CALL FOR ACTION: VALUATION DISCOUNTS FOR FAMILY-OWNED ENTITIES

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WHAT'S THIS ALL ABOUT?

- Valuation discounts currently available for family-owned entities will soon be severely restricted.
- When valuing minority, non-controlling interests, discounts of 30-40% for lack of control and lack of marketability are often appropriate.
- The Treasury Department has issued proposed regulations under Internal Revenue Code Section 2704 which, if finalized in the current form, will severely restrict or even eliminate these valuation discounts for family-owned entities. A public hearing on the proposed regulations is scheduled for December 1, 2016, and the new rules could become effective as soon as 30 days after the public hearing.
- Safe until at least December 31.

Scenario 1: No Estate Planning

- Jack and Jill own investment assets worth $15 million and $2 million of other assets (home, bank accounts, cars, personal assets).
- Five years down the road, Jack and Jill die in a mountain-climbing accident. By this point, the investment assets have grown to $20 million.
- The federal estate tax will be $4,440,000.

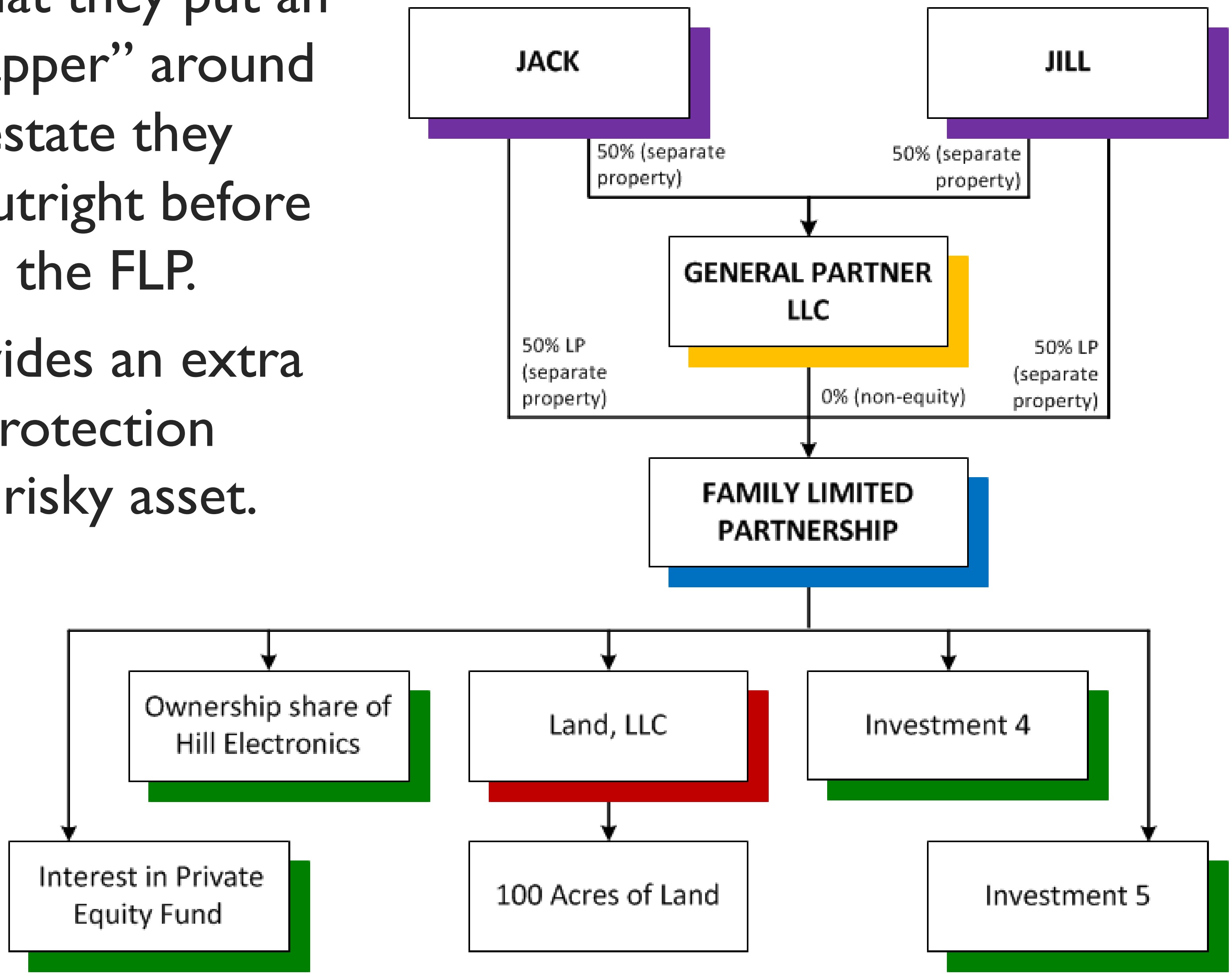
Investment Assets	$20,000,000
Other Assets	2,000,000
Total Assets	22,000,000
Less Estate Tax Exemption x 2	(10,900,000)
Taxable Estate	11,100,000
x 40% Estate Tax Rate	$4,440,000

- State-level estate or inheritance tax may also be assessed.

Scenario 2: FLP Planning

- Jack and Jill own $15 million of investment assets and $2 million of other assets.
- Jack and Jill put their investment assets into a Family Limited Partnership (FLP) with an LLC as the general partner.
- Jack and Jill are the initial limited partners of the FLP and each own 50% of the LLC.
- The following chart shows the new ownership structure.

- Notice that they put an LLC "wrapper" around the real estate they owned outright before putting in the FLP.
- This provides an extra layer of protection around a risky asset.



- Five years down the road, Jack and Jill go up that hill and die in the mountain-climbing accident.
- The investment assets have grown to a value of $20 million.
- Because the new 2704 valuation rules will apply at their deaths, there is no discount on their FLP interests.
- The federal estate tax will be $4,440,000 (and possibly additional state-level estate or inheritance taxes.) Same result as no planning.

Investment Assets	$20,000,000
Other Assets	2,000,000
Total Assets	22,000,000
Less Estate Tax Exemption x 2	(10,900,000)
Taxable Estate	11,100,000
x 40% Estate Tax Rate	$4,440,000

- To lock in the valuation discounts while they're still available, Jack and Jill need to do "Squeeze & Freeze" planning.

Scenario 3: Squeeze & Freeze Planning

- "Squeeze & Freeze" planning squeezes down the value by locking in the discounts for lack of control and lack of marketability that won't be available in the future and then freezes the value of the estate by moving future appreciation outside of your estate.
- Same scenario facts: Jack and Jill have investment assets initially worth $15 million and $2 million of other assets.
- They put their investment assets into an FLP with an LLC general partner, but they don't stop there.
- They <u>lock in the discount</u> by moving the FLP and LLC interests out of their names and out of their estate.

- There are several techniques available to move the interests out of your estate.
- They can be used in any combination of gifts and sales.
  - Gifts/sales to a Defective Grantor Trust ("DGT") for the benefit of your children.
  - Gifts/sales to a Spousal Lifetime Access Trust ("SLAT") for the benefit of your spouse.
  - Sales to a 678 Trust (also called a Beneficiary Defective Trust or "BDT") for the benefit of you and your family.

- Jack and Jill choose a 678 Trust because they want to continue to be able to benefit from the assets held in the FLP.
- A 678 Trust is unique in that it combines asset protection, estate tax savings, the ability to benefit from the assets built up over the years, and the continued ability to direct where the assets pass at your death.
- Jack and Jill sell their FLP and LLC interests to a new 678 Trust in exchange for a promissory note.
- <u>They locked in the discount</u> by moving the FLP and LLC interests out of their estate (out of their names).
- The value of the FLP and LLC interests was squeezed down to just $9,750,000 ($15 million less 35% discount).

- Five years down the road after the investment assets have grown to $20 million, Jack and Jill die.
- The federal estate tax will be $340,000.

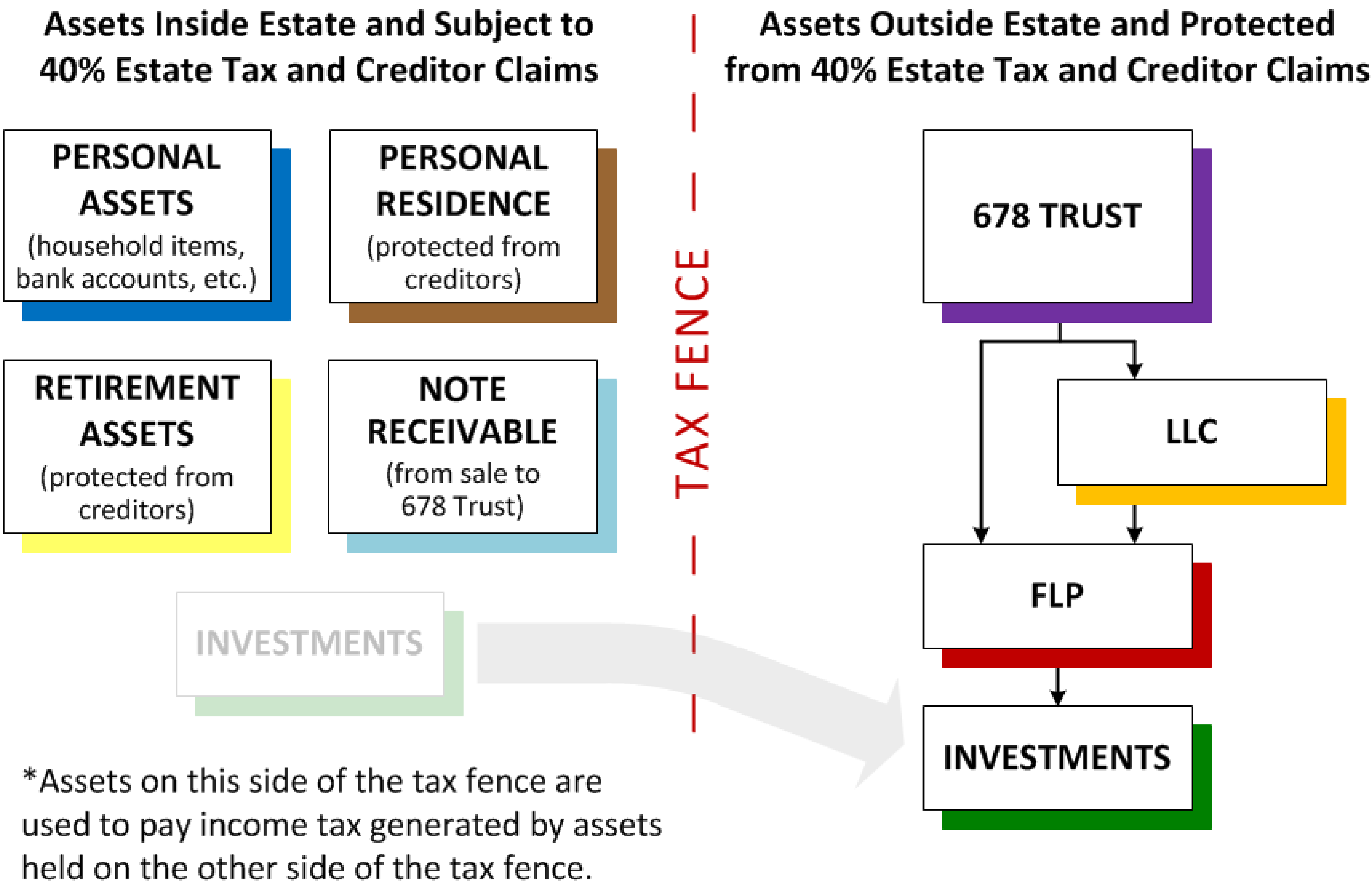
Promissory Note or Note Payments	$9,750,000
Other Assets	2,000,000
Total Assets	11,750,000
Less Estate Tax Exemption x 2	(10,900,000)
Taxable Estate	850,000
x 40% Federal Estate Tax Rate	$340,000

- This calculation assumes that the promissory note payments were not consumed (by living expenses and payment of income taxes) and remained in their estate at death. As the note payments are consumed, the estate tax savings will be even greater.

- Jack and Jill locked in the valuation discounts AND froze the value of their estates by moving future appreciation outside of their estates.

Federal Estate Tax	
Scenario 1: No Planning	$4,440,000
Scenario 2: FLP Planning Only	$4,440,000
Scenario 3: Squeeze & Freeze Planning (including FLP Planning)	$340,000

The Blum Firm's "Tax Fence" With Planning



QUESTIONS?

For more information on this planning technique, see "Squeeze, Freeze, & Burn: Estate Planning with 678 Trusts" available at *http://theblumfirm.com/wp-content/uploads/2016/Squeeze_Freeze_and_Burn_with_678_Trusts_August_2016.pdf*.

For more information on the proposed regulations, see "The End of Valuation Discounts for Family-Owned Entities" available at *http://theblumfirm.com/wp-content/uploads/2016/The_End_of_Valuation_Discounts_Oct2016.pdf.*