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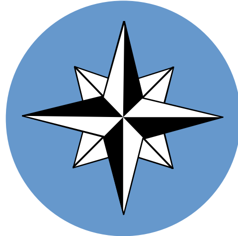

OFFSHORE TRUTH & TAX CONSEQUENCES

THE RISER REPORT

ESTATE PLANNING AND ASSET PROTECTION

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Welcome

Welcome to the inaugural edition of **THE RISER REPORT**. **THE RISER REPORT** is a bi-monthly publication covering issues and opinions related to asset protection and estate planning. **THE RISER REPORT** is written by Attorney Christopher M. Riser, of Mayer & Riser, PLLC (www.mayer-riser.com) in Highlands, North Carolina and published by Axius Publishing, LLC.

THE RISER REPORT will be sent by electronic mail to subscribers of our companion publication, **THE ADKISSON ANALYSIS**, and vice versa. If you aren't already a subscriber to **THE RISER REPORT**, you can subscribe at www.riserreport.com Subscribe to **THE ADKISSON ANALYSIS** at www.falc.com. If you've yet to enter the age of e-mail and Web publications and are reading this from a friend's printed copy, you can subscribe by regular postal mail by writing to the address at the end of this issue.

In this first issue, I look at a bit of the evolving response of the offshore world to the OECD's blacklist of tax and money laundering havens. Next, I examine the Delaware Series Limited Liability Company, which could be an economical and efficient alternative to multiple entities in the right situation. Third, I report on the recent takeover and ongoing investigation of the First International Bank of Grenada by government regulators. Next, I discuss the concept of growth shifting for entrepreneurs; that is, shifting the opportunity for vast increases in wealth to younger generations at a minimal estate and gift tax cost. "Briefly Noted" contains a number of short but relevant news items. Finally there is a short review of John Huggard's book, *Living Trust Living Hell*, which fills a long-standing void in the otherwise one-sided category of living trust publications.

I'll be in London the last two weeks of October preparing for and taking the exam for qualification as an English solicitor, so the November/December issue of **THE RISER REPORT** may be a little late, but I hope to have it ready by November 10th.

Comments and suggestions are welcome. Email them to comments@riserreport.com or use the feedback form on **THE RISER REPORT** Web site at www.riserreport.com.

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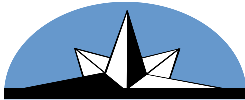
Offshore Response to OECD

In late June, the Organization for Economic Cooperation and Development (OECD), an organization of 29 of the world's most economically developed countries, issued its report entitled *Toward Global Tax Cooperation* (www.oecd.org/daf/fa/harm_tax/Report_En.pdf), which includes the so-called 'blacklist' of "uncooperative tax haven" countries. The June report was a follow-up to 1998's report entitled *Harmful Tax Competition: An Emerging Global Issue.* Since when is competition harmful?

The apparent intent of the high-tax member countries of the OECD is to create a high-income-tax cartel by bullying the world's low-income-tax jurisdictions into cooperation in harmonizing tax regimes and in promoting fiscal transparency by opening foreign financial accounts to tax authorities from other jurisdictions.

At about the same time the OECD's Financial Action Task Force (FATF) on Money Laundering released its *Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures* (www.oecd.org/fatf/pdf/NCCT2000_en.pdf). The FATF report also contained a 'blacklist' of uncooperative offshore countries. Nine of the fifteen countries on the FATF blacklist also appear on the tax haven blacklist. In mid-July, the U.S. Treasury's Financial Crimes Enforcement Network (FINCEN) division issued Advisories notifying U.S. financial institutions of money laundering risks when dealing with banks in the 15 jurisdictions on the OECD blacklist.



The combination of the OECD blacklist and the FINCEN Advisories had an immediate effect on offshore transactions

Even before the issuance of the reports and advisories, financial institutions in the major offshore financial centers had begun to request more detailed information regarding the beneficial owners of financial accounts, i.e., trust settlors and company owners.

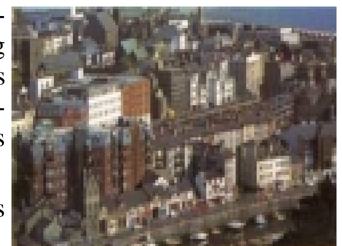
Within a few days of the issuance of the FINCEN Advisory on St. Kitts & Nevis, I had trouble with a U.S. dollar wire from a U.S. bank account to the account of a reputable offshore service provider at The Bank of Nevis International, whose correspondent banking relationships with two U.S. banks suddenly were terminated. Eventually, I was able to make the payment through a Canadian correspondent bank. However, it was apparent that the combination of the OECD blacklist and the FINCEN Advisories had an immediate adverse effect on legitimate offshore financial transactions. These were not idle threats.

The response of the governments of the offshore financial center jurisdictions has been to capitulate for the most part on the issue of transparency. For example, Belize, the Cook Islands, The Bahamas, and the Cayman Islands have all passed emergency legislation intended to make it easier for foreign tax authorities to gather information on foreign financial accounts and generally to expand the scope of international money laundering investigation capabilities of foreign governments. Other offshore jurisdictions are expected to follow suit in one way or another.

And it came to pass in those days that there went out a decree from the OECD that all the world should be taxed...

It's on the tax side of the issue that I think things will get interesting, because that's what this whole issue is really about. The money laundering talk is mostly there to make the idea of cracking down on offshore jurisdictions seem more like "justice" and less like the bullying that it generally is, especially given the recent radical tax reforms in Germany lowering tax rates and similar measures being proposed in Italy. Therefore, the continued viability of offshore jurisdictions will depend on legislative and economic creativity rather than tax regimes which distinguish between resident and non-resident companies.

The Isle of Man saw the writing on the wall and has been aggressively pursuing e-business with some success over the past several years. As a "proving ground" for British Telecom in partnership with the local telecommunications company, Manx Telecom, the Island has one of the most advanced IT infrastructures in the world. In addition, a new Electronic Transactions Act was recently enacted.



Major tax changes are taking place on the Isle of Man

In anticipation of the recent OECD tax report, the Isle of Man cut its business tax to half the current rate as part of a strategy to satisfy the OECD and the EU while remaining economically competitive. The current standard 20% tax rate will be reduced to 10% for companies. Some companies (those vital to the Island's future as a financial center, such as shipping and insurance) will continue to enjoy tax exemption but via a zero tax rate rather than an exemption. Furthermore, any special tax regimes in future will be for certain types of business rather than the distinction between resident and non-resident.

At the same time, the Isle of Man plans to reduce its individual income tax, which already is an attractive personal income tax system with no capital gains tax. The standard personal income tax rate will be fixed

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at 10% and 15%. Although non-residents will pay the new 15% rate on Isle of Man source income, they will have personal allowances which were previously only given to residents. Also, executives on short-term contracts of up to three years will now only be taxed on their Isle of Man source income. These are the kinds of comprehensive changes that signal a jurisdiction's welcome to "new economy" entrepreneurs and workers to both live and establish new businesses in the jurisdiction.

The Bahamas' immediate reaction to the blacklists was to bristle and vow not to cave in to OECD demands. However, it wasn't long before The Bahamas began to move in that direction. New money laundering legislation was introduced quickly and Prime Minister Hubert Ingraham flew to the U.S. and Canada to meet with government officials.

Shortly thereafter, an Act to Amend the Evidence (Proceedings in other Jurisdictions) Act, 2000, was enacted, which will make it easier for foreign government investigators, including those from foreign tax authorities, to obtain evidence on persons and entities holding bank accounts in The Bahamas. The Act purports to restrict "fishing expeditions" by requiring specificity in requests for information. However, for customers of many major financial institutions, especially for new customers, the Act doesn't change much. Many major institutions had already been requiring more extensive identification from customers and some had already been requiring customers to sign confidentiality waivers that would apply in the event of a request for information from a government agency.

Getting The Bahamas to loosen privacy laws in the name of fighting drug traffickers' money laundering efforts is a pretty easy argument for the OECD to make. Convincing a major offshore financial center such as The Bahamas to "harmonize" its tax regime by converting from its current tax regime which includes no direct taxation (although some taxes, such as import duties, are very high) to an income tax based regime is another matter altogether.

Delaware Series LLC

The limited liability company (LLC) has fast become the business entity of choice in the U.S. The LLC allows business owners to achieve limited liability for debts of the business while being taxed on a relatively unrestricted passthrough basis.

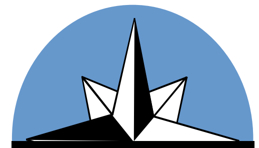
The LLC also provides protection to its owners for debts unrelated to the business in that LLC property and LLC interests themselves generally cannot be directly seized or attached by creditors of debtor members. Instead, such creditors are limited to a "charging order" issued by a court requiring the LLC to divert payments to the debtor member to the creditor.

However, the charging order does not provide the creditor with voting rights, such as the right to vote for a distribution. If no distributions are made to the debtor member, neither are distributions made to the creditor. Furthermore, in some cases, the creditor may be taxable on the debtor member's share of LLC income, whether he receives a distribution or not. Thus the charging order is not a particularly attractive remedy for a creditor. For more about LLCs in general, see the articles at the Mayer & Riser, PLLC Web site at www.mayer-riser.com and the articles at the Adkisson Analysis Web site at www.falc.com.

Segregating "dangerous" assets and businesses into separate entities away from other assets, especially "safe" assets, is always a good idea from an asset protection point of view. For example, an individual who owns a gas station and a rental home shouldn't own both within the same entity. Neither should an individual with a large amount of liquid assets (cash, securities, etc.) to protect hold the cash in the same entity as a business.

Best practices would dictate that every distinct business or major business asset be segregated into a different limited liability entity. In an ideal situation, someone with 25 rental properties would have 25 separate LLCs, one for each property. However, this isn't always practical because of administrative costs and government fees that must be paid for each LLC. What can such a business owner do to protect his assets from liabilities unrelated to those assets in a cost-effective way?

Enter the Delaware series LLC. The Delaware LLC Act provides for the creation of separate "series" within an LLC whose debts and other liabilities are enforceable against that series alone. The Act also provides that classes or groups of members can be established, having whatever rights the LLC agreement says they have. The combination of the two provisions allows a series to be treated in many ways as a separate LLC. Thus, the series provisions in the Delaware LLC Act allow for the creation of separate protected "cells" within one limited liability "container" without the need to create separate entities, thus avoiding the inefficiencies associated with multiple related entities. The concept is similar in function to the segregated portfolio companies and protected cell companies designed for the mutual fund and captive insurance industries in Bermuda, Guernsey, the Cayman Islands, Mauritius and Belize.



The series LLC allows for the creation of separate protected "cells" within one LLC "container" without the need to create separate entities, avoiding some of the inefficiencies associated with multiple entities

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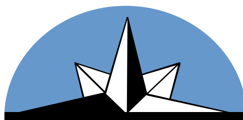
The Act allows an LLC agreement to designate series of members, managers or LLC interests that have separate rights and duties with respect to specific LLC property or obligations. So, each series can be tied to specific assets and can also have different members and managers. If the various series within an LLC have different members or different membership rights, each series may be treated as a separate LLC for income tax purposes, eliminating some of the administrative advantage of the series LLC.

Each series can have its own separate business purposes. A series can be terminated without affecting the other series of the LLC. A series can make distributions to its own members without regard to the financial condition of the other series.

Most importantly, the Act provides that debts, liabilities and obligations incurred, contracted for or otherwise existing with respect to a particular series are enforceable against that series only, and not against the assets of the LLC generally or any other series of the LLC. However, to obtain this protection, each series must be treated separately. Books and records must be kept for each series and the assets of each series must be held and accounted for separately. Finally, in order that the public knows that it is dealing with a series LLC, it must be put on notice by the inclusion of the series limitations in the LLC's Certificate of Formation filed with the Delaware Secretary of State.



The series LLC can be used to save administrative costs — and maybe taxes in some situations — in real estate ventures

Practical Uses of the Series LLC

The most obvious use for the series LLC is to hold multiple parcels of real property in liability-segregated cells. Consider Bob and Nancy, who own ten small rental properties, each worth between $50,000 and $100,000. Forming and maintaining ten separate LLCs would cost several thousand dollars in the year of formation and several thousand dollars each subsequent year. Instead, Bob and Nancy might form a Delaware series LLC and transfer each property by deed to a separate series. They would achieve their goal of segregating the properties for asset protection purposes while saving several thousand dollars in startup costs and another several thousand dollars a year in ongoing administrative costs.

Another use for the series LLC might be to facilitate an equity compensation program in a business with multiple divisions. If each division were segregated into a separate series, the LLC could give the key employees of each series some sort of equity interest tied to that series only rather than equity interests in the entity as a whole. That rewards employees at productive divisions and protects them from the potential downside of another division.

Yet another use for the series LLC might be to make a de facto transfer that avoids gain that would otherwise be recognized on a transfer from one LLC to another LLC. Consider the following example: Dan & Ed contribute adjacent tracts of land to D&E, LLC and develops most of the land. A few years later, they want to sell the remaining undeveloped land, worth $1 million, to Fred for a shopping center. Dan & Ed want D&E, LLC to get some cash out of the deal, but they also want a piece of the shopping center action. If D&E, LLC contributes the property to a new LLC formed with Fred, DEF, LLC, in exchange for DEF, LLC interests and cash, the cash distribution would be taxable to Dan & Ed under Section 707(a)(2)(B) of the Internal Revenue Code as a taxable exchange of appreciated property for cash.

Instead, D&E, LLC creates a new series within D&E, LLC, the Shopping Center Series, issues the Shopping Center Series interests 10% each to Dan and Ed, and 80% to Fred, and transfers the land to the Shopping Center Series. Fred contributes $2 million to D&E, LLC, of which $1.5 million is designated for the Shopping Center Series. If D&E, LLC is respected as a single tax partnership (i.e., the Shopping Center Series is not treated as a separate partnership for tax purposes), the current income tax gain to Dan & Ed on the cash portion of the land exchange that otherwise would have been triggered in a transfer to a new LLC will have been avoided. In addition, since the transfer of the land was entirely inside the LLC, depending on local law, there may be no real estate transfer tax on the transfer whereas there may have been tax on the transfer of the land to a new LLC. This is cutting edge planning with no guarantees, but the possibilities are exciting.

Mayer & Riser, PLLC has considerable experience in using Delaware series LLCs to achieve the asset protection goals of its clients, particularly in the area of real estate investment. If we can help you or your clients, give us a call at 828-526-3731 or send me an e-mail message at criser@mayer-riser.com.

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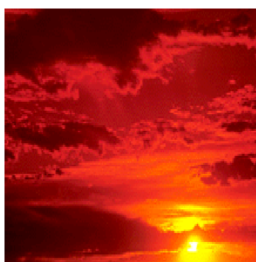
Grenada Finally Acts Against FIBG

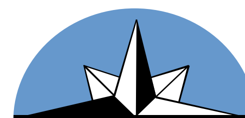
Readers of *The Adkisson Analysis* (www.falc.com), Matt Blackman's *Goldhaven* (www.goldhaven.com), and David Marchant's *Offshore Alert* (www.offshorebusiness.com) are familiar with the First International Bank of Grenada (FIBG). FIBG is an offshore bank, initially capitalized with a single alleged gemstone, that promised investors returns of up to 250% on certificates of deposit. FINALLY, the government of Grenada has taken over FIBG's operations as of August 17th. The story here is not that the government acted, but rather — ***what took so long?*** FIBG's first auditors, Wilson & Co., warned the Prime Minister in March of 1999 that FIBG's assets were "bogus and fictitious" and that the entire Grenadian offshore sector needed a serious overhaul.

Grenada's former Accountant General Garvey Louison has been appointed to investigate the bank and assume control over bank operations. Finance Minister Anthony Boatswain, who appointed Louison, said he knew the bank was experiencing a "shortage of funds," but he did not say how it would affect investors. Well, maybe it will affect them in that most of them will never see their principal, much less their promised interest?



Is the sun finally setting on the First International Bank of Grenada?

FIBG depositors can view a "Proof of Loss & Claims Form" at the Web site of the International Deposit Indemnity Corporation (www.idic-ec.org), the supposed insurer of FIBG deposits, which was last year was kicked out of Nevis and turned away by Dominica (neither of which countries even have insurance legislation) and now simply calls itself a "West Indian corporation." Of course, IDIC is not accepting any of these claims forms, but the reason is not, the IDIC says, "that IDIC is a scam," but rather that "IDIC was never intended to be a quick fix, but rather would/will have to liquidate bank assets in the event of failure. This is a process that takes time and one that for practical reasons can only be used as a last and final solution." What would IDIC and any interested parties likely receive upon liquidation of FIBG? A ruby and accompanying appraiser's certificate if they're lucky.



FIBG reportedly has no assets in place which are immediately available to meet many millions of dollars in depositors' claims

Louison's letter of August 22nd to the present and former directors of FIBG (available for viewing at www.offshorebusiness.com along with other documents relating to FIBG) claims that "many millions of dollars" of depositors' monies have been transferred to four bank directors, including Brink, directly or through IBCs and other entities set up for that purpose. Louison also notes that CDs for "many millions of dollars" have been issued "without any proper assets being in place which are immediately available to meet such claims." Further, apparently many millions of dollars have been diverted to Uganda.

A Grenadian government spokesperson said that the government was continuing to investigate the bank in coordination with the FBI. The investigation reportedly includes the possibility of money laundering. Surprise.

Bank owner Van A. Brink resigned from his bank directorship in 1999 and reportedly has been spending much of his time in Uganda. Before embarking on his career as a Grenadian banker, Brink lived in Oregon as Gilbert Allen Ziegler until he declared bankruptcy in 1994, bought a Grenadian passport and changed his name. Brink's response to Louison's letter ("alleged letter" Brink calls it) was posted to the IDIC Web site on August 28th.

Brink obtained FIBG's banking license in 1998. Apparently not interested in lying low — pun fully intended — FIBG reported gross income last year of $26 billion, about the same as the revenue reported by Bank One Corp., of Chicago, the fifth-largest bank in the U.S. According to Louison's letter, on the last available balance sheet, FIBG claimed to have $62 billion in assets! So, either there's going to be a 62 billion dollar fire sale to pay depositors' principal and interest, or FIBG will end up in the Quatloos! Cyber-Museum of Scams and Traps. My guess is the latter.

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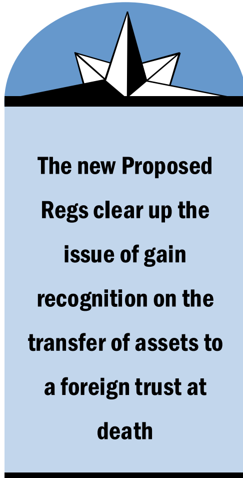
IRS Issues New Foreign Trust Tax Regs

The IRS recently issued new proposed regulations ("Prop Regs") governing the recognition of gain on transfers to foreign trusts under Section 684 of the Internal Revenue Code. The IRS also issued new proposed regulations governing the general income tax treatment of foreign trusts with one or more U.S. beneficiaries under Section 679 of the Code.



The former 35% excise tax on transfers of appreciated property to foreign trusts was eliminated in 1997 and replaced with the new gain recognition provisions of Section 684, which gave the IRS the authority to make exceptions to the general gain recognition rule. As expected, the Prop Regs would require immediate gain recognition upon the transfer of appreciated property to a foreign trust, including upon the trust's change from a domestic trust to a foreign trust, even though there is no actual transfer. However, the Regs would disallow loss recognition on such transfers, including disallowing losses in some transferred property to offset gains in other transferred property.

Most importantly, the 684 Prop Regs would except from gain recognition those transfers to foreign trusts made at death. This had been an area of uncertainty for the last few years. The concern was that instead of a step-up in basis at death under Section 1014, there would be recognition of gain inherent in transferred assets at the moment of death under Section 684. Generally, under the 684 Prop Regs, if the assets transferred to the foreign trust at death are includible in the decedent's estate, the basis in the assets will be stepped-up and the basis in the hands of the foreign trustee will be the value for estate tax purposes.

Your trustee moved to Europe? The proposed 684 Regs can keep you out of tax trouble.

The 684 Prop Regs also provide for relief for trusts that inadvertently change from domestic to foreign, e.g., when a individual non-citizen sole trustee moves from the U.S. and becomes a nonresident alien.

Section 679 of the Internal Revenue Code deals with the income tax treatment of transferors to foreign trusts of which there are one or more U.S. beneficiaries. Generally, the income of such trusts is taxed to the transferor. The 679 Prop Regs make it clear that having U.S. beneficiaries of a foreign trust is all that it takes to make a transferor to such a trust taxable on the income of the trust attributable to the transfer. The 679 Prop Regs also provide that if another person holds a Section 678 general power of appointment that would otherwise make that person taxable, 679 overrides 678.

The 679 Prop Regs also make it clear that the IRS will look beyond the terms of the trust to see who the real beneficiaries are, including looking to letters of wishes and investigating any oral agreements and understandings. Furthermore, if the trust can be amended to benefit a U.S. person, then all potential benefits that could be provided to a U.S. person in accordance with such an amendment will be taken into account. Thus, in order to ensure that a trust will not be taxed to a U.S. grantor, there must be no possibility of adding a U.S. person as beneficiary during the grantor's lifetime.

The 679 Prop Regs also cover the situation where U.S. persons are indirect trust beneficiaries via controlled foreign corporations, partnerships, other trusts, or estates; such trusts will also be taxed to the transferor. Using a foreign "straw man" to make the transfer to the foreign trust won't work either. The 679 Prop Regs provide that indirect transfers will be transfers for 679 purposes if it can be shown that avoidance of U.S. tax was one of the principal reasons for the transfer to the foreign transferor. The Prop Regs contain rules which will deem such reasons to exist.

You can read the 684 Prop Regs online at ftp.fedworld.gov/pub/irs-regs/10852200.pdf and the 679 Prop Regs at ftp.fedworld.gov/pub/irs-regs/20903889.pdf.

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The Adkisson Analysis
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Growth Shifting:
Estate Planning For Entrepreneurs

It's hard enough for many successful entrepreneurs to comprehend their present financial largesse. It's often even more difficult for them to think about estate planning for the future. Planning now instead of later can allow an entrepreneur to pass on business wealth to his family at a minimal transfer tax (i.e., estate tax, gift tax and generation skipping transfer tax) cost compared to waiting until later. Let's take a look at some of the tools that can be used to accomplish these savings. Keep in mind that the following tools can be used alone or in combination with one another.

Outright Gifts of Stock

Outright gifts of stock to children, custodians or children's trusts are the simplest tools for transferring entrepreneurial wealth and often make a lot of sense at a company's formation stage. Well-documented appraisals are key in order to prevent the IRS from challenging the value of such gifts in the future.

GST Exempt Dynasty Trust

An individual with a net worth of over $2 million should consider using her generation-skipping transfer (GST) tax exemption amount ($1.03 million in 2000, and adjusted for inflation as time goes on) to transfer assets to generations below her children's generation (even if she has no children yet) in order to skip the estate tax at the children's generation (for a little more GST tax information, visit the Mayer & Riser, PLLC Estate Planning Basics page at www.mayer-riser.com). It used to be difficult to skip transfer taxes for more than 90 years or so because of an arcane rule of common law, the "rule against perpetuities," which prevents trusts from lasting much longer than that.

Growth shifting estate planning techniques can help assure that your family, not Uncle Sam, benefits from your work

However, a number of states, including South Dakota, Delaware, Alaska and others, have abolished the rule against perpetuities and allow trusts to last forever. Such trusts are often called "dynasty trusts." Establishing a GST exempt dynasty trust for his family allows an entrepreneur to make gifts of stock, at a low startup value, to a trust which will be exempt from estate and GST tax forever.

Preferred Equity Freeze

It may occur to a financially-minded entrepreneur to simply recapitalize his company and give common interests — the growth stock — to his children and keep preferred interests for himself. Congress thought of that too. In 1989, they enacted special valuation rules in Chapter 14 of the Internal Revenue Code to prevent abuses of such recapitalizations. For such a recapitalization to work, the preferred interests must receive a certain minimum payment or liquidation preference that usually works out to be around 10 percent. The rest of the growth potential can be shifted to the common interests. A recapitalization prior to a successful IPO can produce astounding transfer tax savings.

Family Limited Partnership ("FLP") / Family Limited Liability Company ("FLLC")

Using FLPs and FLLCs to make "discounted" gifts of equity interests is becoming more common. What makes the gifts discounted is that it is not the equity interest itself that is gifted, but rather an interest in a FLP or FLLC that owns the equity interest. Because the FLP or FLLC interest is a non-marketable minority interest, it is worth less than a pro rata share of the value of the assets in the FLP or FLLC. Discounts generally range from 25% to 50% or more. Expert appraisals are key to using this technique. For more information on FLPs and FLLCs, visit the Mayer & Riser, PLLC FLP/FLLC page at www.mayer-riser.com.

Charitable Remainder Trust

A charitable remainder trust is a trust to which a grantor transfers assets and in which someone, often the grantor and the grantor's spouse, has an income interest for a term of years or for life. When the income

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interest ends, a charity of the grantor's choosing receives what is left in the trust. The grantor of the CRT receives an income tax deduction for the actuarial value of the charity's remainder interest. In order to qualify for CRT treatment, the actuarial value of the remainder interest must equal at least 10% of the value of the assets transferred to the CRT. The income interest is either a fixed annuity amount or a "unitrust" amount, which is a fixed percentage of the assets of the CRT as valued each year. Charitable remainder unitrusts ("CRUTs") are more prevalent than charitable remainder annuity trusts since the income interest of a CRUT can keep up with inflation by growing with the principal. There are two variations on the CRUT theme—the net income with makeup CRUT (NIMCRUT), which allows CRUT payments to "build up" even if there is not current income to pay them (which can be useful for creating a retirement income stream). There is also the "flip CRUT," which is a NIMCRUT that switches to a regular CRUT upon the happening of some specific event, such as the sale of specific assets contributed to the trust.

CRTs work well for low-basis assets, such as post-IPO stock. This is because the CRT is a charitable entity and does not pay income tax. So, it can sell the low-basis stock and reinvest the entire sales proceeds to pay the income interest. The income interest is not tax-free to the recipient, but the tax hit is spread out over a longer period of time than if the entrepreneur had sold the stock himself.

Charitable Lead Trust ("CLT")

A charitable lead trust is sort of like a CRT in reverse. A trust is established, assets are transferred, and a charity receives an income interest for a term of years, after which time the family receives what's left in the trust. The donor gets an immediate income tax deduction for the actuarial value of the charity's interest (although in the second and later years, the grantor is taxed on the CLT's income). Like a CRT, the income interest of a CLT can be either an annuity amount or a unitrust amount. The annuity trust (a "CLAT") is almost always chosen because the goal is to maximize the amount passing to the family later. If a CLAT is funded with pre-IPO stock and the remainder is post-IPO stock, the transfer tax savings can be huge.

Grantor Retained Annuity Trust ("GRAT")

The GRAT is another tool for transferring future appreciation to children. The entrepreneur funds a trust with rapidly appreciating (e.g., pre-IPO) stock and retains the right to a fixed annuity payment for a term of years, usually 2 to 5 years. What's left in the trust after the term passes to the remainder beneficiaries of the trust, e.g., the children or a children's trust. IRS tables set the minimum annuity payout for GRATs to prevent abuse of the technique. Also, the grantor of a GRAT must survive the annuity payment term for the assets in the GRAT to be excluded from his estate for estate tax purposes. As with the CLAT, if the GRAT is funded with pre-IPO stock and the remainder to the kids is post-IPO stock, the transfer tax savings can be substantial.

Installment Sale to an Irrevocable Grantor Trust

All of the techniques described above require the entrepreneur to use some or all of his or her lifetime estate and gift tax exemption amount ($675,000 this year, increasing to $1 million by 2006). To avoid using the exemption or to avoid paying gift tax after having used the exemption for prior gifts, an entrepreneur might consider selling his equity interests to a "grantor trust" (a/k/a "defective trust" - misleadingly poor nomenclature, in my opinion), i.e., a trust that is income-taxable to the grantor, for an interest-bearing installment note. Because the sale is to a grantor trust, it is essentially a sale to himself for income tax purposes, and therefore not a sale at all; thus there will be no capital gains tax to pay. The interest rate on the note must meet a minimum standard, the equity interests must be carefully valued for purposes of the sale, and the trust must be "seeded" with a gift of cash (usually 10% of the purchase price), but in effect, the technique can work somewhat like a GRAT to save substantial amounts of transfer tax.

Growth-Shifting Tools and Stages for Best Use

Tool	*Formation*	*Pre-IPO*	*Post-IPO*
Outright Gift	•		
GST Exempt Dynasty Trust	•		
Preferred Freeze	•	•	
FLP/FLLC		•	•
CRUT			•
CLAT		•	
GRAT		•	
Installment Sale to Grantor Trust		•	

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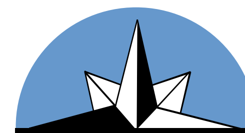
Briefly Noted

U.S. Know-Your-Customer Law Gains Momentum Again

Strong public opposition killed "Know-Your-Customer" laws for U.S. banks two years ago. Now, with the OECD leaning on member states and others, the House Banking and Finance Committee is trying once again to persuade Congress to pass legislation, H.R. 3886, which would require U.S. banks to gather information about depositors and sources of funds and expanding reporting of so-called "suspicious transactions." The bill was passed in committee 18 to 1 and sent to Congress for consideration this fall.

In addition to the information gathering and reporting rules, the bill would give the Treasury Department the power to implement additional rules, prohibit entire classes of international banking transactions, prohibit international banking transactions with designated institutions, and prohibit international banking transactions with designated countries.

Read H.R. 3886 online at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_cong_bills&docid=f:h3886rh.txt.pdf.



The "Know-Your-Customer" bill would require banks to collect more information about customers and sources of funds and would give Treasury broad powers to prohibit international banking transactions.

Brunei Enters the Offshore Financial World

The sultanate of Brunei, a tiny country on the west coast of the Malaysian island of Borneo, has enacted several new laws intended to make Brunei an offshore international financial center and to reduce the economy's dependence on oil and natural gas exports. The new laws cover trusts, partnerships, licensing, and money laundering prevention measures.

Brunei is responding to the 1997 Asian economic crisis and the recent long period of low oil prices. Brunei was particularly hard hit because during the same period of the recent economic difficulty, Prince Jefri Bolkiah, brother of Sultan Hassanal Bolkiah, depleted the state treasury of about $16,000,000,000 while mismanaging the country's investments.

Bankruptcy Reform Pushed in Congress

Bankrupt debtors may be forced to cough up more cash

Fueled by credit card industry lobbyists, the push for bankruptcy reform continues in Congress. The House (H. 836) includes limits on the ability of consumers to eliminate credit card debt by forcing many debtors into a Chapter 13 repayment plan and disallowing the use of Chapter 7 to obtain a discharge of debt.

Popular opinion seems to be that maxed-out credit cards are the primary reason for personal bankruptcy filings. In fact, the most common reason for personal bankruptcy filings is medical expense debt.

Other potential changes involve the homestead exemption and the exemption for IRAs and qualified retirement plans. The Senate's bill contains a $100,000 cap on the bankruptcy homestead exemption in order to curb what it perceives as an abuse of the homestead exemption.

Two key players in the Senate bankruptcy bill debate, Sen. Jeff Sessions (R-AL) and Sen. Chuck Grassley (R-IA), proposed in May to cap the exemption for IRAs and qualified plans at $1 million. The proposal has not made its way into a bill yet, but it is an indication of the sense of Congress on bankruptcy reform.

It appears that no bankruptcy reform bill will be passed in this session of Congress. Whether or not bankruptcy reform will happen in the next few years probably depends largely on the outcome of the November elections.

New Online Offshore Financial Services Directories Launched

Focus Information Systems Limited, a Jersey company affiliated with the Jersey law firm of Crills Advocates, has launched three new online offshore financial services directories: FocusIOM.Com, FocusJersey.Com, and FocusGuernsey.Com. Future sites will cover Anguilla, The Bahamas, Bermuda, BVI, Caymans, Curacao and Gibraltar.

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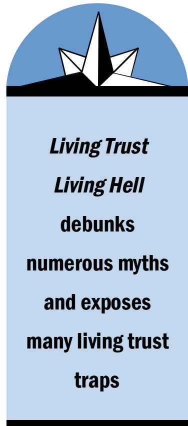

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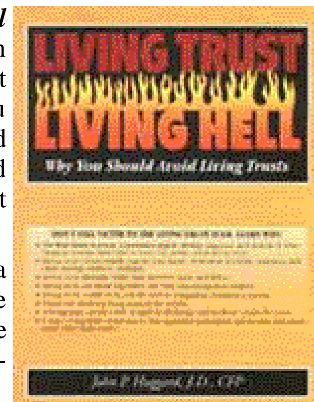
Book Review: *Living Trust Living Hell*

It's not new (published in 1998), but ***Living Trust Living Hell*** by Raleigh, North Carolina attorney John Huggard should be on your reading list (and your lending and giving list—we've lent or given away several copies at Mayer & Riser, PLLC). If you are as irritated by living trust hucksters as I am or if you find yourself actually wanting to believe some of the over-hyped claims of living trust salespeople, you'll find the book a great resource.

The book's style (right down to the cheesy flaming cover) is a little over-the-top, but my guess is that's by design. Fight fire with fire, fight cheese with better cheese. Compared to the Cheez Whiz squirted at the public by many living trust hucksters, Huggard is serving up Camembert.

The book debunks numerous myths and exposes traps related to poor or ignorant planning with living trusts. The short, easy-to-read chapters contain plenty of examples showing how living trusts can actually increase rather than decrease taxes, expenses and administration time, as well as unnecessarily expose assets to claims of creditors.

Order ***Living Trust Living Hell*** directly from the publisher at www.kendallhunt.com or by calling 1-800-338-8290. The book is also available at Amazon.Com and from Barnes & Noble at www.bn.com.



Living Trust Living Hell
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