

THE SCGRAT

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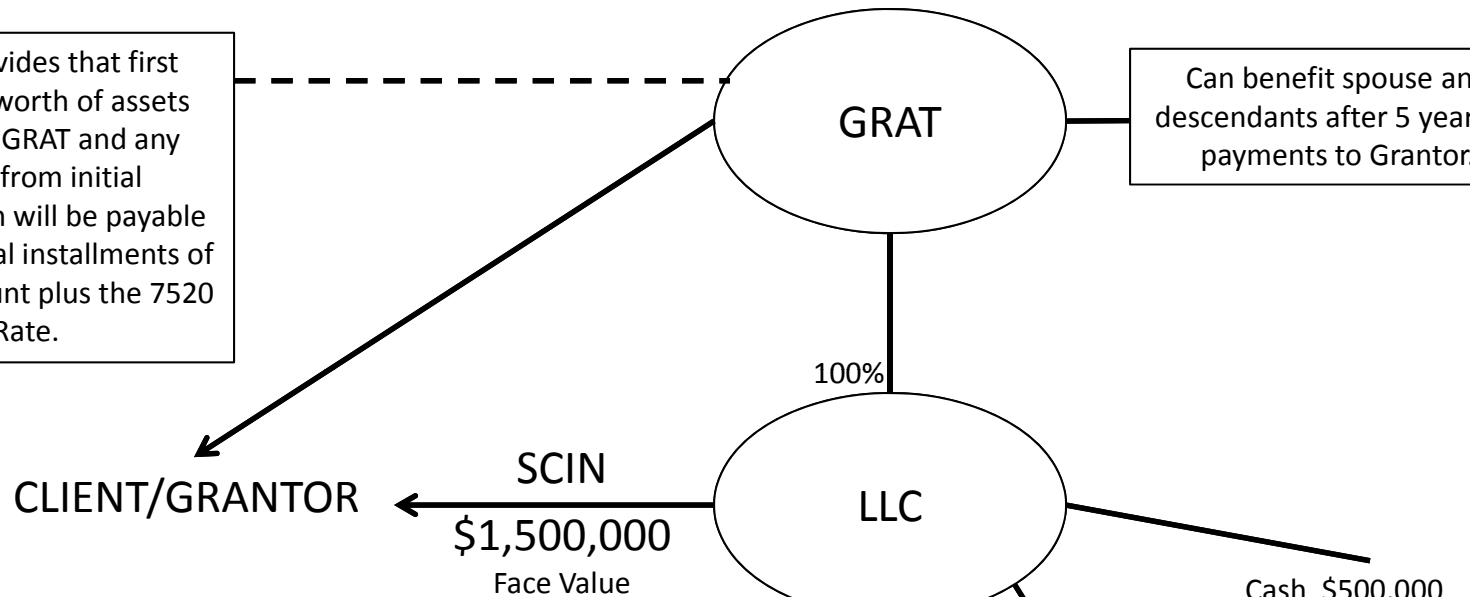
MORE THAN ONE WAY TO SCIN A GRAT? WHAT IF THERE IS NOT TIME TO APPRAISE THE UNDERLYING ASSETS AND ENTITY DISCOUNTS BEFORE COMPLETING A SELF-CANCELLING INSTALLMENT NOTE TRANSACTION?

Who took my tables?



GRAT provides that first \$400,000 worth of assets remain in GRAT and any excess from initial contribution will be payable over 5 annual installments of excess amount plus the 7520 Rate.

Can benefit spouse and descendants after 5 years of payments to Grantor.



Step 1 – Client places assets in LLC owned by client and receives back a Self-Cancelling Installment Note.

Step 2 – Client gifts 100% ownership in the LLC to the GRAT.

Step 3 – A valuation firm values the assets under the LLC and actuarial tables are used to determine the SCIN value.

Step 4 – The excess of asset value over the SCIN value is the GRAT contribution amount.

Step 5 – The GRAT may provide for holding assets equal to \$400,000, and distributing back 5 annual payments based upon any excess over \$400,000. $\$2,000,000 - \$1,500,000 = \$500,000$. $\$500,000 - \$400,000 = \$100,000$. $\$100,000 / 5 = \$20,000$ per year.

Step 6 – If the IRS determines that the valuation assumptions used are incorrect, any excess value will pass back to the Grantor over 5 annual payments, and will qualify for the estate tax marital deduction if the grantor dies during the first 5 years survived by a spouse.



Alan Gassman

\$1,928,571 in assets
 $(\$1,928,571 \times .9 \times .7 = \$1,500,000)$

BACKGROUND INFORMATION THAT IS PERTINENT TO THE CONSIDERATION OF THE SCGRAT

BY: ALAN S. GASSMAN, J.D., LL.M. AND KENNETH J. CROTTY, J.D., LL.M.



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The use of a leveraged Grantor owned limited liability company, or limited partnership is the subject of extensive writings provided by S. Stacy Eastland, who is a well respected estate tax planning lawyer who presently works as a Managing Director for Goldman & Sachs.

Mr. Eastland's Bloomberg BNA outline that was presented on March 23, 2012 entitled Two of our Favorite 2012 Gift Planning Ideas We See Out There; The Leveraged GRAT and the Remainder Purchase Marital Trust discusses the use of an LLC that can initially be owned by the Grantor to hold investments and can owe a note back to the Grantor to effectively leverage the contribution to a Grantor Retained Annuity Trust ("GRAT").

These materials include an in depth discussion of the Step Transaction Doctrine at pages 23 through 26 indicating that "The creation of the family limited partnership, or Family Limited Liability Company should be designed to be sufficiently independent on its own, and as an act that does not require a sale to that trust. There does not have to be a business purpose for the creation of the trust. It is difficult for this writer (Mr. Eastland) to understand the business purpose of any gift. As noted above, the Supreme Court has said on two separate occasions, estate and gift tax law should be applied in a manner that follows estate property law analysis. The outlined footnotes the US Supreme Court Cases of United States v. Bess (1958), Morgan v. Commissioner (1940), and the Ninth Circuit Case of Lindt v. US, which provides the following quote from Learned Hand's decision "that anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury" Helvering v. Gregory 69 F. 2d 809, 810-11 (2d Cir. 1934)?

Mr. Eastland's outline provides further discussion on the ability to have a GRAT provide that a specified dollar of value in assets can be retained, with excess value being used to measure the GRAT's payments back to the Grantor.



BACKGROUND INFORMATION THAT IS PERTINENT TO THE CONSIDERATION OF THE SCGRAT (CONT'D)

BY: ALAN S. GASSMAN, J.D., LL.M. AND KENNETH J. CROTTY, J.D., LL.M.

Footnote 61 on page 57 of Mr. Eastland's materials reads as follows:

For example, the formula might define the annuity as that percentage of the initial value of the trust assets (as finally determined for federal gift tax purposes) which will result in an annuity having a present value at the inception of the trust equal to the initial value of the trust assets (as so determined) less \$4,800,000. A GRAT annuity defined in this way has not been passed upon by the IRS or the courts. It should meet the requirements of Treas. Reg. 25.2702-3(b)(i)(B), which permits the annuity to be "[a] fixed fraction or percentage of the initial fair market value of the property transferred to the trust, as finally determined for federal tax purposes, payable periodically but not less frequently than annually, but only to the extent the fraction or percentage does not exceed 120 percent of the fixed fraction or percentage payable in the preceding year." In order to freeze the remainder value at a constant dollar amount, such a formula definition generates a greater annuity percentage (not just a greater annuity amount) for a higher initial value. The percentage is dependent upon finally -determined asset values and is fixed by them, since there is only one percentage corresponding to any given initial value of the trust. It therefore is hard to see in what sense this would not be a "fixed percentage," and the regulatory definition, with its reference to values "as finally determined for federal tax purposes," seems entirely consistent with defining the annuity percentage in this way. An initial annuity percentage defined in this way could then be made subject to the 20% annual increase permitted under the regulation, although that is not a feature of the technique under discussion.

Mr. Eastland's materials further discuss whether generation skipping tax exemption can be allocated to a GRAT where there is less than a 5% chance that the Grantor will die before receiving all GRAT payments.

Mr. Eastland states that based upon the rates in effect at the time of publication in 2012 that a two year GRAT payable to a Grantor under age 70 would satisfy the 5% maximum life expectancy requirement and that it should therefore be possible to allocate GST exemption to the GRAT under the ETIP ("Estate Tax Inclusion Period") rules. The ETIP rules prevent allocation of GST exemption to a GRAT in many circumstances. This discussion begins at page 55 of those materials.

It would be safest to wait until the GRAT term ends before allocating GST exemption to the GRAT.



Alan Gassman



Kenneth J. Crotty