



AMBROSE
WEALTH MANAGEMENT

[Partners in Managing, Protecting,
and Distributing Wealth.]

Tax Strategies

Helping our Clients become Informed Taxpayers

How much tax are you paying?

What percentage of your earnings (salary and other income or gains) are you paying to taxes?

- a) Less than 25%
- b) 25-50%
- c) Over 50%



As we think about the more obvious taxes that we incur as a result of earning an income, owning a home, investing wisely, or buying a gift for a friend, these are some of the more obvious taxes that may be placed on us.



Income Tax

Property Tax

Capital Gains Tax

Sales Tax

Estate Tax

Chances are, you've paid for many other forms of taxes in the course of daily living...some you might not have known existed!

Accounts Receivable Tax
Amusement Tax
Blueberry Tax Building
Permit Tax Corporate
Income Tax
Flush Tax Fountain
Soda Tax Fuel Permit
Tax Fur Clothing Tax
Gasoline Tax
Inheritance Tax
Liquor Tax

Marriage License Tax
Medicare Tax
Recreational Vehicle Tax
Road Usage Tax
Septic Permit Tax
Service Charge Tax
Social Security Tax
Sparkler and Novelties Tax
Tattoo Tax
Telephone Federal Excise Tax
Telephone Federal Tax
Telephone Federal Universal Service Tax
Telephone State and Local Tax

Toll Bridge Tax
Toll Road Booth Tax
Trailer Registration Tax
Utilities Tax
Vehicle License Registration
Tax
Vehicle Sales Tax
Wagering Tax
Watercraft Registration Tax
Well Permit Tax

If the average American is paying over 50% of their earnings to taxes, how can you win the war against them?

1) You can earn less, save less, and spend less.

We don't have many of those clients!

2) You can try to change tax laws. Regardless of political persuasion, the reality is that taxes are not going down.

OR

3) **You can become an informed tax payer.**

Hire a team of professionals versed and experienced on implementing the most advanced tax strategies designed to help you preserve wealth by deferring, reducing, or eliminating unnecessary taxes.

Tax Strategies

Through a relationship with our collaborative team of Wealth Planning professionals, Clients are able to retain more for their enjoyment today, tomorrow, and generations to come.

The following pages will highlight a variety of unique tax planning strategies that are either investment-based, insurance-based, trust-based, or any combination.

Investment-Based Tax Strategies

1031 “Ready” Exchange Program

If you own highly appreciated property that you no longer want, but would like to remain fully or partly invested in high quality real estate, our “Ready” Exchange Program can quickly and efficiently help you:

- Defer capital gains and depreciation recapture taxes.
- Potentially increase net cash flow.
- Reduce the burden of day-to-day property management.
- Own free-standing retail buildings with investment grade, geographically and industry diversified tenants.



Investment-Based Tax Strategies

Energy Income Programs



The Federal Government has encouraged the support of energy programs, specifically domestic oil & natural gas developmental programs, by offering significant tax deductions to those who invest in them. Since natural gas drilling, in particular, has become such an essential need and efficient developmental operation, our clients have an exciting opportunity to take advantage of rising taxes and energy costs by receiving significant tax deductions and future cash flow.

By no means are the investments in these programs guaranteed or are they a replacement for more traditional investment strategies, but should be considered as part of a client's need for investment diversification, income, and tax reduction.

Investment & Insurance-Based Tax Strategies

Variable Annuities

A variable annuity is a contract between you and an insurance company to provide future income. The variable annuity contract allows you to invest in a number of variable sub accounts, similar to mutual funds. Variable annuities provide several benefits: tax deferral, investment diversification, professional management and the option to take a lifetime income guaranteed by the insurance company.

In addition, many variable annuities provide the option of additional performance features and guarantees that may include a bonus credit percentage based upon applied premiums, minimum income or accumulation guarantees for the owner and/or minimum death benefits for the owner's beneficiaries. All guarantees are provided by the insurance company issuing the variable annuity contract.

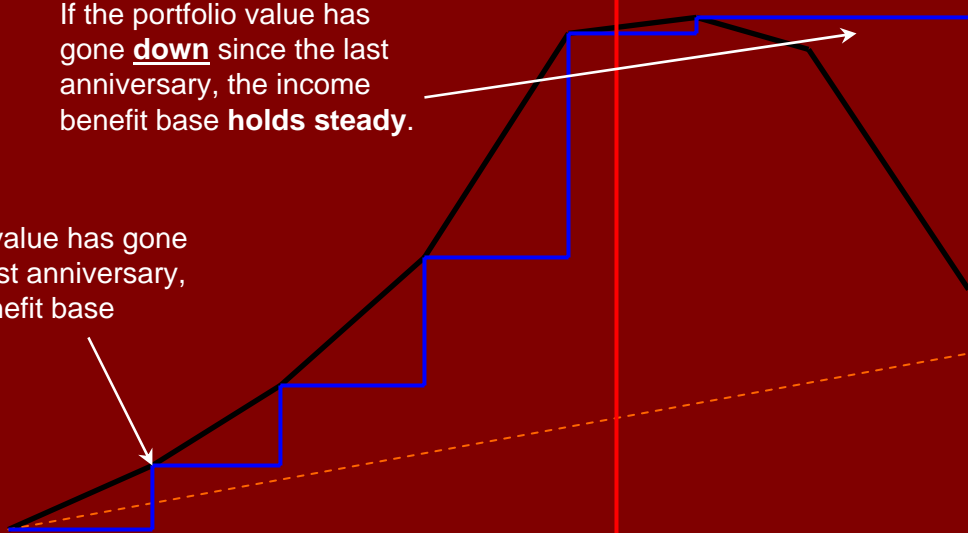
Variable annuity investments may not be suitable for everyone. Please consult your financial advisor before making any investment decisions regarding these or any other investments.

A Variable Annuity Example

1995 1996 1997 1998 1999 2000 2001 2002

If the portfolio value has gone **down** since the last anniversary, the income benefit base **holds steady**.

If the portfolio value has gone **up** since the last anniversary, the income benefit base **increases**.



Portfolio Value	\$500,000	\$578,393	\$692,561	\$801,749	\$1,008,438	\$1,030,103	\$938,829	\$776,206
6% Ratchet	\$500,000	\$530,000	\$560,000	\$590,000	\$620,000	\$650,000	\$680,000	\$710,000
Inc Ben Base	\$500,000	\$578,393	\$692,561	\$801,749	\$1,008,438	\$1,030,103	\$1,030,103	\$1,030,103
Guaranteed Lifetime Income	\$25,000	\$28,920	\$34,628	\$40,087	\$50,422	\$51,505	\$51,505	\$51,505

The best of *all* worlds

Growth of a Stock 

Income of a Bond 

Security of a Cash Account 

And Control !

And when you die, your beneficiaries receive the greatest of your portfolio value, income benefit base, or ratchet value (less any withdrawals)!

At the time of your first withdrawal, your Guaranteed Income is based on 5% of the greatest of Portfolio, Ratchet, or IBB Value. After that, ratchets stop, but your IBB can still automatically "step-up", thereby increasing your lifetime income.

Investment & Insurance-Based Tax Strategies

Variable Annuities

For a more detailed description of the advantages and disadvantages of variable annuities, please visit our “Education Center” or call the Ambrose Wealth Management team of professionals at (610) 388-4424.

Insurance-Based Tax Strategies

Permanent Life Insurance

Permanent Life Insurance offers the ownership benefit of life insurance via a permanent death benefit and the accumulation of cash value within the life insurance policy. Premiums are paid with after-tax dollars. Cash value grows tax-free within the policy based on either dividend rates, interest rates, market index rates, or investment sub-account performance.

In addition to the available death benefit for life, owners of permanent life insurance have the flexibility to access accumulated cash value in future years in the form of tax-free withdrawals or loans. In fact, for those clients who are in need of life insurance and have maximized other forms of tax deferred or tax free retirement planning, permanent insurance offers a potentially great solution.

Please consult your advisor before making any decisions regarding the purchase of life insurance.

Insurance & Trust-Based Tax Strategies

Wealth Replacement Trust (Irrevocable Life Insurance Trust)

It is generally well known that life insurance proceeds, in most cases, pass to the named beneficiary free of any income tax. Less well known, however, but vitally important, is that the payout from a life insurance policy is included in the "gross estate" of the policy owner for estate tax purposes at the policy owner's death and is potentially subject to federal and state estate taxes. At current federal estate tax rate, (37% to 46%) depending on what estate tax rate bracket the decedent policy owner is in, a significant portion of the life insurance proceeds would be payable to the Internal Revenue Service for federal estate tax instead of passing to the policy owner's beneficiaries.

An irrevocable life insurance trust ("ILIT") takes advantage of a purposeful loophole created by Congress. If an ILIT is created to own the life insurance policy and the proceeds of the life insurance policy are payable to the trustee of the ILIT upon the insured's death, then the proceeds are not included in the insured's estate and, therefore, are not taxable for federal estate tax purposes. This is true even though the insured gives the money to the trustee of the ILIT to pay the annual premiums of the life insurance policy.

Insurance & Trust-Based Tax Strategies

Wealth Replacement Trust (Irrevocable Life Insurance Trust)

An example:

If an ILIT is created and the trustee of the ILIT purchases a \$1 million life insurance policy on the life of the person creating the ILIT and the trustee of the ILIT is the beneficiary of the proceeds from the life insurance policy then, at the death of the insured, the trustee of the ILIT will receive the insurance proceeds free from estate tax. The trustee would then manage and dispose of the life insurance proceeds pursuant to the terms of the trust agreement. For example, the terms of the trust could provide that the trustee distribute the income to the surviving spouse for his or her lifetime and then distribute the remaining principal to their children upon the death of the surviving spouse. The result is that the \$1 million of life insurance proceeds is ultimately transferred to the children of the insured free of federal estate tax, state death taxes and probate costs. The \$1 million is not taxed in the estate of the surviving spouse because the ILIT is set up not to qualify for the marital estate tax deduction.

Trust-Based Tax Strategies

Grantor Retained Annuity Trust

With the increase of the net worth of many clients resulting from significant appreciation in the value of common stocks and equity mutual funds, more and more clients have been inquiring as to what strategies are available to minimize the imposition of estate taxes at death. One such strategy, which is relatively new and somewhat sophisticated, is the establishment of a Grantor Retained Annuity Trust ("GRAT").

A GRAT is an irrevocable trust which is established by a written trust agreement. The creator of the trust (the "Grantor") transfers assets to the GRAT while retaining the right to receive fixed annuity payments, payable at least annually, for a specified term of years. After the expiration of the term, the Grantor will no longer receive any further benefits from the GRAT. The remaining trust principal comprising the GRAT at the end of the term interest can be either distributed to specified beneficiaries (such as the children of the Grantor), or held in further trust for the benefit of one or more individuals. If the Grantor survives the initial term of the trust, that is, the term during which the Grantor is to receive annuity payments from the GRAT, the remaining principal of the GRAT will be excluded from the Grantor's gross estate for federal and state estate tax purposes.

Trust-Based Tax Strategies

Grantor Retained Annuity Trust

The GRAT provides a unique opportunity for the Grantor to receive an economic benefit in the GRAT for a specified term, which is different from what would otherwise occur if an outright gift was made by the Grantor to one or more individuals. The primary advantage in establishing a GRAT is that the assets transferred by the Grantor to the GRAT are valued for federal gift tax purposes at a discount. This is because the value of the gift will equal the fair market value of the assets initially transferred to the GRAT reduced by the present value, determined actuarially, of the future annuity payments that the Grantor will receive during the initial term. Just how significant the discount will be is dependent upon the length of the initial term of the GRAT, the amount of the fixed annuity payments that will be made from the GRAT to the Grantor during the initial term, and the applicable federal rate of interest in the month that the assets are transferred by the Grantor to the GRAT as announced by the Internal Revenue Service. In other words, the transfer of property to a GRAT constitutes a gift equal to the total value of the property transferred to the GRAT, less the present value of the retained annuity interest held by the Grantor.

If the Grantor survives the initial term during which the Grantor is to receive a fixed annuity, the property comprising the GRAT will pass to or be retained in trust for the benefit of the designated remainder beneficiaries (such as the Grantor's children) at a reduced gift tax value.

Trust-Based Tax Strategies

Grantor Retained Annuity Trust

An Example:

Assume that an individual, age 60, transfers \$1,000,000 of assets to a GRAT which provides the Grantor with the right to receive an annuity of \$70,000 per year (7% of the value of the assets initially transferred to the GRAT), payable annually, for a fifteen year period. Assume also that the applicable federal rate announced by the Internal Revenue Service in the month that the property is initially transferred to the GRAT is 6.0 percent. Based on applicable Internal Revenue Service tables, the value of the retained interest is \$600,565, so the value of the gift being made by the Grantor to the GRAT upon creating the GRAT is \$399,435. At the end of the term, if the Grantor is still living, the remainder beneficiaries (or a trust to be administered for the benefit of the remainder beneficiaries) receive the balance of the assets comprising the GRAT, which may exceed \$1,000,000, depending on whether the GRAT is able to earn (in terms of income or appreciation) an amount in excess of the annuity payments that will be made by the GRAT to the Grantor annually over the fifteen year term.

Trust-Based Tax Strategies

Grantor Retained Annuity Trust

For federal income tax purposes, it appears that a GRAT will be treated as a grantor-type trust. In other words, during the initial term of the GRAT (the term that the Grantor is to receive the annuity payments) the Grantor will be taxed on all of the income earned by the GRAT during each such year, including capital gains. This results in an even greater benefit from the gift being made by the Grantor because the income taxes that the Grantor will pay will reduce the estate of the Grantor for federal estate tax purposes, rather than reducing the economic value of the assets being gifted to the Grantor's beneficiaries.

One of the disadvantages of a GRAT is the fact that it is irrevocable, that is, it cannot be changed by the Grantor. The trust agreement can provide for *limited* flexibility, but any time a trust is created that cannot be amended by the Grantor, there is always the risk that a change in individual circumstances may make the trust less desirable in the future; not for tax reasons, but for personal reasons. This disadvantage, however, is no different than the risks inherent when making outright gifts, because then the recipients of the gifts are free to dispose of the gifts in any manner the recipients desire.

Trust-Based Tax Strategies

Grantor Retained Annuity Trust

An additional disadvantage of establishing a GRAT is that all of the assets comprising the GRAT will be includible in the gross estate of the Grantor for federal and state estate tax purposes if the Grantor dies prior to the expiration of the initial term of the GRAT. However, other than the transaction costs of establishing and administering the GRAT, the Grantor is really no worse off than if the GRAT was never established. Furthermore, the Grantor can mitigate against the potential for the inclusion of the assets comprising the GRAT in his or her gross estate for estate tax purposes by establishing an irrevocable trust that could purchase and maintain a policy insuring the life of the Grantor for the initial term of the GRAT.

In conclusion, although there are certainly some complexities surrounding the establishment of a GRAT, the GRAT can prove to be an extremely viable tool to reduce the size of a potentially taxable estate by allowing for a substantial reduction of the underlying assets for valuation purposes under federal gift tax laws. This allows individuals to leverage their unified credit exclusion equivalency. As with all estate planning tools, a GRAT has some disadvantages, but those disadvantages are minimal when compared to the potential estate tax savings that can be obtained.

Trust-Based Tax Strategies

Qualified Personal Residence Trust

The Qualified Personal Residence Trust ("QPRT") can be an effective estate planning tool to reduce the size of an individual's taxable estate for federal estate tax purposes, by allowing the owner of a residence to continue to enjoy its use and occupancy for a stated term while providing for ultimate ownership by the individual's children or other persons.

A QPRT is an irrevocable trust established by the owner of a residence by transferring title to his or her residence (which may be a vacation home) to the trust. The trust terms provide that the previous owner of the residence (the "Grantor") will continue to have the right to use and occupy the residence for a term of years. Once the given term has passed, the trust provides that ownership of the personal residence will pass to remainder beneficiaries, often the children of the Grantor. If the Grantor wishes to continue residency after expiration of the term stated in the trust agreement, a fair market rent must be paid by the Grantor to the new owners of the property, the remainder beneficiaries. Of course, the QPRT can continue as an irrevocable trust for the benefit of the remainder beneficiaries at the expiration of the term of years, rather than being distributed outright to the remainder beneficiaries, such as the children of the Grantor at that time.

Trust-Based Tax Strategies

Qualified Personal Residence Trust

The primary advantage in establishing a QPRT is that a residence, which for many persons is the person's most valuable asset, may be given to that person's children, but valued, for federal gift tax purposes, at a significant discount. Therefore, the value of the gift of a personal residence to the owner's children (via a QPRT) is determined by subtracting from the property's true fair market value, the actuarial value of the owner's right to use and occupy the transferred property for a term of years.

An example:

Using current Internal Revenue Service tables and assuming an applicable federal midterm rate of 7.6%, if a residence that is currently worth \$1,000,000 is transferred to a QPRT, and the trust agreement provides that the Grantor may use and occupy the residence for ten years, but at the end of the ten year term, it will belong to the Grantor's children, the result will be that the Grantor's gift of the personal residence will be valued at \$439,740, instead of \$1,000,000. Accordingly, a \$250,000 asset will be removed from the Grantor's gross estate for federal estate tax purposes, but the Grantor will only be charged with making a \$439,740 gift. If the term of the QPRT was for 20 years, the value of the gift would only be \$172,308.

Trust-Based Tax Strategies

Qualified Personal Residence Trust

For federal income tax purposes, a QPRT is treated as a "grantor-type" trust. In other words, during the term that the QPRT provides a benefit to the Grantor, the trust is considered to be the Grantor's alter ego for federal income tax purposes. This is beneficial because the Grantor can use the \$250,000 exclusion (\$500,000 for married persons filing jointly) provided upon the sale of principal residence that would otherwise be available to the Grantor if the Grantor owned the house outside of the QPRT pursuant to Section 121 of the Internal Revenue Code of 1986, as amended. Recently, however, the Internal Revenue Service has indicated that it would seek to disqualify a QPRT that sells the personal residence to the Grantor, the Grantor's spouse or an entity controlled by the Grantor.

The disadvantages of a QPRT are few. First, if the Grantor should die before completion of the term of years set forth in the trust agreement, current estate tax law causes the full value of the residence to be included in the Grantor's gross estate for federal estate tax purposes. However, the estate tax consequences are no worse than if the QPRT had not been created.

Trust-Based Tax Strategies

Qualified Personal Residence Trust

Second, the QPRT is irrevocable, i.e., it cannot be changed. The trust terms can provide for limited flexibility, but any time a trust is created that cannot be changed, there is always the risk that a change in individual circumstances may make the trust undesirable in the future, not for tax reasons, but for personal reasons. A home may be sold even if it is owned by a QPRT; however, a new home must be purchased with the proceeds, or the proceeds must be converted into an annuity for the benefit of the Grantor. That annuity would terminate at the end of the term of years set forth in the trust, and the remaining proceeds would be transferred to the remainder beneficiaries of the trust.

In conclusion, a QPRT is an extremely viable tool to reduce the size of a potentially taxable estate by allowing for a substantial reduction in gift tax valuation. This allows persons to leverage their unified credit. As with all estate planning tools, the QPRT has some disadvantages, but those disadvantages are minimal when compared to the potential estate tax savings.

Trust-Based Tax Strategies

Charitable Remainder Trust

A Charitable Remainder Trust ("CRT") can be established during the lifetime of the creator of the trust (the "Grantor") or upon the death of the Grantor. Transfers to a CRT established during the lifetime of a Grantor will produce an income tax deduction for the Grantor. In addition to the income tax deduction provided to the Grantor who establishes a CRT during the Grantor's lifetime, the CRT itself is a tax exempt entity and will not recognize income resulting from the sale of long-term capital gain property contributed to the CRT by the Grantor. For example, if the Grantor contributes to a CRT appreciated and unencumbered real estate or marketable securities that the Grantor has owned for a period exceeding one year, and the trustee of the CRT later sells such appreciated long-term capital gain property, no taxable gain will be recognized by the CRT and, therefore, the assets comprising the CRT will not be diminished by the payment of federal income taxes.

A CRT created upon the death of a Grantor, although not providing the Grantor with an income tax deduction, can avoid the imposition of federal income taxes with respect to items of "income in respect of a decedent" ("IRD"), such as funds in an individual retirement account (IRA), a qualified retirement plan account or an annuity contract. Note, however, that the transfer of funds from an IRA or a qualified retirement plan account to a CRT created upon the death of a Grantor does not avoid the excess retirement accumulation tax imposed pursuant to the provision of Section 4980A(d) of the Internal Revenue Code of 1986, as amended.

Trust-Based Tax Strategies

Charitable Remainder Trust

Once created, a CRT generally distributes, at least annually, a flow of income to one or more individuals for either the life or lifetimes of the individual or individuals, or for a term of years not to exceed twenty years.

Besides the fact that a CRT can be created during the Grantor's lifetime (inter vivos) or upon the death of the Grantor (testamentary), there are two different types of CRTs. The Charitable Remainder Annuity Trust ("CRAT") is a CRT that pays a specific amount (a fixed annuity payment) to the non-charitable beneficiary or beneficiaries. The amount of the annuity payment will not change regardless of whether the value of the CRAT increases or decreases over the term of the trust. A Charitable Remainder Unitrust ("CRUT"), however, pays the non-charitable beneficiary a percentage of the value of the CRUT determined at the inception of the CRUT as to the first year of the CRUT. The payment from the CRUT to the non-charitable beneficiary in succeeding years is recomputed based on the percentage of the value of the CRUT at the beginning of each subsequent year of the CRUT. Moreover, unlike a CRAT, the Grantor can make additional contributions to the CRUT from time to time.

Trust-Based Tax Strategies

Charitable Remainder Trust

Reasons for establishing an inter vivos CRT would include being able to diversify investments without incurring capital gains taxes, converting non-producing or under-producing long-term capital gain property into higher producing investments without incurring capital gains taxes, creating a non-commercial annuity that is exempt from judgments obtained by creditors, and attaining charitable goals by providing a future benefit to one or more charitable organizations. Oftentimes, a client who establishes an inter vivos CRT will use some of the extra cashflow he or she receives from the CRT to purchase a life insurance policy on his or her life in an "estate tax-free" environment, such as an irrevocable life insurance trust. This added strategy avoids a reduction in the wealth that will eventually pass to non-charitable beneficiaries, such as the client's children and grandchildren.

A client may establish a testamentary CRT to avoid the imposition of income taxes on IRD, such as IRA or a qualified retirement plan account. By establishing a testamentary CRT and naming the testamentary CRT as the beneficiary of the IRA or qualified retirement plan account, those funds will not be subject to income tax when paid to the testamentary CRT, and a charitable estate tax deduction will be available based on the value of the charitable remainder interest as of date of death of the Grantor.

Trust-Based Tax Strategies

Charitable Remainder Trust

In drafting an agreement to establish a CRT, there are certain provisions that can provide the Grantor or members of the Grantor's family with flexibility, such as the power to change the ultimate charitable beneficiary or beneficiaries, and the power to change the individual or entity serving as the trustee of the CRT.

CRTs tend to be most popular during periods of higher interest rates because a high applicable federal mid-term rate results in a greater amount being able to be distributed to non-charitable beneficiaries without a consequential reduction in the amount of the income tax deduction and estate tax deduction that would otherwise be obtainable.

Because a CRT is irrevocable, i.e. it cannot be changed, significant thought should be put into the various provisions before the trust agreement is signed. Through the counsel provided by a knowledgeable and experienced estate planning attorney, a client can be made aware of the various issues that need to be considered in tailoring the trust agreement to fulfill the objectives of the client.

In conclusion, a CRT is an extremely viable tool to minimize or avoid the imposition of federal income taxes with respect to appreciated capital gain property and items of IRD, as well as to reduce estate taxes. As with all estate planning tools, the CRT has some disadvantages, but those disadvantages are often insignificant when compared to the potential income and estate tax savings.

Trust-Based Tax Strategies

Family Limited Partnership Trust

A partnership is a consensual arrangement between two or more persons to join together to engage in a business or other profit motivated activity. A limited partnership is a form of partnership where at least one partner's liability is limited solely to the assets the partner contributes to the limited partnership, and that partner is precluded from participating in the day-to-day management of the limited partnership. A Family Limited Partnership ("FLP") is a limited partnership where most or all of the partners are members of the same family.

Although there are many technical requirements that must be adhered to in order for an FLP to pass muster with the Internal Revenue Service ("IRS"), an FLP, if properly structured and administered, can provide many benefits in the estate and gift tax arena. Because of the costs involved in creating and maintaining an FLP, it is not a strategy that is attractive to everyone despite the claims of many purveyors of FLP arrangements.

Trust-Based Tax Strategies

Family Limited Partnership Trust

One of the most attractive aspects of using an FLP from an estate planning standpoint is the availability of various valuation discounts, such as lack of marketability and minority interest discounts, to depress the value of limited partnership interests gifted to family members or trusts for the benefit of family members. Often, clients are able to reduce the value of the assets conveyed to an FLP by thirty percent or more. In other words, if \$2 million of a client's assets were transferred to a properly structured FLP in return for partnership interests, the value of the FLP partnership interests received by the client may have a value, for transfer tax purposes, of only \$1,400,000 or less.

Another benefit of using an FLP is the ability of senior family members to retain control of the management of the FLP and the cashflow generated by the FLP. Using an FLP may also, to a limited extent, provide some protection from future judgment creditors.

Trust-Based Tax Strategies

Family Limited Partnership Trust

Generally, an FLP is formed by having all partners enter into a formal limited partnership agreement and filing a certificate of limited partnership with the state agency designated under state partnership law. There may be reasons that would cause a family to consider establishing the FLP under the laws of a state other than their own. Under certain circumstances, investment assets may be used to fund an FLP formed under the laws of a state where a corollary benefit may be the legal avoidance of state intangible personal property taxes. The initial and annual filing fees will vary from state to state. In addition, the state laws governing certain aspects of limited partnerships will vary from state to state.

There are certain type of assets that should not be transferred to an FLP. One example is stock in a S Corporation because the transfer of S Corporation stock to an FLP will cause the termination of the S election. Moreover, there may be undesirable estate tax consequences when funding an FLP with stock in a closely-held corporation if the transferor of the stock is the sole or managing general partner of the FLP and the transferor owned at least twenty percent of the voting stock of the closely-held corporation.

Trust-Based Tax Strategies

Family Limited Partnership Trust

When appreciated marketable securities are transferred to an FLP, no gain will be recognized unless more than eighty percent of the non-cash assets of the FLP consists of readily marketable securities and the transfer results directly or indirectly in the diversification of the interests of the transferor. A transfer generally results in diversification of the interests of the transferor if two or more persons transfer nonidentical assets. This problem will generally not arise if a multiple stock portfolio is contributed by one partner and the other partners transfer cash assets which exceed one percent of the value of the total assets transferred to the FLP.

Because most families who establish an FLP for estate planning purposes wish to obtain the substantial benefit of the available valuation discounts, several significant costs will necessarily be incurred. One vital cost involved in forming an FLP is the fee to be paid to the law firm that will advise and counsel the family and draft the actual limited partnership agreement. This cost is necessary because of the valuable expertise needed to avoid the multitude of traps for the unwary contained in both the income tax provisions, the estate tax provisions, and the special valuation rules of the Internal Revenue Code.

Trust-Based Tax Strategies

Family Limited Partnership Trust

Another very significant cost is the fee paid to the business appraisal firm that values the partnership interests to be gifted to other family members, such as children, grandchildren, nieces and nephews. Failure to obtain a comprehensive business valuation from a professional business valuation firm that contains the analyses required by federal tax law will result in uncertainty as to the probable value of the partnership interest transferred to other family members. If the partnership interests that are gifted are undervalued, penalties and interest, as well as unexpected taxes, may be due and owing. If the partnership interests being gifted are overvalued, the transaction fails to provide the full tax savings that would otherwise be available with the proper use of the valuation discounts. Additional appraisals prepared by other types of appraisers, such as real estate appraisers, may also be needed, depending on the types of assets transferred to the FLP.

The initial and annual filing fee that must be paid to the applicable state agency, and the annual accounting fees for preparing an annual partnership income tax return, are also costs that must be taken into account when one is considering forming an FLP.

Trust-Based Tax Strategies

Family Limited Partnership Trust

Ownership by a Trust

The most popular alternative for asset protection and for owning FLP interests is to transfer the ownership into a trust which is designed for this purpose. Recent developments in trust law and advances in strategy now allow unlimited variations in form, to accomplish most reasonable asset protection goals.

- Partnership interests held by the trust are immune from charging order or foreclosure.
- Trusts can be designed to be domestic or foreign, or to convert upon the occurrence of specified events.
- Depending upon the structure of the trust, H and W, as creators of the trust, may retain high levels of power and enjoyment over trust assets without compromising the effectiveness of the asset protection plan.
- The trust may be tax neutral, preserving existing tax status, or may create estate tax savings and income tax advantages when appropriate.
- The trust can be used for asset protection for the family residence and other property without disturbing the current tax benefits; and
- A high level of privacy can be accomplished together with these asset protection features.

Trust-Based Tax Strategies

Family Limited Partnership Trust

Based upon what is intended to be accomplished and the type of assets involved, creating an asset protection plan sometimes involves forming one or more Family Limited Partnerships, Limited Liability Companies or other entities. The key question in these cases is how to hold the interest in these entities. We discussed the fact that owning the interests in your name allows a creditor to obtain a charging order or to foreclose and seize those interests. Generally, we have found that a trust designed to own these entities provides excellent flexibility and convenience and achieves all or most of the goals of a solid asset protection plan.

In conclusion, the use of an FLP (Trust) in conjunction with estate and business planning can be a viable tool resulting in significant reductions in transfer (gift, estate and generation-skipping) taxes. However, the proper implementation of an FLP is a very complex and sophisticated endeavor which requires the use of experienced professionals who understand the numerous requirements of both state and federal laws and have the ability to identify all of the issues and to assist clients in properly resolving those issues. Although the cost of properly implementing and administering an FLP may appear expensive, generally, the benefits to clients who have substantial assets and desire to minimize transfer taxes and, possibly, state intangible personal property taxes are great.

Trust-Based Tax Strategies

Private Annuity Trust

A Private Annuity is a contractual agreement of sale between two private parties. Usually the seller (the *annuitant* – the parent) of an asset transfers property to a family member (the *obligor* – the children or heirs) in exchange for a “special payment contract” (an annuity) of substantially equal value. The obligor is then responsible for making annuity payments to the annuitant during his/her lifetime.

A Private Annuity Trust (PAT) is a specialized and sophisticated trust designed to give structure and convention to the private annuity contract. The trust may sell and use the proceeds to provide an income stream for the life of the annuitant(s).

Benefits of a Private Annuity Trust:

- Eliminates Estate Taxes on assets in the PAT
- Creates an Income Stream for Life or Joint Lives
- Eliminates the Headaches Involved with Property Management
- Offers an estate planning alternative
- Maximizes Medicaid Benefits by Protecting Family Assets from Recovery of Past Nursing Home Expenditures
- Provides Asset Protection in Case of Legal Disputes
- Avoids Expenses, Delays and Publicity of Probate

Trust-Based Tax Strategies

Private Annuity Trust

A Private Annuity Trust (PAT) is an irrevocable trust. The annuitant/grantor must keep “arms length” at all times. This means that he/she may have no control over the assets or investments inside the PAT. Those decisions are the sole responsibility of the trustee. Because the trust is irrevocable the annuitant/grantor should have a sufficient net worth outside of the PAT, so that the principal is not needed for everyday living expenses.

A surplus or reserve account should be put aside. Generally, this reserve account might range from 5-10% of the total assets placed into the PAT and could decrease the annuity payments that the annuitant/grantor may receive. The annuity payments from a PAT may be higher than the income recipient may need or want. The IRS-mandated formula will determine how much income the annuitant/grantor will receive annually based on the annuitant's/grantor's life expectancy, the Federal Midterm Rate, the selling price of the asset and any deferral length before payments begin. If the annuitant(s)/grantor(s) are receiving more income than they can spend, then the excess income might then be reinvested, causing the taxable estate to increase.

In reality, a PAT is less expensive than many competing estate planning strategies. The tax savings and benefits can be substantial, making the time and money spent well worth it. The complexities of a PAT can be overcome with a competent estate planning professional well versed in the area of Private Annuity Trusts.

Tax Strategies

If you are anticipating a substantial tax obligation resulting from:

- Sale of Real Estate or Land
- Sale of your Home
- Sale of a Business
- Stock Sale
- Sale of other highly appreciated assets
- Year end bonus compensation

The team of professionals at Ambrose Wealth Management would be happy to offer you an introductory and confidential consultation.