JOEL S. ROTHMAN
& ASSOCIATES, LTD.
Counselors at Law
55 West Monroe Street, Suite 3330, Chicago, IL 60603 (312) 578-0900 (312) 578-0905 FAX

Joel S. Rothman

Steven L. Baerson
Thomas D. Sterling

Of Counsel
Jean M. Einstein
Raymond P. Gordon
Mark T. Neil
Lorri E.K. Otis
Anita S. Ridge

Administrative Assistant
Darlene M. Smith

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Re: Estate Planning News

Dear Clients and Friends,

We are writing to inform you of some proposed changes in the tax laws which relate to estate planning. President Clinton presented a series of budget proposals to Congress on February 2, 1998. If these proposals become law, they would eliminate the tax benefits of some very popular estate planning tools. With this possibility in mind, now is an excellent time for you to consider reviewing your estate plan to determine if you could benefit from one or more of these endangered planning techniques before they are possibly eliminated.

We would also like to remind you of a change that has already occurred. Unless the deadline is extended by Congress, after June 30, 1998, the income tax deduction available for transfers of publicly traded stock to private foundations and certain charitable remainder trusts will be greatly diminished.

Finally, we are writing to discuss the benefits of what we feel is a very important part of the estate planning services provided by our office, which we most frequently refer to as "Descendant Trusts." These are trusts created under other documents, such as revocable trusts and irrevocable gift trusts, which provide for the benefit of children, grandchildren or other beneficiaries, usually under their own control, with the possibility of creditor protection during their lifetimes and estate tax savings upon their deaths. For those who already are taking advantage of this planning, our letter provides a "refresher," for those who are not, we suggest that you give this serious consideration.

I. President Clinton's Proposed Changes

A. "Crummey" Trusts.

In any calendar year, each of us is entitled to make annual exclusion gifts of up to $10,000 to as many separate individuals as we desire without incurring gift tax liability. These annual exclusion gifts are only allowed for gifts of "present interests." Gifts to trusts are not considered gifts of present interests unless the trust beneficiaries have an immediate right to withdraw the gifts. These rights of withdrawal usually only last for a specific period of time such

as 30 or 45 days. Trusts with these right of withdrawal are known as "Crummey Trusts" after the case which originally established their legality. Our office has prepared hundreds of these trusts, which are often referred to as "Insurance Trusts", "Gift Trusts" or "Family Gift Trusts".

President Clinton's recent budget proposals call for the elimination of "Crummey Trusts." Under the proposals, donors transferring property to trusts after December 31, 1998 would no longer be allowed to treat these transfers as present interest gifts and, as such, no annual gift tax exclusion would be allowed. Although we seriously question the likelihood that these and the other proposals discussed in this letter with ever become law, we strongly recommend that those of you with Crummey Trusts consider making gifts to your trusts now, before any potential change takes place. Those without Crummey Trusts should give serious consideration to establishing them before the end of this year to benefit from 1998 gifts and from the possibility that trusts created before any legislation is initiated would be "grandfathered." We believe that the benefits of this technique for reducing one's estate can be substantial.

B. <u>Family Limited Partnerships</u>.

By establishing a family limited partnership and gifting partnership interests directly to family members or to trusts for the benefit of family members, individuals with significant assets may remove much of the value of these assets from their estates for estate tax purposes without losing management control over the property during their lifetimes.

Family limited partnerships typically consist of a general partner who actively controls the partnership, and a number of limited "silent" partners who are passive investors. Under current law, gifts of family limited partnership interests can be discounted in value for gift tax purposes because of the lack of marketability and the lack of control that are inherent in them. This can provide an important additional benefit.

The President's proposals would eliminate valuation discounts for the transfer of most family owned entities, effective for all transfers made after the statute is enacted. Only family owned businesses with active family participation would still be granted these valuation discounts for lack of marketability and lack of control. With this possible change in mind, now is a good time to set up a family limited partnership. Also, for those of you who already have such partnerships, now is a good time to add assets to those entities and make gifts of the limited partnership interests.

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III. <u>The Benefits of Descendant Trusts.</u>

Most clients and practitioners focus on the immediate need to minimize estate taxes upon the death of the client, or upon the death of the surviving spouse in the case of a husband and wife. This often overlooks significant benefits which can be provided to the children or other beneficiaries if <u>proper provisions are included in the parents' documents</u>.

Instead of providing direct, outright gifts, it is our advice that parents and others provide each beneficiary with a "Descendant Trust" of which the beneficiary, if old enough and capable, can act as his or her own Trustee. If properly drafted and administered, such a trust can provide that beneficiary with exclusive control over and access to his or her inheritance, with the added opportunity of protecting the inheritance against the claims of creditors, including divorcing spouses, and of preventing the trust funds from being taxed <u>again</u> for estate tax purposes upon the death of the beneficiary. This is particularly important in the current era of high estate taxes and of beneficiaries who are already old enough to have taxable estates of their own while needing the security of knowing that their inheritances are available to them "just in case." This planning also helps to assure that family wealth is kept "in the family."

Technically, these are referred to as "generation-skipping trusts." We prefer not to use that term, however, both to avoid the excessive use of technical jargon and more importantly because the term "generation-skipping" is often misunderstood by <u>both</u> professionals and by lay persons as referring to direct gifts from a grandparent to his or her grandchildren, thereby "skipping" the children. As practiced by our firm, these trusts "skip" the children's generation for estate tax purposes, but do not deprive them of the benefits of their inheritance.

The Descendant Trust is one of the most powerful estate planning tools for transferring wealth from one generation to the next without subjecting those funds to future transfer taxes.

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We hope this letter provides some helpful information and perspective for you. Please let us know whenever we may be of assistance.

Kindest personal regards,

Joel S. Rothman & Associates, Ltd.

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C. Qualified Personal Residence Trusts.

For a number of years, people have been using Qualified Personal Residence Trusts ("Residence Trusts") to remove the value of their primary residences and vacation homes from their estates while taking advantage of significant discounts for gift tax purposes. The longer the term chosen for the Residence Trust, the greater the valuation discount allowed. Additionally, assuming the donor outlives the term of the Residence Trust, all future appreciation in the home after the date of transfer to the Residence Trust is removed from the donor's estate for estate tax purposes. Finally, if properly structured, after the initial term of the Residence Trust the donor can continue reducing his or her estate, without income tax consequences, by paying "rent" to a gift trust for the benefit of children, grandchildren or other beneficiaries.

President Clinton's recent proposals would eliminate the special valuation discounts allowed for Residence Trusts. With this in mind, those of you who have not already done so should consider establishing a Qualified Personal Residence Trust before this estate planning option is no longer available.

II. Income Tax Deduction for Gifts of Publicly Traded Stock.

Another change in the law has already taken place. For the last few years, individuals making gifts of publicly traded stock to private foundations have been able to take an income tax deduction equal to the fair market value of the stock as of the date of transfer. However, for all transfers of publicly traded stock to private foundations after June 30, 1998, the income tax deduction will be limited to the transferor's basis. This change in the law will also affect gifts of publicly traded stock to some charitable remainder trusts.

Although the estate tax benefits from such contributions remain the same, for those of our clients with appreciated publicly traded stock, now is a good time to create a private foundation or charitable remainder trust or make contributions to those which have already been established in order to take advantage of the higher income tax deductions which may soon become unavailable. **Remember, unless these tax benefits are extended by Congress, such contributions must be made on or before June 30, 1998 for these benefits to be obtained.**