the flow of income to be equivalent to the power to designate who shall enjoy the income from the transferred property.

> Essentially the power retained by Byrum is the same managerial power retained by the settlors in *Northern Trust* and in *King*. Although neither case controls this one--*Northern Trust*, because it was not decided under § 2036(a)(2) or a predecessor; and *King*, because it is a lower court opinion--the existence of such precedents carries weight. The holding of *Northern Trust*, that the settlor of a trust may retain broad powers of management without adverse estate tax consequences, may have been relied upon in the drafting of hundreds of inter vivos trusts. The modifications of this principle now sought by the Government could have a seriously adverse impact, especially upon settlors (and their estates) who happen to have been "controlling" stockholders of a closely held corporation. Courts properly have been reluctant to depart from an interpretation of tax law that has been generally accepted when the departure could have potentially far-reaching consequences. When a principle of taxation requires reexamination, Congress is better equipped than a court to define precisely the type of conduct that results in tax consequences. When courts readily undertake such tasks, taxpayers may not rely with assurance on what appear to be established rules lest they be subsequently overturned. Legislative enactments, on the other hand, although not always free from ambiguity, at least afford the taxpayers advance warning.[230]

Secondly, the Supreme Court held that *Byrum* did not have a retained "right" as that term is used in IRC Sec. 2036(a)(2) because of the fiduciary duty *Byrum* owed to the corporation:

> It must be conceded that Byrum reserved no such "right" in the trust instrument or otherwise. The term "right," certainly when used in a tax statute, must be given its normal and customary meaning. It connotes an ascertainable and legally enforceable power, such as that involved in O'Malley. Here, the right ascribed to Byrum was the power to use his majority position and influence over the corporate directors to "regulate" the flow of dividends" to the trust. That "right" was neither ascertainable nor legally enforceable and hence was not a right in any normal sense of that term.
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> . . . .
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> A majority shareholder has a fiduciary duty not to misuse his power by promoting his personal interests at the expense of corporate interests. Moreover, the directors also have a fiduciary duty to promote the interests of the corporation. However great Byrum's influence may have been with the corporate directors,

[230] *Byrum*, *supra* at 132-35.

> their responsibilities were to all stockholders and were enforceable according to legal standards entirely unrelated to the needs of the trust or to Byrum's desires with respect thereof.[231]

Thirdly, the Supreme Court ruled that Byrum was not in control of determining the dividends of the corporation because of the many practical difficulties and business realities, under which Byrum had no control that determine what the dividends of a corporation are:

> There is no reason to suppose that the three corporations controlled by Byrum were other than typical small businesses. The customary vicissitudes of such enterprises--bad years; product obsolescence; new competition; disastrous litigation; new, inhibiting Government regulations; even bankruptcy--prevent any certainty or predictability as to earnings or dividends. There is no assurance that a small corporation will have a flow of net earnings or that income earned will in fact be available for dividends. Thus, Byrum's alleged de facto "power to control the flow of dividends" to the trust was subject to business and economic variables over which he had little or no control.
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> . . . .
>
> These various economic considerations are ignored at the directors' peril. Although vested with broad discretion in determining whether, when, and what amount of dividends shall be paid, that discretion is subject to legal restraints. If, in obedience to the will of the majority stockholder, corporate directors disregard the interest of shareholders by accumulating earnings to an unreasonable extent, they are vulnerable to a derivative suit. They are similarly vulnerable if they make an unlawful payment of dividends in the absence of net earnings or available surplus, or if they fail to exercise the requisite degree of care in discharging their duty to act only in the best interest of the corporation and its stockholders.[232]

All three of the considerations that led the Supreme Court to rule that IRC Sec. 2036(a)(2) does not exist in the corporate context also exist in the partnership context. First of all, if a general partner transfers a limited partnership interest or an assignee interest, he only has the right to manage the assets of the partnership. He does not have the "right" to enjoy any of the income of that limited partnership interest or that assignee interest, or to determine who does enjoy that income. Secondly, the general partner has a fiduciary duty not to misuse his power to promote his personal interest at the expense of the partnership (just as a majority shareholder has a fiduciary duty not to misuse his power by promoting his personal interests at the expense of the corporation). Thus, it is important not to negate normal state law fiduciary duties a partner owes to the partnership. Thirdly, the customary vicissitudes of enterprises that affect corporations also affect partnerships. Thus, just as Byrum was not in control of the dividend policy of the corporations because of these vicissitudes, Sam Selfmade as a general partner will not be in control of the cash flow of the partnership because of those same vicissitudes.

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[231] *Id.* at *supra* 136, 137, 138.

[232] *Id.* at *supra* 139, 140, 141, 142.

The IRS has ruled privately that because of the controlling case authority in *United States v. Byrum*, IRC Sec. 2036(a)(2) does not apply.[233]

H. 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.[234] 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).

Assume Sam Selfmade, in Example 1, puts stock in a closely held corporation into a partnership in which he is a general partner. Also assume Sam Selfmade, at a later time, transfers his limited partnership interest or an assignee interest for no consideration. Does IRC Sec. 2036(b) apply?

Letter ruling 199938005, a National Office Technical Advice Memorandum, involved IRC Sec. 2036(b). The decedent and his brother each owned 50% of the voting and nonvoting shares of Corporation. In connection with the renegotiation of a bank loan, the bank required the two shareholders to effect a plan for management and ownership succession. The ruling stated additional facts as follows:

> On Date 1 in Year 1, Decedent and his brother carried out the following transaction. Each transferred 55 percent of his stock to a family limited partnership (Partnership) (Y shares of voting and Z shares of nonvoting common) in exchange for 10 general partnership units, 1,000 Class A limited partnership units, 100 Class B limited partnership units, and 100 Class C limited partnership units. Also on Date 1, Decedent transferred 50 Class B units to Child 1, 50 Class B units to Child 2, 50 Class C units to Child 3, 50 Class C units to Child 4, and his remaining partnership units and stock to a revocable trust of which he was trustee (Trust). Under the terms of the Trust, at his death, Trust assets passed to his four children.

Article 8.3 of the partnership agreement authorized the general partners to vote the shares of Corporation as follows:

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[233] *See* Tech. Adv. Mem. 91-31-006, citing *Byrum*, for the proposition that the IRS will not consider the managing partner in a typical family limited partnership, because of his or her fiduciary duty obligations, as having retained an IRC Sec. 2036(a)(2) power over the transferred limited partnership interest. *See also* Rev. Rul. 81-15, 1981-1 C.B. 457; P.L.R. 94-15-007 (Jan. 12, 1994); P.L.R. 93-32-006 (Aug. 20, 1992); P.L.R. 93-10-039 (Dec. 16, 1992); P.L.R. 90-26-021 (Mar. 26, 1990); G.C.M. 38,984 (May 6, 1983); G.C.M. 38,375 (May 12, 1980).

[234] *See* IRC Sec. 2036(b).

> Prior to death of the survivor of [Decedent] and his [brother], the General Partners will have complete discretion regarding he voting of any Controlled Corporation's shares; provided, however, that if the General Partners cannot agree about how the shares of [Corporation] should be voted on any issue, then each General Partner shall vote a number of the Partnership's shares bearing the same proportion to the total shares owned by the partnership that the number of General Partnership Units held by that Partner bears to the total number of General Partnership Units outstanding.

The ruling holds that the value of the stock transferred by Decedent to Partnership was includable in Decedent's gross estate under IRC Sec. 2036(b) because Decedent as a general partner retained the right to vote the stock.

Regarding the adequate consideration exception in IRC Sec. 2036(a), the ruling said:

> Further, the transfer of Decedent's Y shares of voting stock to Partnership is properly viewed as a transfer of the stock, for purposes of § 2036(b), for less than adequate consideration. That is, Decedent, in substance, transferred the stock to Partnership in exchange for 10 general partnership units and 1000 Class A limited partnership units. The 100 Class B and 100 Class C units passed to Decedent's children, pursuant to an integrated plan, at the moment Partnership was formed. Thus, these units cannot properly be viewed as received by Decedent in exchange for the transfer of his stock to Partnership, Decedent transferred the stock for less than adequate consideration for purposes of § 2036(b). In addition, it is doubtful that the transfer to the family owned partnership designed to produce an estate freeze could be characterized as a "bona fide" sale.

This analysis is troublesome. Since the Decedent made a gift of the Class B and C units to his children, these gifts should be treated as "adequate consideration" for purposes of IRC Sec. 2036(b). This would have been the case if the Decedent had received these units and gifted them to his children one week later.

The ruling discussed a contention of the estate in stating:

> The estate argues that Decedent could only vote Corporation stock in conjunction with the other general partners, and therefore, §2036(b) does not apply. We disagree. First, we note that under Article 8.3 of the partnership agreement, if the general partners cannot agree on how the shares in Corporation are to be voted, then each general partner is to vote that number of shares proportionate to his general partnership units. Thus, the partnership agreement authorized Decedent, at a minimum, unilaterally to vote the shares he transferred to the Partnership. Further under §2036(b), the retained right to vote transferred stock constitutes the retained enjoyment of stock, and the legislative history indicates that the statue applies regardless of the capacity in which a decedent exercises the voting rights. Thus, we believe the statute applies even if the voting power is only exercisable by a decedent in conjunction with another.
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> We believe that §2036(b) would also apply if the steps of the transaction in this case had occurred several years apart. This is, if Decedent had transferred his Y shares of Corporation voting stock and Z shares of nonvoting stock in exchange

for 10 general partnership units, 1,000 Class A limited partnership units, 100 Class B limited partnership units, and 100 Class C limited partnership units and two years later, transferred the Class B and C units to his four children, then under § 2036(b), the date of death value of the Y shares held in the partnership would be includable in Decedent's gross estate.

Despite this TAM, this writer believes IRC Sec. 2036(b) does not apply because of state law considerations. Generally, see the discussion in Section III.C. Sam Selfmade, as general partner, should be considered as having no direct or indirect rights with respect to the property of the partnership, including the stock of the closely held corporation that is owned by the partnership. He only has rights to his partnership interest. Thus, under state law, Sam Selfmade has no individual right to vote that stock. 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).[235] 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).

There is no definitive case authority providing for the nonapplicability of IRC Sec. 2036(b) when a partnership owes IRC Sec. 2036(b) stock. However, the facts of the TAM are docketed in the Tax Court in *Estate of Coulter v. Commissioner* (Docket No. 17458-99) in a case handled by my old law firm (Baker & Botts, LLP).

Thus, it is prudent for planning purposes to structure the partnership to avoid IRC Sec. 2036(b). IRC Sec. 2036(b) will not apply if Sam Selfmade transfers only nonvoting stock to the partnership, and then transfers limited partnership interests or assignee interests to his descendants. IRC Sec. 2036(b) would also not apply if, under the terms of the partnership agreement, all of the partners and assignees have the right to vote the stock on a proportionate basis.

I. Avoiding the Potential Positions That, Because of the Operation of IRC Sec. 2038, a Transferred Partnership Interest, or Transferred Stock, Should Be Included in the Transferor's Estate.

If a partner, in conjunction with another partner, or a shareholder, in conjunction with another shareholder, has the right to alter or amend a partnership agreement, or corporate buy-sell agreement, then a transfer of a partnership interest by that partner (or stock by a shareholder) will subject that partnership interest or stock to being included in that transferor's estate under IRC

[235] *See* Rev. Rul. 81-15, 1981-1 C.B. 457.

Sec. 2038. Thus, 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.

The IRS argued in the *Church* case (see footnote 82) that IRC Sec. 2038 should apply because Mrs. Church, in conjunction with at least one of her other children, had the power to amend the Partnership Agreement. The Court held that 2038 did not apply because she did not make a gift on formation of the partnership (and there were no other transfers). The Court also held that even if a gift had been made, IRC Sec. 2038 did not apply because of Texas state law:

> Mrs. Church did not have the unilateral right to alter, amend, revoke, or terminate the Partnership Agreement. Section 29 of the Partnership Agreement provides that it may be amended "only upon the written agreement of the Partners then entitled to eighty percent (80%) or more of the Partnership interests in profits from operations." The reference to "profits from operations" can logically refer only to Ranch operations, and therefore Mrs. Church was entitled to only 62% of those profits. Nor could Mrs. Church dissolve the Partnership through the use of her amendment power, even if she cast more than 80% of the vote to do so. As Texas partnership law requires, no act in contravention of the agreement (such as dissolution) may be done without the consent of all the partners. TEX. REV. CIV. STAT. ANN. art. 6132b § 18(h). Such a unilateral act would also contravene sections 15(a) and 22 of the Partnership Agreement.

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IV. SELECTED HISTORY OF VALUATION PLANNING FROM 2000-2012 (DEFENDING THE IRC SEC. 2036 ATTACK AND THE ADVENT OF TECHNIQUES TO LIMIT A "VALUATION SURPRISE" FROM VALUATION PLANNING).

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."

* * *

A. 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%**

B. Defending Valuation Planning Against IRC Sec. 2036(a)(2) Inclusion.

1. Key Court Case Analysis.

What should the taxpayer who wishes to have some impact on partnership distributions do to circumvent the potential application of IRC Sec. 2036(a)(2)? The taxpayer should either adopt a strategy of selling all partnership interests, except the management interest, for full consideration, *or* take one of the following actions:

(i) The retained distribution power is subject to a standard that could be enforced by a court;

(ii) The general partnership interest that has distribution power could be contributed by the taxpayer to a trust where the taxpayer has the right to remove and replace the trustee, as long as the replacement is not related or subordinate; *or*

(iii) The general partnership interest, that has the distribution power, could be contributed by the taxpayer to a corporation and the taxpayer could retain the voting stock and transfer the non-voting stock to his family.

a. Supreme Court analysis.

Even if a general partner controls partnership distributions, the partnership agreement could be designed to address IRC Sec. 2036(a) from including any previously transferred limited partnership interests or assignee interests in his estate. The Supreme Court's analysis in *United States v. Byrum*[236] provides authority that IRC Sec. 2036(a)(1), IRC Sec. 2036(a)(2) and IRC Sec. 2038 do not apply (under the right facts). See the discussion in *Byrum* in Section III G of this paper.

[236] 408 U.S. 125 (1972).

b. Tax Court analysis by Judge Cohen in the *Strangi* case.

In the past, the IRS has ruled privately that because of the controlling case authority in *United States v. Byrum*, IRC § 2036(a)(2) does not apply with a properly worded partnership agreement where the partners follow the agreement.[237] However, *Byrum* was distinguished, and the private rulings disavowed, by Judge Cohen in dicta in a memorandum opinion in the *Strangi* case discussed above.

In addition to whether IRC Sec. 2036(a)(1) applies to the facts of *Strangi* (discussed above), Judge Cohen addressed whether IRC Sec. 2036(a)(2) applies to the facts of *Strangi*. Judge Cohen, citing *United States v. O'Malley*, 383 U.S. 627, 631 (1966), held that IRC Sec. 2036(a)(2) applies because the decedent, in conjunction with other individuals, had the power to accumulate partnership income for the benefit of each partner, rather than disperse that income, which in turn constituted a "right to designate" under IRC Sec. 2036(a)(2). The Court distinguished the facts under *United States v. Byrum*, supra, finding that the decedent, along with others, had management rights that exceeded the administrative powers in *Byrum* and, most important, that management in *Strangi* did not owe fiduciary duties that would limit its distribution powers as they were limited in *Byrum*.

Judge Cohen's holding in effect attributes the power of the corporate general partner to the decedent, among others, both because of the decedent's 47% ownership of, and board membership in, the corporate general partner, and because the general partner hired as managing partner the decedent's attorney-in-fact. Since the general partner's right to distribute income or not distribute it does not include a right to shift ownership of the income among partners or to a non-partner, Judge Cohen's holding endorses (without discussing) the idea that a power to control only the timing of receipt of income is a power to designate under IRC Sec. 2036(a)(2).

c. Full Tax Court analysis in the *Cohen* case.

The IRC Sec. 2036(a)(2) position taken by Judge Cohen in *Strangi* is contrary in certain respects to the position taken by the full Tax Court in *Estate of Cohen v. Comm'r*, 79 T.C. 1015 (1982). In *Cohen* the decedent was a co-trustee of a Massachusetts business trust. The trust agreement gave the decedent and his co-trustees broad management powers with respect to the property of the trusts, including the discretionary power to determine whether to declare dividends on common shares of the business trust. Similar to *Strangi*, the IRS argued that the dividend power possessed by the decedent and the co-trustees gave them the "right" to designate the persons who enjoy trustee income.

The *Cohen* emphasized the similarities between the Massachusetts business trust and the corporation in *Byrum*, and stated that "the very fact that we are concerned here with the

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[237]*See* Tech. Adv. Mem. 91-31-006, citing *Byrum*, for the proposition that the IRS will not consider the managing partner in a typical family limited partnership, because of his or her fiduciary duty obligations, as having retained an IRC § 2036(a)(2) power over the transferred limited partnership interest. *See also* Rev. Rul. 81-15, 1981-1 C.B. 457; P.L.R. 94-15-007 (Jan. 12, 1994); P.L.R. 93-32-006 (Aug. 20, 1992); P.L.R. 93-10-039 (Dec. 16, 1992); P.L.R. 90-26-021 (Mar. 26, 1990); G.C.M. 38,984 (May 6, 1983); G.C.M. 38,375 (May 12, 1980).

declaration of ***dividends*** on ***shares*** representing interests in the entity bolsters the corporate analogy, and thus the relevance of *Byrum*." *Id*. at 1025. The Court further opined that:

> In *Byrum*, the critical impediments to the transformation of the power to affect dividend policy into a right to designate enjoyment where the fiduciary obligations imposed by local law on *Byrum* as a controlling shareholder and on the corporate directors he could elect. Therefore, the issue here must turn upon the construction of this trust agreement under Massachusetts law. ***If the agreement may be said to give the trustees unlimited discretion in this respect, so that dividends could be arbitrarily and capriciously withheld or declared, then the dividend power would constitute a "right" under section 2036(a)(2); if, on the other hand, the power is circumscribed by cognizable limits on the exercise of discretion, then no such "right" exists.***

Id. (emphasis added).

The Court determined that a fair reading of the trust agreement would permit the omission of the dividend (or a reduction in amount) "only if the determination to eliminate or reduce the dividend were made in good faith and in the exercise of a bona fide business judgment." *Id*. at 1026. Thus, the Court held that

> In view of the perceived limitations on the dividend power in the trust agreement in question, and the apparent willingness of the Massachusetts courts to hold business trustees to a fair standard of conduct, we conclude that the decedent and his sons did not have the power to withhold dividends arbitrarily. Thus, they did not have an "ascertainable and legally enforceable" *right* to shift income between the classes of shareholders, and the dividend power does not require inclusion of either the common or preferred shares in the decedent's estate under section 2036(a)(2). We think *Byrum* is controlling.

Id. at 1027.

2. Six Separate Methodologies That May Prevent Running Afoul of IRC Sec. 2036(a)(2) Inclusion With Respect to Managing Partner Donors and Owners of Partnership Interests.

If the taxpayer does not retain a distribution power, then he or she will not run afoul of IRC Sec. 2036(a)(2). Other than not retaining any input in distribution decisions by the partnership, what should a potential donor of partnership interests do to circumvent IRC Sec. 2036(a) scrutiny? The following actions should assist:

a. Successfully making the argument that the *O'Malley* analysis and the prerequisites of IRC Sec. 2036(a)(2) are not applicable to a donor partner, who retains a distribution power over a family partnership.

No other court has reviewed Judge Cohen's analysis. This writer believes that if another court reviews her analysis that Court may find her analysis problematic for either of three reasons: (i) that court may find that it is a matter in which IRC Sec. 2033 supersedes IRC Sec. 2036 for estate inclusion purposes; (ii) the analysis in the *Estate of Cohen* is more appropriate; or (iii) that court may find that, unlike the situation with the trust described in the *O'Malley* case, supra, cited by Judge Cohen in *Strangi*, the decedent did not retain the "legal right to designate" who would receive the income of the partnership assets, because each donee partner beneficially owns, through the partnership, any past, current or future income that belongs to his partnership interest, whether it is distributed to him or not.

IRC Sec. 2036(a)(2) will apply to assets contributed to a partnership, if the decedent at the moment of his death had the legal right, either alone or in conjunction with any person, to designate the *persons* who shall possess or enjoy the property or the income therefrom, and not solely the power to affect the *timing* of distributions to such persons, particularly when those persons have the power to receive value for any distributions that are not currently paid.

Assuming the managing partner acts in that capacity with others, it is generally existing precedent that the phrase "in conjunction with any person" in IRC Sec. 2036(a)(2) does not apply to a decedent, like the decedent in *Strangi*, who would have to persuade others (in a non-trusteeship capacity) to act. As Professor Dodge noted:

> . . . a 'power' to persuade others to act, or join in acting, in a way that could affect possession or enjoyment of the transferred property is not considered to be a taxable power. This rule is not limited to the obvious situation where the transferor is not a member of the decision-making body (if such were deemed to be a taxable power, nothing would be immune from §§2036(a)(2) and 2038). The rule applies even to cases in which the transferor is a member of the decision-making group, provided that such body is not a trusteeship (or equivalent body) whose sole purpose is to administer the transferred property. Thus, the doctrine has been applied to irrevocable death-benefit and stock-transfer situations in which the transferor was a major stockholder, executive committee member, and/or member of the board of directors. These holdings probably cover the situation in which the transferor has more than 50% control over the entity, although there is authority in other areas [life insurance and contractual death benefits] lending support to the contrary position. . .[238]

See Estate of Tully v. United States, 528 F.2d 1401 (Ct. Cl. 1976). *But see Estate of Levin v. Commissioner*, 90 T.C. 723 (1988).

A court may also find that IRC Sec. 2036(a)(2) does not apply, even if the court finds the decedent managing partner had control, because the managing partner did not have the *legal right to designate the persons* who shall possess or enjoy the property or the income therefrom. The managing partner in the subject partnership may have the power to accumulate income owed to a partner and pay it at a later time to the partner (or to the partner's estate). However, that income will always be paid or held for the benefit of *that partner* and not some other person. That partner, directly or indirectly, has the ability to enjoy the benefit of any accumulation of income, without interference from the managing partner, by selling his partnership interest. Stated differently, any partner, by simply selling his interest, has the right, in effect, to veto a managing partner's attempt to deny that partner the economic benefit of accumulating the current income.

A court may conclude that Judge Cohen incorrectly compares the trust in *O'Malley* (in which the current beneficiaries may not receive all of the trust estate) to a vested partnership

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[238] Dodge, 50-5th T.M. , Transfers With Retained Interest In Powers (page A-46).

interest. Trusts, of course, are significantly different legal relationships than partnerships. In *O'Malley* the trustee had the ability to withhold income and that withheld income would be accumulated in the trust estate, which could then pass to beneficiaries at the time of the termination of the trust. If the beneficiary did not live beyond the term of the trust, then that property would pass to a different beneficiary (i.e., a different person).

Assume, instead of the facts of *O'Malley*, that a beneficiary of a trust had, at any time, the right to enjoy the income of the trust without trustee interference. For instance, if the beneficiary of the trust in *O'Malley* had a unilateral, unlimited power to enjoy the benefit of the past, current and future income of the trust by vetoing the trustee's accumulation exercise and/or a power to sell the past, current or future income rights of the trust, at any time before the trust terminates, without trustee interference, the trustee would not have the *legal right to designate* which trust beneficiary would enjoy the income.

Similarly, the partners in *Strangi* (and almost all other partnerships and/or business trusts as analyzed in the *Estate of Cohen*) had the right at any time to sell the past, current and future income of the partnership, without managing partner interference, through their right to sell their partnership interests (subject to any rights of first refusal that may have existed under the partnership agreement). The managing partner in *Strangi* did not retain the *legal right to designate* that another person (i.e., another partner) had the right to enjoy that partner's past, current or future income of the partnership. Thus, another court may conclude the distribution powers of the managing partner may affect valuation under IRC Sec. 2033, but those powers do not constitute a *legal right to designate* that another person receives the benefit of that partner's income.

b. Taxpayers should consider adopting a strategy of selling partnership interests (perhaps to defective grantor trusts) in exchange for a note or other full consideration.

The sales should be made for full and adequate consideration. If there is any gift element, and if the prerequisites of IRC Sec. 2036(a)(2) are met, IRC Sec. 2036(a)(2) could apply, at least with respect to the growth in value of the partnership interest, to cause inclusion in the donor's estate. Thus, that transferor partner may wish to sell his or her partnership interest, pursuant to a formula defined value allocation (assuming the formula can be structured, and is structured, in a manner that is not contrary to public policy). Even if the transferor retains a potential IRC Sec. 2036(a)(2) power, if the transfer is for full and adequate consideration (i.e., if the formula is honored), IRC Sec. 2036(a)(2) does not apply. (Additionally, if there is some consideration, but not full consideration, IRC Sec. 2043 would provide for partial inclusion.)

c. IRC Sec. 2036(a)(2) inclusion should not present any issues if the partnership agreement is structured to provide the same fiduciary constraints that Mr. Byrum had.

Normal partnership fiduciary duties should be affirmed in the partnership agreement, including fiduciary constraints on the distribution power that are consistent with Mr. Byrum's constraints. In order to provide protection for management that is acceptable under IRC Sec. 2036(a)(2), consider providing for arbitration for any partner disagreements with management decisions. Consider providing that management will only be liable for decisions that are not within the confines of the business judgment rule. Also consider providing in the partnership agreement that any party who loses that arbitration action shall pay for all costs associated with that arbitration action.

d. IRC Sec. 2036(a)(2) inclusion should not present any issues if the donor partner's distribution power is limited by standards that a court could enforce.

If the donor partner is going to retain a distribution power, consideration should be given to having the distribution power of the managing partner limited to a standard that may be enforced by a court. See Rev. Rul. 73-143, 1973-1 C.B. 407. This may be crucial. If the donor of a partnership interest is the sole managing partner, any gifts of partnership interests may be brought back into the donor's estate under IRC Sec. 2036(a)(2), if the ability to accumulate income for a partner is considered to be a legal right to designate that another person (i.e. another partner) enjoys the past, current or future income of the partnership. Stated differently, if the *O'Malley* analysis applies to partnerships and if the transfer of the partnership interest is not for adequate and full consideration, IRC Sec. 2036(a)(2) may apply unless the dispositive powers are limited by standards that a court can enforce. If the dispositive powers retained by the donor partner are not limited by standards, it may not matter what other actions or drafting constraints are present (with the possible exception of a sale for adequate and full consideration). On the other hand, the transferred partnership interest will not be included in the donor's estate under IRC Sec. 2036(a)(2) where the only distribution power is one subject to a definite external standard subject to supervision by a court. If a power is so constrained, the donor does not have the legal right to designate the persons who shall possess or enjoy the property or the income therefrom. The original source of this doctrine is *Jennings v. Smith,* [239] but it has been approved by the IRS in Rev. Rul. 73-143.

A caveat: the application of the doctrine to powers that, though subject to an enforceable standard, are exercisable in favor of the creator of the power is uncertain. Thus, this approach has greater certainty in negating IRC Sec. 2036(a)(2) with respect to gifted partnership interests than with respect to partnership assets deemed retained by the decedent under IRC Sec. 2036(a)(1). Stated differently, the standard may put more pressure on any potential Sec. 2036(a)(1) argument by the IRS. Obviously, this is not a concern, if the taxpayer only retained *de minimis* partnership interests (i.e., that partner has already transferred all but a small portion of the partnership interests). Secondly, in those situations where significant partnership interests have been retained, if as a matter of partnership practice, the partnership distributions pursuant to the standard are different than the income earned by the partnership assets, the standard may buttress the argument that the decedent-managing partner did not retain income rights with respect to the underlying partnership assets. Furthermore, if the managing partner retains most of his limited partnership interest, there is significant authority that the underlying assets of the partnership that the managing partner originally contributed will not be brought back into that partner's estate under IRC Sec. 2036(a)(1), because the retained right with respect to the distributions is *a retained right with respect to the partnership interest* and not a retained right with respect to the underlying assets of the partnership. *See Estate of Boykin v. Commissioner*, TC Memo 1987-134, 53 TCM 345, (1987). *Boykin* (according to legislative history) led to the

[239] 161 F2d 74 (2nd Cir. 1947).

passage of the infamous IRC Sec. 2036(c), in which Congress overturned existing case law and applied IRC Sec. 2036 to include the contributed assets to an "enterprise" back into the partner or shareholder's estate. In 1990, Congress repudiated its previous work and repealed IRC Sec. 2036(c) (thus, implicitly approving the result of *Boykin*). Stated differently, the prevailing case law with respect to entities, and recent Congressional legislative history, may be persuasive that rights with respect to income of significant retained partnership interests should not be considered rights to possess the partnership assets or income.

An example of partnership drafting that provides a distribution power that is subject to court enforcement is the following:

> No Other Distributions. Except as provided in this Article, the Partnership shall make no distributions of cash or other property to any Partner until its liquidation as provided in Section ____.
>
> Distributable Cash. Distributable Cash includes only that cash held by the Partnership at the end of a Fiscal Year after reasonable reserves of cash have been set aside by the Partnership Management, subject to the duties imposed by Section ___, for working capital and other cash requirements, including current and reasonably projected expenses, current and reasonably projected investment opportunities, and reasonably anticipated contingencies. For purposes of this Section, any of the Partnership Assets which are contributed to the Partnership by the Partners, any borrowed funds, and any cash generated upon the sale of any of the Partnership Assets, including Partnership Assets which are purchased with borrowed funds and including the cash attributable to appreciation in value, shall be considered as necessary for investment purposes.
>
> Operating Distributions. From time to time during each Fiscal Year, the Partnership may distribute any part or all of the Distributable Cash proportionately to each of the Partners based on their Percentage Interests; provided that no more than sixty days after each Fiscal Year, the Partnership shall distribute all of the Distributable Cash proportionately to each of the Partners based on their Percentage Interests. No distributions under this Section shall have the effect of changing any of the Percentage Interests.

To ensure that there are no issues with IRC Sec. 2036(a)(2), caution would indicate that the method listed above should be implemented, even if the donor is not a general partner or manager, because the donor may be imputed with the actions of other partners, as per the analysis of the Court in *Strangi*, and because of the Court's interpretation of the "in conjunction with any person" rule of IRC Sec. 2036(a)(2).

If discretion is not removed from the general partner or manager, is it sufficient protection under IRC Sec. 2036(a)(2) for the transferor not to act as general partner or manager? The answer should be yes. In this regard, however, it should be noted that under Judge Cohen's analysis there are two pitfalls that must be planned for. First, the donor must not bear such a relationship to any of the general partners or managers that their powers will be attributed to him. For example, in *Strangi*, the manager was the donor's attorney-in-fact, who had established the partnership, and the manager's powers were imputed to the donor. Whether this principle would be extended to, for example, the donor's children or spouse, is uncertain, but a strong argument can be made that it should not be extended to anyone, such as a child or spouse, who could serve as trustee of a trust created by the donor without triggering IRC Sec. 2036(a)(2). However, it should be noted that the person who had Mr. Strangi's power of attorney (Mr. Gulig) could have served as trustee without triggering IRC Sec. 2036(a)(2). Second, the donor must not have any rights as limited partner that could affect the timing of distribution of income. One such right identified by Judge Cohen was the right as limited partner to participate in a vote to dissolve the partnership. While this holding was questionable (see the discussion of joint action as a retained "power" above), it cannot be ignored until it is overturned. In effect the limited partners (or at least the donor as limited partner) must be stripped of any rights normally pertaining to limited partners under state law that could implicate IRC Sec. 2036. It is difficult to say where the line must be drawn but, as a practical matter, safety is achieved only by stripping the transferor of all voting rights he would otherwise have as limited partner.

e. IRC Sec. 2036(a)(2) inclusion should not present any issues if the donor partner contributes the partnership interest that controls the distribution power to a trust and retains the power to remove and replace the trustee in a manner that complies with Revenue Ruling 95-58.

If a donor partner wishes to have some influence on distributions, but does not wish to have distributions subject to an enforceable standard, the donor partner could utilize Rev. Rul. 95-58. For instance, the potential donor-managing partner could bifurcate the powers of the general partner. That is, one general partnership interest could have all of the powers of management, except the discretionary right to make distributions. Another general partnership interest would only have rights with respect to determining the distributions of the partnership. The donor general partner would not own the general partnership interest that has the distribution power. The "distribution power" general partnership interest could then be contributed to a trust. The donor could retain the right to remove the trustee, and under Rev. Rul. 95-58, 1995-2 C.B. 151, as long as the successor trustee is not related or subordinate to the donor, concerns about the application of IRC Sec. 2036(a)(2) are addressed.

f. IRC Sec. 2036(a)(2) Inclusion should not present any issues if the donor partner contributes the partnership interest that controls distribution powers to a corporation that has the same considerations and constraints in its structure as existed in *Byrum* and complies with Revenue Ruling 81-15.

If a donor partner wishes to retain the distribution power (and not delegate it to a "removable" independent trustee) and have that power "free" of an enforceable standard, except to the extent restraints exist in the corporation consistent with the *Byrum* case, consideration should be given to utilizing the safe harbor under Revenue Ruling 81-15, 1981-1 C.B. 457. The managing partner interest, including all powers with respect to making discretionary distributions of the partnership, could be contributed by the taxpayer to a Subchapter S corporation. The voting rights of the stock of the corporation could be bifurcated between full voting stock and limited voting stock (e.g., a ratio of 1:99). The "limited" voting stock may be allowed to only vote on decisions with respect to dissolution of the partnership or the corporation. The potential donor could then transfer both limited partnership interests and a majority of the stock that has the limited voting rights to a trust for the benefit of others in his family. Even though the taxpayer controls a corporation, which in turn controls distributions from the partnership, Revenue Ruling

81-15, in combination with the reasoning of the *Byrum* case, appears to provide a safe harbor from application of IRC Sec. 2036(a)(2) to such transfers.

C. The IRC Sec. 2036(a)(1) Problem For Decedents' Who Retain a Significant Family Limited Partnership Interest.

1. Brief Summary.

The IRC Sec. 2036(a)(1) position involves partnerships where the taxpayer dies still owning the vast majority of the partnership interests (unless, as in a handful of cases, the taxpayer transfers the partnership interests during his lifetime and retains the income associated with the transferred partnerships interests). While the IRS has not enjoyed success with most of its arguments on valuation discounts with respect to retained partnership interests, it has enjoyed some success with its IRC Sec. 2036(a)(1) argument. The good news for the taxpayer is this argument is entirely preventable.

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.

It should be noted that the above argument is not available to the IRS on lifetime transfers of partnership interests (which occur at least three years before the taxpayer's death). Stated differently, there is not a gift tax equivalent of IRC Sec. 2036(a)(1).

If prerequisites of IRC Sec. 2036(a)(1) inclusion apply, presumably, the taxpayer will also not be taxed under IRC Sec. 2033 for the fair market value of his retained interest in the partnership since that would result in over a 100% inclusion. That would also seem to be manifestly incompatible with Congressional intent. In fact, as this paper will explore, the presence of IRC Sec. 2033 inclusion may preclude IRC Sec. 2036 inclusion.

2. Analysis of Case Law.

a. Key cases that have not been reviewed by a circuit court.

The IRS was successful in applying IRC Sec. 2036(a)(1) to bring back contributed assets to a partnership in the *Estate of Charles E. Reichardt v. Commissioner*.[240] Judge Colvin agreed with the IRS that the substance of the partnership transaction was that Mr. Reichardt and his children had an implied agreement to allow Mr. Reichardt to continue to substantively enjoy the property contributed to the partnership and retain the right to income from the partnership assets during his lifetime in the same manner he had before the creation of the partnership. The Court found that the transfers to the partnership did not affect Mr. Reichardt's enjoyment of the

[240] 114 T.C. 144 (March 1, 2000).

property. Mr. Reichardt also continued to manage the property in the same fashion that he had before. The Court also found that Mr. Reichardt commingled partnership and personal funds, enjoyed the use of the personal residence, which was contributed to the partnership, without paying rent, and that Mr. Reichardt was solely responsible for the partnership's business activities.

The IRS was successful in arguing the applicability of IRC Sec. 2036 in the *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121 (May 15, 2002). The decedent, at age 85 and under treatment for advanced cancer, created a partnership shortly before he died. The initial partners were his daughter and son as general partners and the decedent had a 99% limited partnership interest (which was held in a revocable trust). The decedent transferred almost 94% of his assets to the partnership. He subsequently transferred a 60% limited partnership interest to his children. The decedent retained the remaining limited partnership interest and converted it to a preferred limited partnership interest paying a guaranteed return of 4.25%.

The IRS argued that the partnership should be ignored because it lacked economic substance, or alternatively, all of the assets the decedent transferred to the partnership should be included in his estate under IRC Sec. 2036. The Estate argued that the partnership assets should not be included under IRC Sec. 2036 either because there was full consideration for the transfers, or the decedent did not have the legal right to retain the income of the property that was transferred to the partnership or did not retain the legal right to affect the income that was distributed from the partnership.

The full Tax Court disagreed with the Estate's position with respect to the IRC Sec. 2036 issue based on the following facts: (i) there was a significant delay in transferring the assets to the partnership; (ii) the decedent's assets and the partnership's assets were commingled; (iii) the general partners seemed indifferent to formalities of the operation of the partnership; (iv) there were disproportionate distributions to the decedent and his Estate; (v) partnership assets were sold to generate funds to pay estate taxes; (vi) distributions were not based on considerations relating to the partnership, but were instead based on the decedent's contemporaneous debts and needs, which "buttresses the inference that the decedent and his Estate had ready access to the partnership cash when needed"; (vii) distributions were made before the partnership had hired an accountant to maintain appropriate accounting records; (viii) guaranteed payments were not made according to a fixed schedule; (ix) the Court observed "the objective record belies any significant predeath change, particularly from the standpoint of economic benefit..."; (x) the unilateral nature of the formation of the partnership by only the decedent; and (xi) almost all of the decedent's assets were transferred to the partnership.

The Tax Court and other courts in several other cases have found that there is a "transfer" for IRC Sec. 2036(a)(1) purposes when there is no business purpose to the partnership other than saving taxes, because the meaning of the term "bona fide" as it is used in IRC Sec. 2036(a)(1) is not satisfied in that situation. [241] It should be noted that the term "bona fide," as used in the gift tax

[241] *See Estate of Schauerhamer v. Commissioner*, T.C. Memo 1997-242; *Estate of Thompson v. Commissioner*, T.C. Memo 2002-246; *Kimbell v. United States*, 2003-1 USTC ¶ 60,455 (N.D. Tex. 2002) (discussed below); *Estate of Strangi v. Commissioner*, T.C. Memo 2003-145 (discussed below); *Estate of Ida Abraham*, T.C. Memo 2004-39; and *Estate of Lea k. Hillgren*, T.C. Memo 2004-46; *Estate of Rosen*, T.C. Memo 2006-115; *Estate of*

regulations (Treas. Reg. § 25.2512-8), according to many of these same courts, is satisfied for gift tax purposes, if the transaction is not a sham (a much easier test to satisfy).[242]

Usually, under these cases, some combination of the following facts is also present: (1) personal use assets are contributed (with no rental arrangement); (2) personal expenses are directly paid out of the partnership; (3) the donor partner has no other source of income, other than the partnership assets and the partnership could distribute under the agreement an amount that is lower than those needs; and (4) there is no change in management rights. Obviously, each of those factors needs to be eliminated if there is any danger that the original contribution to the partnership will not be treated as a bona fide "transfer" for IRC Sec. 2036(a)(1) purposes.

In the Estate of *Bongard v. Comm'r,*[243] the full Tax Court reviewed two different near-simultaneous transfers involving the same family's wealth and found that one of the transfers involved an IRC Sec. 2036 transaction, but the other transfer did not.

Empak, Inc., a successful manufacturer of electronics materials packaging, was established by Mr. Bongard in 1980. In 1996, Empak's shareholders, Mr. Bongard and trusts for Mr. Bongard's children, transferred all of their stock to a family-owned limited liability company ("WCB Holdings"). Almost immediately thereafter, a significant portion of WCB Holdings' nonvoting equity interests were transferred to a family limited partnership ("BFLP"). Certain partnership interests in BFLP were then given to Mr. Bongard's wife as part of a post-nuptial agreement.

Mr. Bongard, a healthy individual, died unexpectedly on November 16, 1998. In 1999, shortly after the decedent's death, Empak merged with a competitor and the surviving entity shortly thereafter went public.

A majority of the Tax Court found that there was a "transfer" for IRC Sec. 2036 purposes to both WCB Holdings and to BFLP. The Court reasoned that the meaning of the word "transfer" as used in IRC Sec. 2036 has a different meaning than it does for gift tax purposes (and has a much broader application).

The Court found, in determining whether a transfer meets a "bona fide sale for full and adequate consideration" exception, the phrase needs to be analyzed in two different sections. That is, the "bona fide" section and the "full and adequate consideration" section need to be analyzed separately.

Erickson, T.C. Memo 2007-107; *Estate of Rector*, T.C. Memo 2007-367; *Estate of Hurford*, T.C. Memo 2008-278; and *Estate of Jorgensen v. Comm'r*, T.C. Memo 2009-66.

[242] Another reason these courts may be reluctant to find a gift on formation is that according to Treas. Reg. § 2511-1(h)(1) the only possible gift is to the partners of the partnership, and if the taxpayer is essentially the only partner, one cannot metaphysically make a gift to one's self. *See also, Estate of Strangi*, 115 T.C. 478 (2000) and *Estate of Jones v. Comm'r*, 116 T.C. 121 (2001) in which the IRS theory of gift on formation was rejected by the full Tax Court. *See also, Holman v. Comm'r*, 130 T.C. 170 (May 27, 2008); and *Gross v. Comm'r*, 96 TCM (CCH) 187 (Sept. 29, 2008) in which gifts were made shortly after the formation of the partnership and the Tax Court allowed valuation discounts.

[243] *See Bongard v. Comm'r*, 124 T.C. 95 (March 15, 2005).

The "full and adequate consideration" section is a test that is applied by the Tax Court in virtually the same objective way it was applied by the Fifth Circuit in *Kimbell*:

> Generally, so long as the interest received by contributors of the partners to a partnership or FLLC corresponds to the percentage value of the property contributed, this test will be met.

However, with respect to the "bona fide" section, the majority of the Tax Court applied an arguably subjective standard:

> In the context of family limited partnerships, [this section] is met where the record establishes the existence of a legitimate and significant non-tax reason for creating the family limited partnership…

The Tax Court found the existence of legitimate and significant non-tax reasons for creating WCB Holdings, but did not find that those reasons existed with respect to the creation of BFLP. The court found that many of the protections that the partnership (BFLP) purported to provide were already provided by WCB Holdings. The Court found that positioning the family company to facilitate a liquidity event, protection from creditors and lowering management fees was already adequately addressed by the formation of WCB Holdings. The Court found that other potential purposes of the partnership such as teaching family members how to manage assets, making gifts of family limited partnership interests and business management reasons did not exist because of the conduct of the decedent.

The majority of the Tax Court also points to a list of factors that would support the finding that the transaction of creating a partnership or limited liability company was *not* motivated by a legitimate and significant non-tax purpose: (i) the taxpayer standing on both sides of the transaction; (ii) the decedent's dependence on distributions from the partnership; (iii) the decedent's commingling of personal and partnership funds; and (iv) the decedent's actual failure to transfer property to the partnership.

The final prerequisite for applying IRC Sec. 2036(a)(1) was whether Mr. Bongard had the right to possess assets or income of the partnership. The Court found that the decedent, in effect, possessed the enjoyment of the partnership assets because of an implied agreement with respect to that enjoyment. Even though Mr. Bongard had not used any of the income of the partnership, nor had he contributed personal use assets to the partnership, the Court found an "implied" agreement existed. The evidence for that implied agreement was Mr. Bongard's indirect "practical" control through his partial control of Empak and WCB Holdings. There is a vigorous dissent filed by Judge Chiechi pointing out that this part of the opinion flew in the face of the Supreme Court case *United States v. Byrum*[244]. As the dissent points out, Mr. Byrum retained many more controls than Mr. Bongard retained. It is interesting to note that the majority opinion of the Tax Court did not cite or distinguish *Byrum*.

[244] 408 U.S. 125 (1972).

Stated differently, the Supreme Court in *Byrum* required in order for possession or enjoyment of property to exist within the meaning of IRC Sec. 2036(a)(1) that the decedent must retain a "substantial economic benefit" from the property as opposed to a "speculative contingent benefit which may or may not be realized". It would seem that the Tax Court did not comply with this standard. That is certainly the standard that is now being applied in the Fifth Circuit, as noted below in the discussion with respect to the *Strangi* case.

Furthermore, it would seem that even if "practical" control had existed, that is not enough under IRC Sec. 2036(a)(1), unless it is unilateral control. The important phrase "or in conjunction with someone else" does not exist for purposes of IRC Sec. 2036(a)(1) as it does for IRC Sec. 2036(a)(2) or IRC Sec. 2038. It appears from the facts of *Bongard* that Mr. Bongard would have to persuade certain other individuals, who controlled the managing member interest of the underlying FLLC, before there could be a "cash out". Under the facts, Mr. Bongard's so-called "practical" control was not unilateral; therefore, IRC Sec. 2036(a)(1) should not have been applied.

It should also be noted that the Tax Court and other courts have found that IRC Sec. 2036(a)(1) does not apply because there has not been a transfer for purposes of IRC Sec. 2036(a)(1) because the meaning of the term "bona fide" has been satisfied under the facts of the case.[245] Under the facts of these cases, it was found that substantive non-tax reasons existed for the formation of the family partnerships and that it did not matter for the bona fide test that the fair market values of the partnership interests that the decedents received for their contribution to the partnerships were less than the value of their contributions.

b. Tax Court and Fifth Circuit analysis in the *Estate of Strangi* of whether IRC Sec. 2036(a)(1) could include assets contributed to a partnership by a decedent, if the decedent never makes a taxable gift.

Judge Cohen amplified the Court's holdings in *Harper* in *Estate of Strangi v. Commissioner*, T.C. Memo 2003-145 (May 20, 2003). The Tax Court considered the applicability of IRC Sec. 2036 to the Strangi family partnership on remand from the Fifth Circuit. *See Gulig on behalf of Estate of Strangi v. Commissioner*, 293 F.3d. 279 (5th Cir. 2002). The Fifth Circuit affirmed the full Tax Court's opinion in *Estate of Strangi v. Commissioner*, 115 T.C. 478 (2000), that Chapter 14 arguments, gift on formation arguments and lack of economic substance arguments did not apply to the *Strangi* facts, but nevertheless reversed the decision because the Tax Court had not considered the applicability of IRC Sec. 2036, saying the Tax Court was wrong in finding that the IRS did not raise the IRC Sec. 2036 issue in a timely fashion.

[245] *Church v. United States*, 85 A.F.T.R.2d (RIA) 804 (W.D. Tex. 2000), *aff'd without published opinion*, 268 F.3d 1063 (5th Cir. 2001) (per curiam), unpublished opinion available at 88 A.F.T.R.2d 2001-5352 (5th Cir. 2001); *Estate of Stone v. Comm'r*, 86 T.C.M. (CCH) 551 (2003); *Estate of Schutt v. Comm'r*, T.C. Memo 2005-126 (May 26, 2005); *Estate of Mirowski v. Comm'r*, T.C. Memo 2008-74; *Estate of Miller v. Comm'r*, T.C. Memo 2009-119; *Rayford L. Keller, et al. v. United States of America*, Civil Action No. V-02-62 (S.D. Tex. August 20, 2009); *Estate of Murphy v. United States*, No. 07-CV-1013, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009); and *Estate of Samuel P. Black, Jr., v. Comm'r*, 133 T.C. No. 15 (December 14, 2009); and *Shurtz v. Comm'r*, T.C. Memo 2010-21.

Under the facts of *Strangi*, the general partner (Stranco, a corporation) of the subject family limited partnership had the power to distribute the assets of the partnership "in the sole and absolute discretion of the managing general partner." The decedent owned all of the limited partnership units of the partnership, representing 99% of the partners' initial contributions. The decedent also owned 47% of the stock of Stranco, the 1% general partner. The decedent's issue owned the remaining 53% of Stranco. In the original *Strangi* case, the full Tax Court made the following fact-findings:

(i) The partnership was valid under state law and would be recognized for estate tax purposes.

(ii) The decedent's transfers of assets to the limited partnership and to the corporate general partner were not taxable gifts.

(iii) The decedent's interest in the limited partnership and the corporate general partner should be valued using the discounts applied by the IRS' expert.

(iv) The Tax Court found that the IRS would have the burden of proof of any fact issues relating to the application of IRC Sec. 2036.

Judge Cohen held that IRC Sec. 2036(a) applies to the decedent's contribution of assets to the partnership and to Stranco, and operates to include in the decedent's estate the underlying property of the partnership and the corporate general partner, even though the decedent under Texas law did not retain an interest in that property (for state law property purposes the partnership and/or the general partner were considered the owner of those contributed properties at the time of the decedent's death). The exception in IRC Sec. 2036(a) for transfers for full consideration did not apply, because "no bona fide sale, in the sense of an arm's length transaction, occurred in connection with the decedent's transfer of property to [the limited partnership and the corporate general partner]." Additionally, according to Judge Cohen, full and adequate consideration as that term is used in IRC Sec. 2036 "does not exist where, as here, there has been 'recycling' of value through partnership or corporation solution." Judge Cohen found that both IRC Sec. 2036(a)(1) (retention of income) and IRC Sec. 2036(a)(2) (retention of control over income) applied. The latter holding is particularly significant because it could be extended to partnership interests gifted by the decedent before death, though *Strangi* did not involve gifted interests.

Judge Cohen found that the facts and circumstances of this case indicated the probability of an implicit agreement to retain the income (or possession and enjoyment) of property transferred to the partnership in addition to the decedent's explicit rights as limited partner under the partnership agreement and applicable law. (Judge Cohen also suggested that the decedent's explicit rights under the arrangement might constitute a retention of income under IRC Sec. 2036(a)(1), but this was *dictum* and was not the basis for the holding.)[246] Facts indicating an

[246] More specifically Judge Cohen found as follows:

> As a threshold matter, we observe that our analysis above of the express documents suggests inclusion of the contributed property under section 2036(a)(1) based on the "right to the income" criterion, without need further to probe for an implied agreement regarding other benefits such as possession or enjoyment. The governing documents contain no restrictions that would preclude decedent himself, acting through Mr. Gulig, from being designated as a

implied agreement sufficient to invoke IRC Sec. 2036(a)(1) included the following: the transfer of most of the decedent's assets to the partnership, continued occupation of transferred property (notably, the decedent's residence), use of entity funds for personal expenses and testamentary characteristics of the arrangement. The Court found that "[f]undamentally, the preponderance of the evidence shows that decedent as a practical matter retained the same relationship to his assets that he had before formation of [the limited partnership and the corporate general partner]... Furthermore, the record suggests that the impetus underlying a number of significant [partnership] disbursements was needs of decedent or his estate, rather than exigencies pertaining to [the corporate general partner] or the partnership itself."

The damage done by applying IRC Sec. 2036 is that the partnership assets, because they are included directly in the gross estate, will be valued without the discounts applicable to a valuation of the partnership interests.

The Fifth Circuit affirmed Judge Cohen's holding on IRC Sec. 2036(a)(1), by holding that clear error was not made by her in applying the facts to the law. *Strangi v. Commissioner*, 417 F.3d 468 (5^{th} Cir. 2005). The Fifth Circuit declined to comment on Judge Cohen's analysis of IRC Sec. 2036(a)(2). However, the Fifth Circuit, while not reversing the Tax Court on IRC Sec. 2036(a)(1), differed with Judge Cohen in its analysis as to the standards or prerequisites as to when IRC Sec. 2036(a)(1) should apply.

The Fifth Circuit, as it did in *Kimbell* (which is discussed below) delineate the prerequisites that must be demonstrated before IRC Sec. 2036(a)(1) applies. One of the prerequisites is that the transferor must retain *substantial present* "possession or enjoyment" of property within the meaning of IRC Sec. 2036(a)(1):

> . . . if he retains a 'substantial present economic benefit' from the property, as opposed to 'a speculative contingent benefit which may or may not be realized.' United States v. Byrum, 408 U.S. 125, 145, 150 (1972). IRS regulations further require that there be an 'express or implied' agreement 'at the time of the transfer' that the transferor will retain possession or enjoyment of the property. 26 C.F.R. § 20.2036-1(a).

Arguably, this differs from the more lenient standard the Tax Court seems to be adopting (see the discussion of *Bongard* above) that a speculative benefit (e.g., the transferor partner has the practical control to possibly turn partnership assets into cash (when in fact that has not occurred)) is enough. The Fifth Circuit found that the payments made prior to Mr. Strangi's death, the continued use of his transferred home and the post death payment of various taxes, debts and expenses were clearly "substantial and present" as opposed to speculative and contingent.

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recipient of income from SFLP and Stranco. Such scenario is consistent with the reach of the right to income phrase as we described it in Estate of Pardee v. Commissioner, 49 T.C. 140, 148 (1967): Section 2036(a)(1) refers not only to the possession or enjoyment of property but also to "right to the income" from property. The section does not require that the transferor pull the "string" or even intend to pull the string on the transferred property; it only requires that the string exist. See McNichol's Estate v. Commissioner, 265 F.2d 667, 671 [3 AFTR 2d 1838] (C.A. 3, 1959), affirming 29 T.C. 1179 (1958). *** .

Particularly noteworthy, is the fact that the partnership seemed to determine its payments based on the need of Mr. Strangi or his estate. For instance, when it was necessary to pay the estate taxes, instead of the Estate selling its partnership interest to family members, or selling it through redemption, or borrowing money from a third party, the partnership made a significant proportionate distribution. Also, prior to Mr. Strangi's death, the partnership made monthly distributions from the partnership of $7,000 each month to supplement Mr. Strangi's social security and pension benefits and the Fifth Circuit found that if that $7,000 had not been paid, the $187,000 in retained liquid assets was not potentially enough to maintain Mr. Strangi in his lifestyle for his remaining life expectancy. This finding is somewhat difficult to understand, given that the Tax Court also found Mr. Strangi was suffering from a terminal illness. Based on those facts, the Fifth Circuit found that it was not clear error that an implied agreement existed to pay Mr. Strangi or his estate a substantial present economic benefit.

Another prerequisite before IRC Sec. 2036(a)(1) can apply to the underlying assets of the partnership is that there does not exist a bona fide sale for adequate and full consideration in money or money's worth upon the creation of the partnership. The Fifth Circuit, as it did in *Kimbell,* noted the exception contains two discrete requirements: (1) a bona fide sale and (2) adequate and full consideration. The Fifth Circuit noted the "adequate and full consideration" requirement was clearly satisfied because the capital accounts were properly and proportionately accounted for upon creation of the partnership. 417 F.3d at 478-479.

The Fifth Circuit, as it did in *Kimbell* (see the discussion below) noted that the inquiry as to whether a transfer of assets is "bona fide" is a purely objective inquiry. However, the Court noted that in *Kimbell* it had not stated precisely what this objective inquiry entails. The Court rejected the estate's contention that the only objective inquiry is whether the transferor actually parted with the transferred property and the transferee (e.g., the partnership) actually parted with partnership interests. The Court noted that the purported transfer in *Strangi* arguably deprives the transferor of literally nothing. As the Court noted:

> As such, the Estate's interpretation of the exception would render the term 'bona fide' superfluous, and must therefore be rejected. 417 F.3d at 479.

The Court said the proper approach is that a sale will be considered "bona fide" if, as an objective matter, it serves a "'substantial business [or] other non-tax' purpose." 417 F.3d at 479, quoting *Kimbell,* 371 F.3d at 267.

The Estate offered five non-tax rationales for Mr. Strangi's transfer of the assets to the partnership: (1) deterring potential tort litigation by a former housekeeper; (2) deterring a potential will contest; (3) encouraging a potential corporate executor to decline to serve; (4) joint investment reasons for the partners; and (5) permitting centralized, active management for certain working interests. The Court found that there was not clear error by the Tax Court in rejecting these rationales. As the Court noted:

> In reviewing for clear error, we ask only whether the Tax Court's findings are supported by evidence in the record as a whole, not whether we would necessarily reach the same conclusions. 417 F.3d at 480.

The most interesting discussion is the analysis with respect to the fourth rationale offered with respect to the joint investment vehicle. The Tax Court rejected this rationale because of the *de minimis* nature of the contribution by the other partners. The Fifth Circuit found that the Tax Court had not made clear error for the following reason:

> It is certainly true that the de minimis contribution of a minority partner is not, in itself, sufficient grounds for finding that a transfer of assets to a partnership is not bona fide. However, where a partnership has made no actual investments, the existence of minimal minority contributions may well be insufficient to overcome an inference by the finder of fact that joint investment was objectively unlikely. Such appears to have been the case here. Thus, it was not clear error for the Tax Court to reject the Estate's 'joint investment' rationale. 417 F.3d at 481.
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> In short, although Strangi may have transferred a substantial percentage of assets that might have been actively managed under SFLP, the Tax Court concluded, based on substantial evidence, that no such management ever took place. From this, the Tax Court fairly inferred that active management was objectively unlikely as of the date of SFLP's creation. As such, we cannot say that the Tax Court clearly erred in rejecting the Estate's 'active management' rationale. 417 F.3d at 481-482.

c. District Court and Fifth Circuit analysis in the *Estate of Kimbell* of whether IRC Sec. 2036(a) could include assets contributed to a partnership by a decedent, if the decedent never makes a taxable gift.

The Fifth Circuit, under the facts of the estate of Ruth Kimbell, had the opportunity to provide an analysis of what factors would need to be present for IRC Sec. 2036 to apply to include assets contributed to a partnership.[247] Ruth Kimbell created a revocable trust in 1991 naming herself and her son, David, as co-trustees. On January 7, 1998, the trust, along with David and his wife, formed a family limited liability company (FLLC). The FLLC had $40,000 in capital. Of the capital, $20,000 came from the trust for a 50% interest and David and his wife each contributed $10,000 for a 25% interest each. On January 28, 1998, the revocable trust and the FLLC formed a Texas limited partnership. The limited partnership had $2.5 million in capital. Around $2.5 million was contributed by the revocable trust for a limited partnership interest and $25,000 was contributed from the FLLC for a 1% general partnership interest. The revocable trust had a 99% limited partnership interest. Thus, Ruth Kimbell owned 99.5% of the partnership (99% through her limited partnership interest and .5% through her half interest in the FLLC). On March 25, 1998, Ruth Kimbell died at the age of 96 (around two months after the partnership was created).

The partnership was to have a 40 year term. The partnership negated some of the fiduciary duties that are normally owed by a general partner. The owner of a 70% or more limited partnership interest (Ruth had a 99% limited partnership interest) could remove the general partner at any time.

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[247] *Estate of Kimbell v. United States*, 371 F.3d 257 (5th Cir. 2004).

At the time of Ruth Kimbell's death, the partnership assets were worth about $2.4 million. Approximately 15% of the partnership assets were oil and gas interests (with a vast majority being working interests) and approximately 85% of the assets were cash or marketable securities. The executor of Ruth Kimbell's estate filed an estate tax return reporting a 49% discount for lack of control and marketability. The IRS took the position that the estate should include the assets that Ruth Kimbell originally contributed to the partnership and, thus, denied any discount. The executors paid the additional estate taxes and sued for a refund in the district court.

On January 14, 2003, the District Court held for the IRS on a motion for summary judgment.[248] The District Court agreed with the IRS that the assets contributed to the partnership should be included in Ruth Kimbell's estate because of the operation of IRC Sec. 2036. The Court held that the prerequisites of IRC Sec. 2036 were met because the transaction was not a bona fide sale for adequate and full consideration. The Court reasoned that it was not an arm's-length transaction because she was on both sides of the transaction. The Court was of the opinion that she did not receive adequate and full consideration because the transaction was a "paper transaction" and nothing changed in terms of the property's management. Relying on the *Harper* decision, the District Court also referred to the transaction as a mere "recycling of value" and, thus, not a transfer for consideration. The court found that Ruth Kimbell had retained the enjoyment of the property because her limited partnership interest gave her the right at any time to remove the general partner and appoint herself or someone else as general partner. Since the general partner had unlimited control and discretion as to making income distributions, Ruth Kimbell "retained the power to either personally benefit from the income of the partnership or to designate who could benefit from the income of the partnership." 244 F. Supp. 2d at 705.

On May 20, 2004, the Fifth Circuit reversed the District Court opinion and remanded the case back to the District Court for valuation considerations relating to whether the interest owned by Ruth Kimbell at the moment of death was a limited partnership interest or an assignee interest. It is this writer's understanding that this case was settled on those valuation considerations. The Fifth Circuit held that the contribution of assets for a limited partnership interest was not a transfer for purposes of the statutory prerequisite to IRC Sec. 2036. It was not a transfer because it was a bona fide sale and it was for adequate and full consideration.

In general, with respect to the bona fide sale prerequisites the Fifth Circuit stated that the transferor must actually part with his or her interest and the transferee must actually part with the requisite adequate and full consideration. The requirement receives heightened scrutiny in intrafamily transfers. However, the absence of negotiation is not a compelling factor, particularly when the exchange value is set by objective factors.

The Fifth Circuit followed its prior opinion in *Wheeler* in determining whether the transaction is a bona fide sale. It is not a bona fide transaction if the transaction is a disguised gift or a sham transaction. The Court noted that under the regulations, a bona fide sale requirement is complied with if it is made in good faith. The presence of tax planning motives do not prevent a sale from being bona fide if is otherwise real, actual or genuine for tax planning purposes.

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[248] *Kimbell v. United States*, 244 F. Supp. 2d 700 (2003).

The Court took the view that objective facts need to be considered in determining whether a bona fide sale took place. The Court noted several objective facts that supported the proposition that a bona fide sale occurred: (i) there was no commingling of personal assets; (ii) the decedent retained sufficient assets for support even if no distributions were made from the partnership; (iii) all partnership formalities were satisfied; (iv) assets were actually assigned to the partnership; (v) some of the assets contributed to the partnership required active management; (vi) certain business and financial strategies were satisfied that could not be satisfied by holding the assets in a revocable trust; (vii) certain administrative costs were lowered; (viii) certain recording costs were lowered by having the oil and gas properties in the partnership; (ix) certain marital property advantages could accrue from preserving the property as separate property for descendant owners; (x) an efficient vehicle for determining current and future management of the properties; (xi) alternative dispute resolutions were in place which may not have been possible using the trust alternative; and (xii) in general, the objective facts confirmed the purposes that were stated in the partnership agreement.

The Court concluded that the bona fide sale transaction was still present even though there were still *de minimis* contributions. In general, there is no *de minimis* test for determining whether the transaction is a sham.

The Court also determined that the transfer met the full consideration exception. The Court noted that the hypothetical willing buyer, willing seller test is not appropriate for determining whether or not adequate and full consideration has been received. That is a test that is used in measuring a gift when in fact a gift has occurred. It does not necessarily determine if a gift has occurred:

> We would only add to the Tax Court's rejection of the government's inconsistency argument that it is a classic mixing of apples and oranges: The government is attempting to equate the venerable "willing buyer-willing seller" test of fair market value (which applies when calculating gift or estate tax) with the proper test for adequate and full consideration under § 2036(a). This conflation misses the mark: The business decision to exchange cash or other assets for a transfer-restricted, non-managerial interest in a limited partnership involves financial considerations other than the purchaser's ability to turn right around and sell the newly acquired limited partnership interest for 100 cents on the dollar. Investors who acquire such interests do so with the expectation of realizing benefits such as management expertise, security and preservation of assets, capital appreciation and avoidance of personal liability. Thus there is nothing inconsistent in acknowledging, on the one hand, that the investor's dollars have acquired a limited partnership interest at arm's length for adequate and full consideration and, on the other hand, that the asset thus acquired has a present fair market value, i.e., immediate sale potential, of substantially less than the dollars just paid – a classic informed trade-off. 371 F.3d at 266.

Thus, in the context of transfers to a partnership, the Fifth Circuit took the view that in determining whether adequate and full consideration was present, the following is an appropriate test:

> The proper focus therefore on whether a transfer to a partnership is for adequate and full consideration is: (1) whether the interests credited to each of the

> partners was proportionate to the fair market value of the assets each partner contributed to the partnership, (2) whether the assets contributed by each partner to the partnership were properly credited to the respective capital accounts of the partners, and (3) whether on termination or dissolution of the partnership the partners were entitled to distributions from the partnership in amounts equal to their respective capital accounts. . . .The answer to each of those questions in this case is yes. Mrs. Kimbell received a partnership interest that was proportionate to the assets she contributed to the Partnership. There is no question raised as to whether her partnership account was properly credited with the assets she contributed. Also, on termination and liquidation of the Partnership, the Partnership Agreement requires distribution to the Partners according to their capital account balances. 371 F.3d at 266.

The Fifth Circuit also rejected the "recycling of value" position of the Tax Court and the District Court in the IRC Sec. 2036 cases. The Court was of the view that that issue is better addressed by the bona fide sale prerequisite of the statute.

The Court did not analyze whether the prerequisites of the statute were met with respect to the transfer to the FLLC. Perhaps they were. On the other hand, perhaps those prerequisites were not satisfied by Mrs. Kimbell because the Court analyzed whether or not she retained an IRC Sec. 2036(a)(2) power. Perhaps, although not stated, the fact that Mrs. Kimbell did not retain management rights while David Kimbell, in contributing assets to the FLLC, did acquire management rights made the Court uncomfortable as to whether Mrs. Kimbell had received full and adequate consideration in comparison to the contribution that David had made. At any rate, the Court took the view that IRC Sec. 2036(a)(2) did not apply because David Kimbell had the management rights to determine what the distributions would be to the partners of the partnership.

d. Tax Court and Third Circuit analysis in *Turner* (the so-called *Thompson* case) of whether IRC Sec. 2036(a)(1) could include assets contributed to a partnership by a decedent, if the decedent never makes a taxable gift.

On September 1, 2004, the Third Circuit issued its opinion in *Turner*, executrix of the *Estate of Thompson v. Commissioner* ("the *Thompson* case").[249] The underlying facts in *Thompson*, most commentators agree, are extreme in establishing a pattern that supports an implied agreement that the partnership assets would be made available as desired by the decedent. The Third Circuit's analysis of whether a transfer has occurred for purposes of IRC Sec. 2036 is quite different than the Tax Court's analysis in prior IRC Sec. 2036 cases. While the analysis is similar to the Fifth Circuit's analysis in *Kimbell*, there are important differences.

Unlike the implication of certain of the Tax Court opinions, the Third Circuit determines that the "bona fide" requirement does not require an arms-length transaction. However, the *Thompson* court seems to emphasis "legitimate business interests" more than the *Kimbell* opinion. The full consideration analysis of determining whether a transfer was made on contribution of assets to the partnership is also different than the Tax Court analysis. However

[249] 382 F.3d 367 (3rd Cir. 2004).

this portion of the opinion clearly has a different analysis than the Firth Circuit's analysis in *Kimbell*. The Third Circuit adopts what certain cases have characterized as "equilibrium rule" (i.e. there was a dissipation of value in the estate when cash and near cash was transferred in return for discounted limited partnership interests). There are, of course, many transactions in which transfers will result in immediate discount, however, hopefully over the long haul value is added by the creation of an entity. The Third Circuit recognized that concern and said that the automatic transfer of marketable assets to an entity, the acquisition of closely-held enterprises, or the acquisition of undivided interests in real estate would not automatically constitute inadequate consideration for purposes of IRC Sec. 2036(a). The Third Circuit took the view that it would not be applied in "routine commercial circumstances" or ordinary commercial transactions, even within families. However, their analysis would be applied to transactions that "obviously were used as tax dodges in circumstances that IRC Sec. 2036(a) was intended for".

The *Kimbell* case, obviously, takes a more objective approach than the subjective approach of the Third Circuit. The Third Circuit's subjective approach can be satisfied if adequate non-tax business reasons for the partnership are demonstrated.

e. Tax Court and First Circuit analysis in *Abraham*.

In *Estate of Ida Abraham*, 87 TCM 975 (2004), the Tax Court held that family limited partnership property was included in the decedent's estate under IRC Sec. 2036(a)(1) because she retained rights in the income from such property. Unlike some of the prior cases discussed above, in this case, based on the documented evidence, including the stipulated decree of the probate court and the understanding of the decedent's children and legal representatives, the Tax Court found there was an *actual* agreement (as opposed to an implied agreement) for the decedent to have all partnership funds for her support first. The Tax Court also found the transfer of the decedent's assets into the partnership was for less than full and adequate consideration. The decedent's daughters had purchased partnership interests for $160,000. The IRS offset this amount against the value of the family limited partnership property included in the gross estate.

The estate appealed the Tax Court determination to the First Circuit. The appeals court affirmed the lower court decision. *Estate of Abraham v. Commissioner*, 408 F.3d 26 (1st Cir. 2005). The First Circuit noted the following:

> The Estate next argues that the Tax Court erred in holding that Mrs. Abraham "retained the right to the income that the FLPs generated to the extent necessary to meet her needs." Estate of Abraham, 87 TCM (CCH) at 981. The Estate makes two intertwined arguments: (1) Mrs. Abraham did not retain a legally enforceable "right" within the meaning of §2036, and (2) there was no agreement that Mrs. Abraham would retain a first-access interest in all the income from the FLPs to the extent necessary for her support.
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> In order for §2036 to apply, it is not necessary that the decedent-transferor retain a *legally enforceable interest* in the property. See Estate of Maxwell v. Comm'r, 3 F.3d 591, 593-94 (2d Cir. 1993); Guynn v. United States, 437 F.2d 1148, 1150 (4th Cir. 1971). "An interest retained pursuant to an understanding or arrangement comes within §2036." Guynn, 437 F.2d at 1150. "The existence or nonexistence of such an understanding is determined from all of the facts and circumstances surrounding both the transfer itself and the subsequent use of the property." Estate of Harper v. Comm'r, 83 TCM (CCH) 1641, 1648 (2002). The

finding by the Tax Court that such an understanding existed is reviewed for clear error. See Estate of Maxwell, 3 F.3d at 594. As with other issues, the Estate "bears the burden (which is especially onerous for transactions involving family member) of proving that an implied agreement or understanding between [Mrs. Abraham] and [her] children did not exist." Estate of Reichardt v. Comm'r, 114 T.C. 144, 151-52 (2000).

We may dispose of the first part of the Estate's argument quickly. The Tax Court did not find that Mrs. Abraham retained a legally enforceable "right" to all the income from the FLPs. Therefore the arguments that the Tax Court decision is in conflict with vested property interests of the children is irrelevant.

What the Tax Court did find was that "t[he] documentary evidence, including the stipulated decree of the probate court, and the understanding of decedent's children and legal representatives demonstrate that decedent was entitled to any and all funds generated from the partnership for her support *first*." Estate of Abraham, 87 TCM (CCH) at 981 (emphasis in original). This finding is not clearly erroneous.

f. Tax Court and Eighth Circuit analysis in *Korby*

In the *Estate of Korby v. Commissioner*, 471 F.3d 848 (8th Cir. 2006), *aff'g* 89 T.C.M. CCH 1150 (2005), the 8th Circuit affirmed the Tax Court and applied IRC Sec. 2036(a)(1) to include the assets of a partnership in the *Korbys'* gross estates. The Tax Court found that Mr. and Mrs. Korby had an implied agreement to retain the income of the assets of the partnership and that the creation of the partnership was not a bona fide sale for adequate and full consideration. The Tax Court found that Mr. and Mrs. Korby had an implied agreement because the partnership was formed while they were in poor health, they transferred almost all of their assets to the partnership and even though they gave away 98% of the limited partnership interest, all distributions made during the term of the partnership were made to Mr. and Mrs. Korby to provide for their nursing home care, medical expenses and other living expenses. The trust to which they made their gifts (even though it owned 98% of the interest) never received distributions from the partnership.

The Tax Court determined that the bona fide sale exception did not apply because the Korbys were financially dependent upon the distributions from the partnership and that Mr. and Mrs. Korby created the partnership with no input from the other partners.

The 8th Circuit found no clear error in the Tax Court's findings. The 8th Circuit rejected the arguments that the payments to Mr. and Mrs. Korby were fees for managing the partnership because of the manner in which the payments were made and Mr. and Mrs. Korby's failure to report the payments as self-employment income.

The 8th Circuit also found that there was no clear error in the Tax Court's finding that the bona fide sale exception did not apply. The 8th Circuit cited with approval the 3rd Circuit's decision in the *Estate of Thompson* (discussed above). The Court noted that "the transaction must be made in good faith which requires an examination as to whether there was some potential for benefit other than the potential estate tax advantages that might result from holding assets in the partnership form." 471 F.3d at 853.

g. Tax Court and Ninth Circuit analysis in *Bigelow*.

In *Estate of Bigelow v. Comm'r*, 503 F.3d 955 (9^{th} Cir. 2007), *aff'g* 89 T.C.M. (CCH) 954 (2005), Virginia Bigelow created a revocable trust in 1991. In December of 1994, the trust contributed investment property to a family limited partnership. At that time Mrs. Bigelow was 85 years old and was living in an assisted living facility. A $450,000 liability secured by the property remained a liability of the trust and was not transferred to the partnership. The trust was the sole general partner and received most of the limited partnership units. After the transfer, Mrs. Bigelow was left with an insufficient amount to meet her living expenses or to satisfy her liability for the indebtedness.

Despite the fact that the loan was not an obligation of the partnership, the partnership made the principal and interest payments and paid some of Mrs. Bigelow's living expenses. Mrs. Bigelow's son, acting as agent for Mrs. Bigelow, made 40 transfers between the partnership and the trust during a period of approximately two years.

During 1994 and 1995, the son, as agent for Mrs. Bigelow, made gifts of some of the partnership units (after the units were transferred from the trust to Mrs. Bigelow) to himself, his sisters and to Mrs. Bigelow's grandchildren. Gift tax returns were not filed until Mrs. Bigelow died in 1997.

The Tax Court judge agreed that IRC Sec. 2036(a)(1) applied to the assets contributed by the trust to the partnership, finding an implied agreement that Mrs. Bigelow would retain the income from enjoyment of the rental property that was contributed.

The Tax Court further held that the bona fide sale exception to IRC Sec. 2036 did not apply because the transfers to the partnership were not in good faith and were not made for legitimate non-tax purposes. The Tax Court further noted that the parties failed to respect partnership formalities, including (1) a failure to maintain partnership capital accounts, (2) the balance sheets improperly reflected the $350,000 liabilities or liability to the partnership, (3) K-1's did not properly reflect capital accounts, (4) the trust's capital account was not adjusted to reflect payments on a $350,000 loan made by the partnership as required by the partnership agreement, and (5) Mrs. Bigelow's capital account never reflected the value of the trust contribution of the rental property. At bottom, the Tax Court found that the Bigelows did not comply with the terms of the partnership agreement.

The Tax Court also held that the transfer did not provide and there was no potential to provide non-tax benefits to Mrs. Bigelow as a result of the creation of the entity "because management of the assets did not change as a result of the transfer and there was no pooling of assets." The non-tax purposes for creating the Partnership relied upon by the estate included (1) creditor protection, (2) continuity of management, and (3) gifting efficiency. The Tax Court distinguished each of these. First, the Tax Court opined that no additional creditor protection was provided because Mrs. Bigelow's Trust was the sole general partner and the general partner was not protected from liability associated with the rental property. Second, the Tax Court noted that there was no change in continuity of management because the Partnership would terminate when the Trust terminated as the Trust was the general partner. Third, the Tax Court opined that gifting efficiency was not a sufficient non-tax reason because "a transfer made solely to reduce taxes and to facilitate gift giving is not considered in this context to be made in good faith or for a bona fide purpose."

On September 14, 2007, the Ninth Circuit upheld the Tax Court's decision. The Ninth Circuit noted that "In reviewing for clear error, we ask only whether the Tax Court's findings are supported by evidence in the record as a whole, not whether we would necessarily reach the same conclusions." 503 F.3d at 964. The Court also noted that IRC Sec. 2036(a)(1) "is designed to recapture the value of certain assets transferred by the decedent during his or her lifetime where the decedent has retained economic benefits from the transferred asset." 503 F.3d at 963.

With respect to the bona fide sale exception, the Court noted that the term "adequate and full consideration in money or money's worth" did not preclude discounts "due to lack of control and marketability." The Ninth Circuit noted that "the validity of the adequate and full consideration prong cannot be gauged independently of the non-tax related business purposes involved in making the bona fide transfer inquiry." 503 F3d. at 969.

The Court, however, rejected the estate's non-tax purposes for creating the partnership, which included limited personal liability, efficient management and ease of gifting. The Ninth Circuit noted that there was no evidence that any of the partners "reasonably faced any genuine exposure to liability that might have validated the partnership formation for a non-tax purpose." 503 F.3d at 971. Regarding efficient management, the Court noted that without some active management, this is not a credible non-tax reason for creating the partnership. Finally, the Court noted, as have other courts, that "gift giving is considered a testamentary purpose and cannot be justified as a legitimate, non-tax business justification." 503 F.3d at 972. Accordingly, the Ninth Circuit found that the Tax Court did not commit clear error in determining that the transfer to the partnership was not a bona fide sale for an adequate and full consideration under IRC Sec. 2036.

3. 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.

If substantial partnership interests are to be held by the taxpayer at death, it is important to document and demonstrate at least one substantial non-tax reason to establish a partnership and capital accounts should reflect interests proportionate to the contributed property.

In order to demonstrate that the original creation of the partnership is "bona fide" for estate tax purposes (and a transfer for estate tax purposes has not occurred) one substantive non-tax reason for its creation should be demonstrated. That demonstration should be documented in correspondence with the taxpayer and in the partnership agreement recitals. That non-tax reason should specifically relate to the taxpayer's concerns and goals. There are many financial advantages of a partnership that are unrelated to potential transfer tax savings.

a. 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.

Example 6: Client Wishes to Create Several Trusts For the
<u>Benefit Of Family Members and Follow Modern Portfolio Theory</u>

Marvin and Maggie Modern have substantial assets including over $30,000,000 in financial assets. They are believers in modern portfolio theory and the need for an asset class of alternative investments.

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

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

When Marvin and Maggie asked their investment adviser to fund a series of GRATs with alternative investments, their advisor explained that the alternatives manager might not be willing to divide the title to those investments to make annuity payments over time. Even if the manager did permit the division of the alternative investment between two separate owners (the annuitant and the GRAT), potential transfer complications may make it difficult to make the annuity payment within 105 days of its due date if the request to divide is not timely.

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

Pam Planner recommends that Marvin and Maggie transfer their significant investment portfolio to a partnership or limited liability company so they have an investment entity that meets the accredited investor and qualified purchaser tests under applicable securities laws. The family limited partnership ("FLP") will not be created for the purpose of accessing a specific hedge fund or private equity investment, and the FLP will have a mix of investment assets. At a later date, Marvin and Maggie could give $300,000 worth of partnership interests to their grandchildren's trusts instead of cash. The survivor's QTIP trust could own partnership interests as well. The partnership, with its larger pool of capital common to all trusts, could own a diversified portfolio.[250]

(1) Securities laws.

Alternative investments often come in partnership or FLLC wrappers for a reason. Managers of hedge funds and private equity funds generally seek one or more exemptions from registration under U.S. securities laws for two reasons. First, the cost to comply with the initial disclosure and ongoing reporting requirements of major U.S. securities legislation is substantial. Large companies who seek to raise capital in the public market can more easily bear these costs than smaller funds which target more narrow investment objectives. Second, federal law strictly

[250] The investing benefits to a trust investing in a closely held family partnership is one of the reasons the Tax Court rejected the IRS's Internal Revenue Code Sections 2035(a)(1), 2036(a)(2), 2038 and 2035 arguments in *Mirowski v. Commissioner*, T.C. Memo 2008-74 (March 26, 2008). See pages 10-12, 18-19 and 40 of that Opinion.

limits the amount of leverage fund managers can use in certain funds available to the general investing public. That limitation prevents managers from using a number of debt-financed investment techniques. Some sophisticated investors, however, want access to portfolios that employ leverage.

Generally, private equity and hedge fund partnerships operate under two basic formats. In broad brush, these partnerships either (1) admit no more than 100 investors who are “accredited investors” (defined below), or (2) in the case of U.S. organized partnerships, admit no more than 499 investors who are “qualified purchasers” (defined below) and in the case of non-U.S. organized partnerships, admit no more than 299 investors who are "qualified purchasers."

Most hedge fund managers seek the latitude to pursue a broad array of investment strategies, some of which are not available within the regulatory and leverage restrictions under the Investment Company Act of 1940 (the "1940 Act"). But first, to understand the background of that legislation and to review the definition of “accredited investor,” it is helpful to understand the history of two significant securities laws enacted in the 1930s.

(2) The Securities Act of 1933 and the Securities Exchange Act of 1934.

Congressional members introduced major legislation to address the securities market after the U.S. financial market crash of 1929. It enacted many of these legislative initiatives during the Great Depression. The thesis of the 1930s legislation is that the securities markets operate more efficiently and transparently if investors have more information to evaluate a company generally and its proposed offering of securities specifically before making a purchase. Accordingly, the Securities Act of 1933 (the “1933 Act”) regulates securities offered or sold to the general investing public in the United States by the original issuer. “Securities” for this purpose is broadly defined and can include partnership interests in private equity, hedge funds and other alternative investments. To ensure prospective investors have a significant amount of financial information, a company must file an extensive registration statement with the Securities and Exchange Commission (“SEC”) about its operations and a detailed prospectus about the specific securities for sale unless an exemption from registration applies.

Most securities trading occurs between holders who have no direct relationship with the issuing company. Those transactions fall under the rubric of “secondary trading.” The 1933 Act addressed only the original issuance of securities. To cover secondary trading, Congress enacted the Securities Exchange Act of 1934 (the “1934 Act”). The 1934 Act created the SEC. It provided rules for securities associations and exchanges.[251] It also required companies with regulated securities available in the secondary market to file extensive updated company information with the SEC regularly.

The 1933 Act provides issuing companies with a number of exemptions from registration. Because the registration requirements of the 1933 and 1934 Acts are time consuming and expensive, especially for smaller companies or funds, and failure to comply leads to substantial

[251] Examples include the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX) and the National Association of Securities Dealers (the association that operates NASDAQ), brokers, transfer agents and clearinghouses.

penalties, finding an exemption is highly desirable. Regulation D under the 1933 Act grants an exemption from registration to a company that sells its securities in a private placement to what are known as "accredited investors."[252]

As defined by Rule 501 of Regulation D, the term "accredited investor" includes, among other things:

- Any natural person whose individual net worth, or joint net worth with the person's spouse, exceeds $1 million at the time of the purchase;
- Any natural person whose individual income exceeded $200,000 in each of the two most recent years or whose joint income with that person's spouse exceeded $300,000 for those years and who has a reasonable expectation of the same income level in the current year;
- Any corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in excess of $5 million;
- A trust with total assets in excess of $5 million, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in Rule 506(b)(2)(ii) (for this purpose, Rule 506 (b)(2)(ii) defines a "sophisticated person" as "one who has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment"); and
- Any entity in which all of the equity owners are accredited investors.

Marvin and Maggie easily qualify as accredited investors under Regulation D because of their income and personal net worth. As such, they are free to acquire investments that can be offered only to accredited investors. When they fund the FLP with cash and various investments, the FLP will also qualify as an accredited investor since all the equity owners of the FLP will be accredited investors. In addition, the FLP itself will qualify because it will own well over $5 million in assets and will not be formed with the acquisition of a specific investment in mind.

If the Moderns sell LP interests to the grandchildren's trusts through a private sale without a general solicitation, the sale will generally not trigger 1933 or 1934 Act registration requirements. However, in the absence of full disclosure at the time of sale, the purchaser could technically later seek to exercise a rescission right pursuant to Rule 10b-5 of the 1934 Act. The successful exercise of a rescission right would be to the detriment of the FLP only to the extent that the assets of the FLP have declined in value since the time that the sale was made, and accordingly a rescission right will not negatively impact the FLP if its assets have increased in value since the time of sale. In addition, the Moderns will need to consult with their counsel to determine whether any state law requirements must be met in connection with such a sale. In certain circumstances, state laws may also provide for rescission rights similar to those that exist under Rule 10b-5 of the 1934 Act. Alternatively, if the Moderns were to give FLP interests to their grandchildren's trusts and the GRATS as a bona fide gift, neither federal securities law nor state law would apply to such gift.

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[252] 17 C.F.R. § 230.501 *et seq*.

(3) Investment Company Act of 1940.

The 1940 Act regulates companies that at the same time invest and trade in securities, and also offer their own securities for purchase to investors. The most common examples of entities subject to the 1940 Act are publicly traded open-end and closed-end mutual funds. Mutual funds allow investors with smaller amounts of capital to own a diversified portfolio of stocks, bonds or other securities. The 1940 Act can also apply to private equity funds, hedge funds and other alternative investments, but it impacts hedge funds most directly. If the 1940 Act applies, a company must make extensive disclosures to prospective investors about the company, the fund it offers and the fund's investment objectives.

The 1940 Act goes beyond disclosure requirements. An investment company registered under the 1940 Act has strict limits on the amount of leverage it can use. It may not issue debt or other senior securities unless its asset coverage (i.e., its assets to debt ratio) is at least 300% after considering the debt issuance. Moreover, an investment company registered under the 1940 Act may not pay any dividends on its common stock if its asset coverage in respect of outstanding indebtedness drops below 300%. Debt holders must also be given control of the board of directors of the investment company if asset coverage drops below 100% for a year or more. Leverage can substantially increase an investor's return, although it can also quickly magnify losses as well. For widely traded public mutual funds accessed by investors with limited capital, the debt coverage ratio is protective. Many hedge fund managers, however, wish to employ leverage either as a consistent investment strategy or opportunistically, and some investors want access to those strategies.

The key exemption to registration under The 1940 Act for hedge fund managers is called the "qualified purchaser" exemption. It provides an exemption for issuers whose outstanding securities are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers.[253]

The 1940 Act goes on to define a "qualified purchaser" as one of the following:

- A natural person (including any person who holds a joint, community property or other similar shared ownership interest in an issuer with that person's qualified purchaser spouse) who owns not less than $5 million in "investments" (as defined by the SEC);
- Any person acting for its own account or the accounts of other qualified purchasers who in the aggregate owns and invests on a discretionary basis at least $25 million in "investments";

[253] Investment Company Act of 1940 § 3(c)(7) provides an exemption from registration for "any issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities. Securities that are owned by persons who received the securities from a qualified purchaser as a gift or bequest, or in a case in which the transfer was caused by legal separation, divorce, death, or other involuntary event, shall be deemed to be owned by a qualified purchaser, subject to such rules, regulations, and orders as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

- A company that owns not less than $5 million in "investments" and that is owned directly or indirectly by two or more natural persons who are related as siblings, spouses, direct lineal descendants by birth or adoption, spouses of such persons, the estates of such persons, or foundations, trusts or charitable organizations established by or for the benefit of such persons (a "family company");
- A trust not formed for the specific purpose of acquiring the securities offered and as to which the trustee or other person authorized to make decisions with respect to the trust, and each person who has contributed assets to the trust are qualified purchasers; and
- A company in which all beneficial owners of all securities issued are qualified purchasers which was not formed for the specific purpose of acquiring the securities offered.[254]

Section 2(a)(8) of the 1940 Act also provides:

> "Company" means a corporation, a *partnership*, an association, a joint-stock company, a trust, a fund, or any organized group of persons whether incorporated or not; or any receiver, trustee in bankruptcy or similar official or any liquidating agent for any of the foregoing, in his capacity as such. (*Emphasis added*).

Marvin and Maggie's joint net worth in excess of $30 million exceeds the threshold of $5 million in investments for an individual to be a qualified purchaser. When they fund the FLP with cash and investments of $20 million, the FLP itself will be a qualified purchaser because all of the initial equity owners of the FLP (Marvin and Maggie) are qualified purchasers. The FLP will also qualify as a qualified purchaser under a different provision if its investment portfolio grows to $25 million. The FLP also qualifies under the "family company" exception which requires only $5 million in investments because of the family relationship between the Moderns and the future owners.[255] Finally, Marvin and Maggie's transfers to the grandchildren's trusts and the GRATs are acceptable because securities received from a qualified purchaser as a gift or bequest are deemed to be owned by a qualified purchaser.[256]

(4) The outcome.

Marvin and Maggie want to move forward with their advisor's recommendations. At a recent family meeting they described the plan to their sons. Marvin and Maggie propose to establish an FLP in which each of them will initially own a .3% interest as a GP and a 49.5% interest as an LP, so that together they will own 99.6% of the partnership interests. They invite each of their sons to invest a *pro rata* amount equal to .2% of the partnership's initial value in exchange for GP interests. As GPs, Marvin and Maggie, and the survivor of them, will control the FLP's investment policy and administrative decisions. Their sons, as GPs, will determine the partnership's distribution policy.

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[254] Section 2(a)(51) of the 1940 Act and Rule 2a51-3 of the 1940 Act.

[255] Section 2(a)(51)(ii) of the 1940 Act; *Cf.* ABA Letter, SEC No-Action Letter, at Section C, Question 4 (Apr. 22, 1999); Meadowbrook Real Estate Fund, SEC No-Action Letter (August 26, 1998).

[256] See footnote 8.

Marvin and Maggie intend to invest the FLP in a $20 million diversified portfolio of investments. A reasonable portion of the portfolio, based on the GPs' statement of the FLP's investment objectives and risk parameters, will access alternative investment vehicles designed to participate in a wide variety of market opportunities, including risk arbitrage, venture, mezzanine, real estate and distressed investing. To fill in their specific asset allocation to these categories, Marvin and Maggie, with the help of their investment advisor, will select individual managers as well as "fund-of-funds" investments.

Once Marvin and Maggie have fully funded the FLP's investment portfolio, they will transfer LP interests to the grandchildren's trusts and to a series of nearly zeroed-out GRATs for their children. To the extent Marvin or Maggie receive LP interests as annuity payments from the GRATs, they plan to transfer the interests to new GRATs or to trusts for the grandchildren over time. Their ultimate goal is to transfer 100% of the LP interests to their children and grandchildren before the death of the surviving spouse. With proper planning, however, any FLP interests that have not been transferred by the death of the first spouse can be held in a marital trust for the surviving spouse.

Marvin and Maggie explain to their family that the FLP is necessary to satisfy investment managers with large minimums, to keep a diversified pool of assets together, and to facilitate transfers for investment and estate planning purposes. They intend to engage a qualified appraiser to determine the fair market value of their LP interests at the time of each gift. On the administrative side, they will hire tax preparers to keep the books of the FLP and to make all the required federal and state tax filings. They will maintain separate bank and brokerage accounts for the FLP.

b. 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.

Smaller trusts may access alternative investments through a closely held partnership as described above. The second investment advantage of family limited partnerships for certain trusts is for income only trusts. Even income only trusts with an asset base large enough to permit stand alone alternative investing can benefit from a partnership wrapper because of the way distributions from a closely held partnership are characterized for income and principal trust accounting. Although mandatory income trusts are not as common today as they were in the past, they continue to be important for QTIP.

(1) Closely held limited partnerships could be a tool to manage distribution fairness issues associated with distributions (or lack of distributions) from alternative investments for income only trusts.

Hedge funds and private equity investments are generally offered as private partnership structures to certain investors. These investments pose certain challenges to mandatory income and income-only trusts. Hedge funds tend to produce short-term capital gains due to their short-term tactical trading strategies. Private equity investments, on the other hand, tend to generate long-term capital gains due to their buy and hold strategies.[257] In either case, these private investment partnerships generally distribute little or no "income" as that term is defined for fiduciary accounting purposes, which means that their cash returns are not income which the trustee is obligated to distribute.[258] As a consequence, to produce the requisite income, a trustee may be forced to invest the trust portfolio in high dividend and high interest bearing investments, and away from growth stocks, hedge funds and private equity, thereby skewing the desired risk adjusted return profile of the trust's portfolio. Recent changes in the laws of many states permitting adjustments between principal and income by the trustee, and/or permitting trust "income" to be defined as a unitrust amount (a fixed percentage of the trust's value, revalued annually) have eased this pressure somewhat, but do not solve the problem presented by hedge fund and private equity investments. Unlike marketable securities, hedge fund and private equity investments may be difficult to revalue annually, as required under a unitrust definition of income. Often it will not be possible to distribute units of such interests to trust beneficiaries in satisfaction of the unitrust amount or as part of an adjustment from principal to income, because beneficiaries are not and perhaps cannot qualify as investors in the fund. Additionally, most general partners of alternative investments have the right to decline transfer requests. Satisfaction of an adjustment or of a unitrust amount may therefore require other trust assets to be distributed, potentially distorting the trust's overall asset allocation.

(2) Trusts: Income-only marital trusts.

Generally, for estate tax purposes the federal government allows a married couple to be treated as a single economic unit, which means that a married couple who plans properly may defer all federal estate taxation on the couple's assets until the death of the surviving spouse. U.S. citizens commonly use a "marital deduction power of appointment trust" or a "qualified terminable interest property trust" ("QTIP") to obtain this estate tax deferral. To qualify for the marital deduction, a surviving spouse must receive an income interest for life.[259] The trustee

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[257] *See* generally IRC §1222; private equity managers generally produce long-term capital gains through selling their underlying investments in portfolio companies, IPOs, and leveraged recapitalizations.

[258] IRC §2056(b)(7).

[259] Treas. Reg. §20.2056(b)-7(d)(2) (concerning QTIP trusts) provides for the application of the principles of Treas. Reg. §20.2056(b)-5 and in particular §20.2056(b)-5(f) (power of appointment trusts) regarding the surviving spouse's right to all income for life; Treas. Reg. §20.2056(b)-5(f)(1) provides: "[T]he surviving spouse is 'entitled for life to all the income from the entire interest or a specific portion of the entire interest'…if the effect of the trust is to give her substantially that degree of beneficial enjoyment of the trust property during her life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Such degree of enjoyment is given only if it was the decedent's intention, as manifested by the terms of the trust instrument and the surrounding circumstances, that the trust should produce for the surviving spouse during her life such an income, or that the spouse should have such use of the trust property as is consistent with the value of the trust corpus and with its preservation. The designation of the spouse as sole income beneficiary for life of the entire interest or a specific portion of the entire interest will be sufficient to qualify the trust unless the terms of the trust and the surrounding circumstances considered as a whole evidence an intention to deprive the spouse of the requisite degree of enjoyment."

cannot circumvent this mandatory income requirement by investing in non-income producing property unless the surviving spouse gives the trustee permission to make that investment.[260]

A trustee who holds a partnership interest must exercise special care to observe the "qualifying income interest for life" requirement in a power of appointment trust or a QTIP trust as set forth in the Internal Revenue Code ("Code").[261] There is no bright-line rule that applies to a partnership interest but, in addition to the surviving spouse's right to compel the trustee to make the property productive, at least one expert suggests that the partnership might have to pay at least 3% of its net asset value per year to satisfy the income requirement of the Code and Treasury Regulations.[262] However, no case or published ruling actually sets forth this percentage requirement.

(3) Partnerships: Basic income tax primer.

Under Subchapter K of the Code, a FLP is treated as a pass-through entity for income tax purposes.[263] This means that while income and loss is determined at the partnership level and reported on IRS Form 1065 for informational purposes, items of partnership income or loss are allocated to each partner on Schedule K-1 of IRS Form 1065.[264] Each partner must then report his or her *pro rata* share of partnership income and loss, including certain separately stated items of partnership income, gain, loss, deduction or credit, on his or her individual IRS Form 1040.[265]

(4) Trusts: Basic income tax primer.

Under Subchapter J of the Code a trust can be treated as a separate tax paying entity, a conduit that distributes income and deductions to its beneficiaries, or a combination of both.[266] A trust must use a calendar year and pay income tax using tax tables set forth in the Code.[267]

A trustee must file an annual federal tax return, IRS Form 1041, for any domestic trust that has: (i) any taxable income for the year, (ii) gross income of $600 or more (regardless of taxable income), or (iii) a beneficiary that is a nonresident alien.[268]

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[260] Treas. Regs. §20.2056(b)-5(f)(5); *See, e.g.*, IRS Priv. Ltr. Rul. 8931005 (marital trust funded solely with closely held stock qualified for marital deduction because wife had power to request sale).

[261] IRC §2056(b)(7)(B)(i)(II).

[262] Carol A. Cantrell, "Comparing S Corporations and Partnerships in Estate Planning," *ALI-ABA: Planning for Large Estates* (April 28 – May 2, 2008).

[263] IRC §710.

[264] IRC §§702, 6031(a)&(b).

[265] A more detailed description of partnership taxation is set forth in Goldman Sachs Strategic Wealth Advisory Team, "Investment Rationales for Investment Partnerships," *SWAT Case Study* Vol. 1, Issue 3 (Part One).

[266] One notable exception to the separate tax paying entity classification is when a trust is classified as a grantor trust under IRC §§671-677, which causes all income and deductions to pass directly through to the grantor's personal tax return.

[267] IRC §644; IRC §1(e) (the top income tax bracket of 35% for trusts and estates in 2009 is reached when taxable income exceeds $11,150).

[268] *See 2007 Instructions for Form 1041 and Schedules A, B, D, G, I, J and K-1* (p. 4).

Trust taxation is similar to the taxation of individuals.[269] The biggest exception is that a trust is generally allowed a deduction for amounts distributed to beneficiaries.[270] After a trustee has determined a trust's adjusted total income, it must complete Schedule B of IRS 1041 to determine whether there is a distribution deduction.[271] For simple trusts, like income-only marital trusts, the deduction will be the lesser of: (1) fiduciary accounting income (discussed immediately below) or (2) distributable net income (discussed below).[272] Failure to compute either trust accounting income or DNI correctly can result in the wrong taxpayer being taxed.

A trust must report and pay income tax on its *pro rata* share of partnership income regardless of whether the trust receives partnership distributions. When distributions from a partnership are less than the trust's *pro rata* share of income from the partnership, the trust will need to find other sources of cash to pay tax on the undistributed income.[273]

(5) Trusts: Basic fiduciary accounting income primer.

Fiduciary accounting is an accounting methodology that categorizes trust receipts, expenditures and disbursements; the ultimate goal of which is to determine the amounts a trustee may distribute or charge against an income beneficiary's share versus a remainder beneficiary's share. Consequently, a trustee is required to keep two sets of books; an income account for the income beneficiaries and a principal account for the remainder beneficiaries. Fiduciary accounting rules address these allocations; they do not address trust taxation.

If the document is silent as to which set of books an item of income or expense should be charged, a determination is made by looking at state law, which in most cases will be some version of the Uniform Principal and Income Act ("UPIA").[274]

(6) Trusts: Distributable net income.

To determine the proportions of the income tax burden to be borne between the trust and its beneficiaries a trustee must calculate a trust's distribution deduction, which is the lesser of fiduciary accounting income ("FAI") or distributable net income ("DNI").[275]

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[269] IRC §641(b).

[270] "In effect, the concept of distributable net income gives statutory expression to the principle underlying trust taxation of estates and trusts, that is, that these separate taxable entities are only *conduits* through which income flows to beneficiaries except where income is accumulated by the estate or trust for future distribution," Senate Report No. 1622: 83d Congress 2d Session; H.R. 8300 (emphasis added).

[271] *See 2007 Instructions for Form 1041 and Schedules A, B, D, G, I, J and K-1* (p. 25).

[272] *See generally* IRS *Form 1041; Schedule B.*

[273] Steve B. Gorin, "Effect of Tax Distributions From Flow-Through Entities to Trusts: Proposed Changes to the Uniform Principal & Income Act," *Memorandum to Joint Editorial Board for Uniform Trusts and Estates Act* (March 20, 2008).

[274] IRC §643(b).

[275] *See generally* IRC §661(a).

While FAI is an accounting concept that is concerned with properly allocating income and expenses between beneficiaries, DNI is a federal tax concept that: (i) places a ceiling on the income distribution deduction of a trust, (ii) determines the amount that is includible in a beneficiary's income, and (iii) determines the character of the distribution received by a beneficiary.[276]

DNI is basically a trust's taxable income; modified as follows: (i) no distribution deduction, (ii) no personal exemption, (iii) capital gains not included, unless allocated to FAI or paid, credited, or required to be distributed to a beneficiary or paid or set aside for charitable purposes, (iv) capital losses are not taken into account, except to the extent they reduce the amount of capital gains actually paid or credited to beneficiaries, (v) no exclusion for gain from certain small business stock under IRC §1202, and (vi) tax-exempt interest is included, net of disallowed deductions attributable to such interest.[277]

(7) Trusts: Uniform Principal and Income Act.

Completed by the Uniform Law Commissioners in 1997 and most recently amended in 2008, the UPIA revised the Uniform Principal and Income Act of 1931 and 1962. The model act has been adopted by a majority of States.[278] The latest version of the UPIA is intended to reflect changes in a trustee's fiduciary accounting obligations brought about by the recognition of modern portfolio theory, in particular the Prudent Investor Act.[279]

Under the UPIA, a trustee must allocate a distribution from an entity like a FLP to the income ledger.[280] Distributions received in a partial liquidation of an entity are credited to the principal ledger.[281]

To the extent tax is required to be paid by a trust, the trustee must fairly allocate the cost of the tax payment between the income beneficiaries and the remainder beneficiaries.[282]

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[276] IRC §643(a); §661; Treas. Regs. §§1.652(b)-2(a), 1.662(b)-1.

[277] IRC §643(b); Treas. Reg. §1.643(d)-2; IRS *Form 1041*, *Schedule B* (lines 1-7).

[278] Adopted by 41 States as of March 2009. *See generally* website for The National Conference for Commissioners on Uniform State Laws at http://www.nccusl.org.

[279] Id.

[280] Unif. Principal & Income Act §401(b) (1997 Act).

[281] Unif. Principal & Income Act §401(d) (1997 Act); A distribution will be considered a "partial" liquidation if the entity indicates that it is such, or if the total amount distributed equals 20 percent of the entity's gross assets. A well-known example occurred in 2004 when Microsoft declared a dividend that exceeded 30 percent of its then book value. Because the distribution exceeded 20 percent of Microsoft's gross assets, it was a "partial" liquidation and trustees should have classified its receipt as principal, despite the fact that Microsoft did not intend to liquidate its business.

[282] Unif. Principal & Income Act §505(c) (1997 Act).

(8) Trusts: Prudent Investor Act.

Promulgated by the Uniform Law Commissioners in 1994, the Uniform Prudent Investor Act has been adopted by most States. The Uniform Act allows for a wide variety of trust investments so long as such investments in the aggregate would be deemed reasonable given the purpose of the trust. This is a break from common law which tended to limit investments by creating lists of appropriate and inappropriate investment choices. Under old trust doctrine, each investment was considered to stand on its own. There was no consideration given towards how one investment worked in tandem with another investment.

According to the Commissioners' website, forty-four States, as well as the District of Columbia and Virgin Islands, had adopted the Uniform Prudent Investor Act by the end of 2009.[283] However, in the six states that are missing from that list (Delaware, Florida, Georgia, Kentucky, Louisiana and New York), there are prudent investor statutes that adopt the overall-portfolio standard and reject the old law investment-by-investment test.[284] In this regard, at least, the principles of the Uniform Act have been adopted in all the States.

Using new prudent investor standards, trusts are no longer restricted to using common trust funds, U.S. large cap stocks and U.S. Treasury securities. Today, modern portfolio theory has greatly expanded trust investment options. In theory, trustees are free to invest among a broad spectrum of asset classes if the trust's portfolio, taken as a whole, is designed to achieve the desired level of risk and return. Depending on the purpose of the trust, investments in alternative investment partnerships and other alternative investments (e.g., real property, art, etc.) can be prudent.

(9) Trusts: Allocating taxes between trust and beneficiaries.

When a trust owns an interest in a partnership, the trust must report its *pro rata* share of the partnership's taxable income each year, regardless of whether the partnership makes a distribution to the trust. The trust must pay the income taxes and then allocate the tax burden between income and principal. In 2008 the Uniform Law Commission amended Section 505 of the UPIA to help clarify how to allocate the taxable income received from a pass-through entity. The goal of newly amended Section 505 is to ensure that the trustee will have enough money to pay the trust's taxes before making distributions to income beneficiaries.[285]

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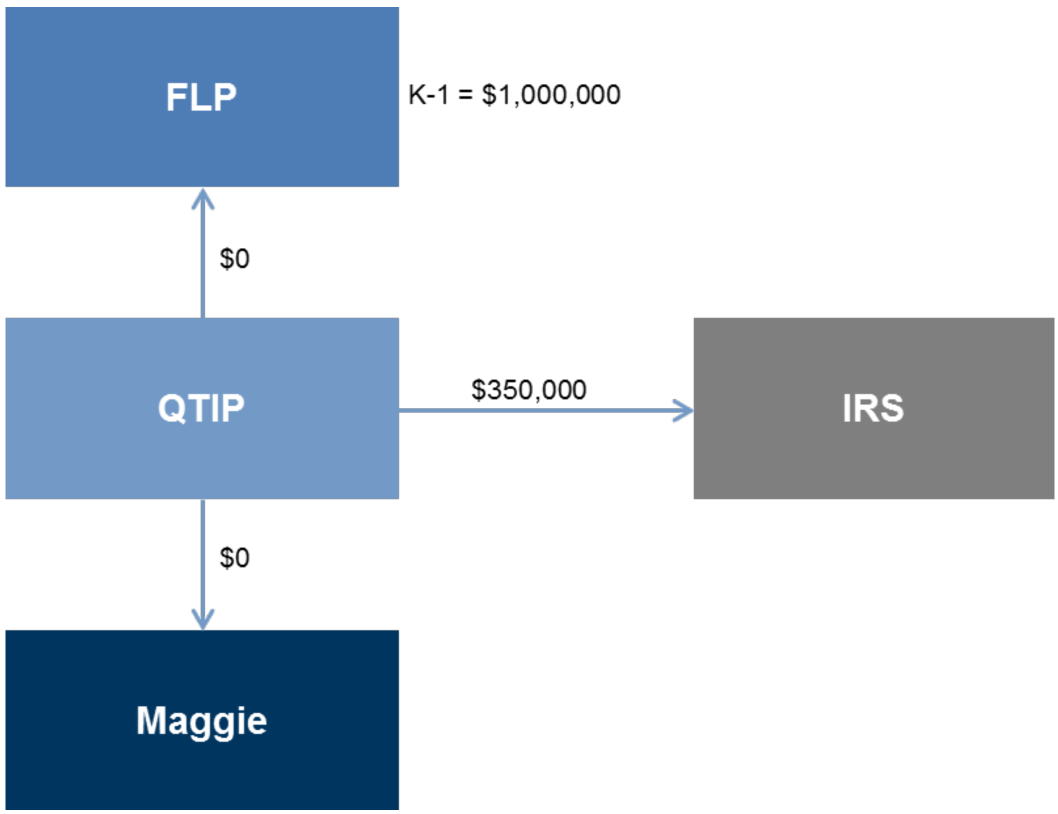
[283] *See generally* the website for The National Conference for Commissioners on Uniform State Laws, http://www.nccusl.org.

[284] Delaware: Del. Code Title 12, §3302(b); Florida: Fla. Stat. 518.11(1)(a)&(b); Georgia: O.C.G.A. § 53-8-1(c); Kentucky: KRS § 286.3-277(2)(corporate trustees), KRS § 386.454(1) (elective for individual trustees); Louisiana La. R.S. 9:2127; New York: EPTL §11-2.3(b)(2) & (b)(4)(A).

[285] Steven B. Gorin and Carol A. Cantrell, "UPIA Amendment Clarifies Tax Allocation Between Income and Principal When Mandatory Income Trust Owns Pass-Through Entity," *Probate & Property*,(January/February 2009); Steve B. Gorin, "The 505 Fix: Trustees of Mandatory Income Trusts Saved by a Change to the UPIA" *Trusts & Estates* (December 2008).

Example 6(a) Partnership distributes nothing. *In year 1 alternative investment partnership makes no distributions during the year. The K-1 indicates that QTIP is subject to tax on $1,000,000.*

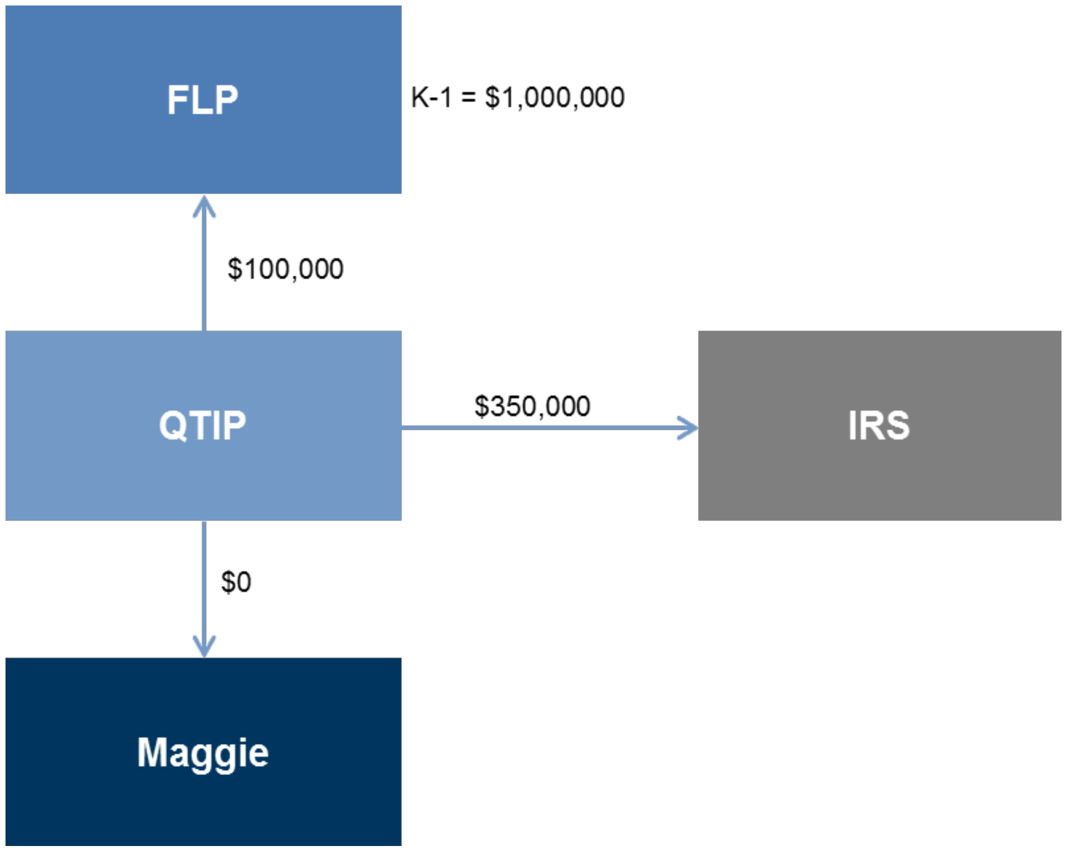
Result - In year 2 the FLP must file IRS Form 1065 for informational purposes. Since the alternative investment partnership made no distributions to the QTIP there is no FAI. Assuming that the QTIP and the spouse, Maggie, are in the 35% bracket, the QTIP must file IRS Form 1041 and find other resources to pay income taxes of $350,000.[286] *The taxes should be charged against principal under UPIA §103(a)(4) and §505(c)(4). If the partnership distributes this income in later years the trustee must then decide whether to reduce the income beneficiary's distribution and allocate the difference to principal under UPIA §506(a)(3) in order to maintain tax fairness between the beneficiaries.*



[286] $1,000,000 multiplied by 35% = $350,000.

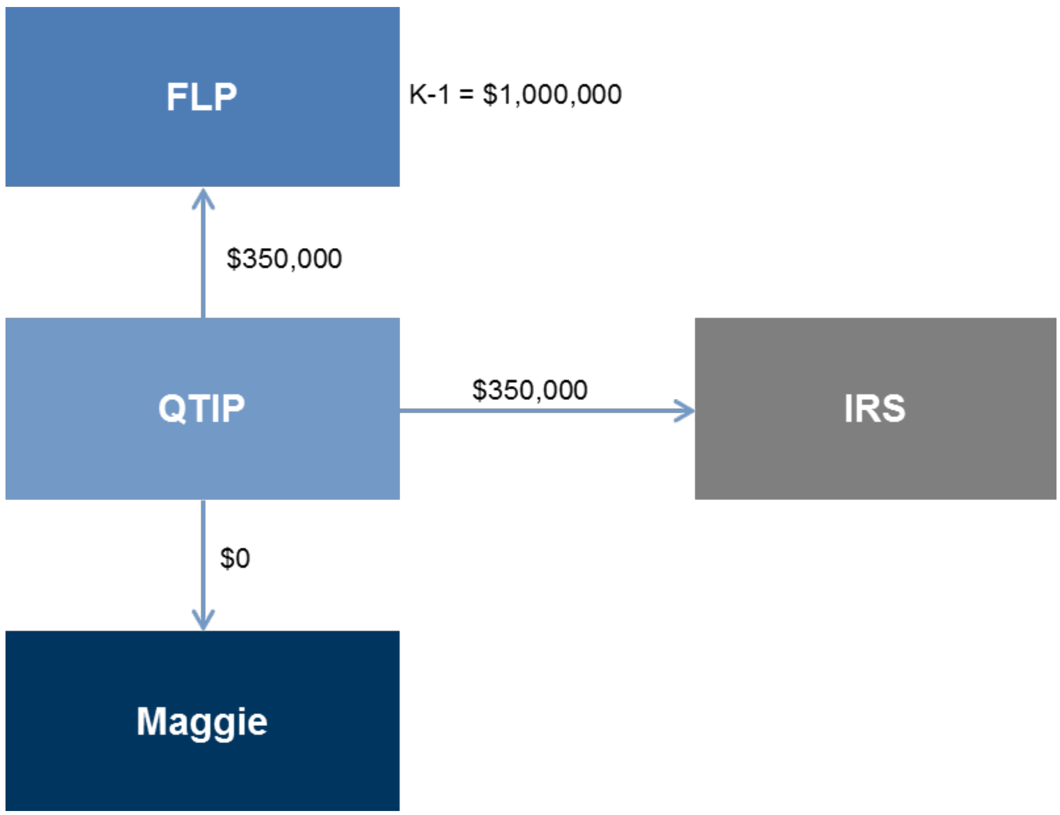
Example 6(b) Partnership distributes less than tax due, trust distributes nothing – *QTIP receives a Schedule K-1 reflecting taxable income of $1,000,000. The partnership distributes $100,000 to QTIP.*

Result - QTIP's tax is $350,000. QTIP must use the entire $100,000 to pay its tax and raise another $250,000 to pay the balance of the tax. The remaining $250,000 should be charged against principal. Maggie receives nothing.



Example 6(c) Partnership distributes tax due – *QTIP receives a Schedule K-1 reflecting taxable income of $1,000,000; partnership distributes $350,000 designated as tax distribution.*

Result – QTIP's tax is $350,000. QTIP uses entire $350,000 to pay its taxes. Maggie receives nothing.



In every case a trustee must allocate taxes between income and principal.[287] The comments to the recently amended UPIA Section 505 provide:

> Because the trust's taxes and amounts distributed to a beneficiary are interrelated, the trust may be required to apply a formula to determine the correct amount payable to a beneficiary. This formula should take into account that each time a distribution is made to a beneficiary, the trust taxes are reduced and amounts distributable to a beneficiary are increased. The formula assures that after deducting distributions to a beneficiary, the trust has enough to satisfy its taxes on its share of the entity's taxable income as reduced by distributions to beneficiaries.

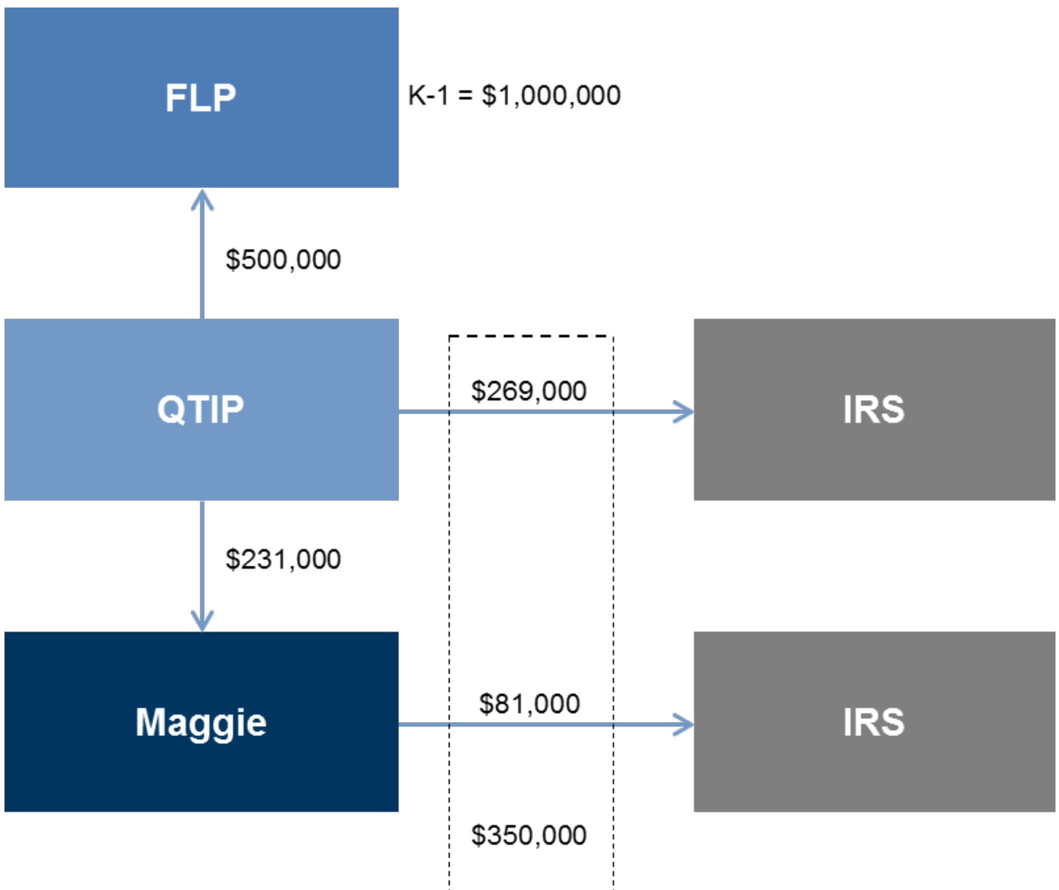
The algebraic formula is called "an infinite series approaching a finite sum" and it is expressed as follows: D = (C-R*K)/(1-R), where: D = distribution to income beneficiary, C = cash paid by the entity to the trust, R = tax rate on income and K = entity's taxable income.

[287] Unif. Principal & Income Act §505(c)&(d)(1997 Act as amended by 2008 technical correction to codify interrelated calculation for distribution deductions (*aka* "Gamble Ordering Rule")).

Example 6(d) Partnership distributes more than tax due, trust makes required income distribution – *QTIP receives a Schedule K-1 reflecting taxable income of $1,000,000. FLP distributes $500,000 to QTIP designated as income.*

Result - QTIP's tax is $269,231. Applying the algebraic formula, QTIP must pay $230,769[288] *to Maggie so that after deducting the payment, QTIP has exactly enough ($269,231) to pay its tax on the remaining taxable income from FLP. Maggie will report $230,769 on her own personal income tax return, paying taxes of $80,769.*

Because QTIP withheld $269,231 to pay its taxes and Maggie paid $80,769 in tax, Maggie essentially bore the entire $350,000 tax burden on the $1,000,000 of entity taxable income.[289] *Depending upon how future distributions from the partnership, and the taxes attributable to them, are allocated between principal and income, an adjustment from principal in favor of Maggie under UPIA §506(a)(3) may be warranted at some point.*



[288] Payment to beneficiary = $230,769; D = ($500,000 – 350,000)/(1-.35) = $230,769.

[289] *See* comments under Amendment 2 to UPIA §505(c)&(d), part of the 2008 Amendments to the UPIA, available at http://www.nccusl.org .

The interrelated calculation in Example 6(d) occurs only when the entity distributes an amount greater than enough to pay the tax on its taxable income, but less than its total taxable income. When the entity distributes less than enough to pay the tax on the trust's share of the entity's taxable income as in Example 6(b), the trust must retain the entire distribution to pay its income tax. When the entity distributes more than its taxable income, the trust's tax liability attributable to its share of the entity's taxable income is zero because the distributions to the income beneficiary of the trust are enough to fully reduce the trust's share of the entity's taxable income to zero.

(10) Possible equitable and flexibility solution for the trustee that owns or desires to own alternative investments: Placing alternative investments in FLP structures.

Placing assets in a partnership arguably gives a trustee greater flexibility to treat income and remainder beneficiaries fairly on distribution and tax apportionment issues. For example, before selling a capital asset that was held longer than twelve months, a trustee could place the asset inside a FLP, sell the asset, and distribute less than 20% of the sales proceeds. For tax purposes, any gain would be taxed as long-term capital gains. But for UPIA purposes, the distributed gains would be characterized as income (i.e., not principal) and credited to the income beneficiary's ledger.

This practice may allow a trustee of a marital trust to be a partner in a FLP that invests in private equity investments which traditionally produce long-term capital gain. Stated differently, a FLP could invest in low distribution investments that are appropriate on a risk-adjusted return basis and the distribution policy of the partnership can, in effect, fairly convert what would be considered principal distributions into income distributions for trust accounting purposes.[290] As a result, the FLP can create the investment and distribution flexibility that a family may need to comply with modern portfolio theory, a flexibility that is not subject to the same fiduciary constraints that would apply under a statutory power to adjust from principal to income, or a fiduciary power to distribute principal.

In addition, by careful management of a closely held limited partnership, an income-only trust could operate like the best features of a unitrust without the negative attributes. A unitrust may operate more evenly when there is a smoothing formula that takes into account the average trust value over several years (a period of time which many QTIPs do not have) and a "collar" provision to ensure that the distributions are neither too high nor too low. The problem is that under some of the state statutes permitting a unitrust definition of income, an income-only trust that is converted into a unitrust may not have a "smoothing" formula or a "collar" provision. Those correcting features for a unitrust are not needed with an income-only trust that invests in a closely held limited partnership, assuming the cash distribution policy of the partnership management is reasonable or the partnership agreement provides for a "smoothing" formula subject to a "collar" provision.[291]

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[290] *See Crisp v. United States*, 34 Fed. Cl. 112 (1995); Stacy Eastland, Managing Director of Goldman, Sachs & Co., "Family Limited Partnerships: Current Status and New Opportunities," *ALI-ABA Planning Techniques for Large Estates Course of Study* (November 18, 2008).

[291] Id. at p.13.

Limited partnerships could also be a tool for income-only trusts to manage fairness issues of who pays income taxes on the alternative investments between income and remainder beneficiaries. As noted above, there are two possible areas of tax fairness contention for income-only trusts under UPIA Section 505. They occur when a private equity partnership does not distribute enough money for the trust beneficiary to pay taxes and when the private equity partnership does distribute enough to pay taxes, but distributes less than its total income.[292] Consider the following:

Example 6(e) A FLP owns a wide variety of assets in different asset classes – *The FLP makes two distributions a year to the QTIP. The first FLP cash distribution is designated as trust accounting income by the FLP. The second distribution to the QTIP is specifically designated to pay the trust's taxes on its undistributed taxable income from its FLP investment. The first distribution is $2,500,000. The second distribution is $75,000. The FLP owns an alternative asset class investment like the asset in Example 6(d). Like Example 6(d), the FLP receives a $500,000 cash distribution from the alternative investment on taxable earnings of $1,000,000. The FLP's other asset classes produce $1,500,000 of ordinary net income and $500,000 of net long-term capital gain. The source for both FLP distributions could be from existing FLP cash or cash flow from any asset class owned by the FLP, including cash that would not be FAI of the current year if held directly by the QTIP but becomes FAI because it is a distribution from an entity. By boosting the QTIP's FAI beyond what it would be if the FLP assets were held directly, the FLP helps the QTIP to "match" FAI and DNI, so that nothing need be withheld by the QTIP and the full $2,500,000 of ordinary income is both distributed, and taxed, to Maggie.*

Result - The first distribution is paid to Maggie and she pays income taxes on that distribution, to the extent it carries out DNI. The FLP, with that second distribution, has effectively designated the character of the payment as corpus (i.e., it is not to be distributed to Maggie) under UPIA Section 401(f) by stating that it is to pay the trust's income taxes. The $75,000 enables the trust to pay its tax (at 15%) on the $500,000 capital gain that was not part of DNI. Unlike Example 6(d), in this case there may not be any need in the future to make an adjustment from principal in favor of Maggie. The FLP does not eliminate the need to make distributions and pay taxes in a way that is fair to the income and remainder beneficiaries, but it increases the flexibility available to attain these goals.[293]

c. 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.

The third advantage of a closely held family limited partnership for certain trusts is that it may be possible under the operation of IRC Sec. 643(a) to allow all or a portion of the closely held family limited partnership capital gain to be included in DNI that is carried out to the income

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[292] *See* Examples 6(c) and 6(d) in this paper.

[293] *See* IRS Priv. Ltr. Ruls. 200531008, 200531009 and 20053202 (payment made by entity to a trust, where entity designated payment for taxes, was allocated to corpus).

beneficiaries for tax purposes. Under UPIA Section 401, a distribution of cash from an entity to a trust may be deemed to have carried out capital gain income as trust accounting income. Final regulations under IRC Sec. 643(a) avoided the question by stating:

> One commentator [the AICPA[294]] requested examples of the effect on DNI of capital gains from a passthrough entity and income from a passthrough entity that is more or less than the trust accounting income from that entity. These issues are beyond the scope of this project.[295]

The reason why the IRS "ducked" this question is that gains from the sale of assets held by a partnership are typically gains in which the trustee has no absolute authority or control. Therefore, the trustee cannot directly allocate those gains to corpus or to income or establish a regular practice of doing one or the other, a key determinant of whether gains are in DNI under IRC Sec. 643(a). The trustee can only allocate receipts from the entity between income and principal according to the trust agreement or UPIA Section 401. See also *Crisp v. United States.*[296] That court held that it was reasonable for the trustee to allocate capital gain profits from a privately held partnership to income.

d. Other non-transfer tax reasons why families form family limited partnerships or family limited liability companies.

(1) 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.

Many successful clients fear that substantial gifts to descendants may hinder their productivity and initiative. In particular, clients with a substantial portfolio of stocks and bonds believe that giving a child or grandchild a readily marketable asset would not be doing him or her any developmental favors. Most clients believe that no one understands their children better than they do. By creating a family limited partnership and transferring only a limited partnership interest to a descendant, a donor controls the marketability of the wealth transferred because the interest effectively cannot be sold, and because the donor can reinvest the partnership's cash flow rather than making distributions to the partners (assuming there is a standard on that discretion that a court could enforce). As we will see from the discussion above (see Section III of this paper), this retained, indirect power to affect the marketability of the transferred partnership interests, if properly structured, does not subject the transferred interest to estate taxes on the donor's death.[297] By contrast, a retained power as trustee to determine the amount of distributions to trust beneficiaries may subject the trust assets to estate tax on the donor's death.

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[294] Tax Notes Today, 2001 TNT 97-26 (May 17, 2001) (Comments by the AICPA to Treasury regarding the proposed regulations to revise the definition of trust income under Section 643(b)).

[295] T.D. 9102.

[296] *Crisp v. United States*, 34 Fed. Cl. 112 (1995).

[297] *See United States v. Byrum*, 408 U.S. 125 (1972). Earlier rulings, relying on *Byrum*, indicated that in a typical family limited partnership, the managing partner will not be considered as having retained an IRC

(2) The partnership vehicle simplifies annual giving for private equity investments.

Many assets are extremely difficult to value and are not prone to gifts of undivided fractional interests. Good examples of such assets are private equity, hedge funds, rural land and closely held unincorporated businesses. Contributing those assets to a family limited partnership not only allows for proper asset allocation, but also allows a donor to assign partnership interests to a descendant with the use of a simple form. A fractional interest is given away, yet there is no immediate risk of partition, and management of the asset remains consolidated. If a client wishes to transfer part of his interest in his limited partnership to his issue, the partnership could be designed where the gift of the interests will qualify for the annual exclusion.[298] 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.

(3) Partnership vehicle facilitates assets that are important to be kept in the family.

Family partnership agreements often are drafted with certain buy-sell provisions to ensure that the partnership's assets will stay in the family. Under such provisions, if any partner attempts to assign his or her interest in the partnership to a person outside of the family, the other partners or the partnership itself may acquire that interest on the same terms, or, in the case of a gratuitous transfer, at its fair market value. Secondly, even without buy-sell provisions, no outsider can have any rights as a partner unless all of the partners admit that outsider as a partner (and can only be an assignee with limited distribution rights).

(4) Partnership vehicle provides some protection against a taxpayer's future unforeseeable creditors, which cannot be provided to that taxpayer under most states law by using trusts.

A family partnership can be a flexible vehicle to provide some protection of an individual's assets from future creditors. This is very important to wealthy clients since studies indicate one out of four Americans (which tend to be the wealthiest Americans) will be sued.

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§ 2036(a)(2) or IRC § 2038 power over the transferred limited partnership interest. Tech. Adv. Mem. 91-31-006 (Apr. 30, 1991), citing *Byrum*. *See also* Rev. Rul. 81-15, 1981-1 C.B. 457; P.L.R. 94-15-007 (Jan. 12, 1994); P.L.R. 93-32-006 (Aug. 20, 1992); P.L.R. 93-10-039 (Dec. 16, 1992), and P.L.R. 90-26-021 (Mar. 26, 1990); G.C.M. 38,984 (May 6, 1983); G.C.M. 38,375 (May 12, 1980). The cases discussed above have cast doubt on these rulings for purposes of IRC Sec. 2036(a)(2) and IRC Sec. 2038, but the application of those sections to FLPs has yet to be fully articulated by the cases, which have focused mainly on IRC Sec. 2036(a)(1). In any case, the application of IRC Sec. 2036(a)(2) and IRC Sec. 2038(a) is negated if the contribution to the partnership qualifies under the exception for a bona fide sale for adequate and full consideration in IRC Sec. 2036(a) and IRC Sec. 2038(a)(1), discussed above in Section III of this paper.

[298] *See* Tech. Adv. Mem. 91-31-006 (Apr. 30, 1991). *See Estate of Wimmer v. Commissioner*, TC Memo 2012-157 (June 4, 2012), in which the annual exclusion was allowed. *But see* Tech. Adv. Mem. 97-51-003 (August 28, 1997); *Hackl v. Comm'r*, 118 T.C. 279 (2002), aff'd, 335 F.3d 664 (7th Cir. 2003); *Price v. Comm'r.*, T.C. Memo 2010-2.

Under the trust laws of most states, creditor protection cannot be achieved for the grantor of self-settled trusts. The principal remedy of a partner's "outside" creditors, as distinguished from the partnerships "inside" creditors, is to receive a "charging order" against the partner's interest in the partnership. Under many states' limited partnership laws, unless a partner has made a fraudulent conveyance to the partnership or a conveyance deemed to be fraudulent, his or her creditors cannot reach the partnership's assets. Instead, a creditor may obtain a charging order against the partner's interest in the partnership, which does not give the creditor any management rights but entitles the creditor only to the partner's share of partnership distributions (*i.e.*, an assignee's interest). In addition, the partnership agreement can be drafted so that an involuntary transfer of a partnership interest to a creditor or any other third party triggers buy-sell provisions that allow the other partners or the partnership itself to purchase that interest at its fair market value. Since the fair market value of a limited partnership interest is usually much less than the underlying asset value, the creditor effectively is paid with less money, and the family assets are more likely to survive the creditor's claims. Furthermore, partnership agreements can be drafted to prohibit the pledging of partnership interests for the debts of a partner.

(5) The partnership vehicle provides greater protection of gifted assets against failed marriages.

The risk of a gift to a descendant being awarded to his or her spouse upon divorce can affect an estate plan, and prenuptial or postnuptial agreements may be distasteful or impractical in many situations. In particular, stocks and bonds are very prone to being commingled with assets of the marriage and in community property states effectively might become community property. Since some studies indicate that one out of two future marriages may end in failure, this consideration is very important to many wealthy clients. Limited partnership agreements, however, can be drafted so that gifts of limited partnership interests are protected from the risk of divorce. Many jurisdictions will not award separate property to a divorced spouse or will limit that award. A partnership provides a convenient means of segregating a descendant's separate property so that commingling is avoided. In addition, a partnership agreement can provide that an involuntary transfer of a partnership interest required by a divorce court will trigger buy-sell provisions under which the other partners or the divorced partner can buy that interest at its fair market value. Because the fair market value of the limited partnership interest is usually less than the underlying asset values, a divorced partner is protected even if a court awards his or her interest to a former spouse.

(6) Unlike irrevocable, non-amendable trust agreements, partnership agreements are comparatively flexible.

In comparison to an irrevocable, unamendable trust, a limited partnership is a very flexible arrangement. If all of the partners agree, the partnership agreement may be amended or the partnership may be terminated. If all of the partners are family members, in some family situations, the change of the agreement is fairly straightforward to obtain. By contrast, an irrevocable trust generally may not be amended or terminated without court participation and participation by a guardian or an attorney ad litem for certain beneficiaries. As compared to corporations, a partnership requires fewer formalities and may be terminated without the potential adverse tax consequences associated with the termination of a corporation.

(7) Business Judgment Rule of partnership law offers greater flexibility in investment management than trust law.

The "prudent man" or "prudent investor" rule applicable to trustees is a stricter standard than the business judgment rule applicable to the managing partners of a partnership. Many financial investments, such as options and commodities, and many business decisions, such as wildcat oil drilling, may be reasonable in terms of normal business judgment, but could be considered imprudent under trust law. Most families want to protect the family member who is charged with the responsibility of making investment decisions. In particular, families often want that family member who is managing the assets to be protected from the "20/20 hindsight" of a court or jury.

(8) 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.

Recent history is replete with examples of highly publicized intrafamily litigation involving the management of family assets. It is extremely difficult to replace a trust beneficiary's right to sue his trustee with a commitment to binding arbitration. Stated differently, the state law right of a beneficiary to sue his or her trustee in many jurisdictions may not be removed by a trust agreement. Because a partnership agreement is a mere contract, however, it can be written so that all of the partners agree to settle disputes by arbitration. When compared to a jury trial, arbitration is usually preferable, especially in the family context. The publicity associated with family disputes can provide an unfair advantage to the person bringing a lawsuit against the family's decision maker. With a well-drafted partnership agreement, such publicity can be avoided through the arbitration process and enforced by a confidentiality provision. In addition, an experienced business person or financial advisor may serve as arbitrator and fact finder. Thus, where the client determines there is an advantage to arbitration, the partnership vehicle is clearly superior to the use of a trust in many jurisdictions.

(9) 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.

Under trust law, frivolous actions can be difficult to prevent and may be brought by beneficiaries just to provoke a resignation or distribution by the trustee. It is difficult to charge a trust beneficiary with the costs associated with legal action. Furthermore, even though a trustee may be reimbursed for legal costs out of the trust's properties, the other beneficiaries of the trust suffer because of that reimbursement. By contrast, a partnership agreement can require a partner who brings an unsuccessful arbitration action against the management of the partnership to pay all of the costs associated with the arbitration. Thus, a family limited partnership more easily avoids frivolous claims and harassment actions.

(10) Partnership arrangements facilitate and institutionalize family communication and education on financial matters.

One of the more enjoyable aspects of a family limited partnership is that it can serve to institutionalize the education of younger family members on the family's wealth management philosophies. Many people see nothing wrong with wealth *per se*, but fear that it can be abused and therefore want to oversee the financial experiences of younger family members. In addition, prudent investment can generate employment and serve other altruistic purposes. The collectivism provided by a partnership agreement institutionalizes this education process.

(11) Partnerships eliminate or lower out-of-state probate costs for real estate investments.

Many people in our mobile society own passive real estate investments, including vacation property, outside of their home state. Contributing that property to a family limited partnership avoids the costs associated with out-of-state probate of those assets. Also, if the home state jurisdiction does not have a basic inheritance tax, the basic inheritance tax of the ancillary jurisdiction may be avoided in certain instances through the use of a family limited partnership.

(12) 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.

Partnerships are "pass through" entities that do not pay income tax. Since the repeal of the General Utilities Doctrine, "C" corporations and business trusts have become very inefficient tax entities because there will always be two levels of income tax, even on unrealized gains.

(13) 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.

In almost all jurisdictions, corporations and business trusts are subject to franchise taxes and/or intangible taxes. However, in many of those same jurisdictions, partnerships do not pay those taxes.

4. 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).

There is not an equivalent gift tax statute equivalent to IRC Sec. 2036(a)(1). For gift tax purposes, a substantive non-tax reason for the contribution to the partnership does not need to exist. As noted above, for gift tax purposes, the taxpayer needs to demonstrate that the partnership is a partnership for state law purposes and is a group that conducts financial operations.[299] Stated differently "the bona fide" requirement for gift tax purposes appears to only require only that a sham transfer has not occurred and that it is a partnership for state law property purposes. Secondly, there needs to exist a proper crediting of capital accounts. Thus, if the donor transfers all of his interest in the partnership and lives three years (*see* IRC Sec. 2035) IRC Sec. 2036(a)(1) will not apply.

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[299] *See Knight* 115 TC 506 (2000); *Estate of Strangi* 115 TC 478 (2000) aff'd on Chapter 14 issues 293 F.3d 279 (5^{th} Cir. 2002).

a. Advantages of the technique.

(1) Tax advantage if the interest in the family entity is sold to a grantor trust.

IRC Secs. 671 through 677 contain rules under which the grantor of a trust will be treated as the owner of all or any portion of that trust, referred to as a "grantor trust." If a grantor retains certain powers over a trust, it will cause the trust to be treated as a grantor trust. If the grantor is treated as the owner of any portion of a trust, IRC Sec. 671 provides that those items of income, deductions, and credits against the tax of the trust that are attributable to that portion of the trust are to be included in computing the taxable income and credits of the grantor to the extent that such items will be taken into account in computing the taxable income or credits of an individual. An item of income, deduction or credit included under IRC Sec. 671 in computing the taxable income and credits of the grantor is treated as if received or paid directly to the grantor.[300] Thus, if the private investor contributes assets to an intentionally defective grantor trust, the assets will grow (from the point of view of the trust beneficiaries) income-tax free. Furthermore, the IRS now agrees that there is no additional gift tax liability, if the private investor continues to be subject to income taxes on the trust assets and there is no right of reimbursement from the trust.[301]

It is possible to design a grantor trust that is defective for income tax purposes (e.g., a retained power to substitute assets of the trust for assets of equivalent value), but is not defective for transfer tax purposes. In comparison to either discounting or freezing a client's net worth, over periods of 20 years or more, the effect of paying the income taxes of a grantor trust is generally the most effective wealth transfer technique there is.

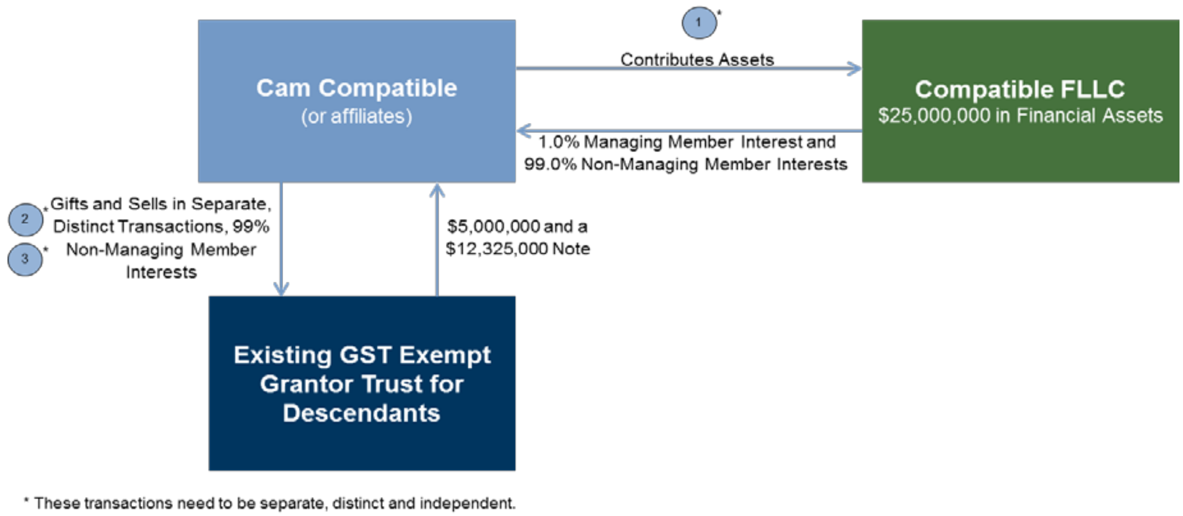
Consider the following example.

Example 7: Cam Compatible Creates a Grantor Trust for the
Benefit of His Spouse and Family and Makes Certain Sales to That Trust

Cam Compatible owns $32,000,000 in financial assets. Cam and affiliates contribute $25,000,000 to a family limited liability company ("FLLC") ("1"). In a separate and distinct transaction ("2") Cam contributes $5,000,000 to a trust that is a grantor trust for income tax purposes. The trust treats his wife, Carolyn, as the discretionary beneficiary and gives her certain powers of appointment over the trust. Cam, at a much later time ("3"), sells non-managing member interests to that trust, pursuant to a defined value allocation formula, in consideration for cash and notes. Assuming a 30% valuation discount, the technique is illustrated below.

[300] Treas. Reg. Section 1.671-2(c).

[301] *See* Rev. Rul. 2004-64, 2004-2 C.B. 7.



If the considerations that are noted below can be addressed, this technique would provide significant flexibility to both Cam and Carolyn in making sure their consumption needs are met in the future and, depending upon the terms of the powers of appointment that Cam gives Carolyn, could provide the flexibility that they need to address any changing stewardship goals that may accrue.

(2) 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. [302]

Assuming there is appreciation of the trust assets above the interest carry on any note that appreciation will not be subject to estate taxes in either the grantor's estate or the grantor spouse's estate. This is a significant transfer tax advantage. In calculations that we have performed in situations where the joint life expectancies exceed 20 years, this is the second biggest driver of transfer tax savings for a client's family. (The most important driver for saving transfer taxes, over a 20-year period, as mentioned above, is the donor's paying the income taxes of the trust on a gift tax-free basis.) The interest on the note does not have to be any higher than the applicable federal rate in order to ensure there are no gift tax consequences. See IRC Sec. 7872. The applicable federal rate, depending upon the length of the term of the note is equal to the average Treasury's securities for that term. See IRC Secs. 7872 and 1274(d).

[302] The President has proposed changes that would cause property sold by a grantor to a grantor trust to be an incomplete transfer for gift tax purposes and to be included in the grantor's gross estate. The proposal is described at p. 198 of the Treasury Department's *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* (February 2015). The proposal would apply to post-enactment sales to existing trusts. If the proposal became law, many of the techniques described in this paper would need to be reevaluated.

(3) The advantage of locating income tax inefficient asset classes inside a grantor trust that is not subject to estate taxes.

(a) The technique of asset class location in order to improve the after-tax, after-risk adjusted rate of return for an investment portfolio.

In order to optimize after-tax risk-adjusted returns, wealth management for the private taxable investor involves: (i) the creation of tax advantaged entities; (ii) the investment in asset classes that produce an optimal after-tax risk-adjusted return; and (iii) asset class location in different tax advantaged entities.

Certain asset classes that may optimize risk-adjusted returns may not be tax efficient, which could produce a less than optimal after-tax risk adjusted return for the private investor, unless the technique of locating those asset classes in estate tax protected grantor trusts is used.

Stated differently, not every asset class that an investor and the investor's family would desire in their collective investment portfolios in order to reduce the portfolio's risk, or volatility, lends itself to investment via a tax efficient low turnover fund (i.e., a broad based passive equity fund). For instance, asset classes such as high yield bonds, hedge funds, master limited partnerships, emerging market debt and various forms of private equity are not available in a passive, low turnover (tax efficient) product. An investor and his family may have all of those asset classes in their collective portfolios.

(b) Advantages of the technique.

(i) Location of tax inefficient investment classes in a grantor trust significantly ameliorates the income income tax inefficiencies of those classes, because transfer taxes are saved when the grantor pays the income taxes of the trust.

Engaging in an asset class location strategy of locating income tax inefficient asset classes in grantor trusts, and other family planning vehicles, may greatly ameliorate those tax inefficiencies and lead to an optimal after tax risk adjusted return for the private investor.

Table 1 below illustrates the annual growth required for an equity fund to double (after both income taxes and transfer taxes) for an investor's beneficiaries, if the investor dies in 10 years, depending upon how a fund is located (also see attached Schedule 1). This table also illustrates the significant wealth management advantages for the private investor who: (i) engages in estate planning; (ii) invests income tax efficiently for those asset classes that he can; and (iii) optimizes location of tax inefficient asset classes in estate tax protected grantor trusts to ameliorate income tax inefficiencies.

Table 1

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

(1) These calculations ignore the effect of investment management fees, state income taxes and investment friction costs. These calculations assume the estate planning vehicles are created without paying gift taxes. An equity fund owned by a tax exempt entity would need 5.52% annual growth rate of return over 10 years, assuming a 2% dividend rate, to achieve $2.06mm.

(2) % improvement necessary to equal fund with 5% annual turnover.

(3) % improvement necessary to equal fund with 50% annual turnover.

(4) 100% short-term realized gains in year 1, 0% short-term realized gains in years 2-10; 100% long-term realized gains in years 2-10.

(5) 100% short-tern realized gains in year 1; 25% short-term realized gains and 75% long-term realized gains in years 2-10.

(6) 100% short-term realized gains in years 1-10.

The asset location of a tax inefficient investment is particularly important. There is a much more modest differential on what is needed to earn pre-tax for a tax inefficient investment, in comparison to a tax efficient investment, in order to double the investment over a 10-year period, if the investment is located in an estate tax protected grantor trust, as opposed to being taxed in the taxpayer's estate. For instance, if a fund is located in an estate tax protected grantor trust, a 200% turnover fund (e.g., certain hedge funds) needs to earn 7.94% before taxes to double the value of the investment after taxes in 10 years and a 5% turnover fund (e.g., S&P 500 index fund) needs to earn 7.06% before taxes to double the investment after taxes in 10 years. Stated differently, a 12.49% improvement in annual pre-tax return is necessary for a 200% turnover fund to equal a 5% annual turnover fund, if the fund is located in a grantor trust and sold after the grantor's death (see column E(2)). Contrast this result with those same funds being held in the taxpayer's estate, if the two different types of funds are subject to estate taxes. If the funds are subject to estate taxes, a 5% turnover will need to earn 12.21% before taxes to double the investment after taxes in 10 years, and the high 200% turnover fund will need to earn 21.03% before taxes to double the investment after taxes in 10 years. A 72.34% annual pre-tax improvement in return is necessary for a 200% turnover fund to equal a 5% annual turnover fund, if the fund is fully taxable in the investor's estate (see column B(2)). The difference between 12.49% annual pre-tax needed improvement and 72.34% annual pre-tax needed improvement is obviously significant.

Similarly, Table 2 below illustrates, if the investor dies in 10 years, the annual interest required for a bond fund to grow by one-third after-tax, depending where a fund is located, and whether the fund interest is tax-free (also see attached Schedule 2).

Table 2

	Annual Interest Rate Required on an Initial $1mm Bond Fund Investment to Equal $1.34mm for Investor's Beneficiaries for an Investor Who Dies in 10 Years[1], Depending Upon How a Fund is Located, and Percentage Improvement to Equal Tax Free Bond Fund[2]					
	No Estate Planning Fund is Owned by Investor		Estate Planning Techniques (Fund is Not Subject to Estate Taxes)			
Type of Bond Investment Fund	Fund is Owned by Investor and is Fully Taxable in the Investor's Estate		Fund is Held in a Grantor Trust at Investor's Death		Fund is Held in a Non-Grantor Trust; or Fund is Owned by Investor and Investor's Estate is Lower than Remaining Estate Tax Exemption; or a Bequest of Fund is Made to Charity at Investor's Death	
	A		B		C	
	(1)	(2)	(1)	(2)	(1)	(2)
Tax Free Bond Fund	8.40%	N/A	3.00%	N/A	3.00%	N/A
Taxable Bond Fund	15.16%	80.51%	4.10%	36.54%	5.42%	80.51%

(1) These calculations ignore the effect of investment management fees, state income taxes and investment friction costs. These calculations assume the estate planning vehicles are created without paying gift taxes.

(2) % improvement necessary to equal tax free bond fund.

(4) Location of tax inefficient classes in a grantor trust, and managing the grantor trust through substitution strategies, further enhances the after tax advantage of a low turnover index fund.

As Column C(1) in Table 2 demonstrates the lowest pre-tax rate of return that is required to more than double the fund assets after 10 years is 6%, if a low turnover fund (e.g., a 5% turnover fund) is held in a grantor trust and if cash is substituted for the fund before the grantor's death. This is a classic example of the synergistic power of estate planning when it is coupled with a basis enhancing strategy.

(5) 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.

(a) Flexibility could be achieved by naming a spouse as a beneficiary of the grantor trust and giving a grantor's spouse a special power of appointment.

It is possible for the patriarch or matriarch to name his or her spouse as a beneficiary of a trust and also give that spouse the power to redirect trust assets that are different than the default provisions of the trust instrument. IRC Sec. 2041 provides that a person may be a beneficiary of a trust and have a power of appointment over the trust as long as the beneficiary does not have the right to enjoy the benefits of the trust under a standard that is not ascertainable and does not have the power to appoint the trust assets to either the beneficiary's estate or creditors of the beneficiary's estate. If an independent third party is trustee of the trust, that third party could have significant additional powers over the trust to distribute assets of the trust for the benefit of that spouse. If the spouse is serving as trustee and has distribution powers in that capacity, the distributions powers must be ascertainable and enforceable by a court for the health, education, maintenance standard of IRC Sec. 2041.

If unanticipated consumption problems accrue during a couple's lifetime and if the trust allows distributions to be made to meet those unanticipated consumption needs, that trust can obviously act as a safety valve for those needs. If the trust allows the grantor's spouse to appoint properties in a manner different than the default provisions of the trust, those powers of appointment could also serve as a safety valve to redirect the properties of the trust that is more consistent with the client's future stewardship goals.

A collateral benefit of the inherent flexibility of creating trusts that have the safety valve of having a client's spouse as the beneficiary, and giving that spouse a limited special power of appointment, is that the technique encourages the client to create such a trust when the client may be reluctant to do so.

(b) 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.

The note retained by the grantor could also be structured and/or converted to meet the grantor's consumption needs, without additional gift taxes, as long as the restructuring is for adequate and full consideration. For instance, the note at a future time could be converted to a private annuity to last the grantor's lifetime. That conversion should be on an income tax free basis since, as noted above, the trust and any consideration received for any sale to the trust are ignored for income tax purposes. The note could also be restructured to pay a different interest rate, as long as the new rate is not lower than the AFR rate or higher than the fair market value rate. If the grantor cannot afford to pay the trust's income taxes in the future, the trust could be converted to a complex trust that pays its own income taxes. However, converting the trust to a complex trust could have income tax consequences if the then principal balance of the note is greater than the basis of the assets that were originally sold. That difference will be subject to capital gains taxes.[303]

[303] *See* Treas. Reg. Section 1.1001-2(e), Ex. 5; *Madorin v. Commissioner*, 84 T.C. 667 (1985); Rev. Rul. 77-402, 1977-2 C.B. 722.

(6) The taxpayer may retain investment control of the family's assets and may also retain limited control of any distributions from the transferred entity interests to family members.

See the discussion above in Section IV B 2 of this paper.

b. Considerations of the technique.

(1) There may need to be substantive equity in the trust from prior gifts (is 10% equity enough?) before the sale is made.

The note needs to be treated as a note for tax purposes. Generally, estate and gift tax law follows state property law.[304] Thus, there needs to be a strong likelihood that the note will be paid and the capitalization of the trust should not be too "thin."[305] If the assets of the trust are almost equal to the value of the note, the note may not be considered a note under equitable tax principles, but rather a disguised interest in the trust. If the note is considered a disguised interest in the trust, the provisions of the trust and the note may not satisfy the requirements of IRC Sec. 2702 and, thus, all of the assets of the trust could be considered as having been given to the donees (the remainder beneficiaries of the trust) without any offsetting consideration for the value of the note. If the note is considered a disguised retained beneficial interest in the trust, instead of a note, the IRS may take the position that IRC Secs. 2036 and/or 2038 apply on the death of the

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[304] *See United States v. Bess*, 357 U.S. 51 (1958); *Morgan v. Commissioner*, 309 U.S. 78 (1940).

[305] In the corporate context *see* IRC Sec. 385(b); *Miller v. Commissioner*, T.C. Memo 1996-3, 71 T.C.M. (CCH) 1674; *see also* IRC Sec. 385 (titled "Treatment of Certain Interests In Corporations As Stock or Indebtedness"); Notice 94-47, 1994–1 C.B. 357. *See also*, Staff of the Joint Committee on Taxation, "Federal Income Tax Aspects of Corporate Financial Structures," JCS-1-89, at 35-37 91989), noting that various courts have determined that the following features, among others, are characteristic of debt:

> 1) a written unconditional promise to pay on demand or on a specific date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest; 2) a preference over, or lack of subordination to, other interests in the corporation; 3) a relatively low corporate debt to equity ratio; 4) the lack of convertibility into the stock of the corporation; 5) independence between the holdings of the stock of the corporation and the holdings of the interest in question; 6) an intent of the parties to create a creditor-debtor relationship; 7) principal and interest payments that are not subject to the risks of the corporation's business; 8) the existence of security to ensure the payment of interest and principal, including sinking fund arrangements, if appropriate; 9) the existence of rights of enforcement and default remedies; 10) an expectation of repayment; 11) the holder's lack of voting and management rights (except in the case of default or similar circumstance); 12) the availability of other credit sources at similar terms; 13) the ability to freely transfer the debt obligation; 14) interest payments that are not contingent on or subject to management of board of directors' discretion; and 15) the labelling and financial statement classification of the instrument as debt. Some of these criteria are the same as those specified in §385, but this elaboration is a more extensive summary of the factors applicable in making the determination.

See also the discussion of what constitutes a valid indebtedness in *Todd v. Comm'r.*, T.C. Memo 2011-123, aff'd per curiam 486 Fed. App. 423 (5th Cir. 2012).

taxpayer.[306] Based on a private letter ruling in 1995[307] and the statutory make-up of IRC Sec. 2701, many practitioners and commentators seem to be comfortable with leverage that does not exceed 90%.[308]

(2) State income tax considerations.

Many states that have a state income tax have similar provisions to the federal tax law with respect to grantor trusts, but it is not clear all states would follow the logic of Rev. Rul. 85-13. Thus, there could be state income tax consequences with the sale, whether there are capital gains consequences and/or there could be a mismatch of the interest income and interest deduction associated with any sale.

(3) 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.

The common law doctrine known as the step transaction doctrine, which is an application of the larger substance over form doctrine, could under certain circumstances, be used by the IRS to deny the tax benefit of taking a valuation discount on the sale of the partnership interest to the grantor trust as illustrated in this Example 7.[309] In applying the step transaction doctrine, the IRS or court may not treat the various steps of the transfer as independent. Instead, the steps in creating the partnership and transferring a partnership interest may be collapsed into a single transaction. Under the circumstances of creating the partnership and selling an interest to a grantor trust, the crucial key to not run afoul of the step transaction doctrine may be establishing that the creation of the family limited partnership ("FLP") or FLLC should stand on its own. Could the act of a transferor creating a FLP or FLLC be independently separated from the gift and/or sale to the trust? The creation of the FLP or FLLC should be designed to be sufficiently independent on its own and as an act that does not require a gift and/or sale to that trust. There does not have to be a business purpose for the creation of the trust. It is difficult for this writer to understand the business purpose of any gift. As noted above, the Supreme Court has said on two separate occasions, estate and gift tax law should be applied in a manner that follows a state property law analysis.[310] Thus, the key questions could be, is the creation of the FLP or FLLC recognized for state property law purposes, and is its creation independent of any other events, including the subsequent gift and/or sale to the trust? It would seem to this writer in many situations it could be demonstrated that the creation of the trust did not require a gift and/or sale to

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[306] The IRS made that argument in *Karmazin* (T.C. Docket No. 2127-03, 2003), but the case was settled on terms favorable to the taxpayer. In *Dallas v. Commissioner* (T.C. Memo 2006-72) the IRS originally made that argument, but dropped the argument before trial. The IRS is currently making both of those argument in two docketed cases, *Estate of Donald Woelbing v. Commissioner* (Docket No. 30261-13) and *Estate of Marion Woelbing v. Commissioner* (Docket No. 30260-13).

[307] P.L.R. 9535026 (May 31,1995).

[308] *See* Martin Shenkman, "Role of Guarantees and Seed Gifts in Family Installment Sales," 37 Estate Planning 3 (Nov. 2010).

[309] *See* Donald P. DiCarlo, Jr., "What Estate Planners Need to Know About the Step Transaction Doctrine," 45 Real Prop. Tr. & Est. L.J. 355 (Summer 2010).

[310] *See United States v. Bess*, 357 U.S. 51 (1958); *Morgan v. Commissioner*, 309 U.S. 78 (1940).

that trust of the interest in the FLP or FLLC for state law property purposes or for tax purposes. Furthermore, as noted above, a sale to such a trust has economic risk to the trust. The trust has both risk and reward. The value of the assets could depreciate below the value of the note. Depending upon the size of the transaction, 10% equity may represent real risk in comparison to the reward of the leverage. One percent equity may not. Also see the discussion in Section V B 3 d of this paper.

(4) If the assets decrease in value, the gift tax exemption equivalent may not be recoverable.

If a trust's assets decrease in value the gift tax exemption equivalent may not be recoverable. The problem inherent in creating a grantor trust, using the grantor's gift tax exemption equivalent, and leveraging that gift through a sale, is that the trust assets could decrease in value. In comparison to the creation of a grantor retained annuity trust ("GRAT") (see Section III C of this paper), this may have the disadvantage of wasting a grantor's gift tax exemption equivalent.

(5) There may be capital gains consequences with respect to the note receivables and/or note payables that may exist at death.

Under the facts of Revenue Ruling 85-13, 1985-1 C.B. 184, a grantor of a trust purchases all of the assets of that trust in consideration for an unsecured promissory note. The purchase is done in a manner that makes the trust a grantor trust. The key issue to be decided by the IRS in the revenue ruling is as follows:

> To the extent that a grantor is treated as the owner of a trust, *whether the trust will be recognized as a separate taxpayer capable of entering into a sales transaction with the grantor*. (Emphasis added.)

The IRS determined that for income tax purposes the trust was not capable of entering into a sales transaction with the grantor as a separate taxpayer. The Revenue Ruling then cited some old cases for the common sense proposition that a taxpayer cannot enter into transactions with himself for income tax purposes and have it recognized. The trust would not be capable of entering into a sales transaction for income tax purposes as a separate taxpayer until the moment of the grantor's death. For income tax purposes, the trust itself is not created and recognized as a separate taxpayer until the moment of the death of the grantor.

If a grantor sells low basis assets to a grantor trust for a note, and if there is an outstanding note **receivable** at death that exceeds the basis of the assets that were sold, is there a capital gains transaction at death when the grantor trust converts into a trust that is for the first time recognized for income tax purposes? The grantor's death is the event, for income tax purposes, that first causes the asset contribution to the trust to be recognized and first causes the sale of certain of those assets to the trust for a note to be recognized. Consider the following analogous example: a decedent directs in his will that his executor contribute certain assets to a trust and sell certain assets to that trust. There would not be any income taxes to the decedent's estate with that sale. Is that the proper analysis when there is an outstanding receivable from a grantor trust at the grantor's death? There is no definitive authority on that question and there is a debate among the commentators as to the correct assumption.[311] To the extent this is a concern, the note could be paid in-kind by the trust before the death of the grantor (perhaps with a low basis asset that will receive a basis step-up on the death of the grantor).

If a grantor purchases a low basis asset from a grantor trust, what is the trust's basis in any note **payable** to the trust by the decedent grantor at the moment of death? The grantor's death is the event, for income tax purposes, that first causes the asset contribution to the trust to be recognized and first causes the purchase of certain of those assets to the trust for a note to be recognized. Consider the following analogous example: a decedent directs in his will that the executor create a trust with part of the assets of his estate. The decedent then directs that the executor purchase certain of those assets from the trust with a note. The decedent finally directs the executor to pay the note with other assets of his estate. There would not be any income taxes recognized by the trust with that payment. Is that the proper analysis in determining the tax consequences of a payment of a note payable to a grantor trust upon the grantor's death, which is the moment when all of the transactions are first recognized for income tax purposes? Again, there is no definitive authority on what the trust's basis in a note payable to the trust is at the moment of death, and the possibility exists that a court could find that the basis of the note is equal to the basis of the trust assets sold to the grantor at the time of the purchase.

To the extent this is a concern, it could be mitigated by the grantor borrowing cash from a third party lender and using that cash to eliminate the note owed to the trust. At a later time, perhaps after the trust is converted to a complex trust for income tax purposes, the grantor (or his executor) could borrow the cash from the trust and pay the third party lender. If the trust, at that later time, does loan cash to the grantor or the executor of the grantor's estate, the trust's basis in that note should be equal to the cash that is loaned. (See the discussion in Section V C and V D of this paper.)

(6) The IRS may contest the valuation of any assets that are hard to value that are donated to a grantor trust or are sold to such a trust.

See the discussion in Section IV D below in this paper.

D. Techniques to Defend Against or Mitigate a "Valuation Surprise" From Valuation Planning.

1. Introduction.

The "conventional wisdom" this author sometimes hears on this subject is as follows: "the IRS will always contest the valuation of "hard to value" assets because the IRS could increase the transfer taxes, if they can demonstrate that the valuation discount is too high;" or "all

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[311] Compare Cantrell, *Gains is Realized at Death*, TR. & ESTS. 20 (Feb. 2010) and Dunn & Handler, *Tax Consequences of Outstanding Trust Liabilities When Grantor Status Terminates*, 95 J. TAX'N (July 2001) with Gans & Blattmachr, *No Gain at Death*, TR. & ESTS. 34 (Feb. 2010); Manning & Hirsch, *Deferred Payment Sales to Grantor Truss, GRATs, and Net Gifts; Income and Transfer Tax Elements*, 24 TAX MGMT. EST., GIFTS & TR. J. 3 (1999); Hatcher & Manigault, *Using Beneficiary Guarantees in Defective Grantor Trusts*, 92 J. TAX'N 152, 161-64 (2000); Blattmachr, Gans & Jacobson, *Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death*, 97 J. TAX'N 149 (Sept. 2002).

valuation clauses in an assignment document are against public policy." The above "conventional wisdom," under the circumstances discussed below, is incorrect.

The IRS will almost always scrutinize significant transfers of "hard to value" assets. Reasonable people (and, of course, unreasonable people) can differ on the value of certain assets (*e.g.*, a family limited partnership interest). From the IRS's point of view, scrutiny of those assets may represent a significant revenue opportunity. One approach that may reduce the chance of an audit of a transfer of a hard to value asset, or a gift tax surprise, if an audit does occur, is to utilize a formula defined value allocation transfer.[312] A formula defined value allocation transfer may increase the retained interest of the donor (as in the case of a grantor retained annuity trust); may define the portion of the property interest that is transferred or may provide that a defined portion of the property transferred passes to a "tax sheltered recipient." For example, a transfer may provide that an undivided part of a "hard to value" asset, which exceeds a defined value of the transferred entity interest, will pass either to a grantor retained annuity trust,[313] the transferor's spouse,[314] charity[315] or a trust in which the grantor has retained an interest that makes the gift incomplete.[316]

"Formula defined value allocation" clauses should be distinguished from "reversion" clauses like the ones discussed in Revenue Ruling 86-41, 1986-1 C.B. 442, and in *Procter*.[317] In Rev. Rul. 86-41, the IRS said that a clause that increased the consideration to be paid for the transferred property, or that caused a portion of the transferred property to revert to the transferor, were conditions subsequent that are not effective to circumvent a taxable gift from being made on the transfer of the property. By contrast, formula clauses defining the amount of the transfer or the identity of the transferee are ubiquitous in the transfer tax context. In fact, such arrangements are specifically permitted in the tax law. [318] If an adjustment occurs in a formula defined value

[312] *See* Tech. Adv. Mem. 86-11-004 (Nov. 15, 1985) discussed below. *See also* Hood, "Defined Value Gifts: Does IRS Have It All Wrong?" Estate Planning (Dec. 2001); Abbin, "Is Valuation the Best Planning Game Remaining?" ALI-ABA Course of Study Planning Techniques for Large Estates (Nov. 2001); McCaffrey, Carlyn "Tax Tuning the Estate Plan by Formula" 33rd Phillip E. Heckerling Institute on Estate Planning 4-1 (1999); Moore, "Attempting to Achieve Finality in Potentially 'Open' Transactions", 29th Phillip E. Heckerling Institute on Estate Planning 13 (1995); Cornfeld, "Formulas, Savings Clauses and Statements of Intent," 27 U. Miami Inst. on Est. Plan. 14 (1990); Peterson, "Savings Clauses in Wills and Trusts," 13 Est., Gifts & Tr. J. 83 (1988); Moore and Buchanan, "Valuation Readjustment Clauses: What's Possible?", 45th NYU Tax Inst. (1987); and C. S. McCaffrey and M. Kalik, Using Valuation Clauses to Avoid Gift Taxes, 125 TRUSTS AND ESTATES 47 (October 1986).

[313] *E.g.*, the excess could be transferred to a grantor retained annuity trust under IRC § 2702 that is nearly "zeroed out" with respect to the grantor and uses the required revaluation clause in the trust agreement with respect to a retained annuity.

[314] *E.g.*, the excess could be transferred to a spouse or a marital deduction trust pursuant to a formula marital deduction clause.

[315] *Eg.*, the excess could be transferred to a charity.

[316] Handler, David, Dunn, Deborah, "The LPA Lid: A New Way to 'Contain' Gift Revaluations" 27 Estate Planning, 206 (June 2000).

[317] *See Commissioner v. Procter*, 142 F.2d 824 (4th Cir. 1944); see also *Charles W. Ward v. Comm.*, 87 TC 78 (1986).

[318] *See* Treas. Reg. 25.2518-3(c) (allowing defined value formula for disclaimer of pecuniary amount); Treas. Reg. 25.2702-3(b)(2) (allowing value of grantor retained annuity trust annuity to be stated in terms of a

allocation clause, a change in the identity of the transferee may occur (*e.g.*, the credit shelter trust owns less of the asset and the marital trust owns more of the asset). If an adjustment occurs in a price adjustment clause, the initial transfer is partially unwound and the identity of the transferee does not change (*e.g.*, the transferee pays an additional amount for the asset). Price reimbursement clauses were found to be against public policy in *Procter* because, if such clauses were effective, the result of an audit of the gift tax return could never result in a deficiency and there is no other penalty of assets passing to a different transferee. Although part of the same public policy argument applies to formula defined value allocation clauses, they are so commonly used that an argument that they are void is not persuasive. Secondly, the public policy argument could be addressed by deliberately structuring the formula to produce a small deficiency on audit. Thirdly, formula clauses that are discussed below have a penalty in that the transferred assets could pass to an unintended transferee.

Any formula defined value allocation clause needs a mechanism to bring finality to the question of who owns what. Where the transfer involves a gift, finality can be achieved by filing a gift tax return that adequately discloses the formula transfer. When the statute of limitations expires on assessing a gift tax deficiency and none has been asserted, the ownership fractions will have been determined. If there is no gift tax return, however, finality cannot be achieved unless there is another mechanism that does not involve any action by the transferor that can be viewed as donative.

2. Defined Value Allocation Clauses Involving a Charity.

Assume a client and/or her family has some charitable intent. That intent could be incorporated in a plan in order to help bring finality to an "open" valuation question. Additionally, that charitable intent could preclude the IRS from unfairly contesting a good faith appraisal of the interest in the family entity as of that client's death.

Example 8: Disclaimer Formula Gift to a Charity

Sally Saint dies with most of her assets in a family limited partnership interest. The underlying asset value of Sally's interest in the partnership, if the partnership were liquidated, would be $10,000,000. Audrey Appraiser, however, believes a willing buyer would only pay $6,500,000 for Sally's interest in the partnership. Sally's will provides that the residue of her estate passes to her daughter Connie Clever. The will also provides that if Connie disclaims, or partially disclaims, an interest in her estate that asset, or assets, will pass to her donor advised fund in the Greater Metro Community Foundation. Connie partially disclaims that part of Sally's estate that she would otherwise receive that has a "fair market value that exceeds $6,400,000."

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fraction or percentage of fair market value); Treas. Reg. § 25.2702-39(c)(2) (requiring the annuity of a grantor retained annuity trust to be increased if an incorrect determination of the fair market value of the trust assets is made); Rev. Proc. 64-19, 1964-1 C.B. 682 (relating to defined value formula for funding the marital deduction); Treas. Reg. § 1.664-2(a)(1)(iii) (allowing defined value dollar amount of charitable remainder annuity trust to be expressed as a fraction or percentage of the initial net fair market value of the property passing in trust as finally determined for Federal tax purposes); Rev. Rul. 72-395, 1972-2 C.B. 340, 344, modified by Rev. Rul. 80-123, 1980-1 C.B. 205 and Rev. Rul. 82-128, 1982-2 C.B. 71 (allowing value definition clauses in charitable remainder trusts); Treas. Reg. § 1.664-3(a)(1)(iii) (requiring adjustments in annuity amounts if an incorrect determination of the fair market value of the charitable remainder trust has been made).

"Fair market value" is defined in the disclaimer document the same way it is defined in the Treasury regulations. The charity hires independent counsel and an independent expert appraiser. After the charity consults with its advisors, it agrees with Audrey Appraiser's appraisal. The charity, approximately one year after Sally's death, sells its rights under the disclaimer document for $100,000 to Connie. The IRS audits the Saint Estate one year after the sale. The IRS believes the discount is excessive and the charity should have sold its interest for $1,000,000. What happens now?

It would appear that no matter what the size of Sally Saint's estate, the IRS should only collect revenues on the first $6,400,000 of her estate. The remainder of Sally Saint's estate (as a matter of state property law) goes to charity. Thus, assuming a good faith appraisal report is made and is persuasive to the independent charity, the IRS may accept the estate tax return as filed with the discounts that are shown in that appraisal. The value of the gift to Connie Clever for state law property and estate tax purposes should be the same – $6,400,000.

Definition clauses with respect to transfers pursuant to a will are very common. Almost all modern wills of a married testator contain one, sometimes known as the formula marital deduction clause. It is submitted that it is unlikely that marital deduction and charitable deduction definition clauses would be invalidated for tax purposes by a court. First of all, as noted above, in determining the value for gift and estate tax purposes of any asset that is transferred, the legal rights and interests inherent in that property must first be determined under state law (unless federal law supersedes state law).[319] After that determination is made, the federal tax law then takes over to determine how such rights and interests will be taxed.[320] In its legislative history to various revenue acts, Congress has endorsed these principles that had been developed under case law. For instance, the reports to the 1948 changes in the estate taxation of community property provide that those changes restore the rule by which estate and gift tax liabilities are to depend upon the ownership of property under state law.[321] The taxable value of Sally Saint's estate is defined under state property law to be worth only $6,400,000. The federal estate tax consequences should be consistent with that definition. Secondly, to invalidate definition clauses would be to invalidate almost all "formula" defined value marital deduction gifts and formula defined value allocation disclaimers (which have always been acceptable by the IRS in its regulations, the courts, and Congress).[322] Thirdly, if such a definition clause were invalidated, it

[319] Occasionally, federal law does supersede state law in this context. For instance, federal law determines what charity is for purposes of IRC § 2055, not state property law.

[320] *See United States v. Bess*, 357 U.S. 51 (1958); *Morgan v. Commissioner*, 309 U.S. 78 (1940).

[321] *See* H. REP. NO. 2543, 83rd Cong. 2nd Sess., 58-67 (1954); H.R. REP. NO. 1274, 80th Cong. 2nd Sess., 4 (1948-1 C.B. 241, 243); S. REP. NO. 1013, 80th Cong., 2nd Sess., 5 (1948-1 C.B. 285, 288) where the Committee Reports on the 1948 changes in the estate taxation of community property states: "Generally, this restores the rule by which estate and gift tax liabilities are dependent upon the ownership of property under state law." *See also* the reports of the Revenue Act of 1932 that define "property" to include "every species of right or interest protected by law and having an exchangeable value." H.R. REP. NO. 708, 72nd Cong., 1st Sess., 27-28 (1932); S. REP. NO. 665, 72nd Cong., 1st Sess., 39 (1932).

[322] *See* Treas. Reg. 25.2518-3(c) (allowing defined value formula for disclaimer of pecuniary amount); Treas. Reg. 25.2702-3(b)(2) (allowing value of grantor retained annuity trust annuity to be stated in terms of a fraction or percentage of fair market value); Treas. Reg. § 25.2702-3(c)(2) (requiring the annuity of a grantor retained annuity trust to be increased if an incorrect determination of the fair market value of the trust assets is made); Rev.

would be impossible to determine the amount of the gift since the clause defines the amount of the transfer.

Clearly a "downside" in the technique from Connie's point of view is that the charity has every incentive and a fiduciary duty to make sure it is allocated the correct property interest. Obviously, the charity may disagree with the estate's appraisal. Charities are not going to accept unreasonable appraisals (nor would any state attorney general allow them).

Assume that, under the facts of Example 8, the IRS believes the discount should be 25%, but both the charity and the probate court believe it should be 35% (Audrey Appraiser is very convincing, except as to the IRS). Assume no collusion by the charity. The IRS discount would produce a value for the estate of $7,500,000, entitling the charity to $1,100,000. Has the charity made a taxable gift of $1,000,000 to Connie by accepting Audrey Appraiser's appraisal and selling all of its right to Connie for $100,000 in a subsequent sale? No gift tax should result if the charity did not enforce its "IRS right" to recover the excess partnership interest allocated to Connie, even if that failure to recover results in a deemed "bargain" transfer to Connie, because the gift tax is only imposed upon transfers by individuals.[323] Secondly, and perhaps more importantly, the charity did not make a transfer to Connie when it sold its rights, because the charity believed in good faith that it received adequate and full consideration.[324] The charity is not a "transferor" for purposes of IRC Sec. 2512. Even if the charity were potentially a transferor, assuming the parties were not in collusion, Connie is not an insider of the charity, the charity had independent counsel, and the charity used independent appraisers, the charity's sale of its rights should meet the requirements of Treas. Reg. §25.2512-8, which provides that "a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth." Those assumptions also mean that the "private inurement" and "excess benefit" rules under IRC Secs. 501(c)(3) and 4958 should not be applicable,[325]

While it is not authority, the IRS in 2001 indicated a willingness to test defined value formulas involving charities. The IRS (according to FSA 200122011) is apparently arguing, through litigation, a defined value clause that it assumes was executed without "[any] evidence of arm's length negotiations" and which the IRS assumes "the transactional documents were

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Proc. 64-19, 1964-1 C.B. 682 (relating to defined value formula for funding the marital deduction); Treas. Reg. § 1.664-2(a)(1)(iii) (allowing defined value dollar amount of charitable remainder annuity trust to be expressed as a fraction or percentage of the initial net fair market value of the property passing in trust as finally determined for Federal tax purposes); Rev. Rul. 72-392, 1972-2 C.B. 340, 344, modified by Rev. Rul. 80-123, 1980-1 C.B. 205 and Rev. Rul. 82-128, 1982-2 C.B. 71 (allowing valuation definition clauses in charitable remainder trusts); Treas. Reg. § 1.664-3(a)(1)(iii) (requiring adjustments in annuity amounts if an incorrect determination of the fair market value of the charitable remainder trust has been made).

[323] *See* IRC § 2501(a)(1); Treas. Reg. § 25.2501-1(a).

[324] *See* Treas. Reg. § 25.2512-8.

[325] *See* Treas. Reg. § 53.4958.

accepted by charity as presented."[326] Thus, on that basis, the IRS concludes the possibility of "any additional transfer to charity under the formula clause was illusory." Of course, if those are the facts, the IRS is right.

Clearly, more problematic is the following IRS "alternative" analysis in FSA 200122011 (for which the IRS does not cite any authority, because such authority does not exist and, it is respectfully submitted, may never exist), even if good faith arms length negotiations did take place:

> Though *Procter* involved a savings clause as opposed to a formula clause, the principles of *Procter* are applicable to this case. If formula clauses like the one at issue actually function to require payment of any increased value to the charitable donee, these clauses would be similar in effect to savings clauses in that they recharacterize the transaction in a manner that would render any adjustment nontaxable. A valuation increase resulting from an examination would serve only to increase the charitable deduction, but would not otherwise generate any gift tax deficiency. Moreover, the adjustment would substantiate a claim for an increase in the income tax charitable deduction claimed by the donor. The sole justification for the Commissioner's examination would be to insure that charity received all that it was entitled to under the transfer documents. This would place federal tax administrators in the position of policing charitable transactions, a role more appropriately performed by the states' attorneys general.

It is respectfully submitted that the IRS analysis misses several key points, including: (i) the IRS does have a "revenue incentive" to examine a charity's actions in agreeing to the amount of a formula gift, because the charity and the "offending" individual will be subject to IRS sanctions (which potentially increases Treasury revenue), if there is any excess benefit to that individual; (ii) state attorneys general *do* have a duty to enforce the formula; (iii) the charity has a fiduciary duty under state property law to enforce the formula (and, as noted above, it is clear law that federal gift tax consequences follow state property law); (iv) assuming the charity does engage in arms length negotiations, it is irrelevant whether the formula clause "works," because under gift tax valuation cases and the IRS's own regulations, it is clear arms length negotiations are the best evidence of value; [327] (v) as noted above, the IRS itself mandates formula clauses for charitable split interest trusts and grantor retained annuity trusts, both of which involve the same public policy considerations; (vi) as noted above, the IRS has long accepted formula marital deduction clauses and formula pecuniary disclaimers, which have no more (or less) public policy considerations than formula gifts to charity; and (vii) there is a key distinction between price adjustment clauses such as the one discussed in *Procter* and defined value formula clauses (*e.g.* marital deduction clauses). One distinction is that the price adjustment clause involves a condition subsequent. In addition, in some defined value formula clauses, the identity of the recipient could change (which is clearly not in the donor's best interest).

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[326] The Field Service Advice Memorandum was apparently written in connection with *McCord v. Commissioner* (T.C. No. 7048-00, 120 T.C. No. 13, 5/14/03) (see discussion below) a case in which this writer was a fact witness.

[327] *See Morrissey v. Comm.*, 243 F3d 1145 (9^{th} Circuit, 2001).

Moreover, the objection that no deficiency will result upon an audit can be easily defeated. Suppose that, instead of Connie's disclaiming all interests having a value in excess of $6,400,000 (the defined amount), Connie disclaimed only 99 percent of such excess. In that case, 1 percent of any valuation adjustment would produce a deficiency. Thus, the audit would not be without any consequence, just without much consequence.

Many of these issues were addressed by the full Tax Court in the *Estate of Christiansen v. Commissioner*.[328] This case involves a testamentary bequest of the decedent's estate to the decedent's daughter. The primary asset was an interest in a family limited partnership. The decedent's daughter disclaimed those limited partnership interests to the extent the value exceeded a formula amount:

> determined by reference to a fraction, the numerator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on [the date of the decedent's death], less…$6,350,000 and the denominator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on [the date of the decedent's death]…[all] as such value is finally determined for federal estate tax purposes.

The portion that was disclaimed passed by the terms of the decedent's will, three-quarters to a CLAT and 25% to a private foundation. Since the daughter was a beneficiary of the CLAT, if she is living at the end of the lead term, this did not meet the technical requirements for a valid disclaimer as to that portion. However, the portion that passed to the private foundation was found by the full Tax Court to be a valid disclaimer. The unanimous court (there was a dissent, but not on this point):

> We do recognize that the incentive to the IRS to audit returns affected by such disclaimer language will marginally decrease if we allow the increased deduction for property passing to the foundation. Lurking behind the Commissioner's argument is the intimation that this will increase the probability that people . . . will lowball the value of an estate to cheat charities. There's no doubt that this is possible.
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> But . . . executors and administrators of estates are fiduciaries, and owe a duty to settle and distribute an estate according to the terms of the will . . . . Directors of foundations . . . are also fiduciaries . . . [and] . . . the state attorney general has authority to enforce these fiduciary duties. . . .
>
> We therefore hold that allowing an increase in the charitable deduction to reflect the increase in the value of the estate's property going to the Foundation violates no public policy and should be allowed.

Thus, court rejected the IRS' assertion that defined value formula provisions that discourage the government from litigating valuation questions are invalid as against public

[328] *Estate of Christiansen v. Commissioner*, 130 T.C. 1 (2008), *aff'd* 586 F.3d 1061 (8th Cir. 2009).

policy. The full Tax Court refused to extend or apply the authority of *Procter* to defined value clauses.

The IRS appealed *Christiansen* to the Eight Circuit. The Eight Circuit rejected the public policy argument. *Estate of Christiansen v. Comm'r*, 586 F.3d 1061 (8^{th} Cir. 2009). The Court gave three reasons for rejecting the IRS argument that the defined valued disclaimer is against public policy: (1) the IRS role is to enforce tax laws, not to just maximize tax receipts; (2) there is no clear congressional intent for the policy to maximize incentive to audit (and indeed, there is congressional policy favoring gifts to charity); and (3) other mechanisms, including certain fiduciary obligations, exist to ensure values are accurately reported.

Consider the following defined value formula for a lifetime transfer to a public charity and a donor's family.

Example 9: Gift or Sale of Limited Partnership
Interest to a Grantor Trust and Gift to a Charity

Steve Supersaver owns a 99% limited partnership interest in Supersavers LP. The interest is appraised for $3,000,000. Steve creates a grantor trust with an independent trustee and funds that trust with $400,000. Steve transfers his 99% interest in Supersavers as follows: (i) Steve assigns to the trust that fraction of his interest the numerator of which is $2,950,000 and the denominator of which is the fair market value of the interest and (ii) the excess to a public charity. Steve's instrument of assignment provides that the fraction to be allocated to each transferee is to be determined using the value of Steve's interest in Supersavers determined under the principles of Rev. Rul. 59-60. The trust gives Steve a note for $2,950,000. (Alternatively, Steve could gift the interest to the trust.) Subsequently, but prior to any audit of the transaction by the IRS, the trust and the charity negotiate an agreement determining what fraction each is entitled to own and the trust purchases the charity's interest for $50,000. Steve does not participate in the negotiations. Steve deducts the value of the interest given to charity. The IRS audits the transaction and decides that the value of Steve's transferred interest in Supersavers was $4,000,000 instead of $3,000,000, so that the fraction allocated to the trust by the agreement between the trustee and the public charity is too great (and the amount paid by the trust for the charity's interest is too small). The IRS asserts that Steve made a gift to the trust of $1,000,000, the excess of what the trust has actually received over the face amount of the promissory note.

Since Steve had no role in determining the arrangements between the trust and the charity, how can it be that Steve has made a gift? If the amount allocated to charity was too small, is Steve entitled to an additional income tax deduction? *See* the discussion of the *McCord* case below.

The full Tax Court and the Fifth Circuit dealt with many of the issues in Example 9. In *McCord v. Comm.*, 120 T.C. 358 (2003), the Tax Court interpreted the meaning of a defined value formula clause where a public charity received a residual gift under a pecuniary defined value formula clause. The Tax Court rejected the IRS argument that the charitable deduction should be limited by the amount that the public charity ultimately received because of either the substance over form doctrine, public policy considerations or the integrated transaction doctrine. However, a majority of the Tax Court found that despite the pecuniary language of the assignment document, under Texas property law, specific undivided interests were intended to be conveyed by the donors, because the assignment agreement contemplated that donee bargaining was to take place. Thus, the possibility existed that the children and grandchildren could "win" that later bargain and the donors should be liable for the gift taxes associated with that later bargaining process (even if the donors did not participate in that bargaining process).

The charities had experienced independent counsel for both key transactions (the agreement as to the percentage interests each donee received under the donor's original assignment document and the redemption by the partnership of those interests). The Tax Court found that the charities could have availed themselves of an independent appraisal and could have participated in an arbitration proceeding described in the partnership agreement. The Tax Court found that on advice of the charities independent counsel, both charities' chose not to hire an independent appraiser (because their internal review showed the appraisal to be reasonable) and also as a consequence chose not to avail themselves of the arbitration procedure described in the partnership agreement. Nonetheless, it felt the charities were not to be considered adverse parties during those negotiations, because "it is against the economic interests of a charitable organization to look a gift horse in the mouth."

It is respectfully submitted by this prejudiced writer (when practicing law, this writer was responsible for the planning of the McCord matter) that this last fact-finding (the charities were not adverse parties), which is crucial to the logic of the majority's opinion, is the most controversial fact-finding. The charitable organizations had to look this "gift horse in the mouth" when they exercised their duties under the formula, and it was very much in their economic interest to make sure they received as large a horse as they were given by the donors (i.e., to acquire all of the transferred partnership interests above the pecuniary amount allocated to the children and grandchildren). Furthermore, the directors of the subject charities were subject to criminal and civil sanctions from both the Texas State Attorney General and the IRS, if they acted in a manner that directly or indirectly privately benefited an individual that was not a ward of the subject charities. In effect the majority concludes that the charities chose not to exercise their right to seek a larger gift in arbitration as a tacit *quid pro quo* for receiving any gift at all. The majority states this without specific findings of fact that would support its conclusion.

A majority of the Court held that under Texas state property law, the donors did not transfer an interest in their partnership interest equal to a specific dollar amount to their children and grandchildren, but rather conveyed to their children and grandchildren an undivided percentage interest in their partnership interest that could only be determined by the Court under Texas state property law, because the term "fair market value" was used. The donees, according to the Court, were not in the position to make a good faith determination of what the term fair market value means under the assignment. The Court also held that the donees had underestimated the fair market value of the donor's interest in the partnership. As a consequence, the percentage interests to be received by each donee, pursuant to the donees' mutual agreement, were incorrect. Thus, even though the donors had nothing to do with those negotiations by the donees, the donors' intentions, conveyances, and promises under the assignment agreement were subject to the results of the later determination by the donees of what the term "fair market value" meant under the assignment document.

Only two of the judges (Judge Laro and Judge Vasquez) would have followed as least some of the IRS tax common law arguments (i.e., *Procter* public policy arguments) and would have allowed a deduction only for the amount actually passing to the charity. What is interesting is that those two judges also found that the majority's Texas state law property contractual argument did not have any merit.

Judge Wiener[329], on behalf of the unanimous Fifth Circuit panel, reversed and rendered against the IRS on appeal of the *McCord* tax court decision. Key parts of Judge Wiener's opinion are as follows:

> With the exception of the ultimate fact question of the taxable and deductible values of the limited partnership interests in MIL that comprise the completed, irrevocable inter vivos donations (the 'gifts') made by the Taxpayers to the exempt and non-exempt donees on January 12, 1996, the discrete facts framing this case are largely stipulated or otherwise undisputed. Having lived in Shreveport, Louisiana, for most of their adult lives, and having accumulated substantial and diversified assets, these octogenarian Taxpayers embarked on a course of comprehensive family wealth preservation and philanthropic support planning, including transfer tax aspects of implementing such a plan. This was done in consultation with Houston-based specialists in that field.
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> . . . .
>
> All gifts were complete on execution of the Assignment Agreement on January 12, 1996. No other agreements – written or oral, express or implied – were found to have existed… Rather, because the interests donated by the Taxpayers to the GST trusts, the Sons, the Symphony were expressed in <u>dollars</u>, 'fair market value' is defined in the Assignment Agreement in terms of the applicable 'willing-buyer, willing-seller' test specified in the applicable Treasury Regulation.
>
> . . . .
>
> Neither the Majority Opinion nor any of the four other opinions filed in the Tax Court found evidence of any agreement – not so much as an implicit, 'wink-wink' understanding – between the Taxpayers and any of the donees to the effect that any exempt donee was expected to, or in fact would, accept a percentage interest in MIL with a value less than the full dollar amount that the Taxpayers had given to such a donee two months earlier.
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> . . . .
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> At the outset, we reiterate that, although the Commissioner relied on several theories before the Tax Court, including doctrines of form-over-substance, violation-of-public policy, and, possibly, reasonable-probability-of-receipt, he has not advanced any of those theories on appeal. Accordingly, Commissioner has waived them, and has instead – <u>not surprisingly</u> – devoted his efforts on appeal solely to supporting the methodology and holdings of the Majority. . . [Emphasis added.]
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> . . . .

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[329] *McCord v. Commissioner*, 461 F.3d 614 (5th Cir. 2006).

. . . the Commissioner specifically opposed a discount grounded in Mr. Frazier's contention that the Taxpayers had transferred less than full limited partners interests. The Commissioner does not, however, advance such a contention on appeal; so it too is waived, and we do not address that issue. <u>Our failure to address it should not, however, be viewed as either agreeing or disagreeing with the Majority's determination on this point. Rather, as shall be shown, we have no need to reach it</u>. [Emphasis added.]

. . . .

Contributing to the framework of our review in this section is the sometimes overlooked fact that this family-partnership case is not an <u>estate</u> tax case, but a <u>gift</u> tax case. Thus, the aggressive and sophisticated estate planning embodied here is not typical of the estate plans that have produced the vast majority of post-mortem estate tax valuation cases. Also helping to frame our review is the fact that this is not a run-of-the-mill fair market value gift tax case. Rather, as recognized by the Majority and by Judges Chiechi and Foley in dissent, the feature that most fractionated the Tax Court here is the Taxpayers' use of the dollar-formula, or 'defined value,' clause specified in the Assignment Agreement (the gift instrument, not either the original or the amended partnership agreement nor the Confirmation Agreement) to quantify the gifts to the various donees <u>in dollars</u> rather than in <u>percentages</u>, the latter being more commonly encountered in gifts and bequests that parcel out interests in such assets as corporate stock, partnerships, large tracts of land, and the like.

. . . .

The Majority's key legal error was its confecting <u>sua</u> <u>sponte</u> its own methodology for determining the taxable or deductible values of each donee's gift valuing for tax purposes here. This core flaw in the Majority's inventive methodology was its violation of the long-prohibited practice of relying on post-gift events. Specifically, the Majority used the after-the-fact Confirmation Agreement to mutate the Assignment Agreement's dollar-value gifts into percentage interests in MIL. <u>It is clear beyond cavil that the Majority should have stopped with the Assignment Agreement's plain wording.</u> By not doing so, however, and instead continuing on to the post-gift Confirmation Agreement's intra-donee concurrence on the equivalency of dollars to percentage of interests in MIL, the Majority violated the firmly-established maxim that a gift is valued as of the date that it is complete; the flip side of that maxim is that subsequent occurrences are off limits. [Emphasis added.]

In this respect, we cannot improve on the opening sentence of Judge Foley's dissent:

> Undaunted by the facts, well-established legal precedent, and respondent's failure to present sufficient evidence to establish his determinations, the majority allow their olfaction to displace sound legal reasoning and adherence to the rule of law. [Footnote omitted.]

. . . .

We obviously agree with Judge Foley's unchallenged baselines that the gift was complete on January 12, 1996, and that the courts and the parties alike are governed by § 2512(a). We thus agree as well that the Majority reversibly erred when, 'in determining the charitable deduction, the majority rely on the [C]onfirmation [A]greement without regard to the fact that [the Taxpayers] were not parties to this agreement, and that this agreement was executed by the donees more than 2 months after the transfer.' In taking issue with the Majority on this point, Judge Foley cogently points out that '[t]he Majority appear to assert, without any authority, that [the Taxpayers'] charitable deduction cannot be determined unless the gifted interest is expressed in terms of a percentage or a fractional share.' As implied, the Majority created a valuation methodology out of the whole cloth. We too are convinced that '[r]egardless of how the transferred interest was described, it had an ascertainable value' on the date of the gift. That value cannot, of course, be varied by the subsequent acts of the donees in executing the Confirmation Agreement. Consequently, the values ascribed by the Majority, being derived from its use of its own imaginative but flawed methodology, may not be used in any way in the calculation of the Taxpayers' gift tax liability.

. . . .

In the end, whether the controlling values of the donated interests in MIL on the date of the gifts are those set forth in the Assignment Agreement based on Mr. Frazier's appraisal of $89,505 per one per cent or those reached by the Majority before it invoked the Confirmation Agreement (or even those reached by the Commissioner in the deficiency notices or those reached by the Commissioner's expert witness for that matter), have no practical effect on the amount of gift taxes owed here. . . In sum, we hold that the Majority erred as a matter of law. [Emphasis added.] [Footnotes omitted.]

* * *

The facts of Example 9 are also very similar to the recent *Petter* case.[330] In mid 2001, Mrs. Petter transferred her UPS stock to an FLLC. In March 2002, Mrs. Petter made gifts of sales to a trust that she had established in late 2001. The gifts reflected about 10% of the trust assets. The gift and sale transactions were implemented by formula transfers with any amounts above certain dollar amount as finally determined for federal gift tax purposes to be allocated to certain donor advised funds. The appraisal indicated that the valuation discount should be 53.2%. The IRS audited. The IRS and the taxpayer finally agreed on using a 35% discount. The IRS did not allow any gift tax charitable deduction for the additional interests that were passed to charities based on this valuation. The Court found that the formula allocation provisions are not "void as contrary to public policy, and there was no severe and immediate frustration of public policy as a result, and no over arching public policy gets these types of arrangements in the first place." The Court

[330] *See, Estate of Anne Y. Petter v. Comm'r,* T.C. Memo 2009-280 (December 7, 2009).

allowed a gift tax charitable deduction for the year of the original transfer. The Court held that public policy is not violated for four principal reasons: (1) general public policy encourages charitable gifts; (2) the gifts were not susceptible to abuse as the IRS maintained because there were other potential sources of enforcement; primarily from the fiduciary duties that were owed and the enforcers of those fiduciary duties through the State Attorney General and/or the IRS Commissioner through revoking the foundations' exempt status; (3) this case does not invoke a moot issue because the judgment regarding the gift tax value would trigger a reallocation, therefore, it is not just a declaratory judgment; and (4) the existence of other sanctioned formula clauses suggest no general public policy against formula clauses.

Another very similar case to the facts of Example 9 is the recent *Hendrix* case.[331] For full disclosure purposes, like *McCord*, this writer was very involved in the planning associated with this case. Mr. and Mrs. Hendrix made a defined formula assignment to certain trusts for the benefit of their family and for the benefit of a donor advised fund of a community foundation (which is a public charity). They assigned nonvoting stock in the closely held Subchapter S corporation. The assignment formula provided for a pecuniary amount of the shares going to trusts for the benefit of their daughters with any remaining portion of the assigned shares being assigned to the donor advised fund. The trusts paid with certain promissory (demand) notes in exchange for the shares. The assignment was subject to certain shareholder agreement provisions that provided for resolution of any disputes about the fair market value of the shares. Before the assignments were made, the donor advised fund engaged independent counsel to negotiate with the donors as to the terms of the assignment. Among the changes made by the donor advised fund's counsel were changes in the assignment form that provided that minimum distributions would be made in order that the charity could pay any income taxes associated with the gifts. After the assignments were made, the donor advised fund also hired its own independent appraiser to determine the reasonableness of the suggested allocation of the shares between the charity and the trust for the donor's family. Also, after the assignments were made, the donors had no further contact with the donor advised fund.

The formula was predicated on the willing buyer, willing seller standard; however, the formula did not depend upon the values that were to be finally determined for federal gift tax purposes. As a result of the independent negotiations between the two recipients of the gift (the trust for the donor's family and the donor advised fund) it was determined that the per share value of the gifted shares was $36.66. The IRS and the taxpayer stipulated, for purposes of the Tax Court proceeding, that if the defined value formula did not control, that the price per share should be $48.60 per share.

The IRS took the position that the formula assignment clause is invalid because it was not bargained for at arm's length and was contrary to public policy. Judge Paris, citing the *Christiansen* case, held that the formula clause was not contrary to public policy. The court also determined that the assignment was arm's length because there was no evidence of collusion between the charity, the donors and the other donees. The court also found a considerable

[331] *See, John H. Hendrix and Karolyn M. Hendrix, Donors v. Comm'r,* T.C. Memo 2011-133 (June 15, 2011).

incentive existed for the charity to take an arm's length position because of the possibility of losing its tax exemption and certain penalties that could accrue under state law.

What conclusions, at this time, can be drawn from the *Hendrix* case, the *Petter* case, the *Christiansen* case and the *McCord* case with respect to defined value formula clauses that involve a gift to charity?

(i) If the assignment document provides that the donee is an assignee, and other surrounding facts are consistent with the assignment document, the Tax Court will recognize that what a hypothetical willing buyer will pay for the transferred interest is only based on assignee rights. That recognition by the Court may have a profound effect on the amount of the marketability discount that is allowed.

(ii) It appears that the current Tax Court, Fifth Circuit and Eight Circuit will find a formula defined value allocation clause is not against public policy when it involves a charity and will even allow a charitable deduction that may be substantially above what the charity actually receives (if the charity later sells its interest). In *McCord*, a majority of the Tax Court allowed the donors a charitable deduction that was approximately 28% above what the charities ultimately received. In *McCord*, Judges Foley and Chiechi also allowed a charitable deduction that was much greater than what the majority would have allowed. Stated differently, in *McCord* the current Tax Court seemed reluctant to allow common law doctrines to negate the state law property result of a formula defined value allocation clause. (There was, obviously, vigorous disagreement as to what the assignment document mandated under Texas state property law.) It would also appear that the Fifth Circuit would not be sympathetic to the "common law" doctrines being applied to deny the taxpayer the ability to use dollar denominated defined value clauses, as Judge Weiner found that it was not "surprising" that the IRS did not wish to appeal based on that argument. In *Christiansen*, the full Tax Court rejected the IRS's public policy arguments. In *Hendrix*, Judge Paris rejected the IRS's public policy arguments.

(iii) These cases strongly suggests that the Tax Court would be prepared to allow formula defined value allocation clauses, with a gift over to entities or trusts other than charities, which incorporates the phrase "as finally determined for federal gift tax purposes" and under which a fiduciary duty exists to enforce the clause. This seems especially so where the value as finally determined will be divided among the donees and be retained by them in the proportions provided by the formula, with no "buyout" by one donee of another prior to final valuation. For instance, formula defined value allocation clauses incorporating that phrase in which the excess value over a stated dollar amount goes to a grantor retained annuity trust, or to a marital deduction trust, which also has independent trustees, appear likely to have the support of the Tax Court.

(iv) The addition of the phrase "as finally determined for federal gift tax purposes" was obviously found to be an unnecessary addition by the Fifth Circuit and the Tax Court under the facts of H*endrix*. There may be key reasons why a donor, in his assignment document, would not wish to add that phrase. One reason is a practical one: over ten years is too long to wait to find out who owns what after an assignment of a closely held enterprise (the facts of *McCord*). Another reason may be a tactical one: an arms-length transaction is the best evidence of value. Thus, by the time the IRS audited the *McCord* matter, the taxpayers had three arguments: (i) the evidence supported the discounts; (ii) as a matter of state property law, which determines the nature of the property transferred for gift tax purposes, the taxable portion of the gift assignment was defined to be $6.9 million; and (iii) a subsequent arms-length transaction indicated that the taxable gift was $6.9 million. The donors (Mr. and Mrs. McCord) may have wanted the sons and the independent charity to bargain (in a binding fashion) as to what they received pursuant to the assignment document. The donors may have wanted them to engage in that bargaining and not to passively wait for a final determination by third parties as to what the assignment document meant. There may have been other reasons.

(v) It may be important, when a charity is not in the defined value allocation assignment, to make sure an independent trustee is involved to enforce the rights under the formula that the "excess" recipient trust may have.

(vi) It should be noted that in *King v. United States*, 545 F.2d 700 (10th Cir. 1976), the Tenth Circuit also found that *Procter* did not apply in a price adjustment clause where the transaction did not contain "contingencies which, upon fruition, alter, change or destroy the nature of the transaction."

3. Defined Value Allocation Clauses Involving a Residual Gift to a Marital Deduction Trust.

Assume a client does not have charitable intent and wishes to transfer a "hard to value" asset. Consider the following example:

<u>*Example 10: Formula Marital Deduction Clause*</u>

Marvin and Mary Madeinheaven are very happily married. Marvin is considering making a significant transfer of his partnership interests to trusts for the benefit of his children and grandchildren. Marvin is worried that reasonable people (and unreasonable people) could differ as to the value of the proposed transfer of partnership interests. Assume that Marvin owns a limited partnership interest that according to an independent appraisal has a fair market value of $5,000,000. The assignment document could provide the following formula: "that undivided part of my limited partnership interest, as finally determined for federal gift tax purposes, that is equal to $4.9 million passes to the ABC Trust for the benefit of my children with the remaining undivided part of my partnership interest passing to the Qualifying Marital Deduction Trust for the benefit of Mary." ABC Trust is adequately funded and issues a $4,900,000 note to Marvin. There is an independent trustee of the Marital Deduction Trust. Will the IRS find the assignment clause is against public policy?

If upon examination, it is determined that the discount associated with the independent appraisal was excessive, that undivided interest that would otherwise have passed to the ABC Trust will instead pass to the marital deduction trust for the benefit of Mary. The IRS has approved the applicability of formula marital clauses since 1964.[332] Thus, the stated goal of Marvin circumventing a gift tax surprise should be achieved using a formula marital deduction clause.

4. Defined Value Allocation Clauses Involving Gifts to a Grantor Trust and a Grantor Retained Annuity Trust ("GRAT").

There has been a debate from time to time between academics and commentators as to which form of making transfers is superior, a transfer to a grantor retained annuity trust or a transfer to an intentionally defective grantor trust pursuant to an installment sale. While much of the debate sometimes sounds like a beer commercial as to whether the commentator's favorite method of transfer is less filling or tastes great, there are some advantages to each technique. Among the advantages of a GRAT is the built-in revaluation clause required by the Treasury Regulations under Sec. 2702 (also see the discussion in Section V C of this paper that immediately follows). The disadvantage of the GRAT in comparison to a sale for a note to an intentionally defective grantor trust is that the GRAT will not work, if the client dies before the end of the term of the GRAT. If cascading GRATs are used to ameliorate against that surprise, interest rates may increase in the future which makes the return on future GRATs problematic. Is there a way to combine the best features of both the GRAT and the sale to the intentionally defective trust? Consider the following example:

<u>Example 11: Formula Defined Value Allocation Gift to Trusts and a GRAT</u>

Sam Single, who is the cousin of Marvin Madeinheaven, owns a limited partnership interest that according to an independent appraisal has a fair market value of $5,000,000. Sam transfers his partnership interest to a trust for the benefit of his children and a grantor retained annuity trust ("GRAT"), which is nearly "zeroed out," pursuant to a formula defined value allocation assignment. The assignment document provides the following formula: "that undivided part of my limited partnership, as finally determined for federal gift tax purposes, that is equal to $4,900,000 passes to the ABC Trust for the benefit of my children with the remaining undivided part of my partnership interest passing to the XYZ GRAT." There is an independent trustee of the XYZ GRAT. ABC Trust is adequately funded and issues a $4,900,000 note to Sam. Under the terms of the GRAT, Sam retains an annuity that is defined as a percentage of the initial value transferred to the GRAT and that annuity will be worth $99,000, if the IRS finally accepts Sam's expert valuation of the partnership interest. Assume the IRS contends that the partnership interest has a value of $7,000,000. If Sam agrees to accept the IRS valuation, what is the size of the additional gift that has Sam made?

According to the Regulations under Sec. 2702, the grantor's retained annuity rights may be defined in the trust instrument as a percentage "of the initial fair market value of the property contributed by the grantor to the trust, *as finally determined for federal tax purposes*." For example, the trust agreement might provide for annual payments of 55% per year for 2 years, where the 55% annual payment amount is derived from the initial value. This type of language operates as a built-in revaluation clause, mitigating the risk of a surprise gift on revaluation of the

[332] Rev. Proc. 64-19, 1964-1CB 682.

transferred property by the IRS. This feature can be especially beneficial with hard to value assets such as Sam's partnership interest.

Under Example 11, on audit the IRS claims the value of the limited partnership interest is $7,000,000. As a result, under the formula defined value allocation, the value given to the GRAT becomes $2,100,000 instead of $100,000. If Sam accepts the results of the audit, the terms of the GRAT provide for an increase in the amount payable to Sam in the form of the annuity without much increase in taxable gift. The GRAT trustee simply pays the grantor an additional annuity amount (for a total of $2,079,000 in present value terms), and the taxable gift is increased by only $20,000. Therefore, by using GRATs in conjunction with formula defined value allocation clauses, owners of hard to value assets may be able to make gifts with little risk of a gift tax surprise. Of course, an audit by the IRS could result in a greater retained annuity (which would later be taxed in the grantor's estate). Because under the facts of Example 11, the GRAT will in fact receive the additional partnership interest comprising the $2,000,000 of additional value assessed by the IRS, the facts are distinguishable from those of the *McCord* case. It should be noted that if there is an adjustment of the GRAT there are some concerns.[333]

Explored below in this paper is a slightly different technique, which should circumvent concerns with respect to prohibited additional contributions to a GRAT. This technique involves a sale to a disregarded income tax entity (a single member FLLC instead of a grantor trust) followed by a gift of an interest in the disregarded entity to a GRAT. See the discussion in Section V B of this paper.

5. Defined Value Allocation Clauses Involving a Defined Dollar Transfer By the Donor.

Technical Advice Memorandum 86-11-004[334] illustrates the effect of a defined value clause when the excess value above the stated dollar defined value accrues to the donor, instead of to a spouse or a charity. Under the facts in Technical Advice Memorandum 86-11-004, a man ("the donor") transferred a sole proprietorship to a partnership in exchange for a 99.9982% interest in the partnership. The other .0018% interest in the partnership was owned by trusts for the donor's children. The donor transferred a portion of his partnership interest equal to a stated dollar amount to the trusts for his children each year from 1971 through 1982. The donor and trustees agreed on the capital ownership attributable to the gifts, and partnership income was allocated accordingly. The IRS concluded that the interests transferred by the donor were those having a fractional equivalent to the stated fair market values of the gifts, based upon the fair market value of the partnership at the time of each gift determined according to recognized valuation principles. The donor's interest extended to the rest of the partnership because he could have asserted ownership to the extent that the gifted fractional interests reflected in the partnership agreement and income tax returns exceeded the fractional interests actually conveyed in the gift assignments. If, however, he were ever barred from enforcing his ownership right to the excess interest, he would be treated as having made an additional gift to the trusts. To the

[333] For concerns that the valuation adjustment could be treated as a prohibited additional contribution to the GRAT, and that use of a GRAT may run afoul of the *Procter* doctrine, see Covey & Hastings, "No More, No Less: Savings Clauses, Formulas and Defined Values, Part II," *Practical Drafting* (October 2006, pp. 8688-8689).

[334] Tech. Adv. Mem. 86-11-004 (Nov. 15, 1985).

extent that income was allocated to the donees in an amount exceeding the partnership interest to which they were actually entitled, the donor made gift assignments of the income, with the implicit right to revoke the assignments by asserting his right to the excess partnership interest. Therefore, according to the Technical Advice Memorandum the gifts of income were to be regarded as complete when each distribution of excess income became irrevocable as a result of the lapse of the statute of limitations.

The recent *Wandry v. Commissioner* case (T.C. No. 10751-09, T.C. Memo. 2012-88, March 26, 2012) partially overrules Technical Advise Memorandum 86-11-004 to the extent it holds that a gift is made when the statute of limitations expires, if the transferred percentage interest of the enterprise exceeds the fair market value of the dollar formula transfer.

On January 1, 2004, Joanne and Dean Wandry executed separate assignments and memorandums of gifts ("gift documents"). Each gift document provided:

> I hereby assign and transfer as gifts, effective as of January 1, 2004, a sufficient number of my Units as a Member of Norseman Capital, LLC, a Colorado limited liability company, so that the fair market value of such Units for federal gift tax purposes shall be as follows:
>
> | **Name** | **Gift Amount** |
> |---|---|
> | Kenneth D. Wandry | $261,000 |
> | Cynthia A. Wandry | $261,000 |
> | Jason K. Wandry | $261,000 |
> | Jared S. Wandry | $261,000 |
> | Grandchild A | $11,000 |
> | Grandchild B | $11,000 |
> | Grandchild C | $11,000 |
> | Grandchild D | $11,000 |
> | Grandchild E | $11,000 |
> | **Total Gifts** | $**1,099,000** |
>
> Although the number of Units gifted is fixed on the date of the gift, that number is based on the fair market value of the gifted Units, which cannot be known on the date of the gift but must be determined after such date based on all relevant information as of that date. Furthermore, the value determined is subject to challenge by the Internal Revenue Service ("IRS"). I intend to have a good-faith determination of such value made by an independent third-party professional experienced in such matters and appropriately qualified to make such a determination. Nevertheless, if, after the number of gifted Units is determined based on such valuation, the IRS challenges such valuation and a final determination of a different value is made by the IRS or a court of law, the number of gifted Units shall be adjusted accordingly so that the value of the number of Units gifted to each person equals the amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or a court of law.

The Tax Court opinion was written by Judge Haines. Judge Haines addressed the IRS argument that the capital account adjustments, rather than the gift documents, determine the percentage interests transferred by the gifts:

> Respondent's reliance on Thomas is misplaced. Thomas is a case about whether and when a gift of corporate stock is complete, and it has no bearing on the nature of petitioners' gifts. We do not find respondent's argument to be persuasive. The facts and circumstances determine [the LLC's] capital accounts, not the other way around. Book entries standing alone will not suffice to prove the existence of the facts recorded when other more persuasive evidence points to the contrary.
>
> …
>
> In fact, the Commissioner routinely challenges the accuracy of partnership capital accounts, resulting in reallocations that affect previous years. If the Commissioner is permitted to do so, it can be said that a capital account is always "tentative" until final adjudication or the passing of the appropriate period of limitations. Accordingly, [the LLC's] capital accounts do not control the nature of petitioners' gifts to the donees.
>
> Even if we agreed with respondent's capital accounts argument, respondent has failed to provide any credible evidence that the [LLC] capital accounts were adjusted to reflect the gift descriptions. The only evidence in the record of any adjustments to [the LLC's] capital accounts in 2004 is the capital account ledger and the [LLC's] members' Schedules K-1, neither of which provides credible support to respondent's argument. The capital account ledger is undated and handwritten. There is no indication that it represents [the LLC's] official capital account records, and it does not reconcile with any of petitioners' or respondent's determinations. The capital account ledger is unofficial and unreliable.

Judge Haines concluded:

> Absent the audit, the donees might never have received the proper [LLC] percentage interests they were entitled to, but that does not mean that parts of petitioners' transfers were dependent upon an IRS audit. Rather, the audit merely ensured that petitioners' children and grandchildren would receive the 1.98% and .083% [LLC] percentage interests they were always entitled to receive, respectively.
>
> It is inconsequential that the adjustment clause reallocates membership units among petitioners and the donees rather than a charitable organization *because the reallocations do not alter the transfers*. On January 1, 2004, each donee was entitled to a predefined [LLC] percentage interest expressed through a formula. The gift documents do not allow for petitioners to "take property back". Rather, the gift documents correct the allocation of LLC membership units among petitioners and the donees because the [business appraiser] report understated [the LLC's] value. The clauses at issue are valid formula clauses. [emphasis added]

Finally, Judge Haines rejected the Procter public policy argument that the IRS made, stating that "[t]he lack of charitable component in the cases at hand does not result in a 'severe and immediate' public policy concern."

*** * ***

V. THE USE OF VALUATION TECHNIQUES FROM 2012 TO THE PRESENT AND FUTURE: USING THE TECHNIQUES TO LOWER BOTH INCOME TAXES AND TRANSFER TAXES.

A. The New Tax Environment and a New Reason to Consider Valuation Techniques.

As a result of the American Taxpayer Relief Act of 2012 ("ATRA") the basis exclusion amount and the GST exemption are $5,430,000 in 2015 that will increase with inflation in future years; the maximum estate tax and gif tax rate is 40%; and the basic exclusion amount not used by a spouse is "portable" and can be used by the other spouse.

The maximum federal income tax rate is now 39.6% and the capital gains rate is 20%. Effective January 1, 2012 the Health Care and Reconciliation Act of 2010 ("HCA") added a 3.8% surtax on net investment income above certain income thresholds.

In states that do not have any state income after considering the 3.8% surtax and the phase out of itemized deductions the effective ordinary rate is 44.6% and the long-term capital gains rate is 25%. Those rate are much higher in states and cities with income taxes (e.g., in New York City the ordinary rate is 52.26% and the long term capital gains rate is 37.29%).

In this context for many wealth taxpayers there is now added emphasis on income tax planning in comparison to transfer tax planning. What is interesting is that a planner and a taxpayer can do both. What is also interest is that many of the structural techniques traditionally used in valuation planning may also be valuable tools in income tax planning.

What follows are excerpts from either 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" or "Putting it Altogether: Some of the Best Estate Planning Strategies We See Out There That Reduce Both Income and Estate Taxes."

* * *

B. Marrying the Best Characteristics of a Discounted Sale to a Grantor Trust With a GRAT: The Advantages and Considerations of Contributing an Interest in a Leveraged FLLC to a GRAT.

1. What is the Technique?

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

Perhaps the best freeze technique that does not have to use any of a taxpayer's unified credit is described below. In addition to preserving the unified credit in order to receive the maximum step up without estate taxes, varieties of the technique described below also have the potential of saving capital gains taxes beyond the estate freeze. See Section V B 2 c (3) below in this paper.

A taxpayer could create a single member family limited liability company ("FLLC") by contributing and selling financial and private equity assets to that FLLC. If the taxpayer is the only owner of the FLLC there should not be any income taxes or gift taxes associated with the creation of the FLLC.[335] The taxpayer could then contribute some or all of the FLLC member interests to a GRAT. After the term of the GRAT, the remainder beneficiary could be a grantor trust that names the grantor's spouse as a beneficiary and gives that spouse a special power of appointment. The technique will sometimes be described below as the "Leveraged FLLC Asset GRAT."

The first inquiry is what is a GRAT? A GRAT is an irrevocable trust to which the grantor transfers an asset in exchange for the right to receive a guaranteed annuity for a fixed number of fiscal years (the "Annuity Period").[336] When the trust term expires, any GRAT balance remaining is transferred tax-free to a designated remainder beneficiary (*e.g.*, a "defective grantor trust" for the benefit of the grantor's spouse and issue).[337] If a grantor makes a gift of property in trust to a member of the grantor's family while retaining an interest in such property, the taxable gift generally equals the fair market value of the gifted property without reduction for the fair market value of the retained interest.[338] However, IRC Sec. 2702 provides that for a gift of the remainder of a GRAT in which the grantor retains a "qualified interest", defined to include a guaranteed annuity, the taxable gift will be reduced by the present value of the qualified interest, as determined pursuant to a statutory rate determined under IRC Sec. 7520(a)(2) (the "Statutory Rate"). In general, the Statutory Rate requires an actuarial valuation under prescribed tables

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[335] For the proposition that there should not be any income taxes because of the sale of assets to a single member FLLC is ignored for income tax purposes, see Treas. Reg. §301.7701-3(b)(1)(ii). For the proposition that there should not be any gift taxes for a sale of assets for less than the value of the assets on creation of the leveraged single member FLLC, please see the *Strangi* discussion in Section I B 3.

[336] The GRAT may also be structured to terminate on the earlier of a period of years or the grantor's death, with a reversion of the entire corpus to the grantor's estate on premature death, but doing so will reduce the value of the retained interest.

[337] IRC Sec. 2702 provides the statutory authority for such transfers after October 8, 1990. IRC Sec. 2702(a) uses the "subtraction-out" method to value retained interests of split-interests transfers. Under IRC Sec. 2702(b), a qualified interest includes any interest that consists of a right to receive fixed amounts. The value of a remainder interest in a GRAT that meets the requirements of IRC Sec. 2702 is computed by subtracting the present value of the grantor's annual annuity payments from the contributed properties' current fair market value. The grantor must recognize a taxable gift to the extent of any computed remainder interest. The present value of the grantor's annual annuity payment is computed by discount rates set by the IRS under IRC Sec. 7520. The IRS Tables change monthly to reflect an interest rate assumption of 120% of the mid-term adjusted Federal Rate for that month under IRC Sec. 1274(d)(1).

[338] *See* IRC Sec. 2702(a)(2)(A). Absent Sec. 2702, the amount of the gift would be reduced by the value of the retained interest. *See* Treas. Reg. Section 25.2511-1(e).

using an interest rate equal to 120 percent of the Federal midterm rate in effect for the month of the valuation.[339]

A grantor's ability to determine the size of the guaranteed annuity and the annuity period at the outset allows the GRAT to be constructed so that the present value of the grantor's retained interest approximately equals the value of the property placed in the GRAT, resulting in a "zeroed out" GRAT.[340] Thus, a GRAT could be structured where there is no, or a relatively modest, taxable gift. If the GRAT does not earn a yield or otherwise appreciate at a rate equal to the Statutory Rate, all the trust property will be returned to the grantor in payment of the retained annuity, and no transfer of property to the GRAT's beneficiaries will occur. If the grantor dies during the GRAT term, depending upon the amount of the annuity payment in comparison to the

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[339] *See*, IRC Sec. 7520(a)(2). Certain exceptions set forth in Treas. Reg. Section 25.7520-3(b) do not appear to be applicable to the facts discussed in this paper.

[340] The possibility of completely "zeroing out" a GRAT was negated by Example 9 of Treas. Reg. §25.2702-3(e). Example 9 was invalidated by *Walton v. Commissioner*, 115 T.C. 589 (2000), acq., Notice 2003-72, 2003-44 I.R.B. 964. Final regulations reflecting *Walton* and containing a revised Example 9 were issued. T.D. 9181 (February 25, 2005), 70 F.R. 9,222-24 (February 25, 2005). Prior to its acquiescence, the IRS, in Revenue Procedure 2002-3, 2002-1 C.B. 117, Section 4.01(51), announced that it will not issue a favorable private letter ruling in circumstances where the amount of the guaranteed annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the GRAT or if the present value of the remainder interest is less than 10 percent of the transferred property's initial net fair market value. This item remains on the "no ruling" list. Rev. Proc. 2015-3, 2015-1 I.R.B. 129, Section 4.01(53). The regulations do not include any such 50/10 limitation, nor would such a limitation be consistent with the *Walton* case itself, which involved a zeroed-out GRAT.

The Obama Administration has proposed changes with respect to GRATs which would require that the remainder have a minimum value. The ability to "zero out" (or almost zero out) the GRAT under current law would be eliminated. *See* Treasury Department, "General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals" (February, 2015.) The proposal is described on pp. 197-198:

> **Reasons for Change**
> GRATs and sales to grantor trusts are used for transferring wealth while minimizing the gift and income tax cost of transfers. In both cases, the greater the post-transaction appreciation, the greater the transfer tax benefit achieved. The gift tax cost of a GRAT often is essentially eliminated by minimizing the term of the GRAT (thus reducing the risk of the grantor's death during the term), and by retaining an annuity interest significant enough to reduce the gift tax value of the remainder interest to close to zero. In addition, with both GRATs and sales to grantor trusts, future capital gains taxes can be avoided by the grantor's purchase at fair market value of the appreciated asset from the trust and the subsequent inclusion of that asset in the grantor's gross estate at death. Under current law, the basis in that asset is then adjusted (in this case, "stepped up") to its fair market value at the time of the grantor's death, often at an estate tax cost that has been significantly reduced or entirely eliminated by the grantor's lifetime exclusion from estate tax.
>
> **Proposal**
> The proposal would require that a GRAT have a minimum term of ten years and a maximum term of the life expectancy of the annuitant plus ten years to impose some downside risk in the use of a GRAT. The proposal also would include a requirement that the remainder interest in the GRAT at the time the interest is created must have a minimum value equal to the greater of 25 percent of the value of the assets contributed to the GRAT or $500,000 (but not more than the value of the assets contributed). In addition, the proposal would prohibit any decrease in the annuity during the GRAT term, and would prohibit the grantor from engaging in a tax-free exchange of any asset held in the trust.
>
> This proposal would apply to trusts created after the date of enactment.

then IRS Sec. 7520 rate, all or most of the GRAT property should be included in the grantor's gross estate and be subject to estate tax, with a reduction for any gift tax paid upon creation of the GRAT. If, however, the grantor survives the GRAT term and the GRAT earns a yield or otherwise appreciates at a rate that exceeds the Statutory Rate, the amount of such excess value should pass to the GRAT's designated beneficiaries free of transfer tax.

Consider the following example:

Example 12: Contribution of a Leveraged FLLC Member Interest to a GRAT

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

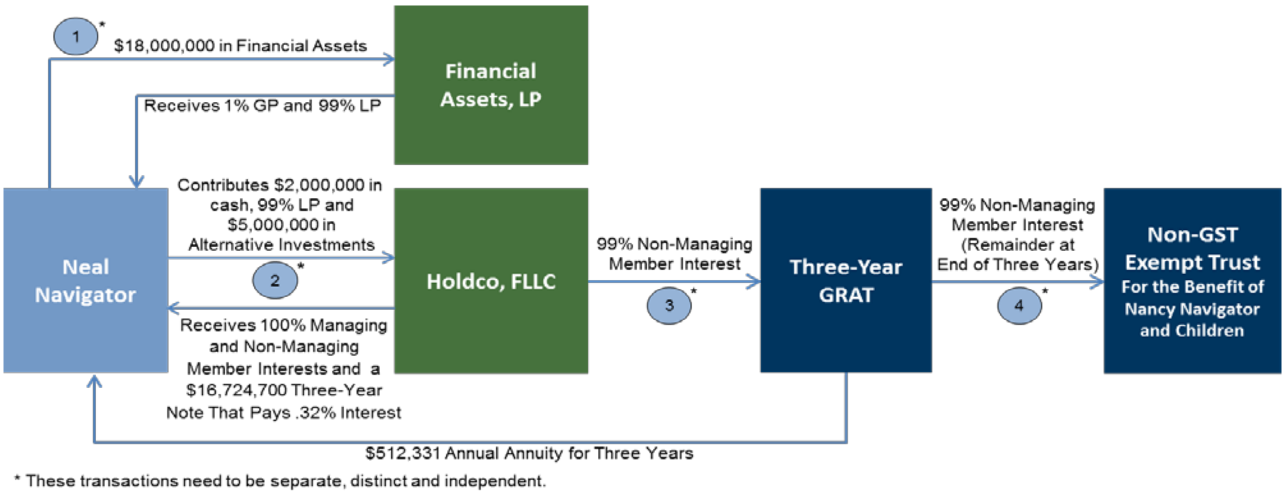
Lenny likes many of the aspects of a GRAT, including its built-in revaluation clause. Lenny also likes using FLPs, or FLLCs, because of the substantive non-tax investment and transfer tax advantages that are sometimes associated with these entities (e.g., they may effectively deal with qualified purchasers and accredited investor requirements for alternative investments and because of the possibility of valuation discounts with FLLCs).[341]

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

Lenny recommends that Neal contribute $18,000,000 of marketable securities to a limited partnership ("FLP"). Lenny assumes Neal's limited partnership interest in FLP will have a 35% valuation discount. Neal would then transfer the 99% limited partnership interest in FLP, together with $5,000,000 of alternative investments and $2,000,000 cash, to a single member limited liability company ("FLLC" or "Holdco") in a part sale/part contribution, receiving a note equal to $16,724,700 (which is 90% of the assumed value of the assets transferred to Holdco). Lennie assumes that Neal's non-managing member interest in Holdco will have a 20% valuation discount.

Lenny's proposed technique is illustrated below:

[341] *See* the discussion by this author in "Some of the Best Family Limited Partnership Planning Ideas We See Out There," ALI-ABA Planning For Large Estates, at 2-32 (Nov. 15, 2010).



The technique described above is designed to join a discounted grantor trust to a near "zeroed out" GRAT so as to get the best of both worlds.

Instead of this transaction, Neal could create Holdco, FLLC without leverage and transfer his non-managing member interest in Holdco to a grantor trust for his spouse and descendants, taking back a note at the appropriate AFR with a principal amount equal to the discounted value of the transferred interest. In addition, cash or other assets with a value equal to 10% of the total transfer could be gifted to the trust. (Alternatively, the Holdco interest could be sold to the trust for 90% of its discounted value, with no additional gift.) The note could be structured so as not to require interest and principal payments in the near term of more than the trust's cash flow. The sale will not result in realization of gain because transactions between a grantor and a grantor trust are disregarded. See the discussion in Section B 2. The underlying assets have a value in excess of the note equal to the "discount amount" resulting from the discounts for FLP and Holdco, which will be indirectly transferred to the Navigator family.

One aspect of the sale is the requirement that the purchasing trust have sufficient capital in excess of the amount of the note to justify treating the note as debt with a value equal to its face amount. A 10% cushion is widely believed to be the minimum adequate amount. In the technique, the discount amount would actually exceed the required cushion, but it is not clear that reliance on the underlying value that is not reflected in gift tax value would be regarded as sufficient, nor would this be good "optics." A bargain sale for 90% of value, or a separate gift, would create a 10% cushion, but each result in a taxable gift.

A key disadvantage of this approach is that the assets that are sold or given could be revalued. The IRS might argue for a lower discount in valuing the sold or given assets. A simple price adjustment clause that would increase the sale price to cover the increased value will not be recognized for gift tax purposes. A defined value transfer that shifts value in excess of the sale price to a marital or charitable disposition might succeed in avoiding a taxable gift but at the cost of diverting property away from the grantor trust, and while this has appellate case law support, there remains legal uncertainty about the success of the technique (the IRS has not acquiesced to the technique). A defined value transfer that reduces the quantum of property transferred to match the sale price has received some case law support, but cannot yet be called a proven technique (the IRS has not acquiesced to the technique), and it too would reduce the property passing to the grantor trust by keeping it with the grantor.

If the note were not treated as debt, because of too much leverage, or for some other reason, then it may be treated as a retained interest in the trust under equitable tax principles, potentially resulting in a taxable gift under IRC Sec. 2702 and inclusion under IRC Sec. 2036. As we shall see, the Leveraged FLLC Asset GRAT finesses the debt issue (both as to adequacy of the cushion and as to the result of the note not being treated as debt under equitable principles) by making the sale to a single member FLLC prior to any transfer to the GRAT.

Alternatively, Neal could create Holdco, FLLC without leverage and contribute his non-managing member interest in Holdco to a GRAT. The GRAT in theory solves the problem of getting the discounts generated by FLP and Holdco through the system without making an initial taxable gift. But will this be the case in the real world? The GRAT has no asset other than the Holdco interest. If "slices" of the Holdco interest are used to pay the annuity, the interests distributed must be valued using the valuation discount. Although the distributed slices of the Holdco interest must be valued at a discount, they carry with them the corresponding "full" value of the underlying assets, and nearly the entire Holdco interest must be distributed to satisfy the annuity. The discount amount does not pass to the donees (though some value may remain as a result of earnings on the discount amount). This problem would be solved if the GRAT could distribute cash in satisfaction of the annuity, but Holdco has only $2 million of cash, plus cash earnings during the GRAT term. Furthermore, the more cash that is distributed from Holdco, the lower the valuation discount will be; which in turn increases the amount of the GRAT annuity that must be paid.

Another approach would be for the GRAT to borrow the amount necessary to pay the annuity in cash from a third party. At the end of the GRAT term, the remainderman would receive the Holdco interest without diminution, and would assume the requirement to eventually repay the note. As long as the remainderman is a grantor trust, the assumption of the note should not be a realization event as to Neal or the GRAT. This approach in effect turns the GRAT into a Leveraged FLLC Asset GRAT. Borrowing from a third party results in interest on the loan passing outside the family. The "third party" could, however, be Neal's spouse or an existing family trust, although taxable interest income to the lender would result.

In summary, unlike the sale to a grantor trust, the contribution of an interest in a non-leveraged entity to a GRAT offers certain protection from an inadvertent taxable gift upon revaluation, but presents the problem of where to get the cash to pay the GRAT's immediate annuity obligation, a problem not present with the sale to a grantor trust, where payment of principal and (if need be) interest on the note can be deferred.

The simplest way to "marry" a discounted sale and a GRAT would be to sell assets that could be discounted to the GRAT. Under the facts of this example, the assets could be sold to the GRAT (itself a grantor trust) for a note with a principal amount equal to 90% of its value, or $16,724,700. The gross taxable gift is $1,858,300. The GRAT annuity would be based on this reduced value. Instead of an annuity of $512,331 as in the pure GRAT discussed above, the annuity would be $646,883. The total annuity payments over three years would have a present value of $1,858,300. The annuity payments could be satisfied using the $2,000,000 cash transferred to the GRAT. Even if there were no cash transferred, a 4% annual cash distribution from the assets would be $743,320, almost enough to cover the annuity and a 0.32% note. The leverage reduces the annuity while protecting from gift tax assets of sufficient magnitude to generate cash sufficient to pay the reduced annuity (or a good portion of it). The annual annuity amount could be further reduced by lengthening the term of the GRAT, until it was covered by the assets' projected cash flow. Thus, even if the GRAT assets earned only at the 7520 rate, the discount amount would be protected and would pass to the grantor trust that is the GRAT remainderman. Of course, the interest and principal on the note must be paid, but that is a longer-term issue.

One problem with this simple marriage is that the same 10% of the transferred value is both the cushion for the note, and the amount subject to the GRAT annuity. It could be argued that because that 10% will be consumed by the GRAT annuity, there really is no cushion. That may lead to the finding that the note has more characteristics as a retained interest in the trust than a note. If the note is not treated as debt under equitable tax principles, then the note may represent an interest in the trust that is not a qualified annuity under IRC Sec. 2702, resulting in a taxable gift.[342] It could be argued that the discount amount itself provides a sufficient cushion for the note, but as noted above, it is uncertain whether one can rely for the cushion on value that does not "exist" in determining the value transferred. The only sure solution would be to have a 10% gift taxable component in the transfer that is not offset by the annuity, which Neal wants to avoid. Any such taxable gift would also increase proportionally if the discount were reduced on audit.

Beyond the cushion issue, the simple marriage of a discounted sale and a GRAT has not been approved in any case or ruling, and many practitioners would be reluctant to be the test case of such a novel format.

The above technique and illustration seek to avoid the problems of the simple marriage by making the sale of the assets to an intermediate entity, a FLLC with a 1% managing member interest and a 99% non-managing member interest, and then transferring the 99% non-managing member interest in FLLC to the GRAT.

A side benefit of using the intermediate entity FLLC in the above illustration is the additional discount provided by FLLC. The illustration assumes that FLLC would afford an additional discount of 20% on top of the 35% discount afforded by FLP, so that the marketable securities indirectly held in FLLC would have a cumulative discount of 48%. The extra discount affords a benefit but is not the primary reason for using the second entity.

The limited partnership interest in FLP in this example is sold to FLLC for a note with a principal amount equal to 90% of its value. The bargain sale leaves a 10% cushion in support of the note. If the note's validity as debt is tested at the moment of this transfer, it passes the cushion test and presumably is valid debt.[343]

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342 In itself, this might not disqualify the annuity as a "qualified interest," though the IRS would probably argue that one or another of the requirements of Treas. Reg. §25.2702-3(d) had been violated.

343 Of course, at the moment of sale nothing turns on whether the note is debt or an interest in FLLC, since Neal already owns all the interest in FLLC. Only on the subsequent transfer to the GRAT does it become important that the note be treated as debt to avoid a possible taxable gift and potential inclusion (but see the discussion below of the consequences of "flunking" the debt test).

Even assuming tax equitable principles determine that the purported debt from the FLLC is not debt for tax purposes, the consequences of flunking that test may not be as disastrous as they would be for an ignored note in a sale to a grantor trust. Assuming the FLLC is recognized, presumably the result of "flunking" is that the note is equitably treated under tax principles as an equity interest in FLLC rather than an equity interest in any trust owner of the FLLC. That equity interest belongs to Neal, but it is an interest in FLLC, not a direct retained interest in the GRAT. Arguably, the result is simply to reduce the value of the interest in FLLC transferred to the GRAT, not to treat the transfer as a transfer in trust retaining a non-qualified interest under IRC Sec. 2702.

2. Advantages of the Technique.

a. If leverage is used in creating the FLLC that is contributed to the GRAT, much more wealth will be transferred to the remainderman of the GRAT than through the use of a conventional GRAT.

In comparing the Leveraged FLLC Asset GRAT to a GRAT that uses discounted entities, but does not use leverage, and to a GRAT that does not use either discounted entities or leverage, under the above assumptions, the transfer tax advantage of the Leveraged FLLC Asset GRAT is significant. The tables below summarize the advantage (also see Schedule 3). The calculations below are made after two years, ignoring valuation discounts, and are net of the outstanding debt. The calculations below assume different rates of returns, as noted. The assumed IRC Sec. 7520 rate is 2.2%.

Table 3a

Hypothetical Techniques: Assets Earn 2.20% Annually	Neal Navigator	Navigator Children	% Improvement Over Hypothetical Technique #1	% Improvement Over Hypothetical Technique #2
Holdco, FLLC Distributes about 2% of the value of assets it owns directly and indirectly.				
No Further Planning	$33,987,889	$0	N/A	N/A
Contributing Assets That Are Not in Entities to a GRAT (Technique #1)	$33,987,745	$144	N/A	N/A
Contribution of Non-Leveraged Entities to a GRAT (Technique #2)	$31,652,714	$2,335,176	1619182.15%	N/A
Leveraged FLLC Asset GRAT (Technique #3)	$26,216,640	$7,771,249	5388721.62%	232.79%

Table 3b

Hypothetical Techniques: Assets Earn 7.40% Annually	Neal Navigator	Navigator Children	% Improvement Over Hypothetical Technique #1	% Improvement Over Hypothetical Technique #2
Holdco, FLLC Distributes about 2% of the value of assets it owns directly and indirectly.				
No Further Planning	$38,774,953	$0	N/A	N/A
Contributing Assets That Are Not in Entities to a GRAT (Technique #1)	$35,891,596	$2,883,358	N/A	N/A
Contribution of Non-Leveraged Entities to a GRAT (Technique #2)	$32,983,854	$5,791,099	100.85%	N/A
Leveraged FLLC Asset GRAT (Technique #3)	$26,883,832	$11,891,122	312.41%	105.33%

Table 3c

Hypothetical Techniques: Assets Earn 10.00% Annually	Neal Navigator	Navigator Children	% Improvement Over Hypothetical Technique #1	% Improvement Over Hypothetical Technique #2
Holdco, FLLC Distributes about 2% of the value of assets it owns directly and indirectly.				
No Further Planning	$41,338,758	$0	N/A	N/A
Contributing Assets That Are Not in Entities to a GRAT (Technique #1)	$36,869,405	$4,469,353	N/A	N/A
Contribution of Non-Leveraged Entities to a GRAT (Technique #2)	$33,612,113	$7,726,645	72.88%	N/A
Leveraged FLLC Asset GRAT (Technique #3)	$27,229,585	$14,109,173	215.69%	82.60%

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

As noted below, not only does paying the GRAT annuity with cash, instead of member interests, produce a much better result, it does not present “deemed contribution” or “deemed commutation” concerns that could accrue if hard to value assets are used to pay the GRAT annuity.

b. The technique has many of the same advantages as the sale to the grantor trust.

See the discussion in Section IV C 4 a of this paper.

c. The technique can be designed to be very flexible to meet changing needs and stewardship goals.

(1) Flexibility to meet changing needs and stewardship goals by adding a spouse as a beneficiary of the trust that is a remainder of the GRAT and giving that spouse a special power of appointment.

Generally, many of the same flexibility advantages of a sale to a grantor trust benefiting a grantor's spouse and family also exist with the technique of contributing non-managing member interests in a leveraged FLLC to a GRAT in which the remainderman is a trust for the transferor's spouse and family. The GRAT and the remainder trust of the GRAT can be designed to be a grantor trust in which the grantor is responsible for paying the income taxes of the trust. The remainder trust may have features that give the transferor's spouse flexibility with consumption issues and stewardship issues. The transferor also has retained leverage and flexibility by owning the note from the FLLC. There is an inherent delay (i.e., the term of the GRAT) before the transferor's spouse can enjoy the benefits of any properties that may accrue to the trust for his or her benefit. This is ameliorated by the transferor being entitled to the distributions of the FLLC either in the form of interest and principal payments by the FLLC on the outstanding note, or in the form of annuity payments by the GRAT.

It is possible for the patriarch or matriarch to name his or her spouse as a beneficiary of the remainder trust and also give that spouse the power to redirect trust assets that are different than the default provisions of the trust instrument. IRC Sec. 2041 provides that a person may be a beneficiary of a trust and have a power of appointment over the trust as long as the beneficiary does not have the right to enjoy the benefits of the trust under a standard that is not ascertainable and does not have the power to appoint the trust assets to either the beneficiary's estate or creditors of the beneficiary's estate. If an independent third party is trustee of the trust, that third party could have significant additional powers over the trust to distribute assets of the trust for the benefit of that spouse. If the spouse is serving as trustee and has distribution powers in that capacity, the distributions powers must be ascertainable and enforceable by a court within the health, education, maintenance standard of IRC Sec. 2041.

If unanticipated consumption problems accrue during a couple's lifetime and if the trust allows distributions to be made to meet those unanticipated consumption needs, that trust can obviously act as a safety valve for those needs. If the trust allows the grantor's spouse to appoint properties on his or her death in a manner different than the default provisions of the trust, those powers of appointment could also serve as a safety valve to redirect the properties of the trust in a way that is more consistent with the client's future stewardship goals.

A collateral benefit of the inherent flexibility of creating trusts that have the safety valve of having a client's spouse as the beneficiary, and giving that spouse a limited special power of appointment, is that the technique encourages the client to create such a trust when the client may be reluctant to do so.

(2) There is inherent flexibility to meet changing consumption needs with the grantor retaining a note from the FLLC that could be converted to a note with a different interest rate or a private annuity.

The note retained by the grantor could also be structured and/or converted to meet the grantor's consumption needs, without additional gift taxes, as long as the restructuring is for adequate and full consideration.

For instance, the note at a future time could be converted to a private annuity to last the grantor's lifetime. That conversion should be on an income tax free basis since, as noted above, the trust and any consideration received for any sale to the trust are ignored for income tax purposes. At the time of the conversion to a private annuity, it is important that enough assets exist in the FLLC to satisfy IRC Sec. 7520 exhaustion test requirements.

The note could also be restructured to pay a different interest rate, as long as the new rate is not lower than the AFR rate or higher than the fair market value rate.

(3) There is an inherent flexibility to enter into basis enhancing strategies with the Leveraged FLLC Asset GRAT.

The use of this technique freezes the taxpayer's assets on a discounted basis. In other words, the appreciation of the assets, similar to a sale of a discounted asset to a grantor trust, is not subject to the taxpayer's future estate taxes. Unlike a sale to a grantor trust that is created by substantial use of a taxpayer's available unified credit, the technique does not require the use of the taxpayer's unified credit. Any unified credit that can be saved by using this technique may be used by the taxpayer to save estate taxes and capital gains taxes on the low basis assets owned by the taxpayer at his death. Thus, this may be an ideal technique for a taxpayer who wishes to preserve his unified credit to save estate taxes and capital gains taxes on certain low basis assets he may own at the time of his death.

The principal and interest of the retained note may be paid with either cash or in kind. There will not be any income tax consequences with in kind payments, if the FLLC remains a disregarded entity. If low basis assets owned by the FLLC are used to make some of those in kind payments, and if those low basis assets are retained by the grantor until the grantor's death, there will be a step-up in basis of those assets on the grantor's death under IRC Sec. 1014.

The creator of the FLLC, as long as it is a disregarded entity, could swap his individually owned high basis assets with the FLLC's low basis assets. If the donor does not have any high basis assets, he could borrow cash from a third party lender to make that exchange.

Another basis enhancing strategy opportunity with this technique is to convert part or all of the retained note at some point to a preferred member interest in the FLLC. The preferred interest, in order to avoid gift tax issues, needs to be compliant with IRC Sec. 2701 and Revenue Ruling 83-120.[344] In this example assets with an underlying value of approximately $25,000,000 were contributed to the single member FLLC. Assume in this example that Neal Navigator and his wife, Nancy, need annual cash flow equal to $600,000 a year for their consumption needs.

[344] Rev. Rul. 83-120, 1983-2 C.B. 170.

Assume in a future year that the retained note has been reduced from $16,724,700 to $12,000,000. Neal could convert $10,000,000 of the $12,000,000 to a $10,000,000 preferred non-managing member interest that pays a 6% annual coupon. The principal of the preferred could be designed to annually increase at the same rate the exemption increases. In this manner, assuming Neal and Nancy have not used any of their exemption in this technique, or any other technique, they will be in a position to eliminate the estate tax. The $2,000,000 in retained notes that are not converted to a preferred interest could be used to pay income taxes associated with the FLLC investments. At some point, distributions from the remainder grantor trust could also be made to Nancy to also pay for Neal and Nancy's income taxes. On Neal's death, his basis in the preferred will receive a step-up in basis equal to the fair market value of the preferred. The FLLC could make an IRC Sec. 754 election and receive a basis step-up of some of its assets commiserate to the step-up in basis of Neal's preferred.

d. The potential IRC Sec. 2036(a)(2) advantage of the structure.

See the discussion in Section IV B of this paper

e. Valuation advantage of a Leveraged FLLC Asset GRAT.

Under the regulations, the grantor's retained annuity rights may be defined in the trust instrument as a percentage of the fair market value of the property contributed by the grantor to the trust, *as such value is finally determined for federal tax purposes*. For example, the trust agreement might provide for payments of 53% per year for two years, where the 53% annual payment amount is derived from the initial value. This type of language operates as a built-in revaluation clause, mitigating the risk of a surprise gift on revaluation of the transferred property by the IRS. This feature can be especially beneficial with contributed alternative investments of which reasonable people (and unreasonable people) could differ as to the initial value (e.g., a private derivative, closely held limited partnership interest, or closely held subchapter S corporation stock). Without the complications of a defined formula allocation clause in an assignment the grantor is in a position to steer clear of a gift tax surprise if it is finally determined that the value of the contributed asset is different than what the grantor reported on his gift tax return.

f. Ability of grantor to pay for income taxes associated with Holdco, the GRAT and remainder grantor trust gift tax-free and substitute assets of Holdco, the GRAT and remainder grantor trust income tax-free.

A GRAT can be designed to be an effective trust for estate and gift tax purposes and income tax purposes (i.e., a so-called grantor trust). That is, the trust will not pay its own income taxes, rather the grantor of the trust will pay the income taxes associated with any taxable income earned by the trust.

Thus, if the assets of the GRAT, any time during the term of the GRAT, have significant appreciation, the grantor is in a position to substitute other assets to lock in the profit of the GRAT. As a practical matter, the ability to substitute assets may be used by the grantor of a GRAT to "lock in" appreciation in the investment of a GRAT prior to the end of the Annuity Period by substituting other assets of equal value that are less likely to fluctuate. In this connection, Treasury Regulation § 25.2702-3(b)(5) requires the governing instrument of a GRAT to prohibit additional contributions to the GRAT after its inception. It might be argued that the power to swap assets of equal value constitutes a power to make an additional contribution. However, to date the IRS has not made this connection. In addition, numerous private letter rulings have approved GRATs containing a power of substitution without raising or reserving as to this issue.[345]

g. Synergy with other techniques.

A GRAT may be a means to transfer enough wealth to a trust for the benefit of the next generation in order to provide leverage for other future estate planning techniques. If the GRAT, or GRATs, that a grantor and a grantor's spouse create are successful (e.g. 10% of the family's wealth is transferred downstream to the grantor's family or to trusts for the grantor's family), further leveraging with respect to other transfer tax planning techniques could occur. For instance, assume that a GRAT (or GRATs) created by a grantor transfers approximately 10% of the family's net worth to a grantor trust for the benefit of his or her family. If confident that 10% is a sufficient cushion, the grantor could transfer his or her remaining assets to a trust in exchange for a note that is equal to the fair market value of what has been transferred. In that fashion, the grantor has achieved a freeze of his or her estate (except for the interest carry on the note) while paying no (or very little) gift tax. That trust could also purchase life insurance to equal approximately 50% of the projected principal amount of the note due on the death of the surviving spouse.

h. Comparatively low hurdle rate.

Currently, the Statutory Rate has been ranging between 1.4% and 3.6%. In today's relatively low interest rate environment for US Treasury obligations, it is certainly possible, and for certain investments probable, that the investments of a GRAT will exceed that hurdle rate. In a leveraged FLLC contribution to a GRAT it is even more probable because of the effect of the discount of the contributed FLLC interests.

i. High leverage.

A GRAT can be created where the grantor retains an annuity amount that is almost equal to the value of the assets that were originally placed in the GRAT. Stated differently, significant leverage can be created by creating an annuity that is almost equal to the value of the assets placed into the GRAT. As noted above, if there is appreciation above the Statutory Rate, the appreciation above the Statutory Rate will accrue to the remainderman. In comparison, most practitioners believe that other leveraged gifting techniques, including a sale to a grantor trust, should have more equity associated with the transaction (e.g., for example, some practitioners advocate at least 10% equity with a sale to a grantor trust, which usually results in a taxable gift).

j. Non-recourse risk to remaindermen.

Another financial advantage of the GRAT technique is that if the asset goes down in value, the remaindermen have no personal exposure. Furthermore, there is no added cost of wasting significant gift tax exemptions of the grantor. For instance, assume, for the sake of

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[345] *See*, e.g., P.L.R. 200220014 (Feb. 13, 2002); P.L.R. 200030010 (Apr. 26, 2000); P.L.R. 200001013 (idem, 200001015 (Sept. 30, 1999)); P.L.R. 9519029 (Feb. 10, 1995); P.L.R. 9451056 (Sept. 26, 1994); P.L.R. 9352007 (Sept. 28, 1993); P.L.R. 9352004 (Sept. 24, 1993); P.L.R. 9239015 (June 25, 1992).

comparison, that at the time of the sale to the grantor trust, the grantor trust had 10% - 15% equity. If the asset goes down in value, that equity of the trust could be eliminated and the exemptions that were originally used to create that equity could also be lost.

k. The "*Atkinson*" worry about paying a GRAT annuity with a hard-to-value asset may be eliminated.

If the annuity amount is kept relatively small because of the use of leverage, then there may be enough cash flow to pay the annuity with cash or near cash. In this example that would be enough cash. Obviously, there are no valuation issues with cash. The U.S. Court of Appeals for the Eleventh Circuit (*see Atkinson*, 309 F.3d 1290 (11th Cir. 2002), cert denied, 540 U.S. 945 (2003)),[346] has held that an inter vivos charitable remainder annuity trust's (CRAT's) failure to comply with the required annual payment regulations during the donor's lifetime resulted in complete loss of the charitable deduction. The Court found that the trust in question was not properly operated as a CRAT from its creation. Even though the subject CRAT prohibited the offending acts of administration, the Court held that the CRAT fails.

In a similar fashion, the IRS could take the position that if the GRAT trustee's administrative practices violate the regulations under IRC Sec. 2702, then the interest retained by the grantor will not be a qualified interest. Just as in the *Atkinson* case, it may not matter if appropriate savings language is in the document. As explored below, there are many areas in which the administration of a GRAT may fail, including the following: (i) inadvertently engaging in an activity that would constitute an underpayment of the amount owed to the grantor, which would constitute a deemed contribution; and/or (ii) inadvertently engaging in an activity that would constitute an acceleration of the amounts owed to the grantor (a commutation).

In order to have a successful GRAT, it is obviously desirable to have an asset that has significant potential for appreciation. It is desirable from a volatility and potential growth standpoint to contribute, in many instances, a hard to value asset to the GRAT. Many of the asset classes that have that potential for appreciation (e.g., closely held partnership interests, real estate, hedge funds and other private equity investments) are very difficult to value accurately.

The problem with a GRAT that owns hard to value volatile assets is that when it is time to pay the retained annuity amounts to the grantor, it is often difficult to value the asset that is being used to satisfy the annuity obligation. If the distributed asset is finally determined to have had too low a value when it is used to satisfy the annuity amount owed by the GRAT, it could be deemed to be an additional contribution by the annuitant to the GRAT, which is prohibited. *See* Treas. Reg. Sec. 25.2702-3(b)(5). On the other hand, if it is finally determined that the hard to value asset that is distributed in satisfaction of the annuity payment to the grantor had too high a value, it could be determined by the IRS that such a payment is a commutation, which is also prohibited. *See* Treas. Reg. Sec. 25.2702-3(d)(5). Thus, the trustee of the GRAT, which is frequently also the grantor, must be very careful, like Goldilocks, to make sure that the annuity payments are "just right". Using hard to value assets, to make the "just right" payments, may be highly problematic. Language in the trust requiring that any payment be retroactively adjusted if later found to be incorrect may help, but is not certain to negate an *Atkinson* type challenge.

[346] *See* also C.C.A. 200628028 (July 14, 2006).

l. There may be less danger that the retained note will be recharacterized as a deemed retained interest in a trust under equitable tax principles with this technique than with a sale to a grantor trust.

The IRS has purportedly made the argument under certain circumstances (e.g., when there is significant leverage) that, in substance, the sale for a note to the grantor trust is a contribution to the trust with a deemed retained interest.[347] If, under equitable tax principles, the transaction is treated as a deemed contribution to the trust with a deemed retained trust interest, severe gift tax and estate tax consequences could accrue under IRC Secs. 2702, 2036 and 2038. Unfortunately, there are no authorities that can provide the taxpayer with guidance on an amount of leverage that may safely be used with a trust.

The Leveraged FLLC Asset GRAT technique employs leverage, but the leverage is in the organization of the entity. Numerous debt/equity tax cases exist regarding whether the debt is treated as a disguised equity in that context. There is ample authority and guidelines on that subject, particularly in interpreting IRC Sec. 385.[348] Furthermore, as noted above, assuming the FLLC is recognized for transfer tax purposes, if the note is found not to be a note under equitable tax principles, the note will be treated as retained equity in the FLLC. The note should not be treated as a retained interest in a trust with the attendant IRC Secs. 2702 and 2036 considerations.

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[347] The IRS made that argument in *Karmazin* (T.C. Docket No. 2127-03, 2003), but the case was settled on terms favorable to the taxpayer. In *Dallas v. Commissioner* (T.C. Memo 2006-72), the IRS originally made that argument, but dropped the argument before trial. The IRS is currently making both of those arguments in two docketed cases, *Estate of Donald Woelbing v. Commissioner* (Docket No. 30261-13) and *Estate of Marion Woelbing v. Commissioner* (Docket No. 30260-13).

[348] In the corporate context *see* IRC Sec. 385(b); *Miller v. Commissioner*, T.C. Memo 1996-3, 71 T.C.M. (CCH) 1674; s*ee* the discussion of what constitutes a valid indebtedness in *Todd v. Comm'r.*, T.C. Memo 2011-123, aff'd per curiam 486 Fed. App. 423 (5th Cir. 2012); s*ee also* IRC Sec. 385 (titled "Treatment of Certain Interests In Corporations As Stock or Indebtedness"); Notice 94-47, 1994–1 C.B. 357. *See also,* Staff of the Joint Committee on Taxation, "Federal Income Tax Aspects of Corporate Financial Structures," JCS-1-89, at 35-37 91989), noting that various courts have determined that the following features, among others, are characteristic of debt:

> 1) a written unconditional promise to pay on demand or on a specific date a sum certain in money in return for an adequate consideration in money or money's worth, and to pay a fixed rate of interest; 2) a preference over, or lack of subordination to, other interests in the corporation; 3) a relatively low corporate debt to equity ratio; 4) the lack of convertibility into the stock of the corporation; 5) independence between the holdings of the stock of the corporation and the holdings of the interest in question; 6) an intent of the parties to create a creditor-debtor relationship; 7) principal and interest payments that are not subject to the risks of the corporation's business; 8) the existence of security to ensure the payment of interest and principal, including sinking fund arrangements, if appropriate; 9) the existence of rights of enforcement and default remedies; 10) an expectation of repayment; 11) the holder's lack of voting and management rights (except in the case of default or similar circumstance); 12) the availability of other credit sources at similar terms; 13) the ability to freely transfer the debt obligation; 14) interest payments that are not contingent on or subject to management of board of directors' discretion; and 15) the labelling and financial statement classification of the instrument as debt. Some of these criteria are the same as those specified in §385, but this elaboration is a more extensive summary of the factors applicable in making the determination.

m. This technique, in combination with a long term lease that has generous terms to the lessor (and under which the donor is the lessee), may be an ideal technique for those assets in which it is difficult to determine the fair market value terms of a lease.

Consider the following example:

Example 13: Al Art Wishes to Use the Above
<u>Leveraged FLLC Asset GRAT Technique to Plan For His Art</u>

Al Art believes he and his wife, Alma, have a 25-year life expectancy. Al owns various FLLCs that have $70,000,000 in financial investments before valuation discounts, private equity that has $25,000,000 in value before valuation discounts, $5,000,000 in financial assets that are not in any FLLCs, and art that has a fair market value of $10,000,000.

Al believes that over the next 25 years his financial investments will average a 7.4% annual return before taxes (with .60% of the return being taxed at ordinary rates, 2.4% of the return being tax free and 4.4% of the return being taxed at long term capital gains rates with a 30% turnover rate). Al believes that over the next 25 years his private equity will average a 7.4% annual return (with 3.4% of the return being taxed at ordinary rates and 4% of the return being taxed at long term capital gains rates with a 10% turnover rate). Al believes his art will average an annual increase of 8% a year for the next 25 years and the art will never be sold.

Other key assumptions that Al is making are that the annual inflation rate will be 2.5% over the next 25 years and that he and Alma will annually spend $2,000,000 a year, inflation adjusted. Al believes a 30% valuation discount is appropriate for his private equity investments and his various financial asset FLLCs. If Al contributes his assets in a single member FLLC, Al believes an additional 20% valuation discount will be appropriate in valuing a non-member interest in a FLLC.

Al likes the technique of contributing an interest in a leveraged FLLC to a GRAT. Al is considering contributing his art to the FLLC subject to a 25-year lease with generous terms to the lessor. Al consulted with valuation experts to determine the terms of a lease that would be generous to the lessor in order to "slam the door shut" on any potential argument that the lease was not for "full and adequate consideration."[349] After that consultation, Al determined that the terms of the lease should be a triple net lease with Al paying all of the insurance and other expenses of the art and an annual rental fee of $1,000,000 (which is 10% of the current value of the art) with an increase in the rent each year by a factor of three times the annual inflation rate (e.g., if the inflation rate is 2.5%, the increase in the rent for that year will be 7.5%). Assuming an annual inflation rate of 2.5% for the next 25 years, and a present value discount rate of 8%, the lease will have a net present value of $22,731,152 and the residual value of the art at the end of the lease term will have a present value of $10,000,000 (for a total value of $32,731,152).

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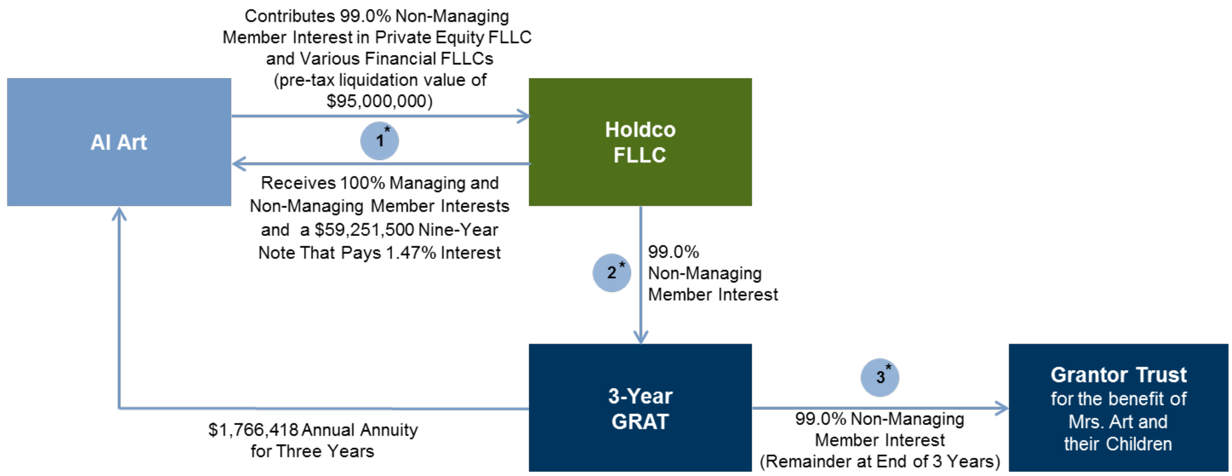
[349] This author would like to thank Garry Marshall and Brad Gates of Stout Risius Ross for their assistance with this example. Mr. Marshall and Mr. Gates used their experience with the Mei Moses® Fine Art Index and other sources to help this author construct an art lease with generous terms to the lessee.

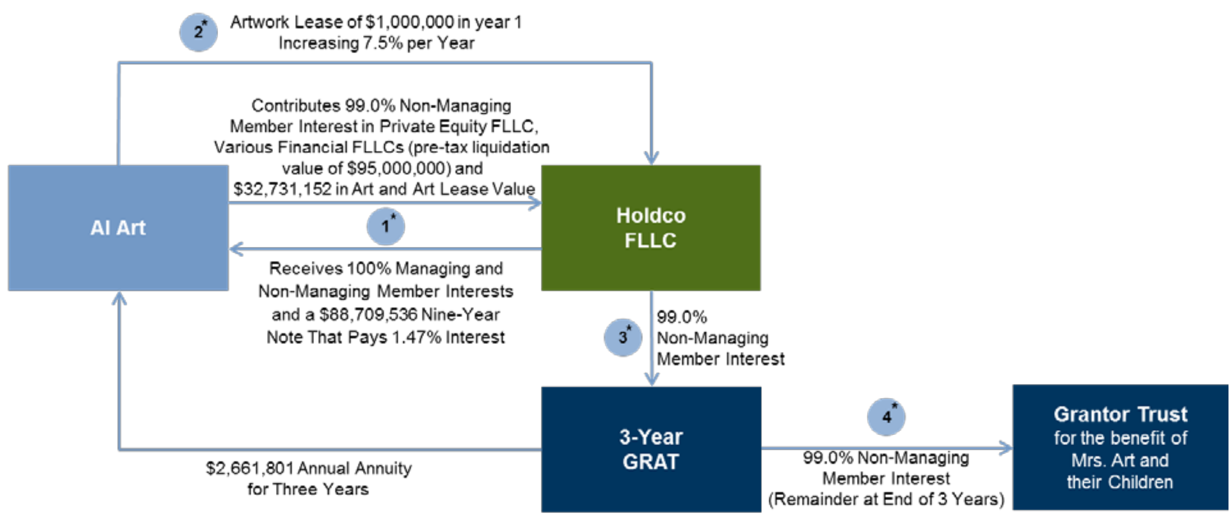
Al would like to compare (i) doing no further planning with (ii) contributing an interest in a Leveraged FLLC Asset GRAT that does not own the art and with (iii) contributing an interest in a Leveraged FLLC Asset GRAT that does own the art subject to the lease with generous terms described above.

The proposed technique ***without*** art being contributed to the FLLC subject to the lease is illustrated below:



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

The proposed technique ***with*** art being contributed to the FLLC subject to the lease is illustrated below:



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

A comparison of the results in 25 years with (i) no further planning, (ii) contributing a Leveraged FLLC Asset GRAT that does not own art and (iii) a Leveraged FLLC Asset GRAT that does own art, are shown in the table below (also see Schedule 4):

Table 4

	Art Children (1)	Art Children and Grandchildren (2)	Consumption (3)	Consumption Investment Opportunity Cost (4)	IRS Income Tax (5)	IRS Income Tax Investment Opportunity Costs (6)	IRS Estate Tax (at 40%) (7)	Total (8)
25-Year Future Values								
No Further Planning	$197,066,795	$19,660,000	$72,918,529	$102,732,004	$66,945,932	$73,592,594	$131,377,863	$664,293,718
Hypothetical Technique #1 (art is not included)	$305,826,923	$19,560,000	$72,918,529	$102,732,004	$68,221,681	$73,592,594	$21,441,986	$664,293,718
Hypothetical Technique #2 (art is included)	$341,191,601	$5,637,298	$72,918,529	$102,732,004	$68,221,692	$73,592,594	$0	$664,293,718
Present Values (Discounted at 2.5%)								
No Further Planning	$106,295,975	$10,604,419	$39,331,568	$55,412,676	$36,110,006	$39,695,153	$70,863,983	$358,313,780
Hypothetical Technique #1 (art is not included)	$164,960,164	$10,550,480	$39,331,568	$55,412,676	$36,798,133	$39,695,153	$11,565,605	$358,313,780
Hypothetical Technique #2 (art is included)	$184,035,539	$3,040,705	$39,331,568	$55,412,676	$36,798,139	$39,695,153	$0	$358,313,780

One advantage of using a generous lease agreement to the lessor is that it should eliminate IRC Sec. 2036 being applied to include the art in the lessee's estate. It also helps ensure that Al has not retained an interest in the trust for purposes of IRC Sec. 2702. A leasehold interest for full consideration is not a "term interest" under IRC Sec. 2702. See Treas. Reg. §25.2702-4. The disadvantage, of course, is that it will increase the value of the gift of the art since it is subject to a valuable lease. The increase is the difference of the net present value of the lease and the residual value of the art (assumed in this example to be $32,731,152) in comparison to the value of the art without a lease (assumed in this example to be $10,000,000) or an increase of $22,731,152. The Leveraged FLLC Asset GRAT technique decreases the amount of gift tax exposure of a generous lease by the retention by the donor of a note equal to 90% of the present value of the art subject to the advantageous lease, and the donor's retention of the increased annuity payments of the GRAT.

The use of a generous lease coupled with the above technique could also be used for residences and summer residences as an alternative to qualified personal residence trusts.

Art that is subject to a lease is a difficult asset to value. If the IRS believes the value should be higher (which would be a great finding from the perspective of avoiding IRC Sec. 2036), the valuation adjustment clause of the GRAT will mitigate the gift tax exposure to the donor.

3. Considerations of the Technique.

a. Part (but not all) of the FLLC interests could be taxable in the grantor's estate if the grantor does not survive the term of the GRAT.

If the grantor does not survive the term of the GRAT, the IRS takes the position that IRC Sec. 2036 will include the assets of a GRAT in the grantor's estate to the extent of the value of the dollar amount of the retained annuity divided by the then IRC Sec. 7520 rate.[350] Under the facts of Example 12, if the IRC Sec. 7520 rate increases to 5% before the GRAT terminates, and if the grantor dies before the end of the term of the GRAT, the lower of the then value of the member interests of the FLLC owned by the GRAT or $10,246,240 ($512,321 ÷ 5%) will be included in the estate of the grantor (Neal Navigator). The then value of the note will also be included under IRC Sec. 2033.

b. It may be more complex than the other GRAT techniques.

While this technique solves considerations in paying GRAT annuities with hard to value assets and has the distinct advantage of substantially outperforming other GRAT techniques, it is more complex to create. However, after the termination of the GRAT, it should not be any more complex to administer than a sale of partnership interests to a grantor trust. Also, with conventional GRAT techniques many times the GRAT technique is repeated over and over again (so-called cascading GRATs) with added legal and valuation costs.

c. Care must be taken to make sure that there is not an "issuance of a note, or other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount."

If there is an indirect issuance of a note in satisfaction of the retained GRAT annuity amounts, the annuity amounts will not be considered qualified annuity interests and the annuity amounts will be worth zero in determining the gift to the remainder trusts. See Treas. Reg. §25.2202-3(b)(1). In the context of the examples of this outline, the gift would be the fair market value of the non-managing member interests that were transferred to the GRATs. That gift would be comparatively low, around 8% of the gross value of the assets of the FLLC (assuming a 20% valuation discount and 90% leverage with respect to the FLLC), but the indirect issuance of a note in satisfaction of the annuity amount should be avoided.

Borrowing from others to make annuity payments is not addressed in the regulations, but is expressly acknowledged as being acceptable in the preamble to the regulations, if the step transaction doctrine does not apply. Borrowing from the grantor for other purposes, such as to enable the trust to make other investments (or the entity the GRAT owns to make other investments), is not addressed and, therefore, should be viewed as permissible, subject to the "directly or indirectly" step transaction caveat (see the discussion in Section V B 3 d below). Usually, it should be easy to trace the borrowing proceeds from a grantor to an investment by the GRAT, or some other use by the GRAT (e.g., paying expenses), other than making an annuity payment.[351]

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[350] *See* Treas. Reg. Sections 20.2036-1(c)(2)(i); 20.2036-1(c)(2)(iii), Ex 2.

[351] See the discussion by Ronald D. Aucutt in "Grantor Retained Annuity Trusts (GRATs) and Installment Sales to Grantor Trusts." The American Law Institute Continuing Legal Education Planning Techniques for Large Estates (April 8-10, 2015).

d. Care must be taken to make sure that the IRS cannot successfully take the position that the creation of Holdco, FLLC should be ignored for gift tax purposes and that the retained notes are in reality retained trust interests in the GRAT that do no constitute a qualified annuity interest under IRC Sec. 2702.

Holdco, FLLC could be disregarded under two different theories: (i) a single member FLLC should be per se disregarded for both income tax purposes and transfer tax purposes and/or (ii) even if single member FLLC's should not be disregarded for transfer tax purposes on a per se basis, the step transaction doctrine applies to the facts of the transaction and the FLLC is disregarded for transfer tax purposes.

The argument that the FLLC should not be ignored for gift tax purposes on a per se basis, or under the step transaction doctrine, is greatly strengthened if the FLLC is also partially owned by another disregarded entity (e.g., an old grantor trust) before the donor contributes his part of the non-managing member interests in the FLLC to the GRAT(s).

Even though the single member FLLC is per se disregarded for income tax purposes (see Treas. Reg. §301.7701-3(b)(1)(ii)), it is not disregarded for gift tax purposes. In *Pierre v. Commissioner*, 133 T.C. 24 (2009), the full Tax Court held that because transfer taxes follows state law property rights, interests in a single member FLLC were valued for gift tax purposes as FLLC interests and not, as the IRS argued, with reference to underlying asset values.[352] The IRS has not acquiesced in the decision.

As noted in the examples, care should be taken to make sure that the leveraged creation of FLLC is recognized as an independent transaction under the step transaction doctrine. In applying the step transaction doctrine, the IRS or court may not treat the various steps of the transfer as independent. Instead, the steps may be collapsed into a single transaction.[353] Under the circumstances of the gift of a non-managing member interest in a leveraged FLLC to a GRAT, the crucial key to not run afoul of the step transaction doctrine may be establishing that the creation of the FLLC should stand on its own. Could the act of a transferor creating the leveraged FLLC be independently separated from the gift to the GRAT? The creation of the FLLC should be designed to be sufficiently independent on its own and as an act that does not require a gift to the GRAT. There does not have to be a non-tax purpose for the creation of and gift to the GRAT. It is difficult for this writer to understand the non-tax purpose of any gift. See the discussion in Section IV C 4 b (3) of this paper.

If the potential IRS position that the FLLC does not exist for gift tax purposes were to prevail, FLLC would not afford any additional discount, but the discount of the assets owned by FLP would still apply.

If the creation of the FLLC is ignored for gift tax purposes, then the sale and contribution of the underlying assets of the FLLC is to the GRAT instead of to the FLLC. The value of the

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[352] A subsequent memorandum decision, T.C. Memo 2010-106, applied the step transaction doctrine to collapse certain sale and gift transfers of 9.5% and 40.5% into single 50% transfers.

[353] *See* Donald P. DiCarlo, Jr., "What Estate Planners Need to Know About the Step Transaction Doctrine," 45 Real Prop. Tr. & Est. L.J. 355 (Summer 2010).

GRAT will increase. Assuming the valuation discount for the transferred non-managing member interests is 20%, then ignoring the valuation discounts will increase the value of the GRAT by 20% and the GRAT annuity amounts will increase by 20%.

If the creation of the FLLC is ignored for gift tax purposes, does it matter what the terms of a trust are in determining if the cushion is adequate on a sale to a trust in order to have a note recognized as a note instead of as a retained interest in the trust? It may matter. On its face, there may be plenty of cushion on the sale and the note would be recognized as a note. However, the terms of this trust, after payment of trust obligations, are that all of the net assets are to be distributed to the grantor of the trust (who is also the owner of the note) unless there is growth of the assets. Does the fact that the GRAT is in effect a short term trust in which most of its assets are to be distributed to the grantor, after payment of the outstanding note to the grantor, equitably convert the note to a retained interest in the trust? If the note is treated as a retained interest in trust the terms of the note may not comply with the definition of a qualified payment under IRC Sec. 2702, and the gift will be all of the assets of the GRAT minus the annuity payments that do qualify.

e. Care Must be taken if the underlying asset that is sold or contributed to the single member FLLC is stock in a subchapter S corporation.

Assuming the FLLC is a single member FLLC and/or is owned by other disregarded entities for income tax purposes, the FLLC may own subchapter S stock.[354] If the FLLC is not a single member FLLC, it will not be a permissible shareholder of a subchapter S corporation and the subchapter S election will be terminated. If the FLLC terminates and dissolves on the single member's death, the subchapter S election may be preserved.

C. Swapping Assets Inside a Grantor Trust, or a Disregarded Single Member FLLC, Before the Death of the Grantor.

If there are low basis assets inside a grantor trust, or a disregarded single member FLLC, the grantor could substitute high basis assets for the low basis assets held by the grantor trust or the disregarded single member FLLC.

1. Advantages of the Technique.

a. The low basis assets, if retained by the grantor, will receive a basis step-up on the grantor's death.

b. If the low basis assets are sold by the grantor before his or her death the cost of the capital gains taxes will be borne by the grantor (just as they would have been if the assets had been sold by the grantor trust or a disregarded single member FLLC.)

[354] *See* PLRs 9739014, 9745017, 200107025 and 20008015. These rulings do not consider whether an FLLC having a grantor and grantor trust as members will be considered to have only one owner and therefore remain a disregarded entity, but they support that result.

2. Considerations of the Technique.

a. The grantor may not have any high basis assets, or cash, to swap.

If that is the case, consider a recourse third party loan of cash to the grantor. The grantor could then use that cash to swap for the low basis asset. The grantor trust may then be converted to a complex non-grantor trust. At a later time, in an independent transaction, the grantor could borrow the high basis cash from the trust with a long-term, recourse note that is unsecured and use that cash to pay the principal of the third party loan. This lending strategy is described in Section V E of this paper.

b. To the extent, after the swap of assets, "swapped" low basis assets grow more than the "swapped" high basis assets in the grantor trust, the grantor's estate taxes will increase.

That consideration could be mitigated by a reverse note purchase technique described above. For instance, assume that a grantor wishes to borrow cash from the trust. That loan could be accomplished by a recourse, unsecured note that pays a fair market value interest rate. That interest rate carry may be higher than the rate of return of the high basis asset, which would mitigate or eliminate any estate tax cost associated with the low basis asset's growth in the grantor's estate. See the discussion in Section V of this paper.

D. Gifting and Selling Low Basis Assets to a Grantor Trust That is Subject to an Older Generation's General Power of Appointment and Estate Taxes.

1. The Technique.[355]

A taxpayer could gift cash and then later sell some of his low basis assets (for adequate and full consideration) to a grantor trust in independent transactions. The beneficiaries of the trust could be the taxpayer's descendants and an older generation beneficiary, such as a parent. The older generation beneficiary could be given a general power of appointment that will be structured to include those trust assets in his or her estate. If the grantor first gifts high basis cash to the trust, IRC Sec. 1014(e) should not apply to that gift of cash because it is not a low basis asset. The sale of low basis assets could be for a recourse, unsecured note in which both the trustee and the older generation beneficiary are personally liable. A sale price that is equal to the fair market value of the low basis assets, perhaps pursuant to a defined value allocation assignment, should also circumvent IRC Sec. 1014(e). For a discussion of defined value assignments see Section IV D of this paper. If the sale price is equal to the value of the low basis asset there is not a gift and IRC Sec. 1014(e) does not apply, even if the older generation beneficiary dies within one year and even if the assets are deemed to have reverted back to the donor.

If the older generation beneficiary's estate is small, that general power of appointment may not result in any estate taxes being assessed against his estate. The general power of

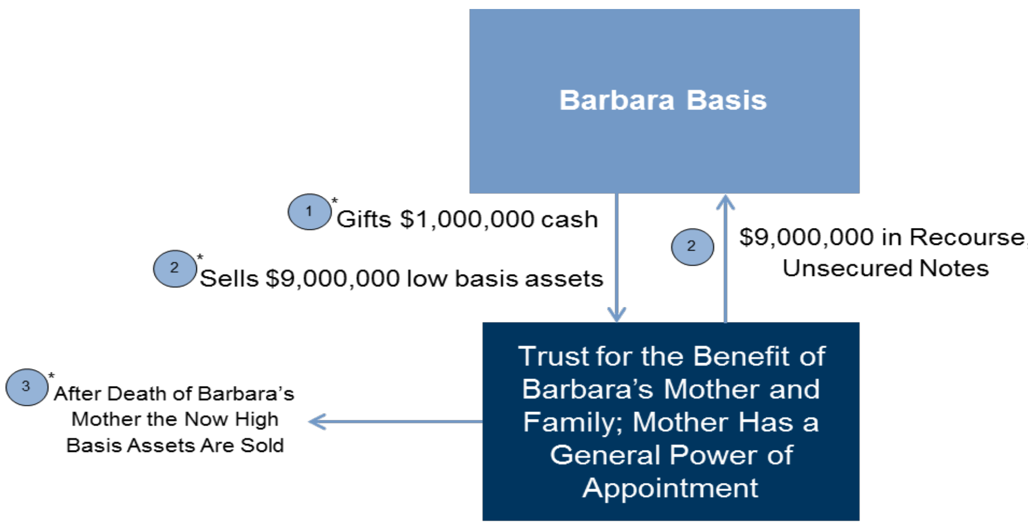
[355] *See* Mickey R. Davis and Melissa J. Willms' discussion of the accidently perfect grantor trust, *Trust and Estate Planning in a High Exemption World and the 3.8% "Medicare" Tax: What Estate and Trust Professionals Need to Know*, 61st Annual Tax Conference – Estate Planning Workshop, 31-33 (December 6, 2013).

appointment could be designed so that it may not be exercised unless approved by a non-adverse party such as an independent trustee. Consider the following example:

Example 14: Barbara Basis Creates a Grantor Trust for the Benefit of Her Mother, Gmom Basis, and Her Family and Makes Certain Sales to That Trust

In separate and distinct transactions ("(1)") Barbara contributes $1,000,000 in cash to a trust that is a grantor trust for income tax purposes. Barbara's mother, Gmom Basis, is the initial beneficiary and is given a general power of appointment over the trust. Barbara, at a later time ("(2)") sells $9,000,000 in low basis property to that trust, pursuant to a defined value allocation formula for a recourse note in which both the trust and Gmom Basis are personally liable. The recourse note is unsecured. After Gmom's death ("(3)"), the trustee of the trust sells the now high basis assets and reinvests the proceeds in new assets.

The technique is illustrated below:



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

2. Advantages of the Technique.

a. This technique has the same advantages as a sale to a grantor trust.

See Section IV C 4 of this paper.

b. The assets of the trust will receive a step-up in basis on the older generation beneficiary's death equal to the fair market value of the assets, if net value rule of Treas. Reg. §2053-7 does not apply (see the discussion below in Section V D 3 e of this paper).

The trust assets could be sold after the older generation beneficiary's death and reinvested without capital gains tax consequences.

c. The assets of the trust may be generation skipping tax protected.

d. 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.

3. Considerations of the Technique.

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

Even though the assets of the trust will receive a step-up in basis on the older generation beneficiary's death, the grantor's note does not. Under the logic of Revenue Ruling 85-13, the note does not exist as long as the grantor status of the trust is maintained. The note may be satisfied before the grantor's death without tax consequences. There is an absence of authority, and a split among certain commentators, as to whether satisfaction of the note after the grantor's death will cause capital gains consequences.

b. The older generation beneficiary could exercise his or her general power of appointment in an unanticipated way.

That possibility could perhaps be mitigated by requiring that an independent, non-adverse trustee approve any exercise of a general power of appointment before it is effective. This veto power seems consistent with IRC Sec. 2041(b)(1)(c)(ii), which says the power is a general power unless the veto right is held by someone "having a substantial interest in the property, subject to the power, which is adverse to exercise of the power in favor of the decedent."

c. 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.

d. 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.

If the donor is a beneficiary of a new trust created after the death of the donee by the donee's exercise of a power of appointment, there may not be a step-up of the trust assets with respect to the donor's actuarial interest in the trust. If the donor's interest is purely discretionary in a new trust created by the older generation's exercise, IRC Sec. 1014(e) may not apply even if the older generation beneficiary dies within one year of the donor's creation of the grantor trust. Another key exception to the application of IRC Sec. 1014(e) is whether the decedent acquired any part of the included low basis assets by "gift". If the decedent acquired the asset by sale, or by part sale-part gift, it would appear that the percentage of the asset acquired by sale should not be subject to IRC Sec. 1014(e). If the donor does not have a high basis asset, or cash, to initially capitalize the trust, the donor may wish to borrow cash to initially capitalize the trust. See the discussion in Section V E of this paper.

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

Treas. Reg. §20.2053-7 provides:

> A deduction is allowed from a decedent's gross estate of the full unpaid amount of a mortgage upon, or of any other indebtedness in respect of, any property of the gross estate, including interest which had accrued thereon to the date of death, provided the value of the property, undiminished by the amount of the mortgage or indebtedness, is included in the value of the gross estate. **If the decedent's estate is liable** for the amount of the mortgage or indebtedness, **the full value of the property** subject to the mortgage or indebtedness **must be included** as part of the value of the gross estate; the amount of the mortgage or indebtedness being in such case allowed as a deduction. **But if the decedent's estate is not so**

> **liable, only the value of the equity of redemption** (or the value of the property, less the mortgage or indebtedness) **need** be returned as part of the value of the gross estate. In no case may the deduction on account of the mortgage or indebtedness exceed the liability therefor contracted bona fide and for an adequate and full consideration in money or money's worth. (Emphasis added.)

In this example, the debt is unsecured and the debtor has personal liability to the lender. As a consequence, the full value of the gross assets could be included in the value of the decedent’s estate and the liability will be separately deducted.

What if the debt is secured and the liability is non-recourse? What is the meaning of the word “need” as it is used in the regulation? Does the word “need” also mean “does not need to be”? Some have suggested it should be. If those who have so suggested are right, a huge loophole could be created with non-recourse liability. For instance, a taxpayer could take the proceeds of a non-recourse borrowing, against a low basis asset, and purchase low basis assets from another grantor trust and achieve an additional step-up on the taxpayer’s death on low basis assets purchased with the proceeds of the non-recourse borrowing. Of course, a similar argument could be made with respect to recourse debt, except it is logical that if the whole estate is liable, the whole estate is available to the lender and the debtor should receive a step-up.

At some point in the future, by regulation, the IRS may make it clear, if an asset is included in a decedent’s estate, and is subject to non-recourse debt, only the net value of the asset is to be reported in the decedent’s estate (gross asset value minus the debt) and there will only be a partial step-up.

In the technique, Gmom’s personal liability on the note is intended to strengthen the case for full inclusion and step-up at her death.

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

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

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

g. IRC Sec. 1014(b)(9) needs to be considered for property that has depreciated.

IRC Sec. 1014(b)(9) (but none of the other IRC 1014 sections) limits the basis adjustment for depreciation taken by a taxpayer other than the decedent. If the trust remains a grantor trust as to the younger generation grantor who originally took the depreciation deduction, after the death of the older generation holder of the general power of appointment, then the amount of the basis adjustment might be reduced by the amount of the depreciation deductions allowed to the younger generation grantor prior to the older generation member's death. See Treas. Reg. §1.1014-6.

Under certain circumstances, if this technique is to be used with depreciable property, it may make sense to use valuation discount techniques to sell a depreciable asset to a non-grantor trust (in order to lower the tax consequences of the sale to the non-grantor trust). For instance, a depreciable asset held in a partnership that can be discounted for valuation purposes, could be sold to a non-grantor trust under which the older generation has a power of appointment. At a later time, before the death of the older generation general power holder, in a transaction that is independent, the depreciated asset could be distributed from the partnership, or the partnership could terminate. IRC Sec. 1014(b)(4) should apply to the depreciated real estate under those circumstances and the depreciated asset should receive a step-up in basis

E. 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.

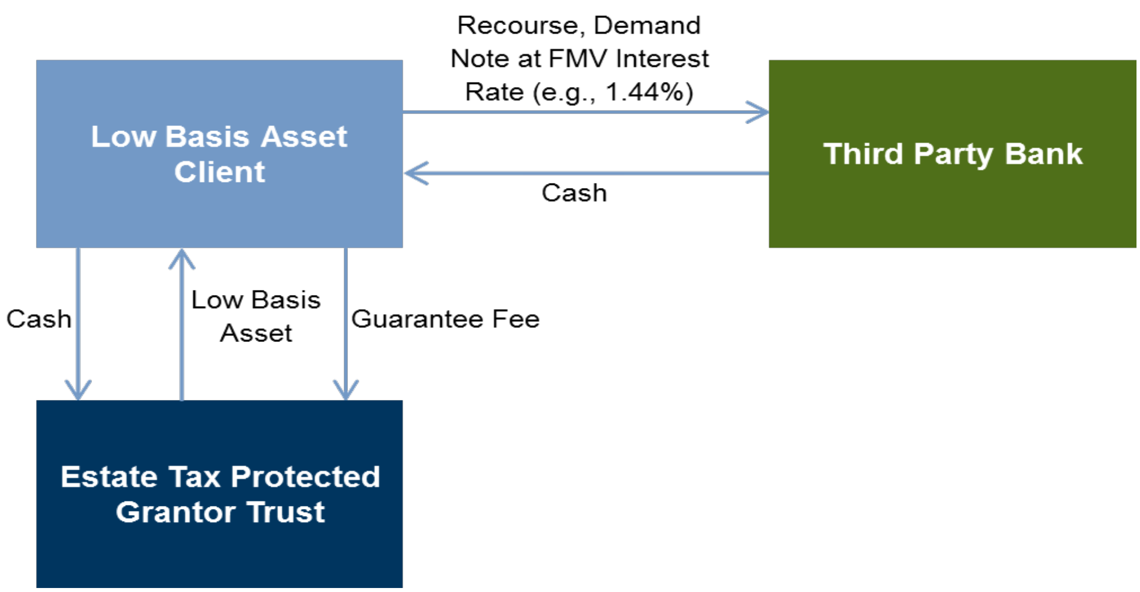
1. The Technique.

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:



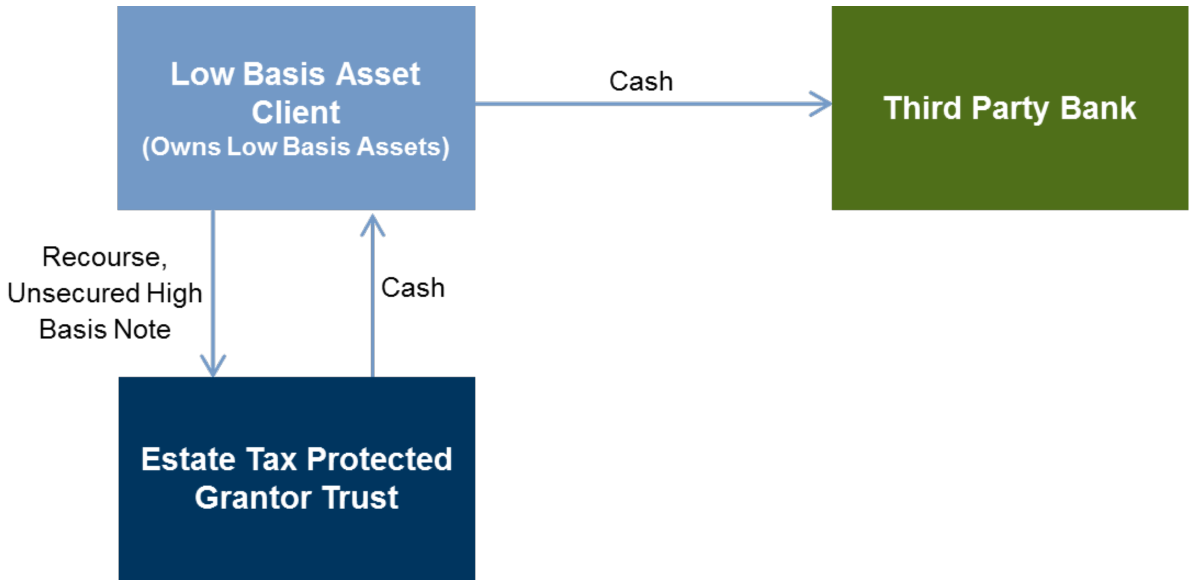
Hypothetical Transaction #2:

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.

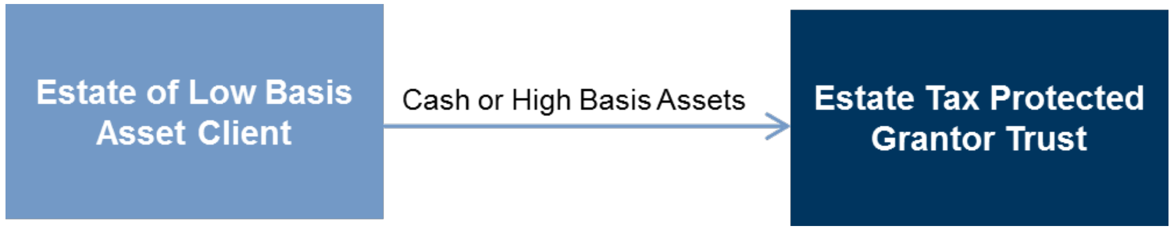
Hypothetical Transaction #2 is illustrated below:



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:



2. The Technique Needs to Be Arranged and Implemented in a Manner That Avoids the Application of the Step Transaction Doctrine. See Section V B 3 d of This Paper.

It is very common for a borrower to refinance his debt. If a borrower refinances debt by borrowing from a family entity the non-tax economic advantage of doing so may exist if there exists more generous terms as to the timing of when the principal note must be paid, the security required for the note (or the lack thereof) is improved from the borrower's perspective, and/or locking in interest rates that could change unfavorably in the future.

3. The Use of a Third Party Loan and Refinancing the Third Party Loan By Borrowing From a Family Entity Adds to the Complexity of the Technique.

However, the use of a third party loan that is refinanced by a family entity may lessen the future administrative burden for the family.

4. Is the Basis of the Note Received For Cash Loaned By the Estate Tax Protected Grantor Trust Equal to the Cash's Fair Market Value?

It is difficult to imagine that when the Estate Tax Protected Grantor Trust loans cash its basis in the resulting note is anything less than the value of the cash. Stated differently, may cash ever have a basis lower that the amount of that cash? Perhaps in the different world of grantor trusts it may.

If that is a concern, consider converting the grantor trust to a complex trust before the loan of the cash is made. If the conversion is made before the trust makes a loan to the grantor there would not appear to be any tax consequences to that conversion (because there are not any outstanding loans owed to or by the grantor). The loan of cash from the now, complex trust, should be treated like any loan of cash from a complex trust.

5. The Effect of Treas. Reg. §20.2053-7 Needs to Be Considered.

See the discussion in Section V D 3 e of this paper.

6. 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.

F. Lifetime Charitable Giving Strategies That Also Benefit Client's Descendants By Reducing the Family's Total Income Tax and Transfer Tax.

1. Use of a Discounted Sale of the Non-charitable Interest in a Charitable Remainder Unitrust ("CRUT") to a Grantor Trust.

a. Introduction and the technique.

The "conventional wisdom" this author sometimes hears on this subject is as follows: "you can no longer use the CRUT technique and benefit your family;" or "the problem with charitable planning is that it will greatly decrease what a client's family will receive." This "conventional wisdom," under the circumstances discussed below, is incorrect.

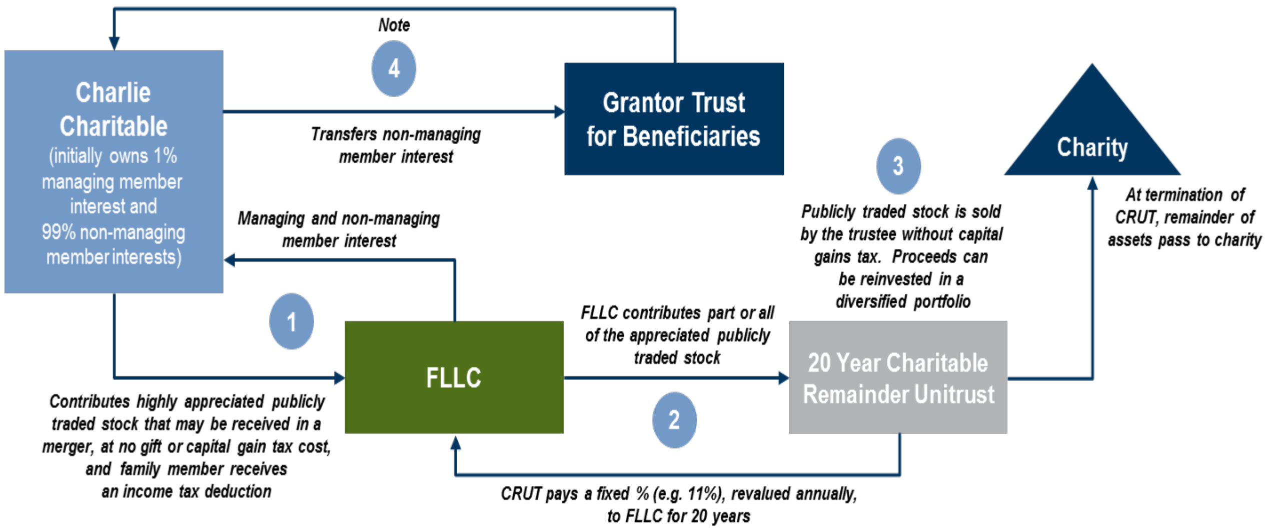
Charitable remainder trusts, particularly charitable remainder unitrusts ("CRUTs") are a very popular planning technique for the charitably inclined client. While the technique has significant benefits to the client and his favorite charitable causes, one downside is the perception that it is difficult to benefit a client's family with the technique. Perhaps that is not true, if the technique is used synergistically with certain other estate planning techniques, that is, sale of FLLC or member interests to a grantor trust. That synergistic planning could simulate the following: a capital gains tax and estate tax holiday with the only cost (or additional benefit) being the taxpayer's favorite charity receiving 21% of his wealth on his death. Consider the following example:

Example 15: Charlie Charitable Wishes to Benefit His Family,
His Charitable Causes and Himself With a Monetization Strategy

Charlie Charitable, age 63, is widowed and has three adult children. Charlie owns $10 million of a publicly traded stock with a zero basis. Charlie also owns $2,500,000 in financial assets that have a 100% basis. He plans to spend $150,000 per year, indexed for inflation. If Charlie's spending needs are secure, he would like to give a large proportion of his after-tax wealth to his family, but he would still like to give between 20% and 25% of what he owns to his favorite charity. Charlie wants to diversify his stock position, but does not want to incur a big capital gains tax. Charlie has considered a CRUT, but he is concerned that charity could receive a windfall at the expense of his family if he dies prematurely. He is not certain he will qualify for favorable life insurance rates to insure against that risk and he generally dislikes insurance as a pure investment vehicle. Charlie would like his family to be eligible to receive some funds now, but he does not want to bear the gift tax consequences of naming family members as current CRUT beneficiaries. Charlie is also willing to take steps to reduce potential estate tax, and he needs help sorting through his options. He would like to involve his children in his estate planning discussions so they can learn about their obligations as fiduciaries and beneficiaries and can start to plan their own family and financial affairs.

Charlie's lawyer, Pam Planner, has a plan to help Charlie achieve his objectives, which significantly reduces the capital gains tax on the sale of his appreciated stock and minimizes the estate tax cost of transferring the stock proceeds to his family. Pam suggests that Charlie fund a FLLC with his stock, and that the partnership create a twenty-year term charitable remainder unitrust ("CRUT"). The partnership will keep an up-front stream of payments for twenty years that represents a 90% actuarial interest in the CRUT. Charlie's favorite charity will receive the remaining CRUT assets at the end of the twenty-year term. The trustee of the CRUT could sell the stock and construct a diversified investment portfolio without triggering immediate capital gains tax consequences. If Charlie owns most of the FLLC when the CRUT is created, most of the income tax charitable deduction for charity's 10% actuarial interest will flow through to him. Charlie could then sell his non-managing member interests to an intentionally defective grantor trust in exchange for a note. Charlie can allocate GST exemption to the grantor trust so his family's wealth is potentially protected from gift, estate and GST taxes forever.

This technique is illustrated below:



A CRUT is an irrevocable trust, often called a "split interest" trust. When a donor creates a CRUT, he can keep or give away a continuing payment stream from the CRUT for a period of time. This payment stream is made to the "noncharitable" beneficiaries.[356] The time period can last for up to twenty years or for the lifetimes of one or more currently living noncharitable beneficiaries.[357] In private letter rulings, the IRS has permitted partnerships and corporations to create CRUTs where the unitrust term is measured in years instead of the lives of individuals.[358] In Charlie's case, the FLLC will be both the donor and the noncharitable beneficiary. The CRUT must pay a fixed percentage of the annual value of its assets to the FLLC each year, so the unitrust payments will fluctuate along with the value of the CRUT's investments.

At the end of the unitrust period, the trustees of the CRUT will distribute the remaining assets to one or more qualified charitable beneficiaries or will hold the assets solely for charitable purposes.[359] These charitable beneficiaries can include private foundations and donor advised funds.[360]

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[356] IRC Sec. 644(d)(2)(A); Treas. Reg. Section 1.664-3(a)(1).

[357] Treas. Reg. Section 1.664-2(a)(1).

[358] *See* P.L.R. 9205031 (Jan. 31, 1992) (C corporation); P.L.R. 9340043 (S corporation); P.L.R. 9419021 (Feb. 10, 1994) (partnership). Under Treas. Reg. Section 1.671-2(e)(4), if a partnership or corporation (an "entity") makes a gratuitous transfer to a trust for a business purpose, the entity is generally treated as the grantor of the trust. However, if an entity makes a gratuitous transfer to a trust for the personal purposes of one or more partners or shareholders, the gratuitous transfer is treated as a constructive distribution to the partners or shareholders and they in turn are treated as the grantors of the trust. The IRS has taken the position that a CRT with multiple grantors is an association taxable as a corporation. See P.L.R. 9547004 (Nov. 24, 1995); P.L.R. 200203034 (Jan. 18, 2002). If the IRS takes the position that Charlie's partnership created the CRUT all or in part for the personal purposes of its partners, then the CRUT may not be valid. If a practitioner is concerned about this result, Charlie could accomplish the transaction by funding a single member FLLC, having the FLLC create the CRUT, and then selling a portion of the FLLC to a grantor trust so that there is only one grantor and income tax owner for the entire series of transactions.

[359] IRC Sec. 664(d)(2)(C).

[360] Qualified organizations are described in IRC Secs. 170(c), 2055(a), and 2522(a).

The FLLC, as the donor, will pass through a current income tax deduction for the value of charity's interest to the members in the year it funds the CRUT. The value of the deduction depends on the value of the assets contributed to the CRUT, how long charity must wait to receive its interest, the size and timing of the partnership's reserved unitrust payment, and an assumed investment rate of return (called the IRC Sec. 7520 rate) that the IRS publishes monthly.[361] Because Charlie will own almost all of the FLLC when the CRUT is created, he will receive most of the deduction. Generally, Charlie can deduct up to 30% of his adjusted gross income for the transfer of appreciated marketable securities to the CRUT (20% if the remainderman is a private foundation), and he can carry forward any excess deduction for five years.[362]

Pam lists some of the key CRUT rules for Charlie:

(i) FLLC, as the noncharitable beneficiary, must receive an annual unitrust payment.[363] This unitrust payment is a fixed percentage of the fair market value of the trust's assets, revalued annually. There are exceptions to this rule that allow some CRUTs to distribute net income instead, but these extra rules are not relevant for Charlie.

(ii) Unitrust payment must be at least 5%,[364] but not more than 50%,[365] of the fair market value of the trust's assets, determined annually.

(iii) The CRUT's inception, the actuarial value of charity's interest in the CRUT must be worth at least 10%.[366] The CRUT can receive additional contributions as long as each additional contribution satisfies the 10% rule.[367]

(iv) The CRUT does not pay income taxes.[368] The CRUT distributions carry out income tax consequences to the noncharitable beneficiary in a specific order: First, as ordinary income to the extent of the trust's current and past undistributed ordinary income (dividends that are taxed at 15% are included in this tier); second, as capital gains to the extent of the trust's current and past capital gains; third, as tax-exempt income to the extent of the trust's current and past tax exempt income; and finally, as a nontaxable return of capital.[369]

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[361] The IRC Sec. 7520 is 120% of the federal midterm rate. The partnership can choose the rate in effect for the month of the gift or for either of the two immediately preceding months.

[362] IRC Sec. 170(b)(1)(B), (b)(1)(D). If a private foundation were the named remainderman and the stock of XYZ Company were not publicly traded, the deduction would be limited to basis (here, zero), and could not exceed 10% of XYZ Company's stock. IRC Sec. 170(e)(1)(b)(ii), (e)(5)(C).

[363] IRC Secs. 664(d)(1)(B), (2)(B); Treas. Reg. Section 1.664-3(a)(1)(i).

[364] Treas. Reg. Section 1.644-2(a).

[365] IRC Sec. 664(d)(1)(A), as amended by The Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 787 (1997).

[366] IRC Sec. 664(d)(1)(D).

[367] Treas. Reg. Section 1.664-3(b).

[368] IRC Sec. 664(c)(1). Charlie's advisors will also want to ascertain the tax treatment of the CRUT under applicable state law. Most states recognize CRUTs as tax exempt, but some, *e.g.*, New Jersey, do not. It will usually

(v) Charlie must factor in additional legal, accounting and administrative costs. Since every unitrust payment depends on an annual valuation of the CRUT's assets, hard to value assets might generate appraisal costs, too.[370]

(vi) The trustees of the CRUT do not have unlimited investment flexibility. There is a 100% excise tax on unrelated business taxable income (UBTI) generated in a CRUT. Broadly defined, UBTI is income derived from any trade or business. UBTI includes debt-financed income, so certain investment strategies that use borrowing might be off limits. Also, the self-dealing rules that apply to charitable trusts prohibit Charlie from transacting with the CRUT, even if the transaction is completely fair.[371]

Charlie is interested in Pam's idea but it seems complicated, so he wonders if the plan is really that much better than just selling his stock. He also wonders how much taxation truly affects the real wealth he can transfer to his family over time. Charlie has already created a successful intentionally defective GST exempt trust so he has been through the planning process before. Still, he is eager to get a lucid explanation of some planning techniques to start educating his children and he wants to understand how the techniques can be combined to achieve his objectives.

b. Advantages of the technique.

(1) The tax advantages of creating a grantor trust and a sale to a grantor trust.

See the discussion in Section IV C 4 of this paper.

(2) 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.

Depending upon the investment performance of the assets held in the CRUT a portion of the built-in capital gains will be allocated to the charity under the tiered income allocation rules. Treas. Reg. § 1.664-1(d)(1). Assuming a 6% to 8% annual return of the CRUT assets during the 20 year term of the CRUT 40% to 60% of the original built-in gain will be allocated to the charity on termination of the CRUT and that portion of the gain will not be taxed when the asset is sold in year one.

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be possible to establish the partnership and CRUT in a state recognizing the exemption regardless of where Charlie lives.

[369] IRC Sec. 664(b); Treas. Reg. Section 1.664-1(d)(1).

[370] Treas. Reg. Section 1.664-1(a)(7).

[371] IRC Sec. 4941.

(3) The tax advantage of lowering opportunity costs by delaying taxes on the portion of the original gain that is not allocated to charity.

If tax rates stay the same, it is better for Charlie to defer paying taxes so he can use those tax dollars to generate investment returns. Paying taxes earlier than necessary is an opportunity cost.

(4) The tax advantage of a charitable deduction in year one for the actuarial value of the remainder interest of the CRUT passing to charity.

Under the facts of this example, Charlie will receive an income tax deduction equal to 10% of the value of the CRUT assets. The benefits of that tax deduction occur in year one.

(5) FLLCs offer many non-tax advantages. Among them, FLLCs:

(a) Allow a family to consolidate its assets for investment efficiency, investment diversity and economies of scale.

(b) Protect limited partners from creditors, divorcing spouses and financial inexperience.

(c) Give Charlie the opportunity to exercise some continuing investment control over the FLLC's assets.

(d) Create a forum for younger family members to participate in investment and other business decisions.

(e) Protect management by use of the business judgment rule and provide non-litigation mechanisms like arbitration to resolve disputes.

(6) The tax advantage of integration, which produces advantageous comparative results.

Charlie can use a combination of gift and estate planning techniques to achieve his objectives. But the plan also requires investment strategies that support the income tax, cash flow and appreciation targets necessary to promote its success. In addition, Charlie must involve the other managing members of the proposed FLLC, the trustees of the grantor trust and the CRUT, and one or more investment advisors, to properly implement the plan.

Charlie, his children and the trustees then show the plan to their investment advisor. The advisor constructs a sample diversified portfolio inside the CRUT that targets an annual 7.4% pre-tax return, with 3% of the return being taxed at ordinary income or short term gains and the balance 4.4% of the return being taxed at long term capital gains rates. Generally, the advisor projects an annual 30% turnover – that is, on average the trust will need to sell and reinvest 30% of the portfolio every year. It is assumed that the total taxes on realized long-term capital gains (including income taxes, surtax on investment income and the so-called "stealth" tax), will be

25%. It is also assumed that total taxes on ordinary income will be 44.6% (including income taxes, surtax on investment income and the so-called "stealth" tax).

Charlie, the children, the trustees and their investment advisor consider how to produce the annual CRUT payments; how much could be in cash and in kind; what happens when the CRUT distributes its unitrust payments to the FLLC and the FLLC distributes some or all of the unitrust payments to the grantor trust; the grantor trust's repayments of Charlie's note; and how to reinvest those distributions to meet the differing objectives for Charlie, charity, the FLLC and the grantor trust. They think through contingency plans to cope with inevitable investment volatility, or the ups and downs that happen in every diversified investment plan. They analyze the different types of note: a "slow" note that preserves leverage for a longer time, and a "fast" note that eliminates the uncertain tax issues at Charlie's death. Charlie decides he would like the trust to repay his note as soon as possible, so the repayment is built into the plan.

To show Charlie the difference that taxes play in accumulating family wealth over time, Pam projects what would happen if there were no initial capital gains taxes when Charlie sells his stock and no estate taxes She also projects what would happen if Charlie sold non-managing member interests to a grantor trust without including the CRUT component. If the investment plan produced smooth returns until Charlie's death (which the group agrees to project twenty-five into the future), the results would look like this (see Schedule 5):

Table 5

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

Using the above assumptions, Charlie will not pay tax on approximately half of the capital gains generated when the CRUT sells the stock. Under the CRUT tiered income distribution rules, approximately half the gain will still be inside the CRUT at the end of twenty years when charity receives the remainder. Although Charlie does pay some capital gains tax on the other half of the gain, he still takes advantage of two of Pam's key concepts: He defers the capital gains tax payment until the CRUT makes distributions, and his estate does not pay estate tax on those capital gains tax payments. In effect, the grantor trust repays Charlie's installment note using pre-tax dollars.

Charlie is currently subject to a combined federal and state transfer tax rate of 44.6%. On the one-half of the capital gains taxed to Charlie (because the rest of the capital gain is still embedded in the CRUT when it passes to charity), Charlie avoids transfer tax on the dollars he spends to pay capital gains tax. Charlie has already paid those dollars to the IRS and so they have been eliminated from his transfer tax base. That means Charlie's total effective capital gains rate on his $10 million stock sale turns out to be less than 7.5% instead of 25% (prior to considering the 4.46% charitable income tax subsidy and the "time" described below). In other words, it costs Charlie a net of 3% of the proceeds in taxes to sell the stock using the proposed technique instead of 25%, even before the time advantage of delaying the payment of the capital gains tax is considered.

Although the simple stock sale generates the lowest amount of income tax – $11,792,247 – the combined total income tax cost of combining income tax with the lost opportunity cost of paying the capital gains tax in year one is $35,555,975, which is dramatically more than in the next two sets of projections (the simulated tax holiday and Pam's CRUT plan) because the early stock sale tax payment contributes to $23,763,728 in investment opportunity costs. Since Charlie pays capital gains tax immediately on the stock sale, his family loses the benefit of reinvesting those tax dollars. On top of that, the simple stock sale without estate planning piles on another $6,682,574 of estate tax. In contrast, there is no estate tax liability at all in the next three projections.

Because Charlie will own more than 99% of the FLLC when the FLLC funds the CRUT, the FLLC will pass through more than 99% of the charitable income tax deduction to Charlie. The deduction equals 10% of the fair market value of the assets contributed to the CRUT, or $1,000,000. In Charlie's case, it is assumed the deduction offsets $1,000,000 of his ordinary income, so it yields a $446,000 income tax benefit. In effect, the income tax deduction pays Charlie a 4.46% subsidy for his $10,000,000 transaction.

The two middle rows of numbers compare Pam's plan to a simulated tax holiday. Both sets of projections shows a total tax burden (which includes the investment opportunity costs of paying the tax) that is less than 65% of the aggregate tax bill generated by the simple stock sale with no planning. Charlie detects only one difference between Pam's plan and the simulated tax holiday. In Pam's plan, the total projected tax cost is an additional $2,110,629 (or 7.8% of the roughly $27,121,384 tax burden in the simulated tax holiday). That $2,110,629 reduces what Charlie's family would keep in a world with no initial capital gains tax on big stock sales and no estate taxes.

Pam asks Charlie to consider the projected outcome if he sells non-managing member interests to a grantor trust, but the FLLC does *not* transfer its appreciated securities to a CRUT first. Those projections are in the final row. Charlie sees that his descendants would end up with $25,621,226, if the FLLC did not create the CRUT, or $1,148,529 more than they would have received, if the FLLC did create the CRUT. Pam explains that when the FLLC creates the CRUT, the trustees do not pay immediate capital gains tax when they sell the stock, and Charlie receives a charitable income tax deduction up front. Without the CRUT, the larger note from the sale to the grantor trust, the early payment of taxes and lack of income tax subsidy compounds over time, so that at the end of the day, Charlie's family pays additional taxes and opportunity costs that cost almost as much as the future $8,207,700 gift to charity. Thus, there is comparatively little net cost to Charlie's family to transfer around $8,207,700 to charity. In fact, in states where a state capital gains tax exists, the net worth of Charlie's family generally *increases* with the use of the CRUT technique.

Although Charlie clearly sees that the two middle rows of numbers – Pam's plan against a simulated tax holiday – produce a nearly identical result, Pam presses the benefits of understanding leverage and opportunity costs even further. If Charlie allocates GST exemption to a 10% seed gift to the grantor trust, or if he sells FLLC interests to an existing GST exempt grantor trust, he will protect more from further transfer taxes by the time of his death. This benefit compounds as the property moves down the generations. By using his GST exemption wisely, Charlie not only solves some of his tax problems, but he also solves some of his descendants' tax problems as well.

c. Considerations of the technique.

(1) Consideration of a FLLC in this context.

(a) For gift tax purposes, to demonstrate the legitimacy of the FLLC, it may be enough that Charlie and the other members are engaged in permissible FLLC activity organized for profit.[372]

(b) Charlie and his other managing members should be prepared to hold regular FLLC meetings and to share relevant FLLC information.

(c) Charlie cannot completely control the FLLC, although he can control the FLLC investments if he chooses. If Charlie keeps too much control over distributions, or if he does not honor the FLLC agreement, or if he makes disproportionate distributions, the IRS may attempt to tax the FLLC interests or the underlying FLLC property in Charlie's estate. Charlie wants to use discounting to help move appreciation from his estate now, so these adverse estate tax consequences (although unlikely, because Charlie is giving away or selling all of his non-managing member interests now) would defeat his current gift strategy.

(d) Like the CRUT, the FLLC will have its own legal, accounting and administrative costs, and Charlie must engage a professional appraiser to set the value of the non-managing member interests.

(e) It is difficult, and sometimes impossible, to use FLLC interests as collateral for a loan.

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[372] *See* IRC Sec. 7701(a)(2); *Knight v. Commissioner*, 115 T.C. 506 (2000); *Estate of Strangi v. Commissioner*, 417 F.3d, 468 (5th Cir. 2005); *Winkler v. Commissioner*, 73 T.C.M. (CCH) 1657. However, care should be taken to make sure the creation of the partnership and the transfer of the partnership interests are sequential, independent acts; otherwise partnership discounts may not be recognized for gift tax purposes. *See Shepherd v. Commissioner*, 283 F.3d, 1258 (11th Cir. 2002); S*enda v. Commissioner*, 433 F.3d, 1044 (8th Cir. 2006).

(f) FLLC income tax rules are complicated and transferring property to and from a partnership can trigger surprising income tax consequences. Charlie and his family must make a long-term commitment to conducting their affairs inside the FLLC.

(g) Since Charlie is selling non-managing member interests that are valued by appraisal to the trust, he will not know for sure if he is making a gift. The IRS may challenge the discount applied to Charlie's non-managing member interests. Charlie might try to use a formula to define the value of the non-managing member interests he wishes to give.

(h) The technique will have the same considerations as a sale to a grantor trust.

2. 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.

a. The technique.

There could be significant after-tax cash flow advantages for giving preferred interests in a FLLC that is designed to last for several years to a public charity, or a donor advised fund, and transferring the growth interests to a taxpayer's family.

Consider the following example.

Example 16: Gift of a Preferred FLLC Interest to a Public Charity
<u>and the Gift or Sale of a Growth FLLC Interest to a Taxpayer's Family</u>

George Generous is unhappy about some of tax limitations associated with traditional charitable giving. Not only do tax limitations exist with respect to the amount of a deduction available for income tax purposes, there also is not any deduction in determining the new healthcare tax. George's stewardship goals are to give around $450,000 a year to his favorite public charities and to give a $6,000,000 bequest to his favorite public charities in his will

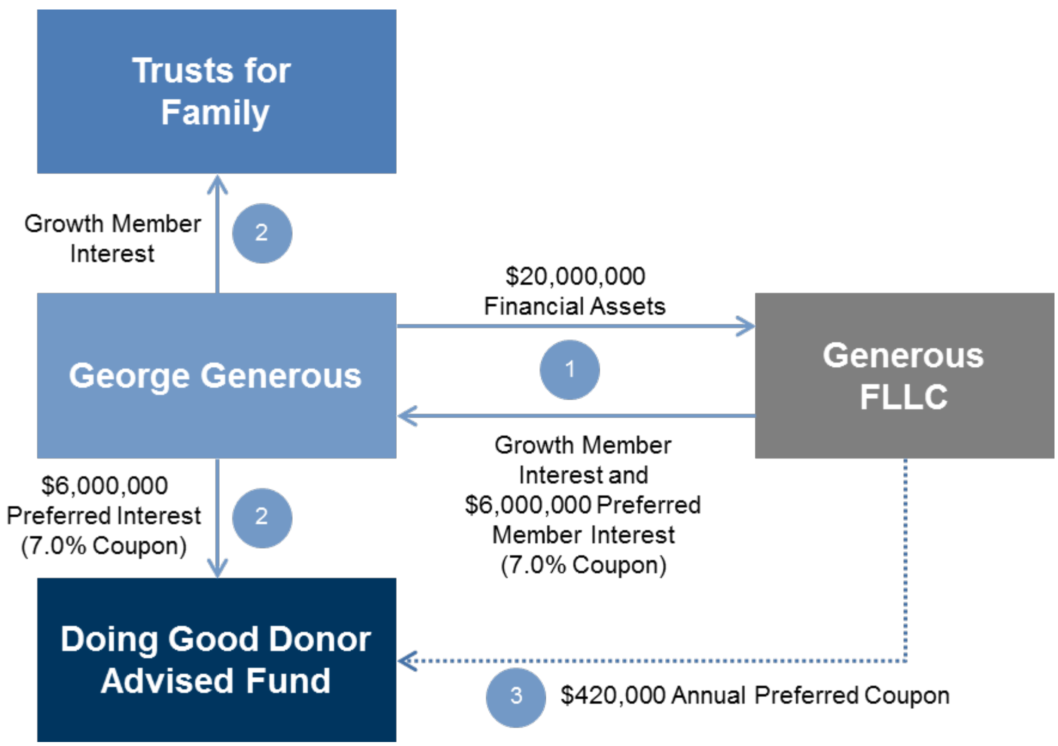
George tells Pam that after he sells a $6,000,000 zero basis security he will have $20,000,000 in financial assets. George asks Pam to assume his assets will annually earn 7.4%, with 3% of that return being taxed as ordinary rates and 4.4% of the return being taxed at long-term capital gains rates with a 30% turnover. George believes he has a 20-year life expectancy. George has a significant pension plan that pays for his consumption needs.

George asks his lawyer, Pam Planner, if she has any ideas that are consistent with his charitable intent where he can get a tax deduction for his projected annual giving without any limitations, both for determining his income tax and the new healthcare tax. He also asks Pam if she has any ideas of how he can get an income tax deduction this year for the actuarial value of the planned testamentary gifts he wishes to make to his favorite charitable causes. George also would like to hear Pam's best ideas on how to avoid the capital gains tax and healthcare tax on the projected $6,000,000 sale of some his highly appreciated securities.

Pam Planner suggests that George consider forming a FLLC that will last until the earlier of his death, or 50 years. The FLLC is structured to have both preferred and growth interests. George could contribute $20,000,000 of his assets to the FLLC. George could contribute his low basis securities to the FLLC and receive a $6,000,000 preferred interest that pays a coupon of 7% (or $420,000 a year). The rest of his member interests, the so-called "growth" interests, would receive any income or gains above what is necessary to fund the preferred coupon.

After the FLLC is formed, Pam suggests that George make a gift of the preferred FLLC member interest to his favorite charity, the Doing Good Donor Advised Fund (which is a donor advised fund at a local community foundation and is a qualified public charity). The Doing Good Donor Advised Fund is entitled to a 7% preferred coupon each year. George could gift and sell the growth interests to a trust for his family.

This technique is illustrated below:



b. Advantages of the technique.

(1) 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.

George may receive a full deduction for the present value of the right to receive the par value of the preferred interest when the FLLC terminates, even though no cash has passed from his hands to the donor advised fund and the payment of the preferred par value will probably occur after George's death. Contrast that treatment with a bequest of a dollar amount under George's will. Obviously, George will not receive a lifetime income tax deduction for that bequest.

(2) 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.

Most of the value of the preferred interest is attributable to receiving the 7% coupon for 50 years, or until George's death. Stated differently, there is no willing buyer who would pay more than a small amount for the right to receive the par value for the preferred interest on George's death and the reason the preferred interest will have a fair market value of $6,000,000 is because of the right to receive a $420,000 annual preferred coupon.

(3) 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 preferred interest income that is allocated to the donor advised fund will not be taxed to the other FLLC members because of operation of IRC Sec. 704(b). George will receive each year, in effect, a simulated income tax and healthcare tax deduction for the preferred interest coupon income that is allocated to the donor advised fund (since he will not be taxed on that income). That simulated deduction will not count against his adjusted gross income limitation, and it will not be subject to limitations associated with itemized deductions.

Contrast the double income tax benefit of the charitable gift of the preferred interest coupon with a charitable lead trust in which the donor may either receive a deduction for the actuarial value of the lead interest payable to the charity, or not be taxed on the annual lead payments allocated to the charity, but cannot have *both* income tax advantages.

(4) 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.

In this example, George receives his preferred interest in exchange for a transfer of his low basis assets. If the FLLC sells those contributed low basis assets, George should not be liable on any capital gains tax associated with the built-in gain that existed at the time of the contribution, because the gain under IRC Sec. 704(c) should be allocated to the donee, the donor advised fund.

Again, contrast that result with a non-grantor charitable lead trust. If highly appreciated assets are sold by a non-grantor charitable lead trust, the gain will be allocated to the trust. The trust will only receive a deduction for the distributions that are made that year to charity. Thus, in many situations with the use of the non-grantor charitable lead trust, if there are substantial capital gains because of a sale of appreciated assets owed by the trust, that trust will pay a significant capital gains tax.

If instead of a non-grantor charitable lead trust, a "grantor" charitable lead trust is used, the income that results are again disadvantageous. There will not be any allocation of the capital gains to the charitable beneficiary. All of the taxable gain will be allocated to the grantor.

(5) 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.

George asked Pam to compare the benefits of the proposed gift of a preferred FLLC interest with a 7% coupon to making annual cash charitable contributions equal to that 7% coupon and a cash testamentary bequest equal to the par value of the preferred to the donor advised fund at George's death. Additionally, George asked Pam to assume that he will live 20 years, and that if he elects to contribute the preferred interest to charity, the charity's preferred interest will be liquidated at his death.

In order to isolate the benefits of each of the annual giving strategies, Pam assumes George's assets will earn 7% before taxes. George asks Pam to assume 3% of the return will be taxed at ordinary rates and 4% will be taxed at capital gains rates (with 30% annual turnover). Using those assumptions she then calculates the income and health care tax efficiency ratio (present value of both total net income and healthcare tax savings divided by the present value of the total out of pocket cash) under the two assumed scenarios. Pam assumes a 7% present value discount rate. Please see Table 6 below and attached Schedule 6.

Table 6

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%

(6) 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.

IRC Sec. 2701 became effective on October 9, 1990. It is a gift tax valuation statute that applies when a junior equity in a corporation or partnership is transferred to a member of the transferor's family and a senior interest in the family or partnership with certain discretionary features is retained by the transferor or an 'applicable family member." A liquidation, put, call, or conversion right is automatically regarded as discretionary because it is within the discretion of the holder. Distribution rights trigger the valuation rules of IRC Sec. 2701 if the transferors hold control of the entity. These discretionary interests are referred to under IRC Sec. 2701 as "applicable retained interests."

IRC Sec 2701 prescribes special valuation rules for the value of certain senior equity interests in a family entity (e.g., preferred interests) for gift tax purposes that are retained by the transferor, and that value is subtracted from total value of the entity. Distribution rights are valued according to their terms if distributions are paid periodically a a fixed rate (under IRC Sec. 2701 they are called "qualified payment"). A transferor may elect to treat distribution rights as "qualified payments" even if they are not by assuming payments in such amounts and at such times as are specified in the election, as long as those terms are consistent with the underlying equity interest. The regulations provide that the right to share in the liquidation proceeds ("liquidation participation right") may be valued without regards to IRC Sec. 2701.

The regulations spell out in detail the methodology of subtracting the value of preferred interests from the value of the entire entity with adjustments to reflect the actual fragmented ownership. After the adjustments of the four step method, which takes the lack of marketability and the likelihood of liquidation into account, the value of any transferred junior equity interests are determined. It should be noted that there is a mandated value that the junior equity interest in the entity cannot be worth less than 10% of the total value of the equity interests in the entity.

There is an adjustment under the regulations to prevent double transfer taxation of the retained senior equity interests. There is a reduction of the transferor's adjusted taxable gifts for estate tax purposes, equal to the lesser of the amount by which IRC Sec. 2701 originally increased taxable gifts or the amount by which the applicable retained interest increases the gross estate or taxable gifts at the time of the subsequent transfer.

Do these IRC Sec. 2701 valuation rules apply to a transfer of a preferred interest to a charity and a later sale or gift of the growth interest to the transferor's family? Stated differently, if a patriarch or matriarch reorganized his or her entity and transferred a high-yielding preferred equity interest to a charity, would this transfer and reorganization be a transaction that is subject to the valuation rules under IRC Sec. 2701, which was passed as part of Chapter 14? The answer is no.[373]

If a retained distribution right exists, there must exist a senior equity interest (*i.e.*, the transferor must have retained preferred stock or, in the case of a partnership, a partnership interest under which the rights as to income and capital are senior to the rights of all other classes of equity interest).[374] The Senate legislative history of Chapter 14 indicates that retention of common stock, after the gift of preferred stock, is not a transaction which is subject to the valuation rules under IRC Sec. 2701 because retained ownership of the common stock generally does not give the transferor the right to manipulate the value of the transferred interest. Any transferred preferred stock that has a cumulative right to a dividend, or any transferred note in a corporation which has a cumulative right to interest, is not subject to value manipulation by the common stock owner. For instance, if a dividend or an interest payment is missed, the preferred stock owner or bondholder, as the case may be, continues to have the right to that dividend payment or interest payment. It is true that in certain instruments the preferred stockholder would

[373] *See* IRC Sec. 2701(c)(1)(B)(i).

[374] *See* IRC Secs. 2701(c)(1)(B)(i); 2701(a)(4)(B); Treas. Reg. Section 25.2701-2(b)(3)(i); s*ee also* P.L.R. 9204016 (Oct. 24, 1991).

not enjoy the compounding effect of receiving a late dividend. However, the "lowering" of value to a transferee, by not paying the transferee's dividend, or delaying the payment of the dividend, does not hurt the fisc since that tends to help or increase the junior equity interest owner's net worth (*i.e.*, it increases the transferor's net worth). Thus, even though a transferee may receive a valuable asset in a junk bond or a junk preferred interest, it is a type of security in which the junior equity interest cannot manipulate value, except to *decrease* the value of the transferred interest at a later date.

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

If George was able to obtain a 35% valuation discount for the gift and sale of the growth interest, Pam projects that in addition to saving income and healthcare taxes, George could save over $15,000,000 in estate taxes. Please see the table below and attached Schedule 6.

Table 7

	20-Year Future Values			
	Pre-Death	Post Death	Present Values (Discounted at 2.5%)	Percentage of Total
No Further Planning Except for $420,000 Annual Gift to Charity: Bequeaths $6mm to Charity at Death; Balance of Estate to Family (assumes $8.53mm estate tax exemption available at death)				
George Generous	58,712,723	-	-	0.00%
Charity	17,989,144	23,989,144	14,639,877	22.49%
Generous Children	-	26,509,634	16,178,059	24.85%
Generous Children and Grandchildren	-	8,530,000	5,205,611	8.00%
IRS Income Tax - Direct Cost	14,567,393	14,567,393	8,890,057	13.65%
IRS Income Tax - Investment Opportunity Cost	15,414,442	15,414,442	9,406,986	14.45%
IRS Estate Tax (at 40.0%)	-	17,673,089	10,785,373	16.57%
Total	**$106,683,701**	**$106,683,701**	**$65,105,963**	**100.00%**
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 (assumes $3.10mm estate tax exemption available at death)				
George Generous	8,204,328	-	-	0.00%
Charity	23,989,144	23,989,144	14,639,877	22.49%
Generous Children	-	3,062,597	1,869,014	2.87%
Generous Children and Grandchildren	47,425,983	50,525,983	30,834,539	47.36%
IRS Income Tax - Direct Cost	17,410,042	17,410,042	10,624,843	16.32%
IRS Income Tax - Investment Opportunity Cost	9,654,204	9,654,204	5,891,680	9.05%
IRS Estate Tax (at 40.0%)	-	2,041,731	1,246,009	1.91%
Total	**$106,683,701**	**$106,683,701**	**$65,105,963**	**100.00%**

Calculations of Remaining Estate Tax Exemption	No Further Planning	Hypothetical Techniques
Current Exemption	5,340,000	5,340,000
Gifts Made	-	(5,430,000)
Future Exemption Available in 20 years (assumes 2.5% inflation)	8,530,000	3,100,000

(8) Income tax valuation advantage: IRS concedes preferred partnership interests should have a high coupon.

Prior to passage of IRC Sec. 2036(c) in 1987 (which was repealed in 1990) and prior to the passage of IRC Sec. 2701 as part of Chapter 14 in 1990, the IRS did not have many tools with which to fight, from their perspective, abusive estate freezes, except valuation principles. In 1983, the IRS issued a Revenue Ruling,[375] which promulgated the factors for determining what an

[375] Rev. Rul. 83-120, 1983-2 C.B. 170.

appropriate coupon should be on preferred stock of a closely held corporation or what an appropriate coupon should be on a preferred partnership interest in a closely held FLP. Generally, the IRS took the view that a secondary market does not exist for interests in FLPs. Accordingly, with respect to a preferred partnership interest in a FLP, the coupon should be very high in order to reflect the embedded marketability discount of the preferred partnership interest. In other words, according to the IRS, to have a preferred partnership interest valued at "par", a hypothetical willing buyer would demand a significant return on that preferred partnership interest, in comparison to other comparable fixed income instruments, in order to compensate that hypothetical willing buyer for the lack of marketability that would be inherent in that family limited preferred partnership interest.

(9) IRC Sec. 2036 advantage, if George gives or sells the growth interests to his family.

If the growth member interest is transferred to the donor's family after the preferred member interest is transferred to a public charity IRC Sec. 2036 should not operate to include the transferred common interest (or the underlying partnership assets) in the transferor's gross estate, for two reasons.

First, there is a substantial investment purpose (i.e., non-tax purpose) with having preferred and common interests that divide the economic return of the FLP or FLLC between the owners of the interests in a different way than would result without the two interests. This creates is a substantive investment reason for the creation of the FLP or FLLC. As such, it should constitute a significant non-tax purpose, one that is inherent in the preferred/common structure. This in turn should minimize the danger of IRC Sec. 2036 being applied to any transfers of interests in the FLP or FLLC, because the Tax Court and the Courts of Appeal are much less likely to apply IRC Sec. 2036 to transferred FLP or FLLC interests if a non-tax reason, preferably an investment non-tax reason, exists for the creation of the FLP or FLLC.[376]

Second, the enactment of IRC Sec. 2036(c) and its subsequent repeal demonstrate that going forward Congress intended to address the preferred/common structure solely by means of the gift tax rules of Chapter 14 (IRC Sec. 2701) and *not* by including the transferred common interest in the transferor's gross estate under IRC Sec. 2036. The legislative history of the repeal of IRC Sec. 2036(c) unmistakably manifests this Congressional intent. Thus, even if the transfer of the growth interests occurs at the taxpayer's death, because of that strong legislative intent, IRC Sec. 2036 should not apply. See the discussion in Section I D of this paper.

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[376] *Estate of Kimbell v. United States, 371 F.3d 257 (5th Cir. 2004); Church v. United States*, 85 A.F.T.R. 2d (RIA) 804 (W.D. Tex. 2000), *aff'd without published opinion*, 268 F.3d 1063 (5th Cir. 2001) (per curiam), unpublished opinion available at 88 A.F.T.R. 2d 2001-5352 (5th Cir. 2001); *Estate of Bongard v. Comm'r, 124 T.C. 95* (2005); *Estate of Stone v. Comm'r,* 86 T.C.M. (CCH) 551 (2003); *Estate of Schutt v. Comm'r,* T.C. Memo 2005-126 (May 26, 2005); *Estate of Mirowski v. Comm'r*, T.C. Memo 2008-74; *Estate of Miller v. Comm'r,* T.C. Memo 2009-119; *Rayford L. Keller, et al. v. United States of America,* Civil Action No. V-02-62 (S.D. Tex. August 20, 2009); *Estate of Murphy v. United States*, No. 07-CV-1013, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009); and *Estate of Samuel P. Black, Jr., v. Comm'r,* 133 T.C. No. 15 (December 14, 2009); and *Shurtz v. Comm'r,* T.C. Memo 2010-21.

c. Considerations of the technique.

(1) 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.

IRC Sec. 170(f)(3) denies an income tax charitable deduction, and IRC Sec. 2522(a)(2) denies a gift tax charitable deduction, for a contribution of an interest in property that consists of less than the taxpayer's entire interest in such property. A gift of the entirety of an asset or an undivided portion of the taxpayer's entire interest in property to a charity does qualify for the income tax and gift tax charitable deduction. The undivided portion of the taxpayer's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right the decedent owned in the property. IRC Sec. 170(f)(3)(B)(ii) and Treas. Reg. § 1.170A-7(b) provide that a deduction is allowed for a contribution, that is not in trust, of a partial interest that is less than the donor's entire interest in property if the partial interest is an undivided portion of the donor's entire interest. An undivided portion of a donor's entire interest in property must, however, consist of a fraction or percentage of *each and every substantial interest or right* owned by the donor in such property. *See* Rev. Rul. 88-37, 1988-1 C.B. 97 (1988).

The Tax Court in the *Estate of John Boykin*[377] held that an ownership of a preferred equity interest does not entitle the owner to any rights to the assets of the entity – it only entitles the owner to rights in the preferred interest. Any gift of the preferred interest should be analyzed as a gift of the preferred interest not a gift of certain rights over the entity's assets. Consistent with the *Boykin* case cited above, the preferred interest should be considered to be a separate interest both from the FLLC's assets and from George's other interests in the FLLC. The separate preferred interest is transferred in its entirety. In this example, all of George's preferred interest passes to charity – he does not retain any interest in the preferred interest or make a gift of part of the preferred interest, so the transfer is not "a contribution (not made by a transfer in trust) of an

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[377] *Estate of Boykin v. Commissioner*, T.C. Memo. 1987-134, 53 T.C.M. 345. *See also Hutchens Non-Marital Trust v. Comm'r,* 66 T.C.M. (CCH) 1599 (1993) (The Tax Court held that the interest that the decedent held in his family-owned corporation prior to recapitalization was not includible in his gross estate under IRC Sec. 2036 because the decedent received adequate consideration for the pre-recapitalization stock, the decedent retained no interest in stock surrendered in the recapitalization, and the decedent's post-recapitalization control and dividend rights came from new and different forms of preferred stock that he received in the recapitalization. *See also* Todd Angkatavanich, Jonathan G. Blattmachr and James R. Brockway, "Coming Ashore – Planning for Year 2017 Offshore Deferred Compensation Arrangements: Using CLAT's, PPLI and Preferred Partnerships and Consideration of the charitable Partial Interest Rules," 39 ACTEC Law Journal 103, 130-145, 152-153. The authors discuss *McCord v. Comm'r*, 120 T.C. 358(2003), rev'd and remanded, 461 F.3d 614 (5th Cir. 2006), *Church v. United States*, 85 AFTR 2d 2000-804 (W.D. Texas 2000), aff'd 268 F.3d 1063 (5th Cir. 2201), and *Estate of Strangi v. Comm'r*, 115 T.C. 478 (2000), aff'd in part and remanded in part, 293 F.3d 279 (5th Cir. 2002), on remand 85 T.C.M. (CCH) 1331 (2003), aff'd 417 F.3d 468 (5th Cir. 2005) and conclude that a gift of a preferred interest to a charity should not be considered a gift of a partial interest because the courts follow the entity rule in determining the property rights associated with a partnership interest. The authors also conclude the argument is strengthened if the gift of a preferred interest is made to a qualifying trust (e.g., a charitable lead trust) and/or the donor only owns the donated preferred interest and does not own any other interest in the partnership.

interest in property which consists of less than the taxpayer's entire interest in such property." IRC Sec. 170(f)(3).

On the gift tax side (see IRC Sec. 2522(c)(2)) there are two Supreme Court cases stating that the gift tax consequences should be applied in a manner that follows a state property law analysis.[378]

State law does not treat a partnership interest as a partial interest in the underlying assets of the partnership. A partner is not a co-owner of partnership property and has no interest in partnership property that can be transferred, either voluntarily or involuntarily. Revised Uniform Partnership Act, §501. The only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions. Ownership of a partnership interest does not entitle the owner to any rights over property owned by the partnership. Revised Uniform Partnership Act, §502; *Michtom v. United States*, 573 F.2d 58, 63 (Ct. Cl. 1978); PLR 9825001. Partnerships are distinct entities. Revised Uniform Partnership Act, §201.

Despite state property law, there is a possibility that the IRS could attempt to deny a charitable deduction for a contribution of preferred units. Treas. Reg. § 1.170A-6(2) allows a deduction for a contribution of a partial interest in property only "if such interest is the taxpayer's entire interest in the property, such as an income interest or a remainder interest." "If, however, the property in which such partial interest exists was divided in order to create such interest and thus avoid IRC Sec. 170(f)(2), the deduction will not be allowed." *Id.* The IRS may take the position that Section 170(f)(3) can apply despite the fact that a contributed interest becomes a separate property interest for federal tax purposes as a result of the transfer. For instance, the IRS has denied charitable deductions in situations where the donor had donated common stock but retained the right to vote that stock (see Rev. Rul. 81-281, 1981-2 C.B. 78; PLR 8136025) because the right constitutes a substantial interest. Carving the right to vote away from the economic interest in the common stock created a non-deductible partial interest.

Similarly, in Rev. Rul. 88-37, the IRS denied a deduction because the donor did not contribute the donor's entire interest in his property but carved out and contributed only a portion of that interest. Further, the portion contributed was not an undivided portion of the donor's entire interest—it did not convey a fraction of each and every substantial right owned by the donor in the property. By transferring an overriding royalty interest or a net profits interest, the donor retained the right inherent in the "working interest" (the ownership of an operating interest under an oil and gas lease) to participate in the control of, the development and operation of the lease. This right to control or to participate in the control, similar to the retained voting rights in Rev. Rul. 81-282, is a substantial right, the retention of which prevented the donated interest from being considered an undivided portion.

There are numerous business and financial reasons to form a partnership or FLLC as an advantageous vehicle for, and being in the best interests of, the members of a family, including consolidation of the management and control of family assets within a partnership owned by the eventual owners of all of the assets; avoidance of fractional asset ownership over time; greater

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[378] *See United States v. Bess*, 357 U.S. 51 (1958) and *Morgan v. Commissioner*, 309 U.S. (1940).

creditor protection; greater ability to keep assets in the family, etc. The more of these factors that are applicable to any proposed FLLC the less likely the IRS will argue that a contribution of preferred units is a prohibited gift of partial interests.

The proposed FLLC should be created for reasons independent of obtaining a charitable deduction and independent of avoiding section 170(f)(3). The fact that the charitable deduction is likely to be only 30% of the value of the preferred units given away may demonstrate that other reasons are more important than the charitable deduction. The more participants in the FLLC the more likely it was created for purposes independent of obtaining a charitable deduction and the less likely the IRS will deny the charitable contribution as a gift of a partial interest.

Consequently, it is important to establish that the purpose of the FLLC is not to slice the voting rights from the FLLC's underlying securities by retaining the managing units (which control the FLLC and thereby control the vote of the underlying securities) and donating only the preferred units (which carry no control over the FLLC). Having an independent entity from the donor as a manager will strengthen the donor's position.

Another factor that could bolster the argument that the FLLC was not created for purposes only related to dividing the economic interests of the contributed property to the FLLC in order to circumvent the partial interest rule is the longevity of the FLLC before gifts are made to charity. The longer the FLLC exists prior to the contribution, the more a separate purpose would be indicated. See Rev. Rul. 86-60, 1986-1 C.B. 302 (four-year delay between creation of partial interest and proposed contribution); Rev. Rul. 76-523, 1976-2 C.B. 54 (1976) (split of interests in stock was for business purpose and done years before the transfer to charity); PLR 20010812 (eight-year delay between the donor's transfer of voting rights in common stock to a voting trust and her charitable donation of that stock); PLR 9721014 (ten-year delay between creation of partial interest and the proposed contribution).

(2) 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.

This example assumes the FLLC owns only financial assets. If the FLLC owns trade or business assets, and if the preferred is given to a donor advised fund (instead of some other public charity) the excess business holding rules need to be considered. See IRC Sec. 4943(b).

(3) The taxpayer must comply with certain reporting requirements in order to receive a deduction for the fair market value of the donated preferred interest.

Among the reporting requirements are:

(i) The taxpayer must get and keep a contemporaneous written acknowledgment of the contribution from the charity. See IRC Sec. 170(f)(8)(A).

(ii) The taxpayer must also keep records that include how the taxpayer acquired the property and the basis information for the donated preferred interest. See Treas. Reg. §§ 1.170A-13(b)(3)(i)(A), (B).

(iii) The taxpayer must also obtain a qualified written appraisal of the donated property from a qualified appraiser, if the preferred interest is worth more than $500,000 attach the qualified appraisal to the taxpayer's return. See IRC Sec. 170(f)(11)(D).

(4) 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.

All items of income of the FLLC will be proportionately allocated to the owner of the preferred interest, including items of income that are considered unrelated business income, which will be subject to the unrelated business income tax under IRC Sec. 511. The unrelated business income tax is imposed on the unrelated business taxable income of most exempt organizations. Gross income subject to the tax consists of income from a trade or business activity, if the business activity is not substantially related to the charity's exempt purposes and is regularly carried on by the organization. Even passive income, such as dividends and interest, will be subject to the tax, if the income is derived from debt-financed property.

3. The Use of a High-Yield Preferred Partnership or Membership Interest With Charitable Lead Annuity Trust ("CLAT").

a. The technique.

What is a CLAT?

(1) A CLAT is a trust in which the lead interest is payable to a charity and is in the form of an annuity amount for the term of the lead interest.

(2) In the CLAT, the annual payment is not based on the income of the trust. Since the annuity amount is not based on the income of the trust, that amount must be paid to the charity even if the trust has no income. If the trust's current income is insufficient to make the required annual payment, the short fall must be made up out of the invasion of the trust principal. If the current income exceeds the required annual payment, it does not have to be paid over to the charity; however, the excess income would then be accumulated and added to the trust corpus.

(3) The lead interest in a CLAT can be for a fixed term of years. Unlike a charitable remainder trust, the fixed term can be indefinite.379 The lead interest can also be measured by the life of an existing individual or the joint lives of existing individuals.

[379] IRC Sec. 170(f)(2)(B).

(4) CLATs are not subject to the minimum payout requirements associated with charitable remainder trusts. Thus, there is no 5% minimum pay out for CLATs.

(5) The CLAT is not a tax-exempt entity, unless the CLAT is a grantor trust. If the CLAT is a non-grantor trust and if taxable income is accumulated in the trust it will be subject to income taxes. The CLAT will receive a charitable income tax deduction when it makes the distribution to the charity. If the CLAT is a grantor trust, the grantor will receive an income tax deduction for the actuarial value of the charitable gift of the annuity amounts upon creation of the CLAT. If the CLAT is a grantor trust, there will not be any future income tax deductions for distributions to charities.

(6) CLATs are characterized as private foundations for purposes of certain restrictions placed on such organizations. Accordingly, CLATs are subject to private foundation excise tax provisions.[380] The governing trust instrument must contain specific prohibitions against (i) self-dealing; (ii) excess business holdings; (iii) jeopardy investments; and (iv) taxable expenditures.[381] If the specified prohibited transactions occur onerous significant excess taxes could accrue.

What if a financial engineering technique existed that would generally ensure the financial success (from the remainderman's perspective) of a CLAT and would create additional discounts for any future non-charitable gifts to family members? Consider the following example:

If a taxpayer creates a preferred interest in a FLP or a FLLC and contributes that preferred interest to a CLAT, the success of the CLAT is virtually assured. This is because all of the assets and the income of all of the assets of the FLP or FLLC are available to ensure the success of the coupon payments that are made on the preferred interest that is contributed to the CLAT. Assuming the preferred coupon rate is substantially in excess of the IRC Sec. 7520 rate, substantial assets will be available to the remainder beneficiaries of the CLAT on its termination.

Consider the following illustration, assuming the IRC Sec. 7520 rate is 1.0%:

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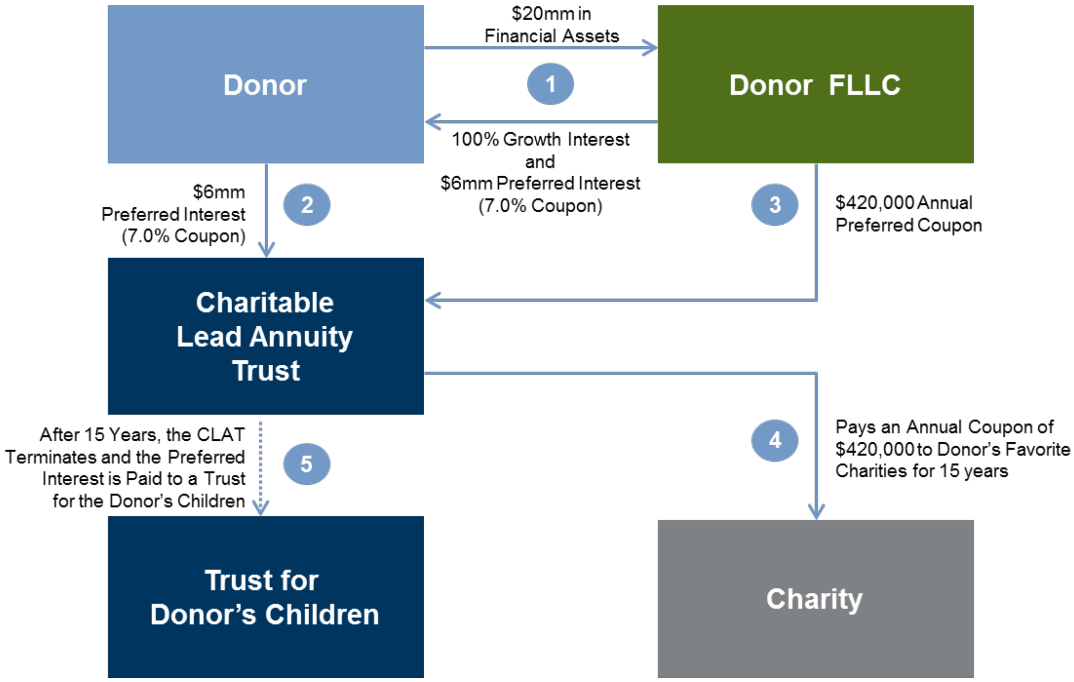
[380] IRC Sec. 4947(a)(2).

[381] *See* IRC Secs. 4941(a), (b), 4943(a), (b).



b. Advantages of the technique.

(1) 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.

Under the assumed facts of the above illustration, George will successfully transfer his preferred interest in 15 years to a trust for his children without using any gift tax exemption and George will not be taxed on the income allocated to the charity. The Donor FLLC needs only to earn 1.17% annual return to have enough earnings to satisfy the $70,000 annual preferred coupon.

The preferred partnership interest or limited liability interest appears to work very well from a transfer tax perspective with all varieties of CLATs, including level payment CLATs, back-loaded payment CLATs, grantor CLATs and non-grantor CLATs.[382]

(2) 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.

In addition to the inherent benefits of a high yielding financial instrument being utilized when the IRC Sec. 7520 rate is low, there are additional estate planning benefits to the structure. As noted above the valuation rules of IRC Sec. 2701 do not apply to gift of the growth member interests if the donor does not retain the preferred partnership interests.[383] If the growth interest in

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[382] *See* Paul S. Lee, Turner P. Berry & Martin Hall, "*Innovative CLAT Structures: Providing Economic Efficiencies to a Wealth Transfer Workhorse*," 37 ACTEC Law Journal 93, 151-53 (Summer 2011).

[383] *See* the discussion in Section V F 3 of this paper.

the FLP or FLLC could be given or sold, additional estate planning benefits could accrue. Substantial valuation discounts may exist with respect to any growth interests that are donated or sold, because of the presence of the preferred interest. Consider the following table (also see Schedule 6 attached to this paper):

Table 8

Description	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		
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

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

See the discussion in Section V F 3 b of this paper.

c. Considerations of the technique.

(1) 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.

The income tax deduction is obviously unimportant if a non-grantor CLAT is used, because the gift on the annuity in a non-grantor CLAT is not eligible for an income tax deduction. What if the CLAT is a grantor trust? It is then important to receive an upfront income tax deduction. The question then becomes whether section 170(f)(3), which denies a charitable deduction for a contribution to charity (not made by a transfer in trust) of certain partial interests in properly, trumps the deduction allowed under 170(f)(2) for gifts to grantor CLATs. The answer should be no.

In addition to the arguments and analysis in Section V F 3 a and V F 3 b of this paper, there is the additional benefit of having the gift structured as a gift of an annuity interest in a charitable lead annuity trust. The sought-after deduction is not for the contribution of the partial interest to the trust, but rather for the contribution of the term interest in the trust to charity. The deduction must be allowable "*with respect to the trust*," not with respect to the assets contributed to the trust. The charitable deduction is specifically allowed by section 170(f)(2) for the contribution of the term interest in the grantor lead trust. Here, the deduction is allowable with respect to the grantor lead trust as long as the grantor lead trust otherwise meets the description of section 664. Second, section 170 (f)(3) specifically refers to contributions "not made by a transfer in trust", whereas 170(f)(2) refers to contributions "in trust." Subsections 170(f)(2) and 170(f)(3) are mutually exclusive: the first applies to contributions in trust and the second applies to contributions outside of trust.

Concerns about the partial interest issue arise from Private Letter Ruling 9501004. This ruling involved a charitable trust funded with an option to purchase real estate. The donor contributed an option to purchase real estate instead of contributing real estate itself because the real estate was encumbered by debt. According to the ruling, an option does not, before exercise, vest in the optionee any interest, estate or title in the land. Accordingly, the taxpayer would not be allowed a charitable deduction in the year in which the option was granted but would be allowed a deduction in the year in charitable organization exercised the option. See Rev. Rul. 82-197, 1982-2 CB 1982).

In that ruling, the IRS disregarded the specific language of Treasury Regulation section 1.664-l(a)(l)(iii). That section defines qualified charitable remainder trusts as *trusts* for which an income or transfer tax deduction is *allowable*. It does not require that each contribution to a trust must be independently deductible in order for the trust to qualify. As justification for ignoring this distinction, the IRS relies upon its "function exclusively" weapon of Treas. Reg. §1.664-l(a)(4), which requires that the charitable remainder trust at all times throughout its existence must "meet the definition of and function exclusively as a charitable remainder trust." Using this weapon, the IRS read into section 1.664-l(a)(l)(iii) a requirement that each asset contributed to the trust must independently qualify for a charitable deduction under section 170, 2055, 2106 or 2522 in order for the trust to be, and to function exclusively as, a charitable remainder trust "in every respect." There is no direct authority to support this argument as there is no direct authority regarding what constitutes meeting the definition of and functioning exclusively as a charitable remainder trust.

Based on this questionable interpretation of the statute and the regulation's language, the IRS proceeded to discuss the denial of the income tax deduction based on the partial interest rule of section 170(f)(3). The IRS posited an example where the property contributed to the trust ultimately passed outside the trust: the facts in the ruling indicated that the option would never be exercised by a charitable organization or trust, but rather would be assigned to a third party. Then, relying on the partial interest rule of section 170(f)(3) (not 170(f)(2)), the IRS denied the income tax deduction because the contribution was of a partial interest which passed *outside* of the trust. The ruling goes out of its way to say: "However, no deduction would be allowable under [the partial interest rule] for any payment made to such a third party purchaser that purchases and exercises the purported option. In such a situation, the payment by Taxpayer would be made to the third party charitable organization *outside the trust* [emphasis added]." That statement would not be necessary if the option itself, as a partial interest, disqualified the trust.

It is also important for purposes of the gift tax charitable deduction whether the partial interest rule applies. As discussed below, the partial interest rule should also not apply for gift tax purposes. Even if the income tax deduction is denied under section 170, the CLAT still qualifies for a gift tax deduction because a gift tax deduction remains allowable under IRC Sec. 2522. IRC Sec. 2522 does not appear to incorporate a 170(f)(3)-type partial interest rule. PLR 9501004 did not address whether IRC Sec. 2522 indirectly incorporates a partial interest rule because the gift was found to be incomplete. "Such [an incomplete] transfer would not constitute a transfer to the Trust for which a gift tax charitable deduction is allowable with respect to the Trust." The converse is implied to be true - if the payment by Taxpayer would be made to a charitable organization inside a trust, such a transfer would constitute a transfer for which a gift tax charitable deduction is allowable with respect to the trust.

The IRS did not import a 170(f)(3)-type partial interest rule into section 2055 in its private letter ruling 200202032. In that ruling, the taxpayer had previously contributed to the museum all of his right, title and interest in and to a 50% undivided interest in 32 paintings. At his death, the taxpayer bequeathed his remaining 50% undivided interest in the 32 paintings to the museum. The ruling held that the taxpayer's 50% undivided interest qualified for the estate tax charitable deduction under section 2055, despite being partial interests.

Sections 170(f)(2), 170(f)(3), 2055(e)(2) and 2522(c)(2) were enacted as part of a comprehensive revision of the tax treatment of charitable contributions in the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487. In that legislation, Congress provided rules governing charitable gifts of partial interests outside of trust, see IRC Sec. 170(f)(3); income tax deductions for gifts in trust, see IRC Sec. 170(f)(2); estate tax deductions, see IRC Sec. 2055(e)(2), and gift tax deductions, see IRC Sec. 2522(c)(2). Notably, Congress did not include a corresponding IRC Sec. l70(f)(3)-like provision in IRC Secs. 2055 or 2522.

The legislative history concerning income tax deductions for gifts of partial interests not in trust weighs against importing the same restrictions into IRC Secs. 2055 and 2522. The history focused on the practice of taking a deduction for the donation of the rent-free use of property for a specified time. Congress agreed with the IRS's position that in such a situation a taxpayer obtains a double benefit by being able to claim a deduction for the fair rental value of property and also exclude from income the receipts from the donated interest during the period of the donation. The legislative solution was to permit the exclusion but deny an income tax deduction. See H.R. Rep. No. 413, 91st Cong., 1st Sess. 57-58 (1969), 1969-3 C.B. at 239. This solution is not relevant in the transfer tax context.

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

This example assumes the FLLC owns only financial assets. If the FLLC owns a trust or business, since the CLAT will be considered a private foundation, the excess business holding rules and IRC Sec. 4943 need to be considered.

G. Strategies That May Lower the Income and Health Care Taxes of Trusts Without Making Cash Distributions to the Beneficiaries of the Trusts.

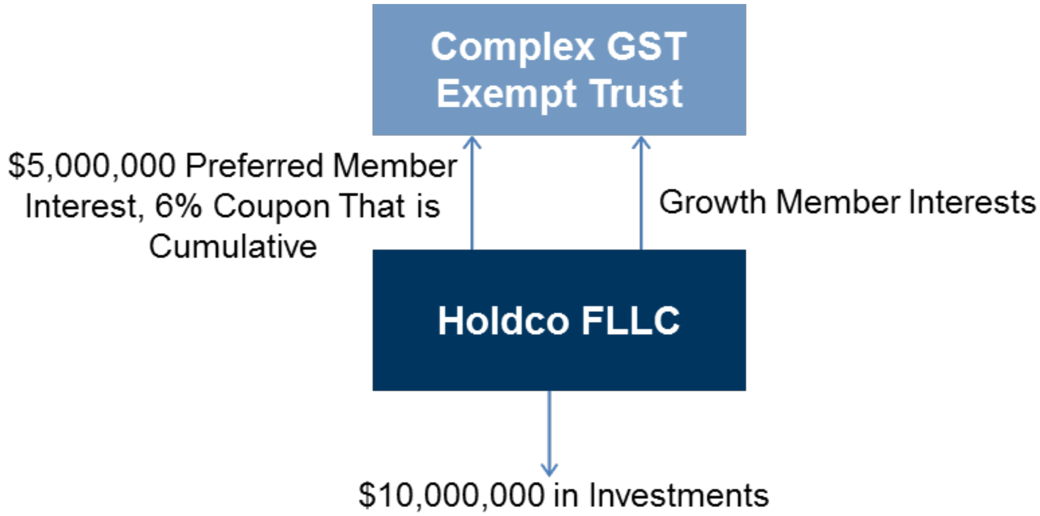
1. The Trustee of a Complex Trust Could Consider Creating a Two Class (One Class is a Preferred Interest and One Class is a Growth Interest) Single Member FLLC and the Trustee Could Distribute Part or All of the Preferred Class to the Current Beneficiary.

a. The technique.

The trustee of a trust could contribute part or all of its assets into a single member FLLC that has both preferred interests and growth interests. The owner of the preferred interest would be paid a fixed coupon and would also be entitled to a fixed liquidation value or “par” value on termination of the single member FLLC. The owner of the common interest would be entitled to the income and assets on liquidation that are not allocated to the preferred owner. The single member FLLC could have the right to call the preferred interest for cash equal to the par value of the preferred that is “called”. The trust could also withhold part of the cash accruing from “called” preferred interests or the preferred coupon and pay that withheld amount to the IRS to satisfy the beneficiary's taxes associated with distributions and ownership of the preferred interest. Consider the following illustrated transactions.

<u>*Hypothetical Transaction #1*</u>

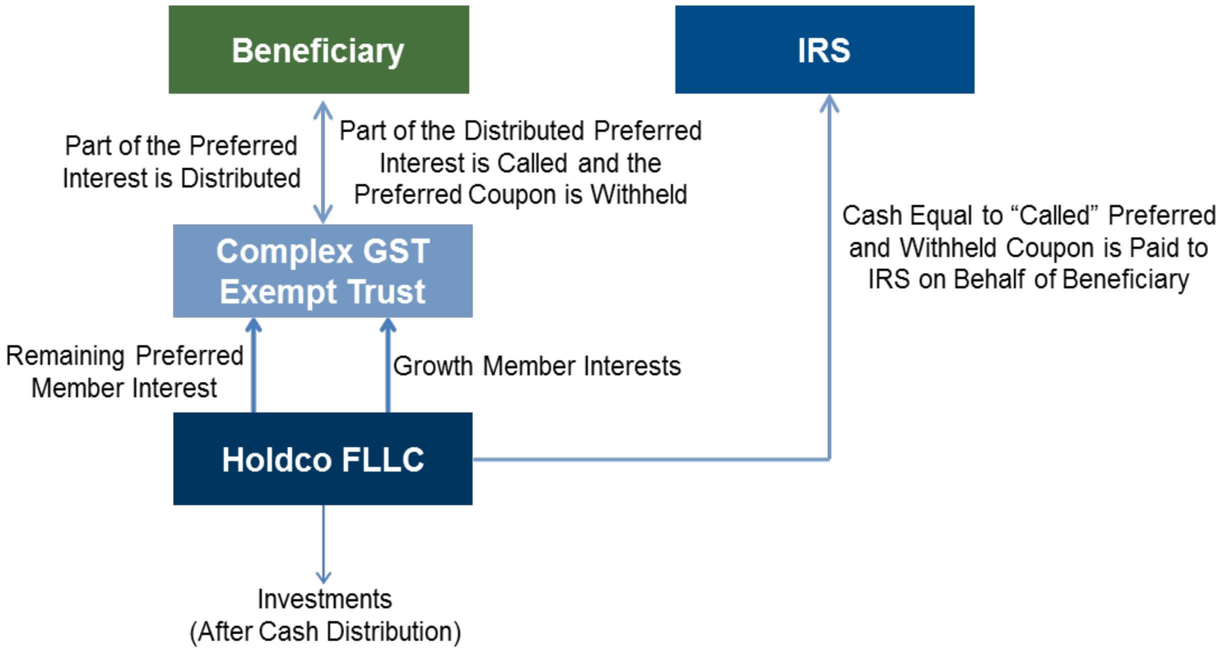
Trustee of Complex GST Exempt Trust, which has $10,000,000 in assets, forms a single member FLLC with preferred and growth member interests as illustrated below:



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.

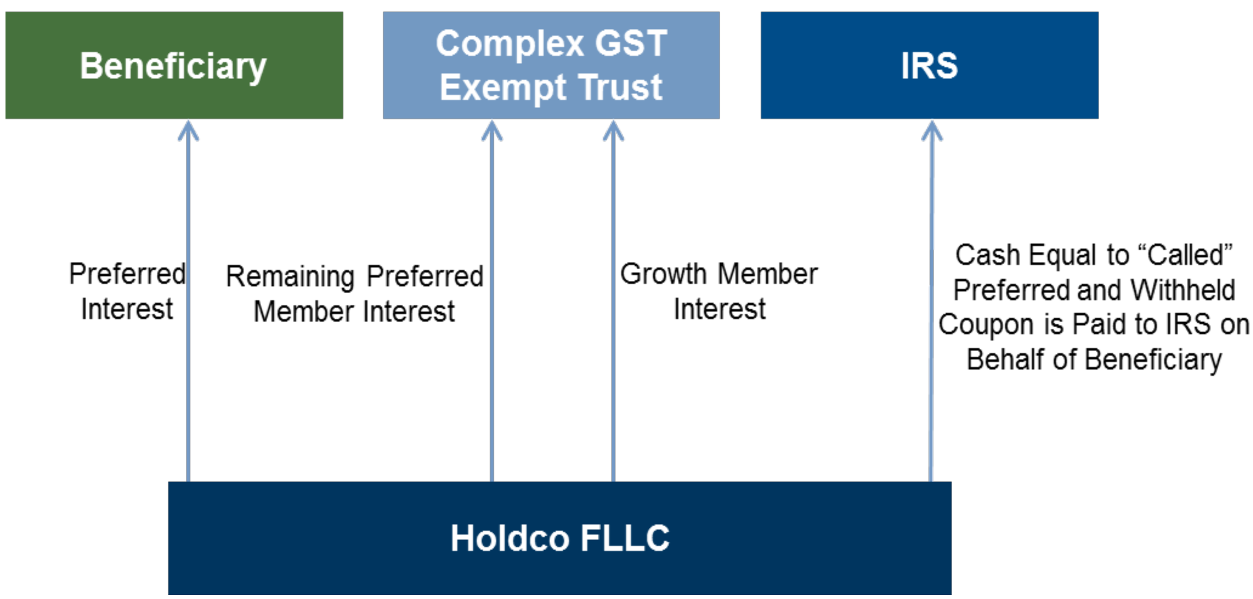
<u>*Hypothetical Transaction(s) #2*</u>

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. This transaction can be shown as follows:



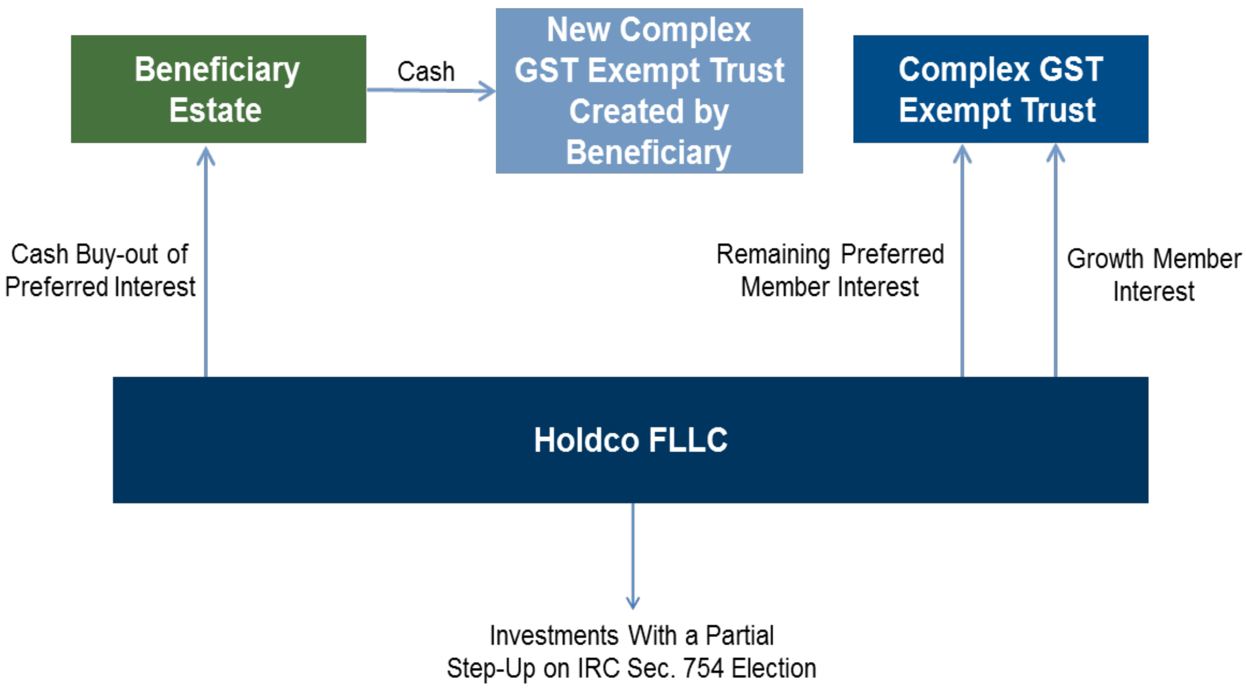
Hypothetical Transaction(s) #3

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:



<u>Hypothetical Transaction #4</u>

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:



b. Advantages of the technique.

(1) 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.

The fair market value of the preferred, when it is distributed to the beneficiary, will carry out distributable net income of the trust for that tax year. See IRC Secs. 661 and 662. The taxable income earned by Holdco that is allocated to the beneficiary as an owner, or part owner, of the preferred will not be taxed to the trust but will be allocated to the beneficiary. See IRC Sec. 704(b). If the beneficiary's income tax bracket is lower than the top bracket of the trust, then income taxes could be saved based on that difference.

(2) 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.

If after distributing the preferred interest to the beneficiary, Holdco FLLC sells the highly appreciated securities that were exchanged for the preferred, the capital gains interest in the securities at the time of the exchange (the so-called "built-in gain") will be allocated to the beneficiary and will not be allocated to the other owners of Holdco (i.e., the trust). See IRC Sec. 704(c). Holdco could "call" part of the preferred, after the sale of securities, in order for the beneficiary to have sufficient cash to pay his taxes that are associated with the allocated gain. If the beneficiary is in a marginal bracket that is lower than the top marginal bracket of the trust, substantial capital gains taxes may be saved.

(3) 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.

In this example, on the death of the beneficiary, Holdco could elect to have an adjustment of its inside basis on its assets under IRC Sec. 754 that are proportionately represented by the preferred interest. That election could save future capital gains and health care taxes when those assets are sold.

(4) 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.

The problem with a trustee distributing cash to a beneficiary in order to lessen the income tax and health care tax burdens is that cash can be spent by the beneficiary instead of being saved and bequeathed to future generations on the death of the beneficiary. A distribution of cash is also readily available to creditors and spouses on divorce. It may be difficult for a beneficiary to find a buyer for the preferred interest. The preferred interest could be subject to a buy-sell agreement. It is generally very likely the preferred interest will still be owned by the beneficiary on his or her death.

(5) 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.

If Holdco earns more than the coupon that is distributed to the beneficiary those excess earnings will accrue to the other beneficiaries of the trust.

(6) The valuation rules of IRC Sec. 2701 probably do not apply to these illustrated transactions.

The valuation rules of IRC Sec. 2701, which apply for gift tax purposes in valuating gifts of common interests in a manner that overrides the hypothetical willing buyer, willing seller standard should not apply in this context. See the discussion in Section V F 3 b of this paper. IRC Sec. 2701 does not apply for generation-skipping purposes. Secondly, IRC Sec. 2701 does not apply, if preferred interests are transferred instead of being retained. See the discussion in Section V F 3 b of this paper. Third, it is difficult to see how a distribution by a trustee to a beneficiary is a gift by any person as a donor, if the trustee is properly exercising fiduciary discretion. Since IRC Sec. 2701 does not apply, this may allow greater flexibility in designing the preferred to comply with the traditional willing buyer, willing seller standard.

c. Considerations of the technique.

(1) It adds a layer of complexity to the administration of the trust.

(2) The beneficiary may not bequeath the preferred interest in a manner consistent with the remainderman provisions of the complex trust.

These same considerations exist with a distribution of cash to the beneficiary.

(3) Creditors of the beneficiary, including divorced spouses, may be able to attach the preferred interest.

These same considerations exist with a distribution of cash to the beneficiary.

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

a. The technique.

A complex trust may significantly reduce its income taxes and may increase its net worth, if it invests its assets in a partnership for a preferred interest and a grantor trust invests in the partnership for a growth interest. Consider the following example:

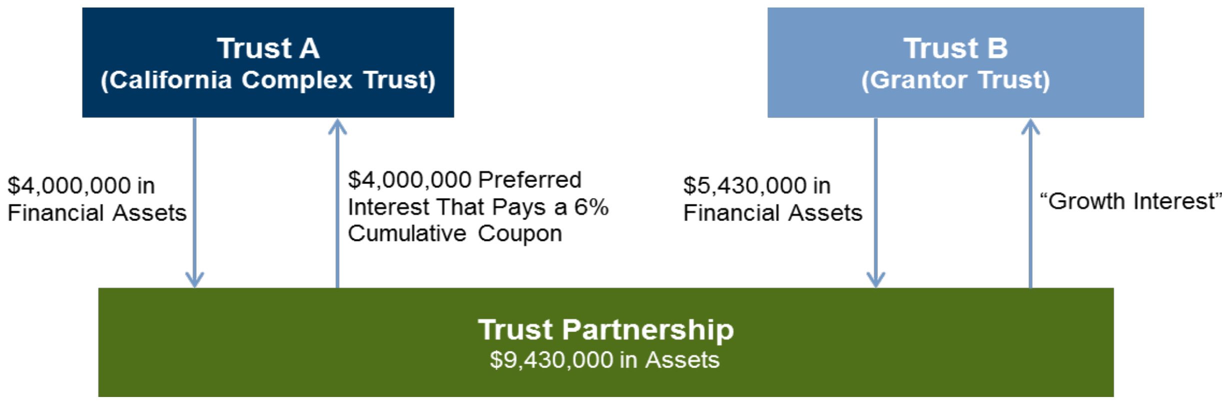
Example 17: Old Complex Trust Enters Into a
<u>Two-Class Partnership With a New Grantor GST Trust</u>

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

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

The proposed transaction is illustrated below:

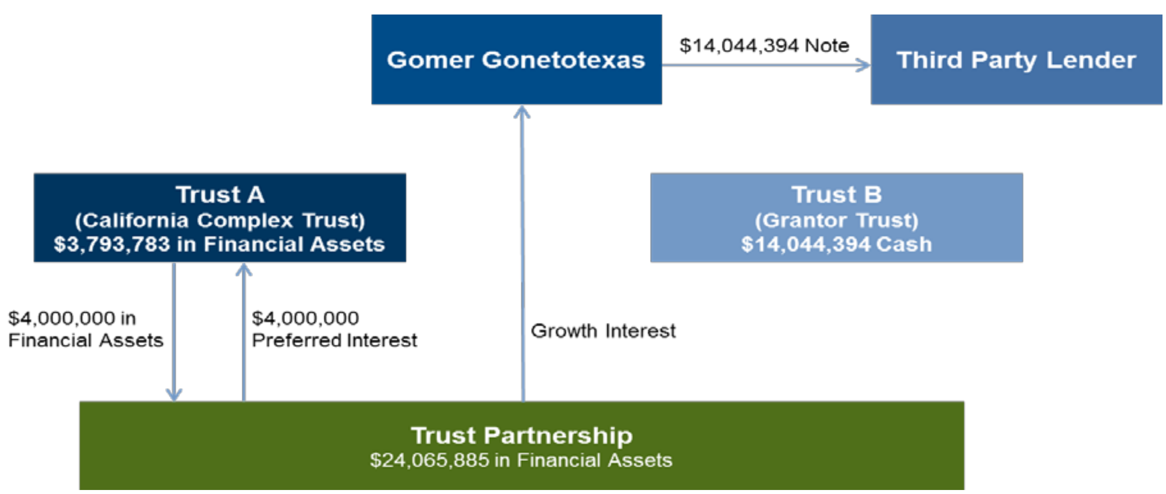
Transaction One:



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. See the discussion in Sections V C and V E of this paper. That transaction is illustrated below:

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



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

b. Advantages of the technique.

(1) 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 technique described is Scenario A in Table 9 below (also see attached Schedule 7). Over a 20-year period Trust A will pay 16.2% less in the total of state income taxes and associated investment opportunity costs by using this technique. If the beneficiaries of Trust A, Trust B and Gomer's estate are the same, Gomer's estate will save $3,380,750 in estate taxes and Gomer's descendants will receive $38,150,544 in assets in comparison to $33,727,835 in assets with no further planning.

Table 9

	Gonetotexas Beneficiaries			Consumption		IRS Income Taxes		CA Income Taxes		Opportunity Cost/ (Benefit) of 3rd Party Note	IRS Estate Tax (at 40.0%)	Total
		Children & Grandchildren										
	Children	California Complex Trust	Texas Grantor Trust	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost			
20-Year Future Values												
No Further Planning	$15,428,576	$9,609,259	$8,690,000	$12,772,329	$13,053,175	$14,277,270	$13,716,783	$1,257,693	$977,577	$0	$10,285,717	$100,068,380
Hypothetical Technique Scenario A	$10,357,451	$12,333,221	$15,459,872	$12,772,329	$13,053,175	$14,389,073	$13,719,802	$986,747	$887,382	($795,639)	$6,904,967	$100,068,380
Hypothetical Technique Scenario B	$10,165,130	$10,164,400	$18,638,941	$12,772,329	$13,053,175	$14,588,078	$13,924,521	$493,205	$443,626	($951,776)	$6,776,753	$100,068,380
Present Values (discounted at 2.5%)												
No Further Planning	$9,415,611	$5,864,252	$5,303,254	$7,794,581	$7,965,974	$8,713,003	$8,370,954	$767,534	$596,587	$0	$6,277,074	$61,068,825
Hypothetical Technique Scenario A	$6,320,851	$7,526,606	$9,434,710	$7,794,581	$7,965,974	$8,781,233	$8,372,797	$602,183	$541,543	($485,555)	$4,213,901	$61,068,825
Hypothetical Technique Scenario B	$6,203,483	$6,203,038	$11,374,804	$7,794,581	$7,965,974	$8,902,680	$8,497,730	$300,988	$270,732	($580,841)	$4,135,655	$61,068,825

(2) 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.

(3) This technique may be easier to manage than some of the other trust income tax savings techniques.

(4) If the two trusts have identical provisions the valuation rules under IRC Sec. 2701 may not apply.

IRC Sec. 2701 valuation rules do not apply for generation skipping purposes. If the two trusts have identical provisions it is difficult to see a gift tax issue or fiduciary issues, if the creator of Trust B is not entitled to any distributions from Trust A because his standard of living is met by other sources.[384] If there is no gift tax or GST tax issue, the trustee of Trust A, because Trust B

[384] *See* Treas. Reg. §25.2511-1(g)(1) and *Saltzman v. Comm.*, 131 F.3d 87 (2nd Cir., 1997).

has the same identical beneficiaries may believe it is in the Trust A beneficiaries' best interest to receive a 3% cumulative preferred interest instead of a 6% cumulative preferred interest in order to save state income taxes.

The technique described above is Scenario B in Table 9 above (also see attached Schedule 7). Over a 20-year period Trust A will pay 58.1% less in the total of state income taxes and associated investment opportunity costs by using this technique. If the beneficiaries of Trust A, Trust B and Gomer's estate are the same, Gomer's estate will save $3,508,964 in estate taxes and Gomer's descendants will receive $39,968,471 in assets in comparison to $33,727,835 in assets with no further planning.

c. Considerations of the technique.

(1) A party may not exist that could create a grantor trust that could invest and receive a preferred partnership interest.

(2) The technique is complex.

(3) In certain circumstances it may be better for the new grantor trust to own the preferred interest if a high coupon is warranted (e.g., 11% – 12%) because the new grantor trust is contributing 80% – 90% of the assets of the partnership. Under these circumstances, if the leveraged reverse freeze is used, the 80% – 90% preferred interest capitalization could be obtained with minimal gift tax consequences by using a contribution from the new grantor trust. See Section V G 3 below in this paper.

(4) In certain circumstances it may be more profitable for the old trust to sell the high basis assets to the new trust for a low interest (AFR rate) note to the new trust.

(5) The IRS may argue that the valuation rules of IRC Sec. 2701 apply despite the identical provisions and beneficial interests of the two trusts.

(6) If there is not a buy-back of the growth interest by the grantor of the new grantor trust before the death of the grantor much of the income tax benefit will be lost because of the lack of step-up that accrues for the assets held in the new grantor trust.

3. The Use of a Leveraged Reverse Freeze to Shift Trust Taxable Income From a High Income Tax State to a Low Income Tax State.

Consider the following example:

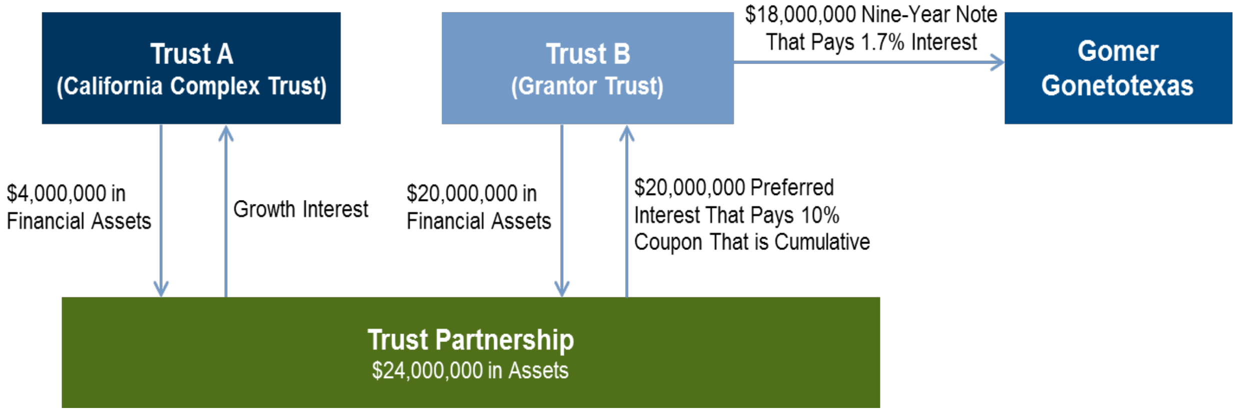
Example 18: A Leveraged Reverse Freeze is Used to Shift Trust
<u>Taxable Income From a High Income Tax State to a Low Income Tax State</u>

The facts are similar to Example 17, except Gomer Gonetotexas contributes all of his net worth ($20,000,000) to a partnership with Trust A and receives a mezzanine preferred partnership interest that pays a cumulative coupon with a coupon rate that is consistent with

Revenue Ruling 83-120 (that rate for purposes of this example is assumed to be 10%). Trust A will receive the growth interest. Gomer then contributes $2,000,000 of the preferred interest and sells $18,000,000 of his preferred interest to Trust B, which has the same provisions as Example 17, in exchange for a nine-year note that pays an AFR interest rate.

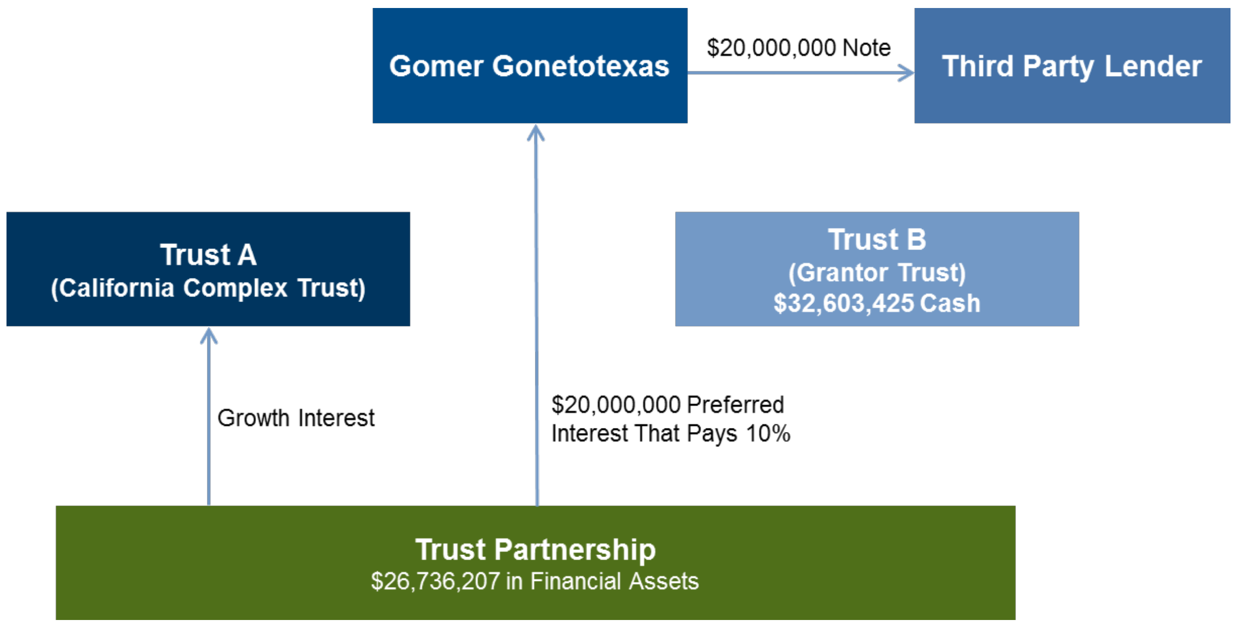
This example is illustrated below:

Transaction One:



Transaction Two:

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



a. The technique.

Under Revenue Ruling 83-120 if a preferred interest represents 80% of the capitalization of a partnership, the coupon rate of that preferred, in order to support par value, should be very high. The preferred value, under those circumstances, should have a yield that is similar to mezzanine financing.

In order to transfer $20,000,000 of preferred to a new grantor trust without gift taxes without gift taxes it may be necessary to have a part gift/part sale transaction of the preferred interest to the grantor trust. Two million of the preferred could be given to the new grantor trust and $18,000,000 of the preferred could be sold to the new grantor trust.

If the assets of the partnership average earning 7.4% and 80% of the capitalization of the preferred is a preferred entitled to a 10% coupon then income of the partnership will be allocated all to the preferred.

In order to get a step-up in basis on the preferred and the inside basis of the assets of the partnership after an IRC Sec. 54 election is made on the death of Gomer, considerations should be given to Gomer purchasing the preferred from Trust B for cash before Gomer's death. See the discussion in Section V E and V I of this paper.

b. Advantages of the technique.

(1) Significant state income taxes and the investment opportunity costs associated with those state income taxes can be saved with this technique.

See Table 10 below and attached Schedule 8. In this technique all of the potential state income taxes and the opportunity costs associated with those state income taxes are eliminated. Under the assumptions of this Example 18, $1,264,013 in state income taxes will be saved and $995,794 in investment opportunity costs on those state income taxes will be saved for a total savings of $2,259,807.

(2) Significant transfer taxes will be saved under this technique.

See Table 10 below and attached Schedule 8. Under the assumed facts of this Example 18, all of the estate taxes are eliminated.

Table 10

	Gonetotexas Beneficiaries			Consumption		IRS Income Taxes		CA Income Taxes		Opportunity Cost/ (Benefit) of 3rd Party Note	IRS Estate Tax (at 40.0%)	Total
		Children & Grandchildren										
	Children	California Complex Trust	Texas Grantor Trust	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost	Direct Cost	Investment Opportunity Cost			
20-Year Future Values												
No Further Planning	$15,428,576	$9,609,259	$8,690,000	$12,772,329	$13,053,175	$14,270,950	$13,698,567	$1,264,013	$995,794	$0	$10,285,717	$100,068,380
Hypothetical Technique	$0	$4,000,000	$43,359,947	$12,772,329	$13,053,175	$15,967,067	$14,173,982	$0	$0	($3,258,119)	$0	$100,068,380
Present Values (discounted at 2.5%)												
No Further Planning	$9,415,611	$5,864,252	$5,303,254	$7,794,581	$7,965,974	$8,709,146	$8,359,837	$771,391	$607,704	$0	$6,277,074	$61,068,825
Hypothetical Technique	$0	$2,441,084	$26,461,316	$7,794,581	$7,965,974	$9,744,237	$8,649,969	$0	$0	($1,988,336)	$0	$61,068,825

(3) 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 insurance could serve as a hedge to Gomer's early death.

(4) In general, this technique has the same advantages discussed in Section V G 1 b of this paper.

c. Considerations of the technique.

This technique has many of the same considerations that are discussed in Section V G 1 c of this paper.

H. Post-Mortem Strategies That Lower the Net Total Income Tax and Transfer Tax.

1. Use of a Leveraged Buy-Out of a Testamentary Charitable Lead Annuity Trust ("CLAT").

a. The technique.

(1) Introduction.

The "conventional wisdom" this author sometimes hears on this subject is as follows: "one can never self-deal, even on a fair basis, with a foundation or a CLAT;" "the problem with testamentary gifts to charity is that the decedent's family always ends up with substantially less;" or "the problem with testamentary CLATs is that the decedent's family has to wait a long time to have access to the decedent's assets." This "conventional wisdom," under the circumstances discussed below, is incorrect.

Assume a client, at his death, wishes for part of his estate to go to his family and the rest to his favorite charitable causes. One technique that is generally considered under those circumstances is the CLAT.

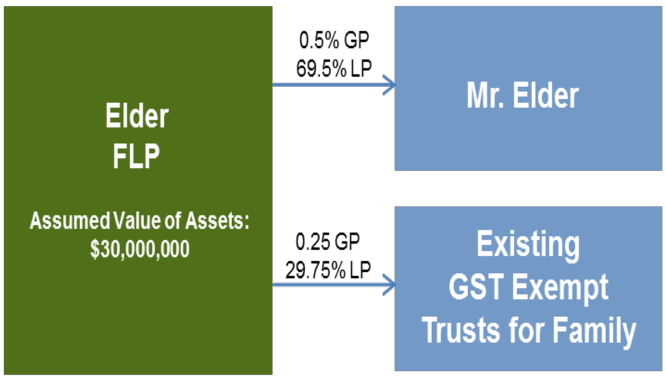
Example 19: Use of a Testamentary CLAT in Conjunction With a
<u>Leveraged Redemption of a Partnership Interest Held by a Decedent</u>

Ed Elder and his family create a FLP. Ed Elder owns 70% of the partnership interests after contributing $30,000,000 in assets to the FLP and doing some lifetime gifting to a generation-skipping trust. Ed does not have any estate tax exemption remaining. The estate tax rate is 40%. However, Ed dies unexpectedly before he has had a chance to make additional transfers of limited partnership interests to trusts for the benefit of his family. It is assumed a valuation discount of 40% of the transferred partnership interests is appropriate. What would be the effect on Ed's estate plan, under those circumstances, if his will bequeaths an upfront dollar gift to trusts for the benefit of his family and the rest to a "zeroed out" testamentary charitable lead annuity trust (CLAT)?

Assume Ed's will provided that the first $3 million of his estate goes to trusts for the benefit of his family and the rest to a 100% "zeroed out" CLAT that is to last for 20 years. Assume that the FLP buys out the charitable lead annuity trust interest in a probate trust proceeding that fits the requirements of the regulations under IRC Sec. 4941.[385] *Assume the partnership interest is redeemed with an interest only note (which pays interest equal to the dollar amount that is owed for the annuity payments to the charitable beneficiaries of the CLAT) with the principal of the note being paid in the 20th year. Finally, it is assumed that the IRC Sec. 7520 rate is 1.0% at the time of Ed's death.*

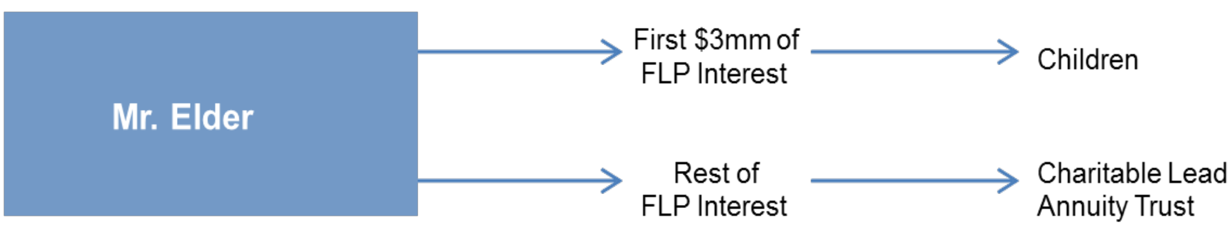
This technique is illustrated below:

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



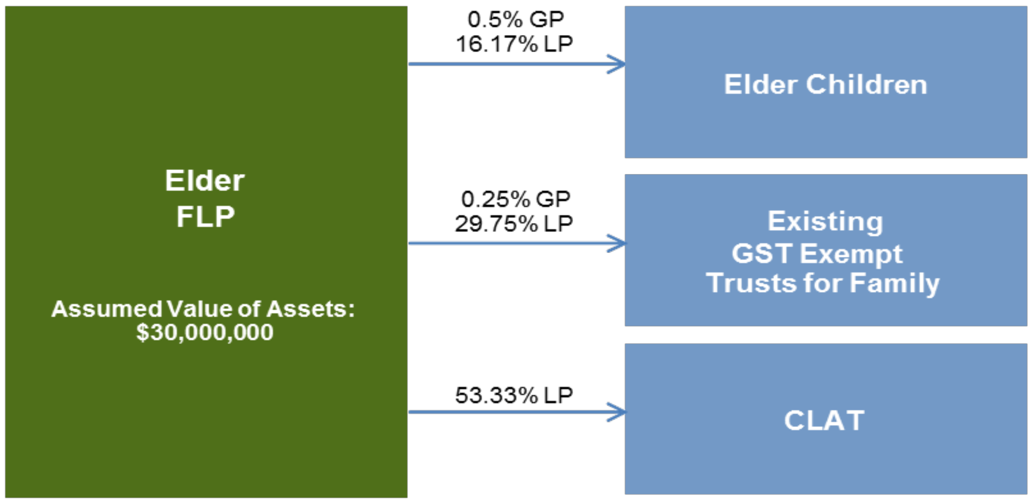
Elder, LP Partner	Ownership (%)
Mr. Elder	0.5% GP; 69.5% LP
Existing GST Exempt Trusts for Family	0.25% GP; 29.75% LP

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

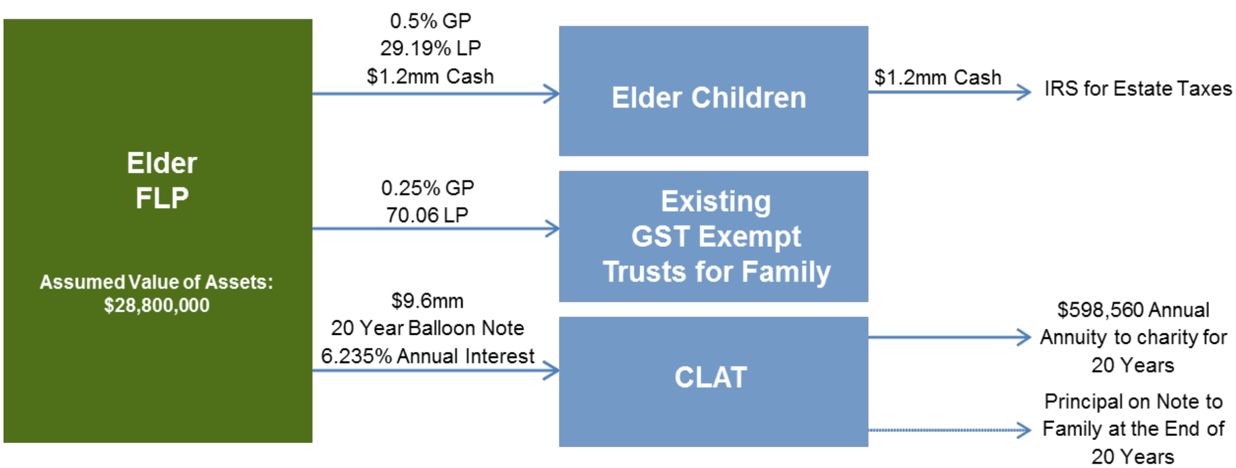


385 *See* P.L.R. 200207029 (Nov. 21, 2002); P.L.R. 200124029 (Mar. 22, 2001); P.L.R. 20024052 (Nov. 2, 2001); *see also* Daniels & Leibell, "Planning for the Closely Held Business Owner: The Charitable Options," 40th Philip E. Heckerling Institute on Estate Planning, Chapter 12 (2006).

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



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



(2) What is a CLAT?

See Section V F 4 of this paper.

(3) What is a leveraged buyout testamentary CLAT?

During probate administration, one of the exceptions to the self-dealing rules, with respect to foundations and CLATs, is that a self-dealing transaction may occur if certain restrictions are met. For instance, if a partnership interest that is to pass to a CLAT is redeemed for a note that may be a permissible transaction.[386] One requirement is that the note has a fair market value that is at least equal to or greater than the fair market value of the existing redeemed partnership interest. Another requirement is that the note must be just as liquid, if not more liquid, than the existing partnership interest. Assuming the appropriate probate court approves the leverage buyout, the note could be structured to be an interest only negotiable note, with the interest rate being higher than the existing AFR rate (e.g. 5.42% in comparison to a long term AFR of 2.18%), with a balloon payment at the end of 20 years (assuming a 20 year testamentary CLAT).

b. Advantages of the technique.

(1) No estate taxes have to be paid with a gift to a properly structured and implemented zeroed-out CLAT.

(2) There is a partial step-up in basis in the decedent's partnership interest that is bequeathed to a zeroed-out CLAT.

If a discounted partnership interest is bequeathed to a CLAT the assets of the partnership may receive a partial step-up in basis if an IRC Sec. 754 election is made. The step-up in the partnership assets will need to take into account the valuation discounts that will exist with the bequeathed partnership interests.

(3) If the decedent bequeaths a dollar gift to his family and the rest of his estate to a zeroed-out CLAT, his will acts like a defined value allocation clause.

Even if all of the assets of the estate are hard to value, the only estate taxes to be paid are on the dollar gifts to the family. Any increase in the value of the estate by the IRS will result in no increase in estate taxes and a future decrease in income tax revenues.

(4) 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.

What would the results be for Ed's family and his charitable beneficiaries under those circumstances in comparison to a gift only to his family (with the IRS allowing a full discount for the partnership interests)? What would be the comparison if the IRS did not allow any discount for the gift to the family? What difference would it make in comparison of the various alternatives if the family earned 3% before taxes, 7.5% before taxes and 10% before taxes during the 20-year period after Ed's death? What difference would it make if instead of bequeathing $3 million to Ed's family, Ed had bequeathed $10 million to his family with the rest to the zeroed out CLAT? The results of those comparisons are summarized below (please see Schedule 9 attached).

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[386] *See* Treas. Reg. Section 53.4941(d)-2; *see also* Matthew J. Madsen, "Funding a CLAT with a Note," 30 Est. Plan 495, 2003 WL 22213736 (2005).

Table 11a
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

Table 11b
Summary of Results For $30 Million of Assets Growing at 7.50% 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

Table 11c
Summary of Results For $30 Million of Assets Growing at <u>10%</u> 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 primary reason the leveraged buy out CLAT technique has a good result for both the client's family and the client's favorite charities, is that, in effect, the client's family is getting two different tax deductions for the interest payments that they are making on the note. There is an estate tax deduction (i.e., the zeroed out CLAT annuity payments) and the family owners of the FLP are also receiving an income tax deduction on the interest payments (assuming there is enough partnership investment income to offset the interest expense). The combined effect of those two different tax deductions is to heavily subsidize the interest payments. Another reason the technique has a good result for the family is that they are not out-of-pocket cash to pay the principal of the note to a third party. From Ed Elder's children's perspective, the principal of the note is, in effect, paid to themselves, since they are the remainderman of the CLAT.

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

One of the downsides of a long term testamentary CLAT (e.g. 20 year term CLAT) is that the remainder beneficiaries have to wait until the CLAT terminates to access the capital of the CLAT. With the leveraged buy-out testamentary CLAT, assuming a conservative sinking fund is set aside to pay future interest payments, the family owners of the partnership may access the rest of the funds of the partnership and, of course, invest the rest of the funds of the partnership.

c. Considerations of the technique.

(1) Need to get probate court approval.

As noted, above the appropriate probate court will need to find that the note has a fair market value equal to or greater than the partnership interest that is being redeemed and the note needs to be more liquid than the redeemed limited partnership interest. The second requirement should be relatively easy to satisfy if the note is negotiable and the first requirement should also be easy to satisfy because subject interest rate should be equal to or greater than the true "fair market value" interest rate.

(2) Leverage could work against the family unless a carefully constructed partnership sinking fund is utilized to pay future interest payments.

If the managers of the partnership do not carve off part of the partnership assets to develop a carefully constructed sinking fund that is conservative in order to assure that future interest payments that are paid to the charitable beneficiary of the CLAT, the assets of the partnership, and the assets available to the family, could decrease.

2. 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.

a. The technique.

Portability permits the estate of the first spouse to die of a married couple to elect to transfer the DSUE amount to the surviving spouse who could use it for making gifts and sales to a grantor trust.[387] 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.

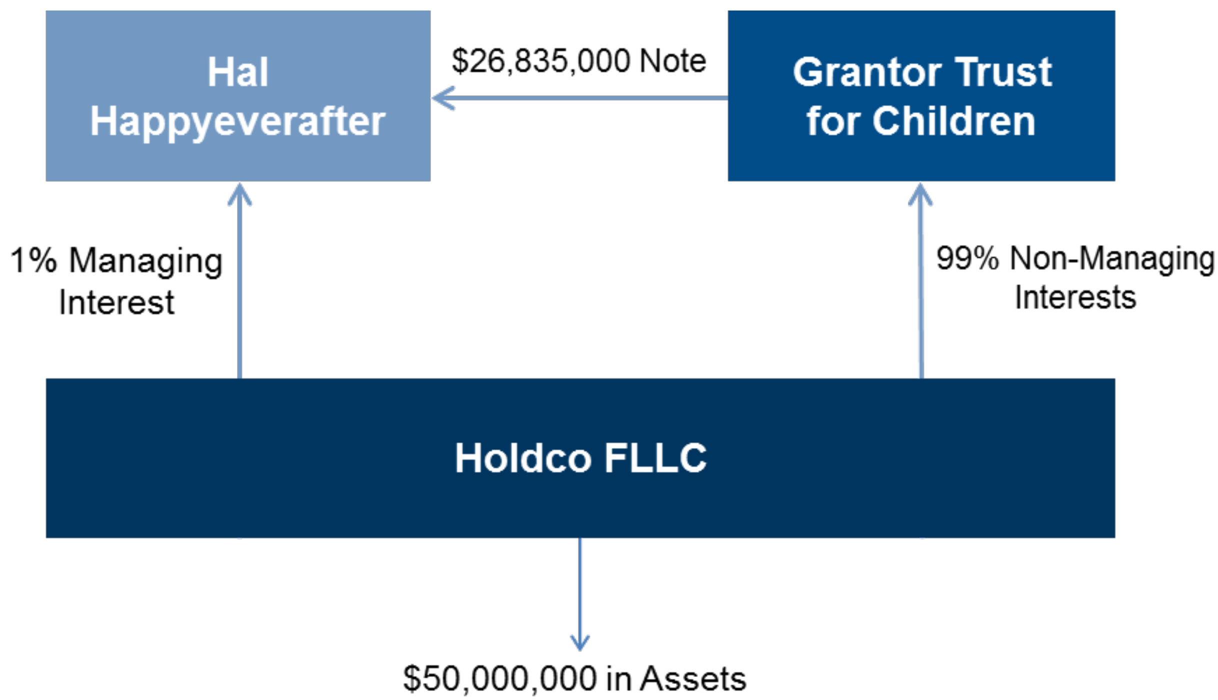
Example 20: Use of the DSUE Amount to Simulate a
Significantly Larger Credit Shelter Trust Than What Can Be
Created By the Use of a Decedent's Available Unified Credit

Harriett Happyeverafter is married to Hal Happyeverafter. Harriett has been very successful and has built a $50,000,000 estate during her 50-year marriage. Her goals, if Hal survives her, are to provide for Hal. Upon Hal's death, Harriett wishes for her remaining estate pass to their children. Harriett has never engaged in lifetime gifting strategies for a variety of reasons, one of which is that she has very low basis assets. Harriett likes the protection, tax benefits and simplicity of the credit shelter trust that could be created on her death. However, Harriett is concerned that the credit shelter trust only protects about one-tenth of her net worth from future estate taxes and creditors. Harriett is intrigued about the possibility of Hal using her DSUE amount, and other techniques, to simulate a significant credit shelter trust for Hal's benefit and their children's benefit.

[387] *See*, Thomas W. Abendroth "Portability: Now Available in Generic Form" Chapter 2, 48th Annual Heckerling Institute on Estate Planning (June, 2014).

Harriett tells her attorney, Ima Mathgeek, that Hal will need approximately $500,000 a year for his consumption needs. Harriett would like Hal to control her investments after her death. Harriett asks Ima to make the following assumptions: her assets will annually earn 7.4% before income taxes with 0.6% of the return being taxed at ordinary rates, 2.4% of the return being tax-free and 4.4% of the return being taxed at long-term capital gains rates (with a 30% turnover rate). Harriett asks Ima to assume Hal will live for 10 years after her death. Harriett asks Ima to design a structure that Hal could use with the DSUE amount to simulate the tax benefits and creditor protection benefits of a larger credit shelter trust.

Ima suggests that after Harriett's death Hal could create a single member FLLC with managing and non-managing interests. Hal in independent steps could gift and sell the non-managing interests to a grantor trust in which their children are beneficiaries. The original gift to the grantor trust will use the DSUE amount. Ima assumes a 30% valuation discount for the non-managing interests will be allowed. The structure, after completion, is illustrated as follows:



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. See the table below and attached Schedule 10.

Table 12

	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

b. Advantages of the technique.

(1) Significantly more assets may be passed to the next generation by using this technique than using the exemption to fund a credit shelter trust.

Using the synergies of a discounted sale of non-member interests to a grantor trust and paying the note with pre-income tax dollars, is a much more powerful planning technique than a transfer to a complex trust that pays its own income taxes. This technique, once again, demonstrates the synergistic power of discounted sales to a grantor trust.

(2) There is a step-up in basis of the deceased spouse's assets at her death.

This technique is particularly advantageous for a taxpayer who has a low basis or negative basis asset. There will be a step-up in basis that is equal to the fair market value of the assets.

(3) 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.

The surviving spouse could substitute cash for any assets owned by Holdco that appreciate during his lifetime. See Section V E of this paper. It is much more difficult to use borrowing strategies to enhance the basis of trust assets in a complex trust.

(4) Significantly more assets may receive protection from creditors by using sales to grantor trusts with the use of the DSUE amount then using the exemption to fund a credit shelter trust.

See the above analysis and Schedule 10.

(5) 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.

There are certain advantages from the surviving spouse's point of view, and the family's point of view, in having the trust's obligations to the surviving spouse being contractual, instead of being under a discretionary standard that is subject to the fiduciary constraints of trust law and the trust document. In comparison to changing a trust document, changing a contract, if circumstances change, is relatively easy (assuming all parties to the contract agree). For instance, in this example, after a few years after the note has been reduced, it may be in Hal's best interest, and the trust's best interest, to convert part, or all, of the note to a private annuity. If the trustee and Hal agree to the change it may be changed without court involvement. A similar profound change in a trust document may require court involvement and the appointment of representatives for minor beneficiaries and unborn beneficiaries.

(6) All of the advantages of creating a grantor trust and selling assets to a grantor trust are present with this technique.

c. Considerations of the technique.

(1) The surviving spouse may not transfer the DSUE amount in the manner that the deceased spouse anticipated.

This probably is not a technique that a taxpayer should use if there is any doubt that her spouse will not use the DSUE amount as anticipated. For instance, this may not be a very good technique in second marriage situations in which there exist blended families.

(2) 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.

Generally, with respect to existing creditors of a surviving spouse, a third party created trust had a much better chance of protection than a trust created by the surviving spouse.

(3) This technique has the same considerations as the creation of a grantor trust and a sale to a grantor trust.

(4) The GST tax exemption is not portable.

A credit shelter trust may be designed to be a dynasty trust. The grantor trust that is created by using the deceased spouses DSUE amount may not be generation skipping tax protected. The surviving spouse could use his own exemption to create a generation skipping trust that is also a grantor trust and save the DSUE amount to protect his estate on his death from estate taxes. The surviving spouse could also use his own exemption to create a generation-skipping trust that is also a grantor trust, use the DSUE amount to create a grantor trust for the first generation, with the first generation trust using low interest loans to the generation-skipping trust to maximize the generation-skipping benefits.

(5) It may be more advantageous to convert a traditional credit shelter trust, with its attendant creditor protection and GST advantages, to an IRC Sec. 678 grantor trust by using the QSST technique.

See the discussion of this technique in Section V H 3 below in this paper.

(6) 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.

However, unless there is careful management of the grantor trust during the grantor's lifetime, significant capital gains cost could accrue in comparison to creating the grantor trust after the grantor's death.

(7) 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.

3. 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.

a. 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.

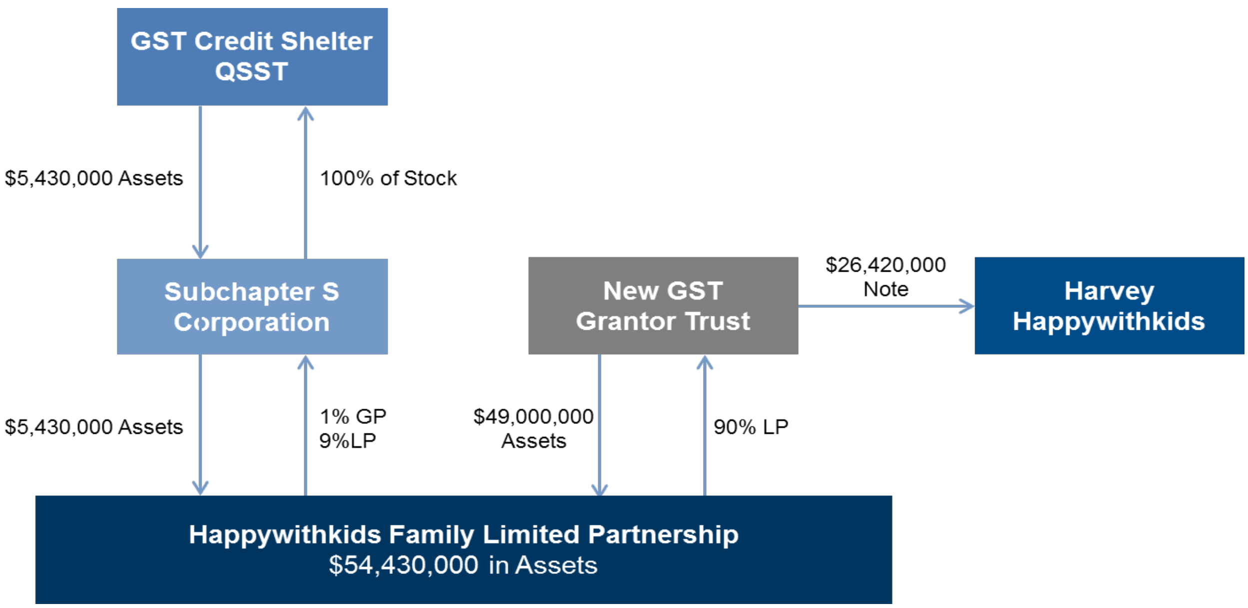
Consider the following example in which the credit shelter trust and the surviving spouse form a FLP together. The credit shelter trust then contributes its share of the partnership to a Subchapter S corporation and the credit shelter trust becomes a QSST. The surviving spouse could use the unified credit to create a new grantor GST trust and could sell his remaining partnership interest to the new grantor trust.

Example 21: Harvey Happywithkids and a Credit Shelter Trust
Create a FLP, the Credit Shelter Trust Contributes its Partnership Interest
to a Subchapter S Corporation, the Credit Shelter Trust Becomes a QSST,
and Harvey Gifts and Sells His Partnership Interest to a New Grantor Trust

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

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

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



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

What is a QSST? A QSST is a trust that has only one income beneficiary and any corpus distributed during the life of the current beneficiary may only be distributed to that beneficiary. After an election is made by the beneficiary, the beneficiary is taxable on the taxable income of any Subchapter S stock that is owned by the trust as if the trust is a grantor trust to the beneficiary under IRC Sec. 678(a).

Under IRC Sec. 678(a) the trust is ignored for income tax purposes, at least with respect to any Subchapter S stock that is held in the trust. The IRS confirmed this grantor trust treatment of Subchapter S stock owned by a QSST as to the beneficiary of the QSST in Revenue Ruling 92-84.[388] The key holdings of that Revenue Ruling are as follows:

> Section 1361(d)(1)(B) of the Code provides that, for purposes of section 678(a), which sets forth the rules for when a person other than the grantor will be treated as a substantial owner, the beneficiary of a QSST shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under section 1361(d)(2) is made.
>
> …
>
> A has made the election under section 1361(d)(2) of the Code with respect to TR and M corporation. Therefore, under section 1361(d)(1)(B), A is treated as the owner of that portion of TR that consists of stock in corporation M for purposes of section 678(a).
>
> …
>
> Section 678(a) is within subpart E of subchapter J of the Code. Therefore, the provisions of section 671 are applicable to the stock of an S corporation with respect to which the beneficiary has made an election under section 1361(d)(2).
>
> Section 1.671-2(b) of the Income Tax Regulations provides that when it is stated in the regulations under subpart E that 'income' is attributed to the grantor or another person, the reference, unless specifically limited, is to income determined for tax purposes and not to income for trust accounting purposes.
>
> Section 1.671-2(c) of the regulations provides that an item of income, deduction, or credit included in computing the taxable income and credits of a grantor or another person under section 671 is treated as if it had been received or paid directly by the grantor or other person (whether or not an individual).
>
> Section 1.671-3(a)(2) of the regulations provides that, if the portion treated as owned by a grantor trust or another person consists of specific trust property and its income, all items directly related to that property are attributable to that portion.
>
> Accordingly, where a grantor or another person is treated as the owner of property constituting corpus under subpart E, the trust is disregarded as a separate entity and any gain or loss on the sale of such corpus is treated as gain or loss of such person.

It should be noted that the IRS revoked Revenue Ruling 92-84, because of cash problems caused by installment sales of Subchapter S stock by a QSST when it modified Treas. Reg. §1.1361-1(j)(8) in TD 8600 (7/20/1995). However, it would seem the other grantor trust aspects of the Revenue Ruling remain, which are consistent with IRC Sec. 1361 (i.e., for income tax purposes, the beneficiary of the QSST is treated as the income tax owner of any Subchapter S stock in the QSST and the beneficiary pays all of the income taxes on the Subchapter S income

[388] *See* Rev. Rul. 92-84, 1992-2 C.B. 216.

earned by the trust). It should also be noted that the trust assets other than the Subchapter S stock will be taxed under the normal Subchapter J rules.

After the trustee converts part of the trust assets to QSST, the trustee could manage the QSST in a manner which duplicates the result of a complex trust with lower income taxes. For instance, the trustee could only distribute that amount of cash from the trust owned Subchapter S stock that is necessary for the beneficiary to pay his income taxes.

b. Advantages of the technique.

(1) Significant estate taxes can be saved with this technique.

Under the assumptions of this example over $24,000,000 in estate taxes can be saved with this technique in comparison to the first spouse to die creating a conventional credit shelter trust with no further planning. This technique, under the assumptions of this example, simulates the same result that would have been obtained if Harriett Happywithkids had a $45,000,000 unified credit that she used to create a credit shelter trust. See Schedule 11 attached and the table below:

Table 13

	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

(2) 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.

(3) Under this example, Harvey Happywithkids does not have to be paid back an equitable adjustment equal to the principal of the note, as is the case with a sale to a QSST like Example 20.

(4) It has all of the advantages of converting a complex trust to a QSST.

(a) The beneficiary may be in a lower tax bracket than the trust.

(b) There is not any concern about the effect of any lapse of withdrawal rights.

Unlike the limited income withdrawal trust, or other IRC Sec. 678 beneficiary grantor trust techniques, there is no need for the beneficiary of the QSST to have withdrawal rights, because there is no attempt to make all of the assets taxed as an IRC Sec. 678 trust (only the Subchapter S stock owned by the trust). The transfer tax, income tax consequences and creditor protection consequences that may accrue from the existence of a withdrawal right, and from its lapse, are not present in this technique.

(c) 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 net investment income, as noted above, is not allocated to the QSST, but is allocated to the beneficiary of the trust under IRC Sec. 678. Thus, if the beneficiary materially, or significantly, participates in the business of the Subchapter S corporation there is not any tax. Secondly, even if the beneficiary does not participate, the beneficiary may be in a lower bracket than the trust.

(d) The beneficiary of the QSST will have access to the cash flow distributed to the trust.

The beneficiary is the sole income beneficiary of the trust. The distributions could be adequate to pay the beneficiary's income taxes associated with the QSST.

(e) 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.

The beneficiary is entitled to receive the distributions paid on the Subchapter S stock held in the trust, as an income beneficiary. However, the beneficiary pays income taxes (and health care taxes) on all of the income associated with the Subchapter S stock owed by the QSST. Much of the income earned by the Subchapter S corporation could be retained by the corporation, and the trust and the Subchapter S corporation could be managed to simulate a complex trust that does not pay income taxes, which only distributes that amount of cash necessary so that the beneficiary may pay his income taxes on the income earned by that trust.

(5) It has all of the advantages of a sale to a grantor trust.

(6) 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.

c. Considerations of the technique.

(1) 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).

Thus, this technique lacks the flexibility to change beneficiaries because of changed circumstances in comparison to techniques in which the surviving spouse sells assets to a trust in which the surviving spouse is a beneficiary and has a power of appointment, the surviving spouse has the significant flexibility to redirect assets if circumstances change.

(2) This technique has the same considerations of converting a complex trust to a QSST.

(a) The federal income tax considerations with utilizing a Subchapter S corporation.

However as noted below, many of the income tax considerations may be either mitigated, eliminated, or do not really exist in comparison to certain of the techniques.

A Subchapter S corporation is generally more advantageous from an income tax standpoint than a Subchapter C corporation, because there are not any corporate taxes to be paid for a corporation that qualifies. A Subchapter S corporation can own passively managed assets, if the corporation has never been a C corporation.

One of the considerations of a Subchapter S corporation is that only certain shareholders may qualify. Shareholders must be United States citizens. To the extent the Subchapter S stock is owned by a trust, the trust needs to be a grantor trust, a QSST or an electing small business trust (ESBT). Of these, the only trusts to which sales of Subchapter S stock may be made without realization of gain are grantor trusts (sale by the grantor) and QSST trusts (sale by the trust beneficiary).

Another consideration of a Subchapter S corporation is that there is not a step-up on the underlying assets of the Subchapter S corporation on the death of the shareholder who owns stock that is subject to estate taxes. FLPs and FLLCs, pursuant to certain elections that can be made under IRC Sec. 754, have the ability to have certain of the partnership assets receive an internal basis step-up on the death of a partner or member who owns the partnership interest or member interest (assuming the assets have appreciated). This may not be a significant consideration, if the planning goal is to have the stock out of the client's estate by the time of the client's death. Obviously, there would also not be a basis change under that goal and those facts, even if a partnership was used in the transfer planning – a taxpayer cannot receive a basis step-up on the underlying assets of the partnership assets, if the taxpayer does not own a partnership interest at the taxpayer's death.

Nevertheless, to the extent Subchapter S stock has not been transferred, and is included in a decedent's estate, the step-up in basis of a decedent's ownership of the Subchapter S stock will not be proportionately allocated to the Subchapter S corporation's low basis assets as would be the case if the decedent owned a partnership interest and an IRC Sec. 754 election were made. However, in some cases, this disadvantage may only be one of timing. For instance, assume in the same year, after the death of the owner of the Subchapter S stock, the Subchapter S corporation sells some of its low basis assets for cash in a transaction that generates capital gain. The corporation may use that cash to redeem the Subchapter S stock. The estate will be allocated its share of the gain on that Subchapter S corporation sale, which will further increase the estate's basis in its Subchapter S shares. That redemption will generate a capital loss (since the estate's basis is equal to its fair market value at death plus its share of the gain generated by Subchapter S corporation sales of the low basis assets), which will be offset by the estate's share of Subchapter S gain on the sale of the low basis assets.

If future generations wish to terminate a Subchapter S corporation, there may be immediate capital gains consequences in comparison to the assets being held in a partnership or FLLC. If the assets owned by the Subchapter S corporation are sold immediately after, or before, the termination, that capital gains comparative disadvantage to a partnership organization may be mitigated. That inside basis disadvantage may also be mitigated by the use of drop down partnerships and leverage strategies, which are discussed in Section V I 2 and V I 3 of this paper.

(b) Any assets of the QSST that are not Subchapter S stock will be taxed under normal Subchapter J rules.

As noted above, under Treas. Reg. Sec. 1.1361-1(j)(8), if there is a sale by the trustee of the QSST of any Subchapter S stock owned by the QSST, the QSST will be taxed on that sale under normal Subchapter J principles. The basis of the Subchapter S stock, that is to be sold, could be low because the only basis adjustment, after the sale of Subchapter S stock, will be the income of the corporation accumulated after the sale. It may be very important to eliminate any note outstanding to the Sec. 678 owner of the QSST, before the QSST sells its Subchapter S stock to a third party, in order to circumvent any income tax complications associated with the outstanding debt.

(c) State income tax considerations.

Certain states may have different tax rules with respect to Subchapter S corporations and the taxation of QSST trusts. Thus, the possibility exists that under many state laws, a sale to a QSST trust may be subject to state capital gains taxes and the beneficiary of the trust will not be taxed on the trust income. For example, a Missouri trust holds S corporation stock that owns Illinois real estate. When the real estate is sold, Illinois would tax the gain on the real estate, but the capital loss on liquidation of the stock would not be Illinois source loss, because the stock is not Illinois property.

(3) This technique has the same considerations as sales of limited partnership interests to a grantor trust.

I. Using Partnership Structures To Achieve Diversification While Delaying the Tax on That Diversification.

1. Key Partnership Tax Accounting Internal Revenue Code Provisions.

a. Generally, the contribution of low basis property to a partnership does not trigger gain, but it could.

The primary purpose of IRC Sec. 721 is to allow the formation of a partnership without the recognition of a taxable gain, thus encouraging the growth of new businesses. Many taxpayers have utilized the same concept in an effort to facilitate a sale through the diversification of their marketable investments. A simple example would be for two individuals to form a partnership with one individual contributing $100 of appreciated stock and the other individual contributing $100 of cash. If the partnership is economically a 50/50 arrangement between the partners, the effect of the formation is a sale of 50% of one partner's stock position to the other partner and the purchase of 50% of the stock position by the other partner. If transactions like this would be allowed, many taxpayers could escape the imposition of capital gains taxes on marketable security exchanges through structures that incorporated these concepts. Thus, certain tests were included in the Internal Revenue Code and the regulations that address these issues and preclude certain arrangements from achieving their disguised goals.

Subchapter K of the Internal Revenue Code indicates, that, in general, no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.[389] However, if the entity is considered an "investment company," then a taxable sale is deemed to occur.[390] The partners in the partnership must determine if a taxable contribution has occurred via the existence of an investment company. In general, an investment company includes an entity that owns stock, bonds, foreign currencies, REITS and other marketable securities.[391]

The Treasury Regulations further detail the definition of an investment company to include entities where the formation results, directly or indirectly, in diversification of the transferors' interests, and more than 80 percent of its value in assets (excluding cash and nonconvertible debt obligations from consideration) that are held for investment and are readily marketable stocks or securities, or interests in regulated investment companies or real estate investment trusts.[392]

[389] *See* IRC Sec. 721(a).

[390] *See* IRC Sec. 721(b).

[391] *See* IRC Sec. 351(e).

[392] Treas. Reg. Section 1.351-1(c)(1).

b. Certain partnership tax accounting rules must be navigated to make sure a partnership is not being used as a vehicle for a disguised sale.

Another area of potential taxpayer abuse involves the concept of a partnership formed to specifically disguise a sale where the investment company rules do not apply. A simple example would be for two individuals to form a partnership with one individual contributing $100 of a non-marketable asset through the ownership of two entities and the other individual contributing $100 of cash. If the partnership is economically a 50/50 arrangement between the ultimate partners, the effect of the formation is again a sale of 50% of one owner's asset to the other partner and the purchase of 50% of the asset by the other partner. Because the asset is not marketable, IRC Sec. 721 does not apply and the formation is not considered a taxable event. However, if the partnership acquired the interest of the second partner by delivering the non-marketable asset, the result would be the receipt of the asset by the second partner without the imposition of a tax and the retention of the cash by the original owner of the non-marketable asset through the partnership. In effect, the original owner would have sold the asset for cash yet not recognized any capital gain until the partnership is ultimately liquidated. In an effort to preclude such disguised sale planning opportunities IRC Secs. 704(c), 737 and 707 were included in subchapter K.

In essence, IRC Secs. 704(c) and 737 prevent the distribution of an appreciated asset to one partner that was originally contributed by another partner during a seven-year period.[393] Another way to view the section is that if a partnership exists for more than seven years, or five years if established prior to June 9, 1997, then the IRS probably will view the partnership as having a business purpose other than the disguised sale of an asset.

Besides the seven-year rule of IRC Secs. 704(c) and 737, there is the so-called two-year rule under the regulations of IRC Sec. 707.[394] If a partner transfers property to a partnership and receives money or other consideration, the transfers are presumed to be a sale. Due to the specificity of the two-year rule, a properly structured partnership could avoid the application of a disguised sale if the assets remain within the partnership for an appropriate length of time.

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

At some point in the future, the partners may wish to realize the economic benefits of their investment through the distribution of partnership assets or the liquidation of their interest in the partnership. IRC Secs. 731 and 732 address the taxation of such transactions.

Generally, gain will not be recognized to a partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution.[395]

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393 *See* IRC Secs. 704(c)(1)(B), 737(a), and 737(b).

394 *See* Treas. Reg. Section 1.707-3(c).

395 *See* IRC Sec. 731(a).

Because of the ease of liquidity related to marketable securities, the IRS has increasingly viewed such instruments as cash. Within the context of a partnership, IRC Sec. 731(c) was added to the Internal Revenue Code. In effect, marketable securities, if deemed to be money, can cause taxable gain, if the fair market value of the distributed securities exceeds the withdrawing partner's tax basis in the partnership.[396] As with many areas of the tax law, there are always exceptions to the rules. If a partnership meets the definition of an investment partnership, then it is excepted from the capital gain issue created by IRC Sec. 731(c).

The receipt of marketable securities will not be considered cash, if the partnership is an investment partnership. The general rule for qualifying as an investment partnership is the ownership of marketable investments and never engaging in an actual trade or business other than investing.[397]

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

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

Under IRC Sec. 732, if a partner receives an asset distribution from a partnership, the partner receives the asset subject to a carryover of the partnership's cost basis, and if the partner receives an asset distribution in liquidation of his interest, then the partner will attach his partnership interest cost basis to the assets received in liquidation.[398] The regulations highlight an example illustrating the result.[399]

e. Existing anti-abuse tax accounting rules.

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

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

If timely election is not made by the partnership (or a distribution and election by the distributee partner under IRC Sec. 732(d)), the death of a partner or a sale of a partnership interest, does not affect the inside basis of the assets held by the partnership at the time of the partner's death or sale. See IRC Secs. 754 and 743(a). However, under those circumstances, if that partnership interest is later completely liquidated the estate of successor partner takes a basis in the distributed assets equal to the basis in the partnership interest.

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396 *See* IRC Sec. 731(c).

397 *See* IRC Sec. 731(c)(3)(C)(i).

398 *See* IRC Secs. 732(a)(1) and 732(b).

399 *See* Treas. Reg. Section 1.732-1(b).

2. Use of Closely Held Family Partnerships.

a. The technique.

There are no prohibitions among related-party transactions that would impact any of the previously mentioned statutes and regulations. However, in a closely-held partnership, attention should be given to the treasury regulations under IRC Sec. 701 (the so-called "anti-abuse" rules). See the discussion in Section V I 1 e of this paper.

A variety of techniques have been developed over the years using privately-managed partnerships, contributions by partners, withdrawals by partners, loans to partnerships and/or loans to partners to substantially delay the taxation of the monetization that has occurred. In some cases, from the IRS point of view, these techniques constitute disguised sales. The techniques are generally referred to in this paper as "closely-held family" partnership techniques. The IRS, in a series of cases, litigated these techniques using certain common law tax doctrines. The IRS in a period from 1978 to 1983 had several significant losses litigating mixing bowl transactions.[400] This lead to the Tax Reform Act of 1984 in which many of the mechanical rules of subchapter K, which are noted in the prior discussion in Section I 1 of this paper. While Congress has now provided mechanical rules, the business purpose of the transaction still needs to be addressed in the context of the common law tax doctrines and the Anti-Abuse Rules of the Treasury regulations under IRC Sec. 701. A sample closely-held family structure technique, which is one of many, is discussed in Example 22 below[401]. In this example the estate tax savings associated with using a family partnership are preserved, while potentially doubling the basis of the family assets.

Example 22: 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

[400] *See Otey v. Commr.*, 70 T.C. 312 (1978), aff'd per curium 634 F.2d 1046 (6th Cir. 1980); *Communication Satellite Corp. v. U.S.*, 625 F.2d 997 (Ct. Cl. 1980); *Park Realty Co. v. Commr.*, 77 T.C. 412 (1981), acq. 1982-2 C.B. 2; and *Jupiter Corp. v. U.S.*, 2 Cls Ct 58 (1983).

[401] See Abrams, Howard "Now You See It; Now You Don't: Exiting a Partnership and Making Gain Disappear" (February 16, 2009, Vol. 50, No. 04 TM Memorandum (BNA)).

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.

b. Advantages of the technique.

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

The real estate investment will retain its zero basis without the imposition of a capital gains tax until it is sold, at which time Sam will recognize capital gains taxes. If Sam chooses to operate the real estate until his death, then IRC Sec. 1014 would apply upon his death and the real estate will receive a step-up in basis to its then fair market value. Betsy and Sonny, if the partnership makes an IRC Sec. 754 election, will receive a basis adjustment because of IRC Sec. 734(b) in the retained Marketable Stock that should allow the partnership to retire its debt with modest tax net consequences.

(2) 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.

(3) Transfer tax benefit of a withdrawal from a long-term partnership structure.

The valuation discount associated with the liquidation of Sam's limited partnership interest, if it is accurate, will not result in a gift tax, even though the fair market value of the remaining partnership interests owned by Betsy and Sonny will increase in value. This is because the withdrawing partner, Sam Singlestock, under the assumptions, received full and adequate consideration.

(4) The total potential transfer tax and capital gains tax savings may be significant.

The net result of these transactions is that Betsy and Sonny's collective net worth (assuming a 25% capital gains rate) after capital gains taxes and/or contingent capital gains taxes will increase by 170%, as calculated below:

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

c. Considerations of the technique.

(1) Are there any tax consequences on formation of the partnership?

Formation of the partnership should not be a taxable event under IRC Secs. 721 or 351, because there is not any diversification. Each partner is still exposed to the same original Marketable Stock, Inc. position. There should not be any gift tax consequences on the formation of the partnership.[402]

(2) Are there any tax consequences when Sam redeems his interest?

After formation, in order to properly diversify into another asset, while still allowing the family members to participate in the upside potential of the marketable stock, the partnership could hedge its position in Marketable Stock, Inc. The hedging strategies could either be structured as a single long-dated contract or multiple contracts over time that do not cause the original security to be sold for income tax purposes. The hedging could be accomplished through a collar with a margin loan, or a pre-paid variable share forward structure. The partnership could invest the cash in a nonmarketable asset (e.g., privately held real estate or oil and gas investments).

Assuming the partnership is seven years old, or older, the partnership can enter into the transactions of this example without directly violating IRC Secs. 704(c), 737 and 731(c). Under the facts of this example, due to family investment reasons, the partnership decides to redeem Sam. In order to redeem that member, the partnership first determines the value of Sam's interest in the partnership. If Sam's interest is valued at $595,000 (assuming a 30% valuation discount), the partnership could either redeem Sam's interest for cash, or the $595,000 non-marketable real estate investment. If the partnership redeems Sam's interest for cash, Sam will be subject to capital gain recognition under IRC Sec. 731(a). If Sam's interest is redeemed with the non-marketable real estate, applying the rules of IRC Secs. 732 and 752, Sam would have a "0" basis in the non-marketable real estate, Sam would pay no immediate capital gains tax and the partnership, because of the application of IRC Sec. 734(b), would have a $595,000 basis in its remaining assets (the hedged Marketable Stock, Inc. stock).

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[402] Please see the discussion in the *Strangi* decision in Section III A 2 f (1) (b) of this paper. Practically, the only tax issue every judge of the full Tax Court agreed upon in the *Strangi* decision is there is not a gift on formation of a pro rata partnership, even if every partner's interest is worth less after formation.

The partnership portfolio is still subject to the $595,000 note payable that must be repaid at some time in the future. The partnership could make an IRC Sec. 754 election after the redemption of Sam's interest, and because of IRC Sec. 734(b) the remaining marketable stock would receive a proportionate basis adjustment. The partnership could sell enough Marketable Stock to eliminate the debt. The sale of the Marketable Stock by the partnership may result in a much smaller taxable gain than if the redemption and the IRC Sec. 754 election had not occurred.

(3) 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.

For instance, the IRS has recently proposed changes to its regulations under IRC Sec. 752 to address perceived abuses associated with the so-called popular "leveraged partnership" technique. Under this technique, one partner contributes a business and receives a small interest in the partnership and the proceeds from a borrowing incurred by the partnership shortly after its formation. Generally in a transaction where a partner contributes property and receives shortly thereafter cash from the partnership, the receipt of the cash will be treated as a disguised sale under IRC Sec. 707. There is an exception, if the partnership borrows funds from a third party and that borrowing is fully allocable to the "business contributing" partner in a properly structured transaction. With a properly structured transaction, the gain from the simulated sale is deferred until the earlier of the partnership terminating or the loan being repaid. The key to the success of the leveraged partnership technique is for the entire partnership liability to be properly allocable to the "business contributing" partner who receives the proceeds of the third party loan to the partnership.

The proposed regulations will change how certain of the leveraged partnerships have been structured in the past. (See proposed Treas. Reg. §§ 1.752-2(b) and 1.752-2(f)). For instance, under the proposed regulation changes, if a limited partner guarantees a recourse liability the guarantor's share of the recourse liability will be zero, if the general partner has net value sufficient to satisfy the obligation. Another change is that certain guarantees will not work, if they are so-called "bottom dollar guarantees." Another example of a proposed change occurs if a partner agrees to indemnify the first losses that the "business contributing" partner may have as guarantor on a partnership debt. Under those circumstances the guarantee will not work.

(4) 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.

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

a. The technique.

Borrowing against low basis assets and using the loan proceeds in estate planning transactions is a popular alternative to achieve a step-up in basis on the death of a taxpayer and also mitigate the taxpayer's estate taxes. One form of that technique is for a taxpayer who owns assets that are highly appreciated (e.g., depreciated real estate) to consider creating a single member limited liability company with preferred and growth member interests. The preferred interest coupon could be cumulative and could be paid in cash or in kind. The taxpayer could contribute the zero basis asset to the single member limited liability company in exchange for a preferred interest. The taxpayer could contribute cash that the taxpayer owns, or borrows, to the single member limited liability company in exchange for the "growth" interests. The taxpayer could then engage in advanced gifting techniques to remove the growth interests from her estate. Consider the following example.

Example 23: Use of a Leveraged Estate Freeze to
Obtain a Basis Adjustment at Death and to Save Estate Taxes

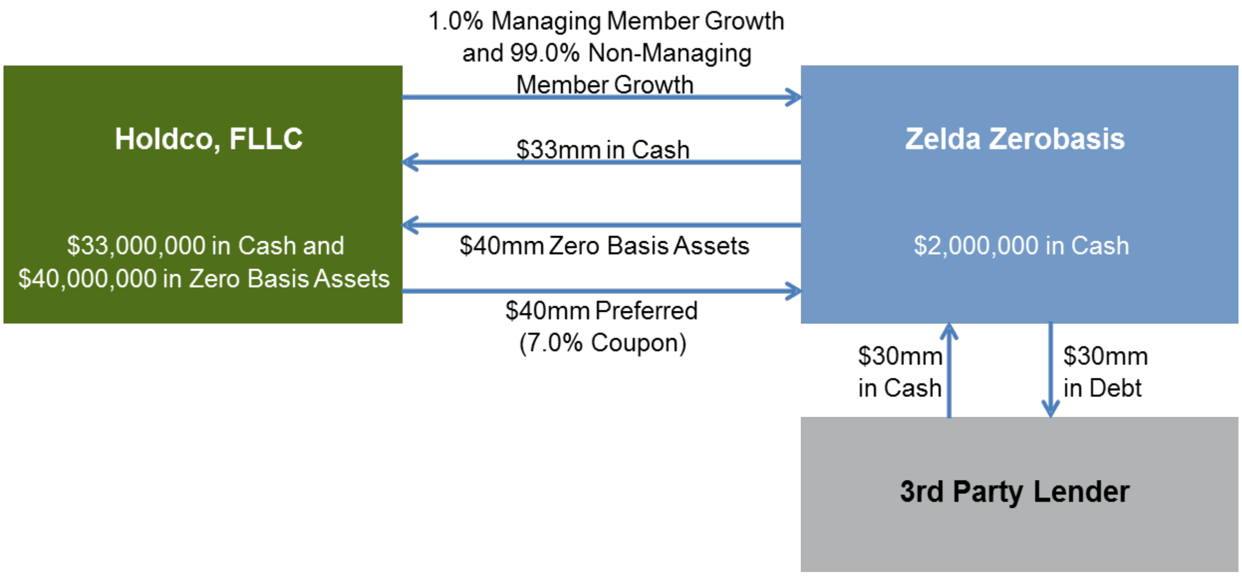
Zelda Zerobasis owns $40,000,000 in zero basis assets and $5,000,000 in cash or near cash assets that have full basis. She tells her advisor, Pam Planner, she wants a plan in which the following goals are met: (i) she does not wish to pay any gift taxes; (ii) she wishes her heirs to pay the lowest possible combination of estate taxes and capital gains taxes at her death; (iii) she wishes to maintain investment control of her assets; and (iv) she wishes to maintain her current lifestyle of $500,000 a year before inflation.

Zelda asks Pam to assume that her zero basis assets will grow at 5% a year and generate 3% ordinary taxable income a year. Zelda asks Pam to assume she will live 20 years and that she will not sell the low basis assets during her lifetime. Zelda tells Pam that based on her assumptions that her zero basis assets will be worth over $106,000,00 at her death, which will cause a terrible estate tax problem, or a capital gains tax problem if she uses gifting techniques to remove the low basis assets from her estate to escape estate taxes.

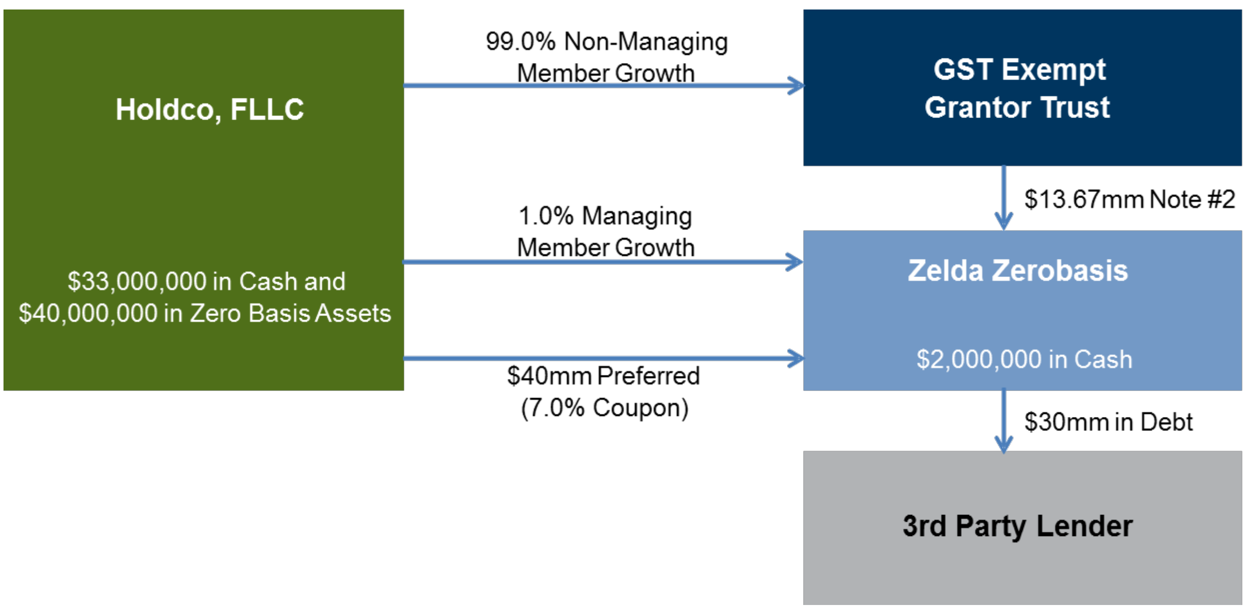
Zelda also asks Pam to assume her cash and near cash investments will have a 7.4% pre-tax rate of return with 0.6% of the return being taxed at ordinary rates, 2.4% of return being tax-free, and 4.4% of the return being taxed at long-term capital gains rates with a 30% turnover.

Pam suggests to Zelda that she create a single member limited liability company with three classes: (i) a "growth" managing member interest; (ii) a "growth" non-managing member interest; and (iii) a preferred non-managing member interest that would pay a coupon of 7% that is cumulative. It is assumed the 7% coupon will be based on the valuation principles of Revenue Ruling 83-120 and will produce a fair market value for the preferred equal to the "par" value of the preferred. The preferred interest will also have a right to $40,000,000 upon liquidation in preference to the growth interests.

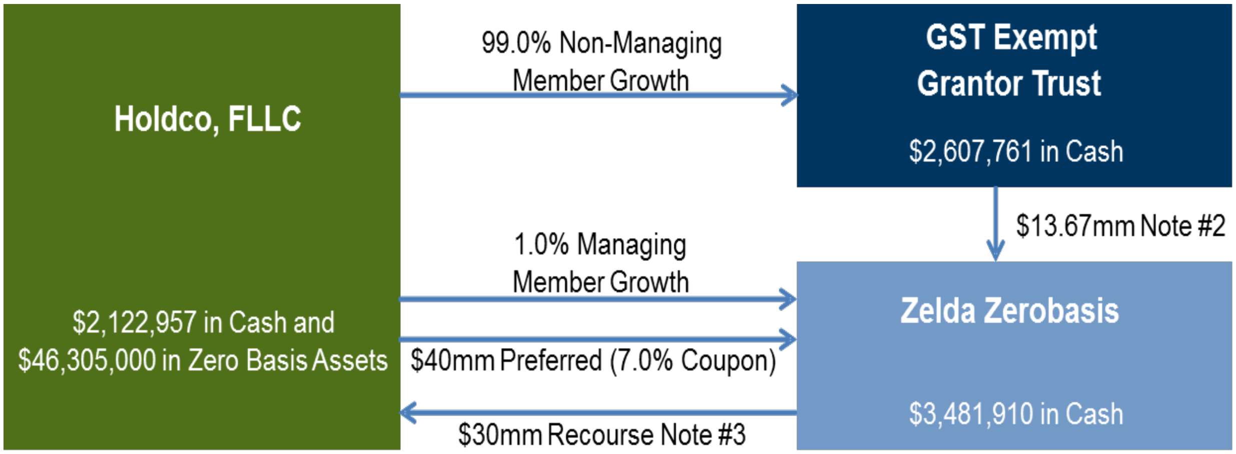
The single member FLLC would terminate on the earlier of her death or 35 years. Pam suggests that Zelda could contribute her low basis assets for the preferred interest. Pam also suggests that Zelda borrow $30,000,000 in cash from a third party lender on a recourse basis and contribute $33,000,000 in cash to the single member FLLC for the growth interests. The diagram below illustrates these transactions.



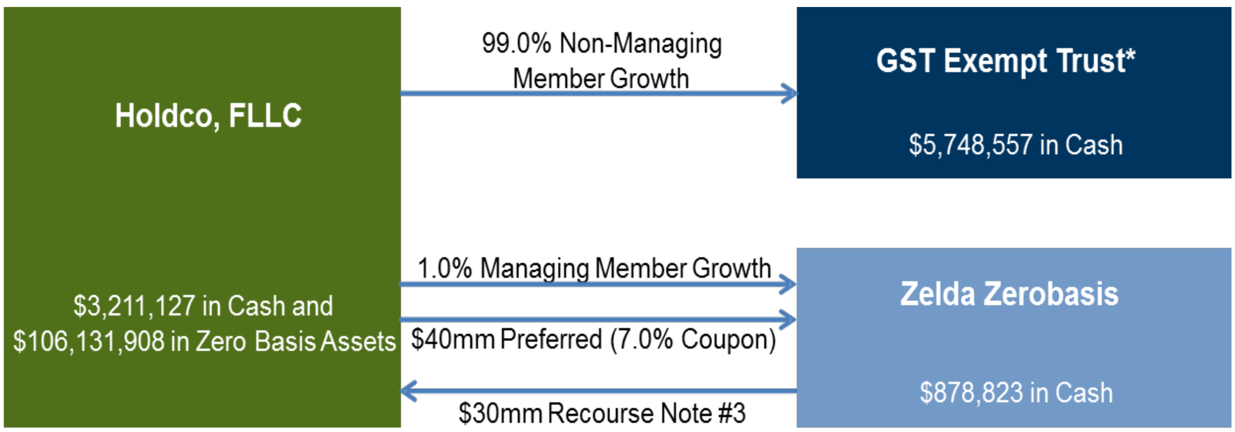
Pam suggests that Zelda could then gift (using her $5,340,000 gift tax exemption) the non-managing member growth interests and sell the remaining non-managing member growth interests to a GST exempt grantor trust in separate independent transactions. Assuming a 40% valuation discount is appropriate because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



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. (See the discussion in Sections V C and V E of this paper.) After the payment of the loan to the third party lender the structure will be as shown below:



The moment before Zelda's death in 20 years the structure under the above assumptions may be as follows (also see attached Schedule 12):



*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 Sec. 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 (see attached Schedule 12):

*Grantor Trust status removed in year 18.

b. Advantages of the technique.

(1) The net after tax savings to Zelda are projected to be substantial. See the table below and attached Schedule 12.

Table 14

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

Unlike a traditional gift planning technique, that eliminates estate taxes by removing an asset from the taxpayer's estate, there will be a significant step-up in basis on the death Zelda. Under this example there will be a step-up on the $40,000,000 preferred interest, which before her death had a zero basis. Assuming an IRC Sec. 754 election is made that outside basis may be allocated to the assets owned by the partnership.

(2) This technique has the same advantages as a sale to a grantor trust.

See the discussion in Section IV C 4 a of this paper.

(3) This technique has the same advantages as using borrowing with a grantor trust to achieve basis adjustment in low basis assets.

See the discussion in Section V E of this paper.

c. Considerations of the technique.

(1) 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.

See the discussion in Section IV C 4 b of this paper.

(2) Care must be taken to comply with the gift tax valuation rules of IRC Sec. 2701.

Among other factors, the preferred interest must be structured (or treated by election and administered) as a "qualified payment right" for purposes of IRC Sec. 2701(c)(3) and Treas. Reg. §25.2701-2(b)(6). See the discussion in Section III B 2 of this paper.

(3) Third party financing, at least on a temporary basis, may be necessary.

The after-tax interest costs of third party financing may lower the amount accruing to the family. However, in this example, it was assumed the financial assets purchased would produce a higher rate of return than the interest rate cost.

(4) This technique has many of the same considerations as using borrowing with a grantor trust to achieve basis adjustment in low basis assets.

See the discussion in Section V E 2, 3, 4, 5 and 6 of this paper.

J. Valuation Planning, if the IRS Issues Regulations Under IRC Sec. 2704(b)(4) That Are Consistent With the Greenbook Proposal.

Since much of this discussion relies on the case law history and legislative history when Chapter 14 was passed, the reader may wish to review Sections I, II B, II E, III B 1, and III B 6. For the reader's convenience some of that history is repeated below.

When Congress added Chapter 14 of the Internal Revenue Code it gave the IRS in IRC Sec. 2704(b)(4) the power to disregard restrictions other than the liquidation restrictions otherwise described in IRC Sec. 2704(b), if those restrictions would have the effect of reducing the value of a transferred interest below what the value would be absent the restriction. However, Congress did not give the IRS the power to substitute new provisions for the disregarded provisions or to rewrite the state statutory law or common law that would apply if a provision of the organizational documents of an entity were disregarded.

1. The Possible Form of the IRS Regulations That May Be Issued Under IRC Sec. 2704(b)(4).

An item promising additional guidance regarding restrictions on liquidation first appeared in the IRS "Priority Guidance Plan" for 2003-2004. The promise of "Guidance" was changed to a promise of "Regulations" in the 2010-2011 plan. Meanwhile, in May, 2009, the Obama Administration proposed statutory changes to IRC Sec. 2704(b) in the "General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals" (the "Greenbook"). The proposal was repeated without substantive change in the Greenbooks for Fiscal 2011, 2012, and 2013. It did not appear in the Greenbooks for Fiscal 2014, 2015, or 2016. The last version of the Administration proposal appeared in the Greenbook for fiscal 2013, released on February 13, 2012 (the "Greenbook Proposal").

Congress has not adopted the expansion of IRC Sec. 2704(b) proposed by President Obama. In fact, a bill to that effect has not even been introduced in Congress. Nevertheless, on May 5, 2015, BNA reported that in an ABA Tax Section meeting a representative for 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.)

I am not aware of any published explanation for the Administration's withdrawal of the Greenbook Proposal. It is clear, however, that the proposed legislation would have conferred authority that is not contained in the existing regulatory authority 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.)

This provision authorizes the IRS by regulation to expand the list of restrictions that are disregarded, but only in the case of restrictions that reduce an interest's value for gift or estate tax purposes, but do not "ultimately" reduce its value to the transferee. The sole authority conferred on the IRS is to place a restriction meeting the statutory criteria on the "disregarded" list. The IRS is *not* authorized (i) to create a new category of "disregarded restrictions" based on assumptions and criteria that are not contained in the statute, which could apply to restrictions already covered by the statute, and/or to restrictions that do not reduce the value of a transferred interest below what the value would be under state law absent the restriction; (ii) to prescribe that an interest subject to a disregarded restriction shall be valued in a manner determined in the regulations, rather than in the manner already prescribed under IRC Sec. 2704(b), i.e., by treating the restriction as if it did not exist and otherwise applying the organizational documents and applicable state law; or (iii) to disregard a restriction imposed by applicable state law. The

Greenbook Proposal would have enacted directly, and/or have conferred authority on the IRS to enact by regulation, both (i) and (ii), and possibly (iii). *At no point did the Greenbook Proposal suggest that these goals could be accomplished by regulations under existing IRC Sec. 2704(b)(4). The whole point of the Greenbook Proposal was to confer the additional statutory authority necessary to enact these goals directly, or by regulations.*

Some have speculated that the new regulations would be directed only at FLPs holding investment assets.[403] However, neither IRC Sec. 2704(b) nor any other part of Chapter 14

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[403] "Navigating Tougher I.R.S. Rules for Family Partnerships," NEW YORK TIMES (August 7, 2015); Moyer, "IRS Takes Aim at an Estate-Planning Strategy THE WALL STREET JOURNAL (June 26, 2015). However, that distinction does not appear in the legislative history or in the statute. It is common for both non-family and family partnerships to own passive securities. Furthermore, Congress and the Treasury have long recognized that it is common and proper for groups (including families) to use partnerships to hold only passive securities and that form of organization should be recognized for all tax purposes:

(i) 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 (including transfer tax purposes). (*See* Rev. Rul. 75-523, 1975-1 C.B. 257 (because of IRC Sec. 7701(a)(2), a partnership was recognized for tax purposes even though the only purpose of the partnership was to invest in certificates of deposit) and Rev. Rul. 75-525, 1975-1 C.B. 350 (because of IRC Sec. 7701(a)(2), a partnership form of ownership was recognized for tax purposes even though the only purpose of the partnership was to invest in marketable stocks and bonds)).

(ii) The Internal Revenue Code liberally defines the term "partnership" in IRC Secs. 761(a), 6231(a), and 7701(a). Under the Internal Revenue Code, Congress clearly provides that for income, gift, estate, and generation-skipping tax purposes 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*. Congress clearly intended that an individual would always be treated as a partner of a partnership for purposes of Chapters 1, 11, 12, 13, and 14 of the Code if that individual is a member of a group that conducts any financial operation, including investing in stocks and bonds, unless that group is a trust, an estate, or a corporation.

(iii) Specific rules that apply only to partnerships holding passive investment assets appear in the Internal Revenue Code 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) will recognize gain or loss on contribution unless each partner's contributed stock portfolio is substantially diversified.

(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

distinguishes between passive investment companies and active businesses, because of the many unanswerable questions it prompts. Is a holding company active or passive if it owns active businesses through subsidiaries? Is the parent who crop shares the farm with her farming children active or passive? When does rental real estate become active or passive? What if the real estate is passively rented to the taxpayer's active business? What about working capital? Congress understood when it enacted Chapter 14 that drawing those distinctions is impossible; the administration is not authorized to create such distinctions now. From the Greenbook Proposal, it appears that the regulations might target limited partnerships, but such regulations would necessarily include limited liability companies,[404] which may be the entity type most often used for active businesses today.[405] It may be an exaggeration to say that the proposed regulations would not impact family businesses.

2. 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.

The seminal case under Chapter 14 finding a Treasury Regulation was an unreasonable and invalid extension of the relevant Internal Revenue Code section is *Audrey Walton v. Commissioner*, 115 T.C. 589 (2000). In *Walton*, the full Tax Court found Treasury Regulation § 25.2702-3(e), Example 5 was an invalid interpretation of IRC Sec. 2702 because the regulation did not follow the origin and purpose of the statute.

The Court found that the taxpayer had met its burden to overturn that regulation example, whether the taxpayer burden of overturning an "interpretive" regulation is used, or the taxpayer burden of overturning a "legislative" regulation is used:

> The regulations at issue here are interpretative regulations promulgated under the general authority vested in the Secretary by section 7805(a). Hence, while entitled to considerable weight, they are accorded less deference than would be legislative regulations issued under a specific grant of authority to address a matter raised by the pertinent statute. See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-844 (1984) (Chevron). United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 (1982). A legislative regulation is to be upheld

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entity-level tax." (*See*, Treas. Reg. §1.701-2(a) (emphasis added). The parenthetical language referring to investment as a business activity was added after the release of the proposed regulation. *Compare* Prop. Reg. § 1.701-2(a).

[404] IRC Sec. 7701 has generally treated a family limited liability company ("FLLC") as a partnership for federal income tax purposes, including for purposes of Chapter 14. However, under the Check the Box regulations in Treas. Reg. § 301.7701-1 *et al.* most state law entities can elect to be a partnership, an S Corporation (because it is taxed under Subchapter S) or an association taxed as a corporation under Subchapter C.

[405] The promulgation of the Check the Box regulations allowed states to revise their laws governing FLLC's to remove some of the awkward provisions intended to provide partnership income tax treatment. The FLLC form provides limited liability for all of its owners with fewer formalities than a corporation requires.

unless "arbitrary, capricious, or manifestly contrary to the statute." Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc. supra at 843-844.

With respect to interpretative regulations, the appropriate standard is whether the provision "'implement[s] the congressional mandate in some reasonable manner.'" United States v. Vogel Fertilizer Co., supra at 24 (quoting United States v. Correll, 389 U.S. 299, 307 (1967)). In applying this test, we look to the following two-part analysis enunciated by the Supreme Court:

> When a court reviews an agency's construction of the statute which is administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as for the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute. [Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., supra at 842-843; fn. refs. omitted.]

A challenged regulation is not considered such a permissible construction or reasonable interpretation unless it harmonizes both with the statutory language and with the statute's origin and purpose. See United States v. Vogel Fertilizer Co., supra at 25-26; National Muffler Dealers Association v. United States, 440 U.S. 472, 477 (1979) (National Muffler).

We pause to note that before the Chevron standard of review was enunciated by the Supreme Court, the traditional standard was simply "whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose", as prescribed by the Supreme Court in National Muffler Dealers Association v. United States, supra at 477. As we have observed in a previous case, the opinion of the Supreme Court in Chevron failed to cite National Muffler and may have established a different formulation of the standard of review. See Central Pa. Sav. Association v. Commissioner, 104 T.C. 384, 390-391 (1995). In the case before us, we conclude that it is unnecessary to parse the semantics of the two tests to discern any substantive difference between them, because the result here would be the same under either.

Because section 2702 does not speak to the issue of the permissible term for a qualified annuity, Example 5 does not expressly contradict any statutory language. Accordingly, we focus on the statute's origin and purpose for further guidance.

As the Tax Court observed in *Walton*, uncertainty then existed about whether *Chevron* supplanted *National Muffler* in testing the validity of tax regulations. In 2011 the Supreme Court resolved this debate and held that the validity of a tax regulation is tested under *Chevron*. *Mayo*

Foundation v. United States.[406] The *Mayo* court noted that *National Muffler* considered a variety of factors that would not be considered under *Chevron,* and concluded that the *Chevron* approach prevails.

Mayo left open the question whether "legislative" and "interpretive" tax regulations continue to be subject to different tests in determining their validity under *Chevron*.[407] The separate tests mentioned by the Tax Court in *Walton* appear to have support in the *Chevron* opinion itself, which states:

> If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. Sometimes the legislative delegation to an agency on a particular question is implicit, rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency. 467 U.S. at 843-844.

However, the *Mayo* opinion does not clearly acknowledge this distinction or say how it would be applied to legislative and interpretive tax regulations. Instead the *Mayo* opinion seems to read *Chevron* as applying a uniform test to all regulations, with "not arbitrary, capricious or manifestly contrary to the statute" and "reasonable interpretation" being different ways of describing the same test.[408]

As the Tax Court mentioned in *Walton*, it was unclear after *Chevron* whether the former test for determining if an interpretative regulation is valid still applied. *Mayo* did not clarify the issue. 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."

The Tax Court in *Walton* found the regulation example it reviewed did not expressly contradict any statutory language. However, the court found the regulation it reviewed to be "manifestly contrary to the statute" by focusing "on the statute's [IRC Sec. 2702] origin and purpose." *Chevron* and *Mayo* do not preclude consideration of the statute's origin and purpose in determining whether a regulation is contrary to the statute. Furthermore, with respect to a legislative regulation issued pursuant to a special grant of regulatory power such as that conferred

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[406] 107 AFTR2d 2011-341, 131 Sup. Ct. 704 (2011).

[407] The terms "legislative" and "interpretive" are used by tax practitioners in a way that differs from standard terminology under the Administrative Procedure Act. Under the APA, both types of tax regulation would be labeled "legislative" because both have the force of law.

[408] One the one hand, referring to the statutory ambiguity and interpretive regulation at issue in the case, the Supreme Court said: "In the typical case, such an ambiguity would lead us inexorably to *Chevron* step two, under which we may not disturb an agency rule unless it is arbitrary or capricious in substance, or manifestly contrary to the statute." (internal quotation marks and citations omitted). 107 AFTR2d p. 2011-345. On the other hand, the Supreme Court said: "The full-time employee rule easily satisfies the second step of *Chevron*, which asks whether the Department's rule is a "reasonable interpretation" of the enacted text." 107 AFTR2d p. 2011-347.

by IRC Sec. 2704(b)(4), whether a regulation is "contrary to the statute" includes not only whether it is contrary to the statute it interprets, but also whether it is in compliance with the statutory provision granting the special power to regulate. As one commentator on *Mayo* has stated: "A regulation is valid only to the extent that it accords with the statutory delegation on which it is based. Thus, assuming that the argument has been properly raised, a court assessing a challenge to a regulation should identify the precise statutory language of the delegation in question, then determine whether the regulation is within the scope of that language."[409]

3. 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).

What follows in this Section V J 3 of the paper are arguments that may compel a taxpayer who transfers an interest in a closely held family enterprise to take the position that any regulation that takes the form of the Greenbook Proposal is invalid and should not be applied.

a. If the taxpayer demonstrates that a new regulation is manifestly contrary to the purpose of IRC Sec. 2704(b), a court will invalidate the regulation, despite its not explicitly contradicting the statutory language.

Under the Greenbook Proposal, the effect of that substitution may be to value a transfer of an interest in a family business as if family attribution applied, which is clearly contrary to the origin and purpose of IRC Sec. 2704(b) and all other provisions of Chapter 14. Stated differently, IRC Sec. 2704(b)(4) authorizes disregarding a restriction that is not already disregarded under the statute, but it does not authorize changing the *result* of disregarding a restriction to something other than the result prescribed by the statute. There is no language in IRC Sec. 2704(b)(4) that would permit rewriting IRC Sec. 2704(b) in this way, and to do so would be contrary to the origin and purpose of IRC Sec. 2704(b).

(1) Prior to the passage of Chapter 14 in 1990, case law for valuing proportionately held family enterprises with one class of equity provided:

(i) That the legal rights and interests inherent in that property must first be determined under state law and after that determination is made federal is 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

[409] Johnson, *Preserving Fairness in Tax Administration in the* Mayo *Era*, 32 Virginia Tax Review (Summer 2012), p. 45.

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

(a) Initial IRS position in 1981 was that closely held family businesses should be valued differently than closely held non-family businesses, but that position was rejected by the courts prior to the passage of Chapter 14.

The courts consistently rejected the IRS position in revoked Rev. Rul. 81-253 that no minority shareholder discount is allowed with respect to transfers of stock between family members if, based upon a composite of the family members' interests at the time of the transfer, control (either majority voting control or de facto control through family relationships) of the corporation exists in the family unit. See the IRS position in revoked Rev. Rul. 81-253, 1981-1 C.B. 187. That ruling also states that the IRS would not follow the *Bright* case discussed below.

In *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981) 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.

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.

For purposes of determining the fair market value of the gifts of closely held interest in a family enterprise, 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.[410] 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, 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.[411] In its legislative history to various revenue acts, Congress has endorsed these principles, which had been developed under case law. For instance, the reports to the 1948

[410] *See Minahan v. Commissioner*, 88 T.C. 492 (1987) (ordering litigation costs assessed against the IRS for continuing to litigate this issue).

[411] *See United States v. Bess*, 357 U.S. 51 (1958); *Morgan v. Commissioner*, 309 U.S. 78 (1940).

changes in the estate taxation of community property provide that those changes restore the rule by which estate and gift tax liabilities are to depend upon the ownership of property under state law.[412]

An excellent synopsis of the relevant case law and authorities for the proposition that state law controls in determining the nature of the legal interest that is transferred for estate tax purposes (in particular, a partnership interest) is found in a brief filed by the government in a Fifth Circuit Court case.[413] The case concerned the estate taxation of a Louisiana partnership interest. *The Justice Department, in one of its briefs in that case, provided that synopsis, which the Court quoted in its opinion:*

> It is now well established that state law is determinative of the rights and interests in property subject to federal estate taxation. In *Morgan v. Commissioner*, 309 U.S. 78 [626], 60 S. Ct. 424, 84 L. Ed. 585 (1940), the Supreme Court said (p. 80): 'State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed.' *Estate of Rogers v. Commissioner*, 320 U.S. 410, 414, 64 S. Ct. 172, 88 L. Ed. 134 (1943); *United States v. Dallas Nat. Bank*, 152 F.2d 582 (C.A. 5th 1945); *Smith's Estate v. Commissioner*, 140 F.2d 759 (C.A. 3d 1944). *See Aquilino v. United States*, 363 U.S. 509, 513, 80 S. Ct. 1277, 4 L. Ed. 2d 1365 (1960); *Commissioner v. Chase Manhattan Bank*, *supra* [259 F.2d 231 (5th Cir. 1958)], p. 249; *United States v. Hils* (C.A. 5th 1963) [318 F.2d 56]. * * *
>
> The courts must determine the substance of the state property law provisions and apply the estate tax provisions to the property interests so determined.[414]

Thus, among the relevant considerations in connection with determining the gift or estate tax value of a transferred partnership interest, or minority position in a corporation, are the liquidation restrictions and voting restrictions that are inherent under the default state law rules.

The IRS argued before passage of Chapter 14 that dissolution and withdrawal rights possessed by a general partner would or could be transferred by that general partner's estate and, thus, would be a key relevant fact considered by a hypothetical willing buyer. That argument was also rejected by the courts. In *Estate of Watts v. Commissioner*,[415] (a case decided before passage of IRC Sec. 2704(b)(4)) both the Tax Court and the Eleventh Circuit allowed an 85% discount to

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[412] *See* H. REP. NO. 2543, 83rd Cong. 2nd Sess., 58-67 (1954); H.R. REP. NO. 1274, 80th Cong. 2nd Sess., 4 (1948-1 C.B. 241, 243); S. REP. NO. 1013, 80th Cong., 2nd Sess., 5 (1948-1 C.B. 285, 288) where the Committee Reports on the 1948 changes in the estate taxation of community property states: "Generally, this restores the rule by which estate and gift tax liabilities are dependent upon the ownership of property under state law." *See also* the reports of the Revenue Act of 1932 that define "property" to include "every species of right or interest protected by law and having an exchangeable value." H.R. REP. NO. 708, 72nd Cong., 1st Sess., 27-28 (1932); S. REP. NO. 665, 72nd Cong., 1st Sess., 39 (1932).

[413] *Aldrich v. United States*, 346 F.2d. 37 (5th Cir. 1965).

[414] *Id*. at 38, 39.

[415] 823 F.2d 483 (11th Cir. 1987), *aff'g* 51 T.C.M. 60.

liquidation value even though the decedent was a general partner who enjoyed, under applicable Oregon law, full dissolution rights during her life. Both courts reasoned that the *transfer* value of the partnership interest was what a hypothetical willing buyer would pay based upon his expectations as to whether or not the family would want the partnership to continue to exist after his purchase. However, the Eleventh Circuit reasoned that this was because the hypothetical willing buyer would only be an assignee.

(2) 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.[416] On the other hand, the Senate Finance Committee advocated for a narrower fix that would prevent estate "freezes" using preferred stock. The Senate proposed to leave alone the valuation of common stock in family companies without preferred stock. Because the two Committees exchanged published "offers," their respective positions are known. The House cut back its family attribution rule so much that it would apply only when the two spouses were the only owners of the business or real estate. The Senate rejected even this very narrow family attribution rule. Congress eventually agreed to enact only the Senate's "anti-estate freeze" provision for preferred stock as a new IRC Sec. 2036(c). The legislative history with respect to IRC Sec. 2036(c) made it clear that Congress was not targeting entity discounts with the passage of IRC Sec. 2036(c).[417] For instance, the House Report made it clear that IRC Sec. 2036(c) did not change the law with respect to the valuation of pro rata corporations and partnerships: "[t]hus, section 2036(c) does not apply if the transferor retains an undivided interest in property, *i.e.*, a fractional or percentage share of each and every interest in the property."[418]

However, when IRC Sec. 2036(c) was added to limit estate freezes it was heavily criticized, including significant criticism by the author of this paper and others.[419] Understanding the history of Chapter 14 can be a challenge, because the statute went through five published iterations, many followed by public hearings addressing the drafts. The initial "Discussion Draft",[420] the "House bill",[421] the "Senate bill",[422] the "Compromise bill"[423] reflecting the tentative

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[416] H.R. REP. NO. 100-3545, at 1041-1044 (1987).

[417] H. R. REP. NO. 100-495, at 995 (1987).

[418] H.R. REP. NO. 100-795, at 423 (1988).

[419] "The Legacy of IRC Section 2036(c): Saving The Closely Held Business After Congress Made 'Enterprise' A Dirty Word." S. Stacy Eastland, Real Property Probate and Trust Journal, Volume 24, Number 3, Fall 1989. *See* Dees, Section 2036(c): The Monster That Ate Estate Planning And Installment Sales, Buy-Sells, Options Employment Contacts and Leases, 66 Taxes 876 1988).

[420] House Ways & Means Committee Press Release No. 28 (March 22, 1990).

[421] H.R. 5425 introduced by Rep. Rostenkowski, August 1, 1990.

[422] S. 3113 introduced by Sens. Bentsen, Boren and Daschle, September 26, 1990.

agreement between the House and Senate and, finally, the "Conference Agreement".[424] Each of these iterations of Chapter 14 reflected a hearing with hundreds of pages of testimony and many negotiations among Congressional staff, Treasury and tax practitioners.

Commentators were not the only persons who had concluded by 1990 that IRC Sec. 2036(c) exemplified poor tax policy, and that estate tax inclusion under IRC Sec. 2036 was not the right solution to the estate freeze problem. Several prominent Republican Senators felt this way. What is perhaps noteworthy is that several powerful Democrat Senators felt the same way. Thus, the repeal of IRC Sec. 2036(c) enjoyed rare bi-partisan consensus.[425]

In 1990 when Congress repealed the failed IRC Sec. 2036(c) and replaced it with a new Chapter 14, it made clear that the compromise that originally produced IRC Sec. 2036(c) required it to reject any family attribution rule and protect traditional minority and lack of marketability discounts in family companies. Because Congress considered Chapter 14 to be a replacement of IRC Sec. 2036(c), Congress never revisited -- in any of these five statutory iterations -- the original compromise rejecting family attribution and preserving valuation discounts. Moreover, Congress was not shy in expressing its intention to preserve traditional valuation discounts in the legislative history of Chapter 14. Congress was not satisfied with merely expressing its intent to preserve traditional valuation discounts; it restricted the IRS from discriminating against family members in family owned businesses through the use of any variation of the family attribution rule, except when Chapter 14 specifically requires the adverse treatment of family member owners. Among the reasons cited by the Senate in its legislative history were the following:

> The [Senate Finance] committee believes that an across-the-board inclusion rule [application of Section 2036(a)] is an inappropriate and unnecessary approach to the valuation problems associated with estate freezes. The committee believes that the amount of any tax on a gift should be determined at the time of the transfer and not upon the death of the transferor . . . . In developing a replacement for current section 2036(c) the committee sought to accomplish several goals: (1) to provide a well defined and administrable set of rules; (2) to allow business owners who are not abusing the transfer tax system to freely engage in standard intra-family transactions without being subject to severe transfer tax consequences; and (3) to deter abuse by making unfavorable assumptions regarding certain retained rights.[426]

Congress adopted the suggestion of numerous commentators and approached the reform with respect to inclusion of partnership interest and corporate interest as a valuation problem. It reaffirmed the traditional inclusion and taxation of partnership interests, in which part of the

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[423] IRC Secs. 7209 and 7210 of Omnibus Reconciliation Bill passed by the Senate, so called because the Senate Finance Committee version reflected a tentative agreement with the House staff.

[424] Chapter 14 enacted as part of the Revenue Reconciliation Act of 1990 (*hereinafter* RRA '90) [IRC Sec. 11602 of the RRA '90].

[425] Congressional Record 101st Congress S. 3113: pg. 1-4 (October 17, 1990).

[426] Informal Senate report accompanying the Revenue Reconciliation Bill of 1990 (S. 3209) as printed in the Oct. 18, 1990, Congressional Record, vol. 136, s. 15679 (Daily Edition) (emphasis added).

partnership is held in preferred form, under IRC Secs. 2511 and 2033. Those sections were modified, however, through the passage of new valuation rules under Chapter 14.

The legislative history in enacting the new valuation rules 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 and determining the legal rights of any transferred interest under the relevant state law.

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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> . . . .
>
> *The bill does not affect minority discounts or other discounts available under present law.*
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> . . . .
>
> . . . *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).[427]

Congress intended for Chapter 14 to provide: "a well defined and administrable set of rules" that would "deter abuse by making unfavorable assumptions regarding certain retained rights". Chapter 14 was not intended to prevent business owners from engaging "in standard intra-family transactions".

The legislative history of Chapter 14 clearly preserves traditional valuation discounts for minority interest and lack of marketability for transfer tax purposes and prohibits a family attribution rule. IRC Sec. 2704(b) is part of Chapter 14. Therefore, in the absence of additional Congressional action expressing a different intent, any regulations under IRC Sec. 2704(b) must

[427] 136 CONG. REC. § 15679, 15681 (October 18, 1990) (emphasis added).

preserve minority and lack of marketability discounts and must not impose a family attribution rule beyond those few specific rules Congress included in Chapter 14.

Thus, the origin and purpose of Chapter 14 (including IRC Sec. 2704(b)(4) for proportionately held family enterprises is not to enact a general family attribution rule or to change the process of first identifying how an interest is treated under state law and then applying Federal tax law. 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; those rules did not enact a general rule of family attribution, or to "back door" family attribution treatment by another means, or negate the important role state property law plays in transfer taxation.

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(3) 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. For instance, certain put rights of senior equity interests are disregarded (See IRC Sec. 2701), certain buy-sell and assignment provisions are disregarded (See IRC Sec. 2703) and certain liquidation restrictions are disregarded (See IRC Sec. 2704). If the entity is family-controlled, IRC Sec. 2704(b) disregards an "applicable restriction" on liquidation (the definition of application restriction is discussed below). Except for the specific provisions that are disregarded, interests in family businesses are to be valued the same way as non-family businesses without any special valuation premiums because of family attribution.

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. In particular, Congress did not provide "substitute" provisions for the "disregarded" provisions that would make the valuation of minority interests in a family business the same as if family attribution applied.

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. All other provisions of the organizational documents for a family business are to remain and are to be considered in valuing interests for transfer tax purposes, as are the provisions of applicable state law. Please see Treas. Reg. §25.2704-2(c).

(4) If regulations under IRC Sec. 2704(b) reinstate safe harbors, that would be a repeat of the failures of IRC Sec. 2036(c), whose repeal was a key origin and purpose of Chapter 14.

The reported IRC Sec. 2704(b) proposed regulations would represent a failure of institutional memory by Treasury and the IRS that would threaten to repeat the waste of resources caused by IRC Sec. 2036(c). The Greenbook Proposal discusses providing "safe harbors" from the adverse impact of IRC Sec. 2704(b) in future regulations. Safe harbors sound harmless, but experience shows they are no substitute for fixing a regulations conceptual problems.

Congress enacted a series of "safe harbors" that if complied with would exempt a transaction from IRC Sec. 2036(c).[428] The safe harbors covered trusts, debt, annuities, loans, preferred stock, compensation arrangements and leases, which IRC Sec. 2036(c) had been interpreted as reaching. If the taxpayer followed the many technical rules under the safe harbors, they need not worry about estate inclusion. Although IRC Sec. 2036(c) applied to a myriad of business and estate planning transactions, under the safe harbors family members were allowed only one way to do each transaction safely. Traditionally it would have been sufficient to have an arrangement with arms-length terms to escape any gift tax consequences. The safe harbors required arms-length, PLUS a whole series of technical requirements. If a taxpayer failed to comply with any one requirement of the safe harbor, it would not matter whether the arrangement had the same terms as every other such arrangement on Earth. As with the family attribution rule, the relationships between family members and non-family members could be exactly the same, but the transfer tax imposed on the family relationship could be many times greater.

Congress abolished the use of safe harbors when it repealed IRC Sec. 2036(c) and replaced it with Chapter 14, which generally allows family business owners engaging with other family members to avoid its application when the terms are arms-length.

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[428] Richard Dee's Testimony S. Hrg. 101-380 at p. 89 described the IRC Sec. 2036(c) safe harbors:

The safe harbors were intended to allow certainty in business transactions without the need to rationalize the statute and its legislative history. The committee reports state that no presumption is to be drawn that the existence of safe harbors imply the application of Section 2036(c) to other business transactions outside a safe harbor. Thus the question of the scope of Section 2036(c) was ducked in favor of 'cookie cutter' estate and business plans. More of the same is promised as a 45-page notice excepting even more transactions from the section has been promised by the Treasury for more than a year. This process will continue indefinitely unless Congress repeals Section 2036(c) and its over-broad, general language.

This approach to narrowing the application of Section 2036(c) is the equivalent of me telling, someone how to get to my house by describing everywhere in America that I don't live. No matter how well traveled I am I will leave something out. And the people who draft these safe harbors are not well traveled in the Business World. A 'safe harbor' sounds like a friendly, inviting, well-lit port of call. A 'safe harbor' under Section 2036(c) is more like a rocky fjord or a slippery sandbar.

(5) 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.

(a) The regulations originally proposed under IRC Sec. 2704(b) protected traditional valuation discounts.

The most obvious interpretation of IRC Sec. 2704(b) was that it had no application, because it referred to restrictions on liquidation of the entity. Such restrictions do not exist. This interpretation of IRC Sec. 2704(b) would have meant that it had no application at all.[429] As the Supreme Court recently observed, an interpretation that would render a statute meaningless indeed would be a strange interpretation.[430] Therefore, that narrow interpretation – despite fitting the actual language most closely – was unlikely to ever be adopted.

On the other hand, if IRC Sec. 2704(b) were interpreted broadly, IRC Sec. 2704(b)(2)(B)(ii) could mean equity in any entirely family owned entity would need to be valued for transfer tax purposes as if the entity were to be liquidated. All of the owners of an entity, acting collectively, always can agree to its liquidation. Such a broad interpretation would contradict Congressional intent to limit family attribution and to preserve traditional discounts for minority interest and lack of marketability.[431]

Neither of the two most obvious interpretations of IRC Sec. 2704(b) would make sense. The question for the government, therefore, was how to interpret IRC Sec. 2704(b) in a meaningful manner that would not contradict the statute. The answer came in regulations:[432]

> *(b) Applicable restriction defined. An applicable restriction is a limitation on the ability to liquidate the entity (in whole or in part) that is more restrictive than the limitations that would apply under the State law generally applicable to the entity in the absence of the restriction.*

This regulation threaded the needle between the two most obvious interpretations of IRC Sec. 2704(b). First, the regulations made the statute meaningful by referring to 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." The regulation must refer to "a limitation on the" *owners'* "ability to liquidate the entity." Second, the regulation made the statute consistent with the legislative history by disregarding only those restrictions that were more restrictive than default state law. The IRS treated provisions that made it more difficult to liquidate an entity than

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[429] *See Kerr v. Comm.*, 113 T.C. No. 30. (Dec. 23, 1999). The Fifth Circuit used different reasoning to hold for the taxpayer. 292 F.2d 490 (5^{th} Cir. 2002).

[430] *King v. Burwell*, 576 U.S. _______ (2015), *Slip. Op.* `14-114 (June 25, 2015) at p.15.

[431] Congressional staff indicated informally in 1990 that they failed to understand the linkage between these discounts and the owner's inability to liquidate her equity interest or to force the entity to liquidate.

[432] Treas. Reg. §2704-2(b).

default state law as mere "bells and whistles" that could be disregarded consistently with the other provisions in Chapter 14.

(b) Elimination of family attribution in *Rev. Rul. 93-12*.

Under the final regulations under IRC Sec. 2704(b)(1), (2) and (3), as noted above, Treasury and the IRS respected Congressional intent by preserving traditional valuation discounts in family owned companies. Within a year after the issuance of these final regulations under Chapter 14, Treasury and the IRS actually conceded in *Rev. Rul. 93-12*[433] that family attribution should not be applied for transfer tax valuation purposes. That ruling considered whether a minority discount was appropriate when the owner of 100% of a corporation transferred all of his shares equally to his five children on the same day.

Rev. Rul. 93-12 revoked *Rev. Rul. 81-25*,[434] which had disagreed with the federal cases overturning the IRS family attribution rule:

> *For estate and gift tax 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.*

The IRS indirectly recognized again that Congress opposed family attribution when it passed Chapter 14.

(c) Treasury takes extraordinary steps in an income tax regulation to comply with Chapter 14 legislative history.

In 1994 Treasury finalized certain anti-abuse income tax regulations authorizing the Secretary to disregard a partnership entity when its purposes were inconsistent with Subchapter K.[435] Despite being published under an income tax section, the final regulations originally applied for both income and transfer tax purposes. Examples 5 and 6 in these regulations permitted a partnership entity to be disregarded for gift tax purposes. Treasury took the unusual step of amending the *Final* Regulations to limit the application of the regulations to income tax issues and delete examples 5 and 6.

Those amended regulations went further to indirectly address whether investment partnerships are somehow different than active business partnerships. The final regulations as amended provide that: "Subchapter K [partnership provisions] is intended to permit taxpayers to conduct joint business (**including investment)** activities through a flexible economic arrangement without incurring an entity-level tax [emphasis added]. The parenthetical language had not appeared in the proposed regulations, but was added in the Final Regulations in response to comments.[436]

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[433] 1993-1 C.B. 201.

[434] 1981-1 C.B. 187.

[435] Treas. Reg. § 1.701-2 in T.D. 8588 (December 29, 1994).

[436] Treas. Reg. § 1.702-2(a).

Again, Treasury and the IRS felt it necessary to comply with the origin, purpose and legislative history of Chapter 14 even when the regulation was promulgated as part of the income tax rules. Moreover, their actions demonstrate how difficult it is for the IRS to draw lines between active businesses and passive investment companies.

(d) The IRS, in 1994, in their own training manual for appeals officers and in its own technical advice memorandum emphasized that valuation discounts are to be allowed for pro rata interests in family entities and are not affected by passage of Chapter 14.

In the Valuation Training for Appeals Officers, issued by the IRS National Office in 1994, the IRS stressed that valuation discounts may be allowed and there is no family attribution in determining those discounts.[437] 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 generally 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,[438] 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. Whether the donor owned a controlling interest prior to the transfer and whether the donees were family members or various third parties were not determining factors in valuing each block of stock transferred to a donee or in deciding whether a separate gift was subject to a minority interest discount.

b. 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).

As noted above, when the Tax Court found in *Walton* that the example in the Treasury Regulations was "manifestly contrary to the statute [IRC Sec. 2702]" the court found the regulation did not expressly contradict the statutory language, but found it violated the statute's origin and purpose. In addition to violating the origin and purpose of IRC Sec. 2704(b) (see the discussion in Section V J 3 a above), if the regulations under IRC Sec. 2704(b)(4) take the form of the Greenbook Proposal, those regulations may expressly contradict the statutory language of IRC Sec. 2704(b)(4). Under the Greenbook Proposal, state statutory and common law would not necessarily provide the substitute for any disregarded provision in an organizational document. Rather, the IRS would be authorized to create new default provisions, which are probably not

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[437] *See Valuation Training for Appeals Officers* (1994) (issued by the Service National Office), which stresses the hypothetical willing buyer and seller, and states unequivocally that "it is irrelevant who are the real seller and buyer."

[438] Tech. Adv. Mem. 94-49-001 (Mar. 11, 1994).

found in state statutory and common law, to substitute for the disregarded provisions. The IRS then would value transferred interests in family companies as if the organizational documents as rewritten by the IRS governed the interests, rather than the terms written by the owners or default provisions enacted by state legislatures. In other words, for valuation purposes the IRS could disregard not only restrictions in the entity's organizational documents, but also restrictions imposed by state law. As discussed below, this would directly violate IRC Sec. 2704(b)(3)(B).

c. Certain of IRC Sec. 2704(b)(4) regulations, if they take the form of the Greenbook Proposal, will apply to restrictions already described and covered under other provisions of Chapter 14; according to the statutory language of IRC Sec. 2704(b)(4) the regulations under that statute may only apply to restrictions not otherwise described and covered under Chapter 14.

"Other restrictions" as it is used in IRC Sec. 2704(b)(4) should refer to restrictions that are not otherwise described under Chapter 14, which also reduces the value of the transferred property below what the value would be absent the restriction. It must be a restriction other than:

(i) any restriction contained in a partnership agreement, articles of incorporation, corporate bylaws, a shareholder's agreement, or is implicit in the capital structure of the entity, or any other agreement that allows the acquisition or use of the transferred interest in an entity at a price less than fair market value (determined without regard to the restriction);[439] or

(ii) any restriction on the ability to liquidate the entity (in whole or in part), which affects the value of a transferred interest in an entity.[440]

The above restrictions were specifically described and dealt with by Congress. The fact that Congress provided exceptions to the above restrictions, or mitigated the effect of those restrictions, does not change the proposition that Congress wanted Treasury to only address "other restrictions" in its regulations under IRC Sec. 2704(b)(4). Congress did not give Treasury the power to revisit its specific handling of the above restrictions.

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). Thus, if a family partnership agreement provides that the partnership shall last 50 years and it requires a unanimous vote of the partners to remove that restriction, that restriction is not within the scope of IRC Sec. 2704(b)(4), because the efficacy of that restriction, and when and in what manner it is

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[439] *See* IRC Sec. 2703; Treas Reg. §25.2703-1(a)(2).

[440] *See* IRC Sec. 2704(b)1, 2, 3; Treas Reg. §25.2704-2(b).

disregarded, is already covered in other parts of IRC Sec. 2704. See Treas. Reg. § 25.2740-2(d) Example 1. If the regulations under IRC Sec. 2704(b)(4) purport to cover liquidation restrictions that are covered by other sections of IRC Sec. 2704(b), then those regulations are contrary to the express statutory provisions of IRC Sec. 2704(b)(4).

IRC Sec. 2704(b)(2)(A) in unclear whether it applies to a restriction on an individual partner's right to withdraw from the partnership (as opposed to a restriction on liquidation of the entire partnership), and is therefore already disregarded as an "applicable restriction" if it is more restrictive than state law. If so, it is not an "other restriction" that can be addressed under IRC Sec. 2704(b)(4).[441] The issue is not of great significance at present because most state statutes strictly curtail a limited partner's right to withdraw from the partnership, but would be significant if the proposed regulations addressed such a restriction and disregarded state law.

Because IRC Sec. 2703, which is part of Chapter 14, addresses the transfer tax effect of transfer restrictions, "other restrictions" cannot refer to transfer restrictions any more than it can refer to liquidation restrictions. The reference in the Greenbook Proposal to ignoring restrictions on the transfer of rights in a partnership should be tested under IRC Sec. 2703, not IRC Sec. 2704(b). Unlike IRC Sec. 2704(b), IRC Sec. 2703 recognizes for valuation purposes terms that are comparable to those in arms-length agreements among non-family owners. Because IRC Sec. 2704 can be used to disregard any specified restriction in agreements for a wholly owned family business, the IRS would prefer to apply IRC Sec. 2704(b). However, IRC Sec. 2704(b)(4) does not authorize regulations that apply to restrictions covered elsewhere in Chapter 14.

d. IRC Sec. 2704(b) only empowers the IRS to disregard certain restrictions in family entity organizational documents not to replace those disregarded provisions with IRS-Invented alternatives.

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 the disregarded restriction. Instead, the organizational documents shall be read as if they omitted the restriction. As noted above, unless there is a contrary provision in the federal statute, the Supreme Court has taken the position that for transfer tax purposes a state's statutes and common law determine how the agreement is to apply absent the "restriction" in the agreement. Indeed, 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.

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[441] While the Tax Court has held that a restriction on a partner's right to withdraw is not an applicable restriction, no appellate court has yet done so, and the Tax Court position may be questioned. *Kerr v. Comm'r*, 113 T.C. 449 (1999), *aff'd. on other grounds*, 292 F.3d 490 (5th Cir. 2002); *Estate of Harper v. Comm'r*, 79 TCM 2232 , T.C. Memo 2000-202; *Estate of Jones v. Comm'r.*, 116 T.C. 121 (2001). *See also Knight v. Commissioner*, 115 T.C. 506 (2000). The *Kerr* case is discussed in Section III B 6 c of the paper.

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; otherwise, no change in the regulations would be necessary. In effect, this would treat restrictions imposed by state law in the same manner as "applicable" restrictions, in direct violation of IRC Sec. 2704(b)(3)(B), which provides that "[t]he term 'applicable restriction' shall not include . . . any restriction imposed, or required to be imposed, by any Federal or State law."

Without enactment of the statute contemplated by the Greenbook Proposal, IRC Sec. 2704(b)(4) is clearly inadequate to authorize substitutions for disregarded provisions. 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 extensive legislative history. In particular, Congress would not, and did not, authorize the IRS to invent "substitute" provisions for the "disregarded" provisions that would make the valuation of minority interests in a family business the same as if family attribution applied.

e. 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.

IRC Sec. 2704(b) applies only to restrictions that would "lapse" or that may be removed by the "family." Family is specifically defined:[442]

> *(2) Member of the family. The term "member of the family" means, with respect to any individual-*
>
> *(A) such individual's spouse,*
>
> *(B) any ancestor or lineal descendant of such individual or such individual's spouse,*
>
> *(C) any brother or sister of the individual, and*
>
> *(D) any spouse of any individual described in subparagraph (B) or (C) .*

The Greenbook Proposal would have authorized regulations to redefine the meaning of family by allowing certain owners to be ignored. The disregarded owners might be charities that would be presumed to oppose liquidation or other owners with minor ownership interests.

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[442] IRC Sec. 2704(c)(2).

We are unaware of any regulations that rewrite the meaning of family when the statute specifically defines the term in the statute. Such regulations would necessarily contradict the statute and, therefore, be invalid without the statutory authorization assumed by the Greenbook Proposal.

f. 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.

For instance, the limited partnership agreement may mandate if the partnership is not sooner liquidated it must be liquidated in 40 years. That provision is not a liquidation restriction, it is the opposite. That provision *mandates* liquidation under a time certain (40 years). The partnership agreement may also provide that a limited partner may not withdraw until the partnership liquidates. While that provision is a liquidation restriction, it may be a restriction that would apply anyway, if the agreement was silent on that issue, because of operation of state law for a term of years limited partnership agreement. As a consequence, that liquidation restriction in the organizational documents, may not be disregarded under IRC Sec. 2704(b)(4), because its removal would not have any effect on the transfer value of a limited partnership interest under state law.

Another example would be a provision in a partnership agreement consistent with state property law that allows the partners to admit a transferee as one of their partners, but does not mandate that the transferee to be so admitted. It would appear the Greenbook Proposal would give the IRS the power to disregard that provision:

> A disregarded restriction also would include any limitation on a transferee's ability to be admitted as a full partner.

If the regulations are consistent with that proposal, then those regulations would be contrary to the express statutory provision that requires that the absence of the disregarded provision in the organizational documents reduce the value of the transferred interest. Even if that provision was absent from the partnership agreement the value of the transferred interest would not be affected because of the operation of state property law, which allows partners to choose their own partners.

4. 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.[443]

Under this method of valuation the fair market value of transferred interests in closely held holding companies is determined by estimating the cost of capital that reflects the greater risk associated with the transferred interest in the closely held enterprise in comparison to the investor holding a proportionate share of the assets of the enterprise. This method of valuation does not use marketability and minority discounts from so-called benchmark studies. Instead, the closely held nature of the transferred interest is treated as a liquidity investment risk that is embodied in the cost of capital for the transferred interest. This method determines what a willing buyer would pay for the transferred interest taking into account liquidity investment risks associated with the expected returns.

5. 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.

The Greenbook Proposal would have applied "to transfers after the date of enactment". Hopefully, proposed regulations under IRC Sec. 2504(b)(4), which are sure to be controversial and are "legislative" in nature, will be made effective only upon issuance of final regulations, but that is not certain. Even after they become final, as the above discussion demonstrates, there may be uncertainty about their scope and validity. Taxpayers will need ways to cope with the uncertainty.

As noted above (see Section V J 3 a (5)(3) of this paper), fresh from the enactment of Chapter 14, the IRS initially took the view that Chapter 14 did not affect the value of closely held family limited partnerships and family limited liability companies 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 family limited partnerships and other closely held entities for estate planning purposes through the issuance of technical advice memoranda and private letter rulings.[444] 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

[443] Frazier, William H. "Cost of Capital of Family Holding Company Interests." *Cost of Capital*, Fifth Edition. Ed. Shannon P. Pratt, Ed. Roger J. Grabowski. Hoboken, New Jersey: John Wiley & Sons, Inc. 2014. 630-649.

[444] *See, e.g.*, PLR 9736004 (June 6, 1997); PLR 9735043 (June 3, 1997); PLR 9735003 (May 8, 1997); PLR 9730004 (April 3, 1997); PLR 9725018 (March 20, 1997); PLR 9725002 (March 3, 1997); PLR 9723009 (February 24, 1997); PLR 9830803 (October 16, 1998).

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 any restrictions on liquidation or withdrawal contained in the partnership agreement or provided under state law.

The IRS reversal on its view of the application of IRC Sec. 2704(b) was repudiated by the full Tax Court in *Kerr v. Commissioner*,[445] which is the first opinion addressing whether the IRS's broad reinterpretation of Chapter 14 was consistent with the courts' understanding of Congress' intent.

The Kerrs, in filing their federal gift tax returns for 1994 and 1995, computed the fair market value of the interests that were transferred to grantor annuity trusts (GRATs), which complied with IRC Sec. 2702, by applying valuation adjustments for minority interest and lack of marketability. The IRS, however, determined that IRC Sec. 2704(b) barred any adjustment for minority interest and lack of marketability in computing the fair market value of the partnership interests. The IRS claimed that the provisions of the partnership agreements that restricted the right of a limited partner to liquidate his limited partnership interest were "applicable restrictions" which should be disregarded in determining the fair market value of the interests transferred.

The IRS's argument had two components. First, the IRS claimed that the provisions of the partnership agreements which stated that the partnership shall liquidate upon the earlier of December 31, 2043, or the consent of all the partners, were restrictions on the liquidation of the partnerships that constitute "applicable restrictions" within the meaning of IRC Sec. 2704(b) that must be disregarded in valuing the interests transferred. Second, the IRS claimed that the provisions of the partnership that restricted a limited partner's right to withdraw from the entity were "applicable restrictions" that must be disregarded in valuing the interests transferred. Because a limited partner in a partnership that did not have a fixed liquidation date (*i.e.*, December 31, 2043) had the right to withdraw his interest under state law on six months notice, the IRS claimed that the fair market value of the interest is equal to the proportionate pro rata net asset value of the partnership interest transferred.

The Tax Court held that IRC Sec. 2704(b) did not apply to the valuation of the transferred interests. The Tax 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.

The Tax Court's holding repudiated the thrust of the IRS's IRC Sec. 2704(b) position in its pronouncements issued from 1997 through 2000. Regulations under IRC Sec. 2704(b) modeled on the Greenbook Proposal would resurrect the arguments buried by the *Kerr* court. Nothing suggests that the courts are any more willing today to accept a reinterpretation of IRC Sec. 2704(b) inconsistent with the Chapter 14 legislative history simply because that reinterpretation might be contained in new regulations, particularly when Congress has refused to enact the statutory authority for regulations requested by the Greenbook Proposal.

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

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[445] 113 T.C. No. 30 (Dec. 23, 1999). *See also Kerr v. Commissioner*, 292 F.3d 490 (5th Cir. 2002), which held IRC Sec. 2704(b) did not apply to the transferred interests on different grounds.

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. See a discussion of the technique in Section V B of this paper. The taxpayer could then file a gift tax return taking the position that the regulations under IRC Sec. 2704(b)(4) do not affect the value of the GRAT assets. If it is finally determined that the regulations under IRC Sec. 2704(b)(4) do not apply, then the taxpayer will get the benefit of any valuation discounts that are appropriate. Similar to *Kerr*, if it is finally determined that the regulations do affect the value of the GRAT assets, the disappointment will not be a gift tax surprise. Again, the disappointment will be that the GRAT owes greater annuity amounts to the taxpayer.

Schedule 1 - Cam Compatible

A: Fund is Owned by Investor and Investor's Estate is Not Subject to Estate Tax Because of Existing Exemptions and/or Charitable Bequests

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	6.338%	8.161%	10.863%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Dividend Income Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Indexed Fund - 5% Turnover - 6.338% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	63,382	(6,413)	-	1,076,969
Year 2	1,076,969	21,539	68,261	(6,991)	-	1,159,778
Year 3	1,159,778	23,196	73,509	(8,243)	-	1,248,240
Year 4	1,248,240	24,965	79,116	(9,552)	-	1,342,769
Year 5	1,342,769	26,855	85,108	(10,923)	-	1,443,809
Year 6	1,443,809	28,876	91,512	(12,362)	-	1,551,835
Year 7	1,551,835	31,037	98,359	(13,874)	-	1,667,356
Year 8	1,667,356	33,347	105,681	(15,467)	-	1,790,917
Year 9	1,790,917	35,818	113,513	(17,147)	-	1,923,100
Year 10	1,923,100	38,462	121,891	(18,922)	-	2,064,530

Managed Fund - 50% Turnover - 8.161% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	81,608	(23,199)	-	1,078,409
Year 2	1,078,409	21,568	88,007	(24,649)	-	1,163,335
Year 3	1,163,335	23,267	94,937	(29,638)	-	1,251,900
Year 4	1,251,900	25,038	102,165	(33,444)	-	1,345,659
Year 5	1,345,659	26,913	109,816	(36,738)	-	1,445,651
Year 6	1,445,651	28,913	117,976	(39,871)	-	1,552,669
Year 7	1,552,669	31,053	126,710	(43,028)	-	1,667,405
Year 8	1,667,405	33,348	136,073	(46,312)	-	1,790,514
Year 9	1,790,514	35,810	146,120	(49,785)	-	1,922,659
Year 10	1,922,659	38,453	156,904	(53,487)	-	2,064,530

Schedule 1 - Cam Compatible

A: Fund is Owned by Investor and Investor's Estate is Not Subject to Estate Tax Because of Existing Exemptions and/or Charitable Bequests

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	6.338%	8.161%	10.863%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Dividend Income Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Managed Fund - 200% Turnover - 10.863% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	108,632	(53,450)	-	1,075,182
Year 2	1,075,182	21,504	116,800	(57,469)	-	1,156,017
Year 3	1,156,017	23,120	125,581	(61,789)	-	1,242,929
Year 4	1,242,929	24,859	135,022	(66,435)	-	1,336,376
Year 5	1,336,376	26,728	145,174	(71,429)	-	1,436,847
Year 6	1,436,847	28,737	156,088	(76,800)	-	1,544,873
Year 7	1,544,873	30,897	167,823	(82,574)	-	1,661,020
Year 8	1,661,020	33,220	180,441	(88,782)	-	1,785,899
Year 9	1,785,899	35,718	194,007	(95,456)	-	1,920,168
Year 10	1,920,168	38,403	208,592	(102,633)	-	2,064,530

Schedule 1 - Cam Compatible

B: Fund is Owned by Investor and is Fully Taxable in the Investor's Estate

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	12.205%	15.622%	21.035%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Indexed Fund - 5% Turnover - 12.205% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	122,050	(7,722)	-	1,134,329
Year 2	1,134,329	22,687	138,445	(8,852)	-	1,286,609
Year 3	1,286,609	25,732	157,031	(11,417)	-	1,457,955
Year 4	1,457,955	29,159	177,944	(14,249)	-	1,650,809
Year 5	1,650,809	33,016	201,482	(17,384)	-	1,867,924
Year 6	1,867,924	37,358	227,981	(20,862)	-	2,112,400
Year 7	2,112,400	42,248	257,819	(24,731)	-	2,387,736
Year 8	2,387,736	47,755	291,424	(29,042)	-	2,697,872
Year 9	2,697,872	53,957	329,276	(33,854)	-	3,047,252
Year 10	3,047,252	60,945	371,918	(39,231)	(1,376,354)	2,064,530

Managed Fund - 50% Turnover - 15.622% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	156,216	(39,836)	-	1,136,379
Year 2	1,136,379	22,728	177,520	(43,898)	-	1,292,729
Year 3	1,292,729	25,855	201,944	(55,762)	-	1,464,765
Year 4	1,464,765	29,295	228,819	(66,182)	-	1,656,698
Year 5	1,656,698	33,134	258,802	(76,403)	-	1,872,230
Year 6	1,872,230	37,445	292,471	(87,146)	-	2,115,001
Year 7	2,115,001	42,300	330,396	(98,861)	-	2,388,835
Year 8	2,388,835	47,777	373,173	(111,877)	-	2,697,909
Year 9	2,697,909	53,958	421,455	(126,463)	-	3,046,858
Year 10	3,046,858	60,937	475,967	(142,878)	(1,376,354)	2,064,530

Schedule 1 - Cam Compatible

B: Fund is Owned by Investor and is Fully Taxable in the Investor's Estate

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	12.205%	15.622%	21.035%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Managed Fund - 200% Turnover - 21.035% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	210,347	(98,815)	-	1,131,532
Year 2	1,131,532	22,631	238,015	(111,812)	-	1,280,366
Year 3	1,280,366	25,607	269,322	(126,519)	-	1,448,775
Year 4	1,448,775	28,976	304,746	(143,161)	-	1,639,336
Year 5	1,639,336	32,787	344,830	(161,991)	-	1,854,962
Year 6	1,854,962	37,099	390,186	(183,298)	-	2,098,950
Year 7	2,098,950	41,979	441,509	(207,408)	-	2,375,030
Year 8	2,375,030	47,501	499,581	(234,688)	-	2,687,423
Year 9	2,687,423	53,748	565,292	(265,557)	-	3,040,906
Year 10	3,040,906	60,818	639,647	(300,488)	(1,376,353)	2,064,530

Schedule 1 - Cam Compatible

C: Fund is in a Grantor Trust and Grantor Buys the Assets from the Grantor Trust for Cash Shortly Before Grantor's Death

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	6.000%	6.906%	7.944%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Dividend Income Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Indexed Fund - 5% Turnover - 6.000% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	60,000	2,535	(6,338)	-	1,076,197
Year 2	1,076,197	21,524	64,572	2,760	(6,901)	-	1,158,153
Year 3	1,158,153	23,163	69,489	3,241	(8,103)	-	1,245,943
Year 4	1,245,943	24,919	74,757	3,744	(9,361)	-	1,340,002
Year 5	1,340,002	26,800	80,400	4,272	(10,680)	-	1,440,794
Year 6	1,440,794	28,816	86,448	4,826	(12,065)	-	1,548,819
Year 7	1,548,819	30,976	92,929	5,410	(13,524)	-	1,664,610
Year 8	1,664,610	33,292	99,877	6,025	(15,062)	-	1,788,741
Year 9	1,788,741	35,775	107,324	6,675	(16,688)	-	1,921,828
Year 10	1,921,828	38,437	115,310	7,363	(18,407)	-	2,064,530

Managed Fund - 50% Turnover - 6.906% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	69,061	8,160	(20,401)	-	1,076,821
Year 2	1,076,821	21,536	74,366	8,666	(21,664)	-	1,159,725
Year 3	1,159,725	23,194	80,092	10,365	(25,912)	-	1,247,463
Year 4	1,247,463	24,949	86,151	11,669	(29,174)	-	1,341,059
Year 5	1,341,059	26,821	92,615	12,808	(32,019)	-	1,441,283
Year 6	1,441,283	28,826	99,536	13,898	(34,744)	-	1,548,799
Year 7	1,548,799	30,976	106,961	15,001	(37,504)	-	1,664,234
Year 8	1,664,234	33,285	114,933	16,153	(40,384)	-	1,788,222
Year 9	1,788,222	35,764	123,496	17,374	(43,435)	-	1,921,422
Year 10	1,921,422	38,428	132,695	18,677	(46,692)	-	2,064,530

Schedule 1 - Cam Compatible

C: Fund is in a Grantor Trust and Grantor Buys the Assets from the Grantor Trust for Cash Shortly Before Grantor's Death

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	6.000%	6.906%	7.944%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Dividend Income Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Managed Fund - 200% Turnover - 7.944% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	79,441	16,172	(40,431)	-	1,075,182
Year 2	1,075,182	21,504	85,413	17,388	(43,470)	-	1,156,017
Year 3	1,156,017	23,120	91,835	18,695	(46,738)	-	1,242,929
Year 4	1,242,929	24,859	98,739	20,101	(50,252)	-	1,336,376
Year 5	1,336,376	26,728	106,163	21,612	(54,030)	-	1,436,847
Year 6	1,436,847	28,737	114,144	23,237	(58,093)	-	1,544,873
Year 7	1,544,873	30,897	122,726	24,984	(62,460)	-	1,661,020
Year 8	1,661,020	33,220	131,953	26,862	(67,156)	-	1,785,900
Year 9	1,785,900	35,718	141,873	28,882	(72,205)	-	1,920,168
Year 10	1,920,168	38,403	152,539	31,053	(77,633)	-	2,064,530

Schedule 1 - Cam Compatible

D: Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years Before Grantor Dies

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	6.593%	7.046%	7.944%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Indexed Fund - 5% Turnover - 6.593% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	65,926	2,588	(6,470)	-	1,082,044
Year 2	1,082,044	21,641	71,335	2,834	(7,085)	-	1,170,769
Year 3	1,170,769	23,415	77,184	3,364	(8,409)	-	1,266,322
Year 4	1,266,322	25,326	83,484	3,921	(9,803)	-	1,369,251
Year 5	1,369,251	27,385	90,269	4,509	(11,272)	-	1,480,141
Year 6	1,480,141	29,603	97,580	5,130	(12,825)	-	1,599,629
Year 7	1,599,629	31,993	105,457	5,788	(14,470)	-	1,728,396
Year 8	1,728,396	34,568	113,946	6,486	(16,214)	-	1,867,182
Year 9	1,867,182	37,344	123,096	7,227	(18,068)	-	2,016,780
Year 10	2,016,780	40,336	132,958	83,696	(209,240)	-	2,064,530

Managed Fund - 50% Turnover - 7.046% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	70,460	8,285	(20,713)	-	1,078,033
Year 2	1,078,033	21,561	75,958	8,805	(22,013)	-	1,162,344
Year 3	1,162,344	23,247	81,899	10,547	(26,367)	-	1,251,669
Year 4	1,251,669	25,033	88,193	11,888	(29,721)	-	1,347,063
Year 5	1,347,063	26,941	94,914	13,062	(32,656)	-	1,449,325
Year 6	1,449,325	28,986	102,120	14,190	(35,474)	-	1,559,146
Year 7	1,559,146	31,183	109,858	15,333	(38,333)	-	1,677,187
Year 8	1,677,187	33,544	118,175	16,529	(41,322)	-	1,804,113
Year 9	1,804,113	36,082	127,118	17,797	(44,493)	-	1,940,617
Year 10	1,940,617	38,812	136,736	34,424	(86,059)	-	2,064,530

Schedule 1 - Cam Compatible

D: Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years Before Grantor Dies

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	6.593%	7.046%	7.944%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Managed Fund - 200% Turnover - 7.944% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	79,441	16,172	(40,431)	-	1,075,182
Year 2	1,075,182	21,504	85,413	17,388	(43,470)	-	1,156,017
Year 3	1,156,017	23,120	91,835	18,695	(46,738)	-	1,242,929
Year 4	1,242,929	24,859	98,739	20,101	(50,252)	-	1,336,375
Year 5	1,336,375	26,728	106,163	21,612	(54,030)	-	1,436,847
Year 6	1,436,847	28,737	114,144	23,237	(58,092)	-	1,544,873
Year 7	1,544,873	30,897	122,726	24,984	(62,460)	-	1,661,020
Year 8	1,661,020	33,220	131,953	26,862	(67,156)	-	1,785,899
Year 9	1,785,899	35,718	141,873	28,882	(72,205)	-	1,920,167
Year 10	1,920,167	38,403	152,539	31,053	(77,633)	-	2,064,530

Schedule 1 - Cam Compatible

E: Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years After Grantor Dies

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	7.062%	7.374%	7.944%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Indexed Fund - 5% Turnover - 7.062% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	70,623	2,630	(6,575)	-	1,086,678
Year 2	1,086,678	21,734	76,744	2,893	(7,231)	-	1,180,817
Year 3	1,180,817	23,616	83,393	3,462	(8,655)	-	1,282,633
Year 4	1,282,633	25,653	90,583	4,063	(10,158)	-	1,392,774
Year 5	1,392,774	27,855	98,362	4,701	(11,751)	-	1,511,941
Year 6	1,511,941	30,239	106,778	5,377	(13,443)	-	1,640,892
Year 7	1,640,892	32,818	115,885	6,097	(15,242)	-	1,780,449
Year 8	1,780,449	35,609	125,740	6,864	(17,159)	-	1,931,503
Year 9	1,931,503	38,630	136,408	7,683	(19,207)	-	2,095,017
Year 10	2,095,017	41,900	147,956	8,559	(228,903)	-	2,064,530

Managed Fund - 50% Turnover - 7.374% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	73,742	8,578	(21,444)	-	1,080,875
Year 2	1,080,875	21,617	79,705	10,590	(26,476)	-	1,166,313
Year 3	1,166,313	23,326	86,006	12,765	(31,913)	-	1,256,497
Year 4	1,256,497	25,130	92,656	14,428	(36,071)	-	1,352,640
Year 5	1,352,640	27,053	99,746	15,875	(39,686)	-	1,455,627
Year 6	1,455,627	29,113	107,340	17,257	(43,141)	-	1,566,195
Year 7	1,566,195	31,324	115,494	18,655	(46,638)	-	1,685,030
Year 8	1,685,030	33,701	124,257	20,115	(50,288)	-	1,812,814
Year 9	1,812,814	36,256	133,680	21,663	(54,158)	-	1,950,255
Year 10	1,950,255	39,005	143,815	23,317	(91,862)	-	2,064,530

Schedule 1 - Cam Compatible

E: Fund is in a Grantor Trust at Investor's Death and Remaining Unrealized Income is Taxed in 10 Years After Grantor Dies

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	7.062%	7.374%	7.944%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Managed Fund - 200% Turnover - 7.944% Growth Rate

	Beginning of Year	Dividend Income	Growth	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	20,000	79,441	16,172	(40,431)	-	1,075,182
Year 2	1,075,182	21,504	85,413	17,388	(43,470)	-	1,156,017
Year 3	1,156,017	23,120	91,835	18,695	(46,738)	-	1,242,929
Year 4	1,242,929	24,859	98,739	20,101	(50,252)	-	1,336,375
Year 5	1,336,375	26,728	106,163	21,612	(54,030)	-	1,436,847
Year 6	1,436,847	28,737	114,144	23,237	(58,092)	-	1,544,873
Year 7	1,544,873	30,897	122,726	24,984	(62,460)	-	1,661,020
Year 8	1,661,020	33,220	131,953	26,862	(67,156)	-	1,785,899
Year 9	1,785,899	35,718	141,873	28,882	(72,205)	-	1,920,167
Year 10	1,920,167	38,403	152,539	31,053	(77,633)	-	2,064,530

Schedule 1 - Cam Compatible

F: Fund is Held in a Non-Grantor Trust and Remaining Unrealized Income is Taxed in 10 Years

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Assumptions:	Indexed Fund 5% Turnover	Managed Fund 50% Turnover	Managed Fund 200% Turnover
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	7.487%	8.481%	10.863%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Indexed Fund - 5% Turnover - 7.487% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Taxes	Estate Taxes	End of Year
Year 1	1,000,000	20,000	74,869	(6,670)	-	1,088,199
Year 2	1,088,199	21,764	81,472	(7,348)	-	1,184,087
Year 3	1,184,087	23,682	88,651	(8,841)	-	1,287,579
Year 4	1,287,579	25,752	96,400	(10,417)	-	1,399,314
Year 5	1,399,314	27,986	104,765	(12,086)	-	1,519,978
Year 6	1,519,978	30,400	113,799	(13,858)	-	1,650,319
Year 7	1,650,319	33,006	123,558	(15,741)	-	1,791,142
Year 8	1,791,142	35,823	134,101	(17,747)	-	1,943,319
Year 9	1,943,319	38,866	145,494	(19,887)	-	2,107,793
Year 10	2,107,793	42,156	157,808	(243,227)	-	2,064,530

Managed Fund - 50% Turnover - 8.481% Growth Rate

	Beginning of Year	Dividend Income	Growth	Income Taxes	Estate Taxes	End of Year
Year 1	1,000,000	20,000	84,809	(23,912)	-	1,080,897
Year 2	1,080,897	21,618	91,670	(25,449)	-	1,168,736
Year 3	1,168,736	23,375	99,119	(30,684)	-	1,260,545
Year 4	1,260,545	25,211	106,905	(34,705)	-	1,357,956
Year 5	1,357,956	27,159	115,167	(38,208)	-	1,462,074
Year 6	1,462,074	29,241	123,997	(41,557)	-	1,573,755
Year 7	1,573,755	31,475	133,468	(44,946)	-	1,693,753
Year 8	1,693,753	33,875	143,645	(48,482)	-	1,822,791
Year 9	1,822,791	36,456	154,589	(52,232)	-	1,961,604
Year 10	1,961,604	39,232	166,361	(102,668)	-	2,064,530

Schedule 1 - Cam Compatible

F: Fund is Held in a Non-Grantor Trust and Remaining Unrealized Income is Taxed in 10 Years

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Assumptions:	**Indexed Fund 5% Turnover**	**Managed Fund 50% Turnover**	**Managed Fund 200% Turnover**
Rate of Return Taxed at Dividend Income Rate	2.000%	2.000%	2.000%
Rate of Return Taxed at Capital Gains Rates	7.487%	8.481%	10.863%
Turnover Rate (% of Capital Gains Recognized/Year)	5.000%	50.000%	100.000%
Long Term Capital Gain and Health Care Tax Rate	25.000%	25.000%	25.000%
Short Term Capital Gain and Health Care Tax Rate	44.600%	44.600%	44.600%
Ordinary and Health Care Tax Rate	25.000%	25.000%	25.000%
Federal Estate Taxes	40.000%	40.000%	40.000%

Managed Fund - 200% Turnover - 10.863% Growth Rate

	Beginning of Year	**Dividend Income**	**Growth**	**Income Taxes**	**Estate Taxes**	**End of Year**
Year 1	1,000,000	20,000	108,632	(53,450)	-	1,075,182
Year 2	1,075,182	21,504	116,800	(57,469)	-	1,156,017
Year 3	1,156,017	23,120	125,581	(61,789)	-	1,242,929
Year 4	1,242,929	24,859	135,022	(66,435)	-	1,336,376
Year 5	1,336,376	26,728	145,174	(71,429)	-	1,436,847
Year 6	1,436,847	28,737	156,088	(76,800)	-	1,544,873
Year 7	1,544,873	30,897	167,823	(82,574)	-	1,661,020
Year 8	1,661,020	33,220	180,441	(88,782)	-	1,785,899
Year 9	1,785,899	35,718	194,007	(95,456)	-	1,920,168
Year 10	1,920,168	38,403	208,592	(102,633)	-	2,064,530

Schedule 2 - Cam Compatible

A: Fund is Owned by Investor and is Fully Taxable in the Investor's Estate

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Assumptions:	Tax Free Bond Fund	Taxable Bond Fund
Rate of Return - Tax Free Income	8.398%	0.000%
Rate of Return Taxed at Ordinary Rates	0.000%	15.159%
Ordinary Income Tax	44.600%	44.600%
Federal Estate Tax	40.000%	40.000%

Tax Free Bond Fund - 8.398% Interest Rate

	Beginning of Year	Tax Free Income	Ordinary Income	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	83,982	-	-	-	1,083,982
Year 2	1,083,982	91,035	-	-	-	1,175,017
Year 3	1,175,017	98,680	-	-	-	1,273,697
Year 4	1,273,697	106,968	-	-	-	1,380,665
Year 5	1,380,665	115,951	-	-	-	1,496,616
Year 6	1,496,616	125,689	-	-	-	1,622,305
Year 7	1,622,305	136,245	-	-	-	1,758,550
Year 8	1,758,550	147,687	-	-	-	1,906,236
Year 9	1,906,236	160,090	-	-	-	2,066,326
Year 10	2,066,326	173,534	-	-	(895,944)	1,343,916

Taxable Bond Fund - 15.159% Interest Rate

	Beginning of Year	Tax Free Income	Ordinary Income	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	-	151,592	(67,610)	-	1,083,982
Year 2	1,083,982	-	164,323	(73,288)	-	1,175,017
Year 3	1,175,017	-	178,123	(79,443)	-	1,273,697
Year 4	1,273,697	-	193,082	(86,115)	-	1,380,665
Year 5	1,380,665	-	209,298	(93,347)	-	1,496,616
Year 6	1,496,616	-	226,875	(101,186)	-	1,622,305
Year 7	1,622,305	-	245,929	(109,684)	-	1,758,549
Year 8	1,758,549	-	266,582	(118,896)	-	1,906,236
Year 9	1,906,236	-	288,970	(128,881)	-	2,066,325
Year 10	2,066,325	-	313,239	(139,704)	(895,944)	1,343,916

Schedule 2 - Cam Compatible
B: Fund is Held in a Grantor Trust at Investor's Death

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Assumptions:	Tax Free Bond Fund	Taxable Bond Fund
Rate of Return - Tax Free Income	3.000%	0.000%
Rate of Return Taxed at Ordinary Rates	0.000%	4.096%
Ordinary Income Tax	44.600%	44.600%
Federal Estate Tax	40.000%	40.000%

Tax Free Bond Fund - 3.000% Interest Rate

	Beginning of Year	Tax Free Income	Ordinary Income	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	30,000	-	-	-	-	1,030,000
Year 2	1,030,000	30,900	-	-	-	-	1,060,900
Year 3	1,060,900	31,827	-	-	-	-	1,092,727
Year 4	1,092,727	32,782	-	-	-	-	1,125,509
Year 5	1,125,509	33,765	-	-	-	-	1,159,274
Year 6	1,159,274	34,778	-	-	-	-	1,194,052
Year 7	1,194,052	35,822	-	-	-	-	1,229,874
Year 8	1,229,874	36,896	-	-	-	-	1,266,770
Year 9	1,266,770	38,003	-	-	-	-	1,304,773
Year 10	1,304,773	39,143	-	-	-	-	1,343,916

Taxable Bond Fund - 4.096% Interest Rate

	Beginning of Year	Tax Free Income	Ordinary Income	Grantor Trust 40% Estate Tax Benefit	Income Tax Withdrawals	Estate Taxes	End of Year
Year 1	1,000,000	-	40,961	7,307	(18,269)	-	1,030,000
Year 2	1,030,000	-	42,190	7,527	(18,817)	-	1,060,900
Year 3	1,060,900	-	43,456	7,753	(19,381)	-	1,092,727
Year 4	1,092,727	-	44,759	7,985	(19,963)	-	1,125,509
Year 5	1,125,509	-	46,102	8,225	(20,562)	-	1,159,274
Year 6	1,159,274	-	47,485	8,471	(21,178)	-	1,194,052
Year 7	1,194,052	-	48,910	8,726	(21,814)	-	1,229,874
Year 8	1,229,874	-	50,377	8,987	(22,468)	-	1,266,770
Year 9	1,266,770	-	51,888	9,257	(23,142)	-	1,304,773
Year 10	1,304,773	-	53,445	9,535	(23,837)	-	1,343,916

Schedule 2 - Cam Compatible

C: Fund is Held in a Non-Grantor Trust; or Fund is Owned by Investor and Investor's Estate is Lower than Remaining Estate Tax Exemption; or a Bequest of Fund is Made to Charity at Investor's Death

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Assumptions:	Tax Free Bond Fund	Taxable Bond Fund
Rate of Return - Tax Free Income	3.000%	0.000%
Rate of Return Taxed at Ordinary Rates	0.000%	5.415%
Ordinary Income Tax	44.600%	44.600%
Federal Estate Tax	40.000%	40.000%

Tax Free Bond Fund - 3.000% Interest Rate

	Beginning of Year	Tax Free Income	Ordinary Income	Income Taxes	Estate Taxes	End of Year
Year 1	1,000,000	30,000	-	-	-	1,030,000
Year 2	1,030,000	30,900	-	-	-	1,060,900
Year 3	1,060,900	31,827	-	-	-	1,092,727
Year 4	1,092,727	32,782	-	-	-	1,125,509
Year 5	1,125,509	33,765	-	-	-	1,159,274
Year 6	1,159,274	34,778	-	-	-	1,194,052
Year 7	1,194,052	35,822	-	-	-	1,229,874
Year 8	1,229,874	36,896	-	-	-	1,266,770
Year 9	1,266,770	38,003	-	-	-	1,304,773
Year 10	1,304,773	39,143	-	-	-	1,343,916

Taxable Bond Fund - 5.415% Interest Rate

	Beginning of Year	Tax Free Income	Ordinary Income	Income Taxes	Estate Taxes	End of Year
Year 1	1,000,000	-	54,152	(24,152)	-	1,030,000
Year 2	1,030,000	-	55,776	(24,876)	-	1,060,900
Year 3	1,060,900	-	57,449	(25,622)	-	1,092,727
Year 4	1,092,727	-	59,173	(26,391)	-	1,125,509
Year 5	1,125,509	-	60,948	(27,183)	-	1,159,274
Year 6	1,159,274	-	62,777	(27,998)	-	1,194,052
Year 7	1,194,052	-	64,660	(28,838)	-	1,229,874
Year 8	1,229,874	-	66,600	(29,703)	-	1,266,770
Year 9	1,266,770	-	68,598	(30,595)	-	1,304,773
Year 10	1,304,773	-	70,656	(31,512)	-	1,343,916

Schedule 3 - Assets Earn 2.2% Annually

Neal and Nancy Navigator

Hypothetical Integrated Income and Estate Tax Plan Comparisons (Three-Year Future Values)

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	Three-Year Future Values	Present Values (Discounted at 2.5%)	Percentage of Total
No Further Planning			
Mr. and Mrs. Neal Navigator	33,987,889	31,561,134	99.50%
Navigator Children	-	-	0.00%
IRS Income Tax - Direct Cost	166,765	154,858	0.49%
IRS Income Tax - Investment Opportunity Cost	4,150	3,854	0.01%
Total	$34,158,805	$31,719,846	100.00%
Conventional GRAT			
Mr. and Mrs. Neal Navigator	33,987,745	31,561,000	99.50%
Navigator Children	144	134	0.00%
IRS - Income Tax	166,765	154,858	0.49%
IRS - Investment Opportunity Costs	4,150	3,854	0.01%
Total	$34,158,805	$31,719,846	100.00%
Contributing Non-Leveraged Family Entities to a Conventional GRAT			
Mr. and Mrs. Neal Navigator	31,652,714	29,392,691	92.66%
Navigator Children	2,335,176	2,168,443	6.84%
IRS Income Tax - Direct Cost	166,765	154,858	0.49%
IRS Income Tax - Investment Opportunity Cost	4,150	3,854	0.01%
Total	$34,158,805	$31,719,846	100.00%
Contributing Leveraged Family Entities to a Conventional GRAT			
Mr. and Mrs. Neal Navigator	26,216,640	24,344,757	76.75%
Navigator Children	7,771,249	7,216,378	22.75%
IRS Income Tax - Direct Cost	166,765	154,858	0.49%
IRS Income Tax - Investment Opportunity Cost	4,150	3,854	0.01%
Total	$34,158,805	$31,719,846	100.00%

Schedule 3 - Assets Earn 2.2% Annually
Neal and Nancy Navigator
Asset Page*

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	Neal and Nancy Navigator
Assets	
FMV: Financial Assets	$27,000,000
Basis: Financial Assets	$27,000,000
FMV: Alternative Investments	$5,000,000
Basis: Alterntative Investments	$5,000,000
Total Assets:	**$32,000,000**
Total Basis:	**$32,000,000**

* Information provided by client. There is no proposed planning for Mr. and Mrs. Navigator's other assets.

Schedule 3 - Assets Earn 2.2% Annually
Neal and Nancy Navigator
No Further Planning

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Assumptions:	
Total Estimated Rate of Return	2.20%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	-0.80%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Income Taxes	End of Year Financial & Other Assets
Year 1	32,000,000	192,000	768,000	(256,000)	(66,432)	32,637,568
Year 2	32,637,568	195,825	783,302	(261,101)	(54,316)	33,301,279
Year 3	33,301,279	199,808	799,231	(266,410)	(46,018)	33,987,889

Schedule 3 - Assets Earn 2.2% Annually
Neal and Nancy Navigator

Conventional GRAT

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Rate of Return Taxed at Capital Gains Rates	-0.80%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Assumptions (continued):	
GRAT Annual Annuity	$8,702,613
IRS §7520 Rate - June 2014	2.20%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Annuity Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	(56,000)	8,702,613	(66,432)	15,790,181
Year 2	15,790,181	94,741	378,964	(126,321)	8,702,613	(54,316)	24,785,861
Year 3	24,785,861	148,715	594,861	(198,287)	8,702,613	(46,018)	33,987,745

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	25,000,000	150,000	600,000	(200,000)	(8,702,613)	-	16,847,388
Year 2	16,847,388	101,084	404,337	(134,779)	(8,702,613)	-	8,515,418
Year 3	8,515,418	51,093	204,370	(68,123)	(8,702,613)	(144)	-

Non-GST Tax Exempt Grantor Trusts Created by Neal Navigator for the Benefit of Nancy Navigator and their Descendants (Remanider of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	GRAT Terminates	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	144	-	-	144

Schedule 3 - Assets Earn 2.2% Annually
Neal and Nancy Navigator
Contributing Non-Leveraged Family Entities to a Conventional GRAT

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Assumptions:	
Total Estimated Rate of Return	2.20%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	-0.80%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	25.00%
Ordinary Tax Rate	44.60%

Assumptions (continued):	
Financial Assets, LP Valuation Discount	35.00%
Financial Assets, LP Distributions	4.00%
Holdco, FLLC Valuation Discount	20.00%
Holdco, FLLC Distributions	2.00%
GRAT Annual Annuity	$4,926,737
IRS §7520 Rate - June 2014	2.20%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets Distributions	Holdco Distributions	Cash Annuity Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	(56,000)	7,200	8,668	858,132	(66,432)	7,961,568
Year 2	7,961,568	47,769	191,078	(63,693)	7,070	244,904	609,065	(54,316)	8,943,447
Year 3	8,943,447	53,661	214,643	(71,548)	6,943	491,209	350,161	(46,018)	9,942,498

Financial Assets, LP

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	18,000,000	108,000	432,000	(144,000)	(720,000)	17,676,000
Year 2	17,676,000	106,056	424,224	(141,408)	(707,040)	17,357,832
Year 3	17,357,832	104,147	416,588	(138,863)	(694,313)	17,045,391

Ownership	
Neal Navigator	Holdco, FLLC
1.00%	99.00%
1.00%	99.00%
1.00%	99.00%

Holdco, FLLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets, LP Distributions	Distributions	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	(56,000)	712,800	(866,800)	7,000,000
Year 2	7,000,000	42,000	168,000	(56,000)	699,970	(853,970)	7,000,000
Year 3	7,000,000	42,000	168,000	(56,000)	687,370	(841,370)	7,000,000

End of Year Ownership	
Neal Navigator	GRAT & Grantor Trust #1
28.68%	71.32%
58.38%	41.62%
90.22%	9.78%

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Cash Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	-	-	-	-	858,132	(858,132)	-	-
Year 2	-	-	-	-	609,065	(609,065)	-	-
Year 3	-	-	-	-	350,161	(350,161)	-	-

In-Kind Annuity Payments with Holdco Units	Holdco %
5,085,756	27.68%
5,397,090	29.70%
5,720,720	31.84%

New Non-GST Grantor Trusts #1 Created by Neal Navigator for the Benefit of Nancy Navigator and their Children (Remanider of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-

Schedule 3 - Assets Earn 2.2% Annually
Neal and Nancy Navigator
Contributing Leveraged Family Entities to a Conventional GRAT

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Assumptions:	
Total Estimated Rate of Return	2.20%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	-0.80%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Assumptions (continued):	
Financial Assets, FLP Valuation Discount	35.00%
Financial Assets, LP Distributions	2.00%
Holdco, FLLC Valuation Discount	20.00%
Holdco, FLLC Distributions	2.00%
GRAT Annual Annuity	$512,331
IRS §7520 Rate - June 2014	2.20%
Intra-Family Interest Rate (short-term) - June 2014	0.32%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets Distributions	Holdco Distributions	Annuity Payments	Note Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	(56,000)	8,000	5,175	512,331	53,519	(66,432)	7,666,593
Year 2	7,666,593	46,000	183,998	(61,333)	8,000	5,175	512,331	53,519	(54,316)	8,359,968
Year 3	8,359,968	50,160	200,639	(66,880)	3,437	5,175	512,331	53,519	(46,018)	9,072,331

Financial Assets, LP

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	18,000,000	108,000	432,000	(144,000)	(800,000)	17,596,000
Year 2	17,596,000	105,576	422,304	(140,768)	(800,000)	17,183,112
Year 3	17,183,112	103,099	412,395	(137,465)	(343,662)	17,217,478

Ownership	Neal Navigator	Holdco, FLLC
Year 1	1.00%	99.00%
Year 2	1.00%	99.00%
Year 3	1.00%	99.00%

Holdco, FLLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets, LP Distributions	Note Payments	Distributions	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	(56,000)	792,000	(53,519)	(517,506)	7,374,975
Year 2	7,374,975	44,250	176,999	(59,000)	792,000	(53,519)	(517,506)	7,758,199
Year 3	7,758,199	46,549	186,197	(62,066)	340,226	(53,519)	(517,506)	7,698,080

Ownership	Neal Navigator	GRAT & Grantor Trust
Year 1	1.00%	99.00%
Year 2	1.00%	99.00%
Year 3	1.00%	99.00%

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	-	-	-	-	512,331	(512,331)	-	-
Year 2	-	-	-	-	512,331	(512,331)	-	-
Year 3	-	-	-	-	512,331	(512,331)	-	-

New Non-GST Tax Exempt Grantor Trusts Created by Neal Navigator for the Benefit of Nancy Navigator and their Children (Remainder of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-

Note #1 Between Neal Navigator and Holdco, FLLC
for the Purchase of Non-Managing Member Interests

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	16,724,700	53,519	(53,519)	16,724,700
Year 2	16,724,700	53,519	(53,519)	16,724,700
Year 3	16,724,700	53,519	(53,519)	16,724,700

Schedule 3 - Assets Earn 7.4% Annually

Neal and Nancy Navigator

Hypothetical Integrated Income and Estate Tax Plan Comparisons (Three-Year Future Values)

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	Three-Year Future Values	Present Values (Discounted at 2.5%)	Percentage of Total
No Further Planning			
Mr. and Mrs. Neal Navigator	38,774,953	36,006,399	97.81%
Navigator Children	-	-	0.00%
IRS Income Tax - Direct Cost	817,777	759,387	2.06%
IRS Income Tax - Investment Opportunity Cost	49,933	46,368	0.13%
Total	$39,642,663	$36,812,154	100.00%
Conventional GRAT			
Mr. and Mrs. Neal Navigator	35,891,596	33,328,915	90.54%
Navigator Children	2,883,358	2,677,484	7.27%
IRS Income Tax - Direct Cost	817,777	759,387	2.06%
IRS Income Tax - Investment Opportunity Cost	49,933	46,368	0.13%
Total	$39,642,663	$36,812,154	100.00%
Contributing Non-Leveraged Family Entities to a Conventional GRAT			
Mr. and Mrs. Neal Navigator	32,983,854	30,628,788	83.20%
Navigator Children	5,791,099	5,377,611	14.61%
IRS Income Tax - Direct Cost	817,777	759,387	2.06%
IRS Income Tax - Investment Opportunity Cost	49,933	46,368	0.13%
Total	$39,642,663	$36,812,154	100.00%
Contributing Leveraged Family Entities to a Conventional GRAT			
Mr. and Mrs. Neal Navigator	26,883,832	24,964,310	67.82%
Navigator Children	11,891,122	11,042,089	30.00%
IRS Income Tax - Direct Cost	817,777	759,387	2.06%
IRS Income Tax - Investment Opportunity Cost	49,933	46,368	0.13%
Total	$39,642,663	$36,812,154	100.00%

Schedule 3 - Assets Earn 7.4% Annually

Neal and Nancy Navigator

No Further Planning

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Income Taxes	End of Year Financial & Other Assets
Year 1	32,000,000	192,000	768,000	1,408,000	(191,232)	34,176,768
Year 2	34,176,768	205,061	820,242	1,503,778	(278,160)	36,427,688
Year 3	36,427,688	218,566	874,265	1,602,818	(348,384)	38,774,953

Schedule 3 - Assets Earn 7.4% Annually
Neal and Nancy Navigator

Conventional GRAT

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Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Assumptions (continued):	
GRAT Annual Annuity	$8,702,613
IRS §7520 Rate - June 2014	2.20%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Annuity Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	308,000	8,702,613	(191,232)	16,029,381
Year 2	16,029,381	96,176	384,705	705,293	8,702,613	(278,160)	25,640,007
Year 3	25,640,007	153,840	615,360	1,128,160	8,702,613	(348,384)	35,891,596

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	25,000,000	150,000	600,000	1,100,000	(8,702,613)	-	18,147,388
Year 2	18,147,388	108,884	435,537	798,485	(8,702,613)	-	10,787,682
Year 3	10,787,682	64,726	258,904	474,658	(8,702,613)	(2,883,358)	-

Non-GST Tax Exempt Grantor Trusts Created by Neal Navigator for the Benefit of Nancy Navigator and their Descendants (Remanider of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	GRAT Terminates	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	2,883,358	-	-	2,883,358

Schedule 3 - Assets Earn 7.4% Annually
Neal and Nancy Navigator
Contributing Non-Leveraged Family Entities to a Conventional GRAT

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Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	25.00%
Ordinary Tax Rate	44.60%

Assumptions (continued):	
Financial Assets, LP Valuation Discount	35.00%
Financial Assets, LP Distributions	4.00%
Holdco, FLLC Valuation Discount	20.00%
Holdco, FLLC Distributions	2.00%
GRAT Annual Annuity	$4,926,737
IRS §7520 Rate - June 2014	2.20%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets Distributions	Holdco Distributions	Cash Annuity Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	308,000	7,200	12,308	1,218,492	(191,232)	8,564,768
Year 2	8,564,768	51,389	205,554	376,850	7,445	319,107	935,928	(278,160)	10,182,880
Year 3	10,182,880	61,097	244,389	448,047	7,698	654,913	625,181	(348,384)	11,875,822

Financial Assets, LP

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	18,000,000	108,000	432,000	792,000	(720,000)	18,612,000
Year 2	18,612,000	111,672	446,688	818,928	(744,480)	19,244,808
Year 3	19,244,808	115,469	461,875	846,772	(769,792)	19,899,131

Ownership	
Neal Navigator	Holdco, FLLC
1.00%	99.00%
1.00%	99.00%
1.00%	99.00%

Holdco, FLLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets, LP Distributions	Distributions	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	308,000	712,800	(1,230,800)	7,000,000
Year 2	7,000,000	42,000	168,000	308,000	737,035	(1,255,035)	7,000,000
Year 3	7,000,000	42,000	168,000	308,000	762,094	(1,280,094)	7,000,000

Ownership	
Neal Navigator	GRAT & Grantor Trust #1
25.43%	74.57%
51.16%	48.84%
78.31%	21.69%

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Cash Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	-	-	-	-	1,218,492	(1,218,492)	-	-
Year 2	-	-	-	-	935,928	(935,928)	-	-
Year 3	-	-	-	-	625,181	(625,181)	-	-

In-Kind Annuity Payments with Holdco Units	Holdco %
4,635,306	24.43%
4,988,511	25.74%
5,376,944	27.15%

New Non-GST Grantor Trusts #1 Created by Neal Navigator for the Benefit of Nancy Navigator and their Children (Remanider of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-

Schedule 3 - Assets Earn 7.4% Annually
Neal and Nancy Navigator
Contributing Leveraged Family Entities to a Conventional GRAT

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Assumptions (continued):	
Financial Assets, FLP Valuation Discount	35.00%
Financial Assets, LP Distributions	2.00%
Holdco, FLLC Valuation Discount	20.00%
Holdco, FLLC Distributions	2.00%
GRAT Annual Annuity	$512,331
IRS §7520 Rate - June 2014	2.20%
Intra-Family Interest Rate (short-term) - June 2014	0.32%

Mr. and Mrs. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets Distributions	Holdco Distributions	Annuity Payments	Note Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	308,000	8,000	5,175	512,331	53,519	(191,232)	7,905,793
Year 2	7,905,793	47,435	189,739	347,855	8,000	5,175	512,331	53,519	(278,160)	8,791,687
Year 3	8,791,687	52,750	211,000	386,834	3,821	5,175	512,331	53,519	(348,384)	9,668,733

Financial Assets, LP

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	18,000,000	108,000	432,000	792,000	(800,000)	18,532,000
Year 2	18,532,000	111,192	444,768	815,408	(800,000)	19,103,368
Year 3	19,103,368	114,620	458,481	840,548	(382,067)	20,134,950

Ownership	Neal Navigator	Holdco, FLLC
Year 1	1.00%	99.00%
Year 2	1.00%	99.00%
Year 3	1.00%	99.00%

Holdco, FLLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets, LP	Note Payments	Distributions	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	308,000	792,000	(53,519)	(517,506)	7,738,975
Year 2	7,738,975	46,434	185,735	340,515	792,000	(53,519)	(517,506)	8,532,634
Year 3	8,532,634	51,196	204,783	375,436	378,247	(53,519)	(517,506)	8,971,270

Ownership	Neal Navigator	GRAT & Grantor Trust
Year 1	1.00%	99.00%
Year 2	1.00%	99.00%
Year 3	1.00%	99.00%

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	-	-	-	-	512,331	(512,331)	-	-
Year 2	-	-	-	-	512,331	(512,331)	-	-
Year 3	-	-	-	-	512,331	(512,331)	-	-

New Non-GST Tax Exempt Grantor Trusts Created by Neal Navigator for the Benefit of Nancy Navigator and their Children (Remainder of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-

Note #1 Between Neal Navigator and Holdco, FLLC
for the Purchase of Non-Managing Member Interests

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	16,724,700	53,519	(53,519)	16,724,700
Year 2	16,724,700	53,519	(53,519)	16,724,700
Year 3	16,724,700	53,519	(53,519)	16,724,700

Schedule 3 - Assets Earn 10.0% Annually

Neal and Nancy Navigator

Hypothetical Integrated Income and Estate Tax Plan Comparisons (Three-Year Future Values)

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	Three-Year Future Values	Present Values (Discounted at 2.5%)	Percentage of Total
No Further Planning			
Mr. Neal Navigator	41,338,758	38,387,146	97.06%
Navigator Children	-	-	0.00%
IRS Income Tax - Direct Cost	1,160,521	1,077,659	2.72%
IRS Income Tax - Investment Opportunity Cost	92,721	86,101	0.22%
Total	$42,592,000	$39,550,906	100.00%
Conventional GRAT			
Mr. Neal Navigator	36,869,405	34,236,908	86.56%
Navigator Children	4,469,353	4,150,238	10.49%
IRS Income Tax - Direct Cost	1,160,521	1,077,659	2.72%
IRS Income Tax - Investment Opportunity Cost	92,721	86,101	0.22%
Total	$42,592,000	$39,550,906	100.00%
Contributing Non-Leveraged Family Entities to a Conventional GRAT			
Mr. Neal Navigator	33,612,113	31,212,188	78.92%
Navigator Children	7,726,645	7,174,958	18.14%
IRS Income Tax - Direct Cost	1,160,521	1,077,659	2.72%
IRS Income Tax - Investment Opportunity Cost	92,721	86,101	0.22%
Total	$42,592,000	$39,550,906	100.00%
Contributing Leveraged Family Entities to a Conventional GRAT			
Mr. Neal Navigator	27,229,585	25,285,376	63.93%
Navigator Children	14,109,173	13,101,770	33.13%
IRS Income Tax - Direct Cost	1,160,521	1,077,659	2.72%
IRS Income Tax - Investment Opportunity Cost	92,721	86,101	0.22%
Total	$42,592,000	$39,550,906	100.00%

Schedule 3 - Assets Earn 10.0% Annually
Neal and Nancy Navigator
No Further Planning

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Assumptions:	
Total Estimated Rate of Return	10.00%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	7.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Mr. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Income Taxes	End of Year Financial & Other Assets
Year 1	32,000,000	192,000	768,000	2,240,000	(253,632)	34,946,368
Year 2	34,946,368	209,678	838,713	2,446,246	(394,585)	38,046,420
Year 3	38,046,420	228,279	913,114	2,663,249	(512,304)	41,338,758

Schedule 3 - Assets Earn 10.0% Annually
Neal and Nancy Navigator

Conventional GRAT

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Assumptions:	
Total Estimated Rate of Return	10.00%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	7.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Assumptions (continued):	
GRAT Annual Annuity	$8,702,613
IRS §7520 Rate - June 2014	2.20%

Mr. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Annuity Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	490,000	8,702,613	(253,632)	16,148,981
Year 2	16,148,981	96,894	387,576	1,130,429	8,702,613	(394,585)	26,071,906
Year 3	26,071,906	156,431	625,726	1,825,033	8,702,613	(512,304)	36,869,405

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	25,000,000	150,000	600,000	1,750,000	(8,702,613)	-	18,797,388
Year 2	18,797,388	112,784	451,137	1,315,817	(8,702,613)	-	11,974,514
Year 3	11,974,514	71,847	287,388	838,216	(8,702,613)	(4,469,353)	-

Non-GST Tax Exempt Grantor Trusts Created by Neal Navigator for the Benefit of Nancy Navigator and their Descendants (Remanider of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	GRAT Terminates	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	4,469,353	-	-	4,469,353

Schedule 3 - Assets Earn 10.0% Annually
Neal and Nancy Navigator
Contributing Non-Leveraged Family Entities to a Conventional GRAT

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Assumptions:	
Total Estimated Rate of Return	10.00%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	7.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	25.00%
Ordinary Tax Rate	44.60%

Assumptions (continued):	
Financial Assets, LP Valuation Discount	35.00%
Financial Assets, LP Distributions	4.00%
Holdco, FLLC Valuation Discount	20.00%
Holdco, FLLC Distributions	2.00%
GRAT Annual Annuity	$4,926,737
IRS §7520 Rate - June 2014	2.20%

Mr. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets Distributions	Holdco Distributions	Cash Annuity Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	490,000	7,200	14,128	1,398,672	(253,632)	8,866,368
Year 2	8,866,368	53,198	212,793	620,646	7,632	347,535	1,108,033	(394,585)	10,821,620
Year 3	10,821,620	64,930	259,719	757,513	8,090	716,316	784,586	(512,304)	12,900,470

Financial Assets, LP

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	18,000,000	108,000	432,000	1,260,000	(720,000)	19,080,000
Year 2	19,080,000	114,480	457,920	1,335,600	(763,200)	20,224,800
Year 3	20,224,800	121,349	485,395	1,415,736	(808,992)	21,438,288

Ownership	Neal Navigator	Holdco, FLLC
Year 1	1.00%	99.00%
Year 2	1.00%	99.00%
Year 3	1.00%	99.00%

Holdco, FLLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets, LP Distributions	Distributions	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	490,000	712,800	(1,412,800)	7,000,000
Year 2	7,000,000	42,000	168,000	490,000	755,568	(1,455,568)	7,000,000
Year 3	7,000,000	42,000	168,000	490,000	800,902	(1,500,902)	7,000,000

Ownership	Neal Navigator	GRAT & Grantor Trust #1
Year 1	23.88%	76.12%
Year 2	47.73%	52.27%
Year 3	72.62%	27.38%

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Cash Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	-	-	-	-	1,398,672	(1,398,672)	-	-
Year 2	-	-	-	-	1,108,033	(1,108,033)	-	-
Year 3	-	-	-	-	784,586	(784,586)	-	-

	In-Kind Annuity Payments with Holdco Units	Holdco %
Year 1	4,410,081	22.88%
Year 2	4,773,380	23.85%
Year 3	5,177,688	24.90%

New Non-GST Grantor Trusts #1 Created by Neal Navigator for the Benefit of Nancy Navigator and their Children (Remanider of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-

Schedule 3 - Assets Earn 10.0% Annually
Neal and Nancy Navigator
Contributing Leveraged Family Entities to a Conventional GRAT

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Assumptions:	
Total Estimated Rate of Return	10.00%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	7.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain and Health Care Tax Rate	25.00%
Ordinary and Health Care Tax Rate	44.60%

Assumptions (continued):	
Financial Assets, FLP Valuation Discount	35.00%
Financial Assets, LP Distributions	2.00%
Holdco, FLLC Valuation Discount	20.00%
Holdco, FLLC Distributions	2.00%
GRAT Annual Annuity	$512,331
IRS §7520 Rate - June 2014	2.20%
Intra-Family Interest Rate (short-term) - June 2014	0.32%

Mr. Neal Navigator

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets Distributions	Holdco Distributions	Annuity Payments	Note Payments	Income Taxes	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	490,000	8,000	5,175	512,331	53,519	(253,632)	8,025,393
Year 2	8,025,393	48,152	192,609	561,778	8,000	5,175	512,331	53,519	(394,585)	9,012,373
Year 3	9,012,373	54,074	216,297	630,866	4,020	5,175	512,331	53,519	(512,304)	9,976,352

Financial Assets, LP

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	18,000,000	108,000	432,000	1,260,000	(800,000)	19,000,000
Year 2	19,000,000	114,000	456,000	1,330,000	(800,000)	20,100,000
Year 3	20,100,000	120,600	482,400	1,407,000	(402,000)	21,708,000

Ownership	
Neal Navigator	Holdco, FLLC
1.00%	99.00%
1.00%	99.00%
1.00%	99.00%

Holdco, FLLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Financial Assets, LP	Note Payments	Distributions	End of Year Financial & Other Assets
Year 1	7,000,000	42,000	168,000	490,000	792,000	(53,519)	(517,506)	7,920,975
Year 2	7,920,975	47,526	190,103	554,468	792,000	(53,519)	(517,506)	8,934,047
Year 3	8,934,047	53,604	214,417	625,383	397,980	(53,519)	(517,506)	9,654,406

Ownership	
Neal Navigator	GRAT & Grantor Trust
1.00%	99.00%
1.00%	99.00%
1.00%	99.00%

Three Year Grantor Retained Annuity Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Annuity Payments	GRAT Terminates	End of Year Financial & Other Assets
Year 1	-	-	-	-	512,331	(512,331)	-	-
Year 2	-	-	-	-	512,331	(512,331)	-	-
Year 3	-	-	-	-	512,331	(512,331)	-	-

New Non-GST Tax Exempt Grantor Trusts Created by Neal Navigator for the Benefit of Nancy Navigator and their Children (Remainder of 3-Year GRAT)

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Holdco, FLLC Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-

Note #1 Between Neal Navigator and Holdco, FLLC
for the Purchase of Non-Managing Member Interests

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	16,724,700	53,519	(53,519)	16,724,700
Year 2	16,724,700	53,519	(53,519)	16,724,700
Year 3	16,724,700	53,519	(53,519)	16,724,700

Schedule 4
Mr. and Mrs. Al Art
Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming Mr. and Mrs. Art have a joint life expectancy of 25 years)

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	25-Year Future Values		Present Values (Discounted at 2.5%)	Percentage of Total
	Pre-Death	Post Death		
No Further Planning				
Schedule 4	348,104,658	-	-	0.00%
Art Children	-	197,066,795	106,295,975	29.67%
Art Children and Grandchildren	-	19,660,000	10,604,419	2.96%
Consumption - Direct Cost	72,918,529	72,918,529	39,331,568	10.98%
Consumption - Investment Opportunity Cost	102,732,004	102,732,004	55,412,676	15.46%
IRS Income Tax - Direct Cost	66,945,932	66,945,932	36,110,006	10.08%
IRS Income Tax - Investment Opportunity Costs	73,592,594	73,592,594	39,695,153	11.08%
IRS - Estate Tax (at 40.0%)	-	131,377,863	70,863,983	19.78%
Total	**$664,293,718**	**$664,293,718**	**$358,313,780**	**100.00%**
Hypothetical Technique #1:				
Schedule 4	73,164,965	-	-	0.00%
Art Children	273,663,944	305,826,923	164,960,164	46.04%
Art Children and Grandchildren	-	19,560,000	10,550,480	2.94%
Consumption - Direct Cost	72,918,529	72,918,529	39,331,568	10.98%
Consumption - Investment Opportunity Cost	102,732,004	102,732,004	55,412,676	15.46%
IRS Income Tax - Direct Cost	68,221,681	68,221,681	36,798,133	10.27%
IRS Income Tax - Investment Opportunity Costs	73,592,594	73,592,594	39,695,153	11.08%
IRS - Estate Tax (at 40.0%)		21,441,986	11,565,605	3.23%
Total	**$664,293,718**	**$664,293,718**	**$358,313,780**	**100.00%**
Hypothetical Technique #2:				
Schedule 4	5,672,187	-	-	0.00%
Art Children	341,160,771	341,160,771	184,018,909	51.36%
Art Children and Grandchildren	-	5,672,187	3,059,525	0.85%
Consumption - Direct Cost	72,918,529	72,918,529	39,331,568	10.98%
Consumption - Investment Opportunity Cost	102,732,004	102,732,004	55,412,676	15.46%
IRS Income Tax - Direct Cost	68,217,632	68,217,632	36,795,949	10.27%
IRS Income Tax - Investment Opportunity Costs	73,592,594	73,592,594	39,695,153	11.08%
IRS - Estate Tax (at 40.0%)	-	-	-	0.00%
Total	**$664,293,718**	**$664,293,718**	**$358,313,780**	**100.00%**

Calculations of Remaining Estate Tax Exemption	**No Further Planning**	**Hypothetical Techniques**
Current Gift and Estate Exemption	10,860,000	10,860,000
Gifts Made	-	(100,000)
Future Estate Tax Exemption Available in 25 years (assumes 3% inflation)	19,660,000	19,560,000

Schedule 4
Mr. and Mrs. Al Art
Asset Page

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	Al Art
Assets and Assumed Basis*	
FMV: Financial & Other Assets	$5,000,000
Basis: Financial & Other Assets	$5,000,000
FMV: Private Equity	$25,000,000
Basis: Private Equity	$25,000,000
FMV: Various Financial LLC Interests	$70,000,000
Basis: Various Financial LLC Interests	$70,000,000
FMV: Artwork	$10,000,000
Basis: Artwork	$10,000,000
Total Assets:	**$110,000,000**
Total Basis:	**$110,000,000**

* Information provided by client. There is no proposed planning for Mr. Art's other assets.

Schedule 4
Mr. and Mrs. Al Art
No Further Planning

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Assumptions:	**Financial Assets**	**Private Equity**	**Various LLC Interests**	**Artwork**
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Schedule 4

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Various LLC Distributions	Private Equity LLC Distributions	Consumption from these Sources	Income Taxes	End of Year Financial Assets	Beginning of Year Artwork	Growth	End of Year Artwork	End of Year Financial & Other Assets
Year 1	5,000,000	30,000	120,000	220,000	2,100,000	950,000	(2,000,000)	(852,300)	5,567,700	10,000,000	800,000	10,800,000	16,367,700
Year 2	5,567,700	33,406	133,625	244,979	2,192,400	1,074,200	(2,060,000)	(1,084,396)	6,101,914	10,800,000	864,000	11,664,000	17,765,914
Year 3	6,101,914	36,611	146,446	268,484	2,288,866	1,190,451	(2,121,800)	(1,271,182)	6,639,790	11,664,000	933,120	12,597,120	19,236,910
Year 4	6,639,790	39,839	159,355	292,151	2,389,576	1,299,262	(2,185,454)	(1,426,368)	7,208,150	12,597,120	1,007,770	13,604,890	20,813,039
Year 5	7,208,150	43,249	172,996	317,159	2,494,717	1,401,110	(2,251,018)	(1,559,703)	7,826,659	13,604,890	1,088,391	14,693,281	22,519,940
Year 6	7,826,659	46,960	187,840	344,373	2,604,485	1,496,439	(2,318,548)	(1,678,139)	8,510,067	14,693,281	1,175,462	15,868,743	24,378,811
Year 7	8,510,067	51,060	204,242	374,443	2,719,082	1,585,666	(2,388,105)	(1,786,655)	9,269,802	15,868,743	1,269,499	17,138,243	26,408,044
Year 8	9,269,802	55,619	222,475	407,871	2,838,721	1,669,184	(2,459,748)	(1,888,834)	10,115,091	17,138,243	1,371,059	18,509,302	28,624,393
Year 9	10,115,091	60,691	242,762	445,064	2,963,625	1,747,356	(2,533,540)	(1,987,277)	11,053,772	18,509,302	1,480,744	19,990,046	31,043,818
Year 10	11,053,772	66,323	265,291	486,366	3,094,025	1,820,525	(2,609,546)	(2,083,893)	12,092,861	19,990,046	1,599,204	21,589,250	33,682,111
Year 11	12,092,861	72,557	290,229	532,086	3,230,162	1,889,012	(2,687,833)	(2,180,103)	13,238,970	21,589,250	1,727,140	23,316,390	36,555,360
Year 12	13,238,970	79,434	317,735	582,515	3,372,289	1,953,115	(2,768,468)	(2,276,985)	14,498,605	23,316,390	1,865,311	25,181,701	39,680,306
Year 13	14,498,605	86,992	347,967	637,939	3,520,670	2,013,116	(2,851,522)	(2,375,379)	15,878,386	25,181,701	2,014,536	27,196,237	43,074,624
Year 14	15,878,386	95,270	381,081	698,649	3,675,579	2,069,276	(2,937,067)	(2,475,958)	17,385,217	27,196,237	2,175,699	29,371,936	46,757,153
Year 15	17,385,217	104,311	417,245	764,950	3,837,305	2,121,842	(3,025,179)	(2,579,280)	19,026,411	29,371,936	2,349,755	31,721,691	50,748,103
Year 16	19,026,411	114,158	456,634	837,162	4,006,146	2,171,045	(3,115,935)	(2,685,826)	20,809,796	31,721,691	2,537,735	34,259,426	55,069,222
Year 17	20,809,796	124,859	499,435	915,631	4,182,416	2,217,098	(3,209,413)	(2,796,025)	22,743,797	34,259,426	2,740,754	37,000,181	59,743,977
Year 18	22,743,797	136,463	545,851	1,000,727	4,366,443	2,260,203	(3,305,695)	(2,910,276)	24,837,513	37,000,181	2,960,014	39,960,195	64,797,708
Year 19	24,837,513	149,025	596,100	1,092,851	4,558,566	2,300,550	(3,404,866)	(3,028,955)	27,100,784	39,960,195	3,196,816	43,157,011	70,257,795
Year 20	27,100,784	162,605	650,419	1,192,435	4,759,143	2,338,315	(3,507,012)	(3,152,433)	29,544,255	43,157,011	3,452,561	46,609,571	76,153,827
Year 21	29,544,255	177,266	709,062	1,299,947	4,968,545	2,373,663	(3,612,222)	(3,281,078)	32,179,438	46,609,571	3,728,766	50,338,337	82,517,775
Year 22	32,179,438	193,077	772,307	1,415,895	5,187,161	2,406,749	(3,720,589)	(3,415,262)	35,018,776	50,338,337	4,027,067	54,365,404	89,384,180
Year 23	35,018,776	210,113	840,451	1,540,826	5,415,397	2,437,717	(3,832,207)	(3,555,365)	38,075,707	54,365,404	4,349,232	58,714,636	96,790,343
Year 24	38,075,707	228,454	913,817	1,675,331	5,653,674	2,466,703	(3,947,173)	(3,701,781)	41,364,732	58,714,636	4,697,171	63,411,807	104,776,540
Year 25	41,364,732	248,188	992,754	1,820,048	5,902,436	13,865,055	(4,065,588)	(10,912,480)	49,215,145	63,411,807	5,072,945	68,484,752	117,699,897

Schedule 4
Mr. and Mrs. Al Art
No Further Planning

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Assumptions:	**Financial Assets**	**Private Equity**	**Various LLC Interests**	**Artwork**
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Private Equity

	Beginning of Year Private Equity	**Income**	**Tax Free Income**	**Growth**	**Distributions**	**End of Year Private Equity**
Year 1	25,000,000	850,000	-	1,000,000	(950,000)	25,900,000
Year 2	25,900,000	880,600	-	1,036,000	(1,074,200)	26,742,400
Year 3	26,742,400	909,242	-	1,069,696	(1,190,451)	27,530,886
Year 4	27,530,886	936,050	-	1,101,235	(1,299,262)	28,268,910
Year 5	28,268,910	961,143	-	1,130,756	(1,401,110)	28,959,699
Year 6	28,959,699	984,630	-	1,158,388	(1,496,439)	29,606,279
Year 7	29,606,279	1,006,613	-	1,184,251	(1,585,666)	30,211,477
Year 8	30,211,477	1,027,190	-	1,208,459	(1,669,184)	30,777,942
Year 9	30,777,942	1,046,450	-	1,231,118	(1,747,356)	31,308,154
Year 10	31,308,154	1,064,477	-	1,252,326	(1,820,525)	31,804,432
Year 11	31,804,432	1,081,351	-	1,272,177	(1,889,012)	32,268,949
Year 12	32,268,949	1,097,144	-	1,290,758	(1,953,115)	32,703,736
Year 13	32,703,736	1,111,927	-	1,308,149	(2,013,116)	33,110,697
Year 14	33,110,697	1,125,764	-	1,324,428	(2,069,276)	33,491,612
Year 15	33,491,612	1,138,715	-	1,339,664	(2,121,842)	33,848,149
Year 16	33,848,149	1,150,837	-	1,353,926	(2,171,045)	34,181,867
Year 17	34,181,867	1,162,183	-	1,367,275	(2,217,098)	34,494,228
Year 18	34,494,228	1,172,804	-	1,379,769	(2,260,203)	34,786,597
Year 19	34,786,597	1,182,744	-	1,391,464	(2,300,550)	35,060,255
Year 20	35,060,255	1,192,049	-	1,402,410	(2,338,315)	35,316,399
Year 21	35,316,399	1,200,758	-	1,412,656	(2,373,663)	35,556,149
Year 22	35,556,149	1,208,909	-	1,422,246	(2,406,749)	35,780,556
Year 23	35,780,556	1,216,539	-	1,431,222	(2,437,717)	35,990,600
Year 24	35,990,600	1,223,680	-	1,439,624	(2,466,703)	36,187,202
Year 25	36,187,202	1,230,365	-	1,447,488	(13,865,055)	25,000,000

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Assumptions:	**Financial Assets**	**Private Equity**	**Various LLC Interests**	**Artwork**
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Various Financials LLCs

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial Assets	Ownership Al Art
Year 1	70,000,000	420,000	1,680,000	3,080,000	(2,100,000)	73,080,000	100.0%
Year 2	73,080,000	438,480	1,753,920	3,215,520	(2,192,400)	76,295,520	100.0%
Year 3	76,295,520	457,773	1,831,092	3,357,003	(2,288,866)	79,652,523	100.0%
Year 4	79,652,523	477,915	1,911,661	3,504,711	(2,389,576)	83,157,234	100.0%
Year 5	83,157,234	498,943	1,995,774	3,658,918	(2,494,717)	86,816,152	100.0%
Year 6	86,816,152	520,897	2,083,588	3,819,911	(2,604,485)	90,636,063	100.0%
Year 7	90,636,063	543,816	2,175,266	3,987,987	(2,719,082)	94,624,050	100.0%
Year 8	94,624,050	567,744	2,270,977	4,163,458	(2,838,721)	98,787,508	100.0%
Year 9	98,787,508	592,725	2,370,900	4,346,650	(2,963,625)	103,134,158	100.0%
Year 10	103,134,158	618,805	2,475,220	4,537,903	(3,094,025)	107,672,061	100.0%
Year 11	107,672,061	646,032	2,584,129	4,737,571	(3,230,162)	112,409,632	100.0%
Year 12	112,409,632	674,458	2,697,831	4,946,024	(3,372,289)	117,355,656	100.0%
Year 13	117,355,656	704,134	2,816,536	5,163,649	(3,520,670)	122,519,304	100.0%
Year 14	122,519,304	735,116	2,940,463	5,390,849	(3,675,579)	127,910,154	100.0%
Year 15	127,910,154	767,461	3,069,844	5,628,047	(3,837,305)	133,538,201	100.0%
Year 16	133,538,201	801,229	3,204,917	5,875,681	(4,006,146)	139,413,881	100.0%
Year 17	139,413,881	836,483	3,345,933	6,134,211	(4,182,416)	145,548,092	100.0%
Year 18	145,548,092	873,289	3,493,154	6,404,116	(4,366,443)	151,952,208	100.0%
Year 19	151,952,208	911,713	3,646,853	6,685,897	(4,558,566)	158,638,105	100.0%
Year 20	158,638,105	951,829	3,807,315	6,980,077	(4,759,143)	165,618,182	100.0%
Year 21	165,618,182	993,709	3,974,836	7,287,200	(4,968,545)	172,905,382	100.0%
Year 22	172,905,382	1,037,432	4,149,729	7,607,837	(5,187,161)	180,513,219	100.0%
Year 23	180,513,219	1,083,079	4,332,317	7,942,582	(5,415,397)	188,455,801	100.0%
Year 24	188,455,801	1,130,735	4,522,939	8,292,055	(5,653,674)	196,747,856	100.0%
Year 25	196,747,856	1,180,487	4,721,949	8,656,906	(5,902,436)	205,404,761	100.0%

Schedule 4
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Hypothetical Technique #1:

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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

Schedule 4

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Various FLLC Distributions	Private Equity FLLC Distributions	Holdco FLLC Distributions	GRAT Annuity	Note Payments	Trust Distributions	Consumption from these Sources	Income Taxes	End of Year Financial Assets	Beginning of Year Artwork	Growth	End of Year Artwork	End of Year Financial & Other Assets
Year 1	5,000,000	30,000	120,000	220,000	21,000	9,500	17,843	1,766,418	870,997	-	(2,000,000)	(852,300)	5,203,458	10,000,000	800,000	10,800,000	16,003,458
Year 2	5,203,458	31,221	124,883	228,952	21,924	10,742	17,843	1,766,418	870,997	-	(2,060,000)	(1,084,396)	5,132,041	10,800,000	864,000	11,664,000	16,796,041
Year 3	5,132,041	30,792	123,169	225,810	22,889	11,905	17,843	1,766,418	870,997	-	(2,121,800)	(1,271,182)	4,808,880	11,664,000	933,120	12,597,120	17,406,000
Year 4	4,808,880	28,853	115,413	211,591	23,896	12,993	-	-	870,997	-	(2,185,454)	(1,426,368)	2,460,801	12,597,120	1,007,770	13,604,890	16,065,690
Year 5	2,460,801	14,765	59,059	108,275	24,947	14,011	-	-	1,128,862	-	(2,251,018)	(1,559,703)	-	13,604,890	1,088,391	14,693,281	14,693,281
Year 6	-	-	-	-	26,045	14,964	-	-	3,955,678	-	(2,318,548)	(1,678,139)	-	14,693,281	1,175,462	15,868,743	15,868,743
Year 7	-	-	-	-	27,191	15,857	-	-	4,131,712	-	(2,388,105)	(1,786,655)	-	15,868,743	1,269,499	17,138,243	17,138,243
Year 8	-	-	-	-	28,387	16,692	-	-	4,303,502	-	(2,459,748)	(1,888,834)	-	17,138,243	1,371,059	18,509,302	18,509,302
Year 9	-	-	-	-	29,636	17,474	-	-	4,473,707	-	(2,533,540)	(1,987,277)	-	18,509,302	1,480,744	19,990,046	19,990,046
Year 10	-	-	-	-	30,940	18,205	-	-	4,644,294	-	(2,609,546)	(2,083,893)	-	19,990,046	1,599,204	21,589,250	21,589,250
Year 11	-	-	-	-	32,302	18,890	-	-	4,816,744	-	(2,687,833)	(2,180,103)	-	21,589,250	1,727,140	23,316,390	23,316,390
Year 12	-	-	-	-	33,723	19,531	-	-	4,992,199	-	(2,768,468)	(2,276,985)	-	23,316,390	1,865,311	25,181,701	25,181,701
Year 13	-	-	-	-	35,207	20,131	-	-	5,171,563	-	(2,851,522)	(2,375,379)	-	25,181,701	2,014,536	27,196,237	27,196,237
Year 14	-	-	-	-	36,756	20,693	-	-	5,355,576	-	(2,937,067)	(2,475,958)	-	27,196,237	2,175,699	29,371,936	29,371,936
Year 15	-	-	-	-	38,373	21,218	-	-	5,544,868	-	(3,025,179)	(2,579,280)	-	29,371,936	2,349,755	31,721,691	31,721,691
Year 16	-	-	-	-	40,061	21,710	-	-	5,739,989	-	(3,115,935)	(2,685,826)	-	31,721,691	2,537,735	34,259,426	34,259,426
Year 17	-	-	-	-	41,824	22,171	-	-	5,941,443	-	(3,209,413)	(2,796,025)	-	34,259,426	2,740,754	37,000,181	37,000,181
Year 18	-	-	-	-	43,664	22,602	91,846	-	6,057,859	-	(3,305,695)	(2,910,276)	-	37,000,181	2,960,014	39,960,195	39,960,195
Year 19	-	-	-	-	45,586	23,006	91,071	-	648,187	5,625,972	(3,404,866)	(3,028,955)	-	39,960,195	3,196,816	43,157,011	43,157,011
Year 20	-	-	-	-	47,591	23,383	91,653	-	-	6,496,818	(3,507,012)	(3,152,433)	-	43,157,011	3,452,561	46,609,571	46,609,571
Year 21	-	-	-	-	49,685	23,737	92,537	-	-	6,727,341	(3,612,222)	(3,281,078)	-	46,609,571	3,728,766	50,338,337	50,338,337
Year 22	-	-	-	-	51,872	24,067	93,554	-	-	6,966,357	(3,720,589)	(3,415,262)	-	50,338,337	4,027,067	54,365,404	54,365,404
Year 23	-	-	-	-	54,154	24,377	94,720	-	-	7,214,321	(3,832,207)	(3,555,365)	-	54,365,404	4,349,232	58,714,636	58,714,636
Year 24	-	-	-	-	56,537	24,667	96,043	-	-	7,471,707	(3,947,173)	(3,701,781)	-	58,714,636	4,697,171	63,411,807	63,411,807
Year 25	-	-	-	-	59,024	138,651	198,433	-	-	15,857,710	(4,065,588)	(12,188,229)	-	63,411,807	5,072,945	68,484,752	68,484,752

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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
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Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

Holdco FLLC

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Various FLLC Distributions	Private Equity FLLC Distributions	Note Payments	Distributions	End of Year Financial Assets	Ownership: Al Art	Ownership: GRAT & Grantor Trust
Year 1	-	-	-	-	2,079,000	940,500	(870,997)	(1,784,261)	364,242	1.0%	99.0%
Year 2	364,242	2,185	8,742	16,027	2,170,476	1,063,458	(870,997)	(1,784,261)	969,873	1.0%	99.0%
Year 3	969,873	5,819	23,277	42,674	2,265,977	1,178,547	(870,997)	(1,784,261)	1,830,909	1.0%	99.0%
Year 4	1,830,909	10,985	43,942	80,560	2,365,680	1,286,270	(870,997)	-	4,747,349	1.0%	99.0%
Year 5	4,747,349	28,484	113,936	208,883	2,469,770	1,387,098	(1,128,862)	-	7,826,659	1.0%	99.0%
Year 6	7,826,659	46,960	187,840	344,373	2,578,440	1,481,474	(3,955,678)	-	8,510,067	1.0%	99.0%
Year 7	8,510,067	51,060	204,242	374,443	2,691,891	1,569,810	(4,131,712)	-	9,269,802	1.0%	99.0%
Year 8	9,269,802	55,619	222,475	407,871	2,810,334	1,652,492	(4,303,502)	-	10,115,091	1.0%	99.0%
Year 9	10,115,091	60,691	242,762	445,064	2,933,989	1,729,882	(4,473,707)	-	11,053,772	1.0%	99.0%
Year 10	11,053,772	66,323	265,291	486,366	3,063,084	1,802,320	(4,644,294)	-	12,092,861	1.0%	99.0%
Year 11	12,092,861	72,557	290,229	532,086	3,197,860	1,870,122	(4,816,744)	-	13,238,970	1.0%	99.0%
Year 12	13,238,970	79,434	317,735	582,515	3,338,566	1,933,584	(4,992,199)	-	14,498,605	1.0%	99.0%
Year 13	14,498,605	86,992	347,967	637,939	3,485,463	1,992,984	(5,171,563)	-	15,878,386	1.0%	99.0%
Year 14	15,878,386	95,270	381,081	698,649	3,638,823	2,048,583	(5,355,576)	-	17,385,217	1.0%	99.0%
Year 15	17,385,217	104,311	417,245	764,950	3,798,932	2,100,624	(5,544,868)	-	19,026,411	1.0%	99.0%
Year 16	19,026,411	114,158	456,634	837,162	3,966,085	2,149,334	(5,739,989)	-	20,809,796	1.0%	99.0%
Year 17	20,809,796	124,859	499,435	915,631	4,140,592	2,194,927	(5,941,443)	-	22,743,797	1.0%	99.0%
Year 18	22,743,797	136,463	545,851	1,000,727	4,322,778	2,237,601	(6,057,859)	(9,184,555)	15,744,803	1.0%	99.0%
Year 19	15,744,803	94,469	377,875	692,771	4,512,981	2,277,545	(648,187)	(9,107,113)	13,945,145	1.0%	99.0%
Year 20	13,945,145	83,671	334,683	613,586	4,711,552	2,314,932	-	(9,165,319)	12,838,251	1.0%	99.0%
Year 21	12,838,251	77,030	308,118	564,883	4,918,860	2,349,926	-	(9,253,688)	11,803,380	1.0%	99.0%
Year 22	11,803,380	70,820	283,281	519,349	5,135,290	2,382,681	-	(9,355,445)	10,839,356	1.0%	99.0%
Year 23	10,839,356	65,036	260,145	476,932	5,361,243	2,413,340	-	(9,471,976)	9,944,075	1.0%	99.0%
Year 24	9,944,075	59,664	238,658	437,539	5,597,137	2,442,036	-	(9,604,322)	9,114,788	1.0%	99.0%
Year 25	9,114,788	54,689	218,755	401,051	5,843,411	13,726,404	-	(19,843,259)	9,515,839	1.0%	99.0%

Schedule 4
Mr. and Mrs. Al Art
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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
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Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

Private Equity FLLC

	Beginning of Year Private Equity	Income	Tax Free Income	Growth	Distributions	End of Year Private Equity	Ownership: Al Art	Ownership: Holdco FLLC
Year 1	25,000,000	850,000	-	1,000,000	(950,000)	25,900,000	1.0%	99.0%
Year 2	25,900,000	880,600	-	1,036,000	(1,074,200)	26,742,400	1.0%	99.0%
Year 3	26,742,400	909,242	-	1,069,696	(1,190,451)	27,530,886	1.0%	99.0%
Year 4	27,530,886	936,050	-	1,101,235	(1,299,262)	28,268,910	1.0%	99.0%
Year 5	28,268,910	961,143	-	1,130,756	(1,401,110)	28,959,699	1.0%	99.0%
Year 6	28,959,699	984,630	-	1,158,388	(1,496,439)	29,606,279	1.0%	99.0%
Year 7	29,606,279	1,006,613	-	1,184,251	(1,585,666)	30,211,477	1.0%	99.0%
Year 8	30,211,477	1,027,190	-	1,208,459	(1,669,184)	30,777,942	1.0%	99.0%
Year 9	30,777,942	1,046,450	-	1,231,118	(1,747,356)	31,308,154	1.0%	99.0%
Year 10	31,308,154	1,064,477	-	1,252,326	(1,820,525)	31,804,432	1.0%	99.0%
Year 11	31,804,432	1,081,351	-	1,272,177	(1,889,012)	32,268,949	1.0%	99.0%
Year 12	32,268,949	1,097,144	-	1,290,758	(1,953,115)	32,703,736	1.0%	99.0%
Year 13	32,703,736	1,111,927	-	1,308,149	(2,013,116)	33,110,697	1.0%	99.0%
Year 14	33,110,697	1,125,764	-	1,324,428	(2,069,276)	33,491,612	1.0%	99.0%
Year 15	33,491,612	1,138,715	-	1,339,664	(2,121,842)	33,848,149	1.0%	99.0%
Year 16	33,848,149	1,150,837	-	1,353,926	(2,171,045)	34,181,867	1.0%	99.0%
Year 17	34,181,867	1,162,183	-	1,367,275	(2,217,098)	34,494,228	1.0%	99.0%
Year 18	34,494,228	1,172,804	-	1,379,769	(2,260,203)	34,786,597	1.0%	99.0%
Year 19	34,786,597	1,182,744	-	1,391,464	(2,300,550)	35,060,255	1.0%	99.0%
Year 20	35,060,255	1,192,049	-	1,402,410	(2,338,315)	35,316,399	1.0%	99.0%
Year 21	35,316,399	1,200,758	-	1,412,656	(2,373,663)	35,556,149	1.0%	99.0%
Year 22	35,556,149	1,208,909	-	1,422,246	(2,406,749)	35,780,556	1.0%	99.0%
Year 23	35,780,556	1,216,539	-	1,431,222	(2,437,717)	35,990,600	1.0%	99.0%
Year 24	35,990,600	1,223,680	-	1,439,624	(2,466,703)	36,187,202	1.0%	99.0%
Year 25	36,187,202	1,230,365	-	1,447,488	(13,865,055)	25,000,000	1.0%	99.0%

Schedule 4
Mr. and Mrs. Al Art
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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

Various Financial FLLCs

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial Assets	Ownership: Al Art	Ownership: Holdco FLLC
Year 1	70,000,000	420,000	1,680,000	3,080,000	(2,100,000)	73,080,000	1.0%	99.0%
Year 2	73,080,000	438,480	1,753,920	3,215,520	(2,192,400)	76,295,520	1.0%	99.0%
Year 3	76,295,520	457,773	1,831,092	3,357,003	(2,288,866)	79,652,523	1.0%	99.0%
Year 4	79,652,523	477,915	1,911,661	3,504,711	(2,389,576)	83,157,234	1.0%	99.0%
Year 5	83,157,234	498,943	1,995,774	3,658,918	(2,494,717)	86,816,152	1.0%	99.0%
Year 6	86,816,152	520,897	2,083,588	3,819,911	(2,604,485)	90,636,063	1.0%	99.0%
Year 7	90,636,063	543,816	2,175,266	3,987,987	(2,719,082)	94,624,050	1.0%	99.0%
Year 8	94,624,050	567,744	2,270,977	4,163,458	(2,838,721)	98,787,508	1.0%	99.0%
Year 9	98,787,508	592,725	2,370,900	4,346,650	(2,963,625)	103,134,158	1.0%	99.0%
Year 10	103,134,158	618,805	2,475,220	4,537,903	(3,094,025)	107,672,061	1.0%	99.0%
Year 11	107,672,061	646,032	2,584,129	4,737,571	(3,230,162)	112,409,632	1.0%	99.0%
Year 12	112,409,632	674,458	2,697,831	4,946,024	(3,372,289)	117,355,656	1.0%	99.0%
Year 13	117,355,656	704,134	2,816,536	5,163,649	(3,520,670)	122,519,304	1.0%	99.0%
Year 14	122,519,304	735,116	2,940,463	5,390,849	(3,675,579)	127,910,154	1.0%	99.0%
Year 15	127,910,154	767,461	3,069,844	5,628,047	(3,837,305)	133,538,201	1.0%	99.0%
Year 16	133,538,201	801,229	3,204,917	5,875,681	(4,006,146)	139,413,881	1.0%	99.0%
Year 17	139,413,881	836,483	3,345,933	6,134,211	(4,182,416)	145,548,092	1.0%	99.0%
Year 18	145,548,092	873,289	3,493,154	6,404,116	(4,366,443)	151,952,208	1.0%	99.0%
Year 19	151,952,208	911,713	3,646,853	6,685,897	(4,558,566)	158,638,105	1.0%	99.0%
Year 20	158,638,105	951,829	3,807,315	6,980,077	(4,759,143)	165,618,182	1.0%	99.0%
Year 21	165,618,182	993,709	3,974,836	7,287,200	(4,968,545)	172,905,382	1.0%	99.0%
Year 22	172,905,382	1,037,432	4,149,729	7,607,837	(5,187,161)	180,513,219	1.0%	99.0%
Year 23	180,513,219	1,083,079	4,332,317	7,942,582	(5,415,397)	188,455,801	1.0%	99.0%
Year 24	188,455,801	1,130,735	4,522,939	8,292,055	(5,653,674)	196,747,856	1.0%	99.0%
Year 25	196,747,856	1,180,487	4,721,949	8,656,906	(5,902,436)	205,404,761	1.0%	99.0%

Schedule 4
Mr. and Mrs. Al Art
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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

3-Year GRAT Created by Al Art

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Holdco LLC Distributions	Annual Annuity	GRAT Terminates to Grantor Trust	End of Year Financial Assets
Year 1	-	-	-	-	1,766,418	(1,766,418)	-	-
Year 2	-	-	-	-	1,766,418	(1,766,418)	-	-
Year 3	-	-	-	-	1,766,418	(1,766,418)	-	-
Year 4	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	-	-	-	-
Year 19	-	-	-	-	-	-	-	-
Year 20	-	-	-	-	-	-	-	-
Year 21	-	-	-	-	-	-	-	-
Year 22	-	-	-	-	-	-	-	-
Year 23	-	-	-	-	-	-	-	-
Year 24	-	-	-	-	-	-	-	-
Year 25	-	-	-	-	-	-	-	-

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Assumptions:	**Financial Assets**	**Private Equity**	**Various LLC Interests**	**Artwork**
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
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Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

Grantor Trust Created by Al Art for the Benefit of Mrs. Art and their Children (GRAT Remaindermen)

	Beginning of Year Financial Assets	**Income**	**Tax Free Income**	**Growth**	**Holdco LLC Distributions**	**GRAT Terminates**	**Beneficiary Distributions**	**Income Taxes**	**End of Year Financial Assets**
Year 1	-	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-	-
Year 4	-	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	9,092,709	-	-	-	9,092,709
Year 19	9,092,709	54,556	218,225	400,079	9,016,041	-	(5,625,972)	-	13,155,639
Year 20	13,155,639	78,934	315,735	578,848	9,073,665	-	(6,496,818)	-	16,706,004
Year 21	16,706,004	100,236	400,944	735,064	9,161,152	-	(6,727,341)	-	20,376,059
Year 22	20,376,059	122,256	489,025	896,547	9,261,890	-	(6,966,357)	-	24,179,420
Year 23	24,179,420	145,077	580,306	1,063,894	9,377,256	-	(7,214,321)	-	28,131,632
Year 24	28,131,632	168,790	675,159	1,237,792	9,508,279	-	(7,471,707)	-	32,249,945
Year 25	32,249,945	193,500	773,999	1,418,998	19,644,826	-	(15,857,710)	-	38,423,557

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Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%

Note Between Al Art and Holdco LLC

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	59,251,500	870,997	(870,997)	59,251,500
Year 2	59,251,500	870,997	(870,997)	59,251,500
Year 3	59,251,500	870,997	(870,997)	59,251,500
Year 4	59,251,500	870,997	(870,997)	59,251,500
Year 5	59,251,500	870,997	(1,128,862)	58,993,635
Year 6	58,993,635	867,206	(3,955,678)	55,905,163
Year 7	55,905,163	821,806	(4,131,712)	52,595,257
Year 8	52,595,257	773,150	(4,303,502)	49,064,905
Year 9	49,064,905	721,254	(4,473,707)	45,312,452
Year 10	45,312,452	666,093	(4,644,294)	41,334,251
Year 11	41,334,251	607,613	(4,816,744)	37,125,120
Year 12	37,125,120	545,739	(4,992,199)	32,678,661
Year 13	32,678,661	480,376	(5,171,563)	27,987,474
Year 14	27,987,474	411,416	(5,355,576)	23,043,313
Year 15	23,043,313	338,737	(5,544,868)	17,837,183
Year 16	17,837,183	262,207	(5,739,989)	12,359,401
Year 17	12,359,401	181,683	(5,941,443)	6,599,641
Year 18	6,599,641	97,015	(6,057,859)	638,796
Year 19	638,796	9,390	(648,187)	-
Year 20	-	-	-	-
Year 21	-	-	-	-
Year 22	-	-	-	-
Year 23	-	-	-	-
Year 24	-	-	-	-
Year 25	-	-	-	-

Schedule 4
Mr. and Mrs. Al Art
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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%
Artwork Lease Payment (increasing by 6% per year)	$1,000,000

Mr. and Mrs. Al Art

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Various FLLC Distributions	Private Equity FLLC Distributions	Holdco FLLC Distributions	GRAT Annuity	Note Payments	Trust Distributions	Artwork Lease Payments	Consumption from these Sources	Income Taxes	End of Year Financial Assets
Year 1	5,000,000	30,000	120,000	220,000	21,000	9,500	26,887	2,661,801	1,304,030	-	(1,000,000)	(2,000,000)	(852,300)	5,540,918
Year 2	5,540,918	33,246	132,982	243,800	21,924	10,742	26,887	2,661,801	1,304,030	-	(1,075,000)	(2,060,000)	(1,084,396)	5,756,934
Year 3	5,756,934	34,542	138,166	253,305	22,889	11,905	26,887	2,661,801	1,304,030	-	(1,155,625)	(2,121,800)	(1,271,182)	5,661,851
Year 4	5,661,851	33,971	135,884	249,121	23,896	12,993	-	-	1,304,030	-	(1,242,297)	(2,185,454)	(1,426,368)	2,567,627
Year 5	2,567,627	15,406	61,623	112,976	24,947	14,011	-	-	2,349,600	-	(1,335,469)	(2,251,018)	(1,559,703)	-
Year 6	-	-	-	-	26,045	14,964	-	-	5,391,307	-	(1,435,629)	(2,318,548)	(1,678,139)	-
Year 7	-	-	-	-	27,191	15,857	-	-	5,675,013	-	(1,543,302)	(2,388,105)	(1,786,655)	-
Year 8	-	-	-	-	28,387	16,692	-	-	5,962,551	-	(1,659,049)	(2,459,748)	(1,888,834)	-
Year 9	-	-	-	-	29,636	17,474	-	-	6,257,185	-	(1,783,478)	(2,533,540)	(1,987,277)	-
Year 10	-	-	-	-	30,940	18,205	-	-	6,561,533	-	(1,917,239)	(2,609,546)	(2,083,893)	-
Year 11	-	-	-	-	32,302	18,890	-	-	6,877,776	-	(2,061,032)	(2,687,833)	(2,180,103)	-
Year 12	-	-	-	-	33,723	19,531	-	-	7,207,808	-	(2,215,609)	(2,768,468)	(2,276,985)	-
Year 13	-	-	-	-	35,207	20,131	-	-	7,553,343	-	(2,381,780)	(2,851,522)	(2,375,379)	-
Year 14	-	-	-	-	36,756	20,693	-	-	7,915,990	-	(2,560,413)	(2,937,067)	(2,475,958)	-
Year 15	-	-	-	-	38,373	21,218	-	-	8,297,312	-	(2,752,444)	(3,025,179)	(2,579,280)	-
Year 16	-	-	-	-	40,061	21,710	-	-	8,698,866	-	(2,958,877)	(3,115,935)	(2,685,826)	-
Year 17	-	-	-	-	41,824	22,171	-	-	9,122,236	-	(3,180,793)	(3,209,413)	(2,796,025)	-
Year 18	-	-	-	-	43,664	22,602	91,842	-	12,598,478	-	(3,419,353)	(3,305,695)	(2,910,276)	3,121,263
Year 19	3,121,263	18,728	74,910	137,336	45,586	23,006	89,171	-	-	6,599,626	(3,675,804)	(3,404,866)	(3,028,955)	-
Year 20	-	-	-	-	47,591	23,383	91,685	-	-	10,448,275	(3,951,489)	(3,507,012)	(3,152,433)	-
Year 21	-	-	-	-	49,685	23,737	95,475	-	-	10,972,255	(4,247,851)	(3,612,222)	(3,281,078)	-
Year 22	-	-	-	-	51,872	24,067	100,317	-	-	11,526,035	(4,566,440)	(3,720,589)	(3,415,262)	-
Year 23	-	-	-	-	54,154	24,377	106,043	-	-	12,111,921	(4,908,923)	(3,832,207)	(3,555,365)	-
Year 24	-	-	-	-	56,537	24,667	112,525	-	-	12,732,317	(5,277,092)	(3,947,173)	(3,701,781)	-
Year 25	-	-	-	-	59,024	138,651	205,628	-	-	21,519,339	(5,672,874)	(4,065,588)	(12,184,180)	-

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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
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Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
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Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%
Artwork Lease Payment (increasing by 6% per year)	$1,000,000

Holdco FLLC

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Various FLLC Distributions	Private Equity FLLC Distributions	Artwork Lease Payments	Note Payments	Distributions	End of Year Financial Assets	Beginning of Year Artwork	Growth	End of Year Artwork	End of Year Financial & Other Assets	Ownership: Al Art	Ownership: GRAT & Grantor Trust
Year 1	-	-	-	-	2,079,000	940,500	1,000,000	(1,304,030)	(2,688,688)	26,782	10,000,000	800,000	10,800,000	10,826,782	1.0%	99.0%
Year 2	26,782	161	643	1,178	2,170,476	1,063,458	1,075,000	(1,304,030)	(2,688,688)	344,980	10,800,000	864,000	11,664,000	12,008,980	1.0%	99.0%
Year 3	344,980	2,070	8,280	15,179	2,265,977	1,178,547	1,155,625	(1,304,030)	(2,688,688)	977,939	11,664,000	933,120	12,597,120	13,575,059	1.0%	99.0%
Year 4	977,939	5,868	23,471	43,029	2,365,680	1,286,270	1,242,297	(1,304,030)	-	4,640,523	12,597,120	1,007,770	13,604,890	18,245,412	1.0%	99.0%
Year 5	4,640,523	27,843	111,373	204,183	2,469,770	1,387,098	1,335,469	(2,349,600)	-	7,826,659	13,604,890	1,088,391	14,693,281	22,519,940	1.0%	99.0%
Year 6	7,826,659	46,960	187,840	344,373	2,578,440	1,481,474	1,435,629	(5,391,307)	-	8,510,067	14,693,281	1,175,462	15,868,743	24,378,811	1.0%	99.0%
Year 7	8,510,067	51,060	204,242	374,443	2,691,891	1,569,810	1,543,302	(5,675,013)	-	9,269,802	15,868,743	1,269,499	17,138,243	26,408,044	1.0%	99.0%
Year 8	9,269,802	55,619	222,475	407,871	2,810,334	1,652,492	1,659,049	(5,962,551)	-	10,115,091	17,138,243	1,371,059	18,509,302	28,624,393	1.0%	99.0%
Year 9	10,115,091	60,691	242,762	445,064	2,933,989	1,729,882	1,783,478	(6,257,185)	-	11,053,772	18,509,302	1,480,744	19,990,046	31,043,818	1.0%	99.0%
Year 10	11,053,772	66,323	265,291	486,366	3,063,084	1,802,320	1,917,239	(6,561,533)	-	12,092,861	19,990,046	1,599,204	21,589,250	33,682,111	1.0%	99.0%
Year 11	12,092,861	72,557	290,229	532,086	3,197,860	1,870,122	2,061,032	(6,877,776)	-	13,238,970	21,589,250	1,727,140	23,316,390	36,555,360	1.0%	99.0%
Year 12	13,238,970	79,434	317,735	582,515	3,338,566	1,933,584	2,215,609	(7,207,808)	-	14,498,605	23,316,390	1,865,311	25,181,701	39,680,306	1.0%	99.0%
Year 13	14,498,605	86,992	347,967	637,939	3,485,463	1,992,984	2,381,780	(7,553,343)	-	15,878,386	25,181,701	2,014,536	27,196,237	43,074,624	1.0%	99.0%
Year 14	15,878,386	95,270	381,081	698,649	3,638,823	2,048,583	2,560,413	(7,915,990)	-	17,385,217	27,196,237	2,175,699	29,371,936	46,757,153	1.0%	99.0%
Year 15	17,385,217	104,311	417,245	764,950	3,798,932	2,100,624	2,752,444	(8,297,312)	-	19,026,411	29,371,936	2,349,755	31,721,691	50,748,103	1.0%	99.0%
Year 16	19,026,411	114,158	456,634	837,162	3,966,085	2,149,334	2,958,877	(8,698,866)	-	20,809,796	31,721,691	2,537,735	34,259,426	55,069,222	1.0%	99.0%
Year 17	20,809,796	124,859	499,435	915,631	4,140,592	2,194,927	3,180,793	(9,122,236)	-	22,743,797	34,259,426	2,740,754	37,000,181	59,743,977	1.0%	99.0%
Year 18	22,743,797	136,463	545,851	1,000,727	4,322,778	2,237,601	3,419,353	(12,598,478)	(9,184,219)	12,623,873	37,000,181	2,960,014	39,960,195	52,584,068	1.0%	99.0%
Year 19	12,623,873	75,743	302,973	555,450	4,512,981	2,277,545	3,675,804	-	(8,917,125)	15,107,244	39,960,195	3,196,816	43,157,011	58,264,255	1.0%	99.0%
Year 20	15,107,244	90,643	362,574	664,719	4,711,552	2,314,932	3,951,489	-	(9,168,522)	18,034,631	43,157,011	3,452,561	46,609,571	64,644,203	1.0%	99.0%
Year 21	18,034,631	108,208	432,831	793,524	4,918,860	2,349,926	4,247,851	-	(9,547,467)	21,338,365	46,609,571	3,728,766	50,338,337	71,676,702	1.0%	99.0%
Year 22	21,338,365	128,030	512,121	938,888	5,135,290	2,382,681	4,566,440	-	(10,031,693)	24,970,122	50,338,337	4,027,067	54,365,404	79,335,526	1.0%	99.0%
Year 23	24,970,122	149,821	599,283	1,098,685	5,361,243	2,413,340	4,908,923	-	(10,604,265)	28,897,151	54,365,404	4,349,232	58,714,636	87,611,787	1.0%	99.0%
Year 24	28,897,151	173,383	693,532	1,271,475	5,597,137	2,442,036	5,277,092	-	(11,252,525)	33,099,280	58,714,636	4,697,171	63,411,807	96,511,087	1.0%	99.0%
Year 25	33,099,280	198,596	794,383	1,456,368	5,843,411	13,726,404	5,672,874	-	(20,562,794)	40,228,522	63,411,807	5,072,945	68,484,752	108,713,274	1.0%	99.0%

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Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
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Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%
Artwork Lease Payment (increasing by 6% per year)	$1,000,000

Private Equity FLLC

	Beginning of Year Private Equity	Income	Tax Free Income	Growth	Distributions	End of Year Private Equity	Ownership: Al Art	Ownership: Holdco FLLC
Year 1	25,000,000	850,000	-	1,000,000	(950,000)	25,900,000	1.0%	99.0%
Year 2	25,900,000	880,600	-	1,036,000	(1,074,200)	26,742,400	1.0%	99.0%
Year 3	26,742,400	909,242	-	1,069,696	(1,190,451)	27,530,886	1.0%	99.0%
Year 4	27,530,886	936,050	-	1,101,235	(1,299,262)	28,268,910	1.0%	99.0%
Year 5	28,268,910	961,143	-	1,130,756	(1,401,110)	28,959,699	1.0%	99.0%
Year 6	28,959,699	984,630	-	1,158,388	(1,496,439)	29,606,279	1.0%	99.0%
Year 7	29,606,279	1,006,613	-	1,184,251	(1,585,666)	30,211,477	1.0%	99.0%
Year 8	30,211,477	1,027,190	-	1,208,459	(1,669,184)	30,777,942	1.0%	99.0%
Year 9	30,777,942	1,046,450	-	1,231,118	(1,747,356)	31,308,154	1.0%	99.0%
Year 10	31,308,154	1,064,477	-	1,252,326	(1,820,525)	31,804,432	1.0%	99.0%
Year 11	31,804,432	1,081,351	-	1,272,177	(1,889,012)	32,268,949	1.0%	99.0%
Year 12	32,268,949	1,097,144	-	1,290,758	(1,953,115)	32,703,736	1.0%	99.0%
Year 13	32,703,736	1,111,927	-	1,308,149	(2,013,116)	33,110,697	1.0%	99.0%
Year 14	33,110,697	1,125,764	-	1,324,428	(2,069,276)	33,491,612	1.0%	99.0%
Year 15	33,491,612	1,138,715	-	1,339,664	(2,121,842)	33,848,149	1.0%	99.0%
Year 16	33,848,149	1,150,837	-	1,353,926	(2,171,045)	34,181,867	1.0%	99.0%
Year 17	34,181,867	1,162,183	-	1,367,275	(2,217,098)	34,494,228	1.0%	99.0%
Year 18	34,494,228	1,172,804	-	1,379,769	(2,260,203)	34,786,597	1.0%	99.0%
Year 19	34,786,597	1,182,744	-	1,391,464	(2,300,550)	35,060,255	1.0%	99.0%
Year 20	35,060,255	1,192,049	-	1,402,410	(2,338,315)	35,316,399	1.0%	99.0%
Year 21	35,316,399	1,200,758	-	1,412,656	(2,373,663)	35,556,149	1.0%	99.0%
Year 22	35,556,149	1,208,909	-	1,422,246	(2,406,749)	35,780,556	1.0%	99.0%
Year 23	35,780,556	1,216,539	-	1,431,222	(2,437,717)	35,990,600	1.0%	99.0%
Year 24	35,990,600	1,223,680	-	1,439,624	(2,466,703)	36,187,202	1.0%	99.0%
Year 25	36,187,202	1,230,365	-	1,447,488	(13,865,055)	25,000,000	1.0%	99.0%

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Artwork Lease Payment (increasing by 6% per year)	$1,000,000

Various Financial FLLCs

	Beginning of Year Financial Assets	**Income**	**Tax Free Income**	**Growth**	**Distributions**	**End of Year Financial Assets**	**Ownership: Al Art**	**Ownership: Holdco FLLC**
Year 1	70,000,000	420,000	1,680,000	3,080,000	(2,100,000)	73,080,000	1.0%	99.0%
Year 2	73,080,000	438,480	1,753,920	3,215,520	(2,192,400)	76,295,520	1.0%	99.0%
Year 3	76,295,520	457,773	1,831,092	3,357,003	(2,288,866)	79,652,523	1.0%	99.0%
Year 4	79,652,523	477,915	1,911,661	3,504,711	(2,389,576)	83,157,234	1.0%	99.0%
Year 5	83,157,234	498,943	1,995,774	3,658,918	(2,494,717)	86,816,152	1.0%	99.0%
Year 6	86,816,152	520,897	2,083,588	3,819,911	(2,604,485)	90,636,063	1.0%	99.0%
Year 7	90,636,063	543,816	2,175,266	3,987,987	(2,719,082)	94,624,050	1.0%	99.0%
Year 8	94,624,050	567,744	2,270,977	4,163,458	(2,838,721)	98,787,508	1.0%	99.0%
Year 9	98,787,508	592,725	2,370,900	4,346,650	(2,963,625)	103,134,158	1.0%	99.0%
Year 10	103,134,158	618,805	2,475,220	4,537,903	(3,094,025)	107,672,061	1.0%	99.0%
Year 11	107,672,061	646,032	2,584,129	4,737,571	(3,230,162)	112,409,632	1.0%	99.0%
Year 12	112,409,632	674,458	2,697,831	4,946,024	(3,372,289)	117,355,656	1.0%	99.0%
Year 13	117,355,656	704,134	2,816,536	5,163,649	(3,520,670)	122,519,304	1.0%	99.0%
Year 14	122,519,304	735,116	2,940,463	5,390,849	(3,675,579)	127,910,154	1.0%	99.0%
Year 15	127,910,154	767,461	3,069,844	5,628,047	(3,837,305)	133,538,201	1.0%	99.0%
Year 16	133,538,201	801,229	3,204,917	5,875,681	(4,006,146)	139,413,881	1.0%	99.0%
Year 17	139,413,881	836,483	3,345,933	6,134,211	(4,182,416)	145,548,092	1.0%	99.0%
Year 18	145,548,092	873,289	3,493,154	6,404,116	(4,366,443)	151,952,208	1.0%	99.0%
Year 19	151,952,208	911,713	3,646,853	6,685,897	(4,558,566)	158,638,105	1.0%	99.0%
Year 20	158,638,105	951,829	3,807,315	6,980,077	(4,759,143)	165,618,182	1.0%	99.0%
Year 21	165,618,182	993,709	3,974,836	7,287,200	(4,968,545)	172,905,382	1.0%	99.0%
Year 22	172,905,382	1,037,432	4,149,729	7,607,837	(5,187,161)	180,513,219	1.0%	99.0%
Year 23	180,513,219	1,083,079	4,332,317	7,942,582	(5,415,397)	188,455,801	1.0%	99.0%
Year 24	188,455,801	1,130,735	4,522,939	8,292,055	(5,653,674)	196,747,856	1.0%	99.0%
Year 25	196,747,856	1,180,487	4,721,949	8,656,906	(5,902,436)	205,404,761	1.0%	99.0%

Schedule 4
Mr. and Mrs. Al Art
Hypothetical Technique #2:

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Assumptions:	**Financial Assets**	**Private Equity**	**Various LLC Interests**	**Artwork**
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%
Artwork Lease Payment (increasing by 6% per year)	$1,000,000

3-Year GRAT Created by Al Art

	Beginning of Year Financial Assets	**Income**	**Tax Free Income**	**Growth**	**Holdco LLC Distributions**	**Annual Annuity**	**GRAT Terminates to Grantor Trust**	**End of Year Financial Assets**
Year 1	-	-	-	-	2,661,801	(2,661,801)	-	-
Year 2	-	-	-	-	2,661,801	(2,661,801)	-	-
Year 3	-	-	-	-	2,661,801	(2,661,801)	-	-
Year 4	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	-	-	-	-
Year 19	-	-	-	-	-	-	-	-
Year 20	-	-	-	-	-	-	-	-
Year 21	-	-	-	-	-	-	-	-
Year 22	-	-	-	-	-	-	-	-
Year 23	-	-	-	-	-	-	-	-
Year 24	-	-	-	-	-	-	-	-
Year 25	-	-	-	-	-	-	-	-

Schedule 4
Mr. and Mrs. Al Art
Hypothetical Technique #2:

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Assumptions:	**Financial Assets**	**Private Equity**	**Various LLC Interests**	**Artwork**
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%
Artwork Lease Payment (increasing by 6% per year)	$1,000,000

Grantor Trust Created by Al Art for the Benefit of Mrs. Art and their Children (GRAT Remaindermen)

	Beginning of Year Financial Assets	**Income**	**Tax Free Income**	**Growth**	**Holdco LLC Distributions**	**GRAT Terminates**	**Beneficiary Distributions**	**Income Taxes**	**End of Year Financial Assets**
Year 1	-	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-	-
Year 4	-	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	9,092,377	-	-	-	9,092,377
Year 19	9,092,377	54,554	218,217	400,065	8,827,953	-	(6,599,626)	-	11,993,540
Year 20	11,993,540	71,961	287,845	527,716	9,076,837	-	(10,448,275)	-	11,509,624
Year 21	11,509,624	69,058	276,231	506,423	9,451,992	-	(10,972,255)	-	10,841,074
Year 22	10,841,074	65,046	260,186	477,007	9,931,376	-	(11,526,035)	-	10,048,654
Year 23	10,048,654	60,292	241,168	442,141	10,498,222	-	(12,111,921)	-	9,178,556
Year 24	9,178,556	55,071	220,285	403,856	11,140,000	-	(12,732,317)	-	8,265,452
Year 25	8,265,452	49,593	198,371	363,680	20,357,166	-	(21,519,339)	-	7,714,922

Schedule 4
Mr. and Mrs. Al Art
Hypothetical Technique #2:

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Assumptions:	Financial Assets	Private Equity	Various LLC Interests	Artwork
Total Estimated Rate of Return	7.40%	7.40%	7.40%	8.00%
Rate of Return Taxed at Ordinary Income Rate	0.60%	3.40%	0.60%	0.00%
Rate of Return Tax Free	2.40%	0.00%	2.40%	0.00%
Rate of Return Taxed at Capital Gain Rate	4.40%	4.00%	4.40%	8.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	10.00%	30.00%	0.00%
Long-Term Capital Gain Tax Rate	25.00%			
Ordinary Tax Rate	44.60%			
Consumption (increasing 2.5% per year)	$2,000,000			

Assumptions (Continued):	
Private Equity Valuation Discount	30.00%
Various LLCs Valuation Discount	30.00%
Holdco LLC Valuation Discount	20.00%
Intra-Family Interest Rate (mid-term) - March 2015	1.47%
IRS §7520 Rate - March 2015	1.80%
Artwork Lease Payment (increasing by 6% per year)	$1,000,000

Note Between Al Art and Holdco LLC

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	88,709,536	1,304,030	(1,304,030)	88,709,536
Year 2	88,709,536	1,304,030	(1,304,030)	88,709,536
Year 3	88,709,536	1,304,030	(1,304,030)	88,709,536
Year 4	88,709,536	1,304,030	(1,304,030)	88,709,536
Year 5	88,709,536	1,304,030	(2,349,600)	87,663,967
Year 6	87,663,967	1,288,660	(5,391,307)	83,561,320
Year 7	83,561,320	1,228,351	(5,675,013)	79,114,658
Year 8	79,114,658	1,162,985	(5,962,551)	74,315,092
Year 9	74,315,092	1,092,432	(6,257,185)	69,150,338
Year 10	69,150,338	1,016,510	(6,561,533)	63,605,316
Year 11	63,605,316	934,998	(6,877,776)	57,662,538
Year 12	57,662,538	847,639	(7,207,808)	51,302,370
Year 13	51,302,370	754,145	(7,553,343)	44,503,172
Year 14	44,503,172	654,197	(7,915,990)	37,241,379
Year 15	37,241,379	547,448	(8,297,312)	29,491,516
Year 16	29,491,516	433,525	(8,698,866)	21,226,175
Year 17	21,226,175	312,025	(9,122,236)	12,415,964
Year 18	12,415,964	182,515	(12,598,478)	-
Year 19	-	-	-	-
Year 20	-	-	-	-
Year 21	-	-	-	-
Year 22	-	-	-	-
Year 23	-	-	-	-
Year 24	-	-	-	-
Year 25	-	-	-	-

Schedule 5
Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust
Stock Sale, No Planning

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Tax Free	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000

Charlie Charitable

	Beginning of Year	Income	Tax Free Income	Growth	Consumption	Taxes on Investment Income	End of Year
Year 1	12,500,000	375,000	-	550,000	(150,000)	(2,708,500)	10,566,500
Year 2	10,566,500	316,995	-	464,926	(153,750)	(205,124)	10,989,547
Year 3	10,989,547	329,686	-	483,540	(157,594)	(227,927)	11,417,253
Year 4	11,417,253	342,518	-	502,359	(161,534)	(247,060)	11,853,535
Year 5	11,853,535	355,606	-	521,556	(165,572)	(263,725)	12,301,400
Year 6	12,301,400	369,042	-	541,262	(169,711)	(278,775)	12,763,217
Year 7	12,763,217	382,897	-	561,582	(173,954)	(292,818)	13,240,924
Year 8	13,240,924	397,228	-	582,601	(178,303)	(306,291)	13,736,158
Year 9	13,736,158	412,085	-	604,391	(182,760)	(319,508)	14,250,365
Year 10	14,250,365	427,511	-	627,016	(187,329)	(332,699)	14,784,864
Year 11	14,784,864	443,546	-	650,534	(192,013)	(346,032)	15,340,899
Year 12	15,340,899	460,227	-	675,000	(196,813)	(359,633)	15,919,679
Year 13	15,919,679	477,590	-	700,466	(201,733)	(373,601)	16,522,401
Year 14	16,522,401	495,672	-	726,986	(206,777)	(388,011)	17,150,272
Year 15	17,150,272	514,508	-	754,612	(211,946)	(402,925)	17,804,521
Year 16	17,804,521	534,136	-	783,399	(217,245)	(418,398)	18,486,413
Year 17	18,486,413	554,592	-	813,402	(222,676)	(434,474)	19,197,257
Year 18	19,197,257	575,918	-	844,679	(228,243)	(451,199)	19,938,413
Year 19	19,938,413	598,152	-	877,290	(233,949)	(468,610)	20,711,296
Year 20	20,711,296	621,339	-	911,297	(239,798)	(486,748)	21,517,386
Year 21	21,517,386	645,522	-	946,765	(245,792)	(505,652)	22,358,228
Year 22	22,358,228	670,747	-	983,762	(251,937)	(525,360)	23,235,440
Year 23	23,235,440	697,063	-	1,022,359	(258,236)	(545,912)	24,150,715
Year 24	24,150,715	724,521	-	1,062,631	(264,692)	(567,349)	25,105,828
Year 25	25,105,828	753,175	-	1,104,656	(271,309)	(335,916)	26,356,434

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

Simulated Tax Holiday (No Initial Capital Gains Tax and No Estate Tax) 76% - 24% Split Between Family and Charit

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Tax Free	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%

Charlie Charitable

	Beginning of Year	Income	Tax Free Income	Growth	Consumption	Taxes on Investment Income	End of Year
Year 1	12,500,000	375,000	-	550,000	(150,000)	(208,500)	13,066,500
Year 2	13,066,500	391,995	-	574,926	(153,750)	(246,824)	13,632,847
Year 3	13,632,847	408,985	-	599,845	(157,594)	(277,792)	14,206,292
Year 4	14,206,292	426,189	-	625,077	(161,534)	(303,730)	14,792,294
Year 5	14,792,294	443,769	-	650,861	(165,572)	(326,290)	15,395,061
Year 6	15,395,061	461,852	-	677,383	(169,711)	(346,648)	16,017,936
Year 7	16,017,936	480,538	-	704,789	(173,954)	(365,643)	16,663,666
Year 8	16,663,666	499,910	-	733,201	(178,303)	(383,876)	17,334,599
Year 9	17,334,599	520,038	-	762,722	(182,760)	(401,782)	18,032,816
Year 10	18,032,816	540,984	-	793,444	(187,329)	(419,679)	18,760,236
Year 11	18,760,236	562,807	-	825,450	(192,013)	(437,801)	19,518,680
Year 12	19,518,680	585,560	-	858,822	(196,813)	(456,324)	20,309,926
Year 13	20,309,926	609,298	-	893,637	(201,733)	(475,384)	21,135,743
Year 14	21,135,743	634,072	-	929,973	(206,777)	(495,090)	21,997,921
Year 15	21,997,921	659,938	-	967,909	(211,946)	(515,531)	22,898,289
Year 16	22,898,289	686,949	-	1,007,525	(217,245)	(536,783)	23,838,735
Year 17	23,838,735	715,162	-	1,048,904	(222,676)	(558,913)	24,821,213
Year 18	24,821,213	744,636	-	1,092,133	(228,243)	(581,983)	25,847,757
Year 19	25,847,757	775,433	-	1,137,301	(233,949)	(606,053)	26,920,489
Year 20	26,920,489	807,615	-	1,184,502	(239,798)	(631,181)	28,041,627
Year 21	28,041,627	841,249	-	1,233,832	(245,792)	(657,424)	29,213,491
Year 22	29,213,491	876,405	-	1,285,394	(251,937)	(684,840)	30,438,512
Year 23	30,438,512	913,155	-	1,339,295	(258,236)	(713,489)	31,719,238
Year 24	31,719,238	951,577	-	1,395,646	(264,692)	(743,432)	33,058,338
Year 25	33,058,338	991,750	-	1,454,567	(271,309)	(442,321)	34,791,025

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Tax Free	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
IRS 7520 Rate (Best)	2.40%
Unitrust Percentage	11.024%

Assumptions (continued):	
Charitable Deduction	$1,000,200
Income Tax Benefit to Charlie	$446,089
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Charlie Charitable FLP Valuation Discount	35.00%
CRUT Starting Value	$10,000,000
CRUT Actuarial Discount (10%)	($1,000,000)
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Partnership Discount (35%)	($3,150,000)
Discounted Value of Partnership Actuarial Interest	$5,850,000
Face Value of Note (99% Transferred to Grantor Trust)	$5,791,500

Charlie Charitable FLP

	Beginning of Year	Income	Tax Free Income	Growth	Unitrust Payments	Distributions	End of Year	Ownership: Charlie Charitable	Ownership: Grantor Trust
Year 1	-	-	-	-	1,102,400	(834,400)	268,000	1.00%	99.00%
Year 2	268,000	8,040	-	11,792	1,062,449	(826,752)	523,529	1.00%	99.00%
Year 3	523,529	15,706	-	23,035	1,023,946	(819,953)	766,263	1.00%	99.00%
Year 4	766,263	22,988	-	33,716	986,838	(813,770)	996,035	1.00%	99.00%
Year 5	996,035	29,881	-	43,826	951,075	(808,031)	1,212,785	1.00%	99.00%
Year 6	1,212,785	36,384	-	53,363	916,608	(802,616)	1,416,523	1.00%	99.00%
Year 7	1,416,523	42,496	-	62,327	883,390	(797,436)	1,607,300	1.00%	99.00%
Year 8	1,607,300	48,219	-	70,721	851,376	(792,427)	1,785,189	1.00%	99.00%
Year 9	1,785,189	53,556	-	78,548	820,522	(787,539)	1,950,277	1.00%	99.00%
Year 10	1,950,277	58,508	-	85,812	790,787	(782,737)	2,102,647	1.00%	99.00%
Year 11	2,102,647	63,079	-	92,516	762,128	(777,991)	2,242,380	1.00%	99.00%
Year 12	2,242,380	67,271	-	98,665	734,509	(773,280)	2,369,545	1.00%	99.00%
Year 13	2,369,545	71,086	-	104,260	707,890	(768,585)	2,484,197	1.00%	99.00%
Year 14	2,484,197	74,526	-	109,305	682,236	(763,890)	2,586,374	1.00%	99.00%
Year 15	2,586,374	77,591	-	113,800	657,512	(759,181)	2,676,096	1.00%	99.00%
Year 16	2,676,096	80,283	-	117,748	633,684	(754,447)	2,753,365	1.00%	99.00%
Year 17	2,753,365	82,601	-	121,148	610,719	(749,675)	2,818,158	1.00%	99.00%
Year 18	2,818,158	84,545	-	123,999	588,587	(744,854)	2,870,435	1.00%	99.00%
Year 19	2,870,435	86,113	-	126,299	567,256	(739,974)	2,910,130	1.00%	99.00%
Year 20	2,910,130	87,304	-	128,046	546,699	(735,023)	2,937,155	1.00%	99.00%
Year 21	2,937,155	88,115	-	129,235	-	(70,168)	3,084,337	1.00%	99.00%
Year 22	3,084,337	92,530	-	135,711	-	(73,055)	3,239,523	1.00%	99.00%
Year 23	3,239,523	97,186	-	142,539	-	(76,286)	3,402,963	1.00%	99.00%
Year 24	3,402,963	102,089	-	149,730	-	(79,820)	3,574,962	1.00%	99.00%
Year 25	3,574,962	107,249	-	157,298	-	(167,164)	3,672,345	1.00%	99.00%

Schedule 5
Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust
FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Tax Free	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
IRS 7520 Rate (Best)	2.40%
Unitrust Percentage	11.024%

Assumptions (continued):	
Charitable Deduction	$1,000,200
Income Tax Benefit to Charlie	$446,089
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Charlie Charitable FLP Valuation Discount	35.00%
CRUT Starting Value	$10,000,000
CRUT Actuarial Discount (10%)	($1,000,000)
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Partnership Discount (35%)	($3,150,000)
Discounted Value of Partnership Actuarial Interest	$5,850,000
Face Value of Note (99% Transferred to Grantor Trust)	$5,791,500

Charitable Remainder Unitrust

	Beginning of Year	Income	Tax Free Income	Growth	Unitrust Payment	Payment to Charity	End of Year
Year 1	10,000,000	300,000	-	440,000	(1,102,400)	-	9,637,600
Year 2	9,637,600	289,128	-	424,054	(1,062,449)	-	9,288,333
Year 3	9,288,333	278,650	-	408,687	(1,023,946)	-	8,951,724
Year 4	8,951,724	268,552	-	393,876	(986,838)	-	8,627,314
Year 5	8,627,314	258,819	-	379,602	(951,075)	-	8,314,660
Year 6	8,314,660	249,440	-	365,845	(916,608)	-	8,013,337
Year 7	8,013,337	240,400	-	352,587	(883,390)	-	7,722,933
Year 8	7,722,933	231,688	-	339,809	(851,376)	-	7,443,054
Year 9	7,443,054	223,292	-	327,494	(820,522)	-	7,173,318
Year 10	7,173,318	215,200	-	315,626	(790,787)	-	6,913,357
Year 11	6,913,357	207,401	-	304,188	(762,128)	-	6,662,817
Year 12	6,662,817	199,885	-	293,164	(734,509)	-	6,421,356
Year 13	6,421,356	192,641	-	282,540	(707,890)	-	6,188,646
Year 14	6,188,646	185,659	-	272,300	(682,236)	-	5,964,370
Year 15	5,964,370	178,931	-	262,432	(657,512)	-	5,748,221
Year 16	5,748,221	172,447	-	252,922	(633,684)	-	5,539,906
Year 17	5,539,906	166,197	-	243,756	(610,719)	-	5,339,139
Year 18	5,339,139	160,174	-	234,922	(588,587)	-	5,145,649
Year 19	5,145,649	154,369	-	226,409	(567,256)	-	4,959,171
Year 20	4,959,171	148,775	-	218,204	(546,699)	(4,779,450)	-

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
IRS 7520 Rate (Best)	2.40%
Unitrust Percentage	11.024%

Assumptions (continued):	
Charitable Deduction	$1,000,200
Income Tax Benefit to Charlie	$446,089
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Charlie Charitable FLP Valuation Discount	35.00%
CRUT Starting Value	$10,000,000
CRUT Actuarial Discount (10%)	($1,000,000)
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Partnership Discount (35%)	($3,150,000)
Discounted Value of Partnership Actuarial Interest	$5,850,000
Face Value of Note (99% Transferred to Grantor Trust)	$5,791,500

Charlie Charitable

	Beginning of Year	Income	Tax Free Income	Growth	Distribution from Partnership	Note Payments	Consumption	Taxes on Investment Income	End of Year
Year 1	2,500,000	75,000	-	110,000	8,344	826,056	(150,000)	64,214	3,433,614
Year 2	3,433,614	103,008	-	151,079	8,268	818,484	(153,750)	(389,799)	3,970,904
Year 3	3,970,904	119,127	-	174,720	8,200	811,754	(157,594)	(398,162)	4,528,948
Year 4	4,528,948	135,868	-	199,274	8,138	805,632	(161,534)	(406,867)	5,109,459
Year 5	5,109,459	153,284	-	224,816	8,080	799,951	(165,572)	(416,007)	5,714,011
Year 6	5,714,011	171,420	-	251,417	8,026	794,590	(169,711)	(425,654)	6,344,099
Year 7	6,344,099	190,323	-	279,140	7,974	789,462	(173,954)	(435,865)	7,001,180
Year 8	7,001,180	210,035	-	308,052	7,924	640,297	(178,303)	(446,688)	7,542,499
Year 9	7,542,499	226,275	-	331,870	7,875	-	(182,760)	(458,163)	7,467,596
Year 10	7,467,596	224,028	-	328,574	7,827	-	(187,329)	(470,327)	7,370,369
Year 11	7,370,369	221,111	-	324,296	7,780	-	(192,013)	(483,215)	7,248,328
Year 12	7,248,328	217,450	-	318,926	7,733	-	(196,813)	(496,859)	7,098,765
Year 13	7,098,765	212,963	-	312,346	7,686	-	(201,733)	(511,292)	6,918,734
Year 14	6,918,734	207,562	-	304,424	7,639	-	(206,777)	(526,547)	6,705,035
Year 15	6,705,035	201,151	-	295,022	7,592	-	(211,946)	(542,658)	6,454,196
Year 16	6,454,196	193,626	-	283,985	7,544	-	(217,245)	(559,658)	6,162,448
Year 17	6,162,448	184,873	-	271,148	7,497	-	(222,676)	(577,584)	5,825,706
Year 18	5,825,706	174,771	-	256,331	7,449	-	(228,243)	(596,474)	5,439,540
Year 19	5,439,540	163,186	-	239,340	7,400	-	(233,949)	(616,367)	4,999,149
Year 20	4,999,149	149,974	-	219,963	7,350	-	(239,798)	(637,305)	4,499,334
Year 21	4,499,334	134,980	-	197,971	702	-	(245,792)	(499,506)	4,087,687
Year 22	4,087,687	122,631	-	179,858	731	-	(251,937)	(522,336)	3,616,634
Year 23	3,616,634	108,499	-	159,132	763	-	(258,236)	(545,160)	3,081,631
Year 24	3,081,631	92,449	-	135,592	798	-	(264,692)	(568,274)	2,477,505
Year 25	2,477,505	74,325	-	109,010	1,672	-	(271,309)	(1,049,890)	1,341,313

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
IRS 7520 Rate (Best)	2.40%
Unitrust Percentage	11.024%

Assumptions (continued):	
Charitable Deduction	$1,000,200
Income Tax Benefit to Charlie	$446,089
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Charlie Charitable FLP Valuation Discount	35.00%
CRUT Starting Value	$10,000,000
CRUT Actuarial Discount (10%)	($1,000,000)
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Partnership Discount (35%)	($3,150,000)
Discounted Value of Partnership Actuarial Interest	$5,850,000
Face Value of Note (99% Transferred to Grantor Trust)	$5,791,500

Charlie Charitable Family's Grantor Trust

	Beginning of Year	Income	Tax Free Income	Growth	Distribution from Partnerships	Note Payments	Taxes on Investment Income	End of Year
Year 1	-	-	-	-	826,056	(826,056)	-	-
Year 2	-	-	-	-	818,484	(818,484)	-	-
Year 3	-	-	-	-	811,754	(811,754)	-	-
Year 4	-	-	-	-	805,632	(805,632)	-	-
Year 5	-	-	-	-	799,951	(799,951)	-	-
Year 6	-	-	-	-	794,590	(794,590)	-	-
Year 7	-	-	-	-	789,462	(789,462)	-	-
Year 8	-	-	-	-	784,503	(640,297)	-	144,205
Year 9	144,205	4,326	-	6,345	779,664	-	-	934,540
Year 10	934,540	28,036	-	41,120	774,909	-	-	1,778,605
Year 11	1,778,605	53,358	-	78,259	770,211	-	-	2,680,433
Year 12	2,680,433	80,413	-	117,939	765,547	-	-	3,644,332
Year 13	3,644,332	109,330	-	160,351	760,899	-	-	4,674,912
Year 14	4,674,912	140,247	-	205,696	756,251	-	-	5,777,106
Year 15	5,777,106	173,313	-	254,193	751,590	-	-	6,956,201
Year 16	6,956,201	208,686	-	306,073	746,902	-	-	8,217,862
Year 17	8,217,862	246,536	-	361,586	742,178	-	-	9,568,162
Year 18	9,568,162	287,045	-	420,999	737,405	-	-	11,013,611
Year 19	11,013,611	330,408	-	484,599	732,574	-	-	12,561,192
Year 20	12,561,192	376,836	-	552,692	727,673	-	-	14,218,393
Year 21	14,218,393	426,552	-	625,609	69,466	-	-	15,340,020
Year 22	15,340,020	460,201	-	674,961	72,324	-	-	16,547,506
Year 23	16,547,506	496,425	-	728,090	75,523	-	-	17,847,544
Year 24	17,847,544	535,426	-	785,292	79,022	-	-	19,247,284
Year 25	19,247,284	577,419	-	846,880	165,492	-	-	20,837,075

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
IRS 7520 Rate (Best)	2.40%
Unitrust Percentage	11.024%

Assumptions (continued):	
Charitable Deduction	$1,000,200
Income Tax Benefit to Charlie	$446,089
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Charlie Charitable FLP Valuation Discount	35.00%
CRUT Starting Value	$10,000,000
CRUT Actuarial Discount (10%)	($1,000,000)
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Partnership Discount (35%)	($3,150,000)
Discounted Value of Partnership Actuarial Interest	$5,850,000
Face Value of Note (99% Transferred to Grantor Trust)	$5,791,500

Charity

	Beginning of Year	Income	Tax Free Income	Growth	CRUT Distribution	End of Year
Year 1	-	-	-	-	-	-
Year 2	-	-	-	-	-	-
Year 3	-	-	-	-	-	-
Year 4	-	-	-	-	-	-
Year 5	-	-	-	-	-	-
Year 6	-	-	-	-	-	-
Year 7	-	-	-	-	-	-
Year 8	-	-	-	-	-	-
Year 9	-	-	-	-	-	-
Year 10	-	-	-	-	-	-
Year 11	-	-	-	-	-	-
Year 12	-	-	-	-	-	-
Year 13	-	-	-	-	-	-
Year 14	-	-	-	-	-	-
Year 15	-	-	-	-	-	-
Year 16	-	-	-	-	-	-
Year 17	-	-	-	-	-	-
Year 18	-	-	-	-	-	-
Year 19	-	-	-	-	-	-
Year 20	-	-	-	-	4,779,450	4,779,450
Year 21	4,779,450	143,384	-	210,296	-	5,133,130
Year 22	5,133,130	153,994	-	225,858	-	5,512,981
Year 23	5,512,981	165,389	-	242,571	-	5,920,942
Year 24	5,920,942	177,628	-	260,521	-	6,359,091
Year 25	6,359,091	190,773	-	279,800	-	6,829,664

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/CRUT/Grantor Trust Sale, Charlie gives remaining estate to charity

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Consumption (increasing at 3% per year)	$150,000
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IRS 7520 Rate (Best)	2.40%
Unitrust Percentage	11.024%

Assumptions (continued):	
Charitable Deduction	$1,000,200
Income Tax Benefit to Charlie	$446,089
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
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CRUT Starting Value	$10,000,000
CRUT Actuarial Discount (10%)	($1,000,000)
Value of Partnership Actuarial Interest in CRUT - Year 1	$9,000,000
Partnership Discount (35%)	($3,150,000)
Discounted Value of Partnership Actuarial Interest	$5,850,000
Face Value of Note (99% Transferred to Grantor Trust)	$5,791,500

Note Between Charlie Charitable and Charlie Charitable Family's Grantor Trust - FLP

	Beginning of Year	Interest	Note Payment	End of Year
Year 1	5,791,500	110,618	(826,056)	5,076,062
Year 2	5,076,062	96,953	(818,484)	4,354,530
Year 3	4,354,530	83,172	(811,754)	3,625,948
Year 4	3,625,948	69,256	(805,632)	2,889,572
Year 5	2,889,572	55,191	(799,951)	2,144,812
Year 6	2,144,812	40,966	(794,590)	1,391,187
Year 7	1,391,187	26,572	(789,462)	628,297
Year 8	628,297	12,000	(640,297)	-
Year 9	-	-	-	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	-	-	-	-
Year 19	-	-	-	-
Year 20	-	-	-	-
Year 21	-	-	-	-
Year 22	-	-	-	-
Year 23	-	-	-	-
Year 24	-	-	-	-
Year 25	-	-	-	-

Schedule 5

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FLP/Grantor Trust Sale, Charlie gives remaining estate to family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
7520 Rate (Best)	2.40%

Assumptions (continued):	
Charlie Charitable FLP Valuation Discount	35.00%
Note Between Charlie Charitable and Grantor Trust	
FLP Starting Value	$10,000,000
Partnership Discount (35%)	($3,500,000)
Discounted Value of Partnership Interest	$6,500,000
Face Value of Note (99% Transferred to Grantor Trust)	$6,435,000

FLP

	Beginning of Year	Income	Tax Free Income	Growth	Distributions	End of Year	Ownership: Charlie Charitable	Ownership: Grantor Trust
Year 1	10,000,000	300,000	-	440,000	(3,466,800)	7,273,200	1.00%	99.00%
Year 2	7,273,200	218,196	-	320,021	(726,273)	7,085,144	1.00%	99.00%
Year 3	7,085,144	212,554	-	311,746	(717,963)	6,891,482	1.00%	99.00%
Year 4	6,891,482	206,744	-	303,225	(705,715)	6,695,736	1.00%	99.00%
Year 5	6,695,736	200,872	-	294,612	(690,876)	6,500,345	1.00%	99.00%
Year 6	6,500,345	195,010	-	286,015	(674,393)	6,306,978	1.00%	99.00%
Year 7	6,306,978	189,209	-	277,507	(656,932)	6,116,762	1.00%	99.00%
Year 8	6,116,762	183,503	-	269,138	(638,959)	5,930,444	1.00%	99.00%
Year 9	5,930,444	177,913	-	260,940	(620,798)	5,748,498	1.00%	99.00%
Year 10	5,748,498	172,455	-	252,934	(602,674)	5,571,213	1.00%	99.00%
Year 11	5,571,213	167,136	-	245,133	(584,741)	5,398,742	1.00%	99.00%
Year 12	5,398,742	161,962	-	237,545	(567,101)	5,231,148	1.00%	99.00%
Year 13	5,231,148	156,934	-	230,171	(549,824)	5,068,429	1.00%	99.00%
Year 14	5,068,429	152,053	-	223,011	(532,953)	4,910,540	1.00%	99.00%
Year 15	4,910,540	147,316	-	216,064	(516,515)	4,757,404	1.00%	99.00%
Year 16	4,757,404	142,722	-	209,326	(500,524)	4,608,928	1.00%	99.00%
Year 17	4,608,928	138,268	-	202,793	(484,986)	4,465,003	1.00%	99.00%
Year 18	4,465,003	133,950	-	196,460	(469,899)	4,325,514	1.00%	99.00%
Year 19	4,325,514	129,765	-	190,323	(455,261)	4,190,341	1.00%	99.00%
Year 20	4,190,341	125,710	-	184,375	(441,063)	4,059,364	1.00%	99.00%
Year 21	4,059,364	121,781	-	178,612	(427,298)	3,932,459	1.00%	99.00%
Year 22	3,932,459	117,974	-	173,028	(413,954)	3,809,507	1.00%	99.00%
Year 23	3,809,507	114,285	-	167,618	(401,022)	3,690,388	1.00%	99.00%
Year 24	3,690,388	110,712	-	162,377	(388,490)	3,574,987	1.00%	99.00%
Year 25	3,574,987	107,250	-	157,299	(475,547)	3,363,989	1.00%	99.00%

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/Grantor Trust Sale, Charlie gives remaining estate to family

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Tax Free	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth t	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
7520 Rate (Best)	2.40%

Assumptions (continued):	
Charlie Charitable FLP Valuation Discount	35.00%
Note Between Charlie Charitable and Grantor Trust	
FLP Starting Value	$10,000,000
Partnership Discount (35%)	($3,500,000)
Discounted Value of Partnership Interest	$6,500,000
Face Value of Note (99% Transferred to Grantor Trust)	$6,435,000

Charlie Charitable

	Beginning of Year	Income	Tax Free Income	Growth	Distribution from Partnership	Note Payments	Consumption	Taxes on Investment Income	End of Year
Year 1	2,500,000	75,000	-	110,000	34,668	3,432,132	(150,000)	(2,708,500)	3,293,300
Year 2	3,293,300	98,799	-	144,905	7,263	719,010	(153,750)	(205,124)	3,904,403
Year 3	3,904,403	117,132	-	171,794	7,180	710,783	(157,594)	(227,927)	4,525,771
Year 4	4,525,771	135,773	-	199,134	7,057	698,658	(161,534)	(247,060)	5,157,799
Year 5	5,157,799	154,734	-	226,943	6,909	683,967	(165,572)	(263,725)	5,801,055
Year 6	5,801,055	174,032	-	255,246	6,744	485,449	(169,711)	(278,775)	6,274,039
Year 7	6,274,039	188,221	-	276,058	6,569	-	(173,954)	(292,818)	6,278,115
Year 8	6,278,115	188,343	-	276,237	6,390	-	(178,303)	(306,291)	6,264,492
Year 9	6,264,492	187,935	-	275,638	6,208	-	(182,760)	(319,508)	6,232,004
Year 10	6,232,004	186,960	-	274,208	6,027	-	(187,329)	(332,699)	6,179,170
Year 11	6,179,170	185,375	-	271,883	5,847	-	(192,013)	(346,032)	6,104,232
Year 12	6,104,232	183,127	-	268,586	5,671	-	(196,813)	(359,634)	6,005,169
Year 13	6,005,169	180,155	-	264,227	5,498	-	(201,733)	(373,601)	5,879,716
Year 14	5,879,716	176,391	-	258,707	5,330	-	(206,777)	(388,011)	5,725,357
Year 15	5,725,357	171,761	-	251,916	5,165	-	(211,946)	(402,925)	5,539,328
Year 16	5,539,328	166,180	-	243,730	5,005	-	(217,245)	(418,398)	5,318,601
Year 17	5,318,601	159,558	-	234,018	4,850	-	(222,676)	(434,474)	5,059,877
Year 18	5,059,877	151,796	-	222,635	4,699	-	(228,243)	(451,199)	4,759,565
Year 19	4,759,565	142,787	-	209,421	4,553	-	(233,949)	(468,610)	4,413,767
Year 20	4,413,767	132,413	-	194,206	4,411	-	(239,798)	(486,748)	4,018,250
Year 21	4,018,250	120,547	-	176,803	4,273	-	(245,792)	(505,652)	3,568,429
Year 22	3,568,429	107,053	-	157,011	4,140	-	(251,937)	(525,360)	3,059,335
Year 23	3,059,335	91,780	-	134,611	4,010	-	(258,236)	(545,912)	2,485,589
Year 24	2,485,589	74,568	-	109,366	3,885	-	(264,692)	(567,349)	1,841,367
Year 25	1,841,367	55,241	-	81,020	4,755	-	(271,309)	(26,533)	1,684,541

Schedule 5
Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust
FLP/Grantor Trust Sale, Charlie gives remaining estate to family

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Tax Free	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth t	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
7520 Rate (Best)	2.40%

Assumptions (continued):	
Charlie Charitable FLP Valuation Discount	35.00%
Note Between Charlie Charitable and Grantor Trust	
FLP Starting Value	$10,000,000
Partnership Discount (35%)	($3,500,000)
Discounted Value of Partnership Interest	$6,500,000
Face Value of Note (99% Transferred to Grantor Trust)	$6,435,000

Charlie Charitable Family's Grantor Trust

	Beginning of Year	Income	Tax Free Income	Growth	Distribution from Partnerships	Note Payments	Taxes on Investment Income	End of Year
Year 1	-	-	-	-	3,432,132	(3,432,132)	-	-
Year 2	-	-	-	-	719,010	(719,010)	-	-
Year 3	-	-	-	-	710,783	(710,783)	-	-
Year 4	-	-	-	-	698,658	(698,658)	-	-
Year 5	-	-	-	-	683,967	(683,967)	-	-
Year 6	-	-	-	-	667,649	(485,449)	-	182,200
Year 7	182,200	5,466	-	8,017	650,363	-	-	846,046
Year 8	846,046	25,381	-	37,226	632,569	-	-	1,541,223
Year 9	1,541,223	46,237	-	67,814	614,590	-	-	2,269,864
Year 10	2,269,864	68,096	-	99,874	596,648	-	-	3,034,481
Year 11	3,034,481	91,034	-	133,517	578,893	-	-	3,837,926
Year 12	3,837,926	115,138	-	168,869	561,430	-	-	4,683,362
Year 13	4,683,362	140,501	-	206,068	544,326	-	-	5,574,256
Year 14	5,574,256	167,228	-	245,267	527,624	-	-	6,514,375
Year 15	6,514,375	195,431	-	286,633	511,350	-	-	7,507,789
Year 16	7,507,789	225,234	-	330,343	495,519	-	-	8,558,884
Year 17	8,558,884	256,767	-	376,591	480,136	-	-	9,672,377
Year 18	9,672,377	290,171	-	425,585	465,200	-	-	10,853,333
Year 19	10,853,333	325,600	-	477,547	450,708	-	-	12,107,188
Year 20	12,107,188	363,216	-	532,716	436,653	-	-	13,439,772
Year 21	13,439,772	403,193	-	591,350	423,025	-	-	14,857,340
Year 22	14,857,340	445,720	-	653,723	409,815	-	-	16,366,598
Year 23	16,366,598	490,998	-	720,130	397,012	-	-	17,974,738
Year 24	17,974,738	539,242	-	790,888	384,605	-	-	19,689,474
Year 25	19,689,474	590,684	-	866,337	470,792	-	(1,044,592)	20,572,694

Schedule 5

Analysis of FLP Creating CRUT Followed by Sale to Grantor Trust

FLP/Grantor Trust Sale, Charlie gives remaining estate to family

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Capital Gains Tax Rate on Growth (includes income taxes, surtax on inv. income & stealth t	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Consumption (increasing at 3% per year)	$150,000
Intra-Family Note Interest Percentage	1.91%
7520 Rate (Best)	2.40%

Assumptions (continued):	
Charlie Charitable FLP Valuation Discount	35.00%
Note Between Charlie Charitable and Grantor Trust	
FLP Starting Value	$10,000,000
Partnership Discount (35%)	($3,500,000)
Discounted Value of Partnership Interest	$6,500,000
Face Value of Note (99% Transferred to Grantor Trust)	$6,435,000

Note Between Charlie Charitable and Charlie Charitable Family's Grantor Trust - FLP

	Beginning of Year	Interest	Note Payment	End of Year
Year 1	6,435,000	122,909	(3,432,132)	3,125,777
Year 2	3,125,777	59,702	(719,010)	2,466,469
Year 3	2,466,469	47,110	(710,783)	1,802,795
Year 4	1,802,795	34,433	(698,658)	1,138,571
Year 5	1,138,571	21,747	(683,967)	476,350
Year 6	476,350	9,098	(485,449)	-
Year 7	-	-	-	-
Year 8	-	-	-	-
Year 9	-	-	-	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	-	-	-	-
Year 19	-	-	-	-
Year 20	-	-	-	-
Year 21	-	-	-	-
Year 22	-	-	-	-
Year 23	-	-	-	-
Year 24	-	-	-	-
Year 25	-	-	-	-

Schedule 6
George Generous
Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming George Generous has a life expectancy of 20 years)

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	20-Year Future Values		Present Values (Discounted at 2.5%)	Percentage of Total
	Pre-Death	Post Death		
No Further Planning Except for $420,000 Annual Gift to Charity: Bequeaths $6mm to Charity at Death; Balance of Estate to Family (assumes $8.53mm estate tax exemption available at death)				
George Generous	58,712,723	-	-	0.00%
Charity	17,989,144	23,989,144	14,639,877	22.49%
Generous Children	-	26,509,634	16,178,059	24.85%
Generous Children and Grandchildren	-	8,530,000	5,205,611	8.00%
IRS Income Tax - Direct Cost	14,567,393	14,567,393	8,890,057	13.65%
IRS Income Tax - Investment Opportunity Cost	15,414,442	15,414,442	9,406,986	14.45%
IRS Estate Tax (at 40.0%)	-	17,673,089	10,785,373	16.57%
Total	**$106,683,701**	**$106,683,701**	**$65,105,963**	**100.00%**
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 (assumes $3.10mm estate tax exemption available at death)				
George Generous	8,204,328	-	-	0.00%
Charity	23,989,144	23,989,144	14,639,877	22.49%
Generous Children	-	3,062,597	1,869,014	2.87%
Generous Children and Grandchildren	47,425,983	50,525,983	30,834,539	47.36%
IRS Income Tax - Direct Cost	17,410,042	17,410,042	10,624,843	16.32%
IRS Income Tax - Investment Opportunity Cost	9,654,204	9,654,204	5,891,680	9.05%
IRS Estate Tax (at 40.0%)	-	2,041,731	1,246,009	1.91%
Total	**$106,683,701**	**$106,683,701**	**$65,105,963**	**100.00%**

Calculations of Remaining Estate Tax Exemption	No Further Planning	Hypothetical Techniques
Current Exemption	5,340,000	5,340,000
Gifts Made	-	(5,430,000)
Future Exemption Available in 20 years (assumes 2.5% inflation)	8,530,000	3,100,000

Schedule 6
George Generous
Asset Page

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	George Generous
Assets*	
FMV: Financial Assets	$20,000,000
Basis: Financial Assets	$20,000,000
FMV: Securities	$6,000,000
Basis: Securities	$0
Total Assets	**$26,000,000**
Total Basis	**$20,000,000**

* Information provided by client and client's advisors. There is no proposed planning for George Generous' other assets.

Schedule 6

George Generous

No Further Planning Except for $420,000 Annual Gift to Charity: Bequeaths $6mm to Charity at Death; Balance of Estate to Family (assumes $8.53mm estate tax exemption a

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$420,000

George Generous

	Beginning of Year Financial Assets	Income	Growth	Sale Proceeds	Charitable Contributions	Income Taxes	End of Year Financial Assets	Beginning of Year Securities	Sale	End of Year Securities	End of Year Financial & Other Assets
Year 1	20,000,000	600,000	880,000	6,000,000	(420,000)	(1,662,240)	25,397,760	6,000,000	(6,000,000)	-	25,397,760
Year 2	25,397,760	761,933	1,117,501	-	(420,000)	(298,475)	26,558,720	-	-	-	26,558,720
Year 3	26,558,720	796,762	1,168,584	-	(420,000)	(362,648)	27,741,417	-	-	-	27,741,417
Year 4	27,741,417	832,242	1,220,622	-	(420,000)	(416,424)	28,957,858	-	-	-	28,957,858
Year 5	28,957,858	868,736	1,274,146	-	(420,000)	(463,280)	30,217,460	-	-	-	30,217,460
Year 6	30,217,460	906,524	1,329,568	-	(420,000)	(505,696)	31,527,856	-	-	-	31,527,856
Year 7	31,527,856	945,836	1,387,226	-	(420,000)	(545,447)	32,895,471	-	-	-	32,895,471
Year 8	32,895,471	986,864	1,447,401	-	(420,000)	(583,811)	34,325,924	-	-	-	34,325,924
Year 9	34,325,924	1,029,778	1,510,341	-	(420,000)	(621,717)	35,824,325	-	-	-	35,824,325
Year 10	35,824,325	1,074,730	1,576,270	-	(420,000)	(659,847)	37,395,478	-	-	-	37,395,478
Year 11	37,395,478	1,121,864	1,645,401	-	(420,000)	(698,711)	39,044,032	-	-	-	39,044,032
Year 12	39,044,032	1,171,321	1,717,937	-	(420,000)	(738,698)	40,774,593	-	-	-	40,774,593
Year 13	40,774,593	1,223,238	1,794,082	-	(420,000)	(780,114)	42,591,798	-	-	-	42,591,798
Year 14	42,591,798	1,277,754	1,874,039	-	(420,000)	(823,209)	44,500,382	-	-	-	44,500,382
Year 15	44,500,382	1,335,011	1,958,017	-	(420,000)	(868,190)	46,505,221	-	-	-	46,505,221
Year 16	46,505,221	1,395,157	2,046,230	-	(420,000)	(915,241)	48,611,366	-	-	-	48,611,366
Year 17	48,611,366	1,458,341	2,138,900	-	(420,000)	(964,531)	50,824,077	-	-	-	50,824,077
Year 18	50,824,077	1,524,722	2,236,259	-	(420,000)	(1,016,215)	53,148,844	-	-	-	53,148,844
Year 19	53,148,844	1,594,465	2,338,549	-	(420,000)	(1,070,447)	55,591,411	-	-	-	55,591,411
Year 20	55,591,411	1,667,742	2,446,022	-	(420,000)	(572,453)	58,712,723	-	-	-	58,712,723

Schedule 6
George Generous
No Further Planning Except for $420,000 Annual Gift to Charity: Bequeaths $6mm to Charity at Death; Balance of Estate to Family (assumes $8.53mm estate tax exemption a

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Assumptions:	
Total Estimated Rate of Return	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$420,000

Doing Good Donor Advised Fund

	Beginning of Year Financial Assets	Income	Growth	Charitable Contributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	420,000	-	420,000
Year 2	420,000	12,600	18,480	420,000	-	871,080
Year 3	871,080	26,132	38,328	420,000	-	1,355,540
Year 4	1,355,540	40,666	59,644	420,000	-	1,875,850
Year 5	1,875,850	56,275	82,537	420,000	-	2,434,663
Year 6	2,434,663	73,040	107,125	420,000	-	3,034,828
Year 7	3,034,828	91,045	133,532	420,000	-	3,679,405
Year 8	3,679,405	110,382	161,894	420,000	-	4,371,681
Year 9	4,371,681	131,150	192,354	420,000	-	5,115,185
Year 10	5,115,185	153,456	225,068	420,000	-	5,913,709
Year 11	5,913,709	177,411	260,203	420,000	-	6,771,324
Year 12	6,771,324	203,140	297,938	420,000	-	7,692,402
Year 13	7,692,402	230,772	338,466	420,000	-	8,681,639
Year 14	8,681,639	260,449	381,992	420,000	-	9,744,081
Year 15	9,744,081	292,322	428,740	420,000	-	10,885,143
Year 16	10,885,143	326,554	478,946	420,000	-	12,110,643
Year 17	12,110,643	363,319	532,868	420,000	-	13,426,831
Year 18	13,426,831	402,805	590,781	420,000	-	14,840,416
Year 19	14,840,416	445,212	652,978	420,000	-	16,358,607
Year 20	16,358,607	490,758	719,779	420,000	-	17,989,144

Schedule 6
George Generous
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 (assumes $3.10mm estate tax exemption available at death)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates - Financial Assets	3.00%
Rate of Return Taxed at Capital Gains Rates - Financial Assets	4.40%
Turnover Rate - Financial Assets (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$0

Assumptions:	
Generous FLLC Valuation Discount	35.00%
Generous FLLC Preferred	$6,000,000
Generous FLLC Preferred Coupon	7.00%
Generous FLLC Ownership - George Generous	1.00%
Generous FLLC Trusts for Family	99.00%
Intra-Family Interest Rate - Mid-Term (June 2014)	1.91%

George Generous

	Beginning of Year Financial Assets	Income	Growth	FLLC Distributions	Note Payments	Charitable Spending	Income Taxes	End of Year Financial Assets
Year 1	6,000,000	180,000	264,000	4,200	68,359	-	2,114,400	8,630,959
Year 2	8,630,959	258,929	379,762	3,692	68,359	-	(532,829)	8,808,872
Year 3	8,808,872	264,266	387,590	4,179	68,359	-	(606,479)	8,926,787
Year 4	8,926,787	267,804	392,779	4,572	68,359	-	(667,116)	8,993,185
Year 5	8,993,185	269,796	395,700	4,902	68,359	-	(718,993)	9,012,948
Year 6	9,012,948	270,388	396,570	5,188	68,359	-	(765,140)	8,988,314
Year 7	8,988,314	269,649	395,486	5,448	68,359	-	(807,719)	8,919,537
Year 8	8,919,537	267,586	392,460	5,691	68,359	-	(848,283)	8,805,349
Year 9	8,805,349	264,160	387,435	5,925	3,647,359	-	(887,954)	12,222,275
Year 10	12,222,275	366,668	537,780	6,156	-	-	(927,554)	12,205,326
Year 11	12,205,326	366,160	537,034	6,389	-	-	(967,690)	12,147,219
Year 12	12,147,219	364,417	534,478	6,626	-	-	(1,008,821)	12,043,919
Year 13	12,043,919	361,318	529,932	6,871	-	-	(1,051,304)	11,890,735
Year 14	11,890,735	356,722	523,192	7,123	-	-	(1,095,423)	11,682,350
Year 15	11,682,350	350,471	514,023	7,386	-	-	(1,141,412)	11,412,818
Year 16	11,412,818	342,385	502,164	7,661	-	-	(1,189,476)	11,075,552
Year 17	11,075,552	332,267	487,324	7,948	-	-	(1,239,794)	10,663,296
Year 18	10,663,296	319,899	469,185	8,249	-	-	(1,292,536)	10,168,093
Year 19	10,168,093	305,043	447,396	8,564	-	-	(1,347,862)	9,581,233
Year 20	9,581,233	287,437	421,574	17,837	-	-	(2,428,057)	7,880,025

Schedule 6
George Generous
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 (assumes $3.10mm estate tax exemption available at death)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates - Financial Assets	3.00%
Rate of Return Taxed at Capital Gains Rates - Financial Assets	4.40%
Turnover Rate - Financial Assets (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$0

Assumptions:	
Generous FLLC Valuation Discount	35.00%
Generous FLLC Preferred	$6,000,000
Generous FLLC Preferred Coupon	7.00%
Generous FLLC Ownership - George Generous	1.00%
Generous FLLC Trusts for Family	99.00%
Intra-Family Interest Rate - Mid-Term (June 2014)	1.91%

Generous FLLC

	Beginning of Year Financial Assets	Income	Growth	Sale Proceeds	Preferred Distributions	Growth Distributions	End of Year Financial Assets	Beginning of Year Securities	Sale	End of Year Securities	End of Year Financial & Other Assets
Year 1	14,000,000	420,000	616,000	6,000,000	(420,000)	(420,000)	20,196,000	6,000,000	(6,000,000)	-	20,196,000
Year 2	20,196,000	605,880	888,624	-	(420,000)	(369,209)	20,901,295	-	-	-	20,901,295
Year 3	20,901,295	627,039	919,657	-	(420,000)	(417,924)	21,610,066	-	-	-	21,610,066
Year 4	21,610,066	648,302	950,843	-	(420,000)	(457,241)	22,331,970	-	-	-	22,331,970
Year 5	22,331,970	669,959	982,607	-	(420,000)	(490,166)	23,074,369	-	-	-	23,074,369
Year 6	23,074,369	692,231	1,015,272	-	(420,000)	(518,836)	23,843,037	-	-	-	23,843,037
Year 7	23,843,037	715,291	1,049,094	-	(420,000)	(544,772)	24,642,649	-	-	-	24,642,649
Year 8	24,642,649	739,279	1,084,277	-	(420,000)	(569,066)	25,477,139	-	-	-	25,477,139
Year 9	25,477,139	764,314	1,120,994	-	(420,000)	(592,502)	26,349,945	-	-	-	26,349,945
Year 10	26,349,945	790,498	1,159,398	-	(420,000)	(615,650)	27,264,192	-	-	-	27,264,192
Year 11	27,264,192	817,926	1,199,624	-	(420,000)	(638,928)	28,222,814	-	-	-	28,222,814
Year 12	28,222,814	846,684	1,241,804	-	(420,000)	(662,650)	29,228,653	-	-	-	29,228,653
Year 13	29,228,653	876,860	1,286,061	-	(420,000)	(687,054)	30,284,519	-	-	-	30,284,519
Year 14	30,284,519	908,536	1,332,519	-	(420,000)	(712,328)	31,393,246	-	-	-	31,393,246
Year 15	31,393,246	941,797	1,381,303	-	(420,000)	(738,624)	32,557,722	-	-	-	32,557,722
Year 16	32,557,722	976,732	1,432,540	-	(420,000)	(766,070)	33,780,923	-	-	-	33,780,923
Year 17	33,780,923	1,013,428	1,486,361	-	(420,000)	(794,780)	35,065,932	-	-	-	35,065,932
Year 18	35,065,932	1,051,978	1,542,901	-	(420,000)	(824,853)	36,415,957	-	-	-	36,415,957
Year 19	36,415,957	1,092,479	1,602,302	-	(420,000)	(856,388)	37,834,350	-	-	-	37,834,350
Year 20	37,834,350	1,135,031	1,664,711	-	(420,000)	(1,783,734)	38,430,358	-	-	-	38,430,358

Schedule 6
George Generous
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 (assumes $3.10mm estate tax exemption available at death)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates - Financial Assets	3.00%
Rate of Return Taxed at Capital Gains Rates - Financial Assets	4.40%
Turnover Rate - Financial Assets (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$0

Assumptions:	
Generous FLLC Valuation Discount	35.00%
Generous FLLC Preferred	$6,000,000
Generous FLLC Preferred Coupon	7.00%
Generous FLLC Ownership - George Generous	1.00%
Generous FLLC Trusts for Family	99.00%
Intra-Family Interest Rate - Mid-Term (June 2014)	1.91%

Doing Good Donor Advised Fund

	Beginning of Year Financial Assets	Income	Growth	Preferred Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	420,000	-	420,000
Year 2	420,000	12,600	18,480	420,000	-	871,080
Year 3	871,080	26,132	38,328	420,000	-	1,355,540
Year 4	1,355,540	40,666	59,644	420,000	-	1,875,850
Year 5	1,875,850	56,275	82,537	420,000	-	2,434,663
Year 6	2,434,663	73,040	107,125	420,000	-	3,034,828
Year 7	3,034,828	91,045	133,532	420,000	-	3,679,405
Year 8	3,679,405	110,382	161,894	420,000	-	4,371,681
Year 9	4,371,681	131,150	192,354	420,000	-	5,115,185
Year 10	5,115,185	153,456	225,068	420,000	-	5,913,709
Year 11	5,913,709	177,411	260,203	420,000	-	6,771,324
Year 12	6,771,324	203,140	297,938	420,000	-	7,692,402
Year 13	7,692,402	230,772	338,466	420,000	-	8,681,639
Year 14	8,681,639	260,449	381,992	420,000	-	9,744,081
Year 15	9,744,081	292,322	428,740	420,000	-	10,885,143
Year 16	10,885,143	326,554	478,946	420,000	-	12,110,643
Year 17	12,110,643	363,319	532,868	420,000	-	13,426,831
Year 18	13,426,831	402,805	590,781	420,000	-	14,840,416
Year 19	14,840,416	445,212	652,978	420,000	-	16,358,607
Year 20	16,358,607	490,758	719,779	420,000	-	17,989,144

Schedule 6
George Generous
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 (assumes $3.10mm estate tax exemption available at death)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates - Financial Assets	3.00%
Rate of Return Taxed at Capital Gains Rates - Financial Assets	4.40%
Turnover Rate - Financial Assets (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$0

Assumptions:	
Generous FLLC Valuation Discount	35.00%
Generous FLLC Preferred	$6,000,000
Generous FLLC Preferred Coupon	7.00%
Generous FLLC Ownership - George Generous	1.00%
Generous FLLC Trusts for Family	99.00%
Intra-Family Interest Rate - Mid-Term (June 2014)	1.91%

GST Tax Exempt Grantor Trust for Generous Family

	Beginning of Year Financial Assets	Income	Growth	FLLC Growth Distributions	Note Payments	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	415,800	(68,359)	-	347,441
Year 2	347,441	10,423	15,287	365,517	(68,359)	-	670,310
Year 3	670,310	20,109	29,494	413,745	(68,359)	-	1,065,299
Year 4	1,065,299	31,959	46,873	452,669	(68,359)	-	1,528,441
Year 5	1,528,441	45,853	67,251	485,265	(68,359)	-	2,058,452
Year 6	2,058,452	61,754	90,572	513,647	(68,359)	-	2,656,066
Year 7	2,656,066	79,682	116,867	539,325	(68,359)	-	3,323,580
Year 8	3,323,580	99,707	146,238	563,375	(68,359)	-	4,064,542
Year 9	4,064,542	121,936	178,840	586,577	(3,647,359)	-	1,304,536
Year 10	1,304,536	39,136	57,400	609,493	-	-	2,010,565
Year 11	2,010,565	60,317	88,465	632,539	-	-	2,791,885
Year 12	2,791,885	83,757	122,843	656,023	-	-	3,654,508
Year 13	3,654,508	109,635	160,798	680,183	-	-	4,605,124
Year 14	4,605,124	138,154	202,625	705,205	-	-	5,651,108
Year 15	5,651,108	169,533	248,649	731,238	-	-	6,800,528
Year 16	6,800,528	204,016	299,223	758,410	-	-	8,062,177
Year 17	8,062,177	241,865	354,736	786,832	-	-	9,445,610
Year 18	9,445,610	283,368	415,607	816,605	-	-	10,961,189
Year 19	10,961,189	328,836	482,292	847,824	-	-	12,620,141
Year 20	12,620,141	378,604	555,286	1,765,896	-	-	15,319,928

Schedule 6
George Generous
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 (assumes $3.10mm estate tax exemption available at death)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates - Financial Assets	3.00%
Rate of Return Taxed at Capital Gains Rates - Financial Assets	4.40%
Turnover Rate - Financial Assets (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gain Tax Rate	21.20%
Ordinary Income Tax Rate	40.80%
Health Care Tax Rate	3.80%
Charitable Spending	$0

Assumptions:	
Generous FLLC Valuation Discount	35.00%
Generous FLLC Preferred	$6,000,000
Generous FLLC Preferred Coupon	7.00%
Generous FLLC Ownership - George Generous	1.00%
Generous FLLC Trusts for Family	99.00%
Intra-Family Interest Rate - Mid-Term (June 2014)	1.91%

Note between George Generous and Grantor Trust for Generous Family

	Beginning of Year Principal	Interest	Note Payment	End of Year Principal
Year 1	3,579,000	68,359	(68,359)	3,579,000
Year 2	3,579,000	68,359	(68,359)	3,579,000
Year 3	3,579,000	68,359	(68,359)	3,579,000
Year 4	3,579,000	68,359	(68,359)	3,579,000
Year 5	3,579,000	68,359	(68,359)	3,579,000
Year 6	3,579,000	68,359	(68,359)	3,579,000
Year 7	3,579,000	68,359	(68,359)	3,579,000
Year 8	3,579,000	68,359	(68,359)	3,579,000
Year 9	3,579,000	68,359	(3,647,359)	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	-	-	-	-
Year 19	-	-	-	-
Year 20	-	-	-	-

Schedule 7

Gomer Gonetotexas

Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming Gomer Gonetotexas has a life expectancy of 20 years)

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	20-Year Future Values		Present Values (Discounted at 2.5%)	Percentage of Total
	Pre-Death	Post Death		
No Further Planning: Bequeaths Estate to Family (assumes $8.69mm inflation adjusted estate tax exemption available in 20 years)				
Gomer Gonetotexas	34,404,293	-	-	0.00%
Gonetotexas Children	-	15,428,576	9,415,611	15.42%
Gonetotexas Children and Grandchildren in California Complex Trust	9,609,259	9,609,259	5,864,252	9.60%
Gonetotexas Children and Grandchildren in Texas Grantor Trust	-	8,690,000	5,303,254	8.68%
Consumption - Direct Cost	12,772,329	12,772,329	7,794,581	12.76%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	13.04%
IRS & CA Income Tax - Direct Cost	3,894,601	3,894,601	2,376,762	3.89%
IRS & TX Income Tax - Direct Cost	11,640,362	11,640,362	7,103,775	11.63%
IRS & CA Income Tax - Investment Opportunity Cost	3,174,203	3,174,203	1,937,124	3.17%
IRS & TX Income Tax - Investment Opportunity Cost	11,520,158	11,520,158	7,030,417	11.51%
IRS Estate Tax (at 40.0%)	-	10,285,717	6,277,074	10.28%
Total	**$100,068,380**	**$100,068,380**	**$61,068,825**	**100.00%**
Hypothetical Technique #1 - Scenario A: 6.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)				
Gomer Gonetotexas	20,522,418	-	-	0.00%
Gonetotexas Children	-	10,357,451	6,320,851	10.35%
Gonetotexas Children and Grandchildren in California Complex Trust	12,333,221	12,333,221	7,526,606	12.32%
Gonetotexas Children and Grandchildren in Texas Grantor Trust	12,199,872	15,459,872	9,434,710	15.45%
Consumption - Direct Cost	12,772,329	12,772,329	7,794,581	12.76%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	13.04%
IRS & CA Income Tax - Direct Cost	3,085,931	3,085,931	1,883,254	3.08%
IRS & TX Income Tax - Direct Cost	12,289,889	12,289,889	7,500,162	12.28%
IRS & CA Income Tax - Investment Opportunity Cost	2,860,359	2,860,359	1,745,594	2.86%
IRS & TX Income Tax - Investment Opportunity Cost	11,746,826	11,746,826	7,168,746	11.74%
Opportunity Cost/(Benefit) of Third Party Note	(795,639)	(795,639)	(485,555)	-0.80%
IRS Estate Tax (at 40.0%)	-	6,904,967	4,213,901	6.90%
Total	**$100,068,380**	**$100,068,380**	**$61,068,825**	**100.00%**
Hypothetical Technique #1 - Scenario B: 3.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)				
Gomer Gonetotexas	20,201,883	-	-	0.00%
Gonetotexas Children	-	10,165,130	6,203,483	10.16%
Gonetotexas Children and Grandchildren in California Complex Trust	10,164,400	10,164,400	6,203,038	10.16%
Gonetotexas Children and Grandchildren in Texas Grantor Trust	15,378,941	18,638,941	11,374,804	18.63%
Consumption - Direct Cost	12,772,329	12,772,329	7,794,581	12.76%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	13.04%
IRS & CA Income Tax - Direct Cost	1,543,906	1,543,906	942,201	1.54%
IRS & TX Income Tax - Direct Cost	13,537,376	13,537,376	8,261,467	13.53%
IRS & CA Income Tax - Investment Opportunity Cost	1,431,450	1,431,450	873,572	1.43%
IRS & TX Income Tax - Investment Opportunity Cost	12,936,697	12,936,697	7,894,890	12.93%
Opportunity Cost/(Benefit) of Third Party Note	(951,776)	(951,776)	(580,841)	-0.95%
IRS Estate Tax (at 40.0%)	-	6,776,753	4,135,655	6.77%
Total	**$100,068,380**	**$100,068,380**	**$61,068,825**	**100.00%**

Schedule 7
Gomer Gonetotexas
Asset Page

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	Gomer Gonetotexas	California Complex Trust
Assets* (assumed value and basis)		
FMV: Financial Assets	$20,000,000	$4,000,000
Basis: Financial Assets	$20,000,000	$4,000,000

* Information provided by client. There is no proposed planning for Mr. Gonetotexas' other assets.

Schedule 7
Gomer Gonetotexas
No Further Planning: Bequeaths Estate to Family (assumes $8.69mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%

Gomer Gonetotexas (Texas Residents)

	Beginning of Year Financial Assets	Income	Growth	Consumption	Income Taxes	End of Year Financial Assets
Year 1	20,000,000	600,000	880,000	(500,000)	(333,600)	20,646,400
Year 2	20,646,400	619,392	908,442	(512,500)	(390,582)	21,271,152
Year 3	21,271,152	638,135	935,931	(525,313)	(434,836)	21,885,068
Year 4	21,885,068	656,552	962,943	(538,445)	(470,203)	22,495,916
Year 5	22,495,916	674,877	989,820	(551,906)	(499,398)	23,109,309
Year 6	23,109,309	693,279	1,016,810	(565,704)	(524,345)	23,729,348
Year 7	23,729,348	711,880	1,044,091	(579,847)	(546,405)	24,359,068
Year 8	24,359,068	730,772	1,071,799	(594,343)	(566,544)	25,000,752
Year 9	25,000,752	750,023	1,100,033	(609,201)	(585,446)	25,656,160
Year 10	25,656,160	769,685	1,128,871	(624,431)	(603,600)	26,326,684
Year 11	26,326,684	789,801	1,158,374	(640,042)	(621,354)	27,013,463
Year 12	27,013,463	810,404	1,188,592	(656,043)	(638,956)	27,717,460
Year 13	27,717,460	831,524	1,219,568	(672,444)	(656,589)	28,439,519
Year 14	28,439,519	853,186	1,251,339	(689,256)	(674,381)	29,180,406
Year 15	29,180,406	875,412	1,283,938	(706,487)	(692,432)	29,940,838
Year 16	29,940,838	898,225	1,317,397	(724,149)	(710,812)	30,721,499
Year 17	30,721,499	921,645	1,351,746	(742,253)	(729,577)	31,523,060
Year 18	31,523,060	945,692	1,387,015	(760,809)	(748,771)	32,346,187
Year 19	32,346,187	970,386	1,423,232	(779,829)	(768,429)	33,191,546
Year 20	33,191,546	995,746	1,460,428	(799,325)	(444,103)	34,404,293

Schedule 7
Gomer Gonetotexas
No Further Planning: Bequeaths Estate to Family (assumes $8.69mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%

California Complex Trust

	Beginning of Year Financial Assets	**Income**	**Growth**	**Beneficiary Distributions**	**Income Taxes**	**End of Year Financial Assets**
Year 1	4,000,000	120,000	176,000	-	(80,601)	4,215,399
Year 2	4,215,399	126,462	185,478	-	(97,151)	4,430,187
Year 3	4,430,187	132,906	194,928	-	(110,683)	4,647,339
Year 4	4,647,339	139,420	204,483	-	(122,157)	4,869,085
Year 5	4,869,085	146,073	214,240	-	(132,256)	5,097,141
Year 6	5,097,141	152,914	224,274	-	(141,471)	5,332,858
Year 7	5,332,858	159,986	234,646	-	(150,150)	5,577,340
Year 8	5,577,340	167,320	245,403	-	(158,546)	5,831,517
Year 9	5,831,517	174,946	256,587	-	(166,843)	6,096,206
Year 10	6,096,206	182,886	268,233	-	(175,175)	6,372,150
Year 11	6,372,150	191,164	280,375	-	(183,643)	6,660,046
Year 12	6,660,046	199,801	293,042	-	(192,321)	6,960,569
Year 13	6,960,569	208,817	306,265	-	(201,269)	7,274,382
Year 14	7,274,382	218,231	320,073	-	(210,535)	7,602,151
Year 15	7,602,151	228,065	334,495	-	(220,157)	7,944,554
Year 16	7,944,554	238,337	349,560	-	(230,169)	8,302,282
Year 17	8,302,282	249,068	365,300	-	(240,601)	8,676,050
Year 18	8,676,050	260,281	381,746	-	(251,481)	9,066,596
Year 19	9,066,596	271,998	398,930	-	(262,836)	9,474,689
Year 20	9,474,689	284,241	416,886	-	(566,556)	9,609,259

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario A: 6.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		6.0%
FLP Valuation Discount		35.0%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Gomer Gonetotexas (Texas Resident)

	Beginning of Year Financial Assets	**Income**	**Growth**	**FLP Terminates**	**3rd Party Note Payments**	**Consumption**	**Income Taxes**	**End of Year Financial Assets**
Year 1	14,570,000	437,100	641,080	-	-	(500,000)	(307,653)	14,840,527
Year 2	14,840,527	445,216	652,983	-	-	(512,500)	(380,777)	15,045,449
Year 3	15,045,449	451,363	662,000	-	-	(525,313)	(435,637)	15,197,863
Year 4	15,197,863	455,936	668,706	-	-	(538,445)	(478,476)	15,305,583
Year 5	15,305,583	459,167	673,446	-	-	(551,906)	(513,184)	15,373,105
Year 6	15,373,105	461,193	676,417	-	-	(565,704)	(542,367)	15,402,644
Year 7	15,402,644	462,079	677,716	-	-	(579,847)	(567,820)	15,394,773
Year 8	15,394,773	461,843	677,370	-	-	(594,343)	(590,795)	15,348,848
Year 9	15,348,848	460,465	675,349	-	-	(609,201)	(612,174)	15,263,288
Year 10	15,263,288	457,899	671,585	-	-	(624,431)	(632,580)	15,135,759
Year 11	15,135,759	454,073	665,973	-	-	(640,042)	(652,456)	14,963,307
Year 12	14,963,307	448,899	658,386	-	-	(656,043)	(672,120)	14,742,428
Year 13	14,742,428	442,273	648,667	-	-	(672,444)	(691,800)	14,469,123
Year 14	14,469,123	434,074	636,641	-	-	(689,256)	(711,663)	14,138,920
Year 15	14,138,920	424,168	622,112	-	-	(706,487)	(731,830)	13,746,883
Year 16	13,746,883	412,406	604,863	-	-	(724,149)	(752,396)	13,287,607
Year 17	13,287,607	398,628	584,655	-	-	(742,253)	(773,431)	12,755,206
Year 18	12,755,206	382,656	561,229	-	(421,332)	(760,809)	(607,078)	11,909,872
Year 19	11,909,872	357,296	524,034	-	(421,332)	(779,829)	(859,577)	10,730,464
Year 20	10,730,464	321,914	472,140	25,039,023	(14,465,726)	(799,325)	(776,073)	20,522,418

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario A: 6.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		6.0%
FLP Valuation Discount		35.0%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Family Limited Partnership

	Beginning of Year Financial Assets	Income	Growth	Preferred Distributions	Growth Distributions	FLP Terminates	End of Year Financial Assets
Year 1	9,430,000	282,900	414,920	(240,000)	-	-	9,887,820
Year 2	9,887,820	296,635	435,064	(240,000)	-	-	10,379,519
Year 3	10,379,519	311,386	456,699	(240,000)	-	-	10,907,603
Year 4	10,907,603	327,228	479,935	(240,000)	-	-	11,474,766
Year 5	11,474,766	344,243	504,890	(240,000)	-	-	12,083,898
Year 6	12,083,898	362,517	531,692	(240,000)	-	-	12,738,107
Year 7	12,738,107	382,143	560,477	(240,000)	-	-	13,440,727
Year 8	13,440,727	403,222	591,392	(240,000)	-	-	14,195,341
Year 9	14,195,341	425,860	624,595	(240,000)	-	-	15,005,796
Year 10	15,005,796	450,174	660,255	(240,000)	-	-	15,876,225
Year 11	15,876,225	476,287	698,554	(240,000)	-	-	16,811,065
Year 12	16,811,065	504,332	739,687	(240,000)	-	-	17,815,084
Year 13	17,815,084	534,453	783,864	(240,000)	-	-	18,893,400
Year 14	18,893,400	566,802	831,310	(240,000)	-	-	20,051,512
Year 15	20,051,512	601,545	882,267	(240,000)	-	-	21,295,324
Year 16	21,295,324	638,860	936,994	(240,000)	-	-	22,631,178
Year 17	22,631,178	678,935	995,772	(240,000)	-	-	24,065,885
Year 18	24,065,885	721,977	1,058,899	(240,000)	-	-	25,606,760
Year 19	25,606,760	768,203	1,126,697	(240,000)	-	-	27,261,661
Year 20	27,261,661	817,850	1,199,513	(240,000)	-	(29,039,023)	-

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario A: 6.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		6.0%
FLP Valuation Discount		35.0%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

California Complex Trust

	Beginning of Year Financial Assets	Income	Growth	FLP Preferred Distributions	FLP Terminates	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	240,000	-	-	(111,946)	128,054
Year 2	128,054	3,842	5,634	240,000	-	-	(108,992)	268,538
Year 3	268,538	8,056	11,816	240,000	-	-	(109,464)	418,946
Year 4	418,946	12,568	18,434	240,000	-	-	(111,661)	578,287
Year 5	578,287	17,349	25,445	240,000	-	-	(114,910)	746,170
Year 6	746,170	22,385	32,831	240,000	-	-	(118,884)	922,502
Year 7	922,502	27,675	40,590	240,000	-	-	(123,407)	1,107,360
Year 8	1,107,360	33,221	48,724	240,000	-	-	(128,375)	1,300,930
Year 9	1,300,930	39,028	57,241	240,000	-	-	(133,727)	1,503,471
Year 10	1,503,471	45,104	66,153	240,000	-	-	(139,429)	1,715,300
Year 11	1,715,300	51,459	75,473	240,000	-	-	(145,459)	1,936,773
Year 12	1,936,773	58,103	85,218	240,000	-	-	(151,810)	2,168,284
Year 13	2,168,284	65,049	95,404	240,000	-	-	(158,480)	2,410,256
Year 14	2,410,256	72,308	106,051	240,000	-	-	(165,472)	2,663,143
Year 15	2,663,143	79,894	117,178	240,000	-	-	(172,794)	2,927,422
Year 16	2,927,422	87,823	128,807	240,000	-	-	(180,454)	3,203,597
Year 17	3,203,597	96,108	140,958	240,000	-	-	(188,465)	3,492,199
Year 18	3,492,199	104,766	153,657	240,000	-	-	(196,839)	3,793,783
Year 19	3,793,783	113,813	166,926	240,000	-	-	(205,593)	4,108,930
Year 20	4,108,930	123,268	180,793	240,000	4,000,000	-	(319,770)	8,333,221

Schedule 7

Gomer Gonetotexas

Hypothetical Technique #1 - Scenario A: 6.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		6.0%
FLP Valuation Discount		35.0%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Texas GST Tax Exempt Grantor Trust

	Beginning of Year Financial Assets	Income	Growth	FLP Growth Distributions	Asset Purchase Proceeds	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-
Year 4	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	14,044,394	-	-	14,044,394
Year 19	14,044,394	421,332	617,953	-	-	-	-	15,083,679
Year 20	15,083,679	452,510	663,682	-	-	-	-	16,199,872

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario A: 6.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		6.0%
FLP Valuation Discount		35.0%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Note Between Gomer Gonetotexas and 3rd Party Lender

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	-	-	-	-
Year 2	-	-	-	-
Year 3	-	-	-	-
Year 4	-	-	-	-
Year 5	-	-	-	-
Year 6	-	-	-	-
Year 7	-	-	-	-
Year 8	-	-	-	-
Year 9	-	-	-	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	14,044,394	421,332	(421,332)	14,044,394
Year 19	14,044,394	421,332	(421,332)	14,044,394
Year 20	14,044,394	421,332	(14,465,726)	-

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario B: 3.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		3.00%
FLP Valuation Discount		35.00%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Gomer Gonetotexas (Texas Resident)

	Beginning of Year Financial Assets	Income	Growth	FLP Terminates	Note Paymemts	Consumption	Income Taxes	End of Year Financial Assets
Year 1	14,570,000	437,100	641,080	-	-	(500,000)	(353,987)	14,794,193
Year 2	14,794,193	443,826	650,945	-	-	(512,500)	(425,544)	14,950,920
Year 3	14,950,920	448,528	657,840	-	-	(525,313)	(480,522)	15,051,453
Year 4	15,051,453	451,544	662,264	-	-	(538,445)	(524,325)	15,102,490
Year 5	15,102,490	453,075	664,510	-	-	(551,906)	(560,513)	15,107,656
Year 6	15,107,656	453,230	664,737	-	-	(565,704)	(591,532)	15,068,386
Year 7	15,068,386	452,052	663,009	-	-	(579,847)	(619,094)	14,984,505
Year 8	14,984,505	449,535	659,318	-	-	(594,343)	(644,402)	14,854,614
Year 9	14,854,614	445,638	653,603	-	-	(609,201)	(668,309)	14,676,345
Year 10	14,676,345	440,290	645,759	-	-	(624,431)	(691,424)	14,446,539
Year 11	14,446,539	433,396	635,648	-	-	(640,042)	(714,181)	14,161,360
Year 12	14,161,360	424,841	623,100	-	-	(656,043)	(736,894)	13,816,363
Year 13	13,816,363	414,491	607,920	-	-	(672,444)	(759,794)	13,406,536
Year 14	13,406,536	402,196	589,888	-	-	(689,256)	(783,050)	12,926,314
Year 15	12,926,314	387,789	568,758	-	-	(706,487)	(806,789)	12,369,585
Year 16	12,369,585	371,088	544,262	-	-	(724,149)	(831,112)	11,729,674
Year 17	11,729,674	351,890	516,106	-	-	(742,253)	(856,097)	10,999,320
Year 18	10,999,320	329,980	483,970	-	(504,014)	(760,809)	(657,018)	9,891,429
Year 19	9,891,429	296,743	435,223	-	(504,014)	(779,829)	(959,087)	8,380,464
Year 20	8,380,464	251,414	368,740	30,178,779	(17,304,486)	(799,325)	(873,703)	20,201,883

Schedule 7

Gomer Gonetotexas

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Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	California	Texas
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		3.00%
FLP Valuation Discount		35.00%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Family Limited Partnership

	Beginning of Year Financial Assets	Income	Growth	Preferred Distributions	Growth Distributions	FLP Terminates	End of Year Financial Assets
Year 1	9,430,000	282,900	414,920	(120,000)	-	-	10,007,820
Year 2	10,007,820	300,235	440,344	(120,000)	-	-	10,628,399
Year 3	10,628,399	318,852	467,650	(120,000)	-	-	11,294,900
Year 4	11,294,900	338,847	496,976	(120,000)	-	-	12,010,723
Year 5	12,010,723	360,322	528,472	(120,000)	-	-	12,779,516
Year 6	12,779,516	383,385	562,299	(120,000)	-	-	13,605,200
Year 7	13,605,200	408,156	598,629	(120,000)	-	-	14,491,985
Year 8	14,491,985	434,760	637,647	(120,000)	-	-	15,444,392
Year 9	15,444,392	463,332	679,553	(120,000)	-	-	16,467,277
Year 10	16,467,277	494,018	724,560	(120,000)	-	-	17,565,856
Year 11	17,565,856	526,976	772,898	(120,000)	-	-	18,745,729
Year 12	18,745,729	562,372	824,812	(120,000)	-	-	20,012,913
Year 13	20,012,913	600,387	880,568	(120,000)	-	-	21,373,869
Year 14	21,373,869	641,216	940,450	(120,000)	-	-	22,835,535
Year 15	22,835,535	685,066	1,004,764	(120,000)	-	-	24,405,364
Year 16	24,405,364	732,161	1,073,836	(120,000)	-	-	26,091,361
Year 17	26,091,361	782,741	1,148,020	(120,000)	-	-	27,902,122
Year 18	27,902,122	837,064	1,227,693	(120,000)	-	-	29,846,879
Year 19	29,846,879	895,406	1,313,263	(120,000)	-	-	31,935,548
Year 20	31,935,548	958,066	1,405,164	(120,000)	-	(34,178,779)	-

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario B: 3.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	California	Texas
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		3.00%
FLP Valuation Discount		35.00%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

California Complex Trust

	Beginning of Year Financial Assets	Income	Growth	FLP Preferred Distributions	FLP Terminates	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	120,000	-	-	(55,973)	64,027
Year 2	64,027	1,921	2,817	120,000	-	-	(54,524)	134,241
Year 3	134,241	4,027	5,907	120,000	-	-	(54,782)	209,393
Year 4	209,393	6,282	9,213	120,000	-	-	(55,896)	288,992
Year 5	288,992	8,670	12,716	120,000	-	-	(57,532)	372,845
Year 6	372,845	11,185	16,405	120,000	-	-	(59,525)	460,911
Year 7	460,911	13,827	20,280	120,000	-	-	(61,789)	553,229
Year 8	553,229	16,597	24,342	120,000	-	-	(64,273)	649,896
Year 9	649,896	19,497	28,595	120,000	-	-	(66,946)	751,042
Year 10	751,042	22,531	33,046	120,000	-	-	(69,793)	856,827
Year 11	856,827	25,705	37,700	120,000	-	-	(72,802)	967,429
Year 12	967,429	29,023	42,567	120,000	-	-	(75,972)	1,083,048
Year 13	1,083,048	32,491	47,654	120,000	-	-	(79,299)	1,203,894
Year 14	1,203,894	36,117	52,971	120,000	-	-	(82,788)	1,330,194
Year 15	1,330,194	39,906	58,529	120,000	-	-	(86,441)	1,462,188
Year 16	1,462,188	43,866	64,336	120,000	-	-	(90,263)	1,600,127
Year 17	1,600,127	48,004	70,406	120,000	-	-	(94,260)	1,744,277
Year 18	1,744,277	52,328	76,748	120,000	-	-	(98,439)	1,894,915
Year 19	1,894,915	56,847	83,376	120,000	-	-	(102,807)	2,052,331
Year 20	2,052,331	61,570	90,303	120,000	4,000,000	-	(159,804)	6,164,400

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario B: 3.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		3.00%
FLP Valuation Discount		35.00%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Texas GST Tax Exempt Grantor Trust

	Beginning of Year Financial Assets	Income	Growth	FLP Growth Distributions	Asset Purchase Proceeds	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-
Year 4	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	16,800,472	-	-	16,800,472
Year 19	16,800,472	504,014	739,221	-	-	-	-	18,043,706
Year 20	18,043,706	541,311	793,923	-	-	-	-	19,378,941

Schedule 7
Gomer Gonetotexas
Hypothetical Technique #1 - Scenario B: 3.0% Preferred Coupon Taxed Pro-Rata; California Complex Trust Owns Preferred; Bequeaths Estate to Family (assumes $3.3mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Preferred Interest		$4,000,000
FLP Preferred Coupon		3.00%
FLP Valuation Discount		35.00%
Assumptions - Other:		
3rd Party Note Interest Rate		3.00%

Note Between Gomer Gonetotexas and 3rd Party Lender

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	-	-	-	-
Year 2	-	-	-	-
Year 3	-	-	-	-
Year 4	-	-	-	-
Year 5	-	-	-	-
Year 6	-	-	-	-
Year 7	-	-	-	-
Year 8	-	-	-	-
Year 9	-	-	-	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	16,800,472	504,014	(504,014)	16,800,472
Year 19	16,800,472	504,014	(504,014)	16,800,472
Year 20	16,800,472	504,014	(17,304,486)	-

Schedule 8

Gomer Gonetotexas

Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming Gomer Gonetotexas has a life expectancy of 20 years)

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	20-Year Future Values		Present Values (Discounted at 2.5%)	Percentage of Total
	Pre-Death	Post Death		
No Further Planning: Bequeaths Estate to Family (assumes $8.69mm inflation adjusted estate tax exemption available in 20 years)				
Gomer Gonetotexas	34,404,293	-	-	0.00%
Gonetotexas Children	-	15,428,576	9,415,611	15.42%
Gonetotexas Children and Grandchildren in California Complex Trust	9,609,259	9,609,259	5,864,252	9.60%
Gonetotexas Children and Grandchildren in Texas Grantor Trust	-	8,690,000	5,303,254	8.68%
Consumption - Direct Cost	12,772,329	12,772,329	7,794,581	12.76%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	13.04%
IRS & CA Income Tax - Direct Cost	3,894,601	3,894,601	2,376,762	3.89%
IRS & TX Income Tax - Direct Cost	11,640,362	11,640,362	7,103,775	11.63%
IRS & CA Income Tax - Investment Opportunity Cost	3,174,203	3,174,203	1,937,124	3.17%
IRS & TX Income Tax - Investment Opportunity Cost	11,520,158	11,520,158	7,030,417	11.51%
IRS Estate Tax (at 40.0%)	-	10,285,717	6,277,074	10.28%
Total	**$100,068,380**	**$100,068,380**	**$61,068,825**	**100.00%**
Hypothetical Technique: 10.0% Cumulative Preferred Coupon; California Complex Trust Owns Growth; Bequeaths Estate to Family (assumes $6.7mm inflation adjusted estate tax exemption available in 20 years)				
Gomer Gonetotexas	2,969,741	-	-	0.00%
Gonetotexas Children	-	-	-	0.00%
Gonetotexas Children and Grandchildren in California Complex Trust	4,000,000	4,000,000	2,441,084	4.00%
Gonetotexas Children and Grandchildren in Texas Grantor Trust	40,390,206	43,359,947	26,461,316	43.33%
Consumption - Direct Cost	12,772,329	12,772,329	7,794,581	12.76%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	13.04%
IRS & CA Income Tax - Direct Cost	-	-	-	0.00%
IRS & TX Income Tax - Direct Cost	15,967,067	15,967,067	9,744,237	15.96%
IRS & CA Income Tax - Investment Opportunity Cost	-	-	-	0.00%
IRS & TX Income Tax - Investment Opportunity Cost	14,173,982	14,173,982	8,649,969	14.16%
Opportunity Cost/(Benefit) of 3rd Party Note	(3,258,119)	(3,258,119)	(1,988,336)	-3.26%
IRS Estate Tax (at 40.0%)	-	-	-	0.00%
Total	**$100,068,380**	**$100,068,380**	**$61,068,825**	**100.00%**

Schedule 8
Gomer Gonetotexas
Asset Page

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	Gomer Gonetotexas	California Complex Trust
Assets* (assumed value and basis)		
FMV: Financial Assets	$20,000,000	$4,000,000
Basis: Financial Assets	$20,000,000	$4,000,000

* Information provided by client. There is no proposed planning for Mr. Gonetotexas' other assets.

Schedule 8
Gomer Gonetotexas
No Further Planning: Bequeaths Estate to Family (assumes $8.69mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%

Gomer Gonetotexas (Texas Residents)

	Beginning of Year Financial Assets	Income	Growth	Consumption	Income Taxes	End of Year Financial Assets
Year 1	20,000,000	600,000	880,000	(500,000)	(333,600)	20,646,400
Year 2	20,646,400	619,392	908,442	(512,500)	(390,582)	21,271,152
Year 3	21,271,152	638,135	935,931	(525,313)	(434,836)	21,885,068
Year 4	21,885,068	656,552	962,943	(538,445)	(470,203)	22,495,916
Year 5	22,495,916	674,877	989,820	(551,906)	(499,398)	23,109,309
Year 6	23,109,309	693,279	1,016,810	(565,704)	(524,345)	23,729,348
Year 7	23,729,348	711,880	1,044,091	(579,847)	(546,405)	24,359,068
Year 8	24,359,068	730,772	1,071,799	(594,343)	(566,544)	25,000,752
Year 9	25,000,752	750,023	1,100,033	(609,201)	(585,446)	25,656,160
Year 10	25,656,160	769,685	1,128,871	(624,431)	(603,600)	26,326,684
Year 11	26,326,684	789,801	1,158,374	(640,042)	(621,354)	27,013,463
Year 12	27,013,463	810,404	1,188,592	(656,043)	(638,956)	27,717,460
Year 13	27,717,460	831,524	1,219,568	(672,444)	(656,589)	28,439,519
Year 14	28,439,519	853,186	1,251,339	(689,256)	(674,381)	29,180,406
Year 15	29,180,406	875,412	1,283,938	(706,487)	(692,432)	29,940,838
Year 16	29,940,838	898,225	1,317,397	(724,149)	(710,812)	30,721,499
Year 17	30,721,499	921,645	1,351,746	(742,253)	(729,577)	31,523,060
Year 18	31,523,060	945,692	1,387,015	(760,809)	(748,771)	32,346,187
Year 19	32,346,187	970,386	1,423,232	(779,829)	(768,429)	33,191,546
Year 20	33,191,546	995,746	1,460,428	(799,325)	(444,103)	34,404,293

Schedule 8
Gomer Gonetotexas
No Further Planning: Bequeaths Estate to Family (assumes $8.69mm inflation adjusted estate tax exemption available in 20 years)

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Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%

California Complex Trust

	Beginning of Year Financial Assets	Income	Growth	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	4,000,000	120,000	176,000	-	(80,601)	4,215,399
Year 2	4,215,399	126,462	185,478	-	(97,151)	4,430,187
Year 3	4,430,187	132,906	194,928	-	(110,683)	4,647,339
Year 4	4,647,339	139,420	204,483	-	(122,157)	4,869,085
Year 5	4,869,085	146,073	214,240	-	(132,256)	5,097,141
Year 6	5,097,141	152,914	224,274	-	(141,471)	5,332,858
Year 7	5,332,858	159,986	234,646	-	(150,150)	5,577,340
Year 8	5,577,340	167,320	245,403	-	(158,546)	5,831,517
Year 9	5,831,517	174,946	256,587	-	(166,843)	6,096,206
Year 10	6,096,206	182,886	268,233	-	(175,175)	6,372,150
Year 11	6,372,150	191,164	280,375	-	(183,643)	6,660,046
Year 12	6,660,046	199,801	293,042	-	(192,321)	6,960,569
Year 13	6,960,569	208,817	306,265	-	(201,269)	7,274,382
Year 14	7,274,382	218,231	320,073	-	(210,535)	7,602,151
Year 15	7,602,151	228,065	334,495	-	(220,157)	7,944,554
Year 16	7,944,554	238,337	349,560	-	(230,169)	8,302,282
Year 17	8,302,282	249,068	365,300	-	(240,601)	8,676,050
Year 18	8,676,050	260,281	381,746	-	(251,481)	9,066,596
Year 19	9,066,596	271,998	398,930	-	(262,836)	9,474,689
Year 20	9,474,689	284,241	416,886	-	(566,556)	9,609,259

Schedule 8

Gomer Gonetotexas

Hypothetical Technique: 10.0% Cumulative Preferred Coupon; California Complex Trust Owns Growth; Bequeaths Estate to Family (assumes $6.7mm inflation adjusted estate tax exemption available in 20 years)

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Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	California	Texas
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Cumulative Preferred Interest		$20,000,000
FLP Cumulative Preferred Coupon		10.0%
Assumptions - Other:		
Intra-Family Interest Rate (mid-term) - February 2015		1.70%
3rd Party Note Interest Rate		3.00%

Gomer Gonetotexas (Texas Resident)

	Beginning of Year Financial Assets	Income	Growth	FLP Preferred Distributions	Note Payments from TX Trust	FLP Terminates	Note Payments to 3rd Party	Consumption	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	-	900,320	-	-	(500,000)	(400,320)	-
Year 2	-	-	-	-	982,866	-	-	(512,500)	(470,366)	-
Year 3	-	-	-	-	1,050,820	-	-	(525,313)	(525,508)	-
Year 4	-	-	-	-	1,108,752	-	-	(538,445)	(570,307)	-
Year 5	-	-	-	-	1,159,902	-	-	(551,906)	(607,996)	-
Year 6	-	-	-	-	1,206,569	-	-	(565,704)	(640,865)	-
Year 7	-	-	-	-	1,250,388	-	-	(579,847)	(670,542)	-
Year 8	-	-	-	-	1,292,525	-	-	(594,343)	(698,183)	-
Year 9	-	-	-	-	1,333,816	-	-	(609,201)	(724,615)	-
Year 10	-	-	-	-	1,374,862	-	-	(624,431)	(750,430)	-
Year 11	-	-	-	-	1,416,100	-	-	(640,042)	(776,058)	-
Year 12	-	-	-	-	7,648,299	-	-	(656,043)	(801,810)	6,190,446
Year 13	6,190,446	185,713	272,380	-	-	-	-	(672,444)	(827,916)	5,148,179
Year 14	5,148,179	154,445	226,520	-	-	-	-	(689,256)	(854,551)	3,985,337
Year 15	3,985,337	119,560	175,355	-	-	-	-	(706,487)	(881,848)	2,691,917
Year 16	2,691,917	80,758	118,444	-	-	-	-	(724,149)	(909,913)	1,257,057
Year 17	1,257,057	37,712	55,311	1,972,960	-	-	(340,000)	(742,253)	(787,192)	1,453,594
Year 18	1,453,594	43,608	63,958	1,974,639	-	-	(340,000)	(760,809)	(1,147,498)	1,287,493
Year 19	1,287,493	38,625	56,650	1,975,866	-	-	(340,000)	(779,829)	(1,239,904)	998,900
Year 20	998,900	29,967	43,952	4,717,493	-	20,000,000	(20,340,000)	(799,325)	(1,681,246)	2,969,741

Schedule 8
Gomer Gonetotexas
Hypothetical Technique: 10.0% Cumulative Preferred Coupon; California Complex Trust Owns Growth; Bequeaths Estate to Family (assumes $6.7mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Cumulative Preferred Interest		$20,000,000
FLP Cumulative Preferred Coupon		10.0%
Assumptions - Other:		
Intra-Family Interest Rate (mid-term) - February 2015		1.70%
3rd Party Note Interest Rate		3.00%

Family Limited Partnership

	Beginning of Year Financial Assets	**Income**	**Growth**	**Preferred Distributions**	**Growth Distributions**	**FLP Terminates**	**End of Year Financial Assets**
Year 1	24,000,000	720,000	1,056,000	(1,036,800)	-	-	24,739,200
Year 2	24,739,200	742,176	1,088,525	(1,290,493)	-	-	25,279,407
Year 3	25,279,407	758,382	1,112,294	(1,475,893)	-	-	25,674,191
Year 4	25,674,191	770,226	1,129,664	(1,611,382)	-	-	25,962,699
Year 5	25,962,699	778,881	1,142,359	(1,710,398)	-	-	26,173,540
Year 6	26,173,540	785,206	1,151,636	(1,782,759)	-	-	26,327,623
Year 7	26,327,623	789,829	1,158,415	(1,835,640)	-	-	26,440,227
Year 8	26,440,227	793,207	1,163,370	(1,874,286)	-	-	26,522,518
Year 9	26,522,518	795,676	1,166,991	(1,902,528)	-	-	26,582,656
Year 10	26,582,656	797,480	1,169,637	(1,923,168)	-	-	26,626,605
Year 11	26,626,605	798,798	1,171,571	(1,938,251)	-	-	26,658,723
Year 12	26,658,723	799,762	1,172,984	(1,949,274)	-	-	26,682,195
Year 13	26,682,195	800,466	1,174,017	(1,957,329)	-	-	26,699,348
Year 14	26,699,348	800,980	1,174,771	(1,963,216)	-	-	26,711,883
Year 15	26,711,883	801,357	1,175,323	(1,967,518)	-	-	26,721,044
Year 16	26,721,044	801,631	1,175,726	(1,970,662)	-	-	26,727,739
Year 17	26,727,739	801,832	1,176,021	(1,972,960)	-	-	26,732,632
Year 18	26,732,632	801,979	1,176,236	(1,974,639)	-	-	26,736,207
Year 19	26,736,207	802,086	1,176,393	(1,975,866)	-	-	26,738,820
Year 20	26,738,820	802,165	1,176,508	(4,717,493)	-	(24,000,000)	-

Schedule 8
Gomer Gonetotexas
Hypothetical Technique: 10.0% Cumulative Preferred Coupon; California Complex Trust Owns Growth; Bequeaths Estate to Family (assumes $6.7mm inflation adjusted estate tax exemption available in 20 years)

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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Cumulative Preferred Interest		$20,000,000
FLP Cumulative Preferred Coupon		10.0%
Assumptions - Other:		
Intra-Family Interest Rate (mid-term) - February 2015		1.70%
3rd Party Note Interest Rate		3.00%

California Complex Trust

	Beginning of Year Financial Assets	**Income**	**Growth**	**FLP Growth Distributions**	**FLP Terminates**	**Beneficiary Distributions**	**Income Taxes**	**End of Year Financial Assets**
Year 1	-	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-	-
Year 4	-	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-	-
Year 11	-	-	-	-	-	-	-	-
Year 12	-	-	-	-	-	-	-	-
Year 13	-	-	-	-	-	-	-	-
Year 14	-	-	-	-	-	-	-	-
Year 15	-	-	-	-	-	-	-	-
Year 16	-	-	-	-	-	-	-	-
Year 17	-	-	-	-	-	-	-	-
Year 18	-	-	-	-	-	-	-	-
Year 19	-	-	-	-	-	-	-	-
Year 20	-	-	-	-	4,000,000	-	-	4,000,000

Schedule 8
Gomer Gonetotexas
Hypothetical Technique: 10.0% Cumulative Preferred Coupon; California Complex Trust Owns Growth; Bequeaths Estate to Family (assumes $6.7mm inflation adjusted estate tax exemption available in 20 years)

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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Cumulative Preferred Interest		$20,000,000
FLP Cumulative Preferred Coupon		10.0%
Assumptions - Other:		
Intra-Family Interest Rate (mid-term) - February 2015		1.70%
3rd Party Note Interest Rate		3.00%

Texas GST Tax Exempt Grantor Trust

	Beginning of Year Financial Assets	Income	Growth	FLP Preferred Distributions	Asset Purchase Proceeds	Note Payments	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	1,036,800	-	(900,320)	-	-	136,480
Year 2	136,480	4,094	6,005	1,290,493	-	(982,866)	-	-	454,207
Year 3	454,207	13,626	19,985	1,475,893	-	(1,050,820)	-	-	912,891
Year 4	912,891	27,387	40,167	1,611,382	-	(1,108,752)	-	-	1,483,075
Year 5	1,483,075	44,492	65,255	1,710,398	-	(1,159,902)	-	-	2,143,318
Year 6	2,143,318	64,300	94,306	1,782,759	-	(1,206,569)	-	-	2,878,114
Year 7	2,878,114	86,343	126,637	1,835,640	-	(1,250,388)	-	-	3,676,346
Year 8	3,676,346	110,290	161,759	1,874,286	-	(1,292,525)	-	-	4,530,156
Year 9	4,530,156	135,905	199,327	1,902,528	-	(1,333,816)	-	-	5,434,100
Year 10	5,434,100	163,023	239,100	1,923,168	-	(1,374,862)	-	-	6,384,529
Year 11	6,384,529	191,536	280,919	1,938,251	-	(1,416,100)	-	-	7,379,135
Year 12	7,379,135	221,374	324,682	1,949,274	-	(7,648,299)	-	-	2,226,165
Year 13	2,226,165	66,785	97,951	1,957,329	-	-	-	-	4,348,231
Year 14	4,348,231	130,447	191,322	1,963,216	-	-	-	-	6,633,216
Year 15	6,633,216	198,996	291,862	1,967,518	-	-	-	-	9,091,592
Year 16	9,091,592	272,748	400,030	1,970,662	-	-	-	-	11,735,033
Year 17	11,735,033	352,051	516,341	-	20,000,000	-	-	-	32,603,425
Year 18	32,603,425	978,103	1,434,551	-	-	-	-	-	35,016,078
Year 19	35,016,078	1,050,482	1,540,707	-	-	-	-	-	37,607,268
Year 20	37,607,268	1,128,218	1,654,720	-	-	-	-	-	40,390,206

Schedule 8

Gomer Gonetotexas

Hypothetical Technique: 10.0% Cumulative Preferred Coupon; California Complex Trust Owns Growth; Bequeaths Estate to Family (assumes $6.7mm inflation adjusted estate tax exemption available in 20 years)

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Assumptions:	
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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$500,000
Gift to Texas GST Tax Exempt Grantor Trust	$5,430,000

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%
Assumptions - Family Limited Partnership:		
FLP Cumulative Preferred Interest		$20,000,000
FLP Cumulative Preferred Coupon		10.0%
Assumptions - Other:		
Intra-Family Interest Rate (mid-term) - February 2015		1.70%
3rd Party Note Interest Rate		3.00%

Note Between Gomer Gonetotexas & Texas GST Tax Exempt Grantor Trust

	Beginning of Year Principal	**Interest**	**Note Payments**	**End of Year Principal**
Year 1	18,000,000	306,000	(900,320)	17,405,680
Year 2	17,405,680	295,897	(982,866)	16,718,710
Year 3	16,718,710	284,218	(1,050,820)	15,952,108
Year 4	15,952,108	271,186	(1,108,752)	15,114,542
Year 5	15,114,542	256,947	(1,159,902)	14,211,587
Year 6	14,211,587	241,597	(1,206,569)	13,246,615
Year 7	13,246,615	225,192	(1,250,388)	12,221,419
Year 8	12,221,419	207,764	(1,292,525)	11,136,658
Year 9	11,136,658	189,323	(1,333,816)	9,992,165
Year 10	9,992,165	169,867	(1,374,862)	8,787,170
Year 11	8,787,170	149,382	(1,416,100)	7,520,452
Year 12	7,520,452	127,848	(7,648,299)	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	-	-	-	-
Year 19	-	-	-	-
Year 20	-	-	-	-

Note Between Gomer Gonetotexas & 3rd Party Lender

	Beginning of Year Principal	**Interest**	**Note Payments**	**End of Year Principal**
Year 1	-	-	-	-
Year 2	-	-	-	-
Year 3	-	-	-	-
Year 4	-	-	-	-
Year 5	-	-	-	-
Year 6	-	-	-	-
Year 7	-	-	-	-
Year 8	-	-	-	-
Year 9	-	-	-	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	20,000,000	340,000	(340,000)	20,000,000
Year 18	20,000,000	340,000	(340,000)	20,000,000
Year 19	20,000,000	340,000	(340,000)	20,000,000
Year 20	20,000,000	340,000	(20,340,000)	-

Schedule 8
Gomer Gonetotexas
Texas Complex Trust versus California Complex Trust

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Assumptions:	
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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$0

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%

Texas Complex Trust

	Beginning of Year Financial Assets	Income	Growth	Consumption	Income Taxes	End of Year Financial Assets
Year 1	4,000,000	120,000	176,000	-	(66,720)	4,229,280
Year 2	4,229,280	126,878	186,088	-	(79,784)	4,462,462
Year 3	4,462,462	133,874	196,348	-	(90,672)	4,702,013
Year 4	4,702,013	141,060	206,889	-	(100,104)	4,949,858
Year 5	4,949,858	148,496	217,794	-	(108,598)	5,207,550
Year 6	5,207,550	156,226	229,132	-	(116,520)	5,476,389
Year 7	5,476,389	164,292	240,961	-	(124,136)	5,757,505
Year 8	5,757,505	172,725	253,330	-	(131,639)	6,051,922
Year 9	6,051,922	181,558	266,285	-	(139,168)	6,360,596
Year 10	6,360,596	190,818	279,866	-	(146,830)	6,684,450
Year 11	6,684,450	200,533	294,116	-	(154,704)	7,024,395
Year 12	7,024,395	210,732	309,073	-	(162,853)	7,381,346
Year 13	7,381,346	221,440	324,779	-	(171,328)	7,756,238
Year 14	7,756,238	232,687	341,274	-	(180,170)	8,150,030
Year 15	8,150,030	244,501	358,601	-	(189,416)	8,563,716
Year 16	8,563,716	256,911	376,803	-	(199,101)	8,998,330
Year 17	8,998,330	269,950	395,927	-	(209,255)	9,454,951
Year 18	9,454,951	283,649	416,018	-	(219,909)	9,934,708
Year 19	9,934,708	298,041	437,127	-	(231,092)	10,438,785
Year 20	10,438,785	313,164	459,307	-	(483,551)	10,727,704
				Total Tax	**3,305,551**	
				Opp. Cost	**2,644,809**	
				Total	**5,950,359**	

Schedule 8

Gomer Gonetotexas

Texas Complex Trust versus California Complex Trust

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$0

Assumptions - Income Taxes:	**California**	**Texas**
Long-Term Capital Gains and Health Care Tax Rate	33.03%	25.00%
Ordinary Income and Health Care Tax Rate	52.63%	44.60%

California Complex Trust

	Beginning of Year Financial Assets	**Income**	**Growth**	**Beneficiary Distributions**	**Income Taxes**	**End of Year Financial Assets**
Year 1	4,000,000	120,000	176,000	-	(80,601)	4,215,399
Year 2	4,215,399	126,462	185,478	-	(97,151)	4,430,187
Year 3	4,430,187	132,906	194,928	-	(110,683)	4,647,339
Year 4	4,647,339	139,420	204,483	-	(122,157)	4,869,085
Year 5	4,869,085	146,073	214,240	-	(132,256)	5,097,141
Year 6	5,097,141	152,914	224,274	-	(141,471)	5,332,858
Year 7	5,332,858	159,986	234,646	-	(150,150)	5,577,340
Year 8	5,577,340	167,320	245,403	-	(158,546)	5,831,517
Year 9	5,831,517	174,946	256,587	-	(166,843)	6,096,206
Year 10	6,096,206	182,886	268,233	-	(175,175)	6,372,150
Year 11	6,372,150	191,164	280,375	-	(183,643)	6,660,046
Year 12	6,660,046	199,801	293,042	-	(192,321)	6,960,569
Year 13	6,960,569	208,817	306,265	-	(201,269)	7,274,382
Year 14	7,274,382	218,231	320,073	-	(210,535)	7,602,151
Year 15	7,602,151	228,065	334,495	-	(220,157)	7,944,554
Year 16	7,944,554	238,337	349,560	-	(230,169)	8,302,282
Year 17	8,302,282	249,068	365,300	-	(240,601)	8,676,050
Year 18	8,676,050	260,281	381,746	-	(251,481)	9,066,596
Year 19	9,066,596	271,998	398,930	-	(262,836)	9,474,689
Year 20	9,474,689	284,241	416,886	-	(566,556)	9,609,259
				Total Tax	**3,894,601**	
				Opp. Cost	**3,174,203**	
				Total	**7,068,804**	

Difference **1,118,445**

Schedule 8
Gomer Gonetotexas
Individual with Stepup at Death versus No Stepup at Death

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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$0

Assumptions - Income Taxes:	Texas
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%

Individual with Stepup at Death

	Beginning of Year Financial Assets	Income	Growth	Consumption	Income Taxes	End of Year Financial Assets
Year 1	20,000,000	600,000	880,000	-	(333,600)	21,146,400
Year 2	21,146,400	634,392	930,442	-	(398,922)	22,312,312
Year 3	22,312,312	669,369	981,742	-	(453,358)	23,510,065
Year 4	23,510,065	705,302	1,034,443	-	(500,521)	24,749,289
Year 5	24,749,289	742,479	1,088,969	-	(542,988)	26,037,749
Year 6	26,037,749	781,132	1,145,661	-	(582,599)	27,381,943
Year 7	27,381,943	821,458	1,204,805	-	(620,681)	28,787,526
Year 8	28,787,526	863,626	1,266,651	-	(658,193)	30,259,610
Year 9	30,259,610	907,788	1,331,423	-	(695,842)	31,802,980
Year 10	31,802,980	954,089	1,399,331	-	(734,151)	33,422,249
Year 11	33,422,249	1,002,667	1,470,579	-	(773,522)	35,121,973
Year 12	35,121,973	1,053,659	1,545,367	-	(814,267)	36,906,732
Year 13	36,906,732	1,107,202	1,623,896	-	(856,639)	38,781,191
Year 14	38,781,191	1,163,436	1,706,372	-	(900,849)	40,750,150
Year 15	40,750,150	1,222,504	1,793,007	-	(947,082)	42,818,579
Year 16	42,818,579	1,284,557	1,884,017	-	(995,506)	44,991,648
Year 17	44,991,648	1,349,749	1,979,633	-	(1,046,276)	47,274,754
Year 18	47,274,754	1,418,243	2,080,089	-	(1,099,544)	49,673,542
Year 19	49,673,542	1,490,206	2,185,636	-	(1,155,460)	52,193,923
Year 20	52,193,923	1,565,818	2,296,533	-	(698,355)	55,357,919
				Total Tax	**14,808,354**	
				Opp. Cost	**13,224,043**	
				Total	**28,032,398**	

Schedule 8
Gomer Gonetotexas
Individual with Stepup at Death versus No Stepup at Death

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Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Annual Consumption (increasing 2.5% per year)	$0

Assumptions - Income Taxes:	Texas
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%

Individual without Stepup at Death

	Beginning of Year Financial Assets	Income	Growth	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	20,000,000	600,000	880,000	-	(333,600)	21,146,400
Year 2	21,146,400	634,392	930,442	-	(398,922)	22,312,312
Year 3	22,312,312	669,369	981,742	-	(453,358)	23,510,065
Year 4	23,510,065	705,302	1,034,443	-	(500,521)	24,749,289
Year 5	24,749,289	742,479	1,088,969	-	(542,988)	26,037,749
Year 6	26,037,749	781,132	1,145,661	-	(582,599)	27,381,943
Year 7	27,381,943	821,458	1,204,805	-	(620,681)	28,787,526
Year 8	28,787,526	863,626	1,266,651	-	(658,193)	30,259,610
Year 9	30,259,610	907,788	1,331,423	-	(695,842)	31,802,980
Year 10	31,802,980	954,089	1,399,331	-	(734,151)	33,422,249
Year 11	33,422,249	1,002,667	1,470,579	-	(773,522)	35,121,973
Year 12	35,121,973	1,053,659	1,545,367	-	(814,267)	36,906,732
Year 13	36,906,732	1,107,202	1,623,896	-	(856,639)	38,781,191
Year 14	38,781,191	1,163,436	1,706,372	-	(900,849)	40,750,150
Year 15	40,750,150	1,222,504	1,793,007	-	(947,082)	42,818,579
Year 16	42,818,579	1,284,557	1,884,017	-	(995,506)	44,991,648
Year 17	44,991,648	1,349,749	1,979,633	-	(1,046,276)	47,274,754
Year 18	47,274,754	1,418,243	2,080,089	-	(1,099,544)	49,673,542
Year 19	49,673,542	1,490,206	2,185,636	-	(1,155,460)	52,193,923
Year 20	52,193,923	1,565,818	2,296,533	-	(2,417,754)	53,638,520

Total Tax	**16,527,753**		
Opp. Cost	**13,224,043**		
Total	**29,751,797**	**Difference**	**1,719,399**

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

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Assumptions:	
Total Rate of Return	3.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	1.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Elder FLP Valuation Discount	40.00%
Gross Proceeds	$30,000,000

	Future Values at the End of 20 Years of Annual Compounded Growth at 3%						
	Elder Children's Future Values	Elder GST Exempt Trust Future Values	Charity	IRS Income Taxes	IRS Income Taxes & Estate Taxes Investment Opp. Costs	IRS Estate Taxes	Totals
No Further Planning - No Discount Allowed	18,333,733	15,073,672	-	5,253,849	7,522,083	8,000,000	54,183,337
No Further Planning - Discount Allowed	23,059,178	15,073,672	-	5,956,415	5,294,072	4,800,000	54,183,337
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
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

No Further Planning - No Discount Allowed		
Elder Children	18,333,733	33.84%
Elder GST Exempt Trust	15,073,672	27.82%
Charity	-	0.00%
IRS (income and estate taxes)	13,253,849	24.46%
IRS (investment opportunity costs)	7,522,083	13.88%
Total	**54,183,337**	**100.00%**

No Further Planning - Discount Allowed		
Elder Children	23,059,178	42.56%
Elder GST Exempt Trust	15,073,672	27.82%
Charity	-	0.00%
IRS (income and estate taxes)	10,756,415	19.85%
IRS (investment opportunity costs)	5,294,072	9.77%
Total	**54,183,337**	**100.00%**

CLAT Redemption - Discount Allowed - $3mm to Family		
Elder Children	16,818,670	31.04%
Elder GST Exempt Trust	17,096,849	31.55%
Charity	16,083,531	29.68%
IRS (income and estate taxes)	2,947,005	5.44%
IRS (investment opportunity costs)	1,237,281	2.28%
Total	**54,183,337**	**100.00%**

CLAT Redemption - Discount Allowed - $10mm to Family		
Elder Children	22,778,999	42.04%
Elder GST Exempt Trust	14,337,710	26.46%
Charity	4,355,956	8.04%
IRS (income and estate taxes)	8,501,200	15.69%
IRS (investment opportunity costs)	4,209,472	7.77%
Total	**54,183,337**	**100.00%**

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

No Further Planning - No Discount Allowed

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Rate of Return on Assets That Are Taxable at Ordinary Rate	1.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%

Elder Children

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	20,000,000	200,000	400,000	(119,200)	(8,000,000)	12,480,800
Year 2	12,480,800	124,808	249,616	(95,386)	-	12,759,838
Year 3	12,759,838	127,598	255,197	(103,853)	-	13,038,780
Year 4	13,038,780	130,388	260,776	(110,572)	-	13,319,371
Year 5	13,319,371	133,194	266,387	(116,077)	-	13,602,875
Year 6	13,602,875	136,029	272,058	(120,744)	-	13,890,218
Year 7	13,890,218	138,902	277,804	(124,838)	-	14,182,086
Year 8	14,182,086	141,821	283,642	(128,547)	-	14,479,002
Year 9	14,479,002	144,790	289,580	(132,001)	-	14,781,370
Year 10	14,781,370	147,814	295,627	(135,294)	-	15,089,517
Year 11	15,089,517	150,895	301,790	(138,492)	-	15,403,711
Year 12	15,403,711	154,037	308,074	(141,641)	-	15,724,181
Year 13	15,724,181	157,242	314,484	(144,775)	-	16,051,132
Year 14	16,051,132	160,511	321,023	(147,916)	-	16,384,750
Year 15	16,384,750	163,847	327,695	(151,083)	-	16,725,210
Year 16	16,725,210	167,252	334,504	(154,287)	-	17,072,679
Year 17	17,072,679	170,727	341,454	(157,538)	-	17,427,321
Year 18	17,427,321	174,273	348,546	(160,842)	-	17,789,299
Year 19	17,789,299	177,893	355,786	(164,206)	-	18,158,772
Year 20	18,158,772	181,588	363,175	(369,802)	-	18,333,733

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

No Further Planning - No Discount Allowed

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Total Rate of Return	3.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	1.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%

Elder GST Trust

	Beginning of Year	Income	Growth	Taxes on Investment Income	End of Year
Year 1	10,000,000	100,000	200,000	(59,600)	10,240,400
Year 2	10,240,400	102,404	204,808	(71,533)	10,476,079
Year 3	10,476,079	104,761	209,522	(80,540)	10,709,822
Year 4	10,709,822	107,098	214,196	(87,502)	10,943,614
Year 5	10,943,614	109,436	218,872	(93,039)	11,178,883
Year 6	11,178,883	111,789	223,578	(97,588)	11,416,662
Year 7	11,416,662	114,167	228,333	(101,454)	11,657,708
Year 8	11,657,708	116,577	233,154	(104,855)	11,902,584
Year 9	11,902,584	119,026	238,052	(107,943)	12,151,719
Year 10	12,151,719	121,517	243,034	(110,824)	12,405,446
Year 11	12,405,446	124,054	248,109	(113,576)	12,664,034
Year 12	12,664,034	126,640	253,281	(116,251)	12,927,704
Year 13	12,927,704	129,277	258,554	(118,888)	13,196,648
Year 14	13,196,648	131,966	263,933	(121,513)	13,471,034
Year 15	13,471,034	134,710	269,421	(124,147)	13,751,018
Year 16	13,751,018	137,510	275,020	(126,802)	14,036,747
Year 17	14,036,747	140,367	280,735	(129,490)	14,328,359
Year 18	14,328,359	143,284	286,567	(132,217)	14,625,993
Year 19	14,625,993	146,260	292,520	(134,990)	14,929,783
Year 20	14,929,783	149,298	298,596	(304,004)	15,073,672

Schedule 9
Elder Family - 3.00% Rate of Return, 20 Years
No Further Planning - Discount Allowed

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Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%
Elder FLP Valuation Discount	40.00%

Elder Children

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	20,000,000	200,000	400,000	(119,200)	(4,800,000)	15,680,800
Year 2	15,680,800	156,808	313,616	(114,458)	-	16,036,766
Year 3	16,036,766	160,368	320,735	(126,744)	-	16,391,125
Year 4	16,391,125	163,911	327,823	(136,345)	-	16,746,514
Year 5	16,746,514	167,465	334,930	(144,078)	-	17,104,832
Year 6	17,104,832	171,048	342,097	(150,517)	-	17,467,460
Year 7	17,467,460	174,675	349,349	(156,066)	-	17,835,418
Year 8	17,835,418	178,354	356,708	(161,012)	-	18,209,468
Year 9	18,209,468	182,095	364,189	(165,555)	-	18,590,197
Year 10	18,590,197	185,902	371,804	(169,836)	-	18,978,067
Year 11	18,978,067	189,781	379,561	(173,956)	-	19,373,453
Year 12	19,373,453	193,735	387,469	(177,985)	-	19,776,672
Year 13	19,776,672	197,767	395,533	(181,975)	-	20,187,997
Year 14	20,187,997	201,880	403,760	(185,960)	-	20,607,677
Year 15	20,607,677	206,077	412,154	(189,967)	-	21,035,940
Year 16	21,035,940	210,359	420,719	(194,014)	-	21,473,005
Year 17	21,473,005	214,730	429,460	(198,115)	-	21,919,080
Year 18	21,919,080	219,191	438,382	(202,279)	-	22,374,374
Year 19	22,374,374	223,744	447,487	(206,515)	-	22,839,089
Year 20	22,839,089	228,391	456,782	(465,084)	-	23,059,178

Schedule 9
Elder Family - 3.00% Rate of Return, 20 Years
No Further Planning - Discount Allowed

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%
Elder FLP Valuation Discount	40.00%

Elder GST Exempt Trust

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	10,000,000	100,000	200,000	(59,600)	-	10,240,400
Year 2	10,240,400	102,404	204,808	(71,533)	-	10,476,079
Year 3	10,476,079	104,761	209,522	(80,540)	-	10,709,822
Year 4	10,709,822	107,098	214,196	(87,502)	-	10,943,614
Year 5	10,943,614	109,436	218,872	(93,039)	-	11,178,883
Year 6	11,178,883	111,789	223,578	(97,588)	-	11,416,662
Year 7	11,416,662	114,167	228,333	(101,454)	-	11,657,708
Year 8	11,657,708	116,577	233,154	(104,855)	-	11,902,584
Year 9	11,902,584	119,026	238,052	(107,943)	-	12,151,719
Year 10	12,151,719	121,517	243,034	(110,824)	-	12,405,446
Year 11	12,405,446	124,054	248,109	(113,576)	-	12,664,034
Year 12	12,664,034	126,640	253,281	(116,251)	-	12,927,704
Year 13	12,927,704	129,277	258,554	(118,888)	-	13,196,648
Year 14	13,196,648	131,966	263,933	(121,513)	-	13,471,034
Year 15	13,471,034	134,710	269,421	(124,147)	-	13,751,018
Year 16	13,751,018	137,510	275,020	(126,802)	-	14,036,747
Year 17	14,036,747	140,367	280,735	(129,490)	-	14,328,359
Year 18	14,328,359	143,284	286,567	(132,217)	-	14,625,993
Year 19	14,625,993	146,260	292,520	(134,990)	-	14,929,783
Year 20	14,929,783	149,298	298,596	(304,004)	-	15,073,672

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder FLP

	Beg. of Year	Income	Growth	Distribution Income Taxes	Distribution Estate Taxes	Note Payment to CLAT	End of Year
Year 1	30,000,000	300,000	600,000	-	(1,200,000)	(598,560)	29,101,440
Year 2	29,101,440	291,014	582,029	-	-	(598,560)	29,375,923
Year 3	29,375,923	293,759	587,518	(20,470)	-	(598,560)	29,638,171
Year 4	29,638,171	296,382	592,763	(36,582)	-	(598,560)	29,892,174
Year 5	29,892,174	298,922	597,843	(48,417)	-	(598,560)	30,141,962
Year 6	30,141,962	301,420	602,839	(57,257)	-	(598,560)	30,390,404
Year 7	30,390,404	303,904	607,808	(64,001)	-	(598,560)	30,639,555
Year 8	30,639,555	306,396	612,791	(69,284)	-	(598,560)	30,890,898
Year 9	30,890,898	308,909	617,818	(73,551)	-	(598,560)	31,145,514
Year 10	31,145,514	311,455	622,910	(77,117)	-	(598,560)	31,404,203
Year 11	31,404,203	314,042	628,084	(80,202)	-	(598,560)	31,667,568
Year 12	31,667,568	316,676	633,351	(82,962)	-	(598,560)	31,936,072
Year 13	31,936,072	319,361	638,721	(85,508)	-	(598,560)	32,210,087
Year 14	32,210,087	322,101	644,202	(87,916)	-	(598,560)	32,489,914
Year 15	32,489,914	324,899	649,798	(90,241)	-	(598,560)	32,775,811
Year 16	32,775,811	327,758	655,516	(92,522)	-	(598,560)	33,068,003
Year 17	33,068,003	330,680	661,360	(94,788)	-	(598,560)	33,366,695
Year 18	33,366,695	333,667	667,334	(97,057)	-	(598,560)	33,672,078
Year 19	33,672,078	336,721	673,442	(99,345)	-	(598,560)	33,984,335
Year 20	33,984,335	339,843	679,687	(489,787)	-	(10,198,560)	24,315,519

Ownership		
Elder Children	CLAT	Elder GST Exempt Trust
16.67%	53.33%	30.00%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%

Schedule 9
Elder Family - 3.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $3mm to Family

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder Children

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Distrib. from Elder FLP Estate Taxes	Distrib. from CLAT	Income Taxes	Estate Taxes	End of Year
Year 1	-	-	-	-	1,200,000	-	-	(1,200,000)	-
Year 2	-	-	-	-	-	-	-	-	-
Year 3	-	-	-	6,077	-	-	(6,077)	-	-
Year 4	-	-	-	10,860	-	-	(10,860)	-	-
Year 5	-	-	-	14,374	-	-	(14,374)	-	-
Year 6	-	-	-	16,998	-	-	(16,998)	-	-
Year 7	-	-	-	19,000	-	-	(19,000)	-	-
Year 8	-	-	-	20,569	-	-	(20,569)	-	-
Year 9	-	-	-	21,835	-	-	(21,835)	-	-
Year 10	-	-	-	22,894	-	-	(22,894)	-	-
Year 11	-	-	-	23,810	-	-	(23,810)	-	-
Year 12	-	-	-	24,629	-	-	(24,629)	-	-
Year 13	-	-	-	25,385	-	-	(25,385)	-	-
Year 14	-	-	-	26,100	-	-	(26,100)	-	-
Year 15	-	-	-	26,790	-	-	(26,790)	-	-
Year 16	-	-	-	27,468	-	-	(27,468)	-	-
Year 17	-	-	-	28,140	-	-	(28,140)	-	-
Year 18	-	-	-	28,814	-	-	(28,814)	-	-
Year 19	-	-	-	29,493	-	-	(29,493)	-	-
Year 20	-	-	-	145,405	-	9,600,000	(145,405)	-	9,600,000

Schedule 9
Elder Family - 3.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions:	
Total Rate of Return	3.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	1.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder GST Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Beneficiary Distributions	Income Taxes	End of Year
Year 1	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-
Year 3	-	-	-	14,393	-	(14,393)	-
Year 4	-	-	-	25,722	-	(25,722)	-
Year 5	-	-	-	34,043	-	(34,043)	-
Year 6	-	-	-	40,259	-	(40,259)	-
Year 7	-	-	-	45,001	-	(45,001)	-
Year 8	-	-	-	48,715	-	(48,715)	-
Year 9	-	-	-	51,715	-	(51,715)	-
Year 10	-	-	-	54,223	-	(54,223)	-
Year 11	-	-	-	56,392	-	(56,392)	-
Year 12	-	-	-	58,333	-	(58,333)	-
Year 13	-	-	-	60,123	-	(60,123)	-
Year 14	-	-	-	61,816	-	(61,816)	-
Year 15	-	-	-	63,451	-	(63,451)	-
Year 16	-	-	-	65,055	-	(65,055)	-
Year 17	-	-	-	66,648	-	(66,648)	-
Year 18	-	-	-	68,244	-	(68,244)	-
Year 19	-	-	-	69,852	-	(69,852)	-
Year 20	-	-	-	344,381	-	(344,381)	-

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions (continued):	
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IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Charitable Lead Annuity Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP - Income Taxes	Note Payment Received	Annuity Payment to Charity	Income Taxes	Distrib. to Elder Family Remaindermen	End of Year
Year 1	-	-	-	-	598,560	(598,560)	-	-	-
Year 2	-	-	-	-	598,560	(598,560)	-	-	-
Year 3	-	-	-	-	598,560	(598,560)	-	-	-
Year 4	-	-	-	-	598,560	(598,560)	-	-	-
Year 5	-	-	-	-	598,560	(598,560)	-	-	-
Year 6	-	-	-	-	598,560	(598,560)	-	-	-
Year 7	-	-	-	-	598,560	(598,560)	-	-	-
Year 8	-	-	-	-	598,560	(598,560)	-	-	-
Year 9	-	-	-	-	598,560	(598,560)	-	-	-
Year 10	-	-	-	-	598,560	(598,560)	-	-	-
Year 11	-	-	-	-	598,560	(598,560)	-	-	-
Year 12	-	-	-	-	598,560	(598,560)	-	-	-
Year 13	-	-	-	-	598,560	(598,560)	-	-	-
Year 14	-	-	-	-	598,560	(598,560)	-	-	-
Year 15	-	-	-	-	598,560	(598,560)	-	-	-
Year 16	-	-	-	-	598,560	(598,560)	-	-	-
Year 17	-	-	-	-	598,560	(598,560)	-	-	-
Year 18	-	-	-	-	598,560	(598,560)	-	-	-
Year 19	-	-	-	-	598,560	(598,560)	-	-	-
Year 20	-	-	-	-	10,198,560	(598,560)	-	(9,600,000)	-

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Charity

	Beg. of Year	Income	Growth	Annuity Payment Received	End of Year
Year 1	-	-	-	598,560	598,560
Year 2	598,560	5,986	11,971	598,560	1,215,077
Year 3	1,215,077	12,151	24,302	598,560	1,850,089
Year 4	1,850,089	18,501	37,002	598,560	2,504,152
Year 5	2,504,152	25,042	50,083	598,560	3,177,836
Year 6	3,177,836	31,778	63,557	598,560	3,871,731
Year 7	3,871,731	38,717	77,435	598,560	4,586,443
Year 8	4,586,443	45,864	91,729	598,560	5,322,597
Year 9	5,322,597	53,226	106,452	598,560	6,080,835
Year 10	6,080,835	60,808	121,617	598,560	6,861,820
Year 11	6,861,820	68,618	137,236	598,560	7,666,234
Year 12	7,666,234	76,662	153,325	598,560	8,494,781
Year 13	8,494,781	84,948	169,896	598,560	9,348,185
Year 14	9,348,185	93,482	186,964	598,560	10,227,190
Year 15	10,227,190	102,272	204,544	598,560	11,132,566
Year 16	11,132,566	111,326	222,651	598,560	12,065,103
Year 17	12,065,103	120,651	241,302	598,560	13,025,616
Year 18	13,025,616	130,256	260,512	598,560	14,014,944
Year 19	14,014,944	140,149	280,299	598,560	15,033,953
Year 20	15,033,953	150,340	300,679	598,560	16,083,531

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Note Between Elder FLP and CLAT

	Beg. Balance	Interest	Payment	End of Year Balance
Year 1	9,600,000	598,560	(598,560)	9,600,000
Year 2	9,600,000	598,560	(598,560)	9,600,000
Year 3	9,600,000	598,560	(598,560)	9,600,000
Year 4	9,600,000	598,560	(598,560)	9,600,000
Year 5	9,600,000	598,560	(598,560)	9,600,000
Year 6	9,600,000	598,560	(598,560)	9,600,000
Year 7	9,600,000	598,560	(598,560)	9,600,000
Year 8	9,600,000	598,560	(598,560)	9,600,000
Year 9	9,600,000	598,560	(598,560)	9,600,000
Year 10	9,600,000	598,560	(598,560)	9,600,000
Year 11	9,600,000	598,560	(598,560)	9,600,000
Year 12	9,600,000	598,560	(598,560)	9,600,000
Year 13	9,600,000	598,560	(598,560)	9,600,000
Year 14	9,600,000	598,560	(598,560)	9,600,000
Year 15	9,600,000	598,560	(598,560)	9,600,000
Year 16	9,600,000	598,560	(598,560)	9,600,000
Year 17	9,600,000	598,560	(598,560)	9,600,000
Year 18	9,600,000	598,560	(598,560)	9,600,000
Year 19	9,600,000	598,560	(598,560)	9,600,000
Year 20	9,600,000	598,560	(10,198,560)	-

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder FLP

	Beg. of Year	Income	Growth	Distribution Income Taxes	Distribution Estate Taxes	Note Payment to CLAT	End of Year	Ownership: Elder Children	Ownership: CLAT	Ownership: Elder GST Exempt Trust
Year 1	30,000,000	300,000	600,000	(106,499)	(4,000,000)	(162,110)	26,631,391	55.56%	14.44%	30.00%
Year 2	26,631,391	266,314	532,628	(117,922)	-	(162,110)	27,150,301	58.46%	0.00%	41.54%
Year 3	27,150,301	271,503	543,006	(139,528)	-	(162,110)	27,663,172	58.46%	0.00%	41.54%
Year 4	27,663,172	276,632	553,263	(156,088)	-	(162,110)	28,174,869	58.46%	0.00%	41.54%
Year 5	28,174,869	281,749	563,497	(169,129)	-	(162,110)	28,688,876	58.46%	0.00%	41.54%
Year 6	28,688,876	286,889	573,778	(179,724)	-	(162,110)	29,207,708	58.46%	0.00%	41.54%
Year 7	29,207,708	292,077	584,154	(188,628)	-	(162,110)	29,733,202	58.46%	0.00%	41.54%
Year 8	29,733,202	297,332	594,664	(196,373)	-	(162,110)	30,266,715	58.46%	0.00%	41.54%
Year 9	30,266,715	302,667	605,334	(203,333)	-	(162,110)	30,809,273	58.46%	0.00%	41.54%
Year 10	30,809,273	308,093	616,185	(209,773)	-	(162,110)	31,361,668	58.46%	0.00%	41.54%
Year 11	31,361,668	313,617	627,233	(215,880)	-	(162,110)	31,924,528	58.46%	0.00%	41.54%
Year 12	31,924,528	319,245	638,491	(221,785)	-	(162,110)	32,498,369	58.46%	0.00%	41.54%
Year 13	32,498,369	324,984	649,967	(227,581)	-	(162,110)	33,083,630	58.46%	0.00%	41.54%
Year 14	33,083,630	330,836	661,673	(233,335)	-	(162,110)	33,680,694	58.46%	0.00%	41.54%
Year 15	33,680,694	336,807	673,614	(239,094)	-	(162,110)	34,289,911	58.46%	0.00%	41.54%
Year 16	34,289,911	342,899	685,798	(244,892)	-	(162,110)	34,911,606	58.46%	0.00%	41.54%
Year 17	34,911,606	349,116	698,232	(250,754)	-	(162,110)	35,546,090	58.46%	0.00%	41.54%
Year 18	35,546,090	355,461	710,922	(256,698)	-	(162,110)	36,193,664	58.46%	0.00%	41.54%
Year 19	36,193,664	361,937	723,873	(262,738)	-	(162,110)	36,854,626	58.46%	0.00%	41.54%
Year 20	36,854,626	368,546	737,093	(681,446)	-	(2,762,110)	34,516,709	58.46%	0.00%	41.54%

Schedule 9
Elder Family - 3.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $10mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder Children

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Distrib. from Elder FLP Estate Taxes	Distrib. from CLAT	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	-	-	-	59,166	4,000,000	-	(59,166)	(4,000,000)	-
Year 2	-	-	-	68,939	-	-	(68,939)	-	-
Year 3	-	-	-	81,570	-	-	(81,570)	-	-
Year 4	-	-	-	91,252	-	-	(91,252)	-	-
Year 5	-	-	-	98,876	-	-	(98,876)	-	-
Year 6	-	-	-	105,069	-	-	(105,069)	-	-
Year 7	-	-	-	110,275	-	-	(110,275)	-	-
Year 8	-	-	-	114,802	-	-	(114,802)	-	-
Year 9	-	-	-	118,872	-	-	(118,872)	-	-
Year 10	-	-	-	122,637	-	-	(122,637)	-	-
Year 11	-	-	-	126,207	-	-	(126,207)	-	-
Year 12	-	-	-	129,659	-	-	(129,659)	-	-
Year 13	-	-	-	133,047	-	-	(133,047)	-	-
Year 14	-	-	-	136,411	-	-	(136,411)	-	-
Year 15	-	-	-	139,778	-	-	(139,778)	-	-
Year 16	-	-	-	143,168	-	-	(143,168)	-	-
Year 17	-	-	-	146,595	-	-	(146,595)	-	-
Year 18	-	-	-	150,070	-	-	(150,070)	-	-
Year 19	-	-	-	153,601	-	-	(153,601)	-	-
Year 20	-	-	-	398,384	-	2,600,000	(398,384)	-	2,600,000

Schedule 9
Elder Family - 3.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $10mm to Family

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Estate Tax Rate	40.00%
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Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder GST Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Beneficiary Distributons	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	-	-	-	31,950	-	(31,950)	-	-
Year 2	-	-	-	48,983	-	(48,983)	-	-
Year 3	-	-	-	57,958	-	(57,958)	-	-
Year 4	-	-	-	64,837	-	(64,837)	-	-
Year 5	-	-	-	70,254	-	(70,254)	-	-
Year 6	-	-	-	74,655	-	(74,655)	-	-
Year 7	-	-	-	78,353	-	(78,353)	-	-
Year 8	-	-	-	81,570	-	(81,570)	-	-
Year 9	-	-	-	84,461	-	(84,461)	-	-
Year 10	-	-	-	87,137	-	(87,137)	-	-
Year 11	-	-	-	89,673	-	(89,673)	-	-
Year 12	-	-	-	92,126	-	(92,126)	-	-
Year 13	-	-	-	94,534	-	(94,534)	-	-
Year 14	-	-	-	96,924	-	(96,924)	-	-
Year 15	-	-	-	99,316	-	(99,316)	-	-
Year 16	-	-	-	101,724	-	(101,724)	-	-
Year 17	-	-	-	104,159	-	(104,159)	-	-
Year 18	-	-	-	106,629	-	(106,629)	-	-
Year 19	-	-	-	109,137	-	(109,137)	-	-
Year 20	-	-	-	283,062	-	(283,062)	-	-

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions (continued):	
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IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Charitable Lead Annuity Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP - Income Taxes	Note Payment Received	Annuity Payment to Charity	Taxes on Investment Income	Distrib. to Elder Family Remaindermen	End of Year
Year 1	-	-	-	15,383	162,110	(162,110)	(15,383)	-	-
Year 2	-	-	-	-	162,110	(162,110)	-	-	-
Year 3	-	-	-	-	162,110	(162,110)	-	-	-
Year 4	-	-	-	-	162,110	(162,110)	-	-	-
Year 5	-	-	-	-	162,110	(162,110)	-	-	-
Year 6	-	-	-	-	162,110	(162,110)	-	-	-
Year 7	-	-	-	-	162,110	(162,110)	-	-	-
Year 8	-	-	-	-	162,110	(162,110)	-	-	-
Year 9	-	-	-	-	162,110	(162,110)	-	-	-
Year 10	-	-	-	-	162,110	(162,110)	-	-	-
Year 11	-	-	-	-	162,110	(162,110)	-	-	-
Year 12	-	-	-	-	162,110	(162,110)	-	-	-
Year 13	-	-	-	-	162,110	(162,110)	-	-	-
Year 14	-	-	-	-	162,110	(162,110)	-	-	-
Year 15	-	-	-	-	162,110	(162,110)	-	-	-
Year 16	-	-	-	-	162,110	(162,110)	-	-	-
Year 17	-	-	-	-	162,110	(162,110)	-	-	-
Year 18	-	-	-	-	162,110	(162,110)	-	-	-
Year 19	-	-	-	-	162,110	(162,110)	-	-	-
Year 20	-	-	-	-	2,762,110	(162,110)	-	(2,600,000)	-

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	3.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	1.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Charity

	Beg. of Year	Income	Growth	Annuity Payment Received	End of Year
Year 1	-	-	-	162,110	162,110
Year 2	162,110	1,621	3,242	162,110	329,083
Year 3	329,083	3,291	6,582	162,110	501,066
Year 4	501,066	5,011	10,021	162,110	678,208
Year 5	678,208	6,782	13,564	162,110	860,664
Year 6	860,664	8,607	17,213	162,110	1,048,594
Year 7	1,048,594	10,486	20,972	162,110	1,242,162
Year 8	1,242,162	12,422	24,843	162,110	1,441,537
Year 9	1,441,537	14,415	28,831	162,110	1,646,893
Year 10	1,646,893	16,469	32,938	162,110	1,858,409
Year 11	1,858,409	18,584	37,168	162,110	2,076,272
Year 12	2,076,272	20,763	41,525	162,110	2,300,670
Year 13	2,300,670	23,007	46,013	162,110	2,531,800
Year 14	2,531,800	25,318	50,636	162,110	2,769,864
Year 15	2,769,864	27,699	55,397	162,110	3,015,070
Year 16	3,015,070	30,151	60,301	162,110	3,267,632
Year 17	3,267,632	32,676	65,353	162,110	3,527,771
Year 18	3,527,771	35,278	70,555	162,110	3,795,714
Year 19	3,795,714	37,957	75,914	162,110	4,071,696
Year 20	4,071,696	40,717	81,434	162,110	4,355,956

Schedule 9

Elder Family - 3.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	3.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	1.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	2.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Note Between Elder FLP and CLAT

	Beg. Balance	Interest	Payment	End of Year Balance
Year 1	2,600,000	162,110	(162,110)	2,600,000
Year 2	2,600,000	162,110	(162,110)	2,600,000
Year 3	2,600,000	162,110	(162,110)	2,600,000
Year 4	2,600,000	162,110	(162,110)	2,600,000
Year 5	2,600,000	162,110	(162,110)	2,600,000
Year 6	2,600,000	162,110	(162,110)	2,600,000
Year 7	2,600,000	162,110	(162,110)	2,600,000
Year 8	2,600,000	162,110	(162,110)	2,600,000
Year 9	2,600,000	162,110	(162,110)	2,600,000
Year 10	2,600,000	162,110	(162,110)	2,600,000
Year 11	2,600,000	162,110	(162,110)	2,600,000
Year 12	2,600,000	162,110	(162,110)	2,600,000
Year 13	2,600,000	162,110	(162,110)	2,600,000
Year 14	2,600,000	162,110	(162,110)	2,600,000
Year 15	2,600,000	162,110	(162,110)	2,600,000
Year 16	2,600,000	162,110	(162,110)	2,600,000
Year 17	2,600,000	162,110	(162,110)	2,600,000
Year 18	2,600,000	162,110	(162,110)	2,600,000
Year 19	2,600,000	162,110	(162,110)	2,600,000
Year 20	2,600,000	162,110	(2,762,110)	-

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Elder FLP Valuation Discount	40.00%
Gross Proceeds	$30,000,000

	Future Values at the End of 20 Years of Annual Compounded Growth at 7.5%						
	Elder Children's Future Values	Elder GST Exempt Trust Future Values	Charity	IRS Income Taxes	IRS Income Taxes & Estate Taxes Investment Opp. Costs	IRS Estate Taxes	Totals
No Further Planning - No Discount Allowed	33,734,275	27,222,640	-	19,049,212	39,429,406	8,000,000	127,435,533
No Further Planning - Discount Allowed	42,018,677	27,222,640	-	21,535,391	31,858,825	4,800,000	127,435,533
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
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

No Further Planning - No Discount Allowed		
Elder Children	33,734,275	26.47%
Elder GST Exempt Trust	27,222,640	21.36%
Charity	-	0.00%
IRS (income and estate taxes)	27,049,212	21.23%
IRS (investment opportunity costs)	39,429,406	30.94%
Total	**127,435,533**	**100.00%**

No Further Planning - Discount Allowed		
Elder Children	42,018,677	32.97%
Elder GST Exempt Trust	27,222,640	21.36%
Charity	-	0.00%
IRS (income and estate taxes)	26,335,391	20.67%
IRS (investment opportunity costs)	31,858,825	25.00%
Total	**127,435,533**	**100.00%**

CLAT Redemption - Discount Allowed - $3mm to Family		
Elder Children	26,774,735	21.01%
Elder GST Exempt Trust	40,677,004	31.92%
Charity	25,920,450	20.34%
IRS (income and estate taxes)	18,003,779	14.13%
IRS (investment opportunity costs)	16,059,565	12.60%
Total	**127,435,533**	**100.00%**

CLAT Redemption - Discount Allowed - $10mm to Family		
Elder Children	41,011,327	32.18%
Elder GST Exempt Trust	27,292,259	21.42%
Charity	7,020,122	5.51%
IRS (income and estate taxes)	24,117,950	18.93%
IRS (investment opportunity costs)	27,993,875	21.97%
Total	**127,435,533**	**100.00%**

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

No Further Planning - No Discount Allowed

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%

Elder Children

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	20,000,000	600,000	900,000	(335,100)	(8,000,000)	13,164,900
Year 2	13,164,900	394,947	592,421	(267,828)	-	13,884,440
Year 3	13,884,440	416,533	624,800	(296,811)	-	14,628,962
Year 4	14,628,962	438,869	658,303	(322,834)	-	15,403,300
Year 5	15,403,300	462,099	693,148	(347,051)	-	16,211,496
Year 6	16,211,496	486,345	729,517	(370,292)	-	17,057,066
Year 7	17,057,066	511,712	767,568	(393,159)	-	17,943,187
Year 8	17,943,187	538,296	807,443	(416,093)	-	18,872,833
Year 9	18,872,833	566,185	849,277	(439,423)	-	19,848,872
Year 10	19,848,872	595,466	893,199	(463,401)	-	20,874,136
Year 11	20,874,136	626,224	939,336	(488,223)	-	21,951,474
Year 12	21,951,474	658,544	987,816	(514,046)	-	23,083,789
Year 13	23,083,789	692,514	1,038,770	(541,003)	-	24,274,070
Year 14	24,274,070	728,222	1,092,333	(569,212)	-	25,525,413
Year 15	25,525,413	765,762	1,148,644	(598,775)	-	26,841,044
Year 16	26,841,044	805,231	1,207,847	(629,793)	-	28,224,329
Year 17	28,224,329	846,730	1,270,095	(662,361)	-	29,678,793
Year 18	29,678,793	890,364	1,335,546	(696,572)	-	31,208,130
Year 19	31,208,130	936,244	1,404,366	(732,521)	-	32,816,219
Year 20	32,816,219	984,487	1,476,730	(1,543,161)	-	33,734,275

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

No Further Planning - No Discount Allowed

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%

Elder GST Trust

	Beginning of Year	Income	Growth	Taxes on Investment Income	End of Year
Year 1	10,000,000	300,000	450,000	(167,550)	10,582,450
Year 2	10,582,450	317,474	476,210	(200,934)	11,175,200
Year 3	11,175,200	335,256	502,884	(228,779)	11,784,561
Year 4	11,784,561	353,537	530,305	(252,929)	12,415,474
Year 5	12,415,474	372,464	558,696	(274,697)	13,071,938
Year 6	13,071,938	392,158	588,237	(295,025)	13,757,308
Year 7	13,757,308	412,719	619,079	(314,589)	14,474,517
Year 8	14,474,517	434,235	651,353	(333,882)	15,226,223
Year 9	15,226,223	456,787	685,180	(353,265)	16,014,925
Year 10	16,014,925	480,448	720,672	(373,006)	16,843,038
Year 11	16,843,038	505,291	757,937	(393,314)	17,712,952
Year 12	17,712,952	531,389	797,083	(414,348)	18,627,075
Year 13	18,627,075	558,812	838,218	(436,241)	19,587,865
Year 14	19,587,865	587,636	881,454	(459,102)	20,597,853
Year 15	20,597,853	617,936	926,903	(483,029)	21,659,663
Year 16	21,659,663	649,790	974,685	(508,108)	22,776,030
Year 17	22,776,030	683,281	1,024,921	(534,424)	23,949,808
Year 18	23,949,808	718,494	1,077,741	(562,055)	25,183,988
Year 19	25,183,988	755,520	1,133,279	(591,083)	26,481,705
Year 20	26,481,705	794,451	1,191,677	(1,245,193)	27,222,640

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

No Further Planning - Discount Allowed

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%
Elder FLP Valuation Discount	40.00%

Elder Children

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	20,000,000	600,000	900,000	(335,100)	(4,800,000)	16,364,900
Year 2	16,364,900	490,947	736,421	(321,444)	-	17,270,824
Year 3	17,270,824	518,125	777,187	(361,110)	-	18,205,026
Year 4	18,205,026	546,151	819,226	(396,043)	-	19,174,359
Year 5	19,174,359	575,231	862,846	(427,989)	-	20,184,447
Year 6	20,184,447	605,533	908,300	(458,195)	-	21,240,086
Year 7	21,240,086	637,203	955,804	(487,567)	-	22,345,525
Year 8	22,345,525	670,366	1,005,549	(516,761)	-	23,504,678
Year 9	23,504,678	705,140	1,057,711	(546,266)	-	24,721,263
Year 10	24,721,263	741,638	1,112,457	(576,446)	-	25,998,912
Year 11	25,998,912	779,967	1,169,951	(607,585)	-	27,341,246
Year 12	27,341,246	820,237	1,230,356	(639,906)	-	28,751,934
Year 13	28,751,934	862,558	1,293,837	(673,595)	-	30,234,734
Year 14	30,234,734	907,042	1,360,563	(708,809)	-	31,793,530
Year 15	31,793,530	953,806	1,430,709	(745,688)	-	33,432,357
Year 16	33,432,357	1,002,971	1,504,456	(784,363)	-	35,155,421
Year 17	35,155,421	1,054,663	1,581,994	(824,955)	-	36,967,122
Year 18	36,967,122	1,109,014	1,663,520	(867,587)	-	38,872,069
Year 19	38,872,069	1,166,162	1,749,243	(912,379)	-	40,875,096
Year 20	40,875,096	1,226,253	1,839,379	(1,922,051)	-	42,018,677

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

No Further Planning - Discount Allowed

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Assumptions:	
Total Rate of Return	7.50%
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Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%
Elder FLP Valuation Discount	40.00%

Elder GST Exempt Trust

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	10,000,000	300,000	450,000	(167,550)	-	10,582,450
Year 2	10,582,450	317,474	476,210	(200,934)	-	11,175,200
Year 3	11,175,200	335,256	502,884	(228,779)	-	11,784,561
Year 4	11,784,561	353,537	530,305	(252,929)	-	12,415,474
Year 5	12,415,474	372,464	558,696	(274,697)	-	13,071,938
Year 6	13,071,938	392,158	588,237	(295,025)	-	13,757,308
Year 7	13,757,308	412,719	619,079	(314,589)	-	14,474,517
Year 8	14,474,517	434,235	651,353	(333,882)	-	15,226,223
Year 9	15,226,223	456,787	685,180	(353,265)	-	16,014,925
Year 10	16,014,925	480,448	720,672	(373,006)	-	16,843,038
Year 11	16,843,038	505,291	757,937	(393,314)	-	17,712,952
Year 12	17,712,952	531,389	797,083	(414,348)	-	18,627,075
Year 13	18,627,075	558,812	838,218	(436,241)	-	19,587,865
Year 14	19,587,865	587,636	881,454	(459,102)	-	20,597,853
Year 15	20,597,853	617,936	926,903	(483,029)	-	21,659,663
Year 16	21,659,663	649,790	974,685	(508,108)	-	22,776,030
Year 17	22,776,030	683,281	1,024,921	(534,424)	-	23,949,808
Year 18	23,949,808	718,494	1,077,741	(562,055)	-	25,183,988
Year 19	25,183,988	755,520	1,133,279	(591,083)	-	26,481,705
Year 20	26,481,705	794,451	1,191,677	(1,245,193)	-	27,222,640

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Total Rate of Return	7.50%
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Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder FLP

	Beg. of Year	Income	Growth	Distribution Income Taxes	Distribution Estate Taxes	Note Payment to CLAT	End of Year
Year 1	30,000,000	900,000	1,350,000	(235,692)	(1,200,000)	(598,560)	30,215,748
Year 2	30,215,748	906,472	1,359,709	(310,182)	-	(598,560)	31,573,187
Year 3	31,573,187	947,196	1,420,793	(383,048)	-	(598,560)	32,959,568
Year 4	32,959,568	988,787	1,483,181	(444,569)	-	(598,560)	34,388,406
Year 5	34,388,406	1,031,652	1,547,478	(498,590)	-	(598,560)	35,870,386
Year 6	35,870,386	1,076,112	1,614,167	(547,852)	-	(598,560)	37,414,253
Year 7	37,414,253	1,122,428	1,683,641	(594,323)	-	(598,560)	39,027,439
Year 8	39,027,439	1,170,823	1,756,235	(639,422)	-	(598,560)	40,716,516
Year 9	40,716,516	1,221,495	1,832,243	(684,182)	-	(598,560)	42,487,513
Year 10	42,487,513	1,274,625	1,911,938	(729,367)	-	(598,560)	44,346,149
Year 11	44,346,149	1,330,384	1,995,577	(775,552)	-	(598,560)	46,297,998
Year 12	46,297,998	1,388,940	2,083,410	(823,176)	-	(598,560)	48,348,612
Year 13	48,348,612	1,450,458	2,175,688	(872,590)	-	(598,560)	50,503,609
Year 14	50,503,609	1,515,108	2,272,662	(924,080)	-	(598,560)	52,768,739
Year 15	52,768,739	1,583,062	2,374,593	(977,892)	-	(598,560)	55,149,942
Year 16	55,149,942	1,654,498	2,481,747	(1,034,243)	-	(598,560)	57,653,385
Year 17	57,653,385	1,729,602	2,594,402	(1,093,331)	-	(598,560)	60,285,499
Year 18	60,285,499	1,808,565	2,712,847	(1,155,346)	-	(598,560)	63,053,005
Year 19	63,053,005	1,891,590	2,837,385	(1,220,474)	-	(598,560)	65,962,947
Year 20	65,962,947	1,978,888	2,968,333	(2,859,869)	-	(10,198,560)	57,851,739

	Ownership		
	Elder Children	CLAT	Elder GST Exempt Trust
Year 1	16.67%	53.33%	30.00%
Year 2	29.69%	0.00%	70.31%
Year 3	29.69%	0.00%	70.31%
Year 4	29.69%	0.00%	70.31%
Year 5	29.69%	0.00%	70.31%
Year 6	29.69%	0.00%	70.31%
Year 7	29.69%	0.00%	70.31%
Year 8	29.69%	0.00%	70.31%
Year 9	29.69%	0.00%	70.31%
Year 10	29.69%	0.00%	70.31%
Year 11	29.69%	0.00%	70.31%
Year 12	29.69%	0.00%	70.31%
Year 13	29.69%	0.00%	70.31%
Year 14	29.69%	0.00%	70.31%
Year 15	29.69%	0.00%	70.31%
Year 16	29.69%	0.00%	70.31%
Year 17	29.69%	0.00%	70.31%
Year 18	29.69%	0.00%	70.31%
Year 19	29.69%	0.00%	70.31%
Year 20	29.69%	0.00%	70.31%

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder Children

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Distrib. from Elder FLP Estate Taxes	Distrib. from CLAT	Income Taxes	Estate Taxes	End of Year
Year 1	-	-	-	39,282	1,200,000	-	(39,282)	(1,200,000)	-
Year 2	-	-	-	92,085	-	-	(92,085)	-	-
Year 3	-	-	-	113,717	-	-	(113,717)	-	-
Year 4	-	-	-	131,982	-	-	(131,982)	-	-
Year 5	-	-	-	148,019	-	-	(148,019)	-	-
Year 6	-	-	-	162,644	-	-	(162,644)	-	-
Year 7	-	-	-	176,440	-	-	(176,440)	-	-
Year 8	-	-	-	189,828	-	-	(189,828)	-	-
Year 9	-	-	-	203,117	-	-	(203,117)	-	-
Year 10	-	-	-	216,531	-	-	(216,531)	-	-
Year 11	-	-	-	230,242	-	-	(230,242)	-	-
Year 12	-	-	-	244,380	-	-	(244,380)	-	-
Year 13	-	-	-	259,050	-	-	(259,050)	-	-
Year 14	-	-	-	274,336	-	-	(274,336)	-	-
Year 15	-	-	-	290,312	-	-	(290,312)	-	-
Year 16	-	-	-	307,041	-	-	(307,041)	-	-
Year 17	-	-	-	324,583	-	-	(324,583)	-	-
Year 18	-	-	-	342,993	-	-	(342,993)	-	-
Year 19	-	-	-	362,328	-	-	(362,328)	-	-
Year 20	-	-	-	849,024	-	9,600,000	(849,024)	-	9,600,000

Schedule 9
Elder Family - 7.50% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $3mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder GST Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Beneficiary Distributions	Income Taxes	End of Year
Year 1	-	-	-	70,708	-	(70,708)	-
Year 2	-	-	-	218,097	-	(218,097)	-
Year 3	-	-	-	269,331	-	(269,331)	-
Year 4	-	-	-	312,588	-	(312,588)	-
Year 5	-	-	-	350,571	-	(350,571)	-
Year 6	-	-	-	385,208	-	(385,208)	-
Year 7	-	-	-	417,883	-	(417,883)	-
Year 8	-	-	-	449,593	-	(449,593)	-
Year 9	-	-	-	481,065	-	(481,065)	-
Year 10	-	-	-	512,836	-	(512,836)	-
Year 11	-	-	-	545,310	-	(545,310)	-
Year 12	-	-	-	578,795	-	(578,795)	-
Year 13	-	-	-	613,540	-	(613,540)	-
Year 14	-	-	-	649,744	-	(649,744)	-
Year 15	-	-	-	687,581	-	(687,581)	-
Year 16	-	-	-	727,202	-	(727,202)	-
Year 17	-	-	-	768,748	-	(768,748)	-
Year 18	-	-	-	812,353	-	(812,353)	-
Year 19	-	-	-	858,146	-	(858,146)	-
Year 20	-	-	-	2,010,845	-	(2,010,845)	-

Schedule 9
Elder Family - 7.50% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $3mm to Family

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Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Charitable Lead Annuity Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP - Income Taxes	Note Payment Received	Annuity Payment to Charity	Income Taxes	Distrib. to Elder Family Remaindermen	End of Year
Year 1	-	-	-	125,703	598,560	(598,560)	(125,703)	-	-
Year 2	-	-	-	-	598,560	(598,560)	-	-	-
Year 3	-	-	-	-	598,560	(598,560)	-	-	-
Year 4	-	-	-	-	598,560	(598,560)	-	-	-
Year 5	-	-	-	-	598,560	(598,560)	-	-	-
Year 6	-	-	-	-	598,560	(598,560)	-	-	-
Year 7	-	-	-	-	598,560	(598,560)	-	-	-
Year 8	-	-	-	-	598,560	(598,560)	-	-	-
Year 9	-	-	-	-	598,560	(598,560)	-	-	-
Year 10	-	-	-	-	598,560	(598,560)	-	-	-
Year 11	-	-	-	-	598,560	(598,560)	-	-	-
Year 12	-	-	-	-	598,560	(598,560)	-	-	-
Year 13	-	-	-	-	598,560	(598,560)	-	-	-
Year 14	-	-	-	-	598,560	(598,560)	-	-	-
Year 15	-	-	-	-	598,560	(598,560)	-	-	-
Year 16	-	-	-	-	598,560	(598,560)	-	-	-
Year 17	-	-	-	-	598,560	(598,560)	-	-	-
Year 18	-	-	-	-	598,560	(598,560)	-	-	-
Year 19	-	-	-	-	598,560	(598,560)	-	-	-
Year 20	-	-	-	-	10,198,560	(598,560)	-	(9,600,000)	-

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Charity

	Beg. of Year	Income	Growth	Annuity Payment Received	End of Year
Year 1	-	-	-	598,560	598,560
Year 2	598,560	17,957	26,935	598,560	1,242,012
Year 3	1,242,012	37,260	55,891	598,560	1,933,723
Year 4	1,933,723	58,012	87,018	598,560	2,677,312
Year 5	2,677,312	80,319	120,479	598,560	3,476,671
Year 6	3,476,671	104,300	156,450	598,560	4,335,981
Year 7	4,335,981	130,079	195,119	598,560	5,259,739
Year 8	5,259,739	157,792	236,688	598,560	6,252,780
Year 9	6,252,780	187,583	281,375	598,560	7,320,298
Year 10	7,320,298	219,609	329,413	598,560	8,467,881
Year 11	8,467,881	254,036	381,055	598,560	9,701,532
Year 12	9,701,532	291,046	436,569	598,560	11,027,707
Year 13	11,027,707	330,831	496,247	598,560	12,453,345
Year 14	12,453,345	373,600	560,401	598,560	13,985,905
Year 15	13,985,905	419,577	629,366	598,560	15,633,408
Year 16	15,633,408	469,002	703,503	598,560	17,404,474
Year 17	17,404,474	522,134	783,201	598,560	19,308,370
Year 18	19,308,370	579,251	868,877	598,560	21,355,057
Year 19	21,355,057	640,652	960,978	598,560	23,555,247
Year 20	23,555,247	706,657	1,059,986	598,560	25,920,450

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Note Between Elder FLP and CLAT

	Beg. Balance	Interest	Payment	End of Year Balance
Year 1	9,600,000	598,560	(598,560)	9,600,000
Year 2	9,600,000	598,560	(598,560)	9,600,000
Year 3	9,600,000	598,560	(598,560)	9,600,000
Year 4	9,600,000	598,560	(598,560)	9,600,000
Year 5	9,600,000	598,560	(598,560)	9,600,000
Year 6	9,600,000	598,560	(598,560)	9,600,000
Year 7	9,600,000	598,560	(598,560)	9,600,000
Year 8	9,600,000	598,560	(598,560)	9,600,000
Year 9	9,600,000	598,560	(598,560)	9,600,000
Year 10	9,600,000	598,560	(598,560)	9,600,000
Year 11	9,600,000	598,560	(598,560)	9,600,000
Year 12	9,600,000	598,560	(598,560)	9,600,000
Year 13	9,600,000	598,560	(598,560)	9,600,000
Year 14	9,600,000	598,560	(598,560)	9,600,000
Year 15	9,600,000	598,560	(598,560)	9,600,000
Year 16	9,600,000	598,560	(598,560)	9,600,000
Year 17	9,600,000	598,560	(598,560)	9,600,000
Year 18	9,600,000	598,560	(598,560)	9,600,000
Year 19	9,600,000	598,560	(598,560)	9,600,000
Year 20	9,600,000	598,560	(10,198,560)	-

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder FLP

	Beg. of Year	Income	Growth	Distribution Income Taxes	Distribution Estate Taxes	Note Payment to CLAT	End of Year	Ownership: Elder Children	Ownership: CLAT	Ownership: Elder GST Exempt Trust
Year 1	30,000,000	900,000	1,350,000	(430,349)	(4,000,000)	(162,110)	27,657,541	55.56%	14.44%	30.00%
Year 2	27,657,541	829,726	1,244,589	(461,976)	-	(162,110)	29,107,771	58.46%	0.00%	41.54%
Year 3	29,107,771	873,233	1,309,850	(530,353)	-	(162,110)	30,598,390	58.46%	0.00%	41.54%
Year 4	30,598,390	917,952	1,376,928	(589,609)	-	(162,110)	32,141,550	58.46%	0.00%	41.54%
Year 5	32,141,550	964,247	1,446,370	(642,983)	-	(162,110)	33,747,073	58.46%	0.00%	41.54%
Year 6	33,747,073	1,012,412	1,518,618	(692,793)	-	(162,110)	35,423,201	58.46%	0.00%	41.54%
Year 7	35,423,201	1,062,696	1,594,044	(740,705)	-	(162,110)	37,177,126	58.46%	0.00%	41.54%
Year 8	37,177,126	1,115,314	1,672,971	(787,932)	-	(162,110)	39,015,368	58.46%	0.00%	41.54%
Year 9	39,015,368	1,170,461	1,755,692	(835,364)	-	(162,110)	40,944,047	58.46%	0.00%	41.54%
Year 10	40,944,047	1,228,321	1,842,482	(883,664)	-	(162,110)	42,969,076	58.46%	0.00%	41.54%
Year 11	42,969,076	1,289,072	1,933,608	(933,339)	-	(162,110)	45,096,308	58.46%	0.00%	41.54%
Year 12	45,096,308	1,352,889	2,029,334	(984,788)	-	(162,110)	47,331,633	58.46%	0.00%	41.54%
Year 13	47,331,633	1,419,949	2,129,923	(1,038,330)	-	(162,110)	49,681,065	58.46%	0.00%	41.54%
Year 14	49,681,065	1,490,432	2,235,648	(1,094,239)	-	(162,110)	52,150,796	58.46%	0.00%	41.54%
Year 15	52,150,796	1,564,524	2,346,786	(1,152,751)	-	(162,110)	54,747,245	58.46%	0.00%	41.54%
Year 16	54,747,245	1,642,417	2,463,626	(1,214,081)	-	(162,110)	57,477,097	58.46%	0.00%	41.54%
Year 17	57,477,097	1,724,313	2,586,469	(1,278,432)	-	(162,110)	60,347,337	58.46%	0.00%	41.54%
Year 18	60,347,337	1,810,420	2,715,630	(1,346,002)	-	(162,110)	63,365,276	58.46%	0.00%	41.54%
Year 19	63,365,276	1,900,958	2,851,437	(1,416,983)	-	(162,110)	66,538,579	58.46%	0.00%	41.54%
Year 20	66,538,579	1,996,157	2,994,236	(3,063,276)	-	(2,762,110)	65,703,586	58.46%	0.00%	41.54%

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Elder Family - 7.50% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $10mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder Children

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Distrib. from Elder FLP Estate Taxes	Distrib. from CLAT	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	-	-	-	239,083	4,000,000	-	(239,083)	(4,000,000)	-
Year 2	-	-	-	270,078	-	-	(270,078)	-	-
Year 3	-	-	-	310,053	-	-	(310,053)	-	-
Year 4	-	-	-	344,695	-	-	(344,695)	-	-
Year 5	-	-	-	375,898	-	-	(375,898)	-	-
Year 6	-	-	-	405,017	-	-	(405,017)	-	-
Year 7	-	-	-	433,028	-	-	(433,028)	-	-
Year 8	-	-	-	460,637	-	-	(460,637)	-	-
Year 9	-	-	-	488,367	-	-	(488,367)	-	-
Year 10	-	-	-	516,604	-	-	(516,604)	-	-
Year 11	-	-	-	545,645	-	-	(545,645)	-	-
Year 12	-	-	-	575,722	-	-	(575,722)	-	-
Year 13	-	-	-	607,024	-	-	(607,024)	-	-
Year 14	-	-	-	639,709	-	-	(639,709)	-	-
Year 15	-	-	-	673,916	-	-	(673,916)	-	-
Year 16	-	-	-	709,770	-	-	(709,770)	-	-
Year 17	-	-	-	747,391	-	-	(747,391)	-	-
Year 18	-	-	-	786,893	-	-	(786,893)	-	-
Year 19	-	-	-	828,390	-	-	(828,390)	-	-
Year 20	-	-	-	1,790,838	-	2,600,000	(1,790,838)	-	2,600,000

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder GST Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Beneficiary Distributons	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	-	-	-	129,105	-	(129,105)	-	-
Year 2	-	-	-	191,898	-	(191,898)	-	-
Year 3	-	-	-	220,301	-	(220,301)	-	-
Year 4	-	-	-	244,915	-	(244,915)	-	-
Year 5	-	-	-	267,085	-	(267,085)	-	-
Year 6	-	-	-	287,775	-	(287,775)	-	-
Year 7	-	-	-	307,678	-	(307,678)	-	-
Year 8	-	-	-	327,295	-	(327,295)	-	-
Year 9	-	-	-	346,997	-	(346,997)	-	-
Year 10	-	-	-	367,060	-	(367,060)	-	-
Year 11	-	-	-	387,695	-	(387,695)	-	-
Year 12	-	-	-	409,066	-	(409,066)	-	-
Year 13	-	-	-	431,306	-	(431,306)	-	-
Year 14	-	-	-	454,530	-	(454,530)	-	-
Year 15	-	-	-	478,835	-	(478,835)	-	-
Year 16	-	-	-	504,311	-	(504,311)	-	-
Year 17	-	-	-	531,041	-	(531,041)	-	-
Year 18	-	-	-	559,108	-	(559,108)	-	-
Year 19	-	-	-	588,593	-	(588,593)	-	-
Year 20	-	-	-	1,272,438	-	(1,272,438)	-	-

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Charitable Lead Annuity Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP - Income Taxes	Note Payment Received	Annuity Payment to Charity	Taxes on Investment Income	Distrib. to Elder Family Remaindermen	End of Year
Year 1	-	-	-	62,162	162,110	(162,110)	(62,162)	-	-
Year 2	-	-	-	-	162,110	(162,110)	-	-	-
Year 3	-	-	-	-	162,110	(162,110)	-	-	-
Year 4	-	-	-	-	162,110	(162,110)	-	-	-
Year 5	-	-	-	-	162,110	(162,110)	-	-	-
Year 6	-	-	-	-	162,110	(162,110)	-	-	-
Year 7	-	-	-	-	162,110	(162,110)	-	-	-
Year 8	-	-	-	-	162,110	(162,110)	-	-	-
Year 9	-	-	-	-	162,110	(162,110)	-	-	-
Year 10	-	-	-	-	162,110	(162,110)	-	-	-
Year 11	-	-	-	-	162,110	(162,110)	-	-	-
Year 12	-	-	-	-	162,110	(162,110)	-	-	-
Year 13	-	-	-	-	162,110	(162,110)	-	-	-
Year 14	-	-	-	-	162,110	(162,110)	-	-	-
Year 15	-	-	-	-	162,110	(162,110)	-	-	-
Year 16	-	-	-	-	162,110	(162,110)	-	-	-
Year 17	-	-	-	-	162,110	(162,110)	-	-	-
Year 18	-	-	-	-	162,110	(162,110)	-	-	-
Year 19	-	-	-	-	162,110	(162,110)	-	-	-
Year 20	-	-	-	-	2,762,110	(162,110)	-	(2,600,000)	-

Schedule 9
Elder Family - 7.50% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Charity

	Beg. of Year	Income	Growth	Annuity Payment Received	End of Year
Year 1	-	-	-	162,110	162,110
Year 2	162,110	4,863	7,295	162,110	336,378
Year 3	336,378	10,091	15,137	162,110	523,717
Year 4	523,717	15,711	23,567	162,110	725,105
Year 5	725,105	21,753	32,630	162,110	941,598
Year 6	941,598	28,248	42,372	162,110	1,174,328
Year 7	1,174,328	35,230	52,845	162,110	1,424,513
Year 8	1,424,513	42,735	64,103	162,110	1,693,461
Year 9	1,693,461	50,804	76,206	162,110	1,982,581
Year 10	1,982,581	59,477	89,216	162,110	2,293,384
Year 11	2,293,384	68,802	103,202	162,110	2,627,498
Year 12	2,627,498	78,825	118,237	162,110	2,986,671
Year 13	2,986,671	89,600	134,400	162,110	3,372,781
Year 14	3,372,781	101,183	151,775	162,110	3,787,849
Year 15	3,787,849	113,635	170,453	162,110	4,234,048
Year 16	4,234,048	127,021	190,532	162,110	4,713,712
Year 17	4,713,712	141,411	212,117	162,110	5,229,350
Year 18	5,229,350	156,881	235,321	162,110	5,783,661
Year 19	5,783,661	173,510	260,265	162,110	6,379,546
Year 20	6,379,546	191,386	287,080	162,110	7,020,122

Schedule 9

Elder Family - 7.50% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	7.50%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	4.50%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Note Between Elder FLP and CLAT

	Beg. Balance	Interest	Payment	End of Year Balance
Year 1	2,600,000	162,110	(162,110)	2,600,000
Year 2	2,600,000	162,110	(162,110)	2,600,000
Year 3	2,600,000	162,110	(162,110)	2,600,000
Year 4	2,600,000	162,110	(162,110)	2,600,000
Year 5	2,600,000	162,110	(162,110)	2,600,000
Year 6	2,600,000	162,110	(162,110)	2,600,000
Year 7	2,600,000	162,110	(162,110)	2,600,000
Year 8	2,600,000	162,110	(162,110)	2,600,000
Year 9	2,600,000	162,110	(162,110)	2,600,000
Year 10	2,600,000	162,110	(162,110)	2,600,000
Year 11	2,600,000	162,110	(162,110)	2,600,000
Year 12	2,600,000	162,110	(162,110)	2,600,000
Year 13	2,600,000	162,110	(162,110)	2,600,000
Year 14	2,600,000	162,110	(162,110)	2,600,000
Year 15	2,600,000	162,110	(162,110)	2,600,000
Year 16	2,600,000	162,110	(162,110)	2,600,000
Year 17	2,600,000	162,110	(162,110)	2,600,000
Year 18	2,600,000	162,110	(162,110)	2,600,000
Year 19	2,600,000	162,110	(162,110)	2,600,000
Year 20	2,600,000	162,110	(2,762,110)	-

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Elder FLP Valuation Discount	40.00%
Gross Proceeds	$30,000,000

	Future Values at the End of 20 Years of Annual Compounded Growth at 10%						
	Elder Children's Future Values	Elder GST Exempt Trust Future Values	Charity	IRS Income Taxes	IRS Income Taxes & Estate Taxes Investment Opp. Costs	IRS Estate Taxes	Totals
No Further Planning - No Discount Allowed	49,533,164	39,520,097	-	29,956,665	74,815,071	8,000,000	201,824,998
No Further Planning - Discount Allowed	61,335,976	39,520,097	-	33,800,051	62,368,873	4,800,000	201,824,998
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
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

No Further Planning - No Discount Allowed		
Elder Children	49,533,164	24.54%
Elder GST Exempt Trust	39,520,097	19.58%
Charity	-	0.00%
IRS (income and estate taxes)	37,956,665	18.81%
IRS (investment opportunity costs)	74,815,071	37.07%
Total	**201,824,998**	**100.00%**

No Further Planning - Discount Allowed		
Elder Children	61,335,976	30.39%
Elder GST Exempt Trust	39,520,097	19.58%
Charity	-	0.00%
IRS (income and estate taxes)	38,600,051	19.13%
IRS (investment opportunity costs)	62,368,873	30.90%
Total	**201,824,998**	**100.00%**

CLAT Redemption - Discount Allowed - $3mm to Family		
Elder Children	36,556,659	18.11%
Elder GST Exempt Trust	63,844,719	31.63%
Charity	34,282,524	16.99%
IRS (income and estate taxes)	30,812,351	15.27%
IRS (investment opportunity costs)	36,328,746	18.00%
Total	**201,824,998**	**100.00%**

CLAT Redemption - Discount Allowed - $10mm to Family		
Elder Children	59,592,669	29.53%
Elder GST Exempt Trust	40,494,791	20.06%
Charity	9,284,850	4.60%
IRS (income and estate taxes)	36,455,697	18.06%
IRS (investment opportunity costs)	55,996,990	27.75%
Total	**201,824,998**	**100.00%**

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

No Further Planning - No Discount Allowed

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%

Elder Children

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	20,000,000	600,000	1,400,000	(372,600)	(8,000,000)	13,627,400
Year 2	13,627,400	408,822	953,918	(327,378)	-	14,662,762
Year 3	14,662,762	439,883	1,026,393	(374,698)	-	15,754,340
Year 4	15,754,340	472,630	1,102,804	(418,460)	-	16,911,313
Year 5	16,911,313	507,339	1,183,792	(460,425)	-	18,142,020
Year 6	18,142,020	544,261	1,269,941	(501,892)	-	19,454,330
Year 7	19,454,330	583,630	1,361,803	(543,840)	-	20,855,922
Year 8	20,855,922	625,678	1,459,915	(587,025)	-	22,354,490
Year 9	22,354,490	670,635	1,564,814	(632,045)	-	23,957,894
Year 10	23,957,894	718,737	1,677,053	(679,395)	-	25,674,288
Year 11	25,674,288	770,229	1,797,200	(729,499)	-	27,512,218
Year 12	27,512,218	825,367	1,925,855	(782,736)	-	29,480,704
Year 13	29,480,704	884,421	2,063,649	(839,462)	-	31,589,312
Year 14	31,589,312	947,679	2,211,252	(900,016)	-	33,848,228
Year 15	33,848,228	1,015,447	2,369,376	(964,738)	-	36,268,313
Year 16	36,268,313	1,088,049	2,538,782	(1,033,973)	-	38,861,171
Year 17	38,861,171	1,165,835	2,720,282	(1,108,076)	-	41,639,213
Year 18	41,639,213	1,249,176	2,914,745	(1,187,418)	-	44,615,717
Year 19	44,615,717	1,338,471	3,123,100	(1,272,390)	-	47,804,898
Year 20	47,804,898	1,434,147	3,346,343	(3,052,223)	-	49,533,164

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

No Further Planning - No Discount Allowed

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%

Elder GST Trust

	Beginning of Year	Income	Growth	Taxes on Investment Income	End of Year
Year 1	10,000,000	300,000	700,000	(186,300)	10,813,700
Year 2	10,813,700	324,411	756,959	(238,209)	11,656,861
Year 3	11,656,861	349,706	815,980	(282,633)	12,539,914
Year 4	12,539,914	376,197	877,794	(322,283)	13,471,622
Year 5	13,471,622	404,149	943,014	(359,126)	14,459,659
Year 6	14,459,659	433,790	1,012,176	(394,596)	15,511,028
Year 7	15,511,028	465,331	1,085,772	(429,759)	16,632,372
Year 8	16,632,372	498,971	1,164,266	(465,416)	17,830,194
Year 9	17,830,194	534,906	1,248,114	(502,189)	19,111,024
Year 10	19,111,024	573,331	1,337,772	(540,573)	20,481,554
Year 11	20,481,554	614,447	1,433,709	(580,979)	21,948,731
Year 12	21,948,731	658,462	1,536,411	(623,760)	23,519,844
Year 13	23,519,844	705,595	1,646,389	(669,235)	25,202,594
Year 14	25,202,594	756,078	1,764,182	(717,702)	27,005,151
Year 15	27,005,151	810,155	1,890,361	(769,450)	28,936,217
Year 16	28,936,217	868,087	2,025,535	(824,766)	31,005,072
Year 17	31,005,072	930,152	2,170,355	(883,944)	33,221,635
Year 18	33,221,635	996,649	2,325,514	(947,287)	35,596,512
Year 19	35,596,512	1,067,895	2,491,756	(1,015,110)	38,141,054
Year 20	38,141,054	1,144,232	2,669,874	(2,435,062)	39,520,097

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

No Further Planning - Discount Allowed

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%
Elder FLP Valuation Discount	40.00%

Elder Children

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	20,000,000	600,000	1,400,000	(372,600)	(4,800,000)	16,827,400
Year 2	16,827,400	504,822	1,177,918	(386,994)	-	18,123,146
Year 3	18,123,146	543,694	1,268,620	(450,925)	-	19,484,535
Year 4	19,484,535	584,536	1,363,917	(508,903)	-	20,924,086
Year 5	20,924,086	627,723	1,464,686	(563,556)	-	22,452,939
Year 6	22,452,939	673,588	1,571,706	(616,812)	-	24,081,420
Year 7	24,081,420	722,443	1,685,699	(670,111)	-	25,819,451
Year 8	25,819,451	774,584	1,807,362	(724,548)	-	27,676,849
Year 9	27,676,849	830,305	1,937,379	(780,978)	-	29,663,556
Year 10	29,663,556	889,907	2,076,449	(840,095)	-	31,789,816
Year 11	31,789,816	953,694	2,225,287	(902,482)	-	34,066,315
Year 12	34,066,315	1,021,989	2,384,642	(968,650)	-	36,504,297
Year 13	36,504,297	1,095,129	2,555,301	(1,039,065)	-	39,115,662
Year 14	39,115,662	1,173,470	2,738,096	(1,114,171)	-	41,913,058
Year 15	41,913,058	1,257,392	2,933,914	(1,194,403)	-	44,909,961
Year 16	44,909,961	1,347,299	3,143,697	(1,280,197)	-	48,120,761
Year 17	48,120,761	1,443,623	3,368,453	(1,372,001)	-	51,560,836
Year 18	51,560,836	1,546,825	3,609,259	(1,470,280)	-	55,246,640
Year 19	55,246,640	1,657,399	3,867,265	(1,575,522)	-	59,195,782
Year 20	59,195,782	1,775,873	4,143,705	(3,779,384)	-	61,335,976

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

No Further Planning - Discount Allowed

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Estate Tax Rate	40.00%
Elder FLP Valuation Discount	40.00%

Elder GST Exempt Trust

	Beginning of Year	Income	Growth	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	10,000,000	300,000	700,000	(186,300)	-	10,813,700
Year 2	10,813,700	324,411	756,959	(238,209)	-	11,656,861
Year 3	11,656,861	349,706	815,980	(282,633)	-	12,539,914
Year 4	12,539,914	376,197	877,794	(322,283)	-	13,471,622
Year 5	13,471,622	404,149	943,014	(359,126)	-	14,459,659
Year 6	14,459,659	433,790	1,012,176	(394,596)	-	15,511,028
Year 7	15,511,028	465,331	1,085,772	(429,759)	-	16,632,372
Year 8	16,632,372	498,971	1,164,266	(465,416)	-	17,830,194
Year 9	17,830,194	534,906	1,248,114	(502,189)	-	19,111,024
Year 10	19,111,024	573,331	1,337,772	(540,573)	-	20,481,554
Year 11	20,481,554	614,447	1,433,709	(580,979)	-	21,948,731
Year 12	21,948,731	658,462	1,536,411	(623,760)	-	23,519,844
Year 13	23,519,844	705,595	1,646,389	(669,235)	-	25,202,594
Year 14	25,202,594	756,078	1,764,182	(717,702)	-	27,005,151
Year 15	27,005,151	810,155	1,890,361	(769,450)	-	28,936,217
Year 16	28,936,217	868,087	2,025,535	(824,766)	-	31,005,072
Year 17	31,005,072	930,152	2,170,355	(883,944)	-	33,221,635
Year 18	33,221,635	996,649	2,325,514	(947,287)	-	35,596,512
Year 19	35,596,512	1,067,895	2,491,756	(1,015,110)	-	38,141,054
Year 20	38,141,054	1,144,232	2,669,874	(2,435,062)	-	39,520,097

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder FLP

	Beg. of Year	Income	Growth	Distribution Income Taxes	Distribution Estate Taxes	Note Payment to CLAT	End of Year
Year 1	30,000,000	900,000	2,100,000	(291,942)	(1,200,000)	(598,560)	30,909,498
Year 2	30,909,498	927,285	2,163,665	(419,136)	-	(598,560)	32,982,751
Year 3	32,982,751	989,483	2,308,793	(538,278)	-	(598,560)	35,144,188
Year 4	35,144,188	1,054,326	2,460,093	(642,527)	-	(598,560)	37,417,520
Year 5	37,417,520	1,122,526	2,619,226	(737,610)	-	(598,560)	39,823,102
Year 6	39,823,102	1,194,693	2,787,617	(827,691)	-	(598,560)	42,379,161
Year 7	42,379,161	1,271,375	2,966,541	(915,837)	-	(598,560)	45,102,680
Year 8	45,102,680	1,353,080	3,157,188	(1,004,338)	-	(598,560)	48,010,049
Year 9	48,010,049	1,440,301	3,360,703	(1,094,945)	-	(598,560)	51,117,549
Year 10	51,117,549	1,533,526	3,578,228	(1,189,032)	-	(598,560)	54,441,712
Year 11	54,441,712	1,633,251	3,810,920	(1,287,717)	-	(598,560)	57,999,606
Year 12	57,999,606	1,739,988	4,059,972	(1,391,946)	-	(598,560)	61,809,060
Year 13	61,809,060	1,854,272	4,326,634	(1,502,554)	-	(598,560)	65,888,853
Year 14	65,888,853	1,976,666	4,612,220	(1,620,306)	-	(598,560)	70,258,872
Year 15	70,258,872	2,107,766	4,918,121	(1,745,935)	-	(598,560)	74,940,265
Year 16	74,940,265	2,248,208	5,245,819	(1,880,159)	-	(598,560)	79,955,572
Year 17	79,955,572	2,398,667	5,596,890	(2,023,706)	-	(598,560)	85,328,863
Year 18	85,328,863	2,559,866	5,973,020	(2,177,320)	-	(598,560)	91,085,870
Year 19	91,085,870	2,732,576	6,376,011	(2,341,776)	-	(598,560)	97,254,120
Year 20	97,254,120	2,917,624	6,807,788	(5,979,594)	-	(10,198,560)	90,801,378

Ownership		
Elder Children	CLAT	Elder GST Exempt Trust
16.67%	53.33%	30.00%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%
29.69%	0.00%	70.31%

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder Children

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Distrib. from Elder FLP Estate Taxes	Distrib. from CLAT	Income Taxes	Estate Taxes	End of Year
Year 1	-	-	-	48,657	1,200,000	-	(48,657)	(1,200,000)	-
Year 2	-	-	-	124,431	-	-	(124,431)	-	-
Year 3	-	-	-	159,801	-	-	(159,801)	-	-
Year 4	-	-	-	190,750	-	-	(190,750)	-	-
Year 5	-	-	-	218,978	-	-	(218,978)	-	-
Year 6	-	-	-	245,721	-	-	(245,721)	-	-
Year 7	-	-	-	271,889	-	-	(271,889)	-	-
Year 8	-	-	-	298,163	-	-	(298,163)	-	-
Year 9	-	-	-	325,062	-	-	(325,062)	-	-
Year 10	-	-	-	352,994	-	-	(352,994)	-	-
Year 11	-	-	-	382,291	-	-	(382,291)	-	-
Year 12	-	-	-	413,234	-	-	(413,234)	-	-
Year 13	-	-	-	446,071	-	-	(446,071)	-	-
Year 14	-	-	-	481,028	-	-	(481,028)	-	-
Year 15	-	-	-	518,324	-	-	(518,324)	-	-
Year 16	-	-	-	558,172	-	-	(558,172)	-	-
Year 17	-	-	-	600,788	-	-	(600,788)	-	-
Year 18	-	-	-	646,392	-	-	(646,392)	-	-
Year 19	-	-	-	695,215	-	-	(695,215)	-	-
Year 20	-	-	-	1,775,192	-	9,600,000	(1,775,192)	-	9,600,000

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions:	
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Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Elder GST Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Beneficiary Distributions	Income Taxes	End of Year
Year 1	-	-	-	87,583	-	(87,583)	-
Year 2	-	-	-	294,705	-	(294,705)	-
Year 3	-	-	-	378,477	-	(378,477)	-
Year 4	-	-	-	451,777	-	(451,777)	-
Year 5	-	-	-	518,632	-	(518,632)	-
Year 6	-	-	-	581,970	-	(581,970)	-
Year 7	-	-	-	643,948	-	(643,948)	-
Year 8	-	-	-	706,175	-	(706,175)	-
Year 9	-	-	-	769,883	-	(769,883)	-
Year 10	-	-	-	836,038	-	(836,038)	-
Year 11	-	-	-	905,426	-	(905,426)	-
Year 12	-	-	-	978,712	-	(978,712)	-
Year 13	-	-	-	1,056,483	-	(1,056,483)	-
Year 14	-	-	-	1,139,278	-	(1,139,278)	-
Year 15	-	-	-	1,227,610	-	(1,227,610)	-
Year 16	-	-	-	1,321,987	-	(1,321,987)	-
Year 17	-	-	-	1,422,918	-	(1,422,918)	-
Year 18	-	-	-	1,530,928	-	(1,530,928)	-
Year 19	-	-	-	1,646,561	-	(1,646,561)	-
Year 20	-	-	-	4,204,402	-	(4,204,402)	-

Schedule 9
Elder Family - 10.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $3mm to Family

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
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Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Charitable Lead Annuity Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP - Income Taxes	Note Payment Received	Annuity Payment to Charity	Income Taxes	Distrib. to Elder Family Remaindermen	End of Year
Year 1	-	-	-	155,703	598,560	(598,560)	(155,703)	-	-
Year 2	-	-	-	-	598,560	(598,560)	-	-	-
Year 3	-	-	-	-	598,560	(598,560)	-	-	-
Year 4	-	-	-	-	598,560	(598,560)	-	-	-
Year 5	-	-	-	-	598,560	(598,560)	-	-	-
Year 6	-	-	-	-	598,560	(598,560)	-	-	-
Year 7	-	-	-	-	598,560	(598,560)	-	-	-
Year 8	-	-	-	-	598,560	(598,560)	-	-	-
Year 9	-	-	-	-	598,560	(598,560)	-	-	-
Year 10	-	-	-	-	598,560	(598,560)	-	-	-
Year 11	-	-	-	-	598,560	(598,560)	-	-	-
Year 12	-	-	-	-	598,560	(598,560)	-	-	-
Year 13	-	-	-	-	598,560	(598,560)	-	-	-
Year 14	-	-	-	-	598,560	(598,560)	-	-	-
Year 15	-	-	-	-	598,560	(598,560)	-	-	-
Year 16	-	-	-	-	598,560	(598,560)	-	-	-
Year 17	-	-	-	-	598,560	(598,560)	-	-	-
Year 18	-	-	-	-	598,560	(598,560)	-	-	-
Year 19	-	-	-	-	598,560	(598,560)	-	-	-
Year 20	-	-	-	-	10,198,560	(598,560)	-	(9,600,000)	-

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Charity

	Beg. of Year	Income	Growth	Annuity Payment Received	End of Year
Year 1	-	-	-	598,560	598,560
Year 2	598,560	17,957	41,899	598,560	1,256,976
Year 3	1,256,976	37,709	87,988	598,560	1,981,234
Year 4	1,981,234	59,437	138,686	598,560	2,777,917
Year 5	2,777,917	83,338	194,454	598,560	3,654,269
Year 6	3,654,269	109,628	255,799	598,560	4,618,256
Year 7	4,618,256	138,548	323,278	598,560	5,678,641
Year 8	5,678,641	170,359	397,505	598,560	6,845,065
Year 9	6,845,065	205,352	479,155	598,560	8,128,132
Year 10	8,128,132	243,844	568,969	598,560	9,539,505
Year 11	9,539,505	286,185	667,765	598,560	11,092,015
Year 12	11,092,015	332,760	776,441	598,560	12,799,777
Year 13	12,799,777	383,993	895,984	598,560	14,678,315
Year 14	14,678,315	440,349	1,027,482	598,560	16,744,706
Year 15	16,744,706	502,341	1,172,129	598,560	19,017,737
Year 16	19,017,737	570,532	1,331,242	598,560	21,518,070
Year 17	21,518,070	645,542	1,506,265	598,560	24,268,437
Year 18	24,268,437	728,053	1,698,791	598,560	27,293,841
Year 19	27,293,841	818,815	1,910,569	598,560	30,621,785
Year 20	30,621,785	918,654	2,143,525	598,560	34,282,524

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $3mm to Family

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Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$598,560
Elder FLP Valuation Discount	40.00%

Note Between Elder FLP and CLAT

	Beg. Balance	Interest	Payment	End of Year Balance
Year 1	9,600,000	598,560	(598,560)	9,600,000
Year 2	9,600,000	598,560	(598,560)	9,600,000
Year 3	9,600,000	598,560	(598,560)	9,600,000
Year 4	9,600,000	598,560	(598,560)	9,600,000
Year 5	9,600,000	598,560	(598,560)	9,600,000
Year 6	9,600,000	598,560	(598,560)	9,600,000
Year 7	9,600,000	598,560	(598,560)	9,600,000
Year 8	9,600,000	598,560	(598,560)	9,600,000
Year 9	9,600,000	598,560	(598,560)	9,600,000
Year 10	9,600,000	598,560	(598,560)	9,600,000
Year 11	9,600,000	598,560	(598,560)	9,600,000
Year 12	9,600,000	598,560	(598,560)	9,600,000
Year 13	9,600,000	598,560	(598,560)	9,600,000
Year 14	9,600,000	598,560	(598,560)	9,600,000
Year 15	9,600,000	598,560	(598,560)	9,600,000
Year 16	9,600,000	598,560	(598,560)	9,600,000
Year 17	9,600,000	598,560	(598,560)	9,600,000
Year 18	9,600,000	598,560	(598,560)	9,600,000
Year 19	9,600,000	598,560	(598,560)	9,600,000
Year 20	9,600,000	598,560	(10,198,560)	-

Schedule 9
Elder Family - 10.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $10mm to Family

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Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder FLP

	Beg. of Year	Income	Growth	Distribution Income Taxes	Distribution Estate Taxes	Note Payment to CLAT	End of Year
Year 1	30,000,000	900,000	2,100,000	(486,599)	(4,000,000)	(162,110)	28,351,291
Year 2	28,351,291	850,539	1,984,590	(566,133)	-	(162,110)	30,458,177
Year 3	30,458,177	913,745	2,132,072	(676,501)	-	(162,110)	32,665,384
Year 4	32,665,384	979,962	2,286,577	(775,145)	-	(162,110)	34,994,667
Year 5	34,994,667	1,049,840	2,449,627	(866,918)	-	(162,110)	37,465,106
Year 6	37,465,106	1,123,953	2,622,557	(955,367)	-	(162,110)	40,094,139
Year 7	40,094,139	1,202,824	2,806,590	(1,043,122)	-	(162,110)	42,898,321
Year 8	42,898,321	1,286,950	3,002,882	(1,132,169)	-	(162,110)	45,893,874
Year 9	45,893,874	1,376,816	3,212,571	(1,224,045)	-	(162,110)	49,097,106
Year 10	49,097,106	1,472,913	3,436,797	(1,319,978)	-	(162,110)	52,524,728
Year 11	52,524,728	1,575,742	3,676,731	(1,420,987)	-	(162,110)	56,194,104
Year 12	56,194,104	1,685,823	3,933,587	(1,527,950)	-	(162,110)	60,123,454
Year 13	60,123,454	1,803,704	4,208,642	(1,641,661)	-	(162,110)	64,332,029
Year 14	64,332,029	1,929,961	4,503,242	(1,762,862)	-	(162,110)	68,840,260
Year 15	68,840,260	2,065,208	4,818,818	(1,892,273)	-	(162,110)	73,669,903
Year 16	73,669,903	2,210,097	5,156,893	(2,030,613)	-	(162,110)	78,844,170
Year 17	78,844,170	2,365,325	5,519,092	(2,178,614)	-	(162,110)	84,387,864
Year 18	84,387,864	2,531,636	5,907,150	(2,337,031)	-	(162,110)	90,327,510
Year 19	90,327,510	2,709,825	6,322,926	(2,506,656)	-	(162,110)	96,691,495
Year 20	96,691,495	2,900,745	6,768,405	(6,111,074)	-	(2,762,110)	97,487,461

	Ownership		
	Elder Children	CLAT	Elder GST Exempt Trust
Year 1	55.56%	14.44%	30.00%
Year 2	58.46%	0.00%	41.54%
Year 3	58.46%	0.00%	41.54%
Year 4	58.46%	0.00%	41.54%
Year 5	58.46%	0.00%	41.54%
Year 6	58.46%	0.00%	41.54%
Year 7	58.46%	0.00%	41.54%
Year 8	58.46%	0.00%	41.54%
Year 9	58.46%	0.00%	41.54%
Year 10	58.46%	0.00%	41.54%
Year 11	58.46%	0.00%	41.54%
Year 12	58.46%	0.00%	41.54%
Year 13	58.46%	0.00%	41.54%
Year 14	58.46%	0.00%	41.54%
Year 15	58.46%	0.00%	41.54%
Year 16	58.46%	0.00%	41.54%
Year 17	58.46%	0.00%	41.54%
Year 18	58.46%	0.00%	41.54%
Year 19	58.46%	0.00%	41.54%
Year 20	58.46%	0.00%	41.54%

Schedule 9
Elder Family - 10.00% Rate of Return, 20 Years
CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder Children

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Distrib. from Elder FLP Estate Taxes	Distrib. from CLAT	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	-	-	-	270,333	4,000,000	-	(270,333)	(4,000,000)	-
Year 2	-	-	-	330,970	-	-	(330,970)	-	-
Year 3	-	-	-	395,493	-	-	(395,493)	-	-
Year 4	-	-	-	453,162	-	-	(453,162)	-	-
Year 5	-	-	-	506,814	-	-	(506,814)	-	-
Year 6	-	-	-	558,522	-	-	(558,522)	-	-
Year 7	-	-	-	609,825	-	-	(609,825)	-	-
Year 8	-	-	-	661,884	-	-	(661,884)	-	-
Year 9	-	-	-	715,596	-	-	(715,596)	-	-
Year 10	-	-	-	771,680	-	-	(771,680)	-	-
Year 11	-	-	-	830,731	-	-	(830,731)	-	-
Year 12	-	-	-	893,263	-	-	(893,263)	-	-
Year 13	-	-	-	959,740	-	-	(959,740)	-	-
Year 14	-	-	-	1,030,596	-	-	(1,030,596)	-	-
Year 15	-	-	-	1,106,252	-	-	(1,106,252)	-	-
Year 16	-	-	-	1,187,128	-	-	(1,187,128)	-	-
Year 17	-	-	-	1,273,651	-	-	(1,273,651)	-	-
Year 18	-	-	-	1,366,264	-	-	(1,366,264)	-	-
Year 19	-	-	-	1,465,430	-	-	(1,465,430)	-	-
Year 20	-	-	-	3,572,628	-	2,600,000	(3,572,628)	-	2,600,000

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Elder GST Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP Income Taxes	Beneficiary Distributons	Taxes on Investment Income	Estate Taxes	End of Year
Year 1	-	-	-	145,980	-	(145,980)	-	-
Year 2	-	-	-	235,163	-	(235,163)	-	-
Year 3	-	-	-	281,008	-	(281,008)	-	-
Year 4	-	-	-	321,983	-	(321,983)	-	-
Year 5	-	-	-	360,104	-	(360,104)	-	-
Year 6	-	-	-	396,845	-	(396,845)	-	-
Year 7	-	-	-	433,297	-	(433,297)	-	-
Year 8	-	-	-	470,286	-	(470,286)	-	-
Year 9	-	-	-	508,450	-	(508,450)	-	-
Year 10	-	-	-	548,299	-	(548,299)	-	-
Year 11	-	-	-	590,256	-	(590,256)	-	-
Year 12	-	-	-	634,687	-	(634,687)	-	-
Year 13	-	-	-	681,921	-	(681,921)	-	-
Year 14	-	-	-	732,266	-	(732,266)	-	-
Year 15	-	-	-	786,021	-	(786,021)	-	-
Year 16	-	-	-	843,485	-	(843,485)	-	-
Year 17	-	-	-	904,963	-	(904,963)	-	-
Year 18	-	-	-	970,767	-	(970,767)	-	-
Year 19	-	-	-	1,041,226	-	(1,041,226)	-	-
Year 20	-	-	-	2,538,446	-	(2,538,446)	-	-

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Charitable Lead Annuity Trust

	Beg. of Year	Income	Growth	Distrib. from Elder FLP - Income Taxes	Note Payment Received	Annuity Payment to Charity	Taxes on Investment Income	Distrib. to Elder Family Remaindermen	End of Year
Year 1	-	-	-	70,287	162,110	(162,110)	(70,287)	-	-
Year 2	-	-	-	-	162,110	(162,110)	-	-	-
Year 3	-	-	-	-	162,110	(162,110)	-	-	-
Year 4	-	-	-	-	162,110	(162,110)	-	-	-
Year 5	-	-	-	-	162,110	(162,110)	-	-	-
Year 6	-	-	-	-	162,110	(162,110)	-	-	-
Year 7	-	-	-	-	162,110	(162,110)	-	-	-
Year 8	-	-	-	-	162,110	(162,110)	-	-	-
Year 9	-	-	-	-	162,110	(162,110)	-	-	-
Year 10	-	-	-	-	162,110	(162,110)	-	-	-
Year 11	-	-	-	-	162,110	(162,110)	-	-	-
Year 12	-	-	-	-	162,110	(162,110)	-	-	-
Year 13	-	-	-	-	162,110	(162,110)	-	-	-
Year 14	-	-	-	-	162,110	(162,110)	-	-	-
Year 15	-	-	-	-	162,110	(162,110)	-	-	-
Year 16	-	-	-	-	162,110	(162,110)	-	-	-
Year 17	-	-	-	-	162,110	(162,110)	-	-	-
Year 18	-	-	-	-	162,110	(162,110)	-	-	-
Year 19	-	-	-	-	162,110	(162,110)	-	-	-
Year 20	-	-	-	-	2,762,110	(162,110)	-	(2,600,000)	-

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
Total Rate of Return	10.00%
Rate of Return on Assets That Are Taxable at Ordinary Rate	3.00%
Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Charity

	Beg. of Year	Income	Growth	Annuity Payment Received	End of Year
Year 1	-	-	-	162,110	162,110
Year 2	162,110	4,863	11,348	162,110	340,431
Year 3	340,431	10,213	23,830	162,110	536,584
Year 4	536,584	16,098	37,561	162,110	752,353
Year 5	752,353	22,571	52,665	162,110	989,698
Year 6	989,698	29,691	69,279	162,110	1,250,778
Year 7	1,250,778	37,523	87,554	162,110	1,537,965
Year 8	1,537,965	46,139	107,658	162,110	1,853,872
Year 9	1,853,872	55,616	129,771	162,110	2,201,369
Year 10	2,201,369	66,041	154,096	162,110	2,583,616
Year 11	2,583,616	77,508	180,853	162,110	3,004,087
Year 12	3,004,087	90,123	210,286	162,110	3,466,606
Year 13	3,466,606	103,998	242,662	162,110	3,975,377
Year 14	3,975,377	119,261	278,276	162,110	4,535,025
Year 15	4,535,025	136,051	317,452	162,110	5,150,637
Year 16	5,150,637	154,519	360,545	162,110	5,827,811
Year 17	5,827,811	174,834	407,947	162,110	6,572,702
Year 18	6,572,702	197,181	460,089	162,110	7,392,082
Year 19	7,392,082	221,762	517,446	162,110	8,293,400
Year 20	8,293,400	248,802	580,538	162,110	9,284,850

Schedule 9

Elder Family - 10.00% Rate of Return, 20 Years

CLAT Redemption - Discount Allowed - $10mm to Family

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Assumptions:	
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Rate of Return on Assets That Are Taxable at Capital Gains Rate	7.00%
Long-Term Capital Gain Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	25.00%
Ordinary Tax Rate (includes income taxes, surtax on inv. income & stealth tax)	44.60%
Estate Tax Rate	40.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%

Assumptions (continued):	
Interest Rate on CLAT Note	6.235%
IRS 7520 Rate (June 2014)	2.20%
CLAT Annuity Payment	$162,110
Elder FLP Valuation Discount	40.00%

Note Between Elder FLP and CLAT

	Beg. Balance	Interest	Payment	End of Year Balance
Year 1	2,600,000	162,110	(162,110)	2,600,000
Year 2	2,600,000	162,110	(162,110)	2,600,000
Year 3	2,600,000	162,110	(162,110)	2,600,000
Year 4	2,600,000	162,110	(162,110)	2,600,000
Year 5	2,600,000	162,110	(162,110)	2,600,000
Year 6	2,600,000	162,110	(162,110)	2,600,000
Year 7	2,600,000	162,110	(162,110)	2,600,000
Year 8	2,600,000	162,110	(162,110)	2,600,000
Year 9	2,600,000	162,110	(162,110)	2,600,000
Year 10	2,600,000	162,110	(162,110)	2,600,000
Year 11	2,600,000	162,110	(162,110)	2,600,000
Year 12	2,600,000	162,110	(162,110)	2,600,000
Year 13	2,600,000	162,110	(162,110)	2,600,000
Year 14	2,600,000	162,110	(162,110)	2,600,000
Year 15	2,600,000	162,110	(162,110)	2,600,000
Year 16	2,600,000	162,110	(162,110)	2,600,000
Year 17	2,600,000	162,110	(162,110)	2,600,000
Year 18	2,600,000	162,110	(162,110)	2,600,000
Year 19	2,600,000	162,110	(162,110)	2,600,000
Year 20	2,600,000	162,110	(2,762,110)	-

Schedule 10

Hal Happyeverafter

Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming Hal Happyeverafter has a life expectancy of 10 years)

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	10-Year Future Values		Present Values (Discounted at 2.5%)	Percentage of Total
	Pre-Death	Post Death		
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				
Hal Happyeverafter	18,016,467	-	-	0.00%
Happyeverafter Children	64,239,785	77,713,665	60,709,791	76.12%
Consumption - Direct Cost	6,722,029	6,722,029	5,251,238	6.58%
Consumption - Investment Opportunity Cost	2,606,804	2,606,804	2,036,431	2.55%
IRS Income Tax - Direct Cost	8,285,914	8,285,914	6,472,943	8.12%
IRS Income Tax - Investment Opportunity Cost	2,225,962	2,225,962	1,738,918	2.18%
IRS Estate Taxes at 40%	-	4,542,587	3,548,662	4.45%
Total	**$102,096,962**	**$102,096,962**	**$79,757,983**	**100.00%**
Hap Happyeverafter's deceased spouse bequeaths her estate to Hal; Hal creates a single member LLC and gifts the DSUE amount to a grantor trust; Hal sells the remaining non-managing member interests to the grantor trust				
Hal Happyeverafter	16,898,961	-	-	0.00%
Happyeverafter Children	64,910,289	77,713,665	60,709,791	76.12%
Consumption - Direct Cost	6,722,029	6,722,029	5,251,238	6.58%
Consumption - Investment Opportunity Cost	2,606,804	2,606,804	2,036,431	2.55%
IRS Income Tax - Direct Cost	8,732,917	8,732,917	6,822,141	8.55%
IRS Income Tax - Investment Opportunity Cost	2,225,962	2,225,962	1,738,918	2.18%
IRS Estate Taxes at 40%	-	4,095,584	3,199,464	4.01%
Total	**$102,096,962**	**$102,096,962**	**$79,757,983**	**100.00%**

Calculations of Remaining Exemption in 10 Years		
Current Total Exemptions		5,340,000
Prior Gifts Made		-
Future Federal Exemption Available in 10 years (assumes 2.5% inflation)		6,660,000

Schedule 10
Hal Happyeverafter
Asset Page

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	Hal Happyeverafter
Assets*	
FMV: Financial Assets	$50,000,000
Assumed Basis: Financial Assets	$50,000,000

* Information provided by client. There is no proposed planning for Hal Happyeverafter's other assets.

Schedule 10
Hal Happyeverafter
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

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (FL)	25.00%
Ordinary Income and Health Care Tax Rate (FL)	44.60%
Annual Consumption from these Sources (increasing 2.5% per year)	$600,000

Hal Happyeverafter

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Credit Shelter Trust Distributions	Annual Consumption from these Sources	Income Taxes	End of Year Financial & Other Assets
Year 1	3,810,915	22,865	91,462	167,680	1,385,673	(600,000)	(146,376)	4,732,219
Year 2	4,732,219	28,393	113,573	208,218	1,442,069	(615,000)	(165,716)	5,743,757
Year 3	5,743,757	34,463	137,850	252,725	1,497,561	(630,375)	(185,001)	6,850,980
Year 4	6,850,980	41,106	164,424	301,443	1,552,940	(646,134)	(204,697)	8,060,060
Year 5	8,060,060	48,360	193,441	354,643	1,608,785	(662,288)	(225,160)	9,377,842
Year 6	9,377,842	56,267	225,068	412,625	1,665,523	(678,845)	(246,668)	10,811,813
Year 7	10,811,813	64,871	259,484	475,720	1,723,476	(695,816)	(269,451)	12,370,096
Year 8	12,370,096	74,221	296,882	544,284	1,782,891	(713,211)	(293,707)	14,061,456
Year 9	14,061,456	84,369	337,475	618,704	1,843,962	(731,042)	(319,612)	15,895,311
Year 10	15,895,311	95,372	381,487	699,394	1,906,848	(749,318)	(212,627)	18,016,467

Happyeverafter Credit Shelter Trust

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	46,189,085	277,135	1,108,538	2,032,320	(1,385,673)	(152,424)	48,068,981
Year 2	48,068,981	288,414	1,153,656	2,115,035	(1,442,069)	(265,324)	49,918,692
Year 3	49,918,692	299,512	1,198,049	2,196,422	(1,497,561)	(350,459)	51,764,656
Year 4	51,764,656	310,588	1,242,352	2,277,645	(1,552,940)	(416,145)	53,626,156
Year 5	53,626,156	321,757	1,287,028	2,359,551	(1,608,785)	(468,267)	55,517,439
Year 6	55,517,439	333,105	1,332,419	2,442,767	(1,665,523)	(510,995)	57,449,212
Year 7	57,449,212	344,695	1,378,781	2,527,765	(1,723,476)	(547,279)	59,429,699
Year 8	59,429,699	356,578	1,426,313	2,614,907	(1,782,891)	(579,213)	61,465,392
Year 9	61,465,392	368,792	1,475,169	2,704,477	(1,843,962)	(608,285)	63,561,584
Year 10	63,561,584	381,370	1,525,478	2,796,710	(1,906,848)	(2,118,509)	64,239,785

Schedule 10
Hal Happyeverafter
Hap Happyeverafter's deceased spouse bequeaths her estate to Hal; Hal creates a single member LLC and gifts the DSUE amount to a grantor trust; Hal sells the remaining non-managing member interests to the grantor trust

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (FL)	25.00%
Ordinary Income and Health Care Tax Rate (FL)	44.60%
Annual Consumption from these Sources (increasing 2.5% per year)	$600,000

Assumptions:	
Happyeverafter LLC Valuation Discount	35.00%
Intra-Family Interest Rate (Mid-Term) - June 2014	1.91%

Hal Happyeverafter

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	LLC Distributions	Note Payments	Annual Consumption from these Sources	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	15,000	1,012,549	(600,000)	(298,800)	128,749
Year 2	128,749	772	3,090	5,665	15,660	1,002,999	(615,000)	(431,040)	110,894
Year 3	110,894	665	2,661	4,879	16,349	1,193,449	(630,375)	(535,460)	163,064
Year 4	163,064	978	3,914	7,175	17,068	1,180,079	(646,134)	(620,842)	105,301
Year 5	105,301	632	2,527	4,633	17,819	1,266,709	(662,288)	(693,427)	41,906
Year 6	41,906	251	1,006	1,844	18,603	1,451,429	(678,845)	(757,663)	78,532
Year 7	78,532	471	1,885	3,455	19,422	1,432,329	(695,816)	(816,730)	23,547
Year 8	23,547	141	565	1,036	20,277	1,613,229	(713,211)	(872,920)	72,664
Year 9	72,664	436	1,744	3,197	21,169	1,590,309	(731,042)	(927,897)	30,579
Year 10	30,579	183	734	1,345	174,862	19,602,389	(749,318)	(2,778,138)	16,282,636

Happyeverafter LLC

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	Distributions	End of Year Financial & Other Assets
Year 1	50,000,000	300,000	1,200,000	2,200,000	(1,500,000)	52,200,000
Year 2	52,200,000	313,200	1,252,800	2,296,800	(1,566,000)	54,496,800
Year 3	54,496,800	326,981	1,307,923	2,397,859	(1,634,904)	56,894,659
Year 4	56,894,659	341,368	1,365,472	2,503,365	(1,706,840)	59,398,024
Year 5	59,398,024	356,388	1,425,553	2,613,513	(1,781,941)	62,011,537
Year 6	62,011,537	372,069	1,488,277	2,728,508	(1,860,346)	64,740,045
Year 7	64,740,045	388,440	1,553,761	2,848,562	(1,942,201)	67,588,607
Year 8	67,588,607	405,532	1,622,127	2,973,899	(2,027,658)	70,562,506
Year 9	70,562,506	423,375	1,693,500	3,104,750	(2,116,875)	73,667,256
Year 10	73,667,256	442,004	1,768,014	3,241,359	(17,486,204)	61,632,429

Ownership	
Hal	Grantor Trust
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%
1.0%	99.0%

Schedule 10
Hal Happyeverafter
Hap Happyeverafter's deceased spouse bequeaths her estate to Hal; Hal creates a single member LLC and gifts the DSUE amount to a grantor trust; Hal sells the remaining non-managing member interests to the grantor trust

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	0.60%
Rate of Return Tax Free	2.40%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (FL)	25.00%
Ordinary Income and Health Care Tax Rate (FL)	44.60%
Annual Consumption from these Sources (increasing 2.5% per year)	$600,000

Assumptions:	
Happyeverafter LLC Valuation Discount	35.00%
Intra-Family Interest Rate (Mid-Term) - June 2014	1.91%

Grantor Trust for Happyeverafter Children

	Beginning of Year Financial & Other Assets	Income	Tax Free Income	Growth	LLC Distributions	Note Payments	Beneficiary Distributions	Income Taxes	End of Year Financial & Other Assets
Year 1	-	-	-	-	1,485,000	(1,012,549)	-	-	472,452
Year 2	472,452	2,835	11,339	20,788	1,550,340	(1,002,999)	-	-	1,054,754
Year 3	1,054,754	6,329	25,314	46,409	1,618,555	(1,193,449)	-	-	1,557,913
Year 4	1,557,913	9,347	37,390	68,548	1,689,771	(1,180,079)	-	-	2,182,891
Year 5	2,182,891	13,097	52,389	96,047	1,764,121	(1,266,709)	-	-	2,841,838
Year 6	2,841,838	17,051	68,204	125,041	1,841,743	(1,451,429)	-	-	3,442,448
Year 7	3,442,448	20,655	82,619	151,468	1,922,779	(1,432,329)	-	-	4,187,640
Year 8	4,187,640	25,126	100,503	184,256	2,007,382	(1,613,229)	-	-	4,891,679
Year 9	4,891,679	29,350	117,400	215,234	2,095,706	(1,590,309)	-	-	5,759,061
Year 10	5,759,061	34,554	138,217	253,399	17,311,342	(19,602,389)	-	-	3,894,184

Note Between Hal Happyeverafter and Grantor Trust

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	26,835,000	512,549	(1,012,549)	26,335,000
Year 2	26,335,000	502,999	(1,002,999)	25,835,000
Year 3	25,835,000	493,449	(1,193,449)	25,135,000
Year 4	25,135,000	480,079	(1,180,079)	24,435,000
Year 5	24,435,000	466,709	(1,266,709)	23,635,000
Year 6	23,635,000	451,429	(1,451,429)	22,635,000
Year 7	22,635,000	432,329	(1,432,329)	21,635,000
Year 8	21,635,000	413,229	(1,613,229)	20,435,000
Year 9	20,435,000	390,309	(1,590,309)	19,235,000
Year 10	19,235,000	367,389	(19,602,389)	-

Schedule 11

Harvey Happywithkids

Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming Mr. Happywithkids has a life expectancy of 10 years)

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	10-Year Future Values		Present Values (Discounted at 2.5%)	Percentage of Total
	Pre-Death	Post Death		
First Spouse to Die Creates a Credit Shelter Trust and There is No Further Planning by the Surviving Spouse (assumes $6.79mm inflation adjusted estate tax exemption available in 10 years)				
Harvey Happywithkids	67,181,900	-	-	0.00%
Children	-	36,235,140	28,306,833	32.01%
Credit Shelter Trust for Children and Grandchildren	8,878,625	8,878,625	6,935,968	7.84%
Children and Grandchildren	-	6,790,000	5,304,337	6.00%
Consumption - Direct Cost	13,444,058	13,444,058	10,502,477	11.88%
Consumption - Investment Opportunity Cost	5,213,608	5,213,608	4,072,862	4.61%
IRS Income Tax - Direct Cost	13,482,783	13,482,783	10,532,728	11.91%
IRS Income Tax - Investment Opportunity Costs	4,983,718	4,983,718	3,893,272	4.40%
IRS Estate Tax (at 40.0%)	-	24,156,760	18,871,222	21.34%
Total	**$113,184,692**	**$113,184,692**	**$88,419,700**	**100.00%**
Simulated $45,172,758 Credit Shelter Trust: Mr. Happywithkids' deceased spouse created a credit shelter trust for Harvey and family and bequeaths the rest of her estate to Lenny (assumes $6.8mm inflation adjusted estate tax exemption available at death)				
Harvey Happywithkids	153,997	-	-	0.00%
Children	-	-	-	0.00%
Credit Shelter Trust for Children and Grandchildren	73,862,244	73,862,244	57,701,067	65.26%
Children and Grandchildren	-	153,997	120,302	0.14%
Consumption - Direct Cost	13,444,058	13,444,058	10,502,477	11.88%
Consumption - Investment Opportunity Cost	5,213,608	5,213,608	4,072,862	4.61%
IRS Income Tax - Direct Cost	15,527,067	15,527,067	12,129,720	13.72%
IRS Income Tax - Investment Opportunity Costs	4,983,718	4,983,718	3,893,272	4.40%
IRS Estate Tax (at 40.0%)	-	-	-	0.00%
Total	**$113,184,692**	**$113,184,692**	**$88,419,700**	**100.00%**
Hypothetical Technique: Surviving Spouse Bequeaths Estate to Family (assumes $1.36mm inflation adjusted estate tax exemption available available in 10 years)				
Harvey Happywithkids	1,393,209	-	-	0.00%
Children	-	19,926	15,566	0.02%
QSST Trust for Children and Grandchildren	11,087,730	11,087,730	8,661,717	9.80%
GST Tax Exempt Trust for Children and Grandchildren	61,394,589	62,754,589	49,023,784	55.44%
Consumption - Direct Cost	13,444,058	13,444,058	10,502,477	11.88%
Consumption - Investment Opportunity Cost	5,213,608	5,213,608	4,072,862	4.61%
IRS Income Tax - Direct Cost	15,667,780	15,667,780	12,239,645	13.84%
IRS Income Tax - Investment Opportunity Costs	4,983,718	4,983,718	3,893,272	4.40%
IRS Estate Tax (at 40.0%)	-	13,284	10,377	0.01%
Total	**$113,184,692**	**$113,184,692**	**$88,419,700**	**100.00%**

Schedule 11
Harvey Happywithkids
Asset Page

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	Mr. Harvey Happywithkids	Credit Shelter Trust
Assets* (assumed value and basis)		
FMV: Financial Assets	$50,000,000	$5,430,000
Basis: Financial Assets	$50,000,000	$5,430,000

* Information provided by client. There is no proposed planning for Mr. and Mrs. Surviving Spouse' other assets.

Schedule 11
Harvey Happywithkids
First Spouse to Die Creates a Credit Shelter Trust and There is No Further Planning by the Surviving Spouse (assumes $6.79mm inflation adjusted estate tax exemption available in 10 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%
Annual Consumption (increasing 2.5% per year)	$1,200,000

Harvey Happywithkids

	Beginning of Year Financial Assets	Income	Growth	Consumption	Income Taxes	End of Year Financial Assets
Year 1	50,000,000	1,500,000	2,200,000	(1,200,000)	(834,000)	51,666,000
Year 2	51,666,000	1,549,980	2,273,304	(1,230,000)	(977,289)	53,281,995
Year 3	53,281,995	1,598,460	2,344,408	(1,260,750)	(1,088,942)	54,875,171
Year 4	54,875,171	1,646,255	2,414,508	(1,292,269)	(1,178,538)	56,465,126
Year 5	56,465,126	1,693,954	2,484,466	(1,324,575)	(1,252,854)	58,066,116
Year 6	58,066,116	1,741,983	2,554,909	(1,357,690)	(1,316,688)	59,688,630
Year 7	59,688,630	1,790,659	2,626,300	(1,391,632)	(1,373,441)	61,340,516
Year 8	61,340,516	1,840,215	2,698,983	(1,426,423)	(1,425,525)	63,027,766
Year 9	63,027,766	1,890,833	2,773,222	(1,462,083)	(1,474,655)	64,755,082
Year 10	64,755,082	1,942,652	2,849,224	(1,498,636)	(866,423)	67,181,900

Credit Shelter Trust

	Beginning of Year Financial Assets	Income	Growth	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	5,430,000	162,900	238,920	-	(90,572)	5,741,248
Year 2	5,741,248	172,237	252,615	-	(108,307)	6,057,793
Year 3	6,057,793	181,734	266,543	-	(123,087)	6,382,983
Year 4	6,382,983	191,489	280,851	-	(135,891)	6,719,432
Year 5	6,719,432	201,583	295,655	-	(147,421)	7,069,249
Year 6	7,069,249	212,077	311,047	-	(158,176)	7,434,198
Year 7	7,434,198	223,026	327,105	-	(168,515)	7,815,813
Year 8	7,815,813	234,474	343,896	-	(178,699)	8,215,484
Year 9	8,215,484	246,465	361,481	-	(188,921)	8,634,509
Year 10	8,634,509	259,035	379,918	-	(394,838)	8,878,625

Schedule 11
Harvey Happywithkids
First Spouse to Die Creates a Credit Shelter Trust and There is No Further Planning by the Surviving Spouse (assumes $6.79mm inflation adjusted estate tax exemption available in 10 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%
Annual Consumption (increasing 2.5% per year)	$1,200,000

Harvey Happywithkids

	Beginning of Year Financial Assets	Income	Growth	Consumption	Income Taxes	End of Year Financial Assets
Year 1	10,257,242	307,717	451,319	(1,200,000)	(171,091)	9,645,187
Year 2	9,645,187	289,356	424,388	(1,230,000)	(184,576)	8,944,355
Year 3	8,944,355	268,331	393,552	(1,260,750)	(188,058)	8,157,429
Year 4	8,157,429	244,723	358,927	(1,292,269)	(183,934)	7,284,876
Year 5	7,284,876	218,546	320,535	(1,324,575)	(173,863)	6,325,518
Year 6	6,325,518	189,766	278,323	(1,357,690)	(158,984)	5,276,933
Year 7	5,276,933	158,308	232,185	(1,391,632)	(140,063)	4,135,731
Year 8	4,135,731	124,072	181,972	(1,426,423)	(117,604)	2,897,748
Year 9	2,897,748	86,932	127,501	(1,462,083)	(91,922)	1,558,176
Year 10	1,558,176	46,745	68,560	(1,498,636)	(20,848)	153,997

$45,172,758 Simulated Credit Shelter Trust

	Beginning of Year Financial Assets	Income	Growth	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	45,172,758	1,355,183	1,987,601	-	(753,482)	47,762,061
Year 2	47,762,061	1,432,862	2,101,531	-	(901,020)	50,395,433
Year 3	50,395,433	1,511,863	2,217,399	-	(1,023,971)	53,100,725
Year 4	53,100,725	1,593,022	2,336,432	-	(1,130,496)	55,899,682
Year 5	55,899,682	1,676,990	2,459,586	-	(1,226,412)	58,809,846
Year 6	58,809,846	1,764,295	2,587,633	-	(1,315,880)	61,845,895
Year 7	61,845,895	1,855,377	2,721,219	-	(1,401,893)	65,020,598
Year 8	65,020,598	1,950,618	2,860,906	-	(1,486,620)	68,345,502
Year 9	68,345,502	2,050,365	3,007,202	-	(1,571,654)	71,831,415
Year 10	71,831,415	2,154,942	3,160,582	-	(3,284,696)	73,862,244

Schedule 11
Harvey Happywithkids
Hypothetical Technique: Surviving Spouse Bequeaths Estate to Family (assumes $1.36mm inflation adjusted estate tax exemption available available in 10 years)

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Assumptions:	
Total Estimated Rate of Return - Financial Assets	7.40%
Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%

Assumptions (continued):	
Annual Consumption (increasing 2.5% per year)	$1,200,000
Family Limited Partnership Valuation Discount	35.00%
Intra-Family Interest Rate - February 2015 (mid-term)	1.70%

Harvey Happywithkids

	Beginning of Year Financial Assets	Income	Growth	Partnership Distributions	Note Payments	QSST Distributions	Consumption	Income Taxes	End of Year Financial Assets
Year 1	1,000,000	30,000	44,000	-	1,050,572	-	(1,200,000)	(924,572)	-
Year 2	-	-	-	-	2,315,596	-	(1,230,000)	(1,085,596)	-
Year 3	-	-	-	-	2,472,779	-	(1,260,750)	(1,212,029)	-
Year 4	-	-	-	-	2,606,698	-	(1,292,269)	(1,314,430)	-
Year 5	-	-	-	-	2,724,851	-	(1,324,575)	(1,400,275)	-
Year 6	-	-	-	-	2,832,554	-	(1,357,690)	(1,474,864)	-
Year 7	-	-	-	-	2,933,588	-	(1,391,632)	(1,541,956)	-
Year 8	-	-	-	-	3,030,647	-	(1,426,423)	(1,604,224)	-
Year 9	-	-	-	-	3,125,660	-	(1,462,083)	(1,663,576)	-
Year 10	-	-	-	-	6,338,103	-	(1,498,636)	(3,446,258)	1,393,209

Family Limited Partnership

	Beginning of Year Financial Assets	Income	Growth	Ownership Distributions	End of Year Financial Assets	Ownership: GST Tax Exempt Grantor Trust	Ownership: QSST
Year 1	54,430,000	1,632,900	2,394,920	(1,763,532)	56,694,288	90.0%	10.0%
Year 2	56,694,288	1,700,829	2,494,549	(2,214,095)	58,675,570	90.0%	10.0%
Year 3	58,675,570	1,760,267	2,581,725	(2,558,020)	60,459,543	90.0%	10.0%
Year 4	60,459,543	1,813,786	2,660,220	(2,825,363)	62,108,186	90.0%	10.0%
Year 5	62,108,186	1,863,246	2,732,760	(3,037,821)	63,666,371	90.0%	10.0%
Year 6	63,666,371	1,909,991	2,801,320	(3,211,061)	65,166,621	90.0%	10.0%
Year 7	65,166,621	1,954,999	2,867,331	(3,356,396)	66,632,554	90.0%	10.0%
Year 8	66,632,554	1,998,977	2,931,832	(3,481,998)	68,081,365	90.0%	10.0%
Year 9	68,081,365	2,042,441	2,995,580	(3,593,772)	69,525,614	90.0%	10.0%
Year 10	69,525,614	2,085,768	3,059,127	(8,669,868)	66,000,642	90.0%	10.0%

Harvey Happywithkids

Hypothetical Technique: Surviving Spouse Bequeaths Estate to Family (assumes $1.36mm inflation adjusted estate tax exemption available available in 10 years)

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Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%

Assumptions (continued):	
Annual Consumption (increasing 2.5% per year)	$1,200,000
Family Limited Partnership Valuation Discount	35.00%
Intra-Family Interest Rate - February 2015 (mid-term)	1.70%

Sub-S Corporation

	Beginning of Year Financial Assets	Income	Growth	Partnership Distributions	Owner Distributions	End of Year Financial Assets	Ownership QSST
Year 1	-	-	-	175,932	-	175,932	100.0%
Year 2	175,932	5,278	7,741	220,881	-	409,832	100.0%
Year 3	409,832	12,295	18,033	255,191	-	695,350	100.0%
Year 4	695,350	20,861	30,595	281,861	-	1,028,668	100.0%
Year 5	1,028,668	30,860	45,261	303,057	-	1,407,846	100.0%
Year 6	1,407,846	42,235	61,945	320,339	-	1,832,365	100.0%
Year 7	1,832,365	54,971	80,624	334,838	-	2,302,798	100.0%
Year 8	2,302,798	69,084	101,323	347,368	-	2,820,574	100.0%
Year 9	2,820,574	84,617	124,105	358,519	-	3,387,815	100.0%
Year 10	3,387,815	101,634	149,064	864,916	-	4,503,429	100.0%

Credit Shelter Trust Converted to QSST

	Beginning of Year Financial Assets	Income	Growth	Sub-S Distributions	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	-	-	-	-
Year 2	-	-	-	-	-	-	-
Year 3	-	-	-	-	-	-	-
Year 4	-	-	-	-	-	-	-
Year 5	-	-	-	-	-	-	-
Year 6	-	-	-	-	-	-	-
Year 7	-	-	-	-	-	-	-
Year 8	-	-	-	-	-	-	-
Year 9	-	-	-	-	-	-	-
Year 10	-	-	-	-	-	-	-

Harvey Happywithkids

Hypothetical Technique: Surviving Spouse Bequeaths Estate to Family (assumes $1.36mm inflation adjusted estate tax exemption available available in 10 years)

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Rate of Return Taxed at Ordinary Rates	3.00%
Rate of Return Taxed at Capital Gains Rates	4.40%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%
Long-Term Capital Gains and Health Care Tax Rate	25.00%
Ordinary Income and Health Care Tax Rate	44.60%

Assumptions (continued):	
Annual Consumption (increasing 2.5% per year)	$1,200,000
Family Limited Partnership Valuation Discount	35.00%
Intra-Family Interest Rate - February 2015 (mid-term)	1.70%

GST Tax Exempt Grantor Trust

	Beginning of Year Financial Assets	Income	Growth	Partnership Distributions	Note Payments	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	1,587,600	(1,050,572)	-	-	537,028
Year 2	537,028	16,111	23,629	1,993,214	(2,315,596)	-	-	254,386
Year 3	254,386	7,632	11,193	2,302,829	(2,472,779)	-	-	103,260
Year 4	103,260	3,098	4,543	2,543,501	(2,606,698)	-	-	47,704
Year 5	47,704	1,431	2,099	2,734,765	(2,724,851)	-	-	61,149
Year 6	61,149	1,834	2,691	2,890,722	(2,832,554)	-	-	123,842
Year 7	123,842	3,715	5,449	3,021,558	(2,933,588)	-	-	220,977
Year 8	220,977	6,629	9,723	3,134,630	(3,030,647)	-	-	341,311
Year 9	341,311	10,239	15,018	3,235,253	(3,125,660)	-	-	476,162
Year 10	476,162	14,285	20,951	7,804,952	(6,338,103)	-	-	1,978,247

Note Between Mr. Happywithkids and GST Tax Exempt Grantor Trust

	Beginning of Year Principal	Interest	Note Payments	End of Year Principal
Year 1	26,420,000	449,140	(1,050,572)	25,818,568
Year 2	25,818,568	438,916	(2,315,596)	23,941,887
Year 3	23,941,887	407,012	(2,472,779)	21,876,120
Year 4	21,876,120	371,894	(2,606,698)	19,641,316
Year 5	19,641,316	333,902	(2,724,851)	17,250,368
Year 6	17,250,368	293,256	(2,832,554)	14,711,070
Year 7	14,711,070	250,088	(2,933,588)	12,027,570
Year 8	12,027,570	204,469	(3,030,647)	9,201,392
Year 9	9,201,392	156,424	(3,125,660)	6,232,156
Year 10	6,232,156	105,947	(6,338,103)	-

Schedule 12
Zelda Zerobasis
Hypothetical Integrated Income and Estate Tax Plan Comparisons (assuming Zelda Zerobasis has a life expectancy of 20 years)

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	20-Year Values Pre-Death	20-Year Values Post Death	Present Values (Discounted at 2.50%)	Percentage of Total
No Further Planning: Bequeaths Estate to Family; Assumes $8.53mm Estate Tax Exemption Available				
Zelda Zerobasis	82,891,476	-	-	0.00%
Zerobasis Children	-	44,616,886	27,228,389	31.89%
Zerobasis Children and Grandchildren	-	8,530,000	5,205,611	6.10%
Consumption	12,772,329	12,772,329	7,794,581	9.13%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	9.33%
Opportunity Cost/(Benefit) of Borrowing from 3rd Party Lender	-	-		
IRS Income Tax	15,575,474	15,575,474	9,505,259	11.13%
IRS Income Tax - Investment Opportunity Cost	15,627,875	15,627,875	9,537,238	11.17%
IRS Estate Taxes @ 40%	-	29,744,590	18,152,259	21.26%
Total	**$139,920,329**	**$139,920,329**	**$85,389,311**	**100.00%**
Hypothetical Technique: Bequeaths Remaining Estate to Family; Assumes $3.19mm Estate Tax Exemption Available				
Zelda Zerobasis	8,416,063	-	-	0.00%
Zerobasis Children	-	3,135,638	1,913,589	2.24%
Zerobasis Children and Grandchildren	79,407,794	82,597,794	50,407,034	59.03%
Consumption	12,772,329	12,772,329	7,794,581	9.13%
Consumption - Investment Opportunity Cost	13,053,175	13,053,175	7,965,974	9.33%
Opportunity Cost/(Benefit) of Borrowing from 3rd Party Lender	(11,079,903)	(11,079,903)	(6,761,743)	-7.92%
IRS Income Tax	22,247,774	22,247,774	13,577,170	15.90%
IRS Income Tax - Investment Opportunity Cost	15,103,098	15,103,098	9,216,982	10.79%
IRS Estate Taxes @ 40%	-	2,090,425	1,275,726	1.49%
Total	**$139,920,329**	**$139,920,329**	**$85,389,311**	**100.00%**

Calculations of Remaining EstateTax Exemptions (assumes 2.5% inflation)	No Further Planning	Hypothetical Technique
Current Estate Tax Exemption	5,340,000	5,340,000
Prior Gifts Made	-	(5,340,000)
Future Exemption Available in 20 years	8,530,000	3,190,000

Schedule 12
Zelda Zerobasis
Asset Page

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	Zelda Zerobasis
Assets*	
FMV: Financial Assets	$5,000,000
Assumed Basis: Financial Assets	$5,000,000
FMV: Other Asset	$40,000,000
Assumed Basis: Other Asset	$0
Total Assets:	**$45,000,000**
Total Assumed Basis:	**$5,000,000**

* Information provided by client. There is no proposed planning for Zelda Zerobasis' other assets.

Schedule 12
Zelda Zerobasis
No Further Planning: Bequeaths Estate to Family; Assumes $8.53mm Estate Tax Exemption Available

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Assumptions:	**Financial Assets**	**Other Asset**
Total Estimated Rate of Return	7.40%	5.00%
Rate of Return Taxed at Ordinary Rates	0.60%	3.00%
Rate of Return Tax Free	2.40%	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%	2.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	0.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (TX)	25.00%	
Ordinary Income and Health Care Tax Rate (TX)	44.60%	
Annual Consumption from these Sources (increasing 2.5% per year)	$500,000	

Zelda Zerobasis

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Other Asset Income	Consumption from these Sources	Income Taxes	End of Year Financial Assets	Beginning of Year Other Asset	Growth	End of Year Other Asset	End of Year Financial & Other Assets
Year 1	5,000,000	30,000	120,000	220,000	1,200,000	(500,000)	(565,080)	5,504,920	40,000,000	800,000	40,800,000	46,304,920
Year 2	5,504,920	33,030	132,118	242,216	1,224,000	(512,500)	(590,351)	6,033,433	40,800,000	816,000	41,616,000	47,649,433
Year 3	6,033,433	36,201	144,802	265,471	1,248,480	(525,313)	(613,679)	6,589,395	41,616,000	832,320	42,448,320	49,037,715
Year 4	6,589,395	39,536	158,145	289,933	1,273,450	(538,445)	(635,835)	7,176,180	42,448,320	848,966	43,297,286	50,473,466
Year 5	7,176,180	43,057	172,228	315,752	1,298,919	(551,906)	(657,373)	7,796,856	43,297,286	865,946	44,163,232	51,960,088
Year 6	7,796,856	46,781	187,125	343,062	1,324,897	(565,704)	(678,694)	8,454,322	44,163,232	883,265	45,046,497	53,500,819
Year 7	8,454,322	50,726	202,904	371,990	1,351,395	(579,847)	(700,093)	9,151,397	45,046,497	900,930	45,947,427	55,098,824
Year 8	9,151,397	54,908	219,634	402,661	1,378,423	(594,343)	(721,788)	9,890,892	45,947,427	918,949	46,866,375	56,757,267
Year 9	9,890,892	59,345	237,381	435,199	1,405,991	(609,201)	(743,946)	10,675,662	46,866,375	937,328	47,803,703	58,479,365
Year 10	10,675,662	64,054	256,216	469,729	1,434,111	(624,431)	(766,695)	11,508,645	47,803,703	956,074	48,759,777	60,268,422
Year 11	11,508,645	69,052	276,207	506,380	1,462,793	(640,042)	(790,141)	12,392,895	48,759,777	975,196	49,734,972	62,127,867
Year 12	12,392,895	74,357	297,429	545,287	1,492,049	(656,043)	(814,371)	13,331,604	49,734,972	994,699	50,729,672	64,061,276
Year 13	13,331,604	79,990	319,958	586,591	1,521,890	(672,444)	(839,460)	14,328,129	50,729,672	1,014,593	51,744,265	66,072,394
Year 14	14,328,129	85,969	343,875	630,438	1,552,328	(689,256)	(865,478)	15,386,004	51,744,265	1,034,885	52,779,151	68,165,155
Year 15	15,386,004	92,316	369,264	676,984	1,583,375	(706,487)	(892,490)	16,508,966	52,779,151	1,055,583	53,834,734	70,343,699
Year 16	16,508,966	99,054	396,215	726,394	1,615,042	(724,149)	(920,559)	17,700,963	53,834,734	1,076,695	54,911,428	72,612,391
Year 17	17,700,963	106,206	424,823	778,842	1,647,343	(742,253)	(949,746)	18,966,178	54,911,428	1,098,229	56,009,657	74,975,835
Year 18	18,966,178	113,797	455,188	834,512	1,680,290	(760,809)	(980,116)	20,309,040	56,009,657	1,120,193	57,129,850	77,438,890
Year 19	20,309,040	121,854	487,417	893,598	1,713,895	(779,829)	(1,011,731)	21,734,244	57,129,850	1,142,597	58,272,447	80,006,691
Year 20	21,734,244	130,405	521,622	956,307	1,748,173	(799,325)	(837,846)	23,453,580	58,272,447	1,165,449	59,437,896	82,891,476

Schedule 12
Zelda Zerobasis
Hypothetical Technique: Bequeaths Remaining Estate to Family; Assumes $3.19mm Estate Tax Exemption Available

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Assumptions:	Financial Assets	Other Asset
Total Estimated Rate of Return	7.40%	5.00%
Rate of Return Taxed at Ordinary Rates	0.60%	3.00%
Rate of Return Tax Free	2.40%	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%	2.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	0.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (TX)	25.00%	
Ordinary Income and Health Care Tax Rate (TX)	44.60%	
Annual Consumption from these Sources (increasing 2.5% per year)	$500,000	

Assumptions (continued):	
Holdco, LLC - Preferred Non-Managing Member Interest	$40,000,000
Holdco, LLC - Preferred Coupon	7.00%
Holdco, LLC - Valuation Discount	40.00%
Note #1 - 3rd Party Interest Rate	4.00%
Note #2 - Intra-Family Interest Rate (mid-term)	1.93%
Note #3 - Interest Rate	8.00%
Zelda Zerobasis Managing Member Growth Interest	1.00%
GST Exempt Grantor Trust Non-Managing Member Growth Interest	99.00%

Zelda Zerobasis

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Holdco Growth Distributions	Loan Proceeds	Holdco Preferred Distributions	Note Payments from GST Trust	Holdco Terminates and Pays Preferred	3rd Party Note Payments	Note Payments to Holdco	Consumption from these Sources	Income Taxes	End of Year Financial Assets
Year 1	2,000,000	12,000	48,000	88,000	7,324	-	2,800,000	275,257	-	(1,200,000)	-	(500,000)	(209,160)	3,321,421
Year 2	3,321,421	19,929	79,714	146,143	8,200	-	2,800,000	275,257	-	(1,200,000)	-	(512,500)	(311,954)	4,626,208
Year 3	4,626,208	27,757	111,029	203,553	8,849	30,000,000	2,800,000	275,257	-	(31,200,000)	(2,400,000)	(525,313)	(395,338)	3,532,003
Year 4	3,532,003	21,192	84,768	155,408	9,069	-	2,800,000	275,257	-	-	(2,400,000)	(538,445)	(821,458)	3,117,794
Year 5	3,117,794	18,707	74,827	137,183	9,347	-	2,800,000	275,257	-	-	(2,400,000)	(551,906)	(805,379)	2,675,828
Year 6	2,675,828	16,055	64,220	117,736	9,631	-	2,800,000	275,257	-	-	(2,400,000)	(565,704)	(801,169)	2,191,854
Year 7	2,191,854	13,151	52,604	96,442	9,922	-	2,800,000	275,257	-	-	(2,400,000)	(579,847)	(805,638)	1,653,744
Year 8	1,653,744	9,922	39,690	72,765	10,220	-	2,800,000	275,257	-	-	(2,400,000)	(594,343)	(816,547)	1,050,708
Year 9	1,050,708	6,304	25,217	46,231	10,525	-	2,800,000	1,275,257	-	-	(2,400,000)	(609,201)	(832,331)	1,372,710
Year 10	1,372,710	8,236	32,945	60,399	10,838	-	2,800,000	1,255,957	-	-	(2,400,000)	(624,431)	(851,900)	1,664,754
Year 11	1,664,754	9,989	39,954	73,249	11,159	-	2,800,000	1,236,657	-	-	(2,400,000)	(640,042)	(874,502)	1,921,216
Year 12	1,921,216	11,527	46,109	84,534	11,487	-	2,800,000	1,217,357	-	-	(2,400,000)	(656,043)	(899,626)	2,136,560
Year 13	2,136,560	12,819	51,277	94,009	11,824	-	2,800,000	1,198,057	-	-	(2,400,000)	(672,444)	(926,929)	2,305,173
Year 14	2,305,173	13,831	55,324	101,428	12,170	-	2,800,000	1,178,757	-	-	(2,400,000)	(689,256)	(956,190)	2,421,237
Year 15	2,421,237	14,527	58,110	106,534	12,524	-	2,800,000	1,159,457	-	-	(2,400,000)	(706,487)	(987,276)	2,478,626
Year 16	2,478,626	14,872	59,487	109,060	12,888	-	2,800,000	1,140,157	-	-	(2,400,000)	(724,149)	(1,020,115)	2,470,825
Year 17	2,470,825	14,825	59,300	108,716	13,261	-	2,800,000	1,120,857	-	-	(2,400,000)	(742,253)	(1,054,682)	2,390,849
Year 18	2,390,849	14,345	57,380	105,197	13,644	-	2,800,000	1,101,557	-	-	(2,400,000)	(760,809)	(1,090,984)	2,231,180
Year 19	2,231,180	13,387	53,548	98,172	14,037	-	2,800,000	1,082,257	-	-	(2,400,000)	(779,829)	(1,129,055)	1,983,697
Year 20	1,983,697	11,902	47,609	87,283	17,482	-	2,800,000	3,324,957	40,000,000	-	(32,400,000)	(799,325)	(6,657,540)	8,416,063

Schedule 12
Zelda Zerobasis
Hypothetical Technique: Bequeaths Remaining Estate to Family; Assumes $3.19mm Estate Tax Exemption Available

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Assumptions:	**Financial Assets**	**Other Asset**
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Rate of Return Tax Free	2.40%	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%	2.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	0.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (TX)	25.00%	
Ordinary Income and Health Care Tax Rate (TX)	44.60%	
Annual Consumption from these Sources (increasing 2.5% per year)	$500,000	

Assumptions (continued):	
Holdco, LLC - Preferred Non-Managing Member Interest	$40,000,000
Holdco, LLC - Preferred Coupon	7.00%
Holdco, LLC - Valuation Discount	40.00%
Note #1 - 3rd Party Interest Rate	4.00%
Note #2 - Intra-Family Interest Rate (mid-term)	1.93%
Note #3 - Interest Rate	8.00%
Zelda Zerobasis Managing Member Growth Interest	1.00%
GST Exempt Grantor Trust Non-Managing Member Growth Interest	99.00%

Holdco, LLC

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Other Asset Income	Note Payments from Zelda Zerobasis	Proceeds from Asset Sale	Loan to Zelda Zerobasis	Preferred Coupon	Growth Distributions & Holdco Termination	End of Year Financial Assets	Beginning of Year Other Asset	Growth	Sale of Assets	End of Year Other Asset	End of Year Financial & Other Assets
Year 1	33,000,000	198,000	792,000	1,452,000	1,200,000	-	-	-	(2,800,000)	(732,408)	33,109,592	40,000,000	800,000	-	40,800,000	73,909,592
Year 2	33,109,592	198,658	794,630	1,456,822	1,224,000	-	-	-	(2,800,000)	(819,997)	33,163,705	40,800,000	816,000	-	41,616,000	74,779,705
Year 3	33,163,705	198,982	795,929	1,459,203	1,248,480	2,400,000	-	(30,000,000)	(2,800,000)	(884,853)	5,581,447	41,616,000	832,320	-	42,448,320	48,029,767
Year 4	5,581,447	33,489	133,955	245,584	1,273,450	2,400,000	-	-	(2,800,000)	(906,938)	5,960,985	42,448,320	848,966	-	43,297,286	49,258,271
Year 5	5,960,985	35,766	143,064	262,283	1,298,919	2,400,000	-	-	(2,800,000)	(934,685)	6,366,332	43,297,286	865,946	-	44,163,232	50,529,564
Year 6	6,366,332	38,198	152,792	280,119	1,324,897	2,400,000	-	-	(2,800,000)	(963,095)	6,799,242	44,163,232	883,265	-	45,046,497	51,845,739
Year 7	6,799,242	40,795	163,182	299,167	1,351,395	2,400,000	-	-	(2,800,000)	(992,190)	7,261,591	45,046,497	900,930	-	45,947,427	53,209,018
Year 8	7,261,591	43,570	174,278	319,510	1,378,423	2,400,000	-	-	(2,800,000)	(1,021,992)	7,755,379	45,947,427	918,949	-	46,866,375	54,621,754
Year 9	7,755,379	46,532	186,129	341,237	1,405,991	2,400,000	-	-	(2,800,000)	(1,052,524)	8,282,745	46,866,375	937,328	-	47,803,703	56,086,448
Year 10	8,282,745	49,696	198,786	364,441	1,434,111	2,400,000	-	-	(2,800,000)	(1,083,808)	8,845,972	47,803,703	956,074	-	48,759,777	57,605,748
Year 11	8,845,972	53,076	212,303	389,223	1,462,793	2,400,000	-	-	(2,800,000)	(1,115,869)	9,447,498	48,759,777	975,196	-	49,734,972	59,182,470
Year 12	9,447,498	56,685	226,740	415,690	1,492,049	2,400,000	-	-	(2,800,000)	(1,148,734)	10,089,927	49,734,972	994,699	-	50,729,672	60,819,599
Year 13	10,089,927	60,540	242,158	443,957	1,521,890	2,400,000	-	-	(2,800,000)	(1,182,430)	10,776,042	50,729,672	1,014,593	-	51,744,265	62,520,308
Year 14	10,776,042	64,656	258,625	474,146	1,552,328	2,400,000	-	-	(2,800,000)	(1,216,984)	11,508,813	51,744,265	1,034,885	-	52,779,151	64,287,964
Year 15	11,508,813	69,053	276,212	506,388	1,583,375	2,400,000	-	-	(2,800,000)	(1,252,427)	12,291,413	52,779,151	1,055,583	-	53,834,734	66,126,146
Year 16	12,291,413	73,748	294,994	540,822	1,615,042	2,400,000	-	-	(2,800,000)	(1,288,790)	13,127,229	53,834,734	1,076,695	-	54,911,428	68,038,657
Year 17	13,127,229	78,763	315,053	577,598	1,647,343	2,400,000	-	-	(2,800,000)	(1,326,106)	14,019,880	54,911,428	1,098,229	-	56,009,657	70,029,537
Year 18	14,019,880	84,119	336,477	616,875	1,680,290	2,400,000	-	-	(2,800,000)	(1,364,409)	14,973,232	56,009,657	1,120,193	-	57,129,850	72,103,082
Year 19	14,973,232	89,839	359,358	658,822	1,713,895	2,400,000	-	-	(2,800,000)	(1,403,735)	15,991,412	57,129,850	1,142,597	-	58,272,447	74,263,859
Year 20	15,991,412	95,948	383,794	703,622	1,748,173	32,400,000	59,437,896	-	(2,800,000)	(107,960,846)	-	58,272,447	1,165,449	(59,437,896)	-	-

Schedule 12

Zelda Zerobasis

Hypothetical Technique: Bequeaths Remaining Estate to Family; Assumes $3.19mm Estate Tax Exemption Available

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Assumptions:	Financial Assets	Other Asset
Total Estimated Rate of Return	7.40%	5.00%
Rate of Return Taxed at Ordinary Rates	0.60%	3.00%
Rate of Return Tax Free	2.40%	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%	2.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	0.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (TX)	25.00%	
Ordinary Income and Health Care Tax Rate (TX)	44.60%	
Annual Consumption from these Sources (increasing 2.5% per year)	$500,000	

Assumptions (continued):	
Holdco, LLC - Preferred Non-Managing Member Interest	$40,000,000
Holdco, LLC - Preferred Coupon	7.00%
Holdco, LLC - Valuation Discount	40.00%
Note #1 - 3rd Party Interest Rate	4.00%
Note #2 - Intra-Family Interest Rate (mid-term)	1.93%
Note #3 - Interest Rate	8.00%
Zelda Zerobasis Managing Member Growth Interest	1.00%
GST Exempt Grantor Trust Non-Managing Member Growth Interest	99.00%

GST Exempt Grantor Trust Created by Zelda Zerobasis for the Benefit of her Descendants

	Beginning of Year Financial Assets	Income	Tax Free Income	Growth	Holdco Growth Distributions	Holdco Terminates	Note Payments to Zelda Zerobasis	Beneficiary Distributions	Income Taxes	End of Year Financial Assets
Year 1	-	-	-	-	725,084	-	(275,257)	-	-	449,827
Year 2	449,827	2,699	10,796	19,792	811,797	-	(275,257)	-	-	1,019,655
Year 3	1,019,655	6,118	24,472	44,865	876,004	-	(275,257)	-	-	1,695,857
Year 4	1,695,857	10,175	40,701	74,618	897,869	-	(275,257)	-	-	2,443,962
Year 5	2,443,962	14,664	58,655	107,534	925,338	-	(275,257)	-	-	3,274,897
Year 6	3,274,897	19,649	78,598	144,095	953,464	-	(275,257)	-	-	4,195,447
Year 7	4,195,447	25,173	100,691	184,600	982,268	-	(275,257)	-	-	5,212,921
Year 8	5,212,921	31,278	125,110	229,369	1,011,772	-	(275,257)	-	-	6,335,193
Year 9	6,335,193	38,011	152,045	278,749	1,041,998	-	(1,275,257)	-	-	6,570,739
Year 10	6,570,739	39,424	157,698	289,113	1,072,969	-	(1,255,957)	-	-	6,873,987
Year 11	6,873,987	41,244	164,976	302,455	1,104,710	-	(1,236,657)	-	-	7,250,716
Year 12	7,250,716	43,504	174,017	319,031	1,137,247	-	(1,217,357)	-	-	7,707,159
Year 13	7,707,159	46,243	184,972	339,115	1,170,605	-	(1,198,057)	-	-	8,250,038
Year 14	8,250,038	49,500	198,001	363,002	1,204,814	-	(1,178,757)	-	-	8,886,598
Year 15	8,886,598	53,320	213,278	391,010	1,239,903	-	(1,159,457)	-	-	9,624,653
Year 16	9,624,653	57,748	230,992	423,485	1,275,903	-	(1,140,157)	-	-	10,472,623
Year 17	10,472,623	62,836	251,343	460,795	1,312,845	-	(1,120,857)	-	-	11,439,586
Year 18	11,439,586	68,638	274,550	503,342	1,350,765	-	(1,101,557)	-	-	12,535,324
Year 19	12,535,324	75,212	300,848	551,554	1,389,698	-	(1,082,257)	-	-	13,770,379
Year 20	13,770,379	82,622	330,489	605,897	1,730,692	66,212,672	(3,324,957)	-	-	79,407,794

Schedule 12
Zelda Zerobasis
Hypothetical Technique: Bequeaths Remaining Estate to Family; Assumes $3.19mm Estate Tax Exemption Available

This is a hypothetical illustration of mathematical principles and is not a prediction or projection of performance of an investment or investment strategy.

This material is based on the assumptions stated herein. In the event any of the assumptions used do not prove to be true, results are likely to vary substantially from the examples shown herein. These examples are for illustrative purposes only and no representation is being made that any client will or is likely to achieve the results shown.

Assumptions:	**Financial Assets**	**Other Asset**
Total Estimated Rate of Return	7.40%	5.00%
Rate of Return Taxed at Ordinary Rates	0.60%	3.00%
Rate of Return Tax Free	2.40%	0.00%
Rate of Return Taxed at Capital Gains Rates	4.40%	2.00%
Turnover Rate (% of Capital Gains Recognized/Year)	30.00%	0.00%
Long-Term Capital Gains, Dividend and Health Care Tax Rate (TX)	25.00%	
Ordinary Income and Health Care Tax Rate (TX)	44.60%	
Annual Consumption from these Sources (increasing 2.5% per year)	$500,000	

Assumptions (continued):	
Holdco, LLC - Preferred Non-Managing Member Interest	$40,000,000
Holdco, LLC - Preferred Coupon	7.00%
Holdco, LLC - Valuation Discount	40.00%
Note #1 - 3rd Party Interest Rate	4.00%
Note #2 - Intra-Family Interest Rate (mid-term)	1.93%
Note #3 - Interest Rate	8.00%
Zelda Zerobasis Managing Member Growth Interest	1.00%
GST Exempt Grantor Trust Non-Managing Member Growth Interest	99.00%

Note #1 - 3rd Party Note

	Beginning of Year Principal	Interest	Note Payment	End of Year Principal
Year 1	30,000,000	1,200,000	(1,200,000)	30,000,000
Year 2	30,000,000	1,200,000	(1,200,000)	30,000,000
Year 3	30,000,000	1,200,000	(31,200,000)	-
Year 4	-	-	-	-
Year 5	-	-	-	-
Year 6	-	-	-	-
Year 7	-	-	-	-
Year 8	-	-	-	-
Year 9	-	-	-	-
Year 10	-	-	-	-
Year 11	-	-	-	-
Year 12	-	-	-	-
Year 13	-	-	-	-
Year 14	-	-	-	-
Year 15	-	-	-	-
Year 16	-	-	-	-
Year 17	-	-	-	-
Year 18	-	-	-	-
Year 19	-	-	-	-
Year 20	-	-	-	-

Note #2 Between Zelda Zerobasis and GST Exempt Grantor Trust

	Beginning of Year Principal	Interest	Note Payment	End of Year Principal
Year 1	14,262,000	275,257	(275,257)	14,262,000
Year 2	14,262,000	275,257	(275,257)	14,262,000
Year 3	14,262,000	275,257	(275,257)	14,262,000
Year 4	14,262,000	275,257	(275,257)	14,262,000
Year 5	14,262,000	275,257	(275,257)	14,262,000
Year 6	14,262,000	275,257	(275,257)	14,262,000
Year 7	14,262,000	275,257	(275,257)	14,262,000
Year 8	14,262,000	275,257	(275,257)	14,262,000
Year 9	14,262,000	275,257	(1,275,257)	13,262,000
Year 10	13,262,000	255,957	(1,255,957)	12,262,000
Year 11	12,262,000	236,657	(1,236,657)	11,262,000
Year 12	11,262,000	217,357	(1,217,357)	10,262,000
Year 13	10,262,000	198,057	(1,198,057)	9,262,000
Year 14	9,262,000	178,757	(1,178,757)	8,262,000
Year 15	8,262,000	159,457	(1,159,457)	7,262,000
Year 16	7,262,000	140,157	(1,140,157)	6,262,000
Year 17	6,262,000	120,857	(1,120,857)	5,262,000
Year 18	5,262,000	101,557	(1,101,557)	4,262,000
Year 19	4,262,000	82,257	(1,082,257)	3,262,000
Year 20	3,262,000	62,957	(3,324,957)	-

Note #3 Between Holdco and Zelda Zerobasis

	Beginning of Year Principal	Interest	Note Payment	End of Year Principal
Year 1	-	-	-	-
Year 2	-	-	-	-
Year 3	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 4	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 5	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 6	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 7	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 8	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 9	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 10	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 11	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 12	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 13	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 14	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 15	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 16	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 17	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 18	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 19	30,000,000	2,400,000	(2,400,000)	30,000,000
Year 20	30,000,000	2,400,000	(32,400,000)	-