

# Lifetime Gifting: The Good, the Bad, and the Ugly



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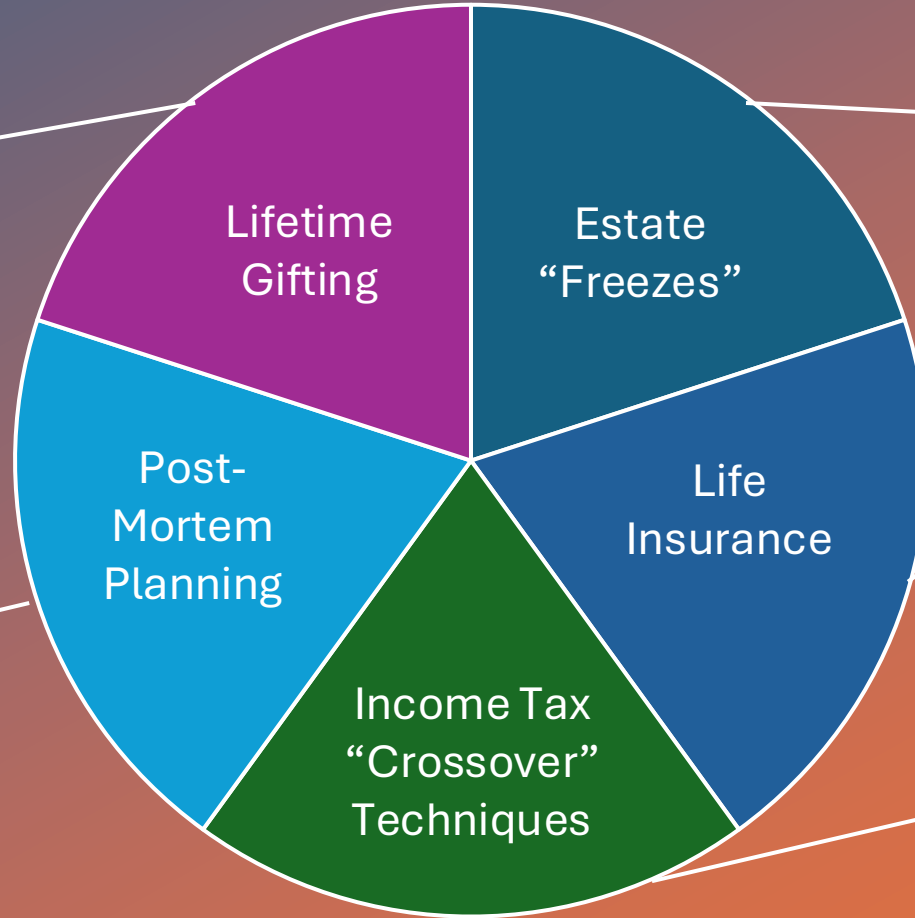
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# A Taxonomy of Estate Planning Techniques

- Spousal Lifetime Access Trusts (SLATs)
- Dynasty Trusts
- Annual Exclusion Gifts/"Crummey" Trusts
- Split Gift Strategies
- Tax-Exclusive Gifts

- Grantor Retained Annuity Trusts (GRATs)
- Charitable Lead Annuity Trusts (CLATs)
- Installment Sales to Grantor Trusts
- Private Annuities
- Qualified Personal Residence Trusts (QPRTs)
- Transfers of Preferred Partnership Interests

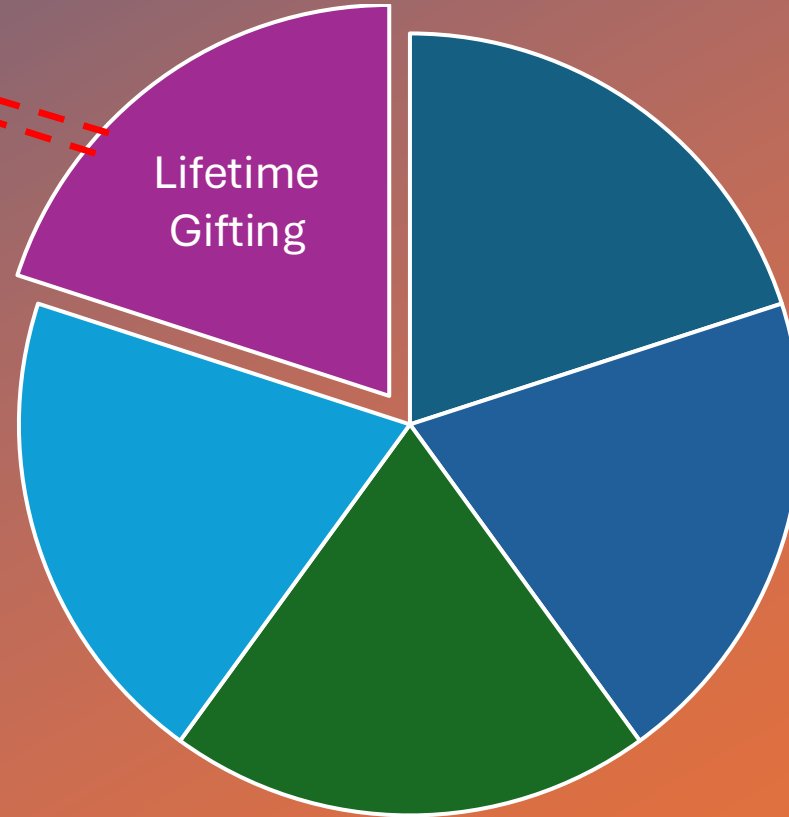


- Making the Portability Election
- Deductions:
  - QTIP Elections
  - Swing Item Election
  - IRD Deduction
- 6166 Deferral
- Graegin Loans/Estate Tax Financing
- Qualified Disclaimers
- Alternate Valuation Date
- Special Use Valuation

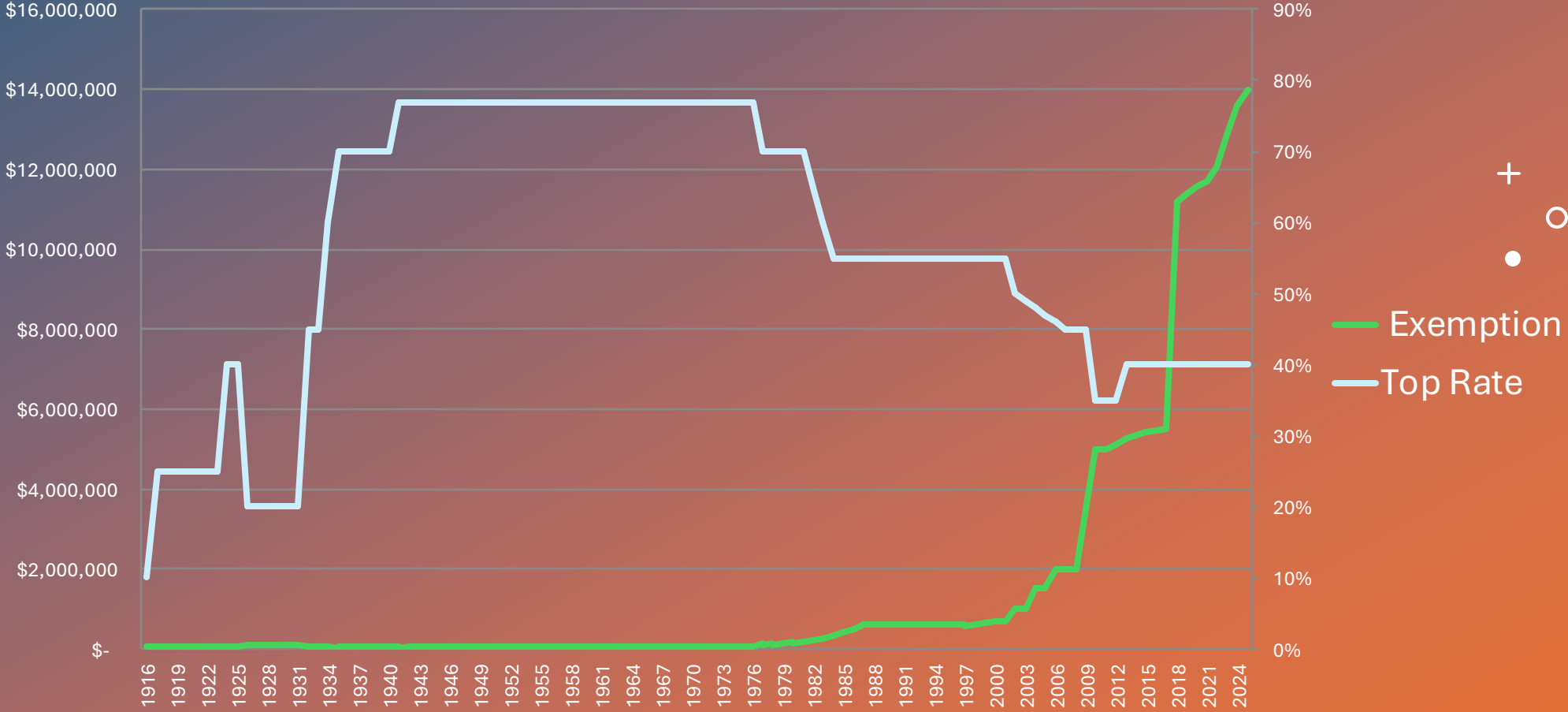
- Irrevocable Life Insurance Trusts
- Split-Dollar Life Insurance Arrangements
- Private Placement Life Insurance
- Premium Financing Arrangements

- Charitable Remainder Trusts (CRTs)
- Using General Powers of Appointment
- Transactions with Grantor Trusts
- State Income Tax Strategies (e.g. Incomplete Gift Non-Grantor trusts)

# A Taxonomy of Estate Planning Techniques



# Federal Gift and Estate Tax: Historical Rates and Exemptions



# Why Lifetime Gifting?

Lifetime

Gifts

- Lock in Current Exemption Levels
- Shelter Appreciation
- Succession Planning/Simplify Administration Before Death
- Witness the Fruits of your Generosity
- Tax Exclusive Gift Tax v. Tax Inclusive Estate Tax

$$R_i = \frac{R_e}{1 + R_e}$$

- Income Tax Neutral
- Separate Property/Non-Property Characterization
- Leveraging Effects of Valuation
- Unique Wealth Transfer Opportunities

# The Power of Off-Balance Sheet Appreciation

Assumptions		
Starting Value	\$	50,000,000
Donor's Lifespan After Day 1 (Years)		10
Value of Gifted Asset	\$	10,000,000
Growth Rate of Gifted Asset		5%
Exemption Remaining	\$	10,000,000
Valuation Discount		40%

**\*Assets NOT transferred grow at 5%**

	Comparison		
	<i>Baseline No Gift</i>	<i>Scenario #1 Gift of \$10M cash (undiscounted)</i>	<i>Scenario #2 Gift of \$16.66M w/ 40% Discount (i.e. \$10M)</i>
Value of Estate at Death	\$ 81,444,731	\$ 65,155,785	\$ 54,296,489
<b>Undiscounted</b> Value of Gifted Assets at Death	\$ -	\$ 16,288,946	\$ 27,148,243
Total Taxes Paid	\$ (28,577,893)	\$ (26,062,314)	\$ (21,718,595)
Total Taxes Paid if Exemption Reduced 50%	\$ (30,577,893)	\$ (26,062,314)	\$ (21,718,595)
Taxes Saved by Making Gift	\$ -	\$ 2,515,579	\$ 6,859,297
Taxes Saved if Exemption is Reduced 50%	\$ -	\$ 4,515,579	\$ 8,859,297



# Asset Choice

The GOOD	The BAD	The UGLY
QSBS Stock	Low/negative basis assets	Assets close to being sold <ul style="list-style-type: none"> <li>Minimal discounting</li> </ul>
Carried Interests <ul style="list-style-type: none"> <li>“Vertical Slice”: GP, LP and Carry</li> <li>Preferred partnership w/ qualified payment right</li> <li>Private Derivatives</li> </ul>	Assets in early financing stage <ul style="list-style-type: none"> <li>Take advantage of lower values</li> </ul>	Assets with no transfer restrictions
Assets with high appreciation potential		Assets with poor redemption or formula buyout features
Real estate holding entities		
Concentrated positions in public securities <ul style="list-style-type: none"> <li>Section 144 Restricted Stock</li> </ul>		



# Retained Interests and Enjoyment

The GOOD	The BAD	The UGLY
SLATs!!!	SLAT distributions to spousal beneficiary	Divorcing spousal beneficiaries
Paying rent for personal use assets	Co-investment with the donor/grantor	Blatantly reciprocal trusts
“Supercharged” credit shelter trusts	Management fees/grantor compensation	Below-market loans with foregone interest
Using swap powers		
Loans from grantor trusts with adequate interest		

# Control

The GOOD	The BAD	The UGLY
Independent fiduciaries	De facto management	Divorcing spousal trustees
<b>Capitalized</b> (economic substance/business purpose), <b>classified</b> (governance and discounting), and <b>constrained</b> ( <i>Powell/IRC 2036(a)(2) and 2038</i> ) FLPs/LLCs	Private trust companies	Fiduciary involvement that subjects the trust to state income tax
Directed trusts	Third-party powers of appointment	Inadvertent grantor trust status via powers held by third parties
Appointment & removal “safety valves”		IRC 2042 Traps
Fiduciaries who materially participate		

# Valuation Discounts

The GOOD	The BAD	The UGLY
<b>Mandelbaum Factors - Marketability</b> <ul style="list-style-type: none"> <li>• Important to factor in qualitative factors along with empirical studies</li> </ul>	<b>Tiered discounts</b> <ul style="list-style-type: none"> <li>• Can be utilized if there is a true lack of control and liquidity</li> </ul>	<b>Poor asset mix</b>
<b>Restricted Stock Studies – Marketability</b> <ul style="list-style-type: none"> <li>• Data driven method to quantify discounts</li> </ul>	<b>Timing of gift relative to the stage of the Company</b> <ul style="list-style-type: none"> <li>• The earlier the better</li> </ul>	<b>Recent redemption values or other indications of value</b>
<b>Options Pricing Models</b>	<b>S Corporation tax affecting</b>	
<b>Closed-End Funds – Control</b> <ul style="list-style-type: none"> <li>• Readily available market comparison for a minority interest in a company</li> </ul>		

# Debt

The GOOD	The BAD	The UGLY
Gifts of receivables/convertible debt	Due-on-transfer clauses	Transfers that violate debt covenants
Debt as residual consideration in a formula clause	Encumbered assets that require significant liquidity to service	Cross-collateralization resulting in a retained interest by the donor or inadvertent additional gifts via personal guarantee
	Debt forgiveness as a gift	“Donative” promissory notes
	Refinancings (rate plays v. <i>Cottage Savings</i> /disguised gifts)	

# Governing Documents/Assignments

The GOOD	The BAD	The UGLY
Transfer restrictions	Special Valuation Rules <ul style="list-style-type: none"> <li>• IRC Sections 2701-2703</li> </ul>	Ugly formula clauses <ul style="list-style-type: none"> <li>• Formula clauses with reversions (<i>Procter</i>)</li> <li>• Formula clauses that do not provide defensible FMV language or totemic “as finally determined for gift tax” language (<i>Nelson</i>)</li> <li>• Formula clauses that allocate based on a subsequent <i>agreement</i> (as opposed to appraisal)</li> </ul>
Management	Concurrent recapitalizations	
Entity capitalization <ul style="list-style-type: none"> <li>• Non-voting share class</li> </ul>	Inattention to partner/member/entity consents	
Pretty formula clauses <ul style="list-style-type: none"> <li>• Third-party tax-neutral beneficiary (<i>Petter and Hendrix</i>)</li> <li>• Defined value (<i>Wandry</i>)</li> <li>• Carefully drafted adjustment clauses</li> </ul>		

# Income Tax

The GOOD	The BAD	The UGLY
Intentional Non-Grantor Trusts	Gifts of low-basis assets	Gifts of unvested options
CRUTs	“Reverse” gifts (IRC 1014(e)) and gifts coupled with general powers of appointment	Assignment of income
QSBS stacking and packing		Accelerated gain on transfer of installment obligations
		Assets with negative capital accounts/debt in excess of basis

# Questions?



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