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PEAK TRUST COMPANY

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Maurice R. Kassimir, Esq.

- Mr. Kassimir is an author on sophisticated tax planning strategies, including minimum distribution planning out of qualified plans and IRA’s. His article entitled “The Revocable-Irrevocable Life Insurance Trust“, published in the CPA Journal (August 2002), discusses the benefits of using second-to-die life insurance in a profit sharing plan.

- Mr. Kassimir is a frequent lecturer for New York banks, life insurance companies and professional organizations on sophisticated estate planning strategies and succession planning for closely held business owners. His clients generally consist of high net worth individuals, closely held business owners and executives of private and public companies.

Valuation Opportunities

- Objective to use current $11.58 million gift tax exemption ($23.16) for a married couple in ways **where access to the assets transferred are not forever lost.**
- Before we discuss how we have our cake and eat it too, let’s lay down the groundwork for a great estate plan.

Valuation Opportunities in a COVID Environment

- Great risk and greater uncertainty due to the pandemic often means lower values and greater valuation discounts.
- In the current economic environment, investors face unprecedented degrees of risk and uncertainty.

Valuation Opportunities in a COVID Environment

- These circumstances create the “Perfect Storm” for a significant reduction in the value of nearly all businesses;
- Especially commercial real estate values as tenants are not paying or slow to pay rent. Also in many areas there is a moratorium on evictions.

Valuation Opportunities

- Techniques may also be employed wherein the business owner or real estate investor transfers a significant percent interest in the business, but still retains significant control.
  - Transfer of voting vs. non-voting shares (S Corps)
  - Transfer of LLC interest in manager managed LLCs as opposed to member managed LLCs
  - *Powell* Case (2017). Bifurcation of management interests. Investments v. Distributions/Liquidations

Grantor Retained Annuity Trust (GRAT)

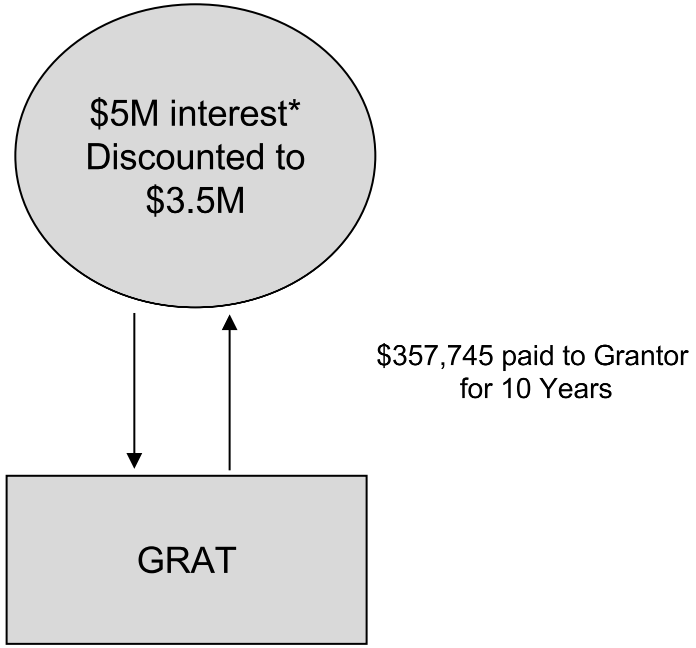
- **<u>How it works?</u>**
  - Grantor contributes property to a GRAT and retains an annuity for a specific term of years

- **<u>Tax Benefits</u>**
  - The assets remaining in the GRAT at the end of the term will pass estate and gift-tax free to the trust beneficiaries
  - *Grantor Trust (i.e. Grantor pays all income tax on income generated by the GRAT assets)*

- **<u>Risks/Downsides</u>**
  - If Grantor dies during term, family loses all estate planning benefits
  - Cannot implement a generation skipping plan
  - Current low interest rates
  - Interest rates are currently at near-historic lows, so it should be easier for the return on assets to exceed federal rates resulting in more property remaining in trust for the beneficiaries
  - November 2020 mid-term 7520 rate is .47%

Grantor Retained Annuity Trust (GRAT)

EXAMPLE



*assets that can be discounted include minority or non-controlling interests in business, commercial real estate and investment partnership

- Grantor contributes $5 million in assets to a GRAT with a discounted value of $3.5 million
- Grantor retains 10-year annuity
- Trust pays Grantor $357,745 annuity
- After retained term, property passes to descendants free of gift and estate tax
- No taxable gift because the Grantor retains exactly what was transferred
- If $5 million generates combined income and growth of 6%, <u>$4.24 million</u> will remain in trust and pass to family without any gift tax.

Gifting

- Get assets out of estate now while exemption is high
  - Exemption is $11,580,000 and decreases to $5,000,000 (as adjusted for inflation) in 2026
  - Exemption could decrease sooner due to a change in Administration

Gifting

- Due to COVID and other related factors, more assets can be squeezed into the exemption amount
  - Values of some securities have declined (airlines, hotels, etc.)
  - Real estate values have substantially declined (NYC real estate up to 75%)
  - Market Discounts have increased due to less likelihood of marketability of closely held business
  - Multiples of EBITDA have decreased in determining valuation of businesses

Gifting

- Estate/Gift Tax rates
  - Likely to increase with a changing in administration

- Compounding
  - Assets with lower current values will likely appreciate faster
  - Assets with higher valuation discounts will likely appreciate faster
  - The earlier assets are transferred the earlier the family can enjoy the power of compounding.

“Compound interest is the eighth wonder of the world. He who understands it, earns it; he who doesn’t pays it.” – Albert Einstein

Grantor Trust Rules

- Most powerful tool in estate planning
- Intentionally Defective Grantor Trusts
  - Completed gift for gift tax purposes
  - Incomplete for income tax purposes (IRC Sections 671-678)

Trust Borrowing

- Interest rates are lower now
  - The applicable federal rate for loans for November 2020 are:
    - Short term (not over 3 years) - 0.13%
    - Mid term (more than 3 but not over 9 years) - 0.39%
    - Long term (over 9 years) - 1.17%
    - 120% mid-term rate for GRATs - .47%

Trust Borrowing

- Doing sales to trusts in exchange for promissory notes using historically low values and interest rates can substantially leverage trust assets. As long as trust pays the .39% mid-term rate for a note 3-9 years, all returns in excess of .39% (plus effects of valuation discounts and grantor trust rules) will cause the trust assets to grow at an accelerated rate.

Having Your Cake and Eating it Too!!

SLATS with and without LLCs

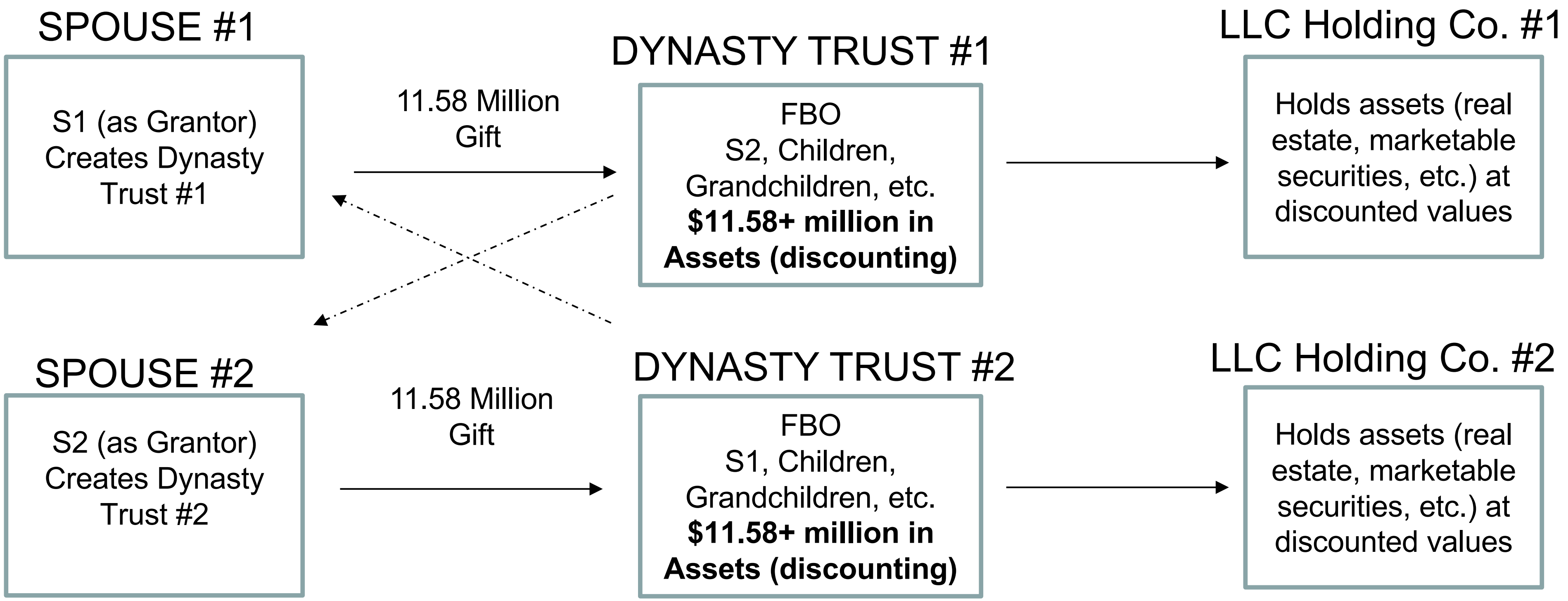
Self-Settled Trusts in Asset Protection Jurisdictions

Spousal Lifetime Access Trusts (SLATs)

S1 and S2 each:

1. "lock in" federal exemption at current value
2. Retain full access: 100% while alive, 50% at first death

<u>AVOID RECIPROCAL TRUSTS</u>



Sale to an IDGT vs. GRAT

Gift/Sale to Defective Grantor Trust	Gift to GRAT
Create trust (IDGT)	Create trust (GRAT)
Make $11.58 million gift to fund the Trust	Fund Trust with underappreciated or rapidly appreciating assets
Sell any remaining business interests to the IDGT in exchange for a promissory note	GRAT uses cash flow to pay annuity for specific term
Trust uses cash flow to service note payments	Grantor reports trust income on his/her tax return and pays the tax
Grantor reports trust income on his/her tax return and pays the tax	

Sale to an IDGT vs. GRAT

Sale to Defective Grantor Trust	Gift to GRAT
Advantages/Benefits	
Availability of Valuation Discounts	Availability of Valuation Discounts
Shifts of Income Tax Burden	Shift of Income Tax Burden
No Capital Gains Tax	Codified in Internal Revenue Code
GST Leveraging	Low Gift Tax Cost
End Loading (balloon note)	Self Adjusting Feature (no gift tax exposure)
Retain Cash Flow	

Sale to an IDGT vs. GRAT

** *Wandry* and *Nelson* Cases – Defined Value Formula

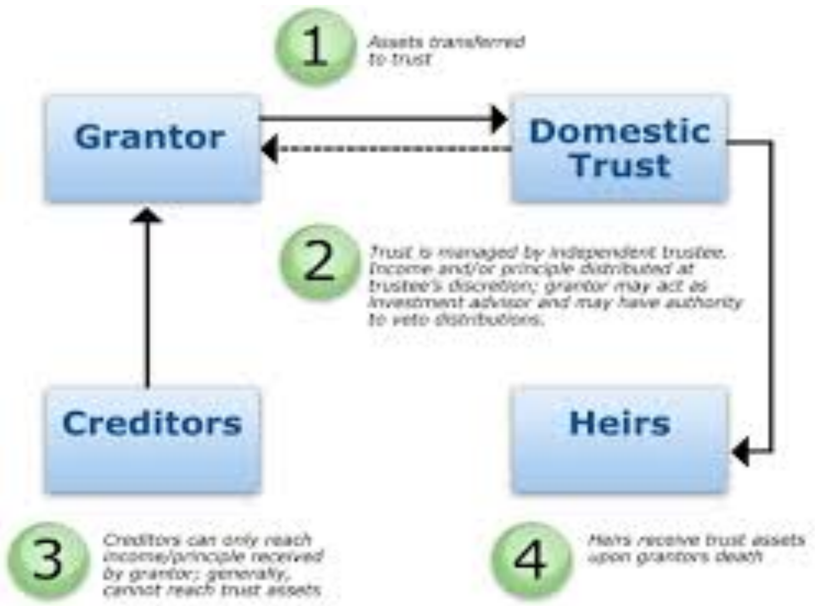
Gift/Sale to Defective Grantor Trust	Gift to GRAT
Disadvantages/Risks	
Non-Statutory	Mortality Risk
Gift Tax Exposure **	GST Concerns
Front-End Gift	No Basis Step-Up
Income Tax Uncertainty Upon Premature Death of the Grantor with a Sale	

Self-Settled Trusts

- **<u>What is it?</u>**
  - Any trust an individual creates or "settles" for the benefit of himself or herself
- **<u>Why?</u>**
  - Asset Protection
  - Access

Self-Settled Trusts

- **<u>Jurisdiction</u>**
  - Alaska Statute 34.40.110 (first state)
  - Nevada Chapter 166
- **<u>Why does it work?</u>**
  - Assets not subject to claims of creditors pursuant to state law (KEY)
  - Key terms:
    - Trust should be entirely discretionary. Ability to accumulate income and make no required principal distributions (at least until Grantor death)
    - Further restricting a Trustee's discretion (either by a HEMS standard, withdrawal power or requiring consent of an adverse party). Extra level of protection.
    - Ensure the trust cannot be/is not used to help satisfy the Grantor's support obligations (divorce, child support, etc.)
    - No evidence of implied understanding or a prearranged plan



Self-Settled Trusts: Alaska Statute

- **Alaska Statute 34.40.110**
  - **"(e)** If a trust contains a transfer restriction allowed under (a) of this section, the transfer restriction prevents a creditor existing when the trust is created, a person who subsequently becomes a creditor, or another person from asserting any cause of action or claim for relief against a trustee of the trust or against others involved in the preparation or funding of the trust for conspiracy to commit fraudulent conveyance, aiding and abetting a fraudulent conveyance, or participation in the trust transaction. Preparation or funding of the trust includes the preparation and funding of a limited partnership or a limited liability company if interests in the limited partnership or limited liability company are subsequently transferred to the trust. The creditor and other person prevented from asserting a cause of action or claim for relief are limited to recourse against the trust assets and the settlor to the extent allowed under AS 34.40.010."

Q&A

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