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The Estate Analyst

TAX REFORM PREVIEW
NEW: THE NEVADA RESTRICTED LLC AND LP
& CELEBRITY ESTATE UPDATES

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"That's one small step for man, one giant leap for mankind." - *Neil Armstrong, July, 1969*

Change is in the air…tax change that is. The recently released "Green Book" from the Treasury contains a look at the tax laws coming down the pike. These may not measure up to the dramatic tax reform changes of yesteryear, but they certainly contain some serious tweaking. (Brace yourself to be semi-dazzled by all this tweaking.)

There is also a brand new species of LLC and LP that was just born in Nevada that will make other state tax havens green with envy. A Restricted LLC or LP provides an easy way to increase and customize valuation discounts for estate-planning purposes. There is also a collection of notable celebrity estates in the news that are covered in this issue.

GREAT TAX OVERHAULS

This 111th Congress is not your father's Congress. A generation ago there were big time reforms and overhauls of the tax code. For instance, the Tax Code of 1954 was renamed the Tax Code of 1986 by the Tax Reform Act of 1986. Yes, it was essentially the same code with a new name, but in terms of big gestures, nothing says "change" like a new name for the entire code.

Some Congresses have channeled the spirit of big time reforms by taking up their brooms and sweeping aside existing tax laws. "Reform," was their mantra and they adopted a Spartan directness in their nomenclature. Hence we have had the Tax Reform Act of 1976, the Tax Reform Act of 1984, the Tax Reform Act of 1986, and the Tax Reform Act of 1997.

Other Congresses have provided descriptive titles that produced awkward acronyms such as the Employee Retirement Income Security Act of 1974 (ERISA) and the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA).

With the new millennium, Congresses have tried using wishful thinking to spin their legislative efforts. This has produced the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the Job Creation and Worker Assistance Act of 2002 (JCWAA), the American Jobs Creation Act of 2004 (AJCA), the Emergency Economic Stabilization Act of 2008 (aka, "the bailout"), and the The American Recovery and Reinvestment Act of 2009 (aka, "the stimulus package").

More recently, members of the 111th Congress of 2009, perhaps regretful of providing bailouts, have proposed HR 1068, which, believe it or not, may be officially cited as the "Let Wall Street Pay for Wall Street's Bailout Act of 2009."

TWEAK-A-RAMA '09

Now that we are all bailed out, stabilized, and stimulated (or close enough), we are once again approaching the serious business of reforming the tax code to reflect all this change. One would expect Congress to step in sometime fairly soon since time is running out on the estate tax at the conclusion of 2009.

We also have been afforded a potential preview thanks to the recent release of the Administration's 130-page "Green Book" on May 11, 2009. This is not a final law, of course, but it provides an outline of what to anticipate for income and transfer taxation for the present as well as beyond 2010. The Green Book is released by the Treasury Department under the title, "General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals."

Don't expect the kind of tax overhauls of the 1980s. Legislators are now caught between the need to "fix the system" through tax cutting stimulations and the need to raise more tax revenues to prevent the chasm of budget deficits from widening even further. As a result the

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"changes" involve such a recycling of previous laws that the next tax package might well be named the Refried Pork and Beans Act of 2009.

Estate and Gift Tax: Under the proposal, the existing rates and limits would NOT expire at the end of 2009 but would continue into 2010 and beyond. So the top estate tax rate would remain at 45% and the estate tax exemption would remain at $3.5 million.

Analysis: Presumably the gift tax exemption would remain separate at $1 million but with the termination of the endeavor to repeal the estate tax, there may no longer be a good reason not to re-unite the estate and gift taxes into a unified transfer tax system once again.

Valuation Discounts: The proposal would address valuation discount techniques by requiring the valuation for estate and gift tax purposes to coordinate with the basis taken by beneficiaries of the estate. A new category of "disregarded restrictions" would be created under Section 2704(b).

Analysis: There is a limited window of opportunity right now. Interest rates are low and could rise significantly as the full effect of deficit spending catches up. Asset values are very low and could appreciate significantly in the future. This would be the ideal time to borrow funds, transfer assets, and utilize valuation-discounting methods before they are restricted.

Lifetime Gifts: The basis on property transferred to a beneficiary during a donor's lifetime cannot exceed the donor's basis. Note: This indicates a continuation of the stepped-up basis for assets held at death, narrowly averting the carryover basis yet again. It also implies greater scrutiny on the basis claimed for lifetime gifts and places an additional burden on executors to establish such basis.

Analysis: The retention of the stepped-up basis is cause for celebration, but the potential "disregarded-restrictions" scrutiny of family limited partnerships, limited liability companies, and other techniques used to create valuation discounts may challenge the benefits of existing arrangements and have a chilling effect on the use of such arrangements.

GRATs: A more specific limitation could be imposed on grantor retained annuity trusts (GRATs) that are used for discounted valuation for transfer tax purposes. A GRAT is an irrevocable trust that enables the grantor to pass along interests often at a current discounted value and then have them appreciate in value inside the trust (and outside of the taxable estate). Under the proposed rules, a minimum ten-year term would apply to GRATs. The problem is that a longer term increases the likelihood of the grantor dying during the term and losing the transfer tax shifting benefits of the GRAT.

Analysis: There is no indication of how such rules would treat trusts that are irrevocable on the date of a new law. Moreover, these are just proposals of laws that might not take affect until 2011. Many modifications in these proposals may take place before they are enacted.

Income Tax Rates: Returning once more to the tax code would be the 10, 15, 25, and 28 percent income tax brackets adopted in 2001 but, effective in 2011, the top rates of 33% and 35% would go to 36% and 39.6%, respectively for individuals earning more than $200,000 and couples filing jointly and earning more than $250,000.

Capital Gains: Also making a return engagement would be the current 10% and 15% brackets for long-term capital gains. These would be made permanent, but after 2010 there would be a 20% bracket for those in the 36% or 39.6% brackets. However, qualified dividends would continue to fall under the more favorable capital gains rates.

AMT: The unsolvable dilemma will neither be abolished nor cured. It will endure. There would continue to be patches to the alternate minimum tax.

Analysis: Many of those in the top income tax brackets are already paying an effective rate of 20% on capital gains as a result of the alternate minimum tax, so the threat of the capital gains increase is somewhat muted.

ECONOMIC SUBSTANCE

The new package may codify the "economic substance" doctrine developed by courts to limit abusive attempts to comply with the letter but not the spirit of the tax code. For example, the Fifth Circuit recently joined the majority of circuits in supporting the IRS argument that a lack of economic substance invalidates a transaction regardless of tax avoidance motives. The decision in, Klamath Strategic Investment Fund v. United States, was handed down on May 15, 2009. The court concluded that "no reasonable possibility of profit existed."

Analysis: Taxpayers attempting to meet explicit requirements may feel that they are within a "safe harbor" and yet have the IRS or a Court utilize the economic substance argument to claim they know what the taxpayer was really thinking. This may inhibit the use of legitimate planning techniques.

NEVADA'S RESTRICTED LLC AND LP

Attention all state havens for income and transfer taxation (this means you Alaska, South Dakota, and Wyoming), prepare to be jealous of the latest state advantage in the effort to be the most taxpayer friendly haven for estate planning.

We return once more to the state of Nevada, where residents are so modest that, according to legend, even the indiscretions of visitors must never be revealed beyond the boundaries of Las Vegas. Judging from state legislation, the elected representatives of this community are equally protective of the estates of their constituents.

Nevada has just introduced something brand new, the Restricted LLC or LP. As signed by the Governor on May 29, 2009 (with effective date

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of October 1, 2009), SB 350 provides a statutory option allowing limited liability companies and limited partnerships the option of including in their original articles of organization or partnership agreement (or the amendments thereof) a provision that imposes restrictions on the making of member or partner distributions for up to 10 years.

This may be one of the first instances of state law adopting a new valuation-oriented variation on the Uniform Laws applicable to such entities.

"I feel a little like Neil Armstrong," said attorney Steven J. Oshins, of Oshins & Associates, LLC of Las Vegas, Nevada.

Oshins originally conceived of the statutorily created restriction in 2003 but it had taken a back seat to his efforts in coaxing the Nevada legislature to make charging orders the exclusive remedy of a judgment creditor of a member or partner of an LLC or LP, respectively (2003) and creating Nevada's 365- year rule against perpetuities (2005).

The new technique adds a useful and flexible option for LLCs and LPs that can shift valuations effectively for estate-planning purposes. Appraisers estimate additional valuation discounts ranging from 10% to 35% on top of the existing valuation discounts applicable to owning a minority or non-voting share of an LLC or LP.

A draftsman could structure restrictions for a specific number of years and set ceiling limits on distributions for that time period. One could design such an entity with specific circumstances and valuation discounts in mind.

Of course, even as the ink dries on the brand new Nevada law, the Treasury is considering drafting rules of their own to counter such valuation techniques by categorizing them as "disregarded restrictions." On the other hand, the Treasury can't dictate how willing buyers and sellers do business and how real restrictions affect value. There will be lobbying efforts and modifications to the Green Book proposals before they take their final form.

"This could impact the restricted LLCs and LPs," noted Oshins.

Nevertheless, the Restricted LLC and LP law is a fabulous innovation that may inspire a chain reaction of state specific variations on how LLCs and LPs are utilized. Vegas odds aren't available but the smart word on the street…always bet on Oshins. When the sun sets over the magnificent desolation of Nevada,1 there will likely be an Oshins-influenced solution to counter anything the Treasury can come up with.

TECHNICAL REFERENCES

1. "Magnificent desolation " takes its cue from the words spoken by the second astronaut to set foot on the lunar surface, Edwin "Buzz" Aldrin. After Aldrin had leapt from the Lunar Module and followed Armstrong out into history, Armstrong had queried, "Isn't that something! Magnificent sight out here." To which Aldrin replied, "Magnificent desolation," which inspired a 2005 documentary in 3-D by that same name. Aldrin then took communion on the moon. He may have been originally intended to be first on the moon. He recently appeared in an episode of The Simpsons on television and tells Homer, "Second comes right after first!" July 20, 2009 marks 40 years since the moon landing.

CELEBRITY ESTATES

MADOFF UPDATE: Bernard Madoff's victims have slightly more chance of recovery these days. Initially the court-appointed trustee had recovered $650 million out of an estimated$50 billion of losses. These days the trustee has recovered $1.2 billion out of an estimated $20 billion of actual losses. Six major lawsuits have been filed by the trustee to recover additional funds.

ELVIS PRESLEY: Elvis and Vegas sound like the perfect combination but investor Robert Sillerman's timing was off when he borrowed $475 million to launch a Las Vegas resort with an Elvis theme. Sillerman purchased commercial rights to Elvis for $50.1 million in 2004 and had purchased 31 acres adjacent to Graceland for purposes of building a hotel and conference center. The Vegas project is in default and the Graceland project is on hold. Sillerman's companies also own the American Idol franchise. Elvis Presley remains the top earning dead celebrity.

MARTIN LUTHER KING, JR.: The estate of Martin Luther King, Jr. has some legal issues to resolve. A potential film deal with Dreamworks was announced and then contradicted. Three lawsuits involving the estate are pending and the three heirs of the King estate are at odds, causing a $1.4 million book deal on Coretta Scott King's life to fall apart as well. An executor over intellectual property rights would have been a valuable aspect of planning.

LEONA HELMSLEY: Although there had been public reports that the entire Leona Helmsley estate was to go to dog-related charities, a New York Surrogate Court ruled in February that Trustees for the estate had the authority to determine the charitable beneficiaries. The Trustees have now named a number of medical research facilities and charities that will receive $136 million and $1 million will go to 10 animal rights charities.

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