

*This is your new Second Edition (November 2011)*

# **Estate Planning & Chapter 14**

## **Understanding the Special Valuation Rules**

### *Second Edition*

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Practising Law Institute is proud to publish this new Second Edition of *Estate Planning & Chapter 14: Understanding the Special Valuation Rules*, a unique and insightful guide to an essential but difficult area of tax law and estate planning.

Chapter 14 of the Internal Revenue Code, enacted in 1990, contains its own set of “special valuation rules” for transfer tax purposes applicable to certain transactions. Its enactment reduced the effectiveness of **estate freeze techniques in the family context**, foreclosing many planning opportunities that had been utilized under prior law and impeding family transactions. The purpose of this book is to explain the special valuation rules in a clear and concise manner and to provide insight and clarification of a complex set of statutory provisions that often create **hurdles to achieving tax-effective results for those involved in the transfer of wealth to younger generations**. Highlights of this new Second Edition include the following:

While a **GRAT has a number of advantages over an outright gift**, under certain circumstances, an outright gift may turn out to be a better estate planning vehicle. For example, **if the grantor of a GRAT dies during the term**, a portion or (more likely) the entire value of the trust property will be included in the grantor’s gross estate. On April 29, 2009, the IRS issued **new proposed regulations addressing “graduated retained interests.”** Consistent with the approach taken in final regulations for a GRAT with equal annuity payments, the proposed regulations provide a formula to determine the amount includ-

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ible under section 2036 for a GRAT with increasing annuity payments. See § 12:2.13 for how to calculate the includible amount.

**Election into Qualified Payment Treatment.** A transferor or an applicable family member who holds a distribution right in a controlled entity that is not a qualified payment right may make an election to treat such distribution right as a qualified payment right. In order for a distribution to be a qualified payment, it must be payable either at a fixed rate or in a fixed amount. See § 2:4.1[B] for discussion of a **recent IRS ruling** in which the distribution did not meet this standard but where the IRS ruled that the shareholder could be treated as holding a qualified payment right.

**Residence GRITs.** One method of creating a residence grantor retained income trust that allows the grantor (typically the parent) to remain in the residence is for the remaindermen (the children), as the new owners of the residence, to **create a short-term QPRT** through which they gift the term interest in the residence to the parent. See § 11:2.4 for a discussion of such method as well as of some potential disadvantages.

**Family Limited Partnerships and Section 2703.** The Eighth Circuit recently affirmed the Tax Court's decision in *Holman v. Commissioner* (see § 17:6), finding that the lower court was correct in holding that the stated purposes for creating the partnership—estate planning, tax reduction, wealth transference, protection against dissipation by their children, and wealth management education—were not bona fide business purposes under section 2703(b)(1). See new § 17:7, discussing *Fisher v. United States*, a decision that builds on the IRS's success applying section 2703 to family limited partnerships in *Holman*.

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