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Grantor Deemed Owner Trusts (GDOTs.)

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Disclosure #2

- This presentation shows how a GDOT works. There are various entities that should be considered. They include GRATs, GRUTs, IDGTs, ILITs, FLIPs, QPRTs and various other combinations of letters from the English alphabet. It is normal for a client to enjoy the benefit of multiple entities.

GDOTs

- What are they?
- How do they work?
- When are they used?

What Are They?

- A Grantor Deemed Owner Trust is an irrevocable trust used to minimize estate and gift taxes and maximize the amounts going to the next generation.
- Grantor pays GDOT income tax
  - We call that "Defective" for Income Tax Purposes. Used this way "Defective" is a good thing.
- Mitigates substantial estate and gift taxes
  - We call that "Effective" for Estate & Gift Tax Purposes.

How They Work?

- While there is no "Typical" estate, the end goal is a common factor.

Client's Estate
$$$

The "goal" is to move as much as possible to the beneficiaries in the most efficient way.

Beneficiaries:

Spouse,
Children,
Grandchildren

It's all about how we get there.

How Do They Work?

- We "get there" by creating or modifying an intermediate entity to serve one or more valid objective and business purposes.

Client's Estate
$$$

LLC*

Beneficiaries:

Spouse,
Children,
Grandchildren

*In addition to the LLC we could create a Family Limited Partnership (FLP) or use a pre-existing S-Corp.

What are Valid Objectives?

- Estate Tax
- Asset Protection Planning
- Business Preservation Planning
- Gift Tax Planning
- Facilitate Annual Gifting

What are Business Purposes?

- Business Succession Planning
- Continuity of Management
- Facilitate Intra-Family Loans
- Planning and Protecting Family’s Future

What are Intermediate Entities?

- Limited Liability Company (LLC)
- Family Limited Partnership (FLP)
- Corporations (C-Corp. & S-Corp.)

Our example here is going to use the LLC but there could be circumstances where an FLP or a pre-existing S-corp would be useful.

Limited Liability Companies (LLC)

- Business entity formed under the laws of the specific state
- Combines many of the characteristics of Corporation and a Partnership
- Owners of an LLC are called Members
- Distinction between 2 classes of Members: Managing and Non-Managing
- Can be formed by only one person

Family Limited Partnerships

- Business entity formed under the laws of the specific state
- Requires at least 2 people to form
- Owners are called Partners
- Distinction between 2 classes of Partners:

  General Partner and Limited Partner

Sub Chapter S Corporation

- A GDOT will cause a Corporate Recapitalization
- Used when existing corporation(s) are already in place
- Reissue Stock as Voting and Non-Voting, specific state laws need to be reviewed

Structuring Transaction Step 1

- Creat Entity (LLC) to serve one or more valid objectives and business purposes coupled with a GDOT.

Client's Estate
$$$

LLC*

GDOT

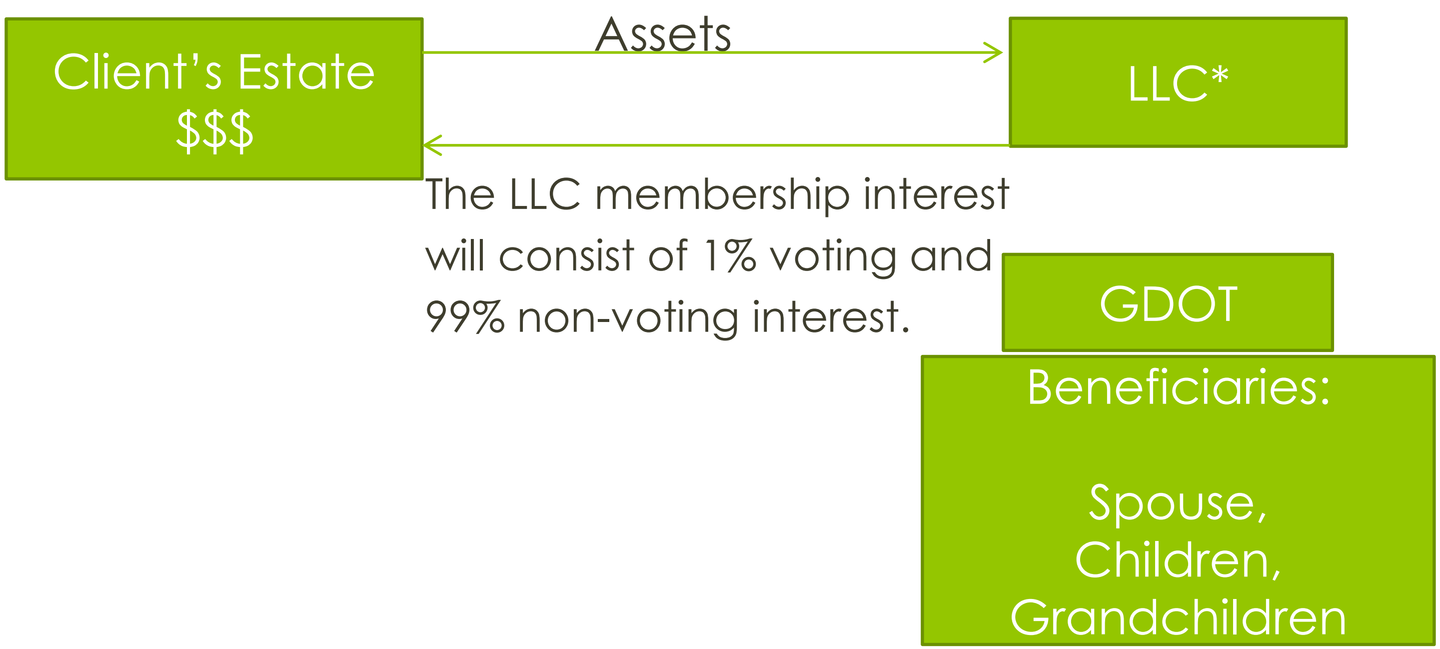
Beneficiaries:

Spouse,
Children,
Grandchildren

*Could also be FLP or S-Corp

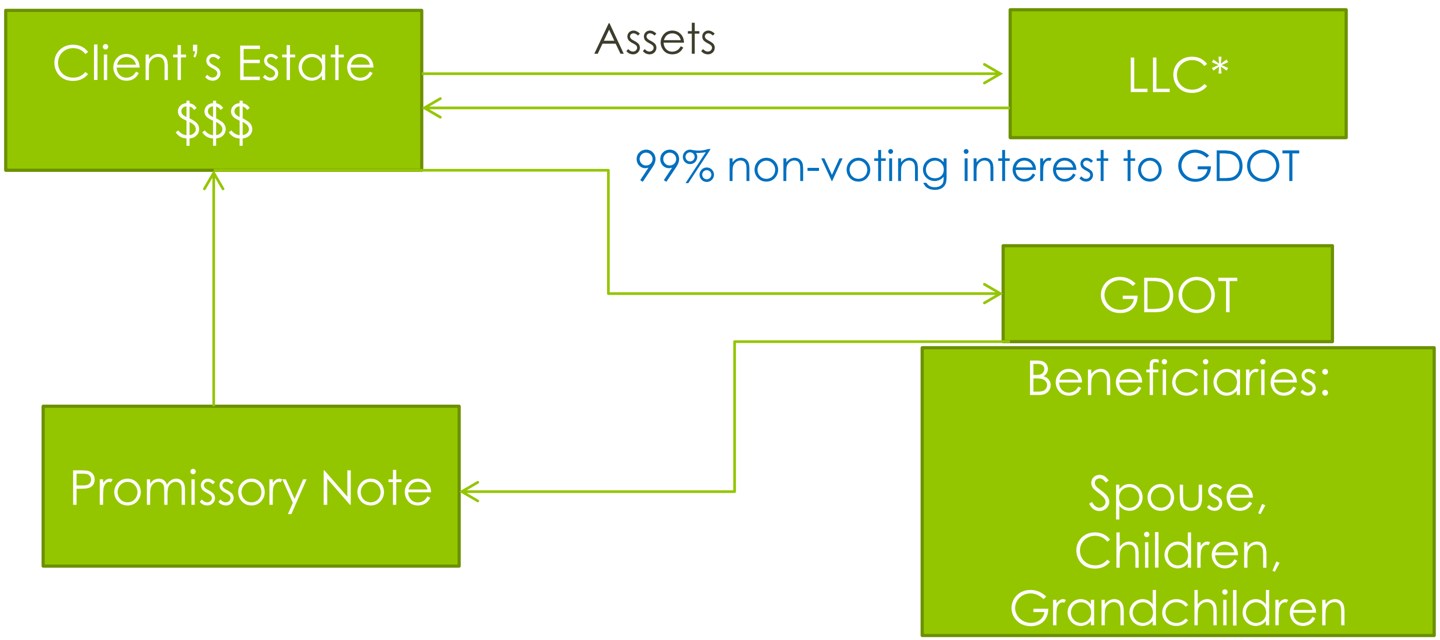
Structuring Transaction Step 2

- The Client transfers appropriate assets to the LLC and receives membership interests in return.



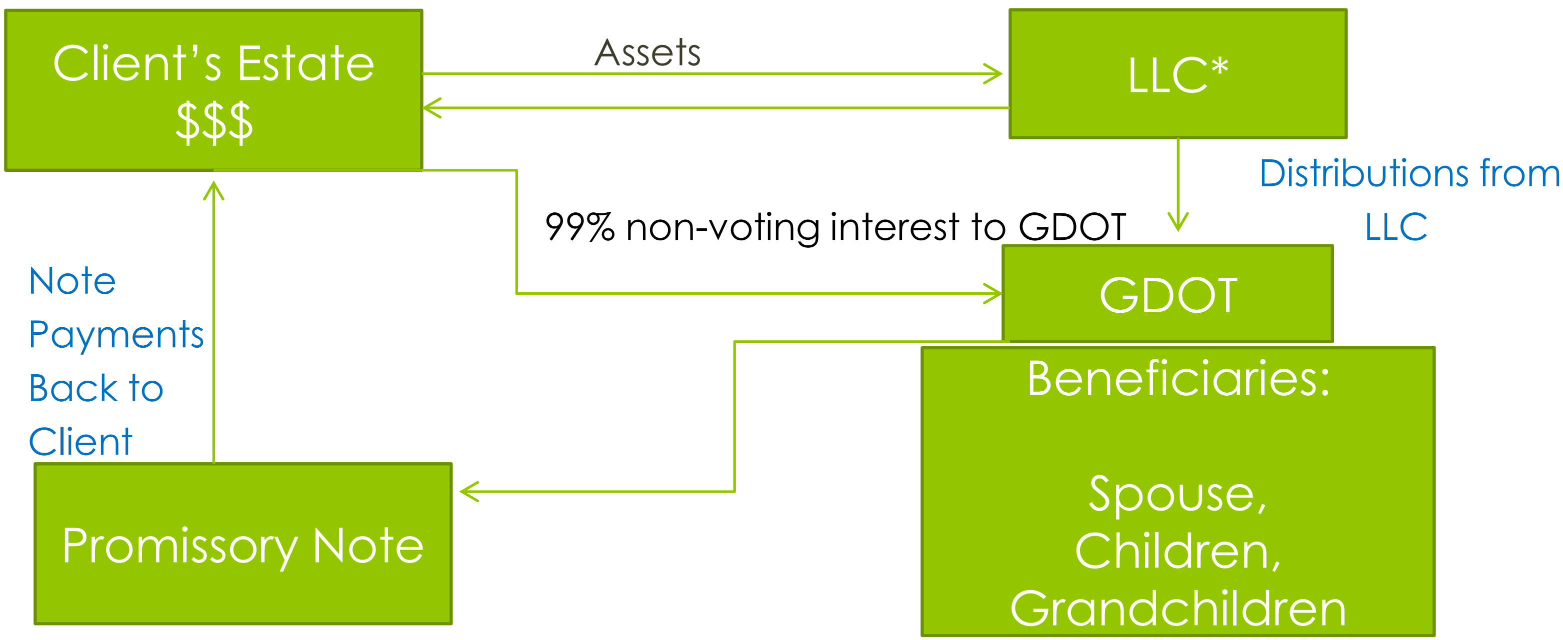
Structuring Transaction Step 3

- The client then sells the 99% non-voting interest to the GDOT in return for cash & a promissory note.
- The non-voting stock would be valued according to an appraisal.



Structuring Transaction Step 4

- LLC, which now owns assets formerly in client's estate, makes cash distributions to GDOT
- Then GDOT uses LLC distributions to pay promissory note.
- GDOT pays other expenses to be identified in later slide.



Structured to Fit Client's Goals and Objectives

- Grantor pays GDOT's income tax which causes those dollars to be removed from Grantors estate (a good thing)
- Income tax payments by grantor are tax free
- The transactions between Grantor, LLC, and GDOT are income tax free
- Future appreciation of assets are outside of the Grantor's estate
- Dynasty-Family Legacy Provisions
  - Bloodline preservation & Secured generational benefits, Trust beneficiaries include spouse, children, etc.
  - Grantor controls events in perpetuity from grave (Dead-Hand control)

When Are They Used?

- Business Succession Planning.
- Assets transferred to LLC need to have positive cash flow so that the note can be paid.
- Ease of Life Insurance Ownership &Annual Maintenance.
- Need for Advanced Estate Tax and Gift Tax Planning.

Example Transaction

- Facts:

Jonathan and Jane Doe – Both 52 years old

- Two young adult children
- Own and operate a successful automobile dealership
- Keep business and real estate profits in LLC for distribution to GDOT
- GDOT pays note and potentially insurance premium, but not income tax.
- Estate Value of $40 million:
  - Business value of $27 million
  - $8,000,000 Real Estate Investments
  - $2,000,000 Homestead
  - $2,500,000 Liquid Assets
  - $500,000 Qualified Assets

Client's Objectives & Goals

- Jon and Jane's Planning Goals:
  - Business Succession Planning.
  - Provide liquidity for surviving spouse ($240,000 annual lifestyle expense).
  - Provide liquidity for the estate upon second death.
  - Asset Protection for the Family.
  - Minimize Estate Tax & Gift Tax exposure.

Structuring the Plan Design

- 5,000,000 of Insurance Recommended:
  - 1,000,000 term policy on Jon's life.
  - 1,000,000 term policy on Jane's life.
  - 3,000,000 Permanent Insurance.
- Techniques:
  - Appraise investment real estate, other estate assets, and then deed into LLC.
  - Obtain Valuation of LLC.
  - Sale of Non-Voting Stock or Non-Controlling LLC Interests to GDOT.

Insurance

- Average annual premiums for insurance of approximately $60,000.
- Using traditional ILIT for insurance would require annual taxable gifts, Crummey[1] Notices to beneficiaries and annual filing of a 709 Gift Tax Return.

1. Crummey is a gentlemen's name. See your advisor for details.

Insurance

- The Better Alternative:
  - Have the GDOT own the insurance, purchase the non-voting stock or non-managing LLC interests.
  - Use the cash flow from the businesses, which are owned by the LLC, to pay the insurance premiums, keeping in mind the businesses are also paying the note back to the Grantor.
  - NO ANNUAL GIFTING, NOTICES OR GIFT TAX RETURN REQUIRED.

Transaction Structure

Could be 1 or both of Jon & Jane's Revocable Trusts or Estate Assets

Rental Real Estate LLC

LLC

Jon's GDOT

Jane's GDOT

Beneficiaries:

Children, Grandchildren

Transaction Structure

Underlying Asset "Full" Value:	$8,000,000*	$27,000,000*
Appraised value of non-voting interests:	$5,200,000	$17,550,000

Could be 1 or both of Jon & Jane's Revocable Trusts or Estate Assets

Assets

Rental Real Estate LLC

LLC

1% Voting
99% Non-Voting LLC Interest

Jon's GDOT

Jane's GDOT

Beneficiaries:

Children, Grandchildren

*8 Million is Investment Real Estate
*27 Million is the value of their business

Transaction Structure

- Underlying Asset "Full" Value: $8,000,000 $27,000,000
- Appraised value of non-voting interests: $5,200,000 $17,550,000

Assets

Could be 1 or both of Jon & Jane's Revocable Trusts or Estate Assets

Rental Real Estate LLC

LLC

LLC interest: 99% Non-Voting Voting

Jon's GDOT

Send Cash Gift of $2,300,000* to GDOT's

Jane's GDOT

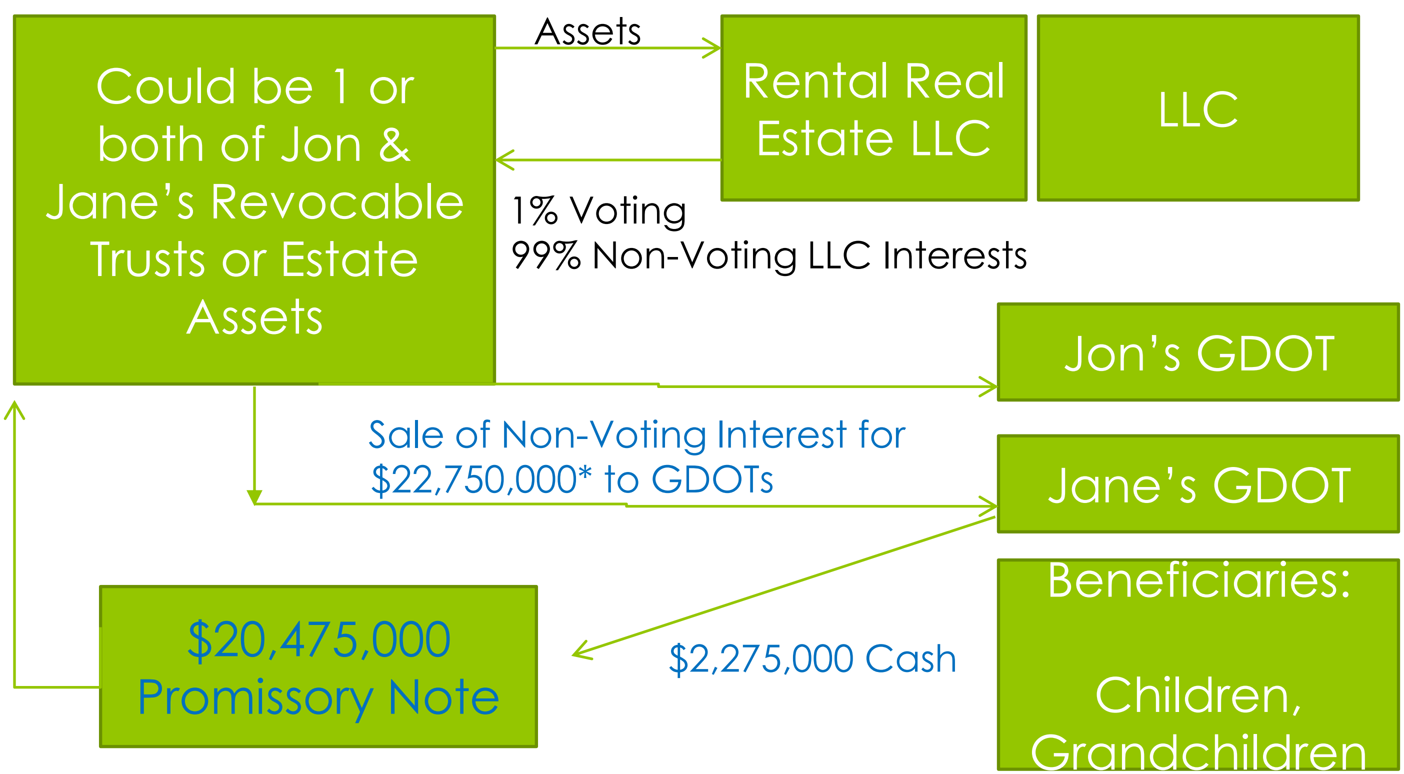
Beneficiaries:

Children, Grandchildren

*Gift Amount is 10% of the Sum of the Appraised Value ($5,200,000 + 17,550,000)x .1

Transaction Structure

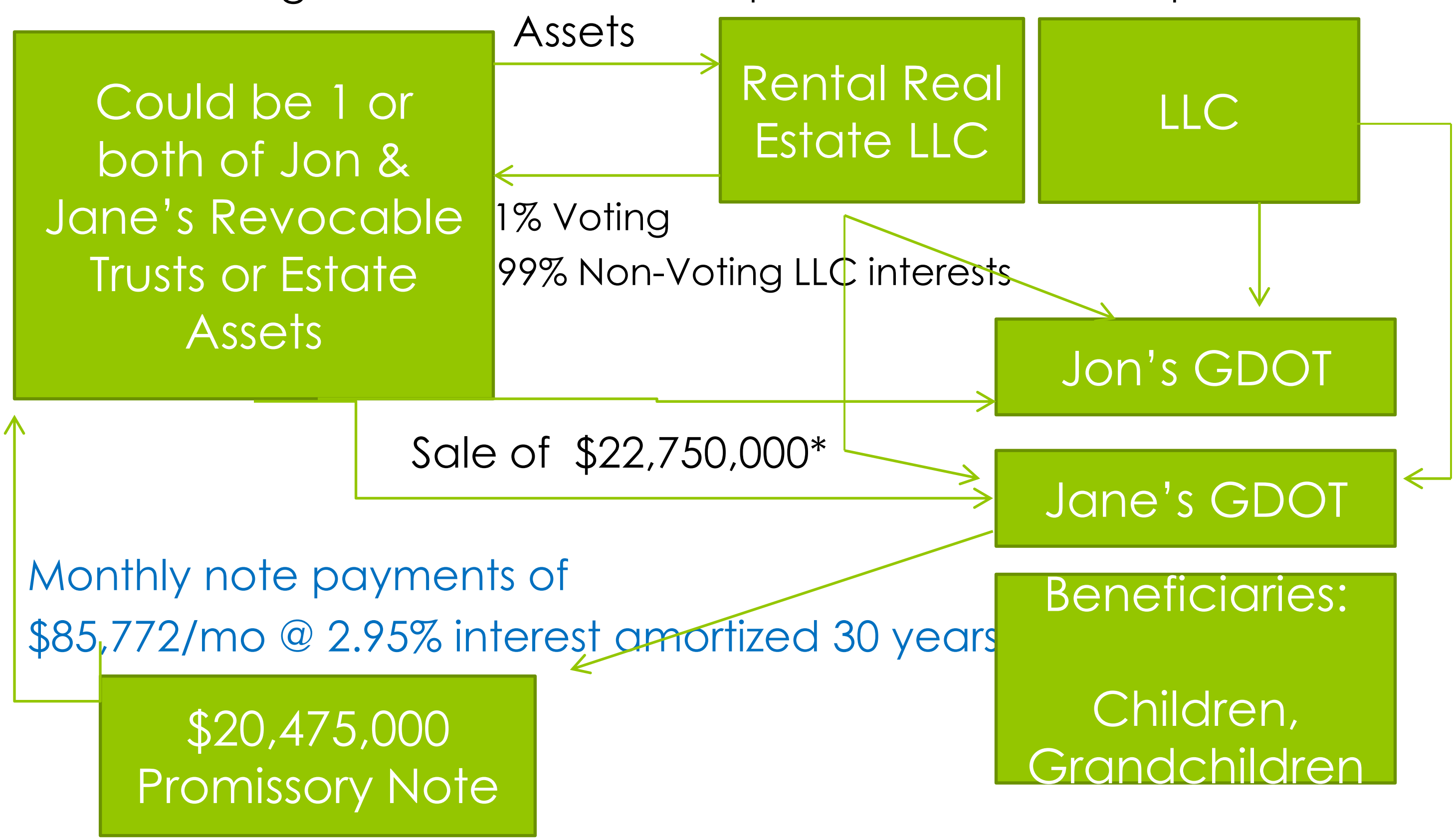
- Underlying Asset "Full" Value: $8,000,000 $27,000,000
- Appraised value of non-voting interests: : $5,200,000 $17,550,000



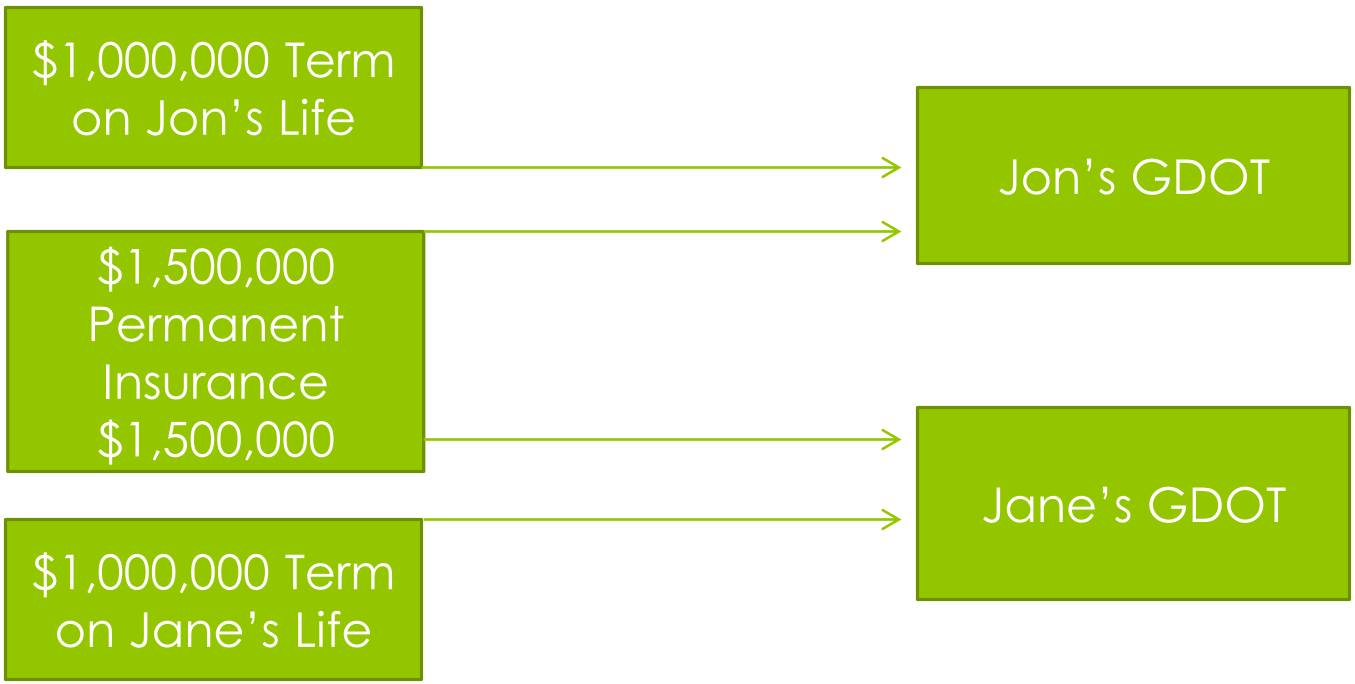
*Sale price equals 100% of the sum of the Appraised Value

Transaction Structure

- Underlying Asset "Full" Value: $8,000,000 $27,000,000
- Appraised value of non-voting interests: $5,200,000 $17,550,000



Insurance Structure



Cash Flow Is King

- It is Critical the GDOT cash flow supports the premium payment as well as the note obligation
- There can be many ways to design insurance premiums

GDOTs

- Benefits:
  - Grantor Makes Tax-Free Gifts of Income Taxes. This removes assets from Grantor’s Estate.
  - Allows Income Tax Free Transactions between Grantor & GDOT
  - Allows for holding S-Corp Stock
  - Assets out of Taxable Estate
  - Future Appreciation out of Taxable Estate
  - Design is flexible and can be custom fitted

GDOTs

- Drawbacks:
  - Creates Phantom Income-typically the amount of the life insurance premium
  - Requires Detailed Cash Flow Analysts
  - Grantors Lose use of Assets
  - Grantors Give Away Future Upside
  - Irrevocable Transaction

Why Now the Best Time for Planning.

- Able to receive low valuation on many different types of assets because of market forces and share classes.
- Increase in the Federal Gift Tax exclusion amounts.
- You probably should plan on taxes going up!
- Thoughtful planning today could save a great deal tomorrow.

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