



ATTORNEYS AT LAW

Marvin E. Blum** Gary V. Post* John R. Hunter° Steven W. Novak* Len Woodard*
Amanda L. Holliday** Edward K. Clark° Catherine R. Moon** Laura L. Haley*
Amy E. Ott* Rachel W. Saltsman Christine S. Wakeman Kandice R. Damiano*
Kerri G. Nipp Julie A. Plemons Anna S. Johnson Kelsey A. Brock Emily K. Seawright
Emily R. Franco Leslie M. Levy

SQUEEZE, FREEZE, AND BURN. . . SQUEEZE THROUGH NOW BEFORE IT'S TOO LATE

by Marvin E. Blum
August 11, 2015

Squeeze, Freeze, and Burn. It sounds like an odd phrase, but it is actually a term used to describe a highly effective estate planning technique. It's so effective, in fact, that as early as this September the IRS is expected to change some of the rules governing the "Squeeze" aspect—but more on that later.

First, you probably already know that the estate tax exemption is around \$5 million per person (\$5.43 million in 2015), and assets above the exemption are subject to a 40% estate tax. But, did you know that the **estate tax is a voluntary tax**? Estate planners have enough estate planning tools in their tool boxes that even the wealthiest of people can avoid making the IRS a "silent partner" in their family's wealth. Consider the example of the world's richest family, the Walton family, founder of Walmart and Sam's Club. Although several of the Waltons have died, they used a variety of estate planning techniques to avoid the estate tax.

But, estate planning is not just for billionaires. Avoiding the estate tax is arguably more valuable for those whose wealth places them right above the exemption level. If you have assets valued above \$5 million, or if you *expect* to have assets valued above \$5 million upon your death, then you need to know about the Squeeze, Freeze, and Burn strategy and how it will likely soon change.

Squeeze, Freeze, and Burn is a well-established estate planning technique. The cornerstone of the Squeeze stage of planning is the valuation discount. By transferring assets to a family limited partnership, you "squeeze" down the value of the assets because the IRS allows the value of the limited partnership interest to be discounted for lack of marketability and lack of control. The valuation discount can be approximately 35%, which means you can turn \$100 worth of assets into a limited partnership interest worth \$65, thereby squeezing the size of your estate.

The next step is the "Freeze," which typically involves gifting and selling parts of your limited partnership interest to a Defective Grantor Trust, a 678 Trust, or a Spousal Lifetime Access Trust—each of which is outside of your estate for estate tax purposes. Once the assets are transferred to one of these trusts, the value of the assets is frozen and any future appreciation will take place outside of your estate.

The "Burn" step is simply the idea that you can Burn down (or spend) the money remaining in your estate over the course of your lifetime, so that upon your death, you leave behind an estate that falls below the exemption amount.

Regardless of the exact planning tools used in the Freeze and Burn stages, the Squeeze acts as a supercharger, accelerating the results of the Freeze. For example, suppose you have \$100 worth of assets and you expect those assets to appreciate to \$150. Skipping the Squeeze, you can still use planning tools to Freeze the assets at \$100, moving the \$50 appreciation outside your estate and leaving \$100 to Burn over your lifetime. But *with* the Squeeze, you can use the valuation discount to immediately turn the \$100 into \$65 (with a 35% discount), leaving yourself \$65 to Burn and moving \$85 outside of your estate (\$35 discount + \$50 appreciation = \$85).

As mentioned above, the IRS has its sights set on the Squeeze. In her speech to the Tax Section of the American Bar Association, Cathy Hughes with the Treasury Office of Tax Policy announced that the Treasury will soon issue proposed regulations that will restrict or eliminate valuation discounts for certain intra-family transfers. This change would severely limit the availability of the Squeeze step. Adding to the urgency, the latest word is that the window will close on the date that the Treasury issues these proposed regulations, not a future set date. However, transfers before that date are expected to be grandfathered.

You may have already transferred assets to a family limited partnership and think that, by doing so, you have completed your estate planning and Squeezed your estate through the use of valuation discounts. But unless you have proceeded to the Freeze stage of planning, those discounts are not yet locked in. With the issuance of the new regulations, any limited partnership interests held in your estate upon your death will be valued *without* a discount. Using the example above, the full \$150 of assets would be taxed in your estate. Squeezing your estate with valuation discounts must be locked in by making gifts or selling partnership interests to trusts outside of your estate.

Although the Freeze techniques will remain in the estate planner's toolbox, the window of opportunity to take advantage of the valuation discount is quickly closing—Squeeze through now while you can!