



Trusts & Estates Client Alert

BEIJING FRANKFURT HONG KONG LONDON LOS ANGELES MUNICH NEW YORK SINGAPORE TOKYO WASHINGTON, DC

Please read the important information relating to U.S. tax advice at the end of this Client Alert.

As you know, we are in the midst of a very challenging time. Financial markets have lost value and interest rates are at historically low levels. The possibility exists for adverse tax law changes that may affect estate planning. These unprecedented times offer an opportunity to consider transferring wealth to future generations, and we wanted to bring to your attention certain estate planning strategies which you may wish to consider and/or implement. In addition, we wanted to alert you to changes to certain transfer tax exemption amounts and the ability to donate certain individual retirement assets to charity.

Estate Planning Techniques

Our troubled economy places us in a very unique situation. Interest rates are low and equities, real estate and other investments are currently at very depressed values. In light of this financial environment and possible adverse tax law changes including unfavorable changes related to grantor retained annuity trusts (GRATs), you may want to consider the following estate planning opportunities.

As you may be aware, a GRAT is an estate planning technique where the grantor transfers assets to a trust and retains an annuity payment for a period of years. The annuity payment is a dollar amount calculated as a percentage of the GRAT's initial value that may increase up to 20% each year. The annuity is based on a growth rate determined monthly by the IRS, which for the month of November is 3.6%. Only the value of the remainder interest in the GRAT is subject to gift tax at the time that the GRAT is established, and depending on how the GRAT is structured, this cost can be minimal. To the extent the assets remaining in the GRAT outperform the growth rate, the excess growth is effectively passed to the grantor's beneficiaries without the imposition of additional gift or estate tax. Please see an illustration of how the GRAT can be used for effective estate planning on page 3.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Trusts & Estates Group.

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel.

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Another technique to consider is a charitable lead trust, or CLT, where the charitable beneficiary, which can be your private foundation, receives an annuity interest (a fixed dollar amount calculated as a percentage of the CLT's initial value) or unitrust interest (a fixed percentage of the CLT's annual value) and the non-charitable beneficiaries receive the remainder interest. A CLT can be used to reduce estate taxes and pass wealth to children and grandchildren at potentially minimal gift tax cost while also satisfying your philanthropic objectives. Similar to a GRAT, the annuity or unitrust interest is calculated using the IRS growth rate, and any appreciation over that rate effectively passes to future generations without additional gift or estate tax.

With a tighter credit market, you may also be considering making loans to family members. Loans, which are made with the expectation of repayment, may be made without gift tax consequences to family members at an IRS approved interest rate (known as the Applicable Federal Rate), which for loans made in November lasting less than three years is 1.62%, for loans lasting three years but less than nine years is 2.95%, and for loans lasting nine years or more is 4.2%. In addition to providing funds to family members at rates lower than those offered by most banks, if loan proceeds outperform these rates, the borrower receives an effective tax-free gift of that outperformance.

Gift and Estate Tax Exemptions

Please be advised that the gift tax annual exclusion amount will increase on January 1, 2009 to \$13,000 from \$12,000, increasing the amount you can give each year to any individual free of gift tax. The gift tax annual exclusion for gifts to noncitizen spouses will also increase in 2009 to \$133,000 from \$128,000.

Also, effective January 1, 2009, the estate and generation skipping tax exemptions will increase to \$3.5 million.

You may want to contact us to discuss how best to make use of these increased exemption amounts.

Charitable Giving from Individual Retirement Accounts (IRAs)

The Emergency Economic Stabilization Act, passed on October 3, 2008, extends through the end of 2009 the ability of certain persons to make tax-free distributions from IRAs for charitable purposes. An IRA owner who has attained the age of 70 1/2 can directly transfer up to \$100,000, free of tax, per year to an eligible charitable organization. This provision was set to expire for tax years ending December 31, 2007.

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In the current financial environment these techniques, as well as others, can help you successfully pass wealth to future generations at considerable tax savings. We would be pleased to discuss these estate planning opportunities with you.

Jonathan G. Blattmachr	212-530-5066	jblattmachr@milbank.com
Georgiana J. Slade	212-530-5616	gslade@milbank.com
James S. Sligar	212-530-5839	jsligar@milbank.com
Jay Swanson	212-530-5396	jswanson@milbank.com

GRAT Illustration

1. Assumptions

- a. Date Created: November, 2008
- b. Internal Revenue Code § 7520 Rate: 3.6%
- c. Trust Contribution: \$10,000,000
- d. Annuity: First-year annuity payment equal to approximately 47.953% (\$4,795,300) of initial trust contribution and second-year annuity payment equal to approximately 57.543% (\$5,754,300) of initial trust contribution. The annuity amount increases by 20% in the second year so that the remainder will be equal to approximately \$10,000 for gift tax purposes at the time property is transferred to the trust.
- e. Payments: Annually
- f. Annual Growth of GRAT: The assets in the GRAT are assumed to grow at 20% each year.
- g. The trust is a “grantor trust”, which means that all income (i.e., dividends, interest and capital gains) of the trust will be taxed to you, but you will not pay any additional income tax on the annuity amounts distributed to you from the GRAT.

2. Computation:

Year	Beginning Principal	Growth	GRAT Value Before Annual Payment	Annual Payment	Remainder
1	\$10,000,000	\$2,000,000	\$12,000,000	\$4,795,300	\$7,204,700
2	\$7,204,700	\$1,440,940	\$8,645,640	\$5,754,300	\$2,891,340

Amount transferred to the remaindermen
(i.e., your children, other family members
or friends) at the end of the trust term → \$2,891,340

The initial value of the GRAT is \$10,000,000. During Year 1, the trust grows at 20% (\$2,000,000). At the end of Year 1, the GRAT pays you the Year 1 annuity payment of \$4,795,300 (which is 47.953% of \$10,000,000), leaving \$7,204,700 in the GRAT at the end of Year 1.

At the beginning of Year 2, the GRAT holds \$7,204,700 in assets. During Year 2, the trust grows at 20% (\$1,440,940). At the end of Year 2, the GRAT pays you the Year 2 annuity payment of \$5,754,300 (which is 57.543% of \$10,000,000), leaving \$2,891,340 in the GRAT. This amount will be held in further trust for the benefit of the remaindermen (i.e., your children, other family members or friends), as provided in the trust agreement.

Statement About Circular 230

Recent amendments to a Treasury Department regulation, known as Circular 230, require lawyers and accountants to follow strict rules in issuing a written statement about a Federal tax issue. The most onerous rules of compliance under §10.35 of the Circular involve written advice about so-called Listed Transactions, arrangements that have tax avoidance as their principal purpose and what are called Marketed Opinions. We do not believe any issue discussed in this memorandum relates to a Listed Transaction. We believe the tax benefit sought is consistent with the Internal Revenue Code of 1986 as amended (Code) and Congressional purpose. That means the principal purpose is not tax avoidance. We also believe no issue discussed herein is a significant Federal tax issue – meaning that we believe the IRS does not have a reasonable basis for a successful challenge on the overall Federal tax treatment of the issues discussed in this memorandum. That means we do not think this memorandum must comply with §10.35 of the Circular. Nevertheless, we add the following statements to ensure compliance with said §10.35. Notwithstanding these statements, we believe the conclusions reached herein are correct.

1. The written advice contained in this memorandum is not intended or written by us to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties.
2. No one may use any part of this memorandum in promoting, marketing or recommending an arrangement relating to any Federal tax issue to any taxpayer.
3. Nothing herein shall be construed to impose a limitation on disclosure by any person of the tax treatment or tax structure of any transaction that is addressed herein.

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For more information about Milbank and its practices, please visit our website at www.milbank.com.

Beijing

Units 05-06, 15th Floor
Tower Two, China Central Place
79 Jianguo Rd, Chaoyang
Beijing 100025, China
+8610-5969-2700

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main
Germany
+49-69-71914-3400

Hong Kong

3007 Alexandra House
18 Chater Road
Central, Hong Kong
+852-2971-4888

London

10 Gresham Street
London EC2V 7JD England
+44-20-7615-3000

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017
+1-213-892-4000

Munich

Maximilianstrasse 15
80539 München, Germany
+49-89-25559-3600

New York

One Chase Manhattan Plaza
New York, NY 10005
+1-212-530-5000

Singapore

30 Raffles Place
#14-00 Chevron House
Singapore 048622
+65-6428-2400

Tokyo

21F Midtown Tower
9-7-1 Akasaka
Minato-ku
Tokyo 107-6221
+81-3-5410-2801

Washington, DC

International Square Building
1850 K Street, N.W., Suite 1100
Washington, DC 20006
+1-202-835-7500