

Carol Cantrell: Well, in this environment, I would say two things. The markets are low, and the exemption was just ratcheted up again. That is why I said there is a cycle. We look at it about every seven years or so.

David Hirschey: So I should buy stocks now?

Carol Cantrell: Don't ask my advice. You need to talk to Tim and Barbara on that.

Nevada Restricted LLCs

Steven Oshins, Carol Cantrell, Richard Oshins, and Sanford Schlesinger consider the possible advantages of new entities available under Nevada law.

Steven Oshins: I wanted to discuss the new Nevada restricted limited liability company (LLC) and limited partnership (LP) legislation that was passed in the 2009 legislative session and became effective October 1. Until now, the state laws have been somewhat uniform. Therefore, the valuation discounts from state to state have not been that different. Certainly, we can get a few extra percentage points going to a state like Nevada or a handful of other states that, as of today, have ranked at the top in terms of the largest discounts that you can get under Code Sec. 2704(b).

The reason that this gives us the higher ceiling on the discount has to do, as I said, with the interplay between the federal and state laws. We now have a much higher valuation discount opportunity using Nevada law than any other state by simply electing to be treated as a restricted entity.

My aim in getting this legislation passed was to try and create a state statute that would enable us to increase the discount ceiling. We would be able to put a little more creativity into the plan to create very substantial valuation discounts. We are often forum shopping to get an extra two or three percent on our discounts. If we were able to get a significant additional discount, it could make a difference of millions or perhaps even tens of millions of dollars, depending on the size of the transaction.

I was very fortunate to get this legislation passed during the last session. This makes Nevada the first state to enact a law making a significant change to the uniform laws. The only reason I was able to get it passed, I think, was that I mixed it in with a very large bill sponsored by the business law section. I do not think it would have passed as a standalone bill.

Let me give you a little background. Under Code Sec. 2704(b) and the regulations thereunder, an applicable restriction on liquidation must be disregarded by the appraiser in valuing the transferred interests. An applicable restriction is one that limits the ability to liquidate the entity and is more restrictive than the limitations that would apply under the applicable default state law. So, there is interplay between the federal law and the state law.

What I decided to do in drafting the statute was to create a greater ability to lock in the assets under this new type of business entity than had previously been allowed. The only additional default provision that I built into the law was one that will allow you, by default if you are otherwise silent and have made the restricted LLC or LP election, to lock in all member or partner distributions for a 10-year period. I came up with 10 years as an arbitrary, but round, number that I thought would not draw too much criticism.

You do not have to use the full 10 years. Certainly, you look at the facts, and you are not going to want to lock in a significant amount of your client's assets in a transaction for 10 years if it is going to cause the family to starve. On the other hand, for our very wealthy clients, we can certainly take a large portion of the estate and do a grantor retained annuity trust (GRAT) transaction or an installment sale to a defective dynasty trust transaction and lock in a lot of the assets to enhance the discount.

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Let me give you an idea of the additional discounts that you can obtain. In coming up with these numbers, I consulted the two business valuation appraisers with whom I do the most business and have worked with for years. I gave them a number of hypotheticals and I'll go through two of them. The first hypothetical asks, what is the size of the additional valuation discount if we fully use the 10-year lock in? This is on top of what the typical discount would have been. One of the appraisers said that the additional discount would

be 10 to 30-plus percent and the other appraiser said the additional discount would be 15 to 35 percent. If a standard discount that is generally obtained in a state that does not have the restricted entity law is about 35 percent, we would be looking at a discount of between 45 and 70 percent.

This is just an estimate that was provided prior to the law's passage, so I am sure that it is going to work its way through the appraisers around the country as they are looking at these transactions. Maybe we will ultimately find that we should be on the more conservative edge of that range. Or maybe we should be on the more aggressive edge. But I have been telling people that we should assume that we are going to be at about a 20-percent additional discount. I feel that is pretty fair.

To put this into perspective, what if we only restrict the distributions to the members and partners for one year? For example, if we were going to set up a GRAT or a sale to a defective trust and the first payment was due in one year, one very conservative option is to just restrict distributions for that year. You have nothing to lose. Both appraisers actually gave me exactly the same response to this hypothetical—an additional discount of 3 to 10 percent. This is very significant on a multimillion-dollar transaction.

You are not limited to restricting the number of years to something between zero and 10. You can alternatively, or in combination, restrict the amount of the distributions allowed. For example, you can provide that only the distributions to pay the phantom income tax can be made, or only the income can be distributed, or only five percent of the assets originally contributed to the entity can be distributed in any one fiscal year. The great thing for the higher level practitioners is that we now have a new toy to play with and there is a high ceiling. We no longer just have to give every client the same standard documents where we take full advantage of the discounts. Now, we might not want to take full advantage of this, but we will find something between what you can do in any other state and the full 10-year lockup.

In drafting this, I made it very simple. If you want to opt in, you simply note that on the articles of organization or the certificate of limited partnership. The way the statute reads, you have to put all of your restrictions into the articles or certificate, and then you would certainly want to repeat them in your operating agreement or partnership agreement. It is very important, if you are going to use this law, that you have a full understanding of what you are doing by electing into it and making sure you file it with the secretary of state.

Carol Cantrell: I have a question. Can the LLC members be on different lock-in periods? If I am in there with my five brothers and sisters and I want a one-year lock-in and they want 10, are we all on different schedules?

Steven Oshins: No, it would be one schedule. Your parent, for example, would set this up and then would make transfers of minority interests to six trusts, either dynasty trusts or GRATs, for the benefit of each of you and your siblings, and it would have the same lock-in for each of you. I do not know how you could draft it, unless you used different types of membership or partnership interests. I suppose you could have a class A and class B. I do not know why you would do that, though, because you are probably going to be drafting it around the actual transaction.

Carol Cantrell: Okay. I just had visions of having every member on a different payout, and then special allocations and accounting fees. But that makes sense.

Steven Oshins: The key here is to make it as simple as possible. I wanted to make it so it is just as user-friendly as a standard entity. It is just a little new because now, if you are going to make use of it, you have to use your creativity, which I think makes the planning a little more fun.

I have found in suggesting the concept to a number of my clients that we have had a lot of very creative discussions. For example, in one case I am doing an increasing annuity GRAT where I have drafted the language to allow an increasing distribution ability from the entity from year to year. In another one, we are doing a nine-year installment sale to an income tax defective dynasty trust, and I have done a nine-year restriction that we planned, and I am going to allow minimal distributions. This is because we are going to have enough seed money to make the interest payments each year with very minimal distributions from the entity, and then at the end of the nine years, when the restriction is off, it is the perfect time to pay back the principal. So, there is a lot of fun that goes into planning these, and I think you will find that your clients will be happy, in that you can forum shop and take advantage of this new law.

Sanford Schlesinger: My question is this. Under the "Greenbook" proposals (the *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals*), as well as the Joint Committee Report that recently came out (*Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal; Part One: Individual Income Tax and Estate and Gift Tax Provisions* (JCS-2-09), September 2009), there is going to be a new definition of disregarded restrictions for valuation purposes under Code Sec. 2704. Is that going to knock out what you are trying to accomplish if it is enacted?

Steven Oshins: I have not read the Joint Committee proposal yet, Sandy, but I read the one in the Greenbook, and, yes, that would probably knock it out because they want to govern it by regulation rather than looking at the state laws. That might be the way you get your client to get the transaction done in October or November, because of the possibility that valuation discount laws could change.

Sanford Schlesinger: I think the Joint Committee thing is even stronger. It mentions disregarded restrictions. The federal government is very conscious of state laws trying to help people out in this area, and it is going to try and act by passing legislation. The Joint Committee proposal is similar to the Greenbook. It is worth taking a look at, because I think they are zeroing in on exactly what you are doing.

Steven Oshins: I would imagine they are. Maybe it is going to be something we talk about historically in hindsight, that unfortunately no one ever got an opportunity to take advantage of it. I have a few of them ready to go for October, so hopefully nothing will pass by then.

Richard Oshins: I think the bottom line is that there might be a short window of opportunity where we can do these transactions and lock them in. It is easy to do it with a GRAT. You just draft the GRAT, transfer the asset into the GRAT, and you do not even have to get the valuation until much later when either the gift tax return is filed or it is time for the first annuity payments to be made. I think it is something that we should look at quickly. It is unfortunate that this opportunity is only just presenting itself, but it is something that we should be encouraging our clients to move forward with as soon as possible.

Sanford Schlesinger: Remember, also, one of those proposals is that GRATs have to be for a minimum of 10 years.

Richard Oshins: That is a second reason we should do it faster.

Sanford Schlesinger: The other comment I would make on that, Dick, is that we do have a history of effective dates that are surprises. Remember generation-skipping, where it was effective a year before it was enacted.

Richard Oshins: Right. If that is the case, then you might be inclined more towards a GRAT, and I think you are going to be grandfathered in if you pick a certain date with a GRAT. I cannot see the IRS coming back and saying, you did a two-year GRAT and we retroactively said you had to do a 10-year GRAT, so now we are punishing you—particularly when the punishment under Code Sec. 2702 is so great. I think that you are going to

need an effective date somewhere in the future. If they do come back—and let us assume the restrictions are retroactive—you are not going to get hurt.

Sanford Schlesinger: I assume you are right. Or, I should say, I hope you are right. But weirder things have happened.

Creative Uses of CRTs

Robert Keebler and Stephen Krass, along with Carol Cantrell, David Hirschey, and Sidney Kess consider the many planning opportunities presented by charitable remainder trusts.

Robert Keebler: For background purposes, a charitable remainder trust (CRT) is an irrevocable trust that pays a non-charitable beneficiary an annuity (CRAT) or a unitrust (CRUT) interest with the remainder interest going to a charity. Code Sec. 664(d)(2)(A) requires that the annuity percentage be at least five percent, but not more than 50 percent of the initial value of the trust assets (as finally determined for federal tax purposes). In addition, the present value of the remainder interest must be equal to at least 10 percent of the net fair market value of the property transferred to the trust (on the date of contribution to the trust). With respect to a unitrust, the noncharitable beneficiary receives periodic payments equal to a fixed percentage of the trust assets revalued annually and this percentage must be at least five percent.

In the case of an *inter vivos* transfer, the grantor receives both an income tax and a gift tax deduction for the present value of the charitable interest. In addition, the gift tax annual exclusion may be used to reduce the value of the lead annuity or unitrust interest. The amount of the gift, income, or estate tax deduction is the fair market value of the property transferred to the trust minus the value of the annuity or unitrust interest. If the annuity or unitrust payments are received by someone other than the donor, gift or estate tax will be payable on the present value of the lead interest, unless, of course, the donor has enough unified credit left or the transfer is completely covered by the marital deduction.

A CRUT is generally a better planning strategy than a CRAT if the trust assets are expected to appreciate rapidly. In a CRAT, all of the trust return in excess of the payment rate accumulates and goes to the charity at the end of the trust term. In a CRUT, on the other hand, part of the growth in principal is paid to the holder of the unitrust interest in the form of higher annual payments.

Once we understand the statutory framework of a charitable remainder trust, the question becomes, how will this technique be used in the next five to 10 years? In