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USE OF DEFINED-VALUE CLAUSES (AND ALTERNATIVES) IN TRANSFERS OF CLOSELY-HELD BUSINESS INTERESTS

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DEFINED–VALUE TRANSFERS

I. INTRODUCTION - FORMULAIC TRANSFERS.

Gift, estate, and generation transfer taxes focus on the value of property rights transferred, whether by gift, sale, or testamentary disposition. Big dollars can be at stake because the transfer tax rate is way too high (currently 45%) and many clients have done a great job of getting rich (a loaded term). Cash available to pay the transfer tax can be scarce even for the wealthiest of families. Uncertainty regarding the amount of that tax is a huge risk that makes planning difficult at best.

In the case of hard-to-value assets, well advised taxpayers spend a great deal of time and money securing opinions from valuation experts in order to support their positions for transfer tax purposes. The future of a family business or trophy property may hang in the balance. In response, the Internal Revenue Service (the "IRS" or the "Service") often takes aggressive, contrary positions that are not supported by a valuation expert's opinion, particularly at the audit level. Even at trial, expert opinions put forth by the IRS can be extreme (*see* the comment by the 5th Circuit in *McCord*, discussed below).

Many clients and their families are not well suited for the rigors of an IRS audit or simply would prefer to avoid it. The prospect of a trial can be even worse, regardless of the venue. Even where valuation positions are imminently reasonable, the prospect of a fight with the IRS is not welcome in many cases.

It is against this backdrop that estate planners, for a very long time, have sought to achieve some tax certainty for clients by using formulaic transfers. The issue is particularly important for ownership interests in a valuable closely-held business or real property. Indeed, some families and practitioners intentionally create hard-to-value assets for transfer tax purposes in the form of interests in a family limited partnership or limited liability company.

The law on formulaic transfers, depending on their type, is still developing. Furthermore, even where appropriate formulaic transfers are at issue, the IRS continues to fight against valuations that are perceived to be abusive (*i.e.*, too low), as well as the formulaic transfer technique itself. In the typical valuation audit (or trial), the taxpayer simply argues that the value determined by his appraiser is correct. The taxpayer has a "split the baby" negotiation on his hands against the IRS, often with the IRS having not obtained an objective third-party appraisal at all. With a formula transfer clause, the taxpayer has additional arguments beyond pure valuation. The IRS sometimes fights both the valuation and the transfer technique, but there can be a benefit for a taxpayer in having two issues on the table. Two recent taxpayer victories bring the issues to the forefront at the present time: *Succession of Charles T. McCord, Jr., et al v. Commissioner*, 461 F.3d 614 (5th Cir. 2006) and, more recently, *Estate of Christensen v. Commissioner*, 130 T.C. No. 1 (2008).

Formulaic transfer clauses generally are designed to limit transfer tax exposure either by (1) adjusting the property transferred or the consideration to be received based on the value "finally determined for tax purposes" (an adjustment clause) or (2) specifying the dollar value of a property interest transferred (a defined-value clause). *See* Stephen T. Dyer, Carlyn S.

McCaffrey, and John W. Porter, *The Christiansen Case and the Use of Formula Clauses*, ABA Section of Real Property, Trust and Estate Law Teleconference (March 26, 2008); and Carlyn S. McCaffrey, *Formula Valuation--Shield Against Gift Tax Risk or Invitation to Audit*, 42nd Annual Philip E. Heckerling Institute on Estate Planning (January 16, 2008).

This outline reviews the relevant authorities in the area and discusses transfer planning techniques, benefits, and pitfalls. This outline also discusses some of the differences between *inter vivos* transfers utilizing formulaic transfer techniques as compared to transfers at death using the techniques.

II. NON-JUDICIAL AUTHORITIES.

Almost all estate planners use a formulaic transfer technique of one sort or another in connection with lots of different estate planning transactions. One of the most common involves funding a marital trust and a bypass trust under a will (pecuniary, reverse pecuniary, minimum worth, etc.). As noted below, many techniques are expressly sanctioned in the Treasury Regulations or other IRS pronouncements.

Following is an excerpt from my firm's reply brief to the 5th Circuit for our clients in *McCord* that, due to page limits imposed by the Court in that case, succinctly noted some of the more important sources of authority:

> Although the Government attempts to sidestep the point, the fact is that formula transfers are commonly used and specifically sanctioned in a number of lifetime and testamentary transfer situations to avoid the imposition of gift, estate, and generation-skipping transfer taxes. The standard unified credit bequest combined with a marital deduction bequest for the benefit of a surviving spouse is a common use of a value definition clause. The IRS specifically sanctioned these types of clauses in Revenue Procedure 64-19, 1964-1 CB 682. Likewise, a bequest of a transfer of unused federal generation-skipping transfer ("GST") tax exemption is another common valuation definition clause. GST tax regulations specifically sanction using formula allocations of the GST tax exemption to ensure that a generation-skipping transfer is exempt from GST tax or that a generation-skipping trust has an inclusion ratio of zero. Treas. Reg. §§ 26.2632-1(b)(2)(ii) (lifetime transfers), 26.2632-1(d)(1) (testamentary transfers). The Treasury Regulations also specifically sanction disclaimers (unqualified refusals to accept property) using formula language – Example 20 of Treas. Reg. § 25.2518-3(d) delineates a fractional disclaimer amount with a numerator equal to the smallest amount that will allow the Estate to pass free of federal estate tax and a denominator equal to value of the decedent's residuary estate. *See also* T.A.M. 8611004 (November 15, 1985).

Other important sources of authority involve grantor retained annuity trusts ("GRATs") and charitable split interest trusts. In the case of the statutory requirement that a GRAT's annuity, in order to be a "qualified interest" under §2702 of the Internal Revenue Code, must convey "the right to receive fixed amounts payable not less frequently than annually," the Treasury Regulations indicate that "[a] fixed amount means...[a] stated dollar amount...or [a] fixed fraction or percentage of the initial fair market value of the property transferred to the trust, as finally determined for federal tax purposes." Treas. Reg. §25.2702-3(b)(1)(ii). Then, the Regulations go on to provide for the consequences of an incorrect valuation of trust property in the case where the annuity is expressed as a percentage of the value as finally determined for tax purposes. Specifically, the Regulations provide that "[i]f the annuity is stated in terms of a fraction or percentage of the initial fair market value of the trust property, the governing instrument must contain provisions meeting the requirements of §1.664-2(a)(1)(iii) of this chapter (relating to adjustments for any incorrect determination of the fair market value of the property in the trust)." Treas. Reg. §25.2702-3(b)(2). The Regulations governing charitable remainder annuity trusts, as referenced in those governing GRATs, provide as follows:

> The stated dollar amount may be expressed as a fraction or a percentage of the initial fair market value of the property irrevocably passing in trust as finally determined for Federal tax purposes. If the stated dollar amount is so expressed and such market value is incorrectly determined by the fiduciary, the requirement of this subparagraph will be satisfied if the governing instrument provides that in such event the trust shall pay to the recipient (in the case of an undervaluation) or be repaid by the recipient (in the case of an overvaluation) an amount equal to the difference between the amount which the trust should have paid the recipient if the correct value were used and the amount which the trust actually paid the recipient. Such payments or repayments must be made within a reasonable period after the final determination of such value.

Treas. Reg. §1.664-2(a)(1)(iii). *See also* Treas. Reg. §1.664-3(a)(1)(iii); Rev. Rul 72-392, 1972-2 C.B. 340, modified by Rev. Rul. 80-123, 1980-1 C.B. 205; Rev. Rul. 82-128, 1982-2 C.B. 71; and Tech. Adv. Memo. 8611004 (Nov. 15, 1985).

There also are plenty of commentators who have written on the subject. The seminal article, and a principal source of my firm's analysis in structuring the *McCord* transaction in 1995, is McCaffrey and Kalik, *Using Valuation Clauses to Avoid Gift Taxes*, 125 Trusts and Estates 47 (October 1986). Everyone should review Carlyn McCaffrey's wonderful writings on the subject. *See* Carlyn S. McCaffrey, *Formula Valuation--Shield Against Gift Tax Risk or Invitation to Audit*, 42nd Annual Philip E. Heckerling Institute on Estate Planning (Jan. 16, 2008); and Carlyn S. McCaffrey, *Tax Tuning the Estate Plan by Formula*, 33 U. OF MIAMI INST. ON EST. PLANNING 4 (1999). *See also* Stephen T. Dyer, Carlyn S. McCaffrey, and John W. Porter, *The Christiansen Case and the Use of Formula Clauses*, ABA Section of Real Property, Trust and Estate Law Teleconference (March 26, 2008).

As stated by former IRS Commissioner Shirley D. Peterson:

> Savings clauses are familiar tools in the estate planner's kit. They are frequently employed to help protect against unintended results, and have traditionally been employed in complex areas of the law in which inadvertent errors may arise. The perpetuities savings clause is a common example of how savings clauses are used to guard against an unexpected violation of a rule.

> In recent years, savings clauses have become increasingly popular among practitioners in the tax context, especially with respect to the marital and charitable deductions and valuation issues. Although the Service has generally displayed a hostile attitude toward the use of tax savings clauses, carefully drafted savings clauses continue to be important drafting tools. As the tax law becomes increasingly complex and the risk of error becomes increasingly hazardous, the importance of savings clauses grows. The newly-revised and 'simplified' generation-skipping tax and the valuation penalties under §§ 6659 and 6660 are examples of the complex and 'hazardous' sides of the tax law...
>
> Both the Service and the courts are more likely to give effect to savings clauses that do not attempt to revoke or alter a completed transaction. Clauses which explicate the testator's or parties' intent and thus serve as an aid in the interpretation of the document are more likely to be acceptable to both the Service and the courts. And, while 'definition' clauses are largely untested in the context of savings clauses, McCaffrey and Kalik make a persuasive argument for their viability.

Shirley D. Peterson, *Savings Clauses in Wills and Trusts*, 13 EST., GIFTS TR. J. 83 (1988). *See also* Malcolm A. Moore, *Attempting to Achieve Finality in Potentially "Open" Transactions*, 29 U. OF MIAMI INST. ON EST. PLANNING 13 (1995); Dan W. Holbrook, *Value Definition Clauses: Reducing the Uncertainty of Gift and Estate Valuation and the Hazard of Audit*, SINGLETON WOLFE MEMORIAL FEDERAL TAX CONFERENCE (October 26, 2000).

III. ADJUSTMENT CLAUSES.

In the category of adjustment clauses (to be distinguished from defined-value clauses), there are generally two types. The first provides that if it is finally determined for transfer tax purposes that the value of the transferred property exceeds a specified dollar amount (*e.g.*, by agreement with the IRS or by a court decision), then the size of the transferred interest is reduced, such that the value of the property transferred equals the specified dollar amount. The second type of adjustment clause, rather than adjusting the size of the transferred interest *per se*, requires the transferee to return additional consideration to the transferor equal to the difference between the value of the interest as finally determined for transfer tax purposes and the specified dollar amount.

The IRS generally has taken the position that adjustment clauses should be ignored for transfer tax purposes. The primary argument is that such a clause is contrary to good public policy because it is a condition subsequent in a transaction that renders any audit or litigation regarding value meaningless (even though collecting increased taxes is not the Service's only role in an audit). The IRS argues that adjustment clauses waste both its time and the court's time, because once a determination is made that value is higher than the taxpayer believed, the formula clause adjusts the transaction so that transfer tax is avoided. Taxpayers assert that such clauses provide the taxpayer with certainty as to the tax amount and are designed with the objective of avoiding valuation disputes. Several adjustment clauses have been tested in the courts, with the results generally favoring the IRS.

An adjustment clause was first addressed in *Comm'r v. Procter*, 142 F.2d 824 (4th Cir. 1944). In *Procter*, the taxpayer provided in the transfer document that if it were determined by a final judgment of a court of last resort that any part of the transfer was subject to gift tax, the property subject to gift tax would be deemed excluded from the transfer and would remain the transferor's property. The Fourth Circuit held that the structure did not eliminate the taxable gift because it imposed a condition subsequent that violated public policy. The Court determined that the provision would be "trifling with the judicial process" (*id.* at 827) and would inhibit tax collection since attempts to enforce the tax would defeat the gift. Moreover, the Court held that giving effect to the provision would obstruct justice because courts would have to pass on a tax issue that becomes moot once the decision is rendered.

Similarly, in *Ward v. Comm'r*, 87 T.C. 78 (1986), the taxpayer made a gift of shares of stock of a closely-held corporation in which the donor reserved the right to revoke the gift to the extent the value of each share was "finally determined for federal gift tax purposes" to exceed $2,000. The Tax Court determined that the transaction was a gift subject to a power of revocation exercisable upon the occurrence of an event beyond the control of the donor. Because the donor had no control over the possible revocation of the gift, the Court determined that the donor parted with all dominion and control over the transferred property and that there was a completed gift of the entire property. The Court also indicated that the clause violated public policy under the analysis set forth in *Procter*.

The Tax Court also ignored adjustment clauses in *Harwood v. Comm'r*, 82 T.C. 239 (1984), *aff'd*, 786 F.2d 1174 (1986), and *Estate of McLendon v. Comm'r*, 66 T.C.M. (CCH) 946 (1993), *rev'd on other grounds*, 77 F.3d 477 (5th Cir. 1995).

There is an important taxpayer victory in a case involving an *inter vivos* transfer with an adjustment clause that took the form of a consideration adjustment, rather than a transfer adjustment. In *King v. United States*, 545 F.2d 700 (10th Cir. 1976), the taxpayer sold stock to trusts for his children for $1.25 per share, a price the taxpayer believed to be equal to its then fair market value. The governing agreement provided that "if the fair market value . . . as of the date of . . . [the agreement] is ever determined by the Internal Revenue Service to be greater than the fair market value determined in the . . . manner described above, the purchase price shall be adjusted to the fair market value determined by the Internal Revenue Service." 545 F.2d at 703-704.[1] The IRS took the position that the shares were worth more than $1.25 per share, and that the price adjustment clause was ineffective. The Tenth Circuit rejected the government's argument, holding that the taxpayer had not made a taxable gift. The Court distinguished the case from *Procter* because the sole purpose of the *Procter* clause was to rescind the transaction in the event it was determined to be a taxable gift. The *King* court stated:

> We believe that the IRS reliance on *Procter*, supra, is misplaced. Here, there was at no time or in any way an attempt to alter or negate the plain terms of the valuation clause and no attempt by the trustees was made to reconvey the stock to King or to cancel the notes in anticipation of an

[1] Note the similarity of the adjustment clause in *King* to the adjustment of annuity payments under the Regulations in the case GRATs and charitable remainder annuity trusts. Treas. Reg. § 25.2702-3(b)(2) and Treas. Reg. § 1.664-2(a)(1)(iii), discussed above in this outline.

> unfavorable valuation ruling. Authorities relied upon by the Government dealing with contingencies which, upon fruition, alter, change or destroy the nature of the transaction do not apply here. The proviso for adjustment of the purchase price of the stock to equal its fair market value did not affect the nature of the transaction.

Id. at 705.

The IRS has taken a view opposed to *King* in Revenue Ruling 86-41, 1986-1 C.B. 300, based on *Procter* and Revenue Ruling 65-144, 1965-1 C.B. 422.

The IRS argued *Procter* and *Ward* in the case of *Knight v. Commissioner*, 115 T.C. 506 (Nov. 30, 2000). In the *Knight* case, the transfer documents transferred partnership units with the following language:

> Transferor irrevocably transfers and assigns to each Transferee above identified, as a gift, that number of limited partnership units in Herbert D. Knight Limited Partnership which is equal in value, on the effective date of this transfer, to $600,000.

Unfortunately, the Tax Court resolved the issue without dealing with the defined-value gift implications, as follows:

> We need not decide whether *Procter* and *Ward* control here because we disregard the stated $300,000 gift value for other reasons. First, petitioners reported on their gift tax returns that they each gave two 22.3-percent interests in the partnership. Contrary to the transfer document, they did not report that they had given partnership interests worth $300,000. We believe this shows their disregard for the transfer document, and that they intended to give 22.3-percent interests in the partnership.
>
> Second, even though petitioners contend that respondent is limited to the $300,000 amount, i.e., that the gifts were for $300,000 and thus cannot be worth more than $300,000, petitioners contend that the gifts are each worth less than $300,000. In fact, petitioners offered expert testimony to show that each gift was worth only $263,165. We find petitioners' contentions to be at best inconsistent. We treat petitioners' contention and offer of evidence that the gifts were worth less than $300,000 as opening the door to our consideration of respondent's argument that the gifts were worth more than $300,000.

Knight at 515-516 (footnotes omitted).

In another case, Judge Laro relied on *Procter* and *Ward* to invalidate a savings clause in a GRAT. *Focardi v. Commissioner*, T.C. Memo 2006-56. The GRAT in question had employed a contingent spousal interest, and in the event that the interest was disregarded, the taxpayer sought to rely on a savings clause, as follows:

> Petitioners argue alternatively that this Court, if we conclude that the spousal interests in the GRATs are not qualified interests, must disregard those interests in that the instruments establishing the GRATs state as much. Petitioners point the Court to Article Five D, which states that "No power, right, or duty under the agreement will be effective or exercisable to the extent that it would cause my retained annuity interest (or my wife's [husband's] interest, if any) hereunder to fail to qualify as a 'qualified annuity interest' under I.R.C. § 2702(b)(1)". Petitioners assert that the quoted text operates to invalidate the spousal interests in that those interests are not qualified interests. Petitioners conclude that each GRAT is now simply a GRAT for a set term of either 2 or 4 years, as the case may be, and should be treated as such.
>
> We reject petitioners' alternative argument. We do not believe that petitioners are entitled at this time to treat each GRAT in issue as one of a set term of years simply because the GRATs state that our determination that the spousal interests are not qualified interests essentially means that the spousal gift is revoked. Such a "savings clause" is ineffective for Federal transfer tax purposes, and we give it no respect.

Focardi (citing *Procter, Ward*, *Harwood*, and Rev. Rul. 65-144).

IV. DEFINED-VALUE TRANSFERS BY GIFT - MCCORD.

Defined-value transactions involve an attempt to avoid IRS disputes just like adjustment clauses, but in a different way. Rather than adjusting the transfer itself (or the consideration involved), a defined-value transaction specifies the value of the transferred property at the time of the transfer. For example, if a transferor wants to give a $1 million interest in an entity to a child, the transfer document would specify that the transferor assigns to his child that number of shares having a fair market value of $1 million on the date of the gift. Some defined-value transactions have been structured where the value referenced is the value as finally determined for tax purposes, and some have involved layering in a third-party (like a charity, as in *McCord*) or a no-tax or low-tax recipient (like a grantor retained annuity trust, a spouse, or an incomplete gift trust). Some have done both (like *Christiansen*).

Until recently, the IRS either had not seen or simply had not focused on value definition clauses. But in FSA 200122011, the IRS took the position that value definition clauses are also void against public policy, under the same theories as set forth in *Procter*, *Ward*, and their progeny.

The application of *Procter* and *Ward* to value definition clauses was directly at issue in *McCord v. Comm'r*, 120 T.C. 358 (2003). My firm handled the *McCord* transaction from its inception through its successful defense, and I was fortunate to work on it the entire time. In *McCord*, the taxpayers made a gift of their 82% limited partnership interest to a group consisting of their sons, trusts for the benefit of each son's family, and two charities. The gift used a defined-value clause in which Mr. and Mrs. McCord specified that their sons and the trusts, collectively, had the right to receive a portion of the 82% interest with a fair market value of

$6.9 million, and the remaining portion passed to the charities. Mr. and Mrs. McCord had substantial charitable intent. They left it up to the group of donees to split the 82% interest based on the pecuniary formula. They completely "washed their hands" of the transferred property. After the gift, and after the appraisal was completed, the donees entered into an arm's length agreement splitting the 82% interest (it was called a "Confirmation Agreement"). Later, the partnership redeemed the charities' interests, at a time when neither of the donors owned an interest in the partnership.

The IRS argued that the value of the 82% interest was way more than the appraisal indicated. Relying on *Procter*, the IRS also sought to ignore the defined-value structure. The taxpayers argued that the appraisal was correct and further that the structure should be respected, because gift tax should be based on state law property rights (*see United States v. Bess*, 357 U.S. 51 (1958)). The taxpayers noted that the property transferred to the sons and the trusts was the right to receive, collectively, interests in the partnership having a fair market value of $6.9 million. Thus, the value of the gift to the sons and the trusts was $6.9 million.

The taxpayers pointed out that similar transfers are commonly used in other areas and have been approved by the IRS (as noted above in this outline). A donor can define the amount subject to tax and ensure that the rest is either entitled to a deduction or is not taxable. *See*, *e.g.*, Rev. Proc. 64-19, 1964-1 C.B. 682 (defined-value formula for funding a marital gift). *See also* Treas. Reg. 25.2518-3(c) (defined-value formula for a pecuniary disclaimer). Similarly, the Treasury Regulations specifically sanction using formula allocations of GST exemption. *See* Treas. Reg. §§ 26.2632-1(b)(2), 26.2632-1(d)(1). Likewise, the Regulations permit formula clauses in determining the charitable amount under a charitable trust. Treas. Reg. § 1.664-2(a)(1)(iii) (percentage of initial fair market value as finally determined for federal tax purposes); Treas. Reg. § 1.664-3(a)(1)(iii) (adjustments in annuity amounts if incorrect determination of fair market value). *See also* Rev. Rul. 72-392, 1972-2 C.B. 573, 344, modified by Rev. Rul. 80-123, 1980-1 C.B. 205; Rev. Rul. 82-128, 1982-2 C.B. 71. The IRS has even recognized the validity of a defined-value clause in one of its pronouncements. T.A.M. 8611004 (Nov. 15, 1985).

In *McCord*, the taxpayers distinguished *Procter* and its progeny because those cases involved adjustment clauses that changed the terms of a gift *after the gift was made*. Contrasting the case with *Procter*, the taxpayers noted that the value of the interests transferred under the *McCord* defined-value clause to the sons and the trusts was readily determinable and not subject to change. By design, the value of the transfer to the sons and the trusts was not to be affected by any determination by a court or the IRS. It was intentional that the defined-value clause did not refer to values as finally determined for tax purposes. Commentators who suggest otherwise are missing the point. Neither the McCords nor their sons wanted the IRS to change who would own what percentage interest in the partnership, as would be the case with a "finally determined" approach. For the sons to negotiate how to split the 82% partnership interest with the charities was a completely different thing, given the disparity in the IRS's unrealistic view of valuation and the more realistic views of others, including charities.

As noted, a formulaic transfer clause gives a taxpayer additional arguments in a valuation dispute. In *McCord*, the defined-value clause provided two arguments in particular (in addition to arguing the appraisal itself): (i) the fair market value of the gift to the "taxable" donees, based on state law property rights, was fixed by the defined-value clause; and (ii) the best evidence of value is derived from an arm's-length transaction (here, the value agreed upon by all of the donees, two of which were independent charities, when splitting the 82% interest).

On May 14, 2003, the Tax Court issued its opinion in *McCord v. Comm'r*, 120 T.C. 358 (2003). Importantly, the Tax Court rejected the IRS's effort to limit the charitable deduction to the amounts the charities received under the substance over form doctrine, public policy considerations, and the integrated transaction doctrine. Unfortunately, a majority of the Tax Court found that the charities received a partnership interest equal to 5.1208888% and then put their own value on that interest. This percentage interest was the percentage accepted by the charities under the "confirmation agreement" signed by all of the donees a few months after the partnership interests were given away by the McCords. Remember that Mr. and Mrs. McCord were not parties to the confirmation agreement. The majority's decision interpreted the assignment agreement under Texas law. Specifically, the Court stated as follows:

> Whenever the concept of "property" is relevant for Federal tax purposes, it is State law that defines the property interest to which Federal tax consequences attach. *E.g.*, *United States v. Craft*, 535 U.S. 274, 278-279 (2002) (Federal tax lien attaches to property held, under State law, as tenants by the entireties). Thus, in order to determine the Federal gift tax consequences that attach to petitioners' assignment of the gifted interest, we look to applicable State law to determine the extent of the rights transferred. Because petitioners transferred interests in a Texas limited partnership, Texas law governs our determination in that regard. . .
>
> . . .In essence, petitioners contend that because (1) they transferred to CFT [the residual charity] a portion of the gifted interest corresponding to the excess of the fair market value of that interest over $7,044,933, and (2) we have determined the fair market value of the gifted interest to be $9,883,832, it follows from the maxim beginning this paragraph that they are entitled to a charitable contribution deduction in the amount of $2,838,899 for their gift to CFT. Because the assignment agreement does not equate the term "fair market value" with the term "fair market value as finally determined for Federal gift tax purposes," petitioners' [property law] argument must fail. . .
>
> . . .By way of the assignment agreement, petitioners transferred to CFT the right to a portion of the gifted interest. That portion was not expressed as a specific fraction of the gifted interest (*e.g.*, one-twentieth), nor did petitioners transfer to CFT a specific assignee interest in MIL (*e.g.*, a 3-percent assignee interest). Rather, CFT was to receive a fraction of the gifted interest to be determined pursuant to the formula clause contained in the assignment agreement. The formula clause provides that CFT is to receive that portion of the gifted interest having a fair market value equal to the excess of (1) the total fair market value of the gifted interest, over (2) $7,044,933. The formula clause is not self-effectuating, and the assignment agreement leaves to the assignees the task of

> (1) determining the fair market value of the gifted interest and (2) plugging that value into the formula clause to determine the fraction of the gifted interest passing to CFT. . .
>
> . . .The assignment agreement provides a formula to determine not only CFT's fraction of the gifted interest but also the symphony's and the children's (including their trusts') fractions. Each of the assignees had the right to a fraction of the gifted interest based on the value of that interest as determined under Federal gift tax valuation principles. If the assignees did not agree on that value, then such value would be determined (again based on Federal gift tax principles) by an arbitrator pursuant to the binding arbitration procedure set forth in the partnership agreement. There is simply no provision in the assignment agreement that contemplates the allocation of the gifted interest among the assignees based on some fixed value that might not be determined for several years. Rather, the assignment agreement contemplates the allocation of the gifted interest based on the assignees' best estimation of that value. Moreover, each of the assignees' percentage interests was determined exactly as contemplated in the assignment agreement (without recourse to arbitration), and none can complain that they got any less or more than petitioners intended them to get. Had petitioners provided that each donee had an enforceable right to a fraction of the gifted interest determined with reference to the fair market value of the gifted interest as finally determined for Federal gift tax purposes, we might have reached a different result. However, that is not what the assignment agreement provides. . .
>
> . . .Of course, the assignees' determination of the fair market value of the gifted interest, while binding among themselves for purposes of determining their respective assignee interests, has no bearing on our determination of the Federal gift tax value of the assignee interests so allocated. . .

120 T.C. at 370-98.

The majority thus decided that the McCords were entitled to a charitable deduction equal to $594,743. Understand that this amount of charitable deduction is <u>*higher*</u> than the amount claimed on the gift tax return. It also exceeds the amount of cash ultimately paid to the charities when their interests were redeemed by the partnership six months after the gift.

Judges Laro and Vasquez dissented. They would have allowed a deduction only for the amount actually received by the charities in the redemption, based on the common law arguments that the majority rejected.

Judges Chiechi and Foley (the trial judge) concurred in part and dissented in part. They rejected the majority's interpretation of the assignment agreement under Texas law. Both found, in separate concurring opinions, that the assignment agreement should govern the property rights transferred to the donees and that under Texas property law, the value of the gift to the taxable donees was $6,910,933 -- the amount specified in the assignment agreement.

On August 22, 2006, the Fifth Circuit reversed. *See Succession of Charles T. McCord, Jr., et al. v. Comm'r.*, 461 F.3d 614, (5th Cir. 2006). The Fifth Circuit emphasized that the fair market value of the interests transferred must be determined on the date of the gift. The Court noted as follows:

> The Majority's key legal error was its confecting *sua sponte* its own methodology for determining the taxable or deductible values of each donee's gift... The core flaw in the Majority's inventive methodology was its violation of the long-prohibited practice of relying on post-gift events. Specifically, the Majority used the after-the-fact Confirmation Agreement to mutate the Assignment Agreement's dollar-value gifts into percentage interests in MIL. It is clear beyond cavil that the Majority should have stopped with the Assignment Agreement's plain wording. By not doing so, however, and instead continuing on to the post-gift Confirmation Agreement's intra-donee concurrence on the equivalency of dollars to percentage of interests in MIL, the Majority violated the firmly-established maxim that a gift is valued as of the date that it is complete; the flip side of that maxim is that subsequent occurrences are off limits.

Id. at pp. 9-10; *citing Ithaca Trust Co. v. United States*, 279 U.S. 151 (1929); *Estate of McMorris v. Commissioner*, 243 F.3d 1254 (10th Cir. 2001); *Estate of Smith v. Commissioner*, 198 F.3d 515, 522 (5th Cir. 1999). Thus, the 5th Circuit focused on the value of the interests transferred by Mr. and Mrs. McCord as stated in the Assignment Agreement -- not the percentage interests reflected in the donee's Confirmation Agreement that was executed several months after the gifts.

Two other points in the *McCord* opinion are important to note when considering transfer planning for hard-to-value assets. One is the 5th Circuit's reference in *McCord* to "a practice of the IRS that [it] see[s] with <u>*disturbingly increased frequency*</u>, e.g., a grossly exaggerated amount asserted in a notice of deficiency." *McCord* at fn. 22 (emphasis added). This quote corresponds to text in the opinion in which the Court elaborates on the fact that the expert for the IRS at trial, Dr. Mukesh Bajaj, asserted values that were substantially lower than those originally asserted by the IRS in its notice of deficiency.

Perhaps the strongest comment favoring the defined-value transfer was when the 5th Circuit said that, "[i]n the end, whether the controlling values are ... [those in the taxpayers' appraisal] ... or those reached by the Majority ... (or even those ... in the deficiency notices or those reached by the Commissioner's expert witness for that matter), *have no practical effect on the amount of gift taxes* owed here." *Id.* at 628 (emphasis added). This quoted passage clearly indicates that the transfer to the "taxable" donees was defined (fixed) in the assignment agreement and that no appraisal would change the value of the state law property rights given to those taxable donees -- the right to $6.9 million worth of the 82% partnership interest.

My firm has had two additional *McCord*-style cases pending before the Tax Court recently. Our motions for summary judgment were denied. See *Hendrix v. Comm'r*, No. 10503-03 (T.C. filed July 3, 2003); and *Rosenbaum v. Comm'r*, No. 13028-03 (T.C. filed August 8, 2003). The *Rosenbaum* case was settled before trial. *Hendrix* was tried by John Porter before Judge Elizabeth Crewson Paris on December 9, 2008. I testified as a fact witness. We received the government's first post-trial brief in the *Hendrix* case in March 2009, just before the due date for this outline.

Hendrix lies in the 5th Circuit. Thus, the IRS is attempting to distinguish *McCord*, or at least to make arguments that, in the Service's view, were not considered in *McCord*. The primary argument generally states that the charitable deduction should not be allowed. The government also is arguing public policy along the lines of *Procter*. It will be interesting to see how the *Hendrix* briefing develops and which facts and issues ultimately are deemed most important by the Tax Court. In *Hendrix*, the charity not only was represented by counsel but also obtained an opinion from a valuation expert as to the fairness of the taxpayer's appraisal. By the time I present this outline on April 30, all of the post-trial briefing should be completed, and perhaps I will have more to say about the case.

V. DEFINED-VALUE TRANSFERS AT DEATH - CHRISTIANSEN

A defined-value disclaimer was at issue in *Estate of Christiansen v. Comm'r*, 130 T.C. No. 1 (2008). In that case, also planned, implemented, and defended at my firm, Ms. Christiansen left her estate to her daughter, Christine Hamilton. The will provided that any disclaimed assets would pass 75% to a charitable lead annuity trust (the "CLAT") and 25% to a private foundation (the "Foundation"). The estate tax return reported assets worth $6.51 million. The principal assets of the estate were 99% limited partner interests in two partnerships involved mostly in the farming and ranching business. Christine Hamilton executed a timely disclaimer that was formulaic, in that she disclaimed a fractional share of the estate exceeding $6.35 million, as follows:

> Intending to disclaim a fractional portion of the Gift, Christine Christiansen Hamilton hereby disclaims that portion of the Gift determined by reference to a fraction, the numerator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on April 17, 2001, less Six Million Three Hundred Fifty Thousand and No/100 dollars ($6,350,000) and the denominator of which is the fair market value of the Gift (before payment of debts, expenses and taxes) on April 17, 2001.

Id. at 7. The formula clause defined fair market value "as such value is finally determined for federal estate tax purposes." *Id* at 8.

The IRS argued § 2036 and, alternatively, that the fair market value of each 99% interest should be increased greatly. Approximately six weeks before trial, the IRS conceded its § 2036 argument, and the parties agreed that the discounts to net asset value should be 37% and 34% for the two partnerships. The agreement increased the gross estate from $6.51 million to approximately $9.6 million.

Christiansen is unlike *McCord* in that the valuation findings by the IRS would change which donees would own what property interests, because the defined-value clause in *Christiansen* referred to values as finally determined for tax purposes. Thus, the settlement in *Christiansen* caused an additional $3.1 million of value (in the form of additional percentage interests in the partnerships) to pass to the CLAT and the Foundation as a result of Christine Hamilton's disclaimer. The question for the Court was whether those increased transfer amounts would qualify for the charitable deduction, and if so, whether there would be no additional estate tax.

A majority of Tax Court held that the disclaimer was not a qualified disclaimer as to the 75% portion that passed to the CLAT. Judge Swift and Judge Kroupa (the trial judge) dissented from this portion of the opinion, as both believed the disclaimer was qualified under I.R.C. § 2518. The majority decided that the requirements of § 2518 were not satisfied as to the CLAT because Christine Hamilton had a contingent remainder interest in the CLAT.

Regarding the 25% portion passing to the Foundation under the disclaimer, however, there was no question that § 2518 was satisfied. Nonetheless, the IRS raised two challenges. First, the IRS argued that any increased amount passing to the Foundation was contingent on a condition subsequent. Second, the IRS argued that the formula clause based on values "as finally determined for federal estate tax purposes" was void as contrary to public policy based on *Procter*.

The Tax Court's decision on the formula clause was unanimous in terms of validating the disclaimer in favor of the Foundation and allowing a charitable deduction for the increased amounts passing to the Foundation. Regarding the argument that the transfer was contingent on a condition subsequent, and thus that it violated Treas. Reg. § 20.2055-2(b)(1), the Tax Court noted that the transfer was the result of a disclaimer governed by Treas. Reg. §20.2055-2(c), which relates back to the decedent's death as if it had been part of the will.

The IRS also argued that the increased bequest to the Foundation was contingent because it depended upon the IRS examining the estate tax return and challenging the reported fair market value of the gross estate. The Tax Court disagreed, stating as follows:

> The regulations speak of the contingency of 'a transfer' of property passing to charity. The transfer of property to the Foundation in this case is not contingent on any event that occurred after Christiansen's death (other than the execution of the disclaimer) -- it remains 25% of the total estate in excess of $6,350,000. That the estate and the IRS bickered about the value of the property being transferred doesn't mean the transfer itself was contingent in the sense of being dependent for its occurrence on a future event. Resolution of a dispute about the fair market value of assets on the day Christiansen died depends only on a settlement or final adjudication of a dispute about the past, not the happening of some event in the future. Our Court is routinely called upon to decide the fair market value of property donated to charity -- for income, or estate tax purposes.

Id. at 24-25.

The IRS also argued public policy because the formula clause would discourage the examination of the estate tax return (any increase to gross estate values would be offset by a charitable deduction). The Tax Court rejected the argument, noting that it was "hard-pressed to find any fundamental public policy against making gifts to charity -- if anything the opposite is true. Public policy encourages gifts to charity, and Congress allows charitable deductions to encourage charitable giving." *Id*. at 26-27. Rejecting the IRS's reliance upon *Procter* and its progeny, the Court noted as follows:

> This case is not *Procter*. The contested phrase would not undo a transfer, but only reallocate the value of the property transferred among Hamilton, the [CLAT] and the Foundation. If the fair market value of the estate's assets is increased for tax purposes, then property must actually be reallocated among the three beneficiaries. That would not make us opine on a moot issue, and wouldn't in any way upset the finality of our decision in this case.

Id. at 27.

The Court further noted that a charity's directors as well as executors of an estate owe fiduciary duties that are enforceable both by the IRS and by the state's Attorney General. Thus, the Tax Court found that *Procter* and its progeny did not apply to the formula disclaimer, and that the transfer to the Foundation qualified for the charitable deduction.

VI. PLANNING ISSUES

This outline has considered both "adjustment clauses" and "defined-value clauses." It also has discussed two types of defined-value clauses: (1) those with a fixed value based on the amount finally determined for tax purposes (*Christiansen*) and (2) those with a fixed value to be allocated to one "taxable" donee as compared to another "nontaxable" donee like a charity (*McCord*), a spouse, or a "low tax" donee like a GRAT with a high annuity payment structure.

In terms of using any of these techniques for planning purposes, I have had much more experience and success with defined-value clauses, both of the *Christiansen* and *McCord* varieties.

A. Adjustment Clauses

Procter is a problem that likely will not go away. Based on *Procter* and the cases following it, I do not recommend adjustment clauses to clients where the actual property transferred would be returned to the donor (or deemed never to have been transferred by the donor in the first place). Note that these really would be at issue only in *inter vivos* transactions. I have seen annual exclusion gifts of hard-to-value assets where practitioners have indicated the gift amount as finally determined for tax purposes, with nothing else. I have seen similar structures using the full gift tax exemption amount. In the case of annual exclusion gifts, if those gifts are not reported on a gift tax return, then we never know the finally determined value until the transferor dies (based on the substantial disclosure requirements for gift tax returns). Further, those transfers likely fall into the *Procter* argument if they ever are discovered by the IRS. In either case, annual exclusion or greater gift amounts, the clients doing transactions like that will settle up among the transferor and the transferee as to who owns what and then have all of the associated economic benefits perhaps in the wrong place for many years. How do you clean that up later in an equitable fashion without additional gift tax exposure?

On the other hand, *King* offers the proposition that a consideration adjustment clause can work, in spite of the Service's reaction in Rev. Rul. 86-41, 1986-1 C.B. 300. After all, *King* is a 10th Circuit opinion. Therefore, perhaps a consideration adjustment in a sale transaction is worthwhile in some cases (those with large dollar amounts), particularly those where the appeal lies in the 10th Circuit. If nothing else, a *King* structure will give the taxpayer a second argument in addition to the pure valuation debate. I would expect the IRS to challenge a *King* structure in cases other than those in the 10th Circuit. That said, I would be bullish in any circuit about the taxpayer's reliance on *King*. In any event, only those clients willing to endure a likely IRS challenge to both valuation and the *King* structure itself should consider a consideration adjustment technique. *King* is, I believe, the only reported case on the topic.

While on the subject of client tolerance for withstanding the rigors of an audit and perhaps more, I must comment on *McCord.* It is a case I will never forget. I am fortunate to have worked on that case from the brainstorming on the front end through the 5th Circuit appeal. We had great clients with bright and involved sons who entered into a somewhat novel transaction and endured a protracted audit and extended gift tax litigation and appeal (with even more delay caused by Hurricane Katrina). Not all clients have the patience or understanding for the rigors of audit and litigation, so I am thankful to them for it. The entire process, from the start of the planning work to 5th Circuit opinion, was <u>*eleven years*</u>. The result was a great opinion from the 5th Circuit that vindicates defined-value transfer planning as a viable approach for clients, especially those resident in the 5th Circuit's jurisdiction. My point is that it took a very long time, and many clients (and their families) will not want to wait that long. Of course, it should not take as long now that we have the opinion. *Hendrix* and *Rosenbaum* have been similarly lengthy, but that is in part because both cases were delayed (by agreement with the IRS) until *McCord* was decided.

B. Charitable Defined-Value Transfers

The charitable defined-value transfer technique of *McCord* is probably my favorite technique for clients with the right mix of assets and objectives. So is the defined-value charitable disclaimer technique in *Christiansen,* which was handled by other attorneys at my firm. But those two techniques are very different in terms of who gets to decide which donees own what property interests. As noted above, *McCord* turns on state law property rights, such that the IRS cannot change who owns what, but *Christiansen* turns on the finally determined value. Thus, in a *Christiansen* structure, the IRS can affect how much property passes to charity as compared to family. Clients need to be fully informed of that distinction.

The idea behind the *McCord* charitable defined-value structure is that if the IRS has a problem with the value of the asset transferred, it is not the donors who are at fault for what was done by the donees in splitting the asset among themselves. There should be no gift tax on the donors if the IRS perceives that family members got the better end of the deal as compared to the charity. To the contrary, the person to whom the IRS should be looking is the charity -- if the charity splits the asset in a manner favorable to the children, based on the IRS's view of valuation, then the charity could perhaps be at fault for conferring a benefit on the children. The IRS has tools at its disposal to deal with charities under the private inurement or private benefit doctrines or elsewhere. Further, as noted by the Tax Court in *Christiansen*, charities owe fiduciary duties to their wards and are supervised by the relevant state's Attorney General. At my firm, we have found that most charities are extremely diligent in a *McCord*-style transaction when it comes to reviewing valuations. Indeed, that is what you want.

Even outside the 5th Circuit, I cannot see how there is any gift by the donors in a *McCord* transaction above the defined-value amount, absent collusion with the charity (it would be the Achilles heel of the technique if there were any collusion). The majority of the Tax Court in *McCord* referenced whether a charitable donee would ever look a gift horse in the mouth (*see* footnote 9 of the Tax Court's opinion). That is, of course, a far cry from collusion, even though it may highlight the vast difference in views on valuation held by the IRS as compared to others. Unfortunately, it appears that the gift horse concern pervades the analysis by the IRS. As noted, most charities are very careful in transactions like this. In *Hendrix*, the charity not only was represented by counsel but also engaged a valuation expert to review the taxpayers' appraisal.

I also have a hard time with those commentators and practitioners who are concerned about the *McCord* structure in the face of the public policy and other common law arguments -- the ones that were favored by the dissent written by Judge Laro and Judge Vasquez in the Tax Court's decision. Even though a majority of the Tax Court rejected those arguments, the concern exists and is expressed by some practitioners because the government did not brief those arguments properly to the 5th Circuit on appeal in *McCord*. As such, the 5th Circuit considered those arguments to be waived, as follows:

> At the outset, we reiterate that, although the Commissioner relied on several theories before the Tax Court, including doctrines of form-over-substance, violation-of-public policy, and, possibly, reasonable-probability-of-receipt, he has not advanced any of those theories on appeal. Accordingly, the Commissioner has waived them, and has instead - *not surprisingly* - devoted his efforts on appeal solely to supporting the methodology and holdings of the Majority.

McCord at 623 (emphasis added). In my view, it is difficult to read the 5th Circuit's opinion in *McCord* and find any part of it that would indicate a reluctance by the Court to support the transaction as it was structured. Almost certainly the 5th Circuit would not have reached a different result if those arguments had been properly briefed by the government. Further, we have seen the 5th Circuit give the government a mulligan before when issues were not properly briefed, yet they did not do so in *McCord*. *See Estate of Strangi v. Comm'r,* 293 F.3d 279 (5th Cir. 2002). Perhaps other circuit courts would favor the policy arguments more than the 5th Circuit, but I feel it would be difficult for the government to prevail on a case with good taxpayer facts (no collusion with the charity). Why would the 5th Circuit have allowed a taxpayer victory if the judges had felt that the public policy would be bad? And remember, even the Tax Court did not find those arguments to be sufficient. In any event, the concern is out there and should be considered with clients before structuring a *McCord* transaction.

One caveat in the *McCord* structure: the appraisal of the asset value and the timing of the appraiser's work in determining that value are critical to the client and his or her family. In order to "set the bar" of the defined-value amount in a *McCord* formula transfer, a client typically will want to know the total value of the asset in question so as to have an idea regarding how much would pass to the family and how much would pass to the charity. Of course, the charity could have a different view of valuation altogether, but almost no client would want to structure the formula without first having the appraiser tell him what the value is. The problem is one of simultaneous information. It is almost impossible to have a "final" appraisal number, set the formula, and close the transaction without having some wiggle room in the appraiser's number. Clients need to be aware of that issue, and the lawyer structuring the transaction, as well as the appraiser, need to be aware of the need for speed in closing the transaction. Communications with the charity should encourage the charity's complete review of the asset and the transaction structure ahead of time, but without any indications of how the asset might be split post-closing or the intended amount to be allocated to the charity in the transaction.

There also is a premium on having quality appraisal work. We had one case at my firm where the client's appraiser missed something in his analysis, the transaction closed, and then the charity's appraiser noticed the missing part of the valuation analysis when it was working with the children to split the transferred property. That client had substantial charitable intent, thankfully. Much more value went to the charity in that case than was originally intended. In other words, the state law property rights transferred are very real, and while charities may be more reasonable on valuation analysis than the IRS, they very certainly will look a gift horse in the mouth when it comes to protecting their own interests and being good fiduciaries for their wards. Again, that is what you want in such a transaction.

C. Testamentary Transfers v. Inter Vivos Transfers

When it comes to testamentary defined-value transfers involving charities, the hard part is that a client will not know the value of his estate at death at the time when he writes his will. So, unless the client has a hard and fast view about how much to leave the children, it will be difficult to set the cut-off defined-value amount between the children's share and the charity's share -- the value of the gross estate is a moving target. This is why we have utilized defined-value disclaimers like *Christiansen* at my firm.

For charitable disclaimer planning, assume for simplicity purposes that the testator provides for the residuary estate to pass to the children. In that circumstance, the testator also provides that if any amount is disclaimed by any child, that amount passes to charity. Thus, the child is not directing where the disclaimed assets will go. It allows the children to consider asset values post-death (with appraisals) and decide on the fly whether or not to do a *Christiansen* plan and where to set the defined-value amount. From the standpoint of the parents, at least they have given the children that opportunity. For once, we have 20/20 hindsight on valuation (just like the IRS) due to the nine-month disclaimer window.

One problem with a *Christiansen* approach is that it really requires all of the children to act together in order for it to work properly. Christine Hamilton was the only legatee in the *Christiansen* case. In other cases, you really need all for one and one for all, or else the defined-value structure will not be achieved (it will have a "leak").

The disclaimer technique also puts stress on the allocation of the burden of the debts, expenses, and taxes. Analyze whether you want the charity's share to bear the tax (which reduces the charitable deduction) or not, and consider whether your decision would affect the IRS's incentives for challenging the valuation. If an increase in valuation would result in some tax increase, then the IRS has the incentive to challenge value (but correspondingly has a hard time making the *Procter* argument). If not, then what incentive does the IRS have to force more property to a charity that is exempt from tax? That last proposition is the backbone of the technique, and *Christiansen* says it works.

Let me also comment briefly, and without too much detail, on the use of private foundations in charitable defined-value transactions. In the *inter vivos* situation like *McCord*, where values are not based on those finally determined, a key component is the independence of the charity. As such, a private foundation is not advisable (even if there were not self-dealing concerns). In a death situation, however, a private foundation can work, subject to a bit more difficulty. If the will contains a hard and fast defined-value cut-off amount for the children (as finally determined) and the residuary passes to a private foundation, then the transaction can work just fine, although it likely will be necessary later to have the foundation sell the hard-to-value asset to family members in a state court proceeding that follows the requirements for indirect self-dealing transactions under the Treasury Regulations to I.R.C. § 4941. On the other hand, if the disclaimer approach of *Christiansen* is being used, there should be some concern about the disclaimant having involvement at the private foundation and his or her authority over the assets disclaimed, as it could render the disclaimer invalid. In those cases, the disclaimant and the foundation would want to create a "Chinese Wall" as to the disclaimed assets so that the disclaimant has no authority over them. Doing so may render the transaction undesirable (it has for a handful of clients at my firm).

Another issue raised by testamentary defined-value transfers is that the estate is a convenient mechanism to hold all the property until the final determination of value is obtained. In an *inter vivos* transaction, there is no such convenient mechanism, and one must be considered if the defined-value transaction will follow the "as finally determined" approach as compared to the *McCord* approach. For example, in the case of flow-through entities like partnerships or S-corporations, it is entirely natural for an estate to hold the asset for some time before funding the bequests under the will, and as such the estate would have the profit and loss allocations as well as the cash distribution. On the other hand, in an inter vivos transaction where there are two different transferees who will not know their ownership shares until "finally determined," how do you handle the intervening profit and loss allocations and cash distributions? Grantor trusts may solve the issue as to the income tax burden not being shifted, but they will not solve the problem of which party enjoys what economic benefits. An escrow arrangement has been suggested by some commentators, and it might work. I just have not had the occasion to do it. Likewise, a majority of the Tax Court indicated in *McCord* that perhaps they would have reached a different result if values had been expressed in the transaction as finally determined values.

D. Non-Charitable Defined-Value Transfers (Briefly)

Another transaction that we have used with success at my firm is a so-called "GRAT lid." If *McCord* is to be called a "charitable lid," then a GRAT lid is an *inter vivos* transaction where a low tax GRAT takes the place of the charity, and the values to be used are those finally determined for tax purposes.

In my view, a *McCord* transaction is superior to a GRAT lid (or a "marital lid"). We have the 5th Circuit precedent now, and as noted previously, there should be no better evidence of value on any given day than what an independent third party will accept or not accept. In addition, *McCord* transactions do not involve any change by the IRS in terms of what assets are transferred to whom. In other words, as noted many times above, an audit and increase to valuation does not change which donees get what amounts -- rather, those amounts are determined by the donees themselves. There is no "as finally determined for tax purposes" in a *McCord* transaction, by design. With the other techniques, there is a change -- the IRS literally changes who gets what. But a *McCord* transaction only makes sense for clients with sufficient charitable intent.

For those clients without the requisite charitable intent, or for those worried about the appraisal risk that operates in favor of charity under a *McCord* transaction, I do consider a GRAT lid and perhaps would consider a consideration adjustment structure like *King*, noted above. In fact, if you think about it, a GRAT lid with a defined-value cut-off based on values as finally determined ($x to children, excess to the GRAT, with values based on finally determined amounts) is similar to a consideration adjustment structure like *King,* given that a valuation increase results in more annuity payable to the transferor. The difference is that in a *King* transaction, the property transferred to the recipient does not change or shift to another recipient; rather, the recipient simply has to pay more for that property. What might make the GRAT lid better than a pure *King* transaction is that the Regulations under I.R.C. § 2702 offer some comfort in the GRAT arena, as noted, if faced with a *Procter* argument. Also, in the case of a GRAT lid transaction, unless your GRAT is a completely zeroed-out GRAT, there would be some gift tax consequence if the IRS shifts assets to the GRAT by increasing the valuations. Indeed, having some tax may be better than having none in the face of a *Procter* argument. I personally prefer in all GRAT transactions to have a small amount of gift and certainly would do so in a GRAT lid structure.