TAX REFORM ACT OF 2010 JUST MADE INTENTIONALLY DEFECTIVE TRUSTS EVEN MORE INTENTIONAL

By Jerry Snow

Among the many benefits of the two-year planning window opened up by the Tax Reform Act of 2010 is the opportunity to hyperfund various trusts. A so-called intentionally defective grantor trust ("IDGT" for convenience) is a vehicle to which a grantor may sell appreciated assets without having to recognize income tax, usually in the form of an installment contract, often with interest-only payments and a balloon payment at the end of the contract. Furthermore, the asset sold may qualify for a valuation discount. With interest rates at historic lows, the burden on the trust to pay for the transferred asset is minimized, but the plan works best if the asset is an interest in a pass-through entity, such as a limited liability company or an S-corporation, which has a healthy cash flow. The result: the future appreciation of the asset is out of the grantor's estate.

The initial funding of the IDGT requires a gift of approximately 10% of the value of the asset to be transferred, with the other 90% being sold to the trust. If other gifting of the grantor has been exhausted or if the size of the asset is large, the 10% up front gift requirement has historically imposed a major limitation on the ability of a grantor to use this technique. However, with the estate and gift tax exemption amount being raised to $5 million, the door has been flung open wide to fund IDGTs (and other similar vehicles).

For example, assuming there are not other countervailing considerations, one could transfer $5 million of interest in the appropriate entity to the IDGT as the funding gift and then sell $45 million of such interest to the IDGT. If a valuation discount applies, the value of what is being transferred may be more like $75 million. In time, the installment debt is paid off, the grantor will have received back $45 million in payments, with low interest thereon, and assuming 100% growth over a nine year period, the trust will own an asset worth $100 million, or more like $150 million in a liquidation or exit scenario. If the grantor had not applied this technique, he would still have an asset worth $100-150 million instead of $50-75 million. The success of this and any other "freezing" technique depends on future growth and minimizing the value of what is initially transferred. But the opportunity to try is there, more than ever before.❖

In recognition of rising gas prices, the IRS has raised by 4.5 cents per mile the standard mileage rate for business, medical, and moving expenses, for miles driven from July 1, 2011 through December 31, 2011. The rate for charitable miles remains unchanged.

	Mileage rate	
	Jan.-June 2011	July-Dec. 2011
Business	51	55.5
Medical/Moving	19	23.5
Charitable	14	14

Tax & Business Newsletter

Samuel A. Lambert – Editor

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ALSO INSIDE THIS ISSUE

THE GOLDEN WINDOW OF OPPORTUNITY FOR LIFETIME GIFTS

By Gary L. Longmore

By increasing the amount of the gift and estate tax exemption from $1 million to $5 million for 2011 and 2012, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, enacted on December 17, 2010, presents a "golden window of opportunity" for the sophisticated and well-advised client by opening up a new paradigm of thinking regarding gift and estate planning strategies. Further, the ability to make transfers of up to $10 million per couple, without having to pay gift taxes, paves the way for leveraging strategies which can transfer vast amounts of wealth outside of the gross estate. The sooner gifts are made, the sooner the assets and appreciation on such assets are removed from the gross estate. The gift tax exemption remained at $1 million for 2010. Beginning in 2011, the gift tax exemption amount is "reunified" with the estate tax applicable exclusion amount of $5 million.

The generation-skipping transfer (GST) tax exemption and rate are tied to the estate tax applicable exclusion and rate. Thus, the GST tax exemption for 2011 and 2012, is $5 million and the "applicable rate" for determining the GST tax is the maximum estate tax rate (currently 35%). The GST tax exemption, now set at an unprecedented level, coupled with the number of states that have no rule against perpetuities (such as Utah), permits trusts to, in effect, last forever. This increases the need for careful consideration of trust terms, attention to provisions for trustee succession, and provisions for maximum built-in flexibility (such as trust protector provisions).

The gift tax exemption is a limited resource and should be used with strategies that maximize its benefit. For the wealthiest individuals, it is not enough just to transfer $5 million of property and start it growing outside the estate. Such individuals should carefully consider the use of gifts to dynasty trusts, sales to intentionally defective grantor trusts (IDGTs), domestic asset protection trusts (DAPTs), and grantor retained annuity trusts (GRATs). The foregoing strategies can be used in combination with valuation "discounts" for transfers of interests in a closely held business. A "lack of marketability discount" is available for closely held business interests because there is no ready market for these business interests. A discount for lack of control, commonly called a "minority interest discount," is appropriate when the business interest being valued does not carry control of the company and the owner of such business interest is unable to dictate the company's management or distribution decisions.

We cannot count on the $5 million gift tax exemption being increased or even lasting beyond 2012 or on the estate tax being eliminated. Careful estate planning therefore requires thoughtful use of this "golden window of opportunity" for lifetime gifts. In addition to identifying high-basis assets and trying to identify assets with good growth potential, the $5 million gift tax exemption will be most effective if used with strategies that reduce the current taxable value of transfers in one or more ways.❖

CHANGE IN UTAH DOMICILE RULES STARTING 2012

By Sam Lambert

Generally, you are presumed to be domiciled in the state where you have a permanent home. The government applies a multifactor factually-intensive test to evaluate a person's claim of domicile. State governments are particularly skeptical when individuals claim to be domiciled in states that have no individual income tax. Utah recently revised its domicile statute. Effective January 1, 2012, you are presumed domiciled in Utah if you (or your spouse):

1. have a dependent enrolled in a public kindergarten, elementary, or secondary school in Utah (unless the dependent is not claimed on your or your spouse's federal return, or you are a divorced, noncustodial parent);
2. are a resident student enrolled in a public university in Utah;
3. claim a residential exemption for your primary residence with respect to the Utah property tax;
4. are registered to vote in Utah;
5. file a Utah income tax return as a resident or part-year resident.

It is legally possible to rebut the presumption presented in cases 3, 4, or 5, but it would be difficult to do so. Even if none of the above apply to you, you may still be domiciled in Utah, depending on an evaluation of your individual facts and circumstances.

Also effective 2012, if you and your spouse are absent from the state for 761 consecutive days (two years and one month), you are presumed not domiciled in Utah so long as you and your spouse do not: have a dependent in a Utah public school; enroll in a Utah public university as a resident; claim a residential property tax exemption; or claim Utah residency on a federal or Utah tax return. During this period, you may return to Utah for 30 days or less during each calendar year. The law implies that you may claim nonresidency as soon as you leave, if you intend to be gone for 761 days or more. However, if you fail any of the requirements listed above, you must file (or amend) past returns and pay the tax due with interest and (in some cases) penalties.❖

UTAH LEGISLATURE PASSES NEW LLC ACT

By Christopher N. Nelson

The 2011 Utah Legislature has passed a new limited liability company ("LLC") act (the "New Act") which will become effective July 1, 2012. In passing the New Act, which is closely based on the Revised Uniform Limited Liability Company Act, Utah joins the District of Columbia, Idaho, Iowa, Nebraska and Wyoming which have also passed similar versions of the New Act. Four additional states have versions of the New Act pending in their Legislatures. The New Act will apply to all new LLCs organized in Utah on or after July 1, 2012, and will apply to all LLCs formed prior to this date on January 1, 2014. The New Act offers additional flexibility to LLCs, reduces the public information required to be filed about LLCs, provides opportunities to customize fiduciary duties and places increased significance on the LLC's operating agreement. While currently-existing LLCs formed under prior law will continue to exist under the New Act, in most cases it is well-advised to consult with an attorney specializing in LLCs to determine whether the New Act provides advantages and opportunities for the LLC. For example, while the New Act provides for perpetual existence of LLCs, currently-existing LLCs with language limiting their duration to 99 years will need to amend their governance documents to provide for perpetual duration. Please feel free to contact a member of the firm's corporate or tax department for further information.❖

IDEAL TIME FOR SPLIT-DOLLAR ROLLOUTS

By Jerry Snow

Sooner or later the participant (usually a trust but often an individual) in a split-dollar insurance funding arrangement (usually with an employer but sometimes with a family entity) faces the necessity of paying off the "split-dollar loan", either at death out of insurance proceeds or in some other way during life. The change in the applicable regulations a few years ago caused the early termination of many split-dollar arrangements, especially those characterized as equity split-dollar, in which equity in the policy builds up in favor of the participant. Before equity exceeds the amount of the split-dollar loan, the participant must decide whether to convert the split-dollar arrangement into a conventional loan or accept unfavorable income tax consequences from the equity build-up.

One of the hurdles to paying off the split-dollar loan during life, at least in the case of an irrevocable insurance trust, is the necessity of contributing a large sum of money to the trust, which constitutes a gift. Now, however, with the increase in the lifetime gift and estate tax exemption amount to $5,000,000 per person, there is a window of opportunity to make such a large gift to the trust and roll out of the split-dollar arrangement at no immediate tax cost to the participant. Careful consideration should be given to this opportunity while it lasts.❖

SPOUSAL PORTABILITY, AS DIFFICULT AS GIVING YOUR SPOUSE A PIGGYBACK RIDE

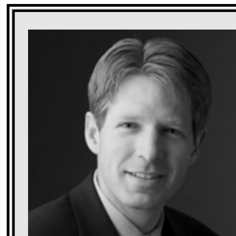
By Charles Livsey

The Problem. Under the Tax Reform Act of 2010, each person has a basic exclusion amount, currently $5,000,000, which is applied to reduce gift or estate tax. Without proper planning, if a person dies with $1,000,000 of assets, then the remaining $4,000,000 exclusion is wasted and can't be used by the surviving spouse. To deal with this problem, estate planners used trusts and transferred assets between husband and wife in an attempt to use all of the basic exclusion of both spouses. Unfortunately, estate plans were sometimes not reviewed and over time couples transferred assets to each other and the basic exclusion of one spouse went largely unused. To solve this problem the 2010 Tax Relief Act created "Spousal Portability," a system to allow the unused exclusion amount of a deceased spouse to be transferred to the surviving spouse.

How Does It Work? For individuals dying during 2011 and 2012, the executor of the deceased spouse's estate must timely file an estate tax return electing to transfer the deceased spouse's unused exclusion amount to the surviving spouse. If done correctly, the $4,000,000, from the above example will be available for the surviving spouse to use for gifts or to reduce estate tax at the surviving spouse's death. Thus, in the above example, the surviving spouse would have his or her own $5,000,000 basic exclusion and additionally the $4,000,000 from the deceased spouse, totaling $9,000,000 that could be transferred tax free.

Cautionary Notes! Without further Congressional action, Spousal Portability will expire at the end of 2012. Special planning is needed to prevent the loss of some or the entire deceased spousal unused exclusion amount, especially if the surviving spouse is planning to remarry. Also, the IRS has not published regulations in this area yet. Thus, there are several unanswered questions. One such question is whether the deceased spousal unused exclusion amount will be available for use after the 2010 Tax Relief Act expires in 2012. Additionally, if the surviving spouse desires to use the deceased spousal unused exclusion amount by making gifts, there is some question as to how the gifts may impact the surviving spouse's own basic exclusion.

Do I Still Need A Trust? Yes. There are many beneficial reasons for trusts including; creditor protection, asset management and a desire to control the disposition to beneficiaries. Additionally, the deceased spousal unused exclusion amount is only effective for gift and estate tax purposes and is not available for generation-skipping transfers "GST." Transfers to an irrevocable trust would be effective for gift, estate and GST purposes.❖



NEW SHAREHOLDER: We are excited to announce that in early 2011, Charles Livsey was voted in as a Shareholder of Ray Quinney & Nebeker P.C. Mr. Livsey is a member of the firm's Tax and Estate Planning Section. Mr. Livsey's legal practice includes: estate and trust administration, estate and gift planning, and probate administration and taxation, with a focus on Split Interest Trusts, Family Limited Liability Companies, Private Foundations, and Charitable Foundations. Mr. Livsey also has considerable experience in Real Estate Land Use Planning. He is a member of several Advisory Committees for Foundations and other non-profit entities. Mr. Livsey enjoys spending time with his wife and son, as well as running, cycling, rock climbing, canyoneering and white water rafting.