

Tax Planning Ideas Under the New Administration

Presented By:

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CURRENT PLANNING IDEAS

- > **C Corporation Dividends**
- > **Sale of Tangible and Intangible Property**
- > **Trigger Long-Term Capital Gains**
- > **Close Held Business Sales**
- > **Real Estate Investors**
- > **Charitable Remainder Trusts**
- > **Dynasty Trusts**
- > **Valuation Adjustments**
- > **Low Interest Rate Transactions**
- > **Roth Conversions**

C CORPORATION DIVIDENDS

C CORPORATION DIVIDENDS

- > **Large Retained Earnings**
- > **15% Federal Tax Rate**
- > **Qualified Dividend**

SALE OF TANGIBLE AND INTANGIBLE PROPERTY

SALE OF TANGIBLE AND INTANGIBLE PROPERTY

- > Unrelated or related party transaction
- > Locks in capital gains
- > Sale to related entity on installment sale method
 - > \$5 million or less
 - > \$10 million or less for married couple
- > IRC Section 453(d) election out installment sale payment

TRIGGER LONG-TERM CAPITAL GAINS

TRIGGER LONG-TERM CAPITAL GAINS

- > **Over-weighted positions in publicly traded companies**
- > **Market pressure**

CLOSELY HELD BUSINESS SALES

CLOSELY HELD BUSINESS SALES

- > Sale to third party before December 31, 2008**
- > Protects against increase in capital gains rate**

REAL ESTATE INVESTORS

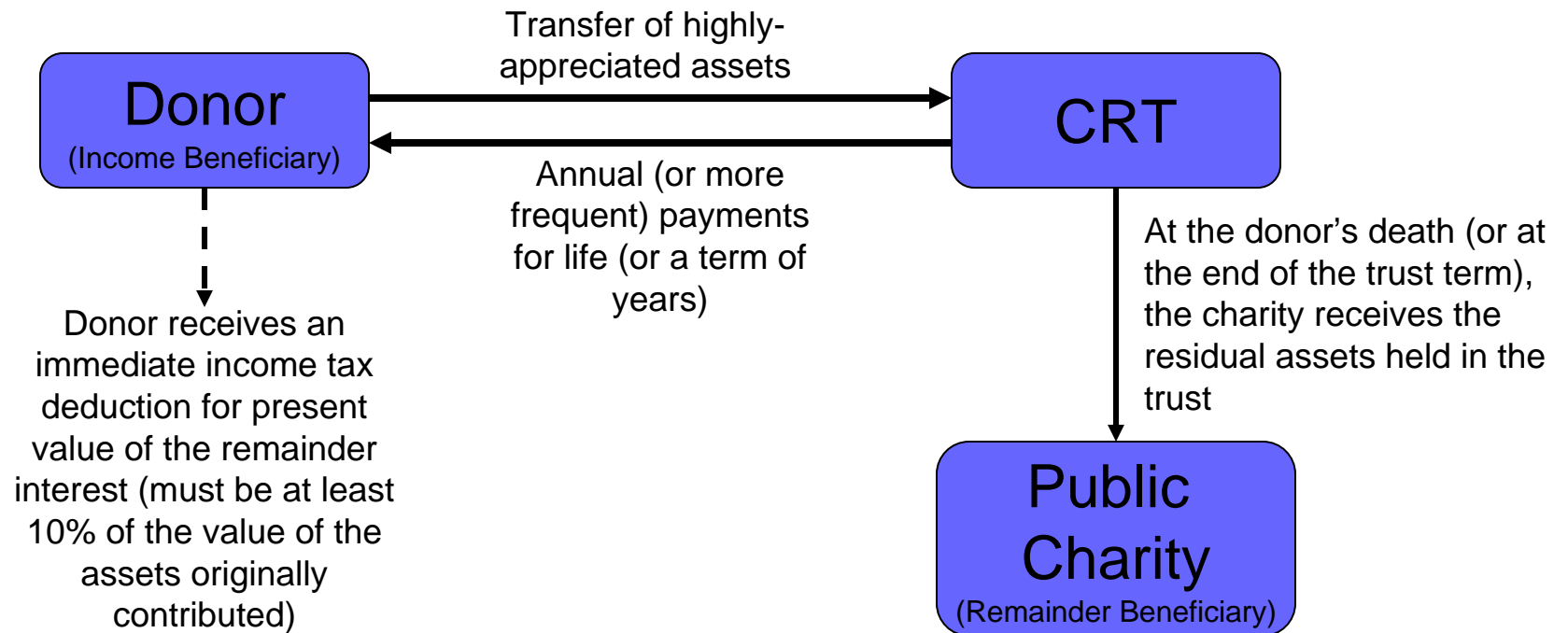
REAL ESTATE INVESTORS

- > **Sale before December 31, 2008**
- > **Protects against increase in capital gains rate**
- > **Section 453 installment sale to related party**
- > **Code Section 1239 related party rules for depreciable property**

CHARITABLE REMAINDER TRUSTS

CHARITABLE REMAINDER TRUST (CRT)

- > A Charitable Remainder Trust (CRT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is usually paid out to the donor (or some other named beneficiary). At the end of the trust term, the remainder (whatever is left in the trust) is paid to the charity or charities that have been designated in the trust document.



Two Main Types of CRTs

> Charitable Remainder Annuity Trust (CRAT)

- The beneficiaries receive a stated amount of the initial trust assets each year
 - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)

> Charitable Remainder Unitrust (CRUT)

- Income beneficiaries receive a stated percentage of the trust's assets each year.
 - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn

Special considerations

- > Annual payout can neither be less than 5% nor more than 50%.
- > The present value of the remainder interest must be at least 10% of the value of the assets contributed to the trust.
- > The trust term cannot be more than 20 years (if a term interest is used)

Charitable Deduction Limitations

- > Cash contributions
 - 50% adjusted gross income (AGI) limitation
- > Non-cash contributions
 - 50% adjusted gross income (AGI) limitation
 - Contributions of “non-appreciated property” (e.g. clothing and household goods) to “public charities”
 - 30% adjusted gross income (AGI) limitation
 - Contributions of “appreciated property” (e.g. publicly-traded stock) to “public charities”
 - 20% adjusted gross income (AGI) limitation
 - Contributions of “appreciated property” (i.e. publicly-traded stock) to private foundations (see later discussion)

Charitable Deduction Limitations

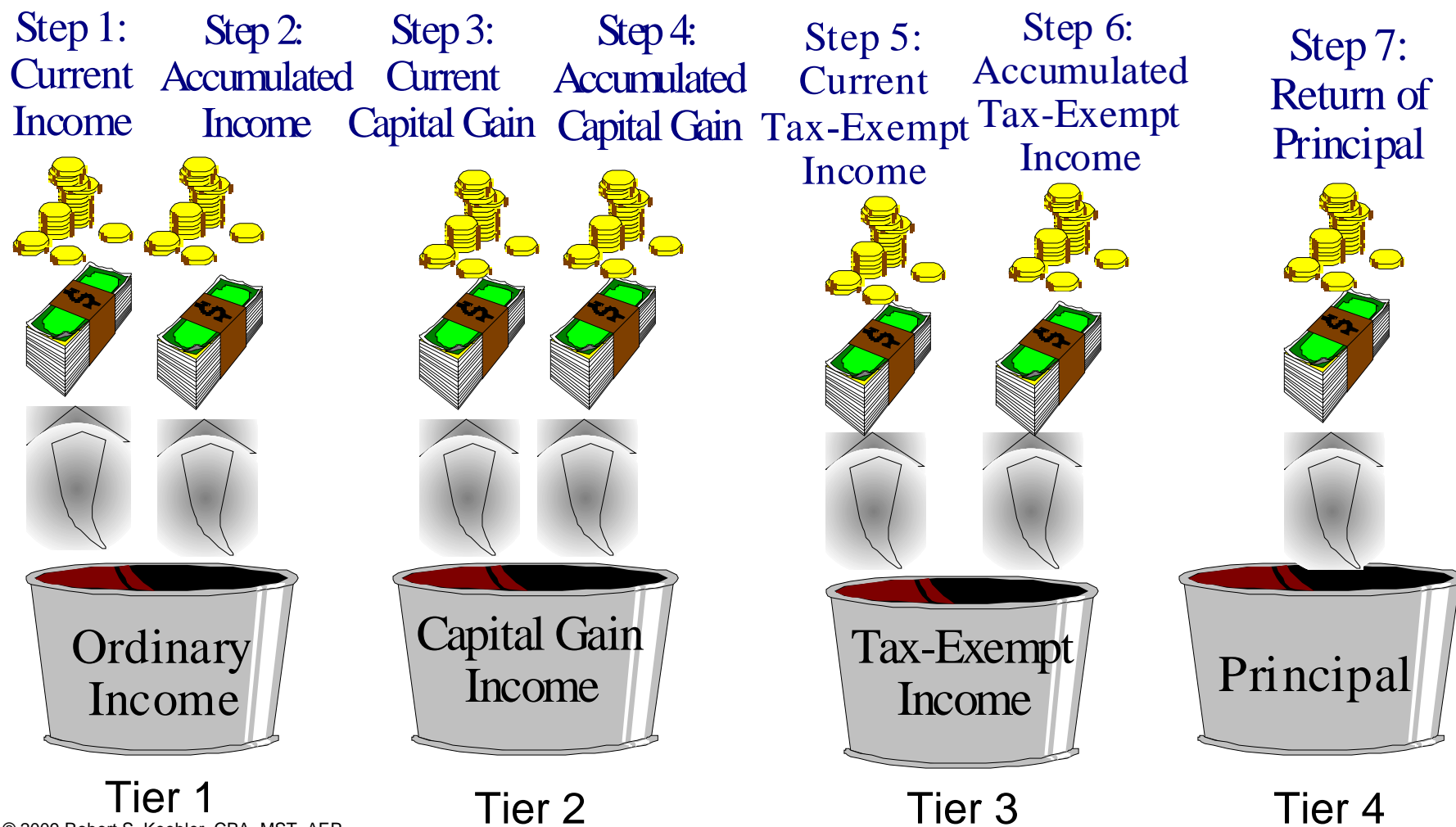
- > Contributions of non-cash property
 - Deduction is the fair market value of the property
- > Exceptions
 - Ordinary income property
 - Tangible property - unrelated Use
 - Private foundation contributions

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- > No gain on contribution
 - > Gain on sale is recognized within the trust
 - > Allows for diversification
 - > Capital gain distributions

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- > Convert ordinary income to capital gain income
 - > Overcome the diversification issue
 - > Defer taxation on the sale of stock
 - > Obtain a substantial charitable deduction
 - > Leave a lasting charitable legacy

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- > The CRT is a tax-exempt trust
 - > No taxation when NUA stock is sold
 - > Distributions to beneficiaries are taxable to the beneficiary
 - > IRC § 664 provides the Tier Rules

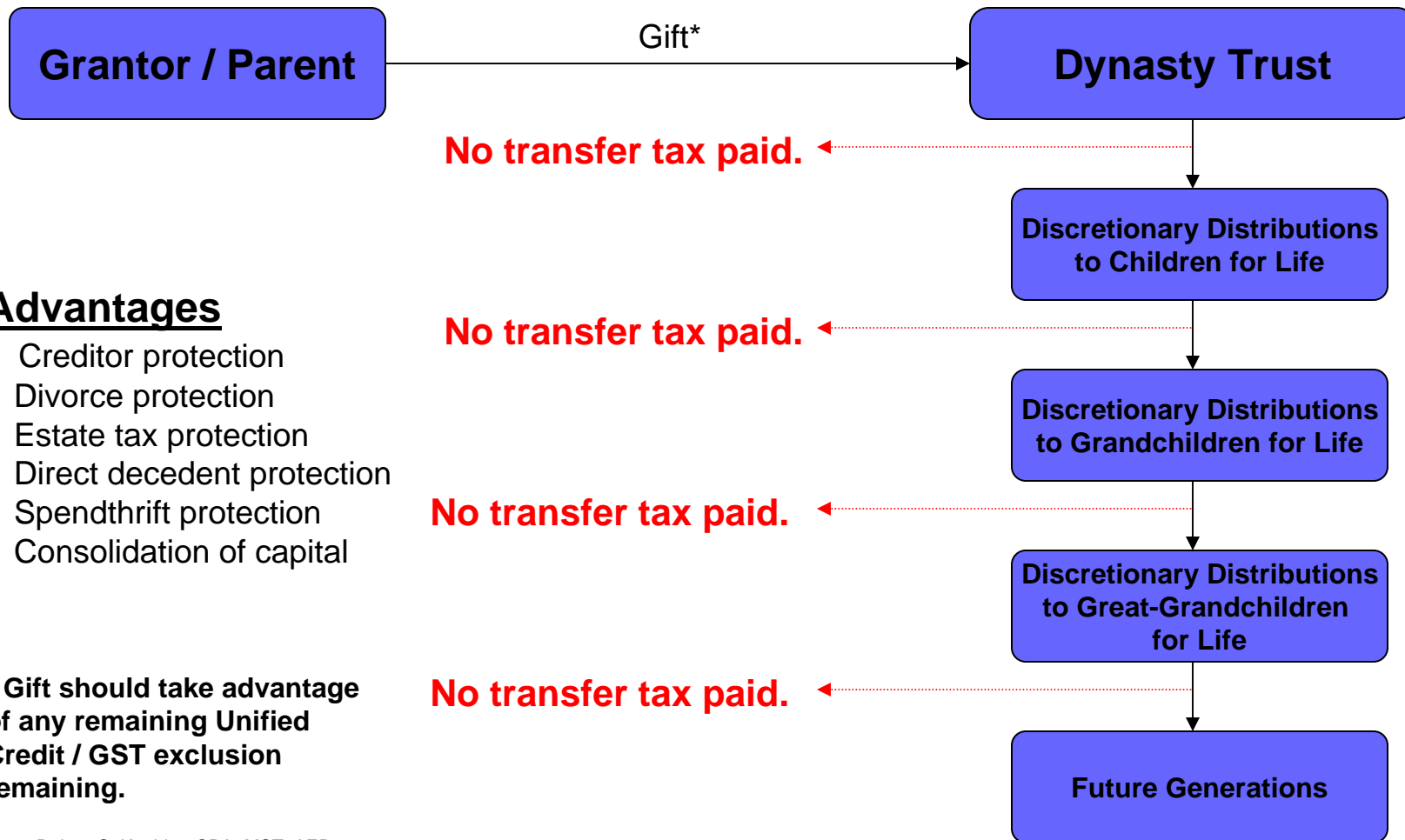
Understanding Tier Rules



DYNASTY TRUST

DYNASTY TRUST

DISTRIBUTION UPON GRANTOR'S DEATH



Advantages

- Creditor protection
- Divorce protection
- Estate tax protection
- Direct decedent protection
- Spendthrift protection
- Consolidation of capital

* Gift should take advantage of any remaining Unified Credit / GST exclusion remaining.

DYNASTY TRUST

ADVANTAGES OF AVOIDING GST TAX*

Wealth of Parents	\$ 4,000,000	\$ 4,000,000	\$ 4,000,000
Estate Tax Rate	45%	45%	45%
Estate Tax	\$ 1,800,000	\$ 1,800,000	\$ 1,800,000
Wealth of Children	\$ 2,200,000	\$ -	\$ -
Estate Tax Rate	45%	45%	45%
Estate Tax	\$ 990,000	\$ -	\$ -
Wealth of Grandchildren	\$ 1,210,000	\$ 2,200,000	\$ -
Estate Tax Rate	45%	45%	45%
Estate Tax	\$ 544,500	\$ 990,000	\$ -
Wealth of Great-Grandchildren	\$ 665,500	\$ 1,210,000	\$ 2,200,000
% of Original Wealth Passing to Great-Grandchildren	16.6375%	30.2500%	55.0000%

* For sake of simplicity, it is assumed that the marginal estate tax rate at each generation's death is 45%.

DYNASTY TRUST

ADVANTAGES

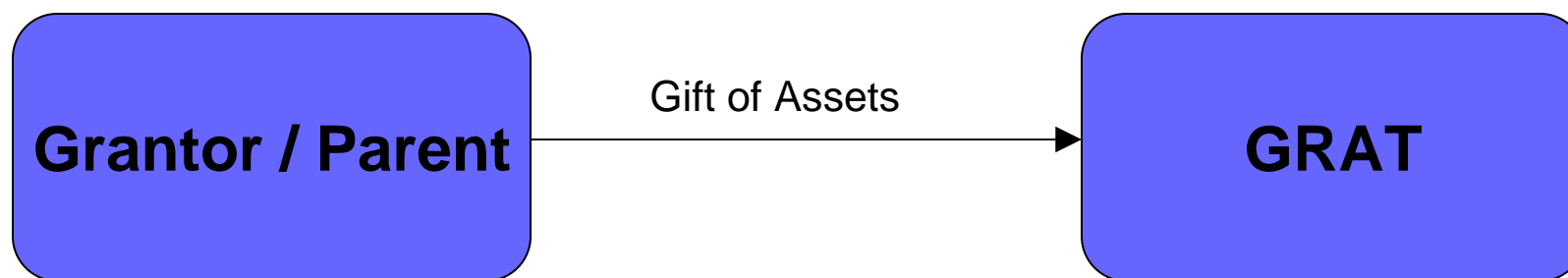
- **Takes maximum advantage of the applicable exclusion amount**
 - **Currently at \$1,000,000**
- **Takes maximum advantage of the one-time application of the \$2,000,000 GSTT exemption**
- **Appreciation of assets will be estate tax free**
- **Provides a layer of asset protection from the beneficiaries' creditors**
- **No transfer tax will be paid at the death of the grantor's descendants**
- **Provides flexibility**
 - **Future trustees can be given the discretion to make distributions as appropriate, given the circumstances that exist at the time the distributions are made**
 - **Grantor can use the trust to positively affect future behavior**

VALUATION ADJUSTMENT PLANNING

GRANTOR RETAINED ANNUITY TRUST (GRAT)

GRANTOR RETAINED ANNUITY TRUST

STEP ONE: GIFT OF ASSETS

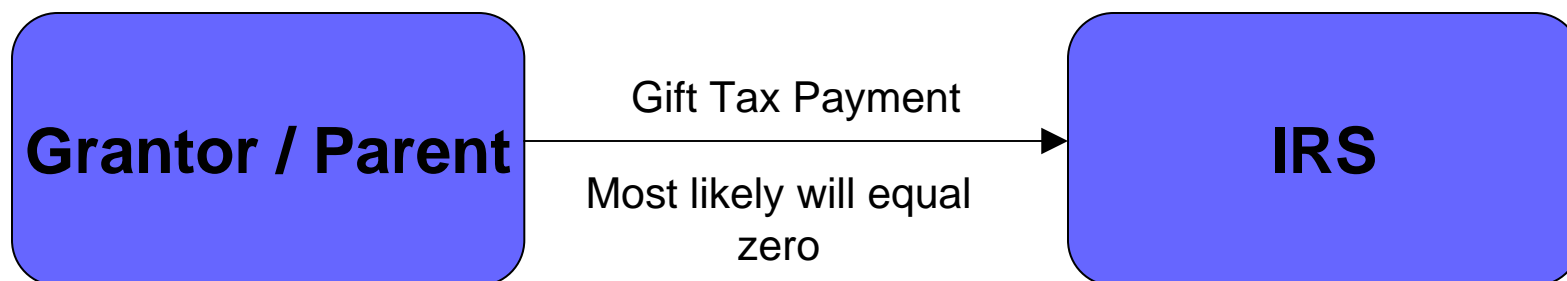


For gift tax purposes, the initial gift is based upon a calculation of the present value of the annuity stream.

All growth in excess of the IRC §7520 rate inures to the beneficiaries, effectively freezing growth of assets to the IRC §7520 rate. **The IRC §7520 rate for February 2007 is 5.60%.**

GRANTOR RETAINED ANNUITY TRUST

STEP TWO: PAYMENT OF GIFT TAX

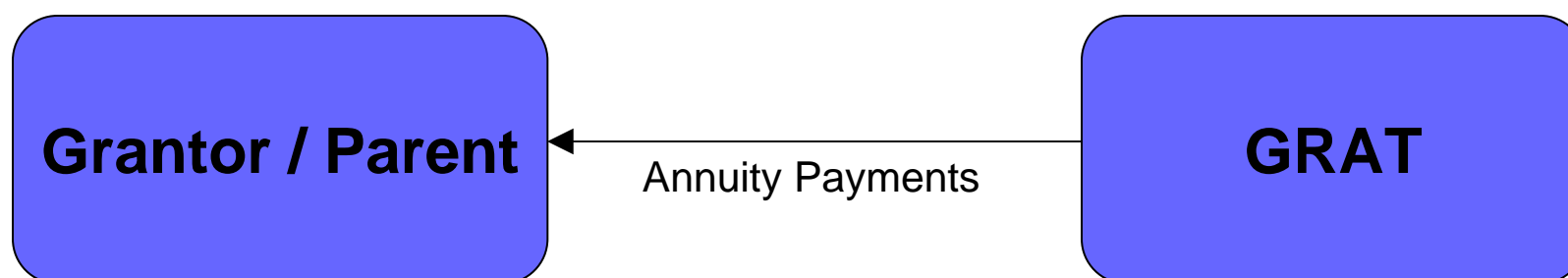


The amount of the taxable gift is the value of the property transferred to the trust minus the present value of the annuity interest that the grantor retains.

In valuing the lead interest, the IRS assumes that the trust assets produce a return equal to the IRC §7520 rate, effectively freezing growth of assets to the IRC §7520 rate.

GRANTOR RETAINED ANNUITY TRUST

STEP THREE: ANNUITY PAYMENTS

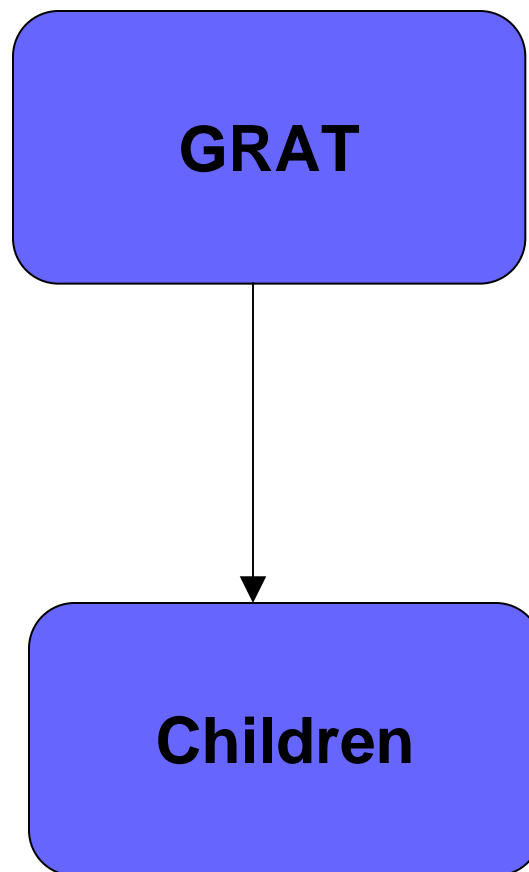


The GRAT must provide for payment of an annuity to the grantor not less frequently than annually.

As cash flow may be insufficient to satisfy the GRAT annuity payments, in-kind distributions may have to be made to the grantor to satisfy the annuity payments. However, these in-kind distributions could be contributed to new GRATs to avoid estate inclusion of the in-kind distributions.

GRANTOR RETAINED ANNUITY TRUST

STEP FOUR: PAYMENT TO BENEFICIARIES



At conclusion of GRAT term, remaining assets are transferred to children.

At this point, no further tax is imposed.

GRANTOR RETAINED ANNUITY TRUST

EXAMPLE*

TEN-YEAR TERM – 10% GROWTH

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 933,134	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (933,134)	\$ 10,066,866
2	\$ 10,066,866	\$ 1,006,687	\$ (933,134)	\$ 10,140,419
3	\$ 10,140,419	\$ 1,014,042	\$ (933,134)	\$ 10,221,328
4	\$ 10,221,328	\$ 1,022,133	\$ (933,134)	\$ 10,310,327
5	\$ 10,310,327	\$ 1,031,033	\$ (933,134)	\$ 10,408,226
6	\$ 10,408,226	\$ 1,040,823	\$ (933,134)	\$ 10,515,915
7	\$ 10,515,915	\$ 1,051,592	\$ (933,134)	\$ 10,634,373
8	\$ 10,634,373	\$ 1,063,437	\$ (933,134)	\$ 10,764,677
9	\$ 10,764,677	\$ 1,076,468	\$ (933,134)	\$ 10,908,011
10	\$ 10,908,011	\$ 1,090,801	\$ (933,134)	\$ 11,065,678

Benefit: \$11,065,678 Transferred to Beneficiaries Tax-Free

* Assuming a \$7,000,000 (after valuation adjustments) initial contribution

GRANTOR RETAINED ANNUITY TRUST

WHY GRAT WORKS – Difference Between Rates of Return

Year	Beginning Balance	Taxable Income 5.60%	Annuity Payment \$ 1,333,048	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 1,333,048	Ending Balance
1	\$ 10,000,000	\$ 560,000	\$ (1,333,048)	\$ 9,226,952	1	\$ 10,000,000	\$ 1,000,000	\$ (1,333,048)	\$ 9,666,952
2	\$ 9,226,952	\$ 516,709	\$ (1,333,048)	\$ 8,410,613	2	\$ 9,666,952	\$ 966,695	\$ (1,333,048)	\$ 9,300,599
3	\$ 8,410,613	\$ 470,994	\$ (1,333,048)	\$ 7,548,560	3	\$ 9,300,599	\$ 930,060	\$ (1,333,048)	\$ 8,897,611
4	\$ 7,548,560	\$ 422,719	\$ (1,333,048)	\$ 6,638,231	4	\$ 8,897,611	\$ 889,761	\$ (1,333,048)	\$ 8,454,324
5	\$ 6,638,231	\$ 371,741	\$ (1,333,048)	\$ 5,676,924	5	\$ 8,454,324	\$ 845,432	\$ (1,333,048)	\$ 7,966,709
6	\$ 5,676,924	\$ 317,908	\$ (1,333,048)	\$ 4,661,784	6	\$ 7,966,709	\$ 796,671	\$ (1,333,048)	\$ 7,430,332
7	\$ 4,661,784	\$ 261,060	\$ (1,333,048)	\$ 3,589,796	7	\$ 7,430,332	\$ 743,033	\$ (1,333,048)	\$ 6,840,317
8	\$ 3,589,796	\$ 201,029	\$ (1,333,048)	\$ 2,457,776	8	\$ 6,840,317	\$ 684,032	\$ (1,333,048)	\$ 6,191,300
9	\$ 2,457,776	\$ 137,635	\$ (1,333,048)	\$ 1,262,364	9	\$ 6,191,300	\$ 619,130	\$ (1,333,048)	\$ 5,477,382
10	\$ 1,262,364	\$ 70,692	\$ (1,333,048)	\$ 8	10	\$ 5,477,382	\$ 547,738	\$ (1,333,048)	\$ 4,692,073

Benefit: \$4,692,065 Additional Wealth Transferred to Beneficiaries Tax-Free (of which \$536,867 is due to taxes paid to grantor)

GRANTOR RETAINED ANNUITY TRUST

WHY GRAT WORKS – Valuation Adjustments

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 1,333,048	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 933,134	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (1,333,048)	\$ 9,666,952	1	\$ 10,000,000	\$ 1,000,000	\$ (933,134)	\$ 10,066,866
2	\$ 9,666,952	\$ 966,695	\$ (1,333,048)	\$ 9,300,599	2	\$ 10,066,866	\$ 1,006,687	\$ (933,134)	\$ 10,140,419
3	\$ 9,300,599	\$ 930,060	\$ (1,333,048)	\$ 8,897,611	3	\$ 10,140,419	\$ 1,014,042	\$ (933,134)	\$ 10,221,328
4	\$ 8,897,611	\$ 889,761	\$ (1,333,048)	\$ 8,454,324	4	\$ 10,221,328	\$ 1,022,133	\$ (933,134)	\$ 10,310,327
5	\$ 8,454,324	\$ 845,432	\$ (1,333,048)	\$ 7,966,709	5	\$ 10,310,327	\$ 1,031,033	\$ (933,134)	\$ 10,408,226
6	\$ 7,966,709	\$ 796,671	\$ (1,333,048)	\$ 7,430,332	6	\$ 10,408,226	\$ 1,040,823	\$ (933,134)	\$ 10,515,915
7	\$ 7,430,332	\$ 743,033	\$ (1,333,048)	\$ 6,840,317	7	\$ 10,515,915	\$ 1,051,592	\$ (933,134)	\$ 10,634,373
8	\$ 6,840,317	\$ 684,032	\$ (1,333,048)	\$ 6,191,300	8	\$ 10,634,373	\$ 1,063,437	\$ (933,134)	\$ 10,764,677
9	\$ 6,191,300	\$ 619,130	\$ (1,333,048)	\$ 5,477,382	9	\$ 10,764,677	\$ 1,076,468	\$ (933,134)	\$ 10,908,011
10	\$ 5,477,382	\$ 547,738	\$ (1,333,048)	\$ 4,692,073	10	\$ 10,908,011	\$ 1,090,801	\$ (933,134)	\$ 11,065,678

Benefit: \$6,373,605 Additional Wealth Transferred to Beneficiaries Tax-Free

GRANTOR RETAINED ANNUITY TRUST

WHY GRAT WORKS – Payment of Taxes by Grantor

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 933,134	Less: Taxes @ 40.00%	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 933,134	Less: Taxes @ 40.00%	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (933,134)	\$ (26,747)	\$ 10,040,120	1	\$ 10,000,000	\$ 1,000,000	\$ (933,134)	\$ -	\$ 10,066,866
2	\$ 10,040,120	\$ 1,004,012	\$ (933,134)	\$ (28,351)	\$ 10,082,647	2	\$ 10,066,866	\$ 1,006,687	\$ (933,134)	\$ -	\$ 10,140,419
3	\$ 10,082,647	\$ 1,008,265	\$ (933,134)	\$ (30,052)	\$ 10,127,726	3	\$ 10,140,419	\$ 1,014,042	\$ (933,134)	\$ -	\$ 10,221,328
4	\$ 10,127,726	\$ 1,012,773	\$ (933,134)	\$ (31,856)	\$ 10,175,509	4	\$ 10,221,328	\$ 1,022,133	\$ (933,134)	\$ -	\$ 10,310,327
5	\$ 10,175,509	\$ 1,017,551	\$ (933,134)	\$ (33,767)	\$ 10,226,159	5	\$ 10,310,327	\$ 1,031,033	\$ (933,134)	\$ -	\$ 10,408,226
6	\$ 10,226,159	\$ 1,022,616	\$ (933,134)	\$ (35,793)	\$ 10,279,849	6	\$ 10,408,226	\$ 1,040,823	\$ (933,134)	\$ -	\$ 10,515,915
7	\$ 10,279,849	\$ 1,027,985	\$ (933,134)	\$ (37,941)	\$ 10,336,759	7	\$ 10,515,915	\$ 1,051,592	\$ (933,134)	\$ -	\$ 10,634,373
8	\$ 10,336,759	\$ 1,033,676	\$ (933,134)	\$ (40,217)	\$ 10,397,085	8	\$ 10,634,373	\$ 1,063,437	\$ (933,134)	\$ -	\$ 10,764,677
9	\$ 10,397,085	\$ 1,039,708	\$ (933,134)	\$ (42,630)	\$ 10,461,030	9	\$ 10,764,677	\$ 1,076,468	\$ (933,134)	\$ -	\$ 10,908,011
10	\$ 10,461,030	\$ 1,046,103	\$ (933,134)	\$ (45,188)	\$ 10,528,811	10	\$ 10,908,011	\$ 1,090,801	\$ (933,134)	\$ -	\$ 11,065,678

Benefit: \$536,867 Additional Wealth Transferred to Beneficiaries Tax-Free

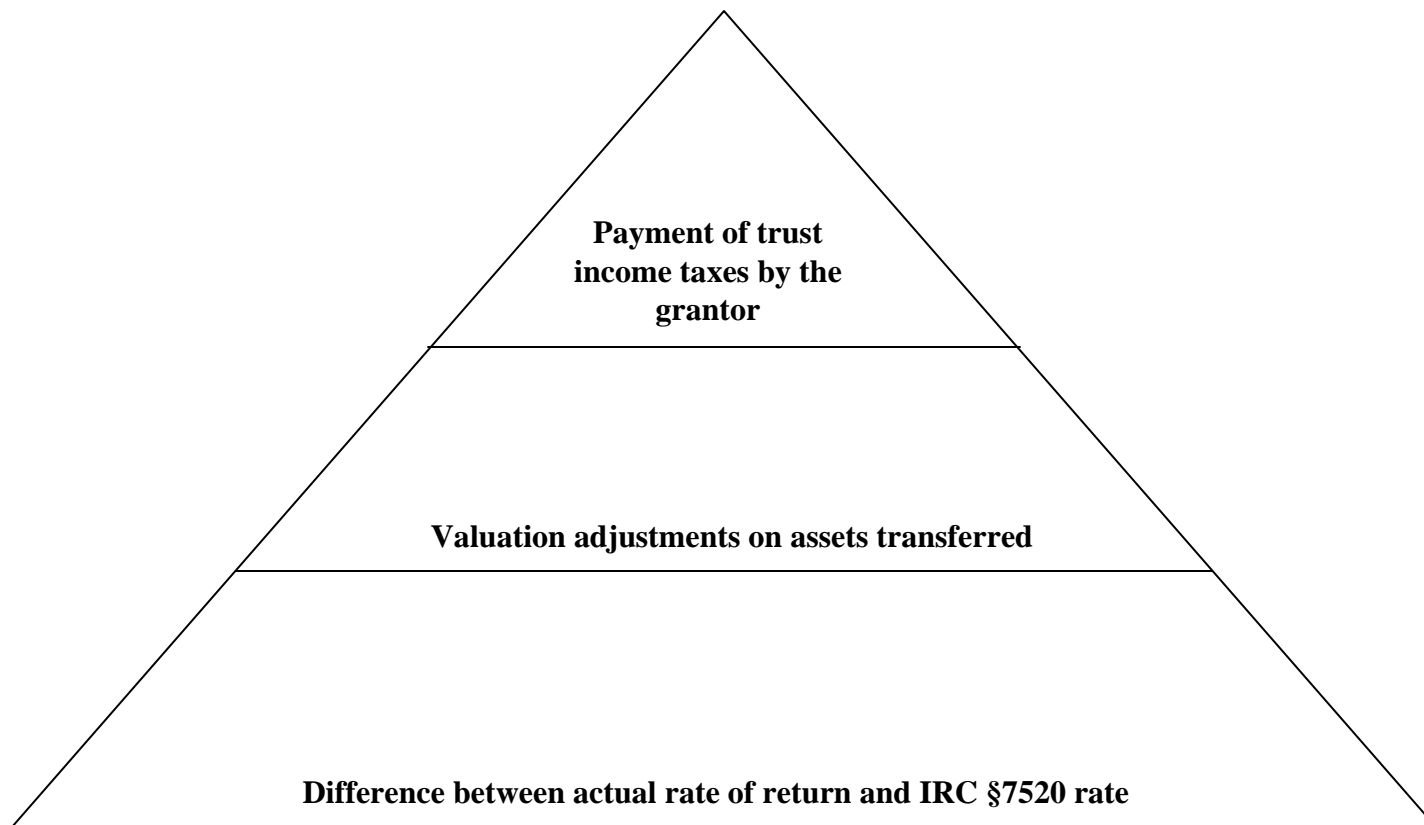
GRANTOR RETAINED ANNUITY TRUST

WHY GRAT WORKS – Summary

Total Wealth Transferred		<u>\$ 11,065,678</u>
Reasons for Total Wealth Transferred		
Differential Between Rates of Return	\$ 4,155,198	
Valuation Adjustment	6,373,605	
Income Taxes Paid by Grantor	536,867	
Rounding Adjustment	8	
Total Wealth Transferred		<u>\$ 11,065,678</u>

GRANTOR RETAINED ANNUITY TRUST

WHY GRAT WORKS



GRANTOR RETAINED ANNUITY TRUST

ADDITIONAL GRAT FEATURE – 20% Increasing Payment

Under Treas. Reg. §25.2702-3(b)(1)(ii)(B), the annual GRAT payment may increase by up to 20% over the annuity payment from the previous year. Accordingly, by “back-end loading” the GRAT payments, more wealth is left to future generations.

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 933,134	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (933,134)	\$ 10,066,866	1	\$ 10,000,000	\$ 1,000,000	\$ (389,089)	\$ 10,610,911
2	\$ 10,066,866	\$ 1,006,687	\$ (933,134)	\$ 10,140,419	2	\$ 10,610,911	\$ 1,061,091	\$ (466,907)	\$ 11,205,094
3	\$ 10,140,419	\$ 1,014,042	\$ (933,134)	\$ 10,221,328	3	\$ 11,205,094	\$ 1,120,509	\$ (560,289)	\$ 11,765,315
4	\$ 10,221,328	\$ 1,022,133	\$ (933,134)	\$ 10,310,327	4	\$ 11,765,315	\$ 1,176,532	\$ (672,346)	\$ 12,269,500
5	\$ 10,310,327	\$ 1,031,033	\$ (933,134)	\$ 10,408,226	5	\$ 12,269,500	\$ 1,226,950	\$ (806,816)	\$ 12,689,634
6	\$ 10,408,226	\$ 1,040,823	\$ (933,134)	\$ 10,515,915	6	\$ 12,689,634	\$ 1,268,963	\$ (968,179)	\$ 12,990,419
7	\$ 10,515,915	\$ 1,051,592	\$ (933,134)	\$ 10,634,373	7	\$ 12,990,419	\$ 1,299,042	\$ (1,161,815)	\$ 13,127,646
8	\$ 10,634,373	\$ 1,063,437	\$ (933,134)	\$ 10,764,677	8	\$ 13,127,646	\$ 1,312,765	\$ (1,394,178)	\$ 13,046,233
9	\$ 10,764,677	\$ 1,076,468	\$ (933,134)	\$ 10,908,011	9	\$ 13,046,233	\$ 1,304,623	\$ (1,673,013)	\$ 12,677,843
10	\$ 10,908,011	\$ 1,090,801	\$ (933,134)	\$ 11,065,678	10	\$ 12,677,843	\$ 1,267,784	\$ (2,007,616)	\$ 11,938,011

Benefit: \$872,333 Additional Wealth Transferred to Beneficiaries Tax-Free

GRANTOR RETAINED ANNUITY TRUST

DISADVANTAGES

- > If the grantor dies before the end of the GRAT term, the assets in the GRAT are included in the grantor's estate**
- > The remainder beneficiaries will have the same basis in the property transferred to the GRAT as the grantor had at the time the property was transferred (no step-up in basis)**
- > Risk that rate of return will not exceed interest rate resulting in no assets being transferred to remainder beneficiaries**

GRANTOR RETAINED ANNUITY TRUST

ADVANTAGES

- > **Annuity payments provide income stream to the grantor**
- > **Ability to make gifts of substantial amounts of property tax-free**
- > **Grantor pays income tax on trust income, leaving more assets in the GRAT for remainder beneficiaries**
- > **Reduces the taxable estate of the grantor**
- > **Valuation adjustments increase effectiveness of sale for estate tax purposes**

GRANTOR RETAINED ANNUITY TRUST

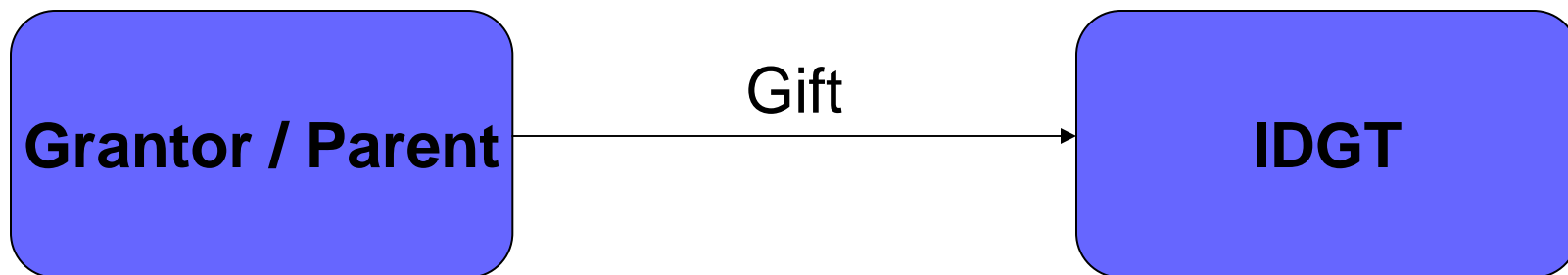
DISADVANTAGES

- > If the grantor dies before the end of the GRAT term, the assets in the GRAT are included in the grantor's estate**
- > The remainder beneficiaries will have the same basis in the property transferred to the GRAT as the grantor had at the time the property was transferred (no step-up in basis)**
- > Risk that rate of return will not exceed interest rate resulting in no assets being transferred to remainder beneficiaries**

SALE TO AN INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT)

SALE TO AN IDGT

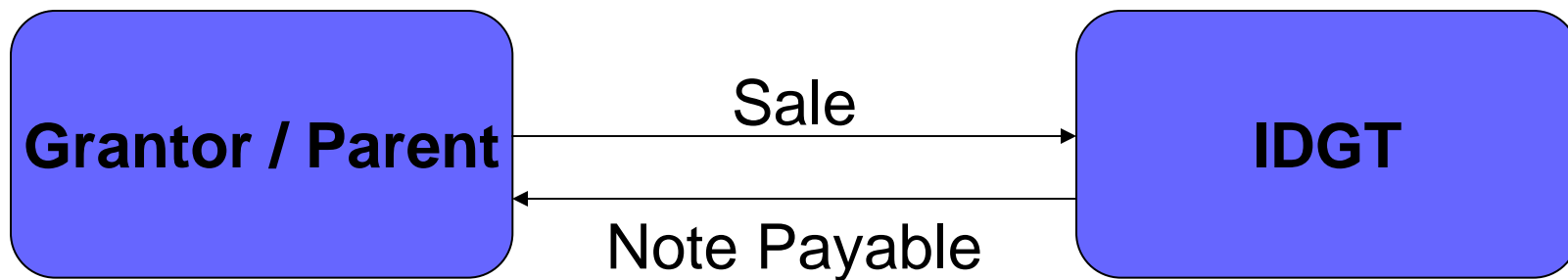
STEP ONE: GIFT OF ASSETS



Gift approximately 10% of total value that needs to be transferred to trust. This transfer will be a taxable gift that may require gift tax to be paid. The assets transferred, and the earnings on the assets transferred, will pay for future installment payments.

SALE TO AN IDGT

STEP TWO: SALE OF ASSETS



The remaining assets are transferred to the IDGT in exchange for an installment note payable.

SALE TO AN IDGT

STEP THREE: INSTALLMENT PAYMENTS



Annual installment payments are made from the IDGT to the seller/grantor. These may include interest and principal or just interest with a balloon payment due at the end of the term.

SALE TO AN IDGT

EXAMPLE*

TEN-YEAR TERM – 10% GROWTH

Year	Beginning Balance	Taxable Income 10.00%	Annual Payment	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (340,200)	\$ 10,659,800
2	\$ 10,659,800	\$ 1,065,980	\$ (340,200)	\$ 11,385,580
3	\$ 11,385,580	\$ 1,138,558	\$ (340,200)	\$ 12,183,938
4	\$ 12,183,938	\$ 1,218,394	\$ (340,200)	\$ 13,062,132
5	\$ 13,062,132	\$ 1,306,213	\$ (340,200)	\$ 14,028,145
6	\$ 14,028,145	\$ 1,402,814	\$ (340,200)	\$ 15,090,759
7	\$ 15,090,759	\$ 1,509,076	\$ (340,200)	\$ 16,259,635
8	\$ 16,259,635	\$ 1,625,964	\$ (340,200)	\$ 17,545,399
9	\$ 17,545,399	\$ 1,754,540	\$ (340,200)	\$ 18,959,739
10	\$ 18,959,739	\$ 1,895,974	\$ (7,340,200)	\$ 13,515,513

Benefit: \$13,515,513 Transferred to Beneficiaries Tax-Free

* Assuming a \$7,000,000 (after valuation adjustments) interest only, balloon payment feature installment note with a 4.86% annual interest rate (long-term AFR)

SALE TO AN IDGT

WHY SALE TO AN IDGT WORKS – Difference Between Rates of Return

Year	Beginning Balance	Taxable Income 4.86%	Installment Payment \$ 486,000	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 486,000	Ending Balance
1	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	1	\$ 10,000,000	\$ 1,000,000	\$ (486,000)	\$ 10,514,000
2	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	2	\$ 10,514,000	\$ 1,051,400	\$ (486,000)	\$ 11,079,400
3	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	3	\$ 11,079,400	\$ 1,107,940	\$ (486,000)	\$ 11,701,340
4	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	4	\$ 11,701,340	\$ 1,170,134	\$ (486,000)	\$ 12,385,474
5	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	5	\$ 12,385,474	\$ 1,238,547	\$ (486,000)	\$ 13,138,021
6	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	6	\$ 13,138,021	\$ 1,313,802	\$ (486,000)	\$ 13,965,824
7	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	7	\$ 13,965,824	\$ 1,396,582	\$ (486,000)	\$ 14,876,406
8	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	8	\$ 14,876,406	\$ 1,487,641	\$ (486,000)	\$ 15,878,046
9	\$ 10,000,000	\$ 486,000	\$ (486,000)	\$ 10,000,000	9	\$ 15,878,046	\$ 1,587,805	\$ (486,000)	\$ 16,979,851
10	\$ 10,000,000	\$ 486,000	\$ (10,486,000)	\$ -	10	\$ 16,979,851	\$ 1,697,985	\$ (10,486,000)	\$ 8,191,836

Benefit: \$8,191,836 Additional Wealth Transferred to Beneficiaries Tax-Free (of which \$5,297,500 is due to taxes paid to grantor)

SALE TO AN IDGT

WHY SALE TO AN IDGT WORKS – Valuation Adjustments

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 486,000	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 340,200	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (486,000)	\$ 10,514,000	1	\$ 10,000,000	\$ 1,000,000	\$ (340,200)	\$ 10,659,800
2	\$ 10,514,000	\$ 1,051,400	\$ (486,000)	\$ 11,079,400	2	\$ 10,659,800	\$ 1,065,980	\$ (340,200)	\$ 11,385,580
3	\$ 11,079,400	\$ 1,107,940	\$ (486,000)	\$ 11,701,340	3	\$ 11,385,580	\$ 1,138,558	\$ (340,200)	\$ 12,183,938
4	\$ 11,701,340	\$ 1,170,134	\$ (486,000)	\$ 12,385,474	4	\$ 12,183,938	\$ 1,218,394	\$ (340,200)	\$ 13,062,132
5	\$ 12,385,474	\$ 1,238,547	\$ (486,000)	\$ 13,138,021	5	\$ 13,062,132	\$ 1,306,213	\$ (340,200)	\$ 14,028,145
6	\$ 13,138,021	\$ 1,313,802	\$ (486,000)	\$ 13,965,824	6	\$ 14,028,145	\$ 1,402,814	\$ (340,200)	\$ 15,090,759
7	\$ 13,965,824	\$ 1,396,582	\$ (486,000)	\$ 14,876,406	7	\$ 15,090,759	\$ 1,509,076	\$ (340,200)	\$ 16,259,635
8	\$ 14,876,406	\$ 1,487,641	\$ (486,000)	\$ 15,878,046	8	\$ 16,259,635	\$ 1,625,964	\$ (340,200)	\$ 17,545,399
9	\$ 15,878,046	\$ 1,587,805	\$ (486,000)	\$ 16,979,851	9	\$ 17,545,399	\$ 1,754,540	\$ (340,200)	\$ 18,959,739
10	\$ 16,979,851	\$ 1,697,985	\$ (10,486,000)	\$ 8,191,836	10	\$ 18,959,739	\$ 1,895,974	\$ (7,340,200)	\$ 13,515,513

Benefit: \$5,323,677 Additional Wealth Transferred to Beneficiaries Tax-Free

SALE TO AN IDGT

WHY SALE TO AN IDGT WORKS – Payment of Taxes by Grantor

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 340,200	Less: Taxes @ 40.00%	Ending Balance	Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment \$ 340,200	Less: Taxes @ 40.00%	Ending Balance
1	\$ 10,000,000	\$ 1,000,000	\$ (340,200)	\$ (263,920)	\$ 10,395,880	1	\$ 10,000,000	\$ 1,000,000	\$ (340,200)	\$ -	\$ 10,659,800
2	\$ 10,395,880	\$ 1,039,588	\$ (340,200)	\$ (279,755)	\$ 10,815,513	2	\$ 10,659,800	\$ 1,065,980	\$ (340,200)	\$ -	\$ 11,385,580
3	\$ 10,815,513	\$ 1,081,551	\$ (340,200)	\$ (296,541)	\$ 11,260,324	3	\$ 11,385,580	\$ 1,138,558	\$ (340,200)	\$ -	\$ 12,183,938
4	\$ 11,260,324	\$ 1,126,032	\$ (340,200)	\$ (314,333)	\$ 11,731,823	4	\$ 12,183,938	\$ 1,218,394	\$ (340,200)	\$ -	\$ 13,062,132
5	\$ 11,731,823	\$ 1,173,182	\$ (340,200)	\$ (333,193)	\$ 12,231,612	5	\$ 13,062,132	\$ 1,306,213	\$ (340,200)	\$ -	\$ 14,028,145
6	\$ 12,231,612	\$ 1,223,161	\$ (340,200)	\$ (353,184)	\$ 12,761,389	6	\$ 14,028,145	\$ 1,402,814	\$ (340,200)	\$ -	\$ 15,090,759
7	\$ 12,761,389	\$ 1,276,139	\$ (340,200)	\$ (374,376)	\$ 13,322,952	7	\$ 15,090,759	\$ 1,509,076	\$ (340,200)	\$ -	\$ 16,259,635
8	\$ 13,322,952	\$ 1,332,295	\$ (340,200)	\$ (396,838)	\$ 13,918,210	8	\$ 16,259,635	\$ 1,625,964	\$ (340,200)	\$ -	\$ 17,545,399
9	\$ 13,918,210	\$ 1,391,821	\$ (340,200)	\$ (420,648)	\$ 14,549,182	9	\$ 17,545,399	\$ 1,754,540	\$ (340,200)	\$ -	\$ 18,959,739
10	\$ 14,549,182	\$ 1,454,918	\$ (7,340,200)	\$ (445,887)	\$ 8,218,013	10	\$ 18,959,739	\$ 1,895,974	\$ (7,340,200)	\$ -	\$ 13,515,513

Benefit: \$5,297,500 Additional Wealth Transferred to Beneficiaries Tax-Free

SALE TO AN IDGT

WHY SALE TO AN IDGT WORKS – Summary

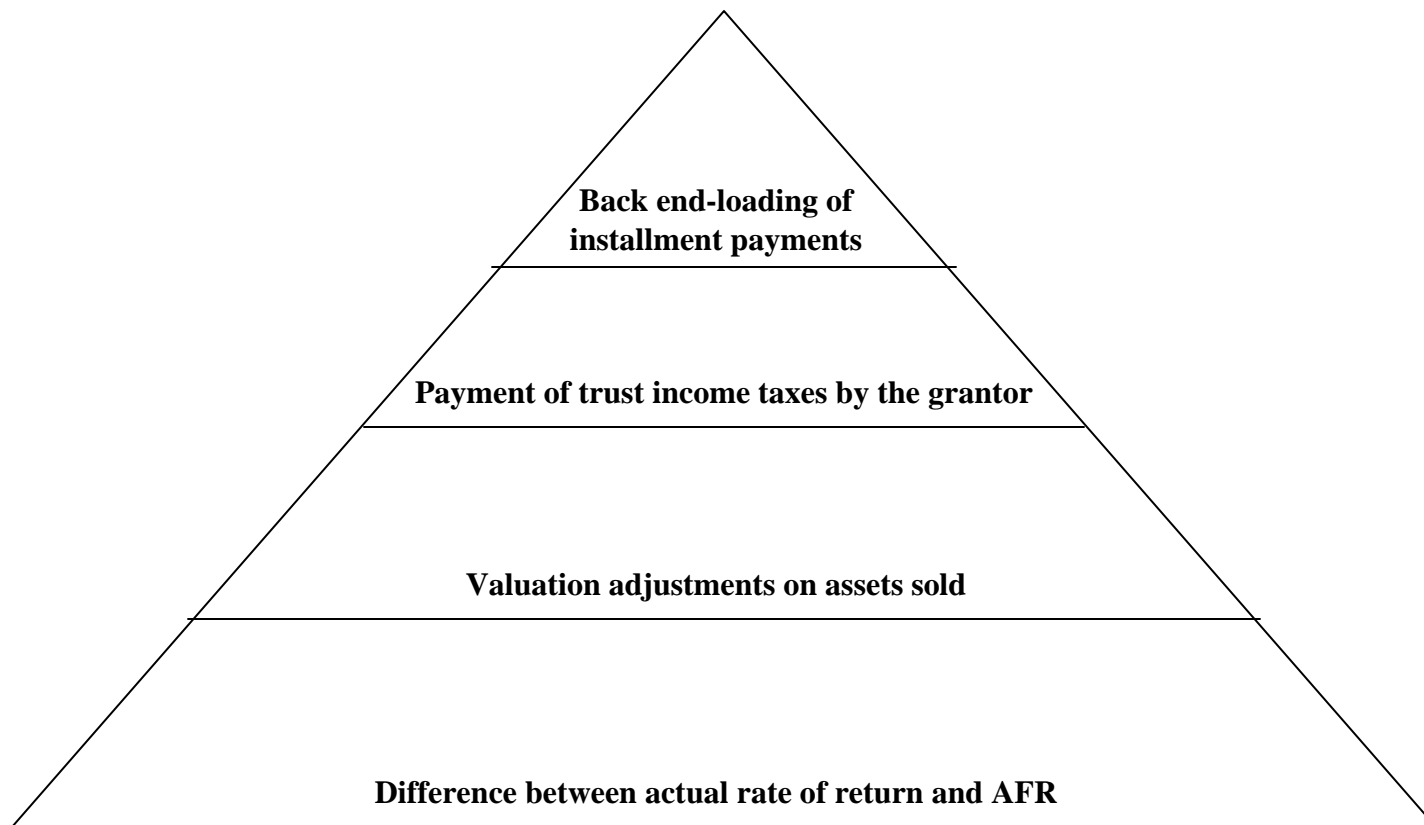
Total Wealth Transferred **\$ 13,515,513**

Reasons for Total Wealth Transferred

Differential Between Rates of Return	\$ 2,894,336	
Valuation Adjustment	\$ 5,323,677	
Income Taxes Paid by Grantor	\$ 5,297,500	
Total Wealth Transferred		<u><u>\$ 13,515,513</u></u>

SALE TO AN IDGT

WHY A SALE TO AN IDGT WORKS



SALE TO AN IDGT

INTENTIONALLY DEFECTIVE GRANTOR TRUST

- > Trust income is taxed to the seller/grantor**
- > Trust assets sold are not in seller/grantor's estate for estate tax purposes**
- > Payments of income tax on behalf of the trust should not be an additional gift to the trust**

SALE TO AN IDGT

ADVANTAGES

- > Freezes value of appreciation on assets sold in the seller/grantor's taxable estate at the low interest rate on the installment note payable**
- > No capital gains tax due on installment sale**
- > Interest income on installment note is not taxable to the seller/grantor**
- > Grantor pays income tax on trust income, leaving more assets in the IDGT for remainder beneficiaries**
- > Valuation adjustments increase effectiveness of sale for estate tax purposes**

SALE TO AN IDGT

DISADVANTAGES

- > Estate inclusion of note if seller/grantor dies during term of installment note**
- > No step-up in basis at seller/grantor's death**
- > Trust income taxable to seller/grantor during his/her life could cause a cash flow problem if there is not sufficient income earned by the seller/grantor**
- > Possible gift and estate tax exposure if insufficient assets are used to fund the trust**
- > Possible taxable gift for amount of loan**
- > Possible taxable estate inclusion under *Karmazin* (retained life estate)**

ROTH CONVERSIONS

Roth IRAs

- > **100% of growth is tax-exempt**
- > **No required minimum distributions at age 70¹/₂**
 - **NOTE: Distributions from Roth IRAs cannot be used to fulfill the RMD from a traditional IRA**
- > **\$100,000 Modified Adjusted Gross Income (MAGI) limitation**
- > **RMDs on Inherited Roth IRAs**
- > **Roth 401(k) plans**

Roth IRAs

- > **Starting in 2010, the \$100,000 Adjusted Gross Income (AGI) limitation no longer applies**
 - **The taxable income recognized on a Roth IRA conversion in 2010 may be spread over the following two tax years (i.e. 2011 and 2012)**
- > **Married Filing Separately taxpayers can convert to a Roth IRA**

Roth IRAs

Computation of MAGI - New Rule (Conversions After 12/31/2004)

Adjusted Gross Income		\$XX,XXX
Less:		
Income from Roth Conversion	(\$XX,XXX)	
Required Minimum Distribution (IRAs Only)	(XX,XXX)	(XX,XXX)
Add-in:		
Traditional IRA Deduction	\$X,XXX	
Student Loan Interest	X,XXX	
Tuition & Fee Deduction	X,XXX	
Foreign Income/Housing Exclusion	X,XXX	
Foreign Housing Deduction	X,XXX	
Exclusion of Interest on U.S. Series EE Savings Bonds	X,XXX	XX,XXX
Modified Adjusted Gross Income (Must be less than \$100,000)		\$XX,XXX

Roth IRAs

> **Convertible accounts**

- **Traditional IRAs**
- **401(k) plans (Starting in 2008)**
- **Profit sharing plans (Starting in 2008)**
- **403(b) annuity plans (Starting in 2008)**
- **457 plans (Starting in 2008)**

Roth IRAs

- > **Non-convertible accounts**
 - **“Inherited” IRAs**
 - **Education IRAs**

Roth IRAs

- > The 5-year period for all of a participant's Roth IRAs begins on January 1 of the first year for which a contribution was made to any Roth IRA owned by that participant.
 - Except a surviving spouse gets to treat an inherited Roth IRA as one of her own for purposes of the 5-year rule.
 - The 5-year period continues to run with the participant dies.
 - If a participant dies within the 5-year period, distributions to a beneficiary are taxable until the 5-year period ends.

Roth IRAs

Taxation of Distributions

Qualified distributions are
not subject to income tax

Non-qualified distributions
will be subject to income tax

Roth IRAs

Taxation of Distributions

- > Basis Can be Withdrawn Tax-Free (FIFO Method)
- > Distributions are not subject to income tax if they do not exceed aggregate contributions and/or conversions to the Roth IRA.

Roth IRAs

Taxation of Distributions

Early Withdrawal Tax

- > Withdrawals made within five years of conversion if owner under age 59½ and no other exception applies
- > Five-year period independent of five-year period for qualified distribution

Roth IRAs

Taxation of Distributions

Early Withdrawal Tax for Non-Qualified Distributions

- > **If attributable to a regular contribution:
applicable to amounts includible in gross
income**

- > **If attributable to a rollover contribution:
applicable to amounts that were included in
gross income at rollover**

Roth IRAs

Seven Reasons Why to Convert to a Roth IRA

- (1) Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, etc.
- (2) Suspension of the minimum distribution rules at age 70½ provides a considerable advantage to the Roth IRA holder.

Roth IRAs

Seven Reasons Why to Convert to a Roth IRA

- (3) Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax.
- (4) Taxpayers who can pay the income tax on the IRA from non IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields.

Roth IRAs

Seven Reasons Why to Convert to a Roth IRA

- (5) Taxpayers who need to use IRA assets to fund their Unified Credit bypass trust are well advised to consider making a Roth IRA election for that portion of their overall IRA funds.
- (6) Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.

Roth IRAs

Seven Reasons Why to Convert to a Roth IRA

- (7) Because federal tax brackets are more favorable for married couples filing joint returns than for single individuals, Roth IRA distributions won't cause an increase in tax rates for the surviving spouse when one spouse is deceased because the distributions are tax-free.

Roth IRAs

Advantage of Paying Income Tax on a Roth IRA Conversion Before Incurring an Estate Tax

	Estate Tax First Traditional IRA	Income Tax First Roth IRA
IRA Balance	\$ 2,500,000	\$ 2,500,000
Less: Federal & State Income Taxes @ 40%	-	(1,000,000)
Subtotal	\$ 2,500,000	\$ 1,500,000
Less: Federal Estate Tax @ 45%	(1,125,000)	(675,000)
Less: State Estate Tax @ 10%	(250,000)	(150,000)
Subtotal	\$ 1,125,000	\$ 675,000
IRA Balance	\$ 2,500,000	
Less: IRC §691(c) Deduction*	(1,125,000)	
Subtotal	\$ 1,375,000	
Less: Federal & State Income Taxes @ 40%	(550,000)	
Net Wealth to Family	\$ 575,000	\$ 675,000

PROOF: $(\$2,500,000 - \$1,500,000) \times 10\%$ state estate tax = \$100,000

* NOTE: Under IRC §691(c), a deduction is allowed ONLY for federal estate taxes paid.

Roth IRAs

Understanding the Mechanics

In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that:

- **The annual growth rates are the same**
- **The tax rate in the conversion year is the same as the tax rate during the withdrawal years**

(i.e. $A \times B \times C = D$; $A \times C \times B = D$)

Roth IRAs

Understanding the Mechanics

	Traditional IRA	Roth IRA
2008 Account Balance	\$ 100,000	\$ 100,000
Less: Income Taxes @ 40%	-	(40,000)
Net Balance	\$ 100,000	\$ 60,000
 Growth Until Death	 300.00%	 300.00%
Account Balance @ Death	\$ 300,000	\$ 180,000
Less: Income Taxes @ 40%	(120,000)	-
Net Account Balance to Family	\$ 180,000	\$ 180,000

Roth IRAs

Understanding the Mechanics

- > **Critical decision factors**
 - **Tax rate differential**
 - **Year of conversion vs. withdrawal years**
 - **Use of “outside funds” (i.e. non-qualified retirement accounts) to pay the income tax liability**
 - **Time horizon**
 - **IRC §691(c) “effect”**

Roth IRAs

Understanding the Mechanics

- > The key to successful Roth IRA conversions is to keep as much of the conversion income as possible in the current marginal tax bracket**
 - However, there are times when it may make sense to convert more and go into higher tax brackets**

Roth IRAs

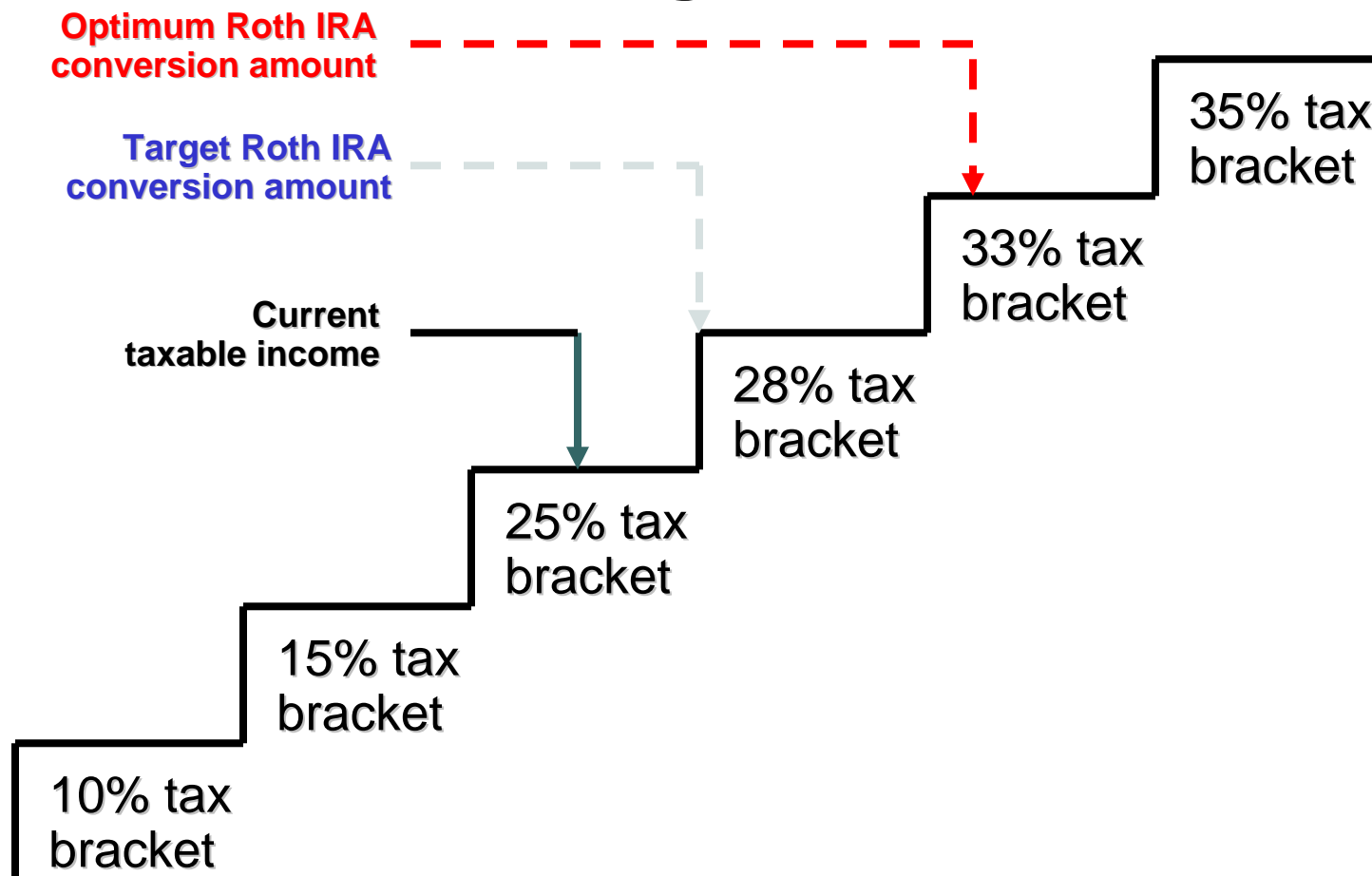
Understanding the Mechanics

Tax Brackets

	Single	Married Filing Jointly	Head of Household
10%	\$8,025	\$16,050	\$11,200
15%	\$32,550	\$65,100	\$43,650
25%	\$78,850	\$131,450	\$112,650
28%	\$164,550	\$200,300	\$182,400
33%	\$357,700	\$357,700	\$357,700
35%	> \$357,700	> \$357,700	> \$357,700

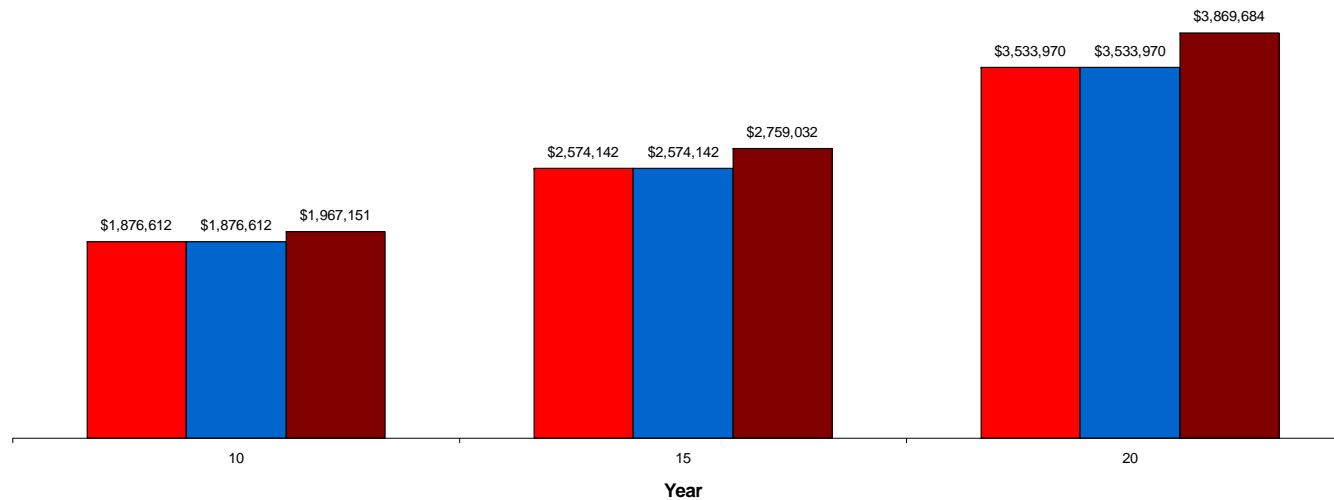
Roth IRAs

Understanding the Mechanics



Understanding the Mechanics – Case Study

After-Tax Investment Balance
(Tax Rates Remain the Same)



■ Traditional IRA
■ Roth IRA Conversion (Pay Tax w/Roth IRA)
■ Roth IRA Conversion (Pay Tax w/Outside Account)

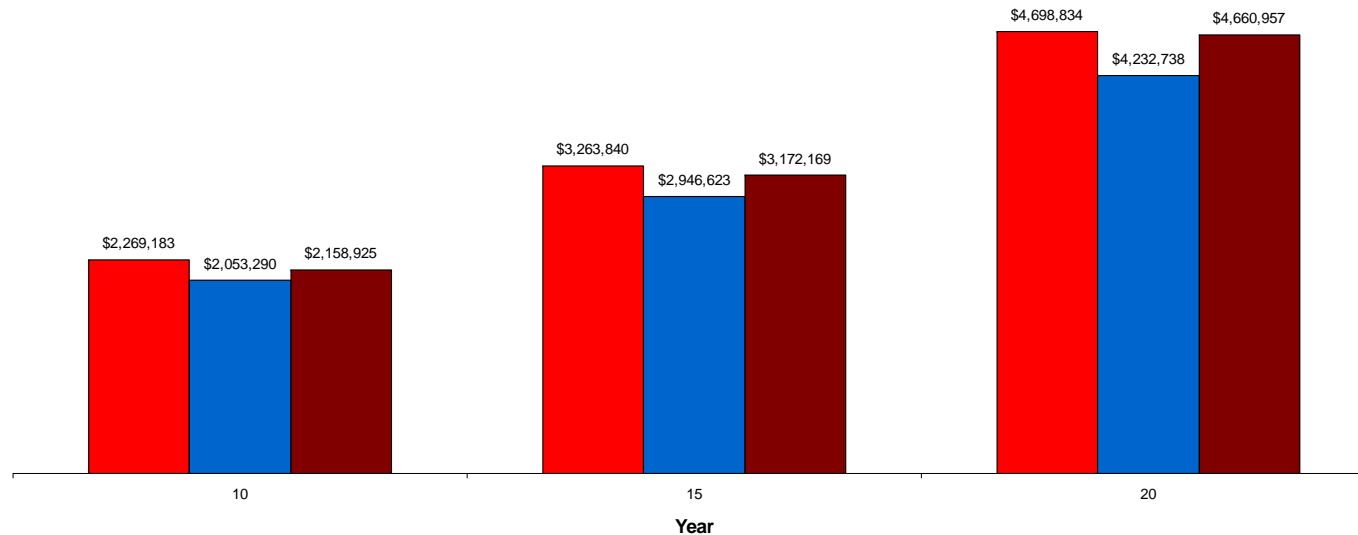
ASSUMPTIONS

IRA Owner's Age	50
IRA Balance	\$ 1,000,000
Outside Account Balance	\$ 400,000
Yield Rate	2.00%
Growth Rate	6.00%
Total Return (Pre-Tax)	8.00%
Less: Income Tax on Yield @ 40%	-0.80%
Less: Income Tax on Growth @ 20%*	-0.60%
Total Return (After-Tax)	6.60%
Tax Rate - Current Year	40.00%
Tax Rate - Future Years	40.00%

* Assumes 50% annual turnover on growth

Understanding the Mechanics – Case Study

After-Tax Investment Balance
(Lower Tax Rates in Future Years)



■ Traditional IRA
■ Roth IRA Conversion (Pay Tax w/Roth IRA)
■ Roth IRA Conversion (Pay Tax w/Outside Account)

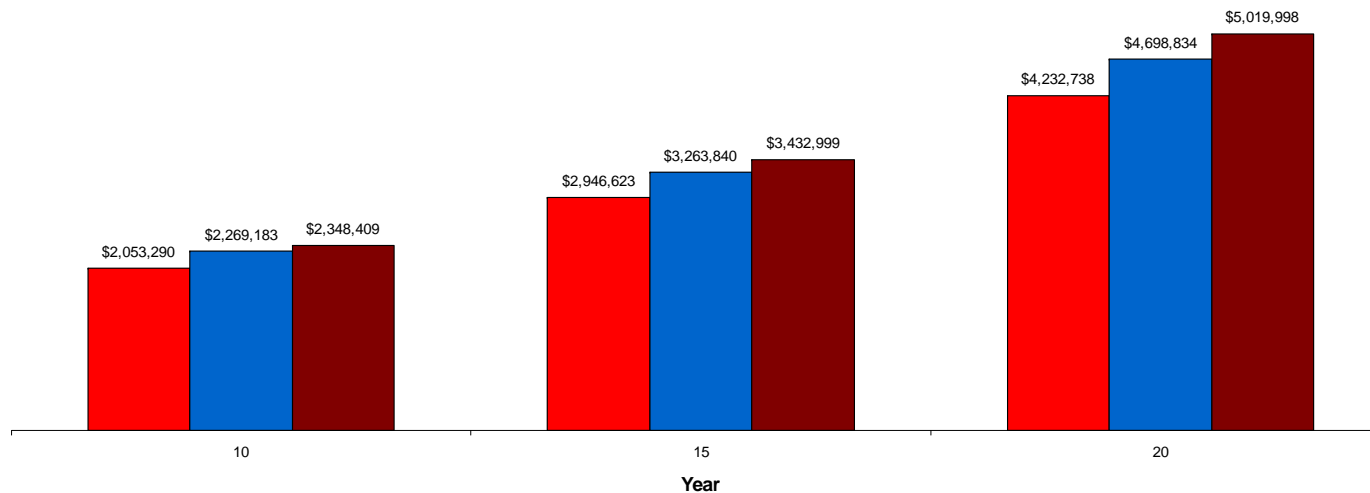
ASSUMPTIONS

IRA Owner's Age	50
IRA Balance	\$ 1,000,000
Outside Account Balance	\$ 400,000
Yield Rate	2.00%
Growth Rate	6.00%
Total Return (Pre-Tax)	8.00%
Less: Income Tax on Yield @ 40%	-0.80%
Less: Income Tax on Growth @ 20%*	-0.60%
Total Return (After-Tax)	6.60%
Tax Rate - Current Year	40.00%
Tax Rate - Future Years	30.00%

* Assumes 50% annual turnover on growth

Understanding the Mechanics – Case Study

After-Tax Investment Balance
(Higher Tax Rates in Future Years)



■ Traditional IRA
■ Roth IRA Conversion (Pay Tax w/Roth IRA)
■ Roth IRA Conversion (Pay Tax w/Outside Account)

ASSUMPTIONS

IRA Owner's Age	50
IRA Balance	\$ 1,000,000
Outside Account Balance	\$ 400,000
Yield Rate	2.00%
Growth Rate	6.00%
Total Return (Pre-Tax)	8.00%
Less: Income Tax on Yield @ 40%	-0.80%
Less: Income Tax on Growth @ 20%*	-0.60%
Total Return (After-Tax)	6.60%
Tax Rate - Current Year	30.00%
Tax Rate - Future Years	40.00%

* Assumes 50% annual turnover on growth

Roth IRA

Tactical Considerations

- > Utilize unused charitable contribution carryovers
- > Offset current year ordinary losses
- > Utilize current year Net Operating Losses (NOL) or carryovers from prior years
- > Utilize Alternative Minimum Tax (AMT) carryovers

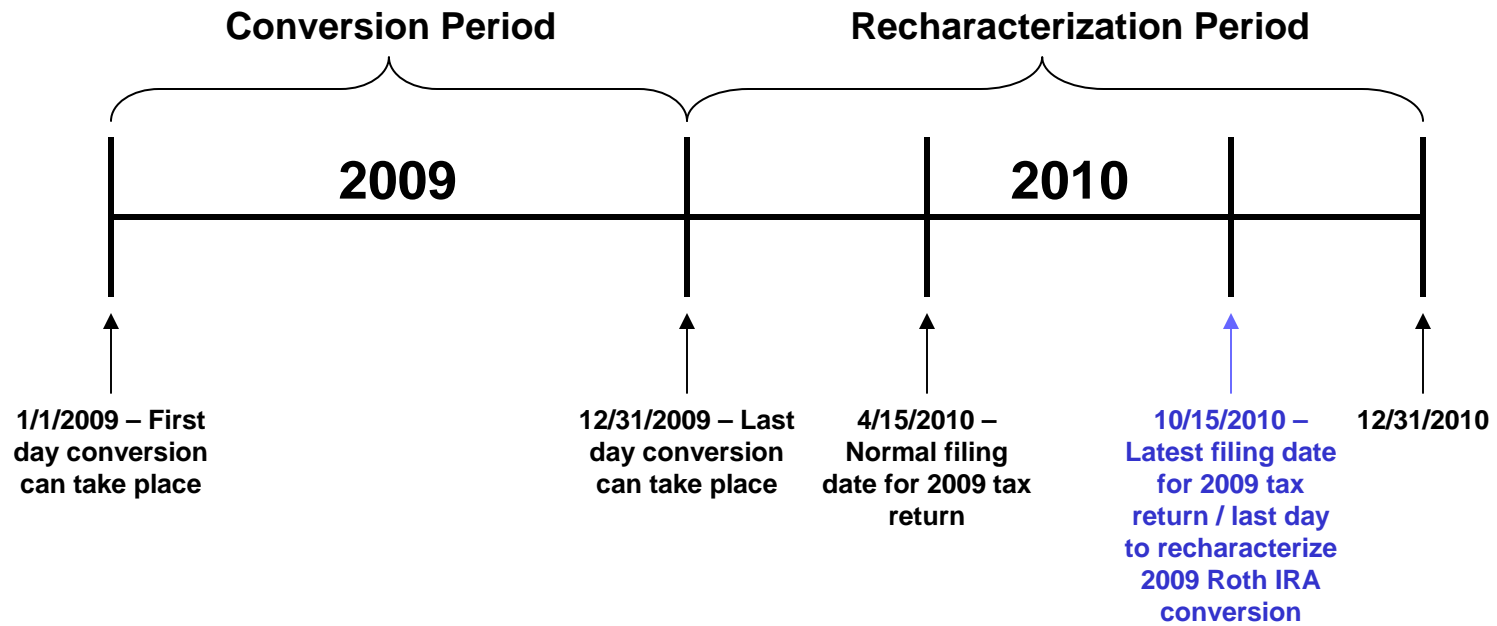
Roth IRA

Tactical Considerations

- > Taxpayers may recharacterize (i.e. “undo”) the Roth IRA conversion in current year or by the filing date of the current year’s tax return
 - > - Recharacterization can take place as late as 10/15 in the year following the year of conversion

- > Taxpayers may choose to “reconvert” their recharacterization
 - > - Reconversion may only take place at the later of the following two dates:
 - > (1) The tax year following the original conversion **OR**
 - > (2) 30 days after the recharacterization

Roth IRA Conversion Timetable



Roth IRA Conversion Dilemma

- > Taxpayers cannot recharacterize a portion of a Roth conversion by “cherry picking” only those stocks that decline in value
(IRS Notice 2000-39)
- > All gains and losses to the entire Roth IRA, regardless of the actual stock or fund re-characterized, must be pro-rated

Roth IRA Conversion Dilemma - Example

On January 2, 2008, when John Smith's IRA was worth \$500,000, he converted the entire amount to a Roth IRA. John will owe ordinary income tax on the entire \$500,000. The IRA consisted of 50% ABC Fund (\$250,000) and 50% YYZ Fund (\$250,000). As of April 15th, 2009 the ABC fund had declined in value to \$125,000, while the YYZ fund had increased in value to \$275,000. Thus, the total value of the IRA account declined in value to \$400,000.

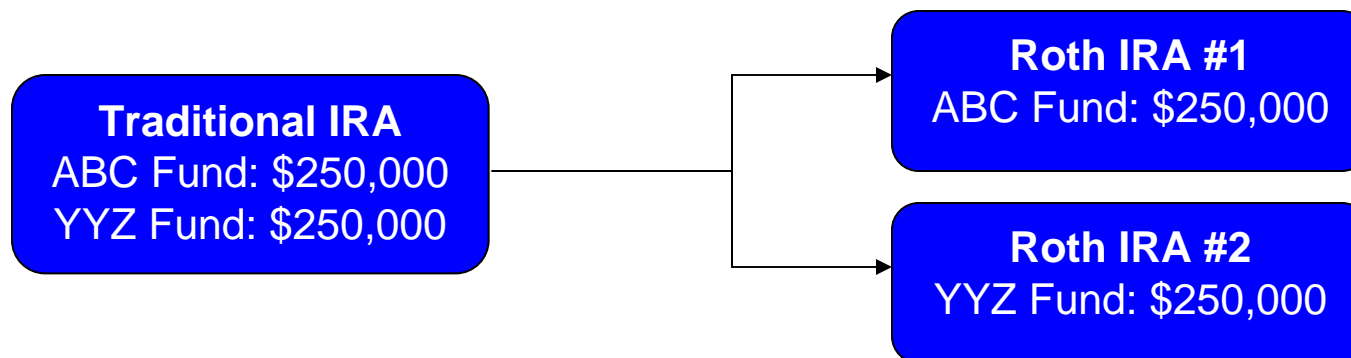
Even though John would like to re-characterize all of his ABC fund and leave the YYZ fund in his Roth IRA, he must allocate the total loss to each fund pro-ratably. As a result of this loss allocation, John may only recharacterize \$156,250 ($31.25\% * \$500,000$) instead of \$250,000.

Roth IRA Conversion Dilemma - Example

	Initial Value on Date of Conversion	Value on Date of Recharacterization	Relative Percentages of overall Roth IRA on Date of Recharacterization	Increase / Decrease in Value
ABC Fund	\$ 250,000	\$ 125,000	31.25%	\$ (125,000)
YYZ Fund	\$ 250,000	\$ 275,000	68.75%	\$ 25,000
Total	\$ 500,000	\$ 400,000	100%	\$ (100,000)

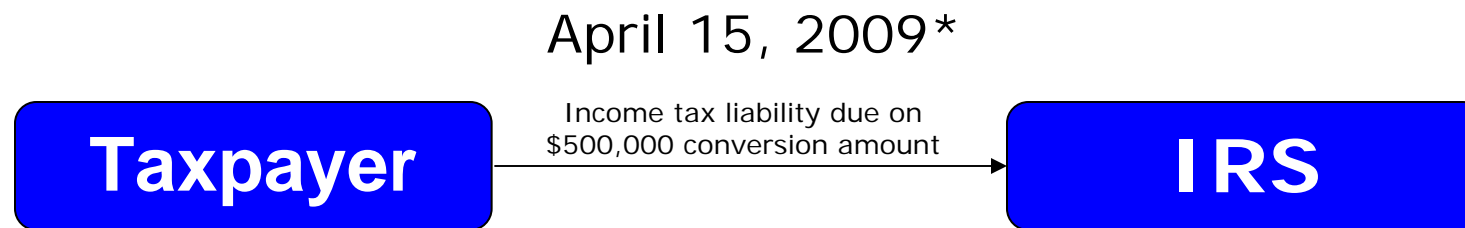
Roth IRA Segregated Conversion Strategy

STEP 1 – Convert Traditional IRA Into Two Separate Roth IRAs



Roth IRA Segregated Conversion Strategy

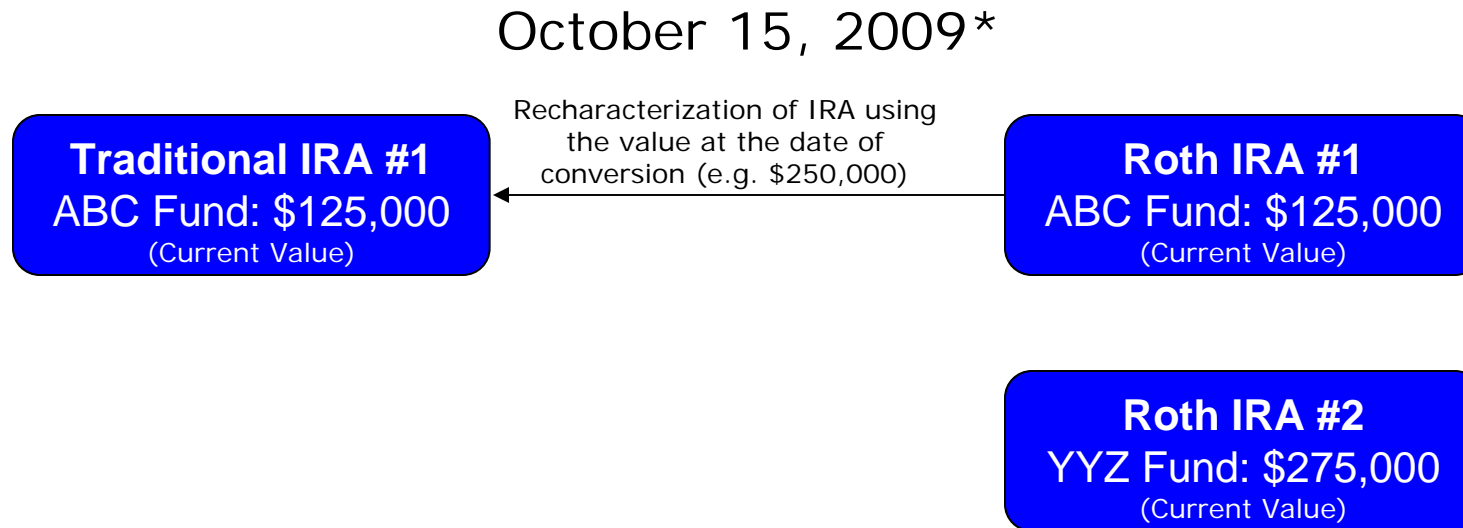
STEP 2 – Payment of Income Taxes on Roth IRA Conversion



* **NOTE:** Either a tax return or an extension must be filed by this date. Regardless of what is chosen, the tax liability due on the Roth IRA conversion must be remitted by this date in order to avoid late payment penalties and interest.

Roth IRA Segregated Conversion Strategy

STEP 3 – Recharacterization of Roth IRA Conversion

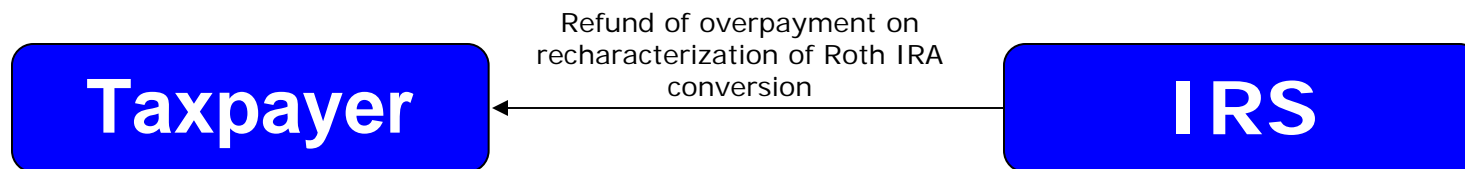


* **NOTE:** October 15, 2009 is the latest date for which a 2008 recharacterization can take place (either by filing extensions or by filing an amended return).

Roth IRA Segregated Conversion Strategy

STEP 4 – Refund on Overpayment of Income Taxes Paid on Roth IRA Conversion

October 15, 2009



Roth IRA Segregated Conversion Strategy – Example

Using the facts from the earlier Example, instead of converting his entire IRA into a single Roth IRA, John created two separate Roth IRAs, one for each fund. As of April 15th, 2009 the ABC Fund had declined in value to \$125,000, while the YYZ Fund had increased in value to \$275,000.

As a result of the poor performance of the ABC Fund, John chose to recharacterize the Roth IRA that held the ABC Fund before he filed his income tax return.

The tax savings from John's Roth IRA Segregated Conversion Strategy can be summarized on the following slide:

Roth IRA Segregated Conversion Strategy

Benefits of Segregating Roth IRA Accounts

	Without Roth IRA Segregation	With Roth IRA Segregation	Difference
Value on Date of Conversion	\$ 500,000	\$ 500,000	\$ -
Value of Roth IRA after recharacterization	\$ 275,000	\$ 275,000	\$ -
Value of Traditional IRA after recharacterization	\$ 125,000	\$ 125,000	\$ -
Ordinary Income Recognized	\$ 343,750	\$ 250,000	\$ (93,750)
Ordinary Income Tax @ 28%	\$ 96,250	\$ 70,000	\$ (26,250)

THANK YOU

**To be added to our IRA update
newsletter, please email
robert.keebler@bakertilly.com**