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"SUCCESS IS IN THE PLANNING"

PLANNING OPPORTUNITIES THAT CAN'T WAIT

To our clients and friends,

*In this time of economic uncertainty and with the elections only days away, we know that many of you are in a holding pattern or a "wait and see" mode when it comes to both your financial planning as well as your estate planning. But we at the Blum Firm just couldn't wait for our annual year-end newsletter to share all the exciting planning opportunities that you should be considering **today**. Not only are the benefits of these techniques unrelated to the status of the current political or economic state, but they are also most valuable to you when properly implemented at the earliest possible date. Some of these techniques could be implemented this fall, in time for a January 1, 2005 effective date, so please take time to review this newsletter.*



One of the changes we couldn't wait to share with you is a welcome addition to our firm. The Blum Firm is proud to welcome Amanda Holliday as the newest member of our tax and estate planning team. A native of Arlington, Amanda graduated magna cum laude with a degree in Accounting from Texas State University in 2001, and went on to graduate summa cum laude from Texas Tech School of Law in 2004 - a feat she accomplished while serving as Executive Managing Editor of the Law Review. In 2003 Amanda was named Texas Tech School of Law's Outstanding Student in Taxation, which further motivated her in her long-standing goal to work in the field of estate planning and taxation. Amanda sat for the state bar exam in August, and she is preparing to take the CPA exam within the next year. Amanda has already proven to be a great addition to our team. Please join us in welcoming Amanda!

FIFTH CIRCUIT RULING A MAJOR VICTORY FOR TAXPAYERS IN USE OF FAMILY LIMITED PARTNERSHIPS

Recent case law confirms that estate and gift taxes can be saved by the use of family limited partnerships ("FLPs") if they are structured and operated correctly.

If you have an FLP, we recommend that you schedule an appointment with us to ensure that it is being operated properly.

If you do not have an FLP, consider forming one.

The IRS was handed a significant defeat by the United States Fifth Circuit Court of Appeals (which includes all of Texas) in its attack on valuation discounts used in valuing FLP interests for estate and gift tax purposes. The ruling in *Kimbell v. Commissioner* confirms that the creation of an FLP continues to be an important estate and asset protection tool. While the use of FLPs can provide significant estate and gift tax savings, they also offer a wide variety of non-tax benefits such as creditor protection, centralization of management of assets, protection of family assets in the event of a child's divorce, ease of annual gifting, and retention of assets within a family group.

While an FLP is often thought of as an estate planning technique (something that once signed never needs to be looked at again), it is important to remember that the FLP is a separate legal entity and must be treated as such in order to maximize estate and asset protection benefits. Therefore, it is important to ensure that proper formalities are maintained, such as titling all property in the name of the FLP, making distributions of cash or other property in accordance with the partnership agreement, paying partnership expenses only from partnership funds, and otherwise complying with the terms of the FLP agreement. It is also important to check to see if the FLP agreement needs to be amended to comply with lessons learned from recent tax cases.

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*Estate Planning & Probate Law N Tax Law

•Certified Public Accountant •Pending Bar Admission

MAKE GIFTING OF ESTATE ASSETS AN ANNUAL EVENT

Three reasons why making gifts to younger generation family members makes sense:

1. Gift Tax Exemption Frozen at \$1 Million

While the estate tax exemption amount has increased to \$1.5 million this year, the lifetime gift tax exemption amount remains at \$1 million. Thus, for clients who have already utilized their lifetime gift exemption of \$1 million, the increase in the estate tax exemption amount will offer no additional tax-free gifting opportunity.

Annual exclusion gifts do not count against either the lifetime gift tax exemption or the estate tax exemption. Remember to use your annual exclusion each year (\$11,000 per donee, \$22,000 per donee for a husband and wife). Also, direct transfers to qualifying educational institutions for educational expenses as well as amounts paid for medical expenses on behalf of an individual do not count against either the annual exclusion or the lifetime gift tax exemption.

2. Transfer of Assets with Appreciation Potential

One major benefit of making lifetime gifts, as opposed to testamentary gifts, is that the appreciation on the gift is removed from the grantor's taxable estate.

With the poor performance of the stock market and the economy over the last several years, valuations of assets are low and it may be a good time to transfer assets to younger generation family members so that the anticipated appreciation will not be taxed as part of the senior generation family member's taxable estate.

3. Take Advantage of Low Interest Rate Environment

Everyone, including those who have already used their entire \$1 million gift tax exemption, can still take advantage of the techniques outlined below to claim both tax and non-tax benefits on the lifetime transfer of assets to younger generation family members. These techniques are particularly attractive in the low interest rate environment which still exists. They also provide a creative way to transfer wealth without using much (if any) lifetime gift tax exemption. This is especially important since the gift tax exemption is frozen at \$1 million.

TECHNIQUES TO SHIFT FUTURE APPRECIATION OF ASSETS

1. SET UP A "GRANTOR RETAINED ANNUITY TRUST" (GRAT)

A GRAT involves the transfer of assets to a trust in which the donor retains an annuity for a number of years. The GRAT can be structured so that there is minimal or no gift tax upon creation. If the assets transferred to the GRAT grow in excess of the interest rate required by the IRS (which is currently 4.4% for October 2004) then the excess growth is transferred free of estate and gift tax.

2. SELL ASSETS TO AN "INTENTIONALLY DEFECTIVE GRANTOR TRUST" (IDGT)

The use of an IDGT involves the "sale" of assets to an irrevocable trust in exchange for a promissory note for the fair market value of the assets plus interest at the current interest rate required by the IRS, which is currently 3.62% for a 3 - 9 year note. There is no income tax due upon the sale, since the grantor is treated as the owner of the irrevocable trust for income tax purposes. However, when the grantor dies, only the balance due on the promissory note is included in the estate. If the assets grow in excess of the required interest rate of 3.62%, then this growth is transferred free of estate and gift tax to the descendants. The IDGT is **even more appealing** now since a recent IRS ruling clarifies some past uncertainty about gift tax benefits.

IT IS NEVER TOO LATE TO REDUCE ESTATE TAXES

1. SELL ASSETS IN EXCHANGE FOR A PRIVATE ANNUITY

The private annuity involves the sale of an asset in exchange for an annuity. For individuals with short life expectancies, the private annuity is a useful federal estate tax saving tool because, by design, payments end when the transferor dies, and the **entire value** of the asset sold is immediately removed from the transferor's gross estate. In other words, there is no estate tax in the

transferor's estate from the transferred property - because it belongs to the buyer from the moment the private annuity document is executed. Only the annuity payments received by the transferor, to the extent not spent, will be included in the estate. The annuity amount is based on the IRS life expectancy tables, and not on the seller's actual life expectancy. The seller must have at least a 50% chance of living at least one year, or the tables may not be used.

2. SELL ASSETS IN EXCHANGE FOR SELF-CANCELLING INSTALLMENT NOTE (SCIN)

A SCIN is a debt obligation which will terminate upon the death of the seller, with any remaining balance payable by the purchaser automatically cancelling. In order to compensate the seller for the risk of cancellation, the SCIN must have a risk premium which can be in the form of a higher interest rate or a higher sale price. A SCIN can be an effective estate planning tool because if a senior family member sells an asset to a junior family member in exchange for a SCIN, any remaining balance on the SCIN at the time of the senior family member's death will not be subject to taxation in the estate. The treatment of the SCIN for estate tax purposes differs from the treatment of a traditional installment note which would be subject to estate tax in the estate of a decedent.

DON'T FORGET TO PURSUE WAYS TO SAVE FRANCHISE TAXES AND PAYROLL TAXES

Although several bills were introduced in the last Texas legislative session which would have expanded the scope of the franchise tax to include partnerships, no change was made to existing law which exempts both general and limited partnerships from being subject to the franchise tax. The franchise tax is imposed at the rate of 4.5% of net income and applies to all corporations and limited liability companies with gross receipts in excess of \$150,000 per year. It is important to note that the sale of business or investment assets will also trigger franchise tax for a corporation or limited liability company and may cause an entity which was not normally subject to the franchise tax to become subject to such tax.

It is possible to convert an existing corporation or limited liability company into a partnership in order to avoid the imposition of the franchise tax. The conversion can be accomplished without incurring any federal income tax and may even be accomplished immediately prior to the sale of assets and still avoid the franchise tax on such sale.

If you are avoiding franchise tax by taking a bonus, then you are still paying 2.9% payroll taxes. You can avoid payroll taxes by converting to an entity not subject to franchise tax and taking the bonus as a dividend instead. This savings is especially easy for doctors, dentists, and other professionals who can operate as a Professional Association, but is available for other businesses and professionals as well. In appropriate circumstances, you can also reduce payroll taxes by taking part of the bonus as a payment for personally owned goodwill.

ASSET PROTECTION TRUSTS

Several states have now enacted legislation which would allow an individual to transfer assets to a trust and to name himself or herself as a beneficiary of this trust and not have the assets in the trust subject to the claims of his or her creditors. Although Texas has not enacted this legislation, it is still possible for a Texas resident to create a trust in another state (such as Alaska or Delaware), without leaving home.

These various statutes attempt to override the common law principle that an individual cannot create a trust of which he or she is a beneficiary and shield the assets in the trust from the claims of the individual's creditors. This opportunity is attractive to those who are concerned about liability exposure. A recent opportunity to decrease out-of-state Trustee fees makes this technique even more appealing. We can help you decide if such a trust, or one or more other asset protection tools, is right for you.

PRIVACY NOTICE

All work done within our Firm is subject to "attorney-client privilege," which means that, under the law, we cannot be forced to divulge any information that you have given to us. Beyond that, we are bound by our ethical standards to responsibly manage your file and information about you. Specifically, you need to be informed in regard to the following:

1. We collect nonpublic personal information about you as follows:
 - Information we receive from the estate planning questionnaire, insurance applications, tax returns, or other forms (e.g. date of birth, social security number, personal and business assets and liabilities, information regarding family relationships, etc.)
 - Information we are told by you, your family members, your CPA, banker, broker or insurance agent.
2. We do not disclose any nonpublic personal information about our clients or former clients to anyone, except as permitted by law.
3. We restrict access to nonpublic personal information about you to those who need to know that information to provide services to you. We maintain physical, electronic and procedural safeguards to protect your nonpublic personal information.

The comments compiled for this newsletter are general in nature and are not tailored to any particular situation. As in the case with any estate, tax or financial planning recommendation, the planning tips suggested in this summary should not be implemented without carefully considering the total economic impact. The advice of an attorney, accountant, or other financial planning professional will provide valuable aid in analyzing the suitability of the particular estate, tax, or financial planning tip for you.

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PRACTICE AREAS - THE FIRM'S "TOOLBOX"

ASSET PROTECTION PLANNING

- Partition Planning
- Homestead Exemption
- Family Limited Partnerships
- Gift Trusts
- IRAs
- Pension Plans
- Life Insurance Planning
- Accounts Receivable Pledging

BUSINESS PLANNING

- Choice of Entity Analysis
- Business Succession Planning
- Shareholder Agreements
- Buy-Sell Agreements
- Partnership Agreements
- Professional Association Agreements
- LLC Regulations
- Bylaws
- Asset Sale and Purchase Agreements
- Stock Sale and Purchase Agreements
- Partnership Interest Sale and Purchase Agreements
- Employment Agreements
- Covenants Not to Compete
- Incentive Stock Option Plans
- Non-qualified Stock Option Plans
- Leases
- General Business Contracts
- Tax Free Business Reorganizations
- Split Dollar Life Insurance

ESTATE PLANNING

- Living Trusts
- Wills
- Powers of Attorney
- Living Wills
- Gift Trusts
- 529 Plans
- Irrevocable Life Insurance Trusts
- Charitable Remainder Trusts
- Charitable Lead Trusts
- Lifetime QTIP Trusts

- Pre-Nuptial Planning
- Post-Nuptial Planning
- Estate, Gift, and Generation-Skipping Transfer Tax Reduction/Elimination
- Grantor Retained Annuity Trusts
- Grantor Retained Unitrusts
- Gift/Sale to Intentionally Defective Grantor Trusts

- Gifts of Limited Partnership Interests
- Qualified Personal Residence Trusts
- Private Annuities

TAX PLANNING

- Elimination of Texas Franchise Tax
- Reduction of Tax on Sale of Business
- Installment Sales
- 1031 Tax Deferred Exchanges
- Leveraged Partnerships
- Mixing Bowl Partnerships
- License of Personal Goodwill
- Compensation Planning
- Taxable Sale of Business
- Tax Free Acquisitive Reorganizations
- Tax Free Spinoffs
- Partnership Divisions
- IRA Partnerships

TAX EXEMPT ORGANIZATIONS

- Private Foundations
- Supporting Organizations
- Form 1023 Filings
- Form 990 Filings

ESTATE ADMINISTRATION/PROBATE

- Probate Court Matters
- Post-Mortem Tax Planning
- Estate Tax Return Preparation
- Trust Funding
- Disclaimers

TAX CONTROVERSY

- IRS Audit Representation
- Tax Court Representation

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