

MEMORANDUM

November 15, 2013

To: Leon D. Black

From: Alan S. Halperin

Subject: Charitable Lead Annuity Trust

This memorandum briefly describes how a testamentary charitable lead annuity trust, or CLAT, might be incorporated into your estate plan.

A. Overview of a Testamentary CLAT

With a CLAT, which works in a fashion similar to a GRAT, one or more charities (which may be the Leon Black Family Foundation) would receive the annuity flow for a term of years. Upon the expiration of the term of years, the assets remaining in the CLAT could pass to the Heritage Trust. Effectively, similar to a GRAT, a CLAT would permit you to transfer the future appreciation (beyond the IRS assumed rate of return as of the date of your death) to your family with virtually no estate tax, assuming the present value of the annuity flow approximates the value of the initial trust corpus. To the extent the cash flow generated by the assets is sufficient to fund the annuity payments to the Leon Black Family Foundation (or other charities), you eventually will be able to leave a significant bequest to the Heritage Trust virtually free of estate tax.

B. Alternative CLAT Terms

Based on the current (low) IRS rate of 2%, the following trust terms lead to a zeroed-out CLAT (so that charity's interest approximates the full value of the trust).

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<u>Trust Term</u>	<u>Annuity</u>
15 years	7.8%
17 years	7.0%
20 years	6.1%

Please note that, if the CLAT is funded with assets that are to be valued with discounts due to lack of marketability or lack of control, the requisite annuity percentage is applied against the discounted value.

CLATs are particularly attractive in the current low interest rate environment. If interest rates increase, the required annuity rate will be higher (assuming the same term of years). In order to address these issues, your testamentary documents could be drafted in a fashion to provide flexibility in terms of the CLAT term. If the interest rate (effective at death) increases beyond a certain rate, the term of the CLAT could be extended.

C. Purchase of Trust Assets for a Note

The rules that prohibit certain transactions with a foundation and limit the type of foundation assets generally apply to CLATs. However, certain transactions with CLATs (and foundations) are permitted during the period of estate administration provided certain requirements are met. Specifically, the Heritage Trust could purchase assets otherwise destined to pass to the CLAT, provided, among other things, the transaction is approved by the probate court with jurisdiction over your estate, the transaction occurs before your estate is terminated, your estate receives a payment that equals or exceeds the fair market value of the property being sold, and the transaction results in the charity receiving property at least as liquid as it gave up.

Assuming the foregoing conditions are satisfied, the sale may be for cash alone, or in exchange for cash and, in part, a promissory note.

D. Action Steps

The steps involved with this strategy are outlined below, and charts summarizing these steps are attached as Exhibit A.

1. Step One

At the death of the survivor of Debra and you, certain assets (or the residuary estate) would be directed to a CLAT for a term of years. These interests will receive a step-up in basis to their then fair market value. Your estate will receive an estate tax charitable deduction. No estate tax will be due with respect to the value of the property passing to a CLAT.

2. Step Two

Before the estate assets are distributed to the CLAT, the Heritage Trust could purchase them from the estate in exchange for cash and a promissory note. The note could be structured as an interest only note, with a balloon payment due at the end of the CLAT term. In order to satisfy the liquidity requirements, such note will bear an interest in excess of the IRS rate. The sales price would need to be substantiated by an appraisal. To the extent that your estate is comprised of closely held interests (such as your interest in Black Family Partners), the value of the assets will reflect discounts for lack of control and lack of marketability. Those valuation discounts will reduce the purchase price and will facilitate payment of the interest on the promissory note from the cash flow of the purchased assets.

The probate court would need to approve the transaction. Because the interests of charity are involved, the then Attorney General of the New York State will be a party to that proceeding.

3. Step Three

After the estate assets are sold to the Heritage Trust in exchange for cash and the note, the cash and the note would be distributed to the CLAT. The cash, along with the interest paid on the note by the Heritage Trust to the CLAT, would be used to satisfy the annuity due to the Leon Black Family Foundation. Since the purchase relates to acquiring investment property, the Heritage Trust will receive an income tax deduction with respect to the interest paid on the note. Presumably, the Heritage Trust will use the cash flow from the acquired interest to pay the interest on the note.

Separately, we could explore whether, at that point, further generational planning could be achieved.

4. Step Four

At the end of the CLAT term, the assets remaining in the CLAT, which will include the note, will pass to the Heritage Trust, as the remainderman of the CLAT. At that moment, the obligor and the obligee of the note will be the same, thereby causing the note to cancel. Accordingly, assuming principal is not due until the conclusion of the CLAT term, the principal due on the note effectively will be forgiven. The Heritage Trust will own the estate assets free and clear of the promissory note, and the annuity obligations to the Leon Black Family Foundation will cease.

E. Summary of the Proposal

In summary, assuming the CLAT is a zeroed-out CLAT, no estate tax will be due because of the charitable deduction, and the Leon Black Family Foundation would receive predictable cash flow for a term of years. Although the Heritage Trust will be subject to the obligations of the promissory note, it will own the estate assets. To the extent the cash flow generated by the assets exceeds the Heritage Trust's obligations with respect to the promissory note, the Heritage Trust also will enjoy a current benefit (in addition to the income tax deduction in connection with the interest paid on the note). At the end of the CLAT term, the Heritage Trust will own the estate assets, which will be free and clear of any note obligations, with the principal effectively having been forgiven. However, to achieve these results, among other things, it will be necessary to have the transaction approved by the probate court, with the New York State Attorney General as a party to the proceeding.

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I would be happy to discuss these issues at your convenience.

A.S.H.