The Estate Planner

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Estate and Gift Tax Measures in President Clinton's 1999 Budget Proposal

By Kenneth Edelman

President Clinton's 1999 Budget Proposal contains certain proposed changes to the tax laws which could greatly impact your estate and financial plans. A few of the more important proposed changes are summarized below:

Elimination of Non-Business Valuation Discounts

An estate planning vehicle in favor with many wealthy individuals involves the transfer of marketable assets into a family limited partnership, and subsequent gifts of limited partnership interests to family members of a younger generation. The donor usually claims a "discount" on the valuation of the gifts. President Clinton's proposal would completely eliminate these types of valuation discounts unless they apply to active businesses.

Elimination of Crummey Powers.

Certain trusts, such as insurance trusts, take advantage of a method that allows gifts to the trust to be eligible for the $10,000.00 per donee gift tax annual exclusion ("Crummey powers"). Crummey powers permit the donee to withdraw all or a portion of the transferred amount within a limited period of time. The new proposal would amend the tax law to provide that only "outright" gifts, and not gifts to trusts, would qualify for the annual exclusion. This would be particularly damaging to insurance trusts.

Elimination of Gift Tax Exemption for Qualified Personal Residence Trusts.

A Qualified Personal Residence Trust ("QPRT") is a very effective estate planning vehicle, as it allows an individual to transfer his or her personal residence into trust for himself or herself, and then pass it to family members at a greatly discounted gift tax cost. QPRT's would be eliminated under President Clinton's proposal. ❖

If you would like to discuss any aspect of the proposed laws or their possible effect on your estate plan, please contact any of our attorneys in the Trusts and Estates Department of Broad and Cassel.

Family Limited Partnerships: Recent Government Challenges

By Debra K. Smietanski

Family limited partnerships can provide significant estate planning benefits, however, under a series of recent technical advice memoranda, the Internal Revenue Service has mounted a significant challenge to the family limited partnership as an estate planning tool due primarily to the Service's view of the family limited partnership as a tax avoidance mechanism. In addition, President Clinton's 1999 budget proposal includes provisions which would severely restrict the use of the family limited partnership in an estate planning context.

Gift and Estate Tax, and Asset Protection Benefits

Under most circumstances, an individual creates a family limited partnership to which investment assets are transferred and the individual retains the right to control the management aspects of the family limited partnership by creating a wholly-owned corporation which is named the general partner of the limited partnership. The individual also retains the

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FAMILY LIMITED PARTNERSHIPS: RECENT GOVERNMENT CHALLENGES

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limited partnership interests in the family limited partnership and later gifts those interests to his or her children and/or grandchildren in accordance with a planned gifting program. Because of the limitations and restrictions imposed upon limited partnership interests under the partnership agreement as to control and management of the underlying assets, the value of the gift of the limited partnership interests is subject to significant discounts for both the lack of marketability and the minority status of the interests.

Further, remedies available to a judgment creditor of a partner under a family limited partnership are limited in most cases to obtaining a charging order against the interests of the partner. Under a charging order, the judgment creditor will only hold the rights of an assignee and, as such, is not a partner and is only entitled to receive those distributions to which the limited partner is entitled under the terms of the partnership agreement. All distributions are usually controlled by the general partner, therefore, under these circumstances, distributions may not occur and the creditor would receive no assets from the limited partnership.

In addition, under federal income tax law, a creditor who holds a charging order is treated as a substituted limited partner resulting in the need for the judgment creditor to report as income the share of the limited partnership interest over which the creditor has a charging order. These income tax implications are a major deterrent for a judgment creditor to obtain a charging order over a partner's interest in a family limited partnership.

Business Succession Benefits

Family limited partnerships have significant non-tax and non-creditor protection advantages. Parents can maintain control over the assets in the limited partnership as general partners and this can foster family succession planning allowing children employed in the family business to gradually take control of the business by receiving successive gifts of interests in the partnership over a period of time. This prevents the fractionalization of specific assets which are a part of the limited partnership while the parent continues to maintain control over the investment and management of the partnership assets and the cash flow of the income generated by these assets. In other words, the family limited partnership provides an entity to manage family assets which can promote family succession planning, an enhanced return on assets through more efficient and consolidated management of assets and flexibility in determining cash flow from these assets.

Internal Revenue Service Challenges

The Internal Revenue Service has recently mounted a significant challenge to the tax benefits of family limited partnerships through a series of technical advice memoranda. Under these memoranda, the Service has taken the position that a family limited partnership created shortly before death is a testamentary disposition effective only at death. In other words, the Service treated the creation of a family limited partnership and subsequent gifts of partnership interests as sham transactions.

Under these memoranda, the Service has also argued that the creation of a family limited partnership itself is a restriction on the right to use the underlying property owned by the transferor and should be ignored for valuation purposes under Internal Revenue Code Section 2703. Finally, the Service has argued under these memoranda that family limited partnership interests should be valued based on their liquidation value rather than their going-concern value under Internal Revenue Code Section 2704(b), thus, any liquidation restrictions under the limited partnership agreement would be ignored in valuing the entity if the restrictions were more onerous than applicable state law would

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Spending a Few Dollars Now Can Save Many Dollars Later

By Michael A. Dribin

We in the Trust and Estates Department of Broad and Cassel have a great deal of pride in the quality of the estate planning documents which we prepare. Collectively, we spend a substantial amount of time reviewing the wording of our documents and monitoring changes in the law to keep the documents current and up-to-date.

The downside of failing to keep documents current and up-to-date and, in general, failing to be truly expert at the drafting of estate planning documents was recently the subject of an article in the Wall Street Journal. The headline over the article read "Some Revocable Living Trusts Can Cost Thousands of Dollars in Needless Taxes." The article goes on to describe how sometimes unscrupulous sales people are marketing estate planning documents that, at best, are ineffective to accomplish their intended results and, at worst, are totally invalid.

There is simply no substitute for hiring an estate planning attorney.

The article goes on to describe "trust mills" that churn out trust documents without considering whether they make sense for a particular individual. The costs, from both an administrative point of view and a tax point of view, can often turn out to be disastrous.

The article concludes that there is simply no substitute for hiring an estate planning attorney for the drafting of estate planning documents, particularly where there are significant tax consequences involved. It is certainly fair to say that the fees which we charge for our estate planning services are greater than the trust mills or the cost of a book which publishes a form for a trust. While we believe we are extremely competitive with lawyers and law firms with similar expertise, we believe that the price paid for our attorney's fees in preparing estate planning documents is a reflection of the time we invest in completing those documents and the quality of the documents. We also believe that the fees which are paid today will inure to the benefit of your beneficiaries in years to come. ❖

Family Limited Partnerships: Recent Government Challenges

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provide. If the restrictions are less onerous than state law, then Section 2704 would not apply and the restrictions in the agreement would not be ignored for valuation purposes.

Further, the Service has recently ruled in a technical advice memorandum that gifts of a limited partnership interest are gifts of a future interest, lacking the tangible and immediate economic benefits required of a present interest in property and, thus, do not qualify for the $10,000.00 per donee annual gift tax exclusion.

It is significant to note that a number of the technical advice memoranda have dealt with situations where a family limited partnership was created when the death of the transferor was imminent and, thus, there is an appearance that the creation of the limited partnership was an abuse of the tax system and evidenced an intent to evade estate taxes otherwise properly attributable to the underlying assets at death. Therefore, these memoranda should be read and interpreted in light of their specific factual circumstances.

Administration's Budget Proposal Challenges

Recently, under President Clinton's 1999 budget proposal, concern was expressed that a number of taxpayers were claiming large discounts relative to gifts and devises of interests in entities such as family limited partnerships which primarily held readily marketable assets (such as securities), and that such discounts were inappropriate and not reflective of the economic reality of these transactions. As a result, the Administration has proposed to eliminate these discounts except as they may apply to active businesses. Thus, to the extent a family limited partnership held marketable assets, the interests in that entity would be valued for federal estate and gift tax purposes strictly as a proportionate share of the net asset value of the entity, without any discounts for lack of marketability or minority status. This proposal, if enacted, would be effective for all transfers made after the date of enactment. At this point in time, Congressional support for this proposal has not been determined.

Conclusion

The use of family limited partnerships in the appropriate estate planning context can be a very beneficial tool. However, each family situation should be analyzed carefully in order to insure that a family limited partnership would be suitable under the circumstances, in light of recent government challenges. ❖

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