

MINIMIZING THE ESTATE TAX HIT

1. FEDERAL ESTATE TAX STRUCTURE

TRANSFERS TO A SPOUSE OR CHARITY ARE TAX FREE.

LIFETIME EXEMPTION (AS OF 2015) OF \$5,430,000 PER DONOR FOR TRANSFERS TO CHILDREN, ETC.

EXEMPTION INDEXED ANNUALLY FOR INFLATION.

PORTABILITY-HUSBAND AND WIFE CAN COMBINE EXEMPTIONS AT FIRST DEATH.

FLAT RATE, FOR BOTH GIFT AND ESTATE TAX ON TRANSFERS OVER THE EXEMPTION OF 40% FEDERAL.

COMBINED FEDERAL AND OREGON RATE OF 50% FOR ESTATES OVER \$10 MILLION.

FEDERAL GIFT TAX APPLIES TO LIFETIME TRANSFERS OVER THE EXEMPTION.

ANNUAL GIFTS OF \$14,000 PER RECIPIENT ARE EXEMPT FROM GIFT TAX.

OREGON HAS NO GIFT TAX.

FEDERAL AND OREGON ESTATE TAX RETURNS ARE DUE 9 MONTHS AFTER DATE OF DEATH.

6 MONTH AUTOMATIC EXTENSIONS ARE AVAILABLE BUT THE TAX IS STILL DUE ON THE 9 MONTH DATE.

14 YEAR INSTALLMENT PAYMENT-6166 ELECTION BY ESTATE.

CLOSELY HELD BUSINESS MUST BE 35% OF ESTATE VALUE.

INTEREST ONLY AT 1/2 FEDERAL RATE FOR 4 YEARS; TAX PLUS INTEREST AT 1/2 THE FEDERAL RATE IS PAID OVER NEXT 10 YEARS.

IRS MUST GET SECURITY FROM THE ESTATE

CONSIDER "PROTECTIVE" 6166 ELECTION EVEN IF BUSINESS IS LESS THAN 35% OF ESTATE.

OREGON ALLOWS DEFERRED TAX PAYMENT, AT DEPARTMENT OF REVENUE DISCRETION, BUT AT FULL OREGON INTEREST RATE.

GRAEGIN LOANS

ESTATE BORROWS THE MONEY TO PAY THE TAX.

LOAN PROHIBITS PREPAYMENT.

TOTAL INTEREST OVER THE LIFE OF THE LOAN DEDUCTED ON THE FEDERAL AND OREGON ESTATE TAX RETURNS.

RESULT IS 50% SAVING TODAY FOR INTEREST PAID OVER THE LIFE OF THE LOAN.

REPEAL OF THE FEDERAL ESTATE TAX

THE FEDERAL ESTATE TAX NOW APPLIES TO 14/100THS OF 1% OF DECEDENTS DYING IN THE U.S. AND PRODUCES A MINISCULE AMOUNT OF REVENUE (ABOUT \$20 BILLION PER YEAR).

REPEAL WOULD LIKELY MEAN MODIFICATION OR REPEAL OF STEPPED UP BASIS (NOW A VERY LARGE TAX SAVING TO FAMILIES).

THE POLITICOS LIKE TO SCARE DONORS WITH THE "LOOSE YOUR FARM-LOOSE YOUR BUSINESS" PITCH, AND IT JUST AIN'T SO.

EXPECT REPEAL TO BE LIKE THE WEATHER- LOTS OF TALK BUT NO ACTION.

OREGON ESTATE TAX

OREGON EXEMPTION IS ONLY \$1 MILLION.

NATURAL RESOURCES CREDIT.

INCOME TAX BASIS "STEP UP" CAN BE THE MOST IMPORTANT TAX OPPORTUNITY.

2. OPTIMUM STRATEGIES

LIFETIME GIFTING

THE ESTATE TAX RATE AT DEATH IS 50% OF THE TOTAL ESTATE MINUS EXEMPTIONS.

THE GIFT TAX RATE IS 50% OF THE GIFT AMOUNT.

THE EFFECTIVE GIFT TAX RATE (FOR LIFETIME GIFTS) IS 29% INSTEAD OF 50%.

PROOF:

TOM HAS \$100 AND LEAVES HIS ENTIRE ESTATE TO HIS SON SAM WHEN TOM DIES.

TOM'S ESTATE PAYS A 50% TAX OF \$50 TO THE IRS AND SAM INHERITS \$50.

INSTEAD TOM GIVES HIS ENTIRE ESTATE, LESS THE GIFT TAX, TO SAM DURING HIS LIFETIME.

SAM GETS \$72 AND TOM PAYS 40% OF \$72 TO THE IRS: $\$72 \text{ GIFT} + .4 \times \$72 = \$100$.

TO GET THIS RESULT TRANSFEROR MUST LIVE 3 YEARS AFTER THE GIFT.

TRADEOFF: THE RECIPIENT GETS THE DONOR'S INCOME TAX BASIS.

MORAL: IF THE BUSINESS IS GOING TO STAY IN THE FAMILY LIFETIME GIFTS ARE MORE TAX EFFICIENT.

MAKING NUMEROUS GIFTS DURING LIFETIME GIVES THE IRS A SMALLER TARGET TO DISPUTE.

GIFT TAX AUDITS ARE RARER THAN ESTATE TAX AUDITS.

VALUE MINIMIZATION

"DISCOUNT" PLANNING WITH CLOSELY HELD BUSINESS INTERESTS IS THE NAME OF THE GAME (DISCUSSED BELOW).

GETTING BASIS STEP UP

"UNDISCOUNTING" THE BUSINESS OWNERSHIP; OREGON NATURAL RESOURCES CREDIT.

3. BUSINESS FORMS AND CONTROL DEVICES

SOLE PROPRIETOR

GENERAL PARTNERSHIP

S-CORPORATION

LIMITED PARTNERSHIP

LLC

GRANTOR TRUST

SELL BUSINESS INTEREST TO A TRUST FOR BENEFIT OF OWNER'S SPOUSE.

ANYBODY CAN BE TRUSTEE EXCEPT THE DONOR.

NO INCOME TAX BECAUSE TRUST IS TAXED TO THE DONOR.

INHERITOR'S TRUST

TRUST FOR CHILD.

CHILD CAN BE TRUSTEE.

TRUST IS KEPT OUT OF THE ESTATE OF THE CHILD.

PROTECTED FROM CHILD'S CREDITORS AND "EX-SPOUSE."

ROLL OF THE FAMILY OFFICE

4. VALUATION PRINCIPALS

HYPOTHETICAL WILLING BUYER-WILLING SELLER

LACK OF CONTROL

LACK OF MARKETABILITY

VALUING MULTIPLE LIFETIME GIFTS INSTEAD OF ALL IN THE GROSS ESTATE

HANCOCK STUDY BLOCKAGE DISCOUNT

Hancock Timber Research Report, R-00-1, "Taking Advantage of the Wholesale Discount for Large Timberland Transactions," February 2000; Internal Revenue Service Publication, September 2005, "Timber Casualty Loss Audit Techniques Guide-Chapter 6 Diminution of FMV: Verification."

TENANTS IN COMMON

5. FIGHTING THE IRS

WATTS

Estate of Watts v. Commissioner, T.C.M. 1985-595; affirmed, 823 F. 2d 483 (11th Cir., 1987).

Martha Watts owned a 15% partnership interest in Rosboro Lumber Company when she died on December 7, 1978.

Rosboro owned 22,300 acres of timber land as well as several manufacturing facilities.

Mrs. Watts estate reported her interest in Rosboro as worth \$2,550,000 using a going concern capitalized income valuation.

The IRS concluded the 15% partnership interest was worth \$20,006,000 using a business liquidation (sale) analysis.

The Tax Court and the 11th Circuit agreed with the estate:

Rosboro had been in business for over 30 years.

The partnership agreement prohibited transfer of a partnership interest to anyone who did not agree to continue the partnership.

Mrs. Watts could not, with only a 15% interest, force the partnership to dissolve.

Because the standard of value presumes a hypothetical "willing buyer" the actual intent of the partners to continue or discontinue the business is irrelevant.

Therefore any assumption about liquidation is purely speculative and the valuation based on a "going concern" is correct.

SIMPLOT

Estate of Richard R. Simplot v. Commissioner, 112 T.C. 130 (1999); reversed and remanded 249 F. 3d 1191 (9th Cir., 2001).

Richard Simplot died in 1993 owning 23.5% of the voting stock of J.R. Simplot Co, an Idaho agricultural conglomerate founded by his father who survived Richard.

Richard also owned 2.8% of the nonvoting shares of the company. The ratio of voting to nonvoting shares was a whopping 1,848 nonvoting shares to each voting share.

The Tax Court speculated that the 23.5% of voting stock could someday combine with other voting stockholders to control the company and concluded that the total of all voting stock carried a premium equal to 3% of the total company equity (the total equity was \$830 million). So while the estate's voting stock was only .0127% of the company equity, it carried a premium of .7% of the company total equity (a 5500% premium)

The estate had reported the value in the company owned by Richard at \$10.5 million. The Tax Court redetermined the total to be \$18.5 million.

The estate appealed to the 9th Circuit Court in San Francisco.

The 9th Circuit held: "The facts supplied by the Tax Court were imaginary scenarios as to who a purchaser might be..." "...all of these imagined facts, are what the Tax Court based its 3% [total equity] premium upon."

The case was remanded with instructions to rule for the taxpayer's position.

GIUSTINA

Estate of Giustina v. Commissioner, T.C. Memo 2011-141 (2011); on appeal to 9th Cir. Case No. 10983-09.

N.B. Giustina died in Eugene, Oregon on August 13, 2005. At the time of his death Giustina owned a 44.128% equity interest as a limited partner in Giustina Land & Timber Co ("GLT"). While GLT had been organized as a limited partnership in 1990, that form of business was a continuation of timber and lumber businesses going back to 1917.

GLT bought and sold timber parcel generally to coordinate operations with its other timber holdings and was not a "trader" in timber lands.

The taxpayer reported the GLT interest of the decedent at \$12,678,117 on the Estate Tax Return filed May 15, 2006. On audit the IRS asserted the value of the GLT interest was \$35,710,000.

The Tax Court trial was conducted in Portland beginning March 9, 2010 and lasted 3 days.

The Tax Court concluded in an opinion issued June 22, 2011 that, though it took 70% of the limited partner interest to dissolve the partnership, there was a 25% chance that a buyer of the decedent's interest could combine with other limited partners to force a liquidation. The Tax Court came up with a blended valuation:

Going concern (capitalized earnings) total company value = \$51,702,857.

Liquidation value of the company = \$150,680,000 (after applying a Hancock discount of 40%).

75% weighting to going concern = \$38,777,142 and 25% to liquidation = \$37,670,000. Added together the total value of GLT was \$76,447,143. To this a partial marketability discount was applied leaving a total GLT equity value of \$66,752,857.

The enterprise value multiplied by the estate's interest of 41.128% results in a taxable value of \$27,454,115 (217% of the estate's reported value).

Tax Court speculations:

That the buyer of the 41.128% limited partnership interest would be admitted as a voting limited partner.

That the owner of the 41.128% limited partnership interest could combine with members of the Giustina family (which had been in the timber business for 88 years) to force a liquidation of the company.

That the buyer of the 41.128% limited partnership interest would be so rich that he or she would diversify their risk of such a large concentration in timber investments by buying other diversified assets (securities and real estate).

The Tax Court decision is on appeal and a hearing before a 3 judge panel of the 9th Circuit Court of Appeals was conducted in Portland during March of 2014.

The best analysis and critique of the Tax Court decision was written by Steve Akers, Senior Fiduciary Trust Counsel, Bessemer Trust. It can be found by Googling "Steve Akers Estate of Giustina" and opening the hit "Estate Planning Current Developments." This is a PDF file. Go to page 142, topic 15.

6. WORKING WITH APPRAISAL FIRMS

THE TAXPAYER'S APPRAISER

THE GOVERNMENT'S APPRAISER

REMEMBER THE "HANCOCK" BLOCKAGE DISCOUNT