

Insight

May 2009

Supportable Valuation Critical to Gifting and Estate Planning

As the economy remains in a downturn and values continue to be depressed, estate planning has become an important issue for 2009. Now is a good time to transfer assets in an effort to minimize estate taxes and reduce probate costs. With property values being depressed, gifting assets now may have the effect of transferring greater future value to heirs.

“Gifting practice requires a gift tax return and a valuation of the gift.”

The primary objectives of estate planning are 1) minimization of federal and state income, estate and gift taxes, and inheritance taxes, 2) reduction of probate and associated property transfer costs, and 3) conservation of net worth.

It is a unique time from an estate and gift tax perspective. The tax law changes that gave rise to the reductions in tax rates and the increase in the unified credit/exemption over the last several years are scheduled to sunset at the end of 2010. Accordingly, there is uncertainty and speculation as to what will occur after 2010. With no legislative action, the estate and gift tax rates and structure would revert back to the pre-law change level, when the top tax rate was 55% and the unified credit was \$1,000,000. The most widely held view, and what is reflected in the Obama Administration’s Fiscal Year 2010 Revenue Proposals, is that the rates and exemption would be frozen at the 2009 levels.

TAX RATES

Current tax rates reflect the anticipated rates, assuming the rates after 2010 are based on 2009 rates:

	Estate Tax	Unified Credit	Gift Tax	Unified Credit
2009	45%	\$3,500,000*	45%	\$1,000,000*
2010	Eliminated	N/A	35%	\$1,000,000*
2011	45%	\$3,500,000*	45%	\$1,000,000*

*Expressed in terms of property value

Consider the following simplified example of an individual with a deceased spouse and a \$15mm estate, no lifetime gifts (assuming the tax rate schedule above):

	Value of estate	Estate tax
Deceased in 2009	\$15mm	\$5.2mm
Deceased in 2010	\$15mm	-0-
Deceased in 2011	\$15mm	\$5.2mm

When one transfers property during his lifetime or at death the property is potentially subject to tax. This tax is based on the value of property transferred and is paid by the donor. The recipient generally takes a carryover tax basis for gifts made during the life of the donor. The recipient generally receives a step up in tax basis to FMV for property transferred at death.

Unlimited amounts of property may be transferred to one’s spouse either during lifetime or at death. Under current gift tax exclusions, an individual and his or her spouse can each gift up to \$13,000, or a total of \$26,000 per donee for 2009, without incurring a gift tax.

continued on back...

Supportable Valuation Critical to Gifting and Estate Planning

ADEQUATE DISCLOSURE

Gift-giving practice requires a gift tax return and a valuation of the gift. The IRS requires that any gifts made are “adequately disclosed.” Under IRS Reg. Sec. 301.6501(c)-1(f)(2), “transfer will be adequately disclosed if it is reported in a manner adequate to apprise the IRS of the nature of the gift and the basis for the value so reported.”

“FLPs are one of the areas frequently challenged by the IRS. It is important to engage a valuation professional in these situations.”

Among other disclosures, the IRS requires a description of the method used to determine the value of the property transferred as well as the financial data used to determine the value, and a description of discounts for blockage, minority or fractional interests, and lack of marketability.

IRS Reg. Sec. 301.6501(c)-1(f)(3) goes on to say that in lieu of providing the valuation detail above the donor can submit an appraisal of the property if the appraisal is performed by a professional appraiser. The appraiser must be qualified in appraisals of said property and the appraiser’s qualifications must be described in the appraisal. Under the IRS’ safe harbor rule once you file a gift tax return the IRS has three years to question the valuation enclosed in the return.

FAMILY LIMITED PARTNERSHIPS

A number of strategies can be employed in estate planning including lifetime gifts, trusts, charitable trusts, and family limited partnerships (FLPs). For purposes of this *Insight*, we will focus on FLPs, one of the most commonly used tools for estate planning. Interests in FLPs’ holding assets generally have a lower value than direct ownership of the assets, due to the minority ownership position as well as the restrictions on transferability. Accordingly, use of an FLP may afford the opportunity to transfer assets at a lower tax cost. The following example shows the potential benefit of an FLP:

Mr. and Mrs. Smith own a number of commercial buildings worth \$20mm. They have four children and have established a family limited partnership. They have decided to give 50% of their holdings to their children. If they outright gift 50% of the properties, the resulting gift tax will be approximately \$3.6mm, assuming the use of the unified credit. However, if they gift in the form of an FLP established with gifting of 50% of the limited partnership interests, the gift tax will be approximately \$2mm, assuming marketability and lack of control discounts totaling 35% as well as unified credit.

Note that the Obama Administration’s Fiscal Year 2010 Revenue Proposals outline changes which could impact the determination of value of certain gifts such as FLP interests. The proposals would specify that certain restrictions would be ignored for purposes of valuing an interest in a family controlled entity.

FLPs are the one of the areas frequently challenged by the IRS. It is important to engage a valuation professional in these situations. For more information contact your VRC representative. **VR**

Editor: Theresa Miller © Valuation Research Corporation. All rights reserved.



www.valuationresearch.com

Boston	617.342.7366
Chicago	312.957.7500
Cincinnati	513.579.9100
Milwaukee	414.271.8662
New York	212.983.3370
Princeton	609.243.7000
San Francisco	415.277.1800
Tampa	813.463.8510

VRG Member Firms:

Argentina
Australia
Brazil
China
Mexico
Spain
United Kingdom
Venezuela