SELECTED PROVISIONS OF INTEREST TO INDIVIDUALS IN PRESIDENT CLINTON'S RECENT BUDGET PROPOSAL

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FEBRUARY 24, 1998

MEMORANDUM TO CLIENTS

This memorandum summarizes certain provisions of President Clinton's recent budget proposal that may be of particular significance to your estate planning.

ELIMINATION OF CERTAIN VALUATION DISCOUNTS

When individuals make gifts of limited partnership interests or limited liability company (LLC) interests, the gifts should be subject to valuation discounts for lack of marketability and minority interest. The budget proposal calls for the elimination of the valuation discounts, except as they apply to "active businesses." For estate and gift tax purposes, interests would be valued at a proportional share of the underlying net asset value of the entity to the extent that the entity holds readily marketable assets at the time the interest is transferred. Discounts would not be allowed.

If passed, this proposal would be effective for all transfers made after the date of enactment.

"CRUMMEY" POWERS

Under current law, an individual may make gifts to a trust under the terms of which the beneficiaries have certain withdrawal powers ("Crummey" powers), and those gifts will qualify for the gift tax annual exclusion (up to $10,000 (or $20,000 for gifts "split" with a spouse) for the benefit of an unlimited number of individuals).

The budget proposal calls for the repeal of the "Crummey" rule. This means that gifts to trusts with withdrawal powers would no longer qualify for the gift tax annual exclusion. Outright gifts within the annual limits would continue to qualify for the exclusion.

If passed, the proposal would be effective for gifts to trusts made after December 31, 1998. 1998 gifts to trusts with withdrawal powers could still qualify for the gift tax annual exclusion.

QUALIFIED PERSONAL RESIDENCE TRUSTS

A Qualified Personal Residence Trust ("QPRT") is a trust to which an individual transfers a home and in which the individual retains the right to live in the home for a period of years, after which time, the home passes to designated beneficiaries (e.g., children or trusts for their benefit). Upon the transfer to the trust, there is a gift of the present value of the remainder interest, and gift tax is payable only on that part of the value transferred. As long as the individual survives the term of years of the retained interest, there is no additional gift tax (and no estate tax) when the property passes to the beneficiaries.

The budget proposal would repeal the QPRT rule. If the proposal passes, a transfer of a home to a trust would be treated in the same way as the transfer of any other asset.

If passed, the proposal would be effective for transfers made after the date of enactment.

EXCHANGES OF INSURANCE CONTRACTS REALLOCATIONS OF ASSETS WITHIN VARIABLE INSURANCE CONTRACTS

Under existing law, if an individual invests in life insurance, endowment, and annuity contracts, the individual may exchange the contract for certain other insurance contracts, without being subject to tax on the exchange.

Special rules also apply to holders of variable life insurance and variable annuity contracts. The holder can invest the funds in the contract in any number of mutual funds, and can currently liquidate part or all of an investment and reinvest the proceeds in another fund within the same insurance policy without the imposition of income tax.

The proposal would make taxable any exchange of a life insurance, endowment, or annuity contract for a variable contract and any exchange of a variable contract for a life insurance, endowment, or annuity contract. In addition, each investment in a separate account mutual fund or in the insurance company's general account pursuant to a variable contract would be treated as a separate contract (and therefore taxable as such).

This proposal will apply to contracts issued after the date of first committee action.

If you would like to discuss any of these proposals in further detail or in the context of your own estate plan, please feel free to call Robin Yunis (at 212-455-2981), Millie Kalik (at 212-

455-2778), Joe Kartiganer (at 212-455-2860), Pamela Rollins (at 212-455-3468) or any other member of our Personal Planning department.

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