MACK BUSINESS APPRAISALS LLC

Valuation Insights

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The Future of the Estate Tax???

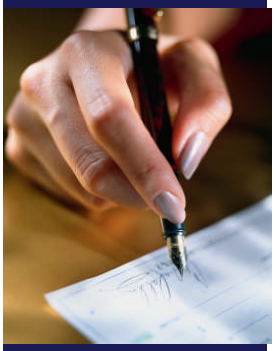
Prior to leaving Washington in December 2009, the House of Representatives passed an estate tax freeze. The House plan proposed to freeze the estate exemption at $3.5 million and the estate tax rate at 45%. However, the Senate was unable to come to a compromise. By December, the Democratic proposal was to accept the House estate tax freeze, while the Republicans generally were supporting an exemption of $5 million and an estate tax rate of 35%. Since Congress did not act during 2009, the estate and generation skipping transfer tax is currently repealed for 2010 but will be restored on January 1, 2011. At that time there will be a $1 million estate exemption (as indexed for inflation) and a 55% estate rate. While no one knows with certainty what Congress will do to remedy this situation, several key Congressmen have stated publicly that they will attempt to pass estate tax legislation early in 2010. Furthermore, many in Congress have expressed the desire to make such legislation retroactive to January 1, 2010. However, it is not a foregone conclusion that Congress can make the estate tax legislation retroactive to January 1, 2010. John Buckley, Chief Tax Counsel to the House Ways and Means Committee, has opined publicly that reinstituting the estate tax retroactive to January 1, 2010, would be unconstitutional. Thus, it is likely that there would be numerous lawsuits over the constitutionality of such retroactivity. These lawsuits would likely not be resolved until after years of litigation culminating in a Supreme Court decision.

What will the Democrats and Republicans do now? Well, some cynics say that the Democrats have incentive to do nothing because the current Estate tax law was passed by a Republican Congress and signed by a Republican President - they have no responsibility for the insanity caused by the sunset. Furthermore, by doing absolutely nothing, the $1 million estate exemption (indexed for inflation) and 55% estate tax rate come back into play on January 1, 2011. Thus, some analysts believe that Democrats see this as a way to raise taxes long-term without ever having to pass a tax increase. Republicans, alternatively, are incentivized to do nothing in 2010 because they have steadfastly argued for total repeal of the estate tax. In what potentially will be a significant mid-term election, many in Congress will likely use their position on the estate tax in an attempt to ensure reelection. The rules of the Senate and politics of an election year make progress very difficult. In election years, the Senate normally acts by June. During the fall, those Senators who are running in competitive races are very reluctant to face controversial issues. For this reason, the Senate may miss the May-June window for legislation. Thus, with the current political structure and rules of the Senate, it is very possible that an estate tax compromise will occur after the fall election – which will only keep estate planning professionals in limbo that much longer. Only time will tell!

INSIDE THIS ISSUE:

Estate of Roger D. Malkin et al. v. Commissioner; T.C. Memo 2009-212; September 16, 2009

The Facts:



Mr. Roger Malkin was the chairman and chief executive officer of Delta & Pine Land Co. (D&PL) from 1980 until his death in November of 2000. During the time in which he was employed, Mr. Malkin accumulated more than 1,000,000 D&PL shares and options. In 1997, Mr. Malkin decided he wanted to transfer approximately $16,000,000 worth of D&PL shares to his children. However, he did not want his children to sell the shares after they had received them. Mr. Malkin discussed this with his financial planner and an estate planning expert from Arthur Andersen. After a series of conference calls, Mr. Malkin decided to form an FLP to hold the D&PL shares and two trusts, one for each child, to hold limited partnership interests in the FLP. Mr. Malkin and his advisors then proceeded to establish a complicated estate plan involving the formation of two family limited partnerships (FLPs), four trusts (two for each of his children), four LLC's, two self cancelling installment notes (SCINs), additional sales with installment notes and various other gift transfers.

As a result of the transfers, Mr. Malkin was able to move approximately $20 million of D&PL stock from the estate into the two FLPs keeping in mind his stated objective of transferring the stock but not wanting his children to be able to sell it.

Mr. Malkin also had personal loans with Bank of America and Morgan Guaranty which he collateralized with the shares of stock he had previously transferred to the FLPs.

At the time of Mr. Malkin's death in 2000, the transfers to the FLPs, the SCINs and the loan owned to Morgan Guaranty for over $12 million rendered the estate insolvent.

The IRS reviewed Mr. Malkin's various transfers over the time frame in question and assessed deficiencies on the estate and the 1998, 1999, and 2000 gifts in the amount of nearly $17 million. The primary issues in the case were whether or not Mr. Malkin retained control of the shares of transferred stock under Section 2036(a) and whether the transfers of the stock to the created LLCs and FLPs created indirect gifts.

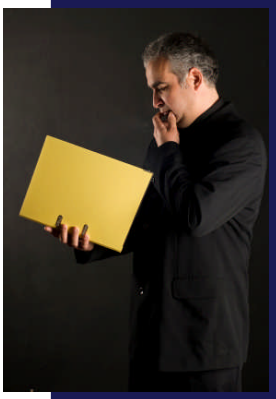
The Arguments and Findings:

The petitioners argued that there was no express or implied agreement with Mr. Malkin to retain economic benefits of the property he transferred to the FLPs. However, the Court concluded, after review of all pertinent facts, that because the D&PL stock had been pledged by Mr. Malkin as collateral on a personal loan, there was indeed an implied agreement as he retained the "right to use that transferred stock". Furthermore, because the decision to pledge said stock had been approved by both Mr. Malkin and the FLP trustees, but was not "a

business decision made at arm's length" the D&PL stock was held to be an asset of the estate under Section 2036(a)(1) of the Code.

In addition, the Court determined that there was no significant nontax reason for using the stock as collateral even though the estate claimed there was a bona fide sale of the stock.

Furthermore, the Court determined that any claimed sale of a partnership interest "was a sham" and as a result, the transfer of shares of D&PL were essentially indirect gifts to the children and as a result the transfers were treated as gifts in each case.



The Court did permit the deduction of the nearly $13 million dollar debt to Morgan Guaranty, as a nonrecourse debt, but only to the extent of its collateral value.

Parting Thoughts:

Another case where putting the "cart ahead of the horse" came back to bite the taxpayer. The decedent made indirect gifts because the chronological order of establishing the FLPs and creating the trusts, funding the FLPs or LLCs and then transferring the interests was not followed.

Cubs Corner: My 40th birthday present from my wife was a week at the Cubs Fantasy Camp in Mesa with my brother. Wow, what an experience! The camp is a week long camp where you live the life of a major leaguer playing baseball at their Fitch Park facilities in Mesa . The coaches of my team were Jody Davis and Jose Cardinal—who ended up being two of the nicest guys I've ever met. Other coaches at the camp included Lee Smith (see picture), Willie Wilson, Todd & Randy Hundley, Leon Durham, Glenn Beckert, Don Kessinger, Rick Reuschel, Pete LaCock, Ed Lynch, Ron Coomer, Bob Dernier , Keith Moreland and a few others. We also played the San Francisco Giants fantasy campers one day (coaches of the Giants team we played were Gary Matthews and Jack Clark) and on the last day we faced the ex-major leaguers in a game at Ho Ho Kam park. We played 11 games over 5 1/2 days so everyone was extremely sore and always in the training room getting treatment from the Cubs professional trainers. Ron Santo was even there for a few of the days—which was a personal highlight for myself. I also enjoyed listening to all of the stories from the ex-major leaguers. The experience gave me a much different perspective and respect for what these guys go through. I had a productive week at the plate and in left field and then in my one at bat in the big game against the ex-major leaguers I faced Ed Lynch and lined out to Ron Coomer at shortstop. So, in my career, I will end up 0 for 1 with a lineout. I was hoping to get an invite to Spring Training but that didn't happen so I'll stick to business appraisal and let the real players try and break the 102 year World Series drought this year! More on the new season in the next issue!

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www.mackbusinessappraisals.com

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About Mack Business Appraisals, LLC

Mack Business Appraisals, LLC provides expert business valuation services to businesses across the United States for various purposes including, but not limited to: gift and/or estate tax, merger and acquisition, ESOP's, buy-sell agreements, S-corporation election, SBA funding, stock option granting and management planning purposes. Mack Business Appraisals, LLC also has extensive experience in valuing family limited partnerships (FLP's) and limited liability companies (LLC's) for gift and estate tax purposes. We have built a strong reputation of providing superior service, technical expertise, and a commitment to excellence. Unlike many multi-disciplinary valuation firms, we focus our expertise on one area - business valuation.

John G. Mack, ASA, CBA, is the managing member of Mack Business Appraisals, LLC. Mr. Mack is a 1993 graduate of the University of Iowa with a Bachelor's degree in Finance from the College of Business Administration. Mr. Mack is an accredited member of the American Society of Appraisers (ASA), Business Valuation Discipline, and has also attained the Certified Business Appraiser (CBA) designation offered by the Institute of Business Appraisers. Inc.

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