Please note, the first meeting of the course (8/30) is cancelled and will be rescheduled for a later date to be announced.
Federal Estate & Gift Taxation

Syllabus

Fall 2017

Professor Gans

I. Overview of the Transfer Tax System

II. Scope of § 2033: What is an Interest in Property?

III. Testamentary Substitutes: §§ 2036, 2037, 2038
   A. § 2036(a)(1)
   B. § 2036(a)(2) & § 2038
   C. § 2037
   D. § 2036(b)

IV. Annuities and Joint Interests in Property: §§ 2039 & 2040

V. Powers of Appointment: § 2041

VI. Life Insurance: § 2042

VII. Deductions from the Gross Estate: §§ 2053, 2054, 2055 & 2056
   A. In General
   B. Charitable
   C. Marital

VIII. Introduction to the Gift Tax

IX. Special Valuation Rules: § 2702

X. Disclaimers: § 2518

XI. Annual Exclusions, Life Insurance Trusts & Crummey Powers

XII. Valuation Issues: Alternate Valuation Date and Valuing Interests in Family Businesses

XIII. Computational Problems

Text:
   Federal Wealth Transfer Taxation, McDaniel, Repetti and Caron (Foundation Press)
Federal Estate & Gift Taxation

Problem 1

Overview of Transfer Taxes

Assignment:

Code: •• 1014, 1015, 1022, 2001(a)-(c), 2010, 2501(a)(1), 2502, 2503(b)(1)(first sentence), 2505.


Textbook:
Chapters 1, 6, 7, 9, 10, 27 (pp. 499-500; and 541-543), 29 and 34

Questions:

1. Aaron, who was not married, made no taxable gifts prior to 2017. In January 2017, he made a gift of appreciated stock to his daughter. The stock had a fair market value of $6,014,000 on the date of the transfer.

   Aaron died later in 2017. His taxable estate consists of cash, stock, and other liquid assets, having an aggregate value of $1,000,000. Assume that Aaron’s estate is not entitled to any deductions and that the state in which Aaron was a resident did not have an estate or inheritance tax.

   a. What is Aaron’s gift tax liability for 2017?

   b. What is Aaron’s federal estate tax liability (assuming section 2035(b) is for some reason inapplicable)? What is Aaron’s federal estate tax liability (assuming section 2035(b) does apply)?

2. Assume Aaron died in 2017 with a gross estate of $3M and that he bequeathed his entire estate to his spouse, Alice (assume he had not made any inter vivos gifts and that the only available deduction is the marital deduction). If Alice died later in 2017, what would be her applicable exclusion amount? Would it make a difference if Alice had remarried and her new husband predeceased her with a taxable estate of $6M (assuming he had bequeathed his entire estate to his children from his first marriage)?
Federal Estate & Gift Taxation

Problem 2

Scope of Section 2033: What is an “Interest” in Property?

Assignment:

Code: §§ 2031(a); 2033; skim § 2041(a)(2), (b)(1). Glance at §§ 691(a) & (c) and 1014(c).

Regs: §§ 20.2031-1(a) & (b), -5; 20.2033-1(a)

Textbook: Chapters 12 and 11 (we will cover chapter 12 first). See also the majority opinion in Smith v. Shaughnessy, p. 314 (discussing various interests in property).

Questions:

1. Adriana transfers $1,000,000 to Tony as trustee, in trust. The trust provides that its income is to be payable to Bobby for life, the remainder to Christopher if living at Bobby’s death, or if Christopher predeceases Bobby, then to Dante or Dante’s estate. What are the relevant estate tax consequences if:

   a. Tony dies.

   b. Bobby dies.

   c. Christopher predeceases Bobby.

   d. Dante predeceases both Bobby and Christopher.

   e. Dante dies, survived by Bobby but not Christopher. If Bobby is 40 years old at the time of Dante’s death, conceptually what amount should be included in Dante’s estate? What would be the amount of the actual inclusion if the appropriate rate under § 7520(a)(2) is 8%? See Tables under § 20.2031-7(d).

2. On June 1, 2014, Carmela loans Meadow $200,000. The loan is memorialized through a promissory note which calls for annual 8% interest payments and a balloon payment at the end of 5 years. On January 1, 2016, Carmela died. At that time, $8,000 of interest had accrued on the loan since Meadow’s last payment. Carmela’s will directs that any
indebtedness represented by the June 1, 2014 loan shall be canceled. What amounts are included in Carmela’s estate under IRC § 2033 on account of the loan?

3. Artie is injured in an auto accident caused by another’s negligence. Artie spends several days in the hospital before dying. The applicable state law provides that wrongful death actions are to be prosecuted by a decedent’s executor as opposed to certain statutory beneficiaries. Accordingly, any proceeds of the lawsuit will pass according to Artie’s will. Artie’s executor sues the negligent driver, and recovers the following amounts: (a) $35,000 for medical expenses incurred by Artie; (b) $200,000 for Artie’s pain and suffering; and (c) $1 million for Artie’s lost earning capacity. What amounts are included in Artie’s gross estate under IRC § 2033?

4. On December 31, 2015, Jennifer dies. Which of the following items are includible in her gross of estate under § 2033?

a. Jennifer owned a life insurance policy on the life of her son, who is still living.

b. Jennifer’s employer owed Jennifer $5000 for work she performed in December 2015.

c. Jennifer held a § 453 installment obligation that she received three years ago in exchange for property she sold.

d. The Social Security benefits payable to Jennifer’s family.

e. What are the relevant income tax consequences of b and c?
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Problem 3

Testamentary Substitutes: Sections 2036, 2037 & 2038

Assignment for Part A:

Code: §§ 2035(a), (b) & (d); 2036 and 2043(a)

Regs: § 20.2036-1

Textbook: Chapters 16, 19 and 25

1. Andy’s will creates the following testamentary trust: Income to Ben for life, remainder to Candy upon Ben’s death. Upon Ben’s death, will anything be included in Ben’s gross estate under IRC § 2033? 2036(a)(1)?

2. Owen creates Trust 1 with the following terms: Income to Luke (Owen’s brother) for life, remainder to the descendants of Luke then living. Owen funds the trust with $500,000 of cash. Two months later, Luke creates Trust 2 with the following terms: Income to Owen for life, remainder to the descendants of Owen then living. Luke funds the trust with $400,000 of cash. Owen predeceases Luke. What amount, if any, is included in Owen’s gross estate under IRC § 2036(a)(1) as a result of Trust 1 and/or Trust 2?

3. Donna contributes $1,000,000 of appreciated stock to a trust and appoints a commercial bank trustee. Is all or any portion of the trust includible in Donna’s estate under § 2036(a)(1) if, in the alternative, the terms of the trust are as follows:

   a. One-half of the trust income is to be paid annually to Donna for life, one-half to be accumulated. At Donna’s death, the corpus is to be distributed to her son, Charlie, or Charlie’s estate.

   b. Same as a. except that Donna is not entitled to any trust income for the year prior to her death.

   c. Same as a. except that the term of the trust is only for 10 years. Upon termination, the corpus is to be distributed to Charlie or Charlie’s estate. Donna dies 6 years after the formation of the trust.

   d. All trust income is to be paid to Donna’s spouse, Josh, for life, then to Donna for her life. Upon the death of the survivor of Donna and Josh, the corpus is to be distributed to Charlie or Charlie’s estate. Donna predeceases Josh.
e. The trustee, in her sole discretion, may distribute as much of the net trust income to or for the benefit of Charlie as the trustee determines to be necessary or appropriate for the support or maintenance of Charlie. Any net income not so distributed shall be accumulated and added to principal. Donna dies when Charlie is 15 years old. Suppose Charlie were 25?

4. Donald transfers to his daughter, Ivanka, his personal residence for no consideration. Immediately after the transfer, Donald leases the residence back from Ivanka for its fair rental value. Three years later, while still living in the residence, Donald dies. Is any or all of the value of the residence includible in Donald’s estate under § 2036(a)(1)? What difference, if any, would it make if Donald had sold (rather than gifted) the residence to Ivanka for its fair market value?

5. Derek transfers $1 million dollars to a trust. Under the trust instrument, all income is payable to Derek for life with the remainder to his son, Sammy. At the time of the trust’s formation, Sammy’s remainder interest is worth $250,000. On this date, Sammy transfers to Derek $250,000 in full consideration of the remainder. When Derek dies, the trust is worth $5 million dollars. What amount, if any is includible in Derek’s gross estate under § 2036(a)(1)?
Assignment for Part B:

Code: §§ 2036; & 2038

Regs: § 20.2036-1(b)(3)

Textbook: Chapter 17

1. In each of the following variations, Gail creates a trust and names himself as the sole trustee. Scott is Gail’s son and Dana is Gail’s daughter. The terms of the trust vary, but in all cases the income interest is for Gail’s life and, upon Gail’s death, the trust terminates and the corpus is distributed to Zoe (unrelated) or Zoe’s estate. In all cases, Gail predeceases Scott, Dana, and Zoe. In each of the following variations, please determine whether any or all of the trust corpus will be included in Gail’s gross estate under § 2036(a)(2) and/or § 2038.

   a. The trust instrument provides that the trustee, in her sole discretion, may distribute trust income to Scott or Dana in such amounts and proportions as she shall determine. Any income not so distributed shall be added to principal.

   b. The trust instrument provides that the net income of the trust shall be distributed to Scott and Dana in amounts necessary for their support and maintenance. Any income not so distributed shall be added to principal.

   c. The trust instrument provides that the net income of the trust is to be distributed on an annual basis to Scott and Dana in equal shares. As trustee, Gail has the authority to invest the assets in income-producing or non-income producing assets as she sees fit.

   d. As trustee, Gail can invade the corpus for the benefit for the benefit of Zoe.

   e. The trust instrument provides that the trustee shall first distribute the trust’s net income to Zoe in an amount needed for Zoe’s support and maintenance; the excess, if any, is to be distributed to Scott and Dana in equal shares.

   f. The trust instrument provides that the trust’s income shall be payable in equal shares to Scott and Dana. Gail retains the power to give the remainder to Chip (unrelated).

2. Same basic facts as in (1)(a), except that Gail is not the sole trustee. Instead:

   a. Gail is one of 3 co-trustees, and any action taken on behalf of the trust requires unanimous approval of all trustees.

   b. G appoints her brother, Bob, as trustee.
c. Gail appoints Bob as trustee, but reserves the right to replace Bob without cause and can, if she desires, appoint herself.

d. Gail appoints a corporate trustee, but reserves the right to remove and replace the trustee with another corporate trustee.

e. Gail appoints a corporate trustee, but retains the power to have the trustee return the corpus to Gail six months after Gail notifies the trustee of her exercise.
**Assignment for Part C:**

- **Code:** § 2036
- **Regs:** § 20.2037-1(a)-(e). Glance at § 20.7520-3(b)(3)(ii)
- **Prop. Regs:** § 20.2036-2
- **Textbook:** Chapter 17 and 18

**Basic Facts:** Ernie owns 10% of X Corp. stock, which has one class of stock (voting common) outstanding. Ernie’s wife Liesel owns an additional 10% interest in X Corp. Ernie transfers one-half of his interest in X Corp. (representing a 5% interest overall) to a trust for the benefit of his children. Ernie serves as the initial trustee of the trust. The 5% interest has a value of $300,000 at the time the trust was funded. The trust requires that the net income be distributed to Ernie’s children until Ernie dies, with the remainder passing to the children outright. When Ernie dies, the 5% interest owned by the trust is worth $500,000. At Ernie’s death, Ernie still owns 5% of the X Corp. stock outright, and Liesel still owns her 10% interest.

1. What amount, if any, is included in Ernie’s gross estate under IRC § 2036(a)(1)?

2. Same as (1) except Ernie named an independent commercial trust company as trustee instead of himself?

3. Same as (1) except X Corp. had two classes of common stock outstanding (one voting and one nonvoting), and the 5% interest transferred to the trust consisted of nonvoting shares?
Assignment for Part D:

Code: § 2037


Textbook: Chapter 18

1. Georgia creates a trust with income to Harry (Georgia’s spouse) for life, remainder to Catherine (her child), if living and if not, to Georgia or Georgia’s estate. If Georgia predeceases Harry and Catherine, is all or any portion of the trust includible in her estate?

2. Georgia creates a trust with income to Harry for Georgia’s life, remainder to Catherine if living, if not to Zach or Zach’s estate. If Georgia predeceases Harry, Catherine and Zach, is any portion of the trust includible in her estate?

3. Georgia creates a trust with income to Harry for life, reversion to Georgia if living and if not to Zach or Zach’s estate. If Georgia predeceases Harry, Catherine and Zach, is any portion of the trust includible in her estate?

4. Same as #3 except that the trust further provides that if Georgia and Harry divorce, the trust shall terminate that the corpus will revert to Georgia.

5. Georgia creates a trust with the following terms: The trust will accumulate its income for 25 years or until Georgia’s death, whichever occurs first. At that time the trust will be terminated and the corpus distributed to Seth if living. Georgia dies five years after creation of the trust while Seth is living.
Federal Estate & Gift Taxation

Problem 4

Annuities and Joint Interests in Property

Part A: Section 2039: Annuities

Assignment:

Code: §§ 2039. Glance at §§ 72(b)(2) & (3), 691(d)(1)
Regs: §§ 20.2039-1(a), (b)(1) & (c).
Textbook: Chapter 21 and 22

Questions:

Basic Facts: In the year 2003, Dan entered into the following contract with an insurance company: Dan would pay the company a single premium of $1,000,000 on the date of the contract, and, in exchange, beginning in the year 2008, the company would pay Dan $10,000 a month for his life, and upon his death, $10,000 a month to his wife, Wendy, for her life. In 2006, Dan died.

1. What if anything is includible in Dan’s estate?
2. What if Wendy paid one-half of the premium (i.e., $500,000)?
3. What if Dan’s employer paid one-half of the premium?
4. What if Dan’s employer entered into this contract pursuant to a qualified plan?
5. In 1, what are the income tax consequences to Wendy in 2008 as a result of the annuity?

Part B: Joint Interests in Property

Assignment:

Code § 2040. See also § 1014
Regs: § 20.2040-1
Textbook: Chapter 21 (skim Estate of Goldsborough)

Problems:

1. In general, how does the Code treat jointly held property? Consider, for example, the appropriate amount to include in the estate of a decedent who died owning property jointly in the following forms.

   a. Tenancy in common?
b. Joint tenancy with right of survivorship?
c. Tenancy by the entirety?
d. Community property?

2. Mother and Daughter own Blackacre as joint tenants. It was worth $200,000 when they acquired it and $500,000 at the decedent’s death. How much should be included in the decedent’s estate if, in the alternative:

   a. Mother paid the full purchase price and Mother is first to die? Suppose Daughter dies first?
   b. Same as a. except Daughter contributed $50,000 towards the purchase?

   Same as a. except Mother and Daughter inherited Blackacre as joint tenants?
Federal Estate & Gift Taxation

Problem 5

Powers of Appointment

Assignment:

Code: §§ 2041, 2046; skim §§ 2514 & 2518
Regs: § 20.2041-1 (omit (c)(3)); 20.2041-3(a)-(d)
Textbook: Ch. 23

Problems:

1. Parent creates a trust naming her son, Sammy, and three grandchildren (Sammy’s children) as beneficiaries. Under the terms of the trust, the trustee, in her sole discretion, can distribute the net income and/or principal of the trust to any or all of the beneficiaries as she deems appropriate. Upon Sammy’s death, the trust principal is to be distributed equally to Sammy’s children or their estates. Sammy is named as trustee. Upon Sammy’s death, will any portion of the trust be included in his gross estate under IRC § 2041?

   a. Same as (1), except that Trust Co. is named as Sammy’s co-trustee and the trust requires approval of both co-trustees before any action can be taken.

   b. Same as (1), except that Parent is named as Sammy’s co-trustee. Upon the death of one of the trustees, the survivor will serve as sole trustee.

   c. Same as (1.b.) except that the eldest grandchild is named as Sammy’s co-trustee.

   d. Same as (1), except that the trustee can make distributions only for the recipient’s “health, education, support in his or her accustomed manner of living, or maintenance.”

2. Xavier created a testamentary trust naming Andrea the income beneficiary for life and Ben or Ben’s estate the remainderman. Andrea was also given the power to appoint the corpus of the trust. Andrea died this year without having exercised the power and the corpus went to Ben. What is included in Andrea’s estate?

   a. Would your answer change if the Andrea’s power could only be exercised six months after Andrea notified the remainderman (Ben or Ben’s estate) of her intention to do so? Assume Andrea never sent a notification.
b. Would your answer change if Andrea could only exercise her power after Ben’s death? Andrea predeceases Y.

c. When the trust was created, if Andrea did not want the power of appointment, what could she have done?

3. Grant created a trust naming Bank the trustee, Drew the income beneficiary for life, and Zanie or Zanie’s estate the remainderman. Grant funded the trust with $400,000 of securities. Drew was given a noncumulative general power to appoint $20,000 per year of corpus. Assume throughout the term of the trust that the value of the corpus remained $400,000. Drew died five years after formation, never having exercised his general power. What portion of the trust, if any, must be included in Drew’s estate?

   a. Suppose in (3) that Drew’s power could only be exercised in November and D died in December?

   b. Suppose in (3) that Drew had a noncumulative general power to appoint $50,000 per year?

Additional Hypos on § 2041

1. G creates a trust with income to H for life, remainder to his children (A, B, and C) or their estates in equal shares. The trustee(s) has the power, in her sole discretion, to appoint so much of the corpus of the trust as she deems necessary for H’s happiness. In each of the following alternatives, what portion, if any is includible in H’s estate on his death?

   1. Bank is named trustee.
   2. Bank is named trustee, but H has the power to replace Bank without cause and name a successor.
   3. H and G are co-trustees and both must approve any appointment of corpus. In the event of G’s death, H will serve as sole trustee.
   4. H and the Bank are named co-trustees and both must approve any appointment of corpus.
   5. H and A are named co-trustees and both must approve any appointment of corpus.
   6. Same as 5 except that the original instrument names H the life income beneficiary, and the remainder to whichever of his children he designates. In the absence of a designation, the taker in default is Z or Z’s estate.
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Problem 6

Life Insurance

Assignment:

Code: §§ 2035, 2042

Regs: §§ 20.2031-8(a); 20.2042-1; 25.2512-6(a)

Textbook: Chapter 24 (especially Rev. Rul. 84-179 and the Estate of Skifter)

Problems:

1. Arlene took out a single premium life insurance policy on her own life and immediately assigned the policy to Daisy, retaining no rights whatsoever. If Daisy dies, survived by Arlene, is any amount includible in Daisy’s estate with respect to the policy?

2. Daisy takes out an insurance policy on her own life. Daisy designated her eldest child as the beneficiary. Daisy has come to you for advice with respect to two issues relating to this policy. First she wants to know if she died today, would the proceeds of the policy be includible in her estate. Second, if proceeds would be includible, she would like to know if there is any action she can take to prevent inclusion. What advice would you give Daisy?

3. Daisy takes out an insurance policy on her own life and transfers the policy to her husband, Hank, retaining no rights whatsoever. Hank dies, survived by Daisy. In accordance with Hank’s will, his residuary estate (including the policy) is transferred to a trust of which Daisy is the trustee. Daisy is not a beneficiary of the trust, but as trustee, she may surrender the policy for its cash surrender value. When Daisy dies, is any amount includible in her estate with respect to the policy? Do you need any additional facts?

4. Suppose in #3 that Daisy could invade the corpus of the trust if necessary to maintain her standard of living?

5. Daisy takes out an insurance policy on her own life and transfers it to a trust in which Daisy is trustee. Daisy is not a beneficiary. As trustee, Daisy has normal fiduciary powers, including the power to surrender the policy for its cash surrender value.

6. Daisy owns 60% of all the stock in X Corp. X Corp. took out a life insurance policy on Daisy’s life and retained all incidents of ownership. To what extent, if any, are the proceeds includible in Daisy’s estate when Daisy dies? Do you need any additional facts?
7. Five years ago, Daisy acquired a life insurance policy of $1 million on her own life, naming her son, Scott, the beneficiary. This year, Daisy transferred the policy outright to Scott, retaining no rights whatsoever. Daisy continues to pay the annual premiums on the policy. In the alternative, what are the estate tax consequences if Daisy dies two years after the transfer? Daisy dies four years after the transfer? If either case, would your answer change if Scott had made the premium payments after the transfer?
Federal Estate & Gift Taxation

Problem 7

Deductions

A. Deductions in General

Assignment:

Code: §§ 2051, 2053(a)-(c) & (e), 2054. See also § 642(g).

B. The Marital Deduction

Assignment:

Code: §§ 2056(a), (b)(1), (3)-(8), (c); 2044; 2519. See also §§ 2046, 2518 and 2207A.

Regs: §§ 20.2056(a)-2; 20.2056(b)-1(a)-(d) & (g); 20.2056(b)-5(a), (b), (f)(1), (g); 20.2056(b)-7(a)-(d); 20.2056(c)-1 & -2.

Textbook: Chapters 28, 30 and 32

Questions

Basic Facts: Debbie and Steve are married and have one child, Clark. Debbie has additional children from a prior marriage. All parties are U.S. citizens. In each of the following questions, Debbie dies, survived by Steve. For each question, your task is to determine whether Debbie’s estate is entitled to a marital deduction under § 2056.

1. Under her will, Debbie left her entire estate to Clark, the couple’s only child. Under state law, Steve is entitled to elect to take 1/3 of Debbie’s probate estate. Steve makes this election.

2. Suppose in #1, Steve does not make an election. Instead, Clark files a qualified disclaimer under § 2518. As a result of Clark’s disclaimer, the entire estate passes to Steve as a contingent beneficiary.

3. Debbie and Steve jointly owned Blackacre as tenants by the entirety.

4. Debbie makes a specific bequest of a patent which has three years remaining before it expires.

5. Prior to Debbie’s death, Debbie had purchased a joint and survivor annuity under which Debbie and Steve were the beneficiaries. When Debbie died, Steve became entitled to an annuity for life.
6. Debbie’s will creates a trust with income to her Father for life, remainder to Steve.

7. By will Debbie directs her executor to buy a $1,000,000 single premium annuity for Steve.

8. Debbie leaves her entire estate to Steve as long as he survives the administration of her estate. If he does not, the estate passes to Clark. The administration of the estate is concluded after four months, while Steve is still living.

9. Debbie’s will creates a trust with income payable quarterly to Steve for life. Steve is also given a testamentary power to appoint the corpus to his estate. If he fails to exercise the power, the corpus goes to Clark.

10. Debbie leaves her entire estate, $4 million of property, in trust, naming a bank as Trustee. Under the terms of the trust, Steve is to receive all of the trust’s income for life (payable quarterly), and the remainder to Debbie’s children from a prior marriage.

   a. Assuming that Debbie’s executor makes the election under § 2056(b)(7), are there any future transfer tax consequences that the various parties should be aware of?

   b. Suppose the Trustee had the power to accumulate income.

   c. Suppose the Trustee had the power to invade the corpus for Steve’s benefit.

   d. Suppose Steve was given the inter vivos power to appoint corpus among Debbie’s children from the prior marriage.

   e. If asked by Debbie’s executor, what would be your advice with respect to the § 2056(b)(7) election?

11. Debbie dies leaving $5 million dollars of property to a qualified charitable annuity trust which will pay Steve an annuity of $300,000 a year for life.
C. Charitable Deductions

Assignment:

Code: §§ 170(f)(3)(B); 642(c)(5); 664(a), (d) & (e); 2031(c); 2032(b); 2055(a)-(e)(2). See also § 2518.

Textbook: Chapter 30 (skim Section A)

Questions:

1. Dorothy leaves $1,000,000 in stock to a testamentary trust with the following terms: Income to Andy for life, remainder to NYU. Is Dorothy’s estate entitled to a deduction under § 2055?

   a. Suppose, instead of the income interest, Andy were given a $60,000 annual annuity for life with the remainder to NYU. Would Dorothy’s estate be entitled to a deduction under § 2055?

   b. Suppose, instead, Andy were given an annual annuity for life equal to 5% of the value of the corpus of the trust determined at the time of each distribution. Would Dorothy’s estate be entitled to a deduction under § 2055?

2. Suppose in #1(a), that in addition to his annuity, Andy was permitted to invade the corpus of the trust as necessary for his comfort and happiness. Two months after Dorothy’s death, Andy dies without ever exercising this power. Is Dorothy’s estate entitled to a deduction under § 2055? Is Andy’s estate?

3. Suppose in #1, that the terms of the trust were as follows: Income to NYU for 10 years, remainder to Andy. Is Dorothy’s estate entitled to a deduction under § 2055?

   a. Suppose instead of the income interest NYU were to receive an annuity for 20 years of $25,000.

4. Dorothy, by will, leaves her personal residence to her son for life, remainder to NYU. Is Dorothy’s estate entitled to a § 2055 deduction?
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Problem 8

Introduction to the Gift Tax

Part A: In General

Assignment:

Code: §§ 2501(a)(1), 2511(a), 7872(a), (c), (d) & (e)

Regs: §§ 25.2501-1(a); 25.2511-1(a) & -2.

Textbook: Ch. 13

Questions:

1. For each of the following transactions, please determine the gift and/or estate tax consequences. Unless specifically stated to the contrary, assume all parties are unrelated.
   b. David transfers property to a trust, retaining the right to income for life with the remainder to Zelda or Zelda’s estate. David dies the same year.
   c. David transfers property to a trust under which the trust’s income is to be paid to Alex for life. At Alex’s death, the corpus of the trust was to be distributed to David, if living and to Bernie or Bernie’s estate if not. David dies, survived by Alex.
   d. David transfers property to a trust under which the trust’s income is to be paid to Alex for life, with the remainder to Bernie or Bernie’s estate. David retained the power to alter or amend the terms of the trust as he sees fit.

2. On January 1, 2002, Grace loaned her daughter Diane $1 million. Under the terms of the loan, Diane was to repay the loan without interest on December 31, 2004. Assume the applicable federal rate is 10% and that the present value of $1 million dollars payable in three years is $750,000. What are the gift tax consequences, if any?

3. Grace is the executor of her mother’s estate. Grace and her children are the residuary beneficiaries. Before serving, Grace renounces any right to compensation for her services. Has Grace made a taxable gift to her children?
4. Grace’s son, Sam, just graduated from college this June. As a graduation present, Grace allowed Sam to live, rent-free, in the family’s “beach cottage” in East Hampton for the summer while the rest of the family went to Europe. Has Grace made a taxable gift?

NOTE: For the balance of this Problem, assume that all of the parties are unrelated to one another.

5. Grace creates a trust naming herself as trustee. Under the terms of the trust, income is to be distributed during Grace’s life to Anna and/or Beth, as the trustee directs, with the remainder to Chloe or Chloe’s estate. At the end of the trust’s first year, Grace directed that the income of the trust be paid equally to Anna and Beth. Has Grace made any taxable gifts?

   a. What difference would it make if Grace had appointed an independent trustee whom Grace could not remove without cause?

6. Grace creates a trust with income to Anna for 15 years, remainder to Anna or Anna’s estate. Grace as trustee retains the power to accumulate the income. Has Grace made a taxable gift? Further Question: If Grace dies four years after the creation of the trust, are there any estate tax consequences to Grace’s estate?

7. Grace creates a trust, appointing an independent trustee, with the following terms: income to Anna for life, and remainder to Beth or Beth’s estate. Grace retains the power to appoint all or a portion of the income to Chloe, but only with Anna’s approval. Has Grace made a taxable gift?

8. Grace creates a trust, appointing an independent trustee, with the following terms: income to Anna or Beth for Grace’s life, remainder to Chloe or Chloe’s estate. Has Grace made a taxable gift?

9. Suppose in #8, that the trustee was also given the power, in its absolute discretion, to distribute all or any portion of the corpus to Grace. Has Grace made a taxable gift?
Part B: Special Valuation Rules of Section 2702

Assignment:

Code: §§ 2701(e)(2), 2702 (omit (c)(4)), 2704(e). Glance at §§ 6501(c)(9) & 7520

Regs: §§ 25.2702-1; 25.2702-2(a), (b) & (d) Exs. 1-8; 25.2702-4(a), (c) & (d); 25.2702-5(a), (b)(1) & (2), (c)(1) & (d) Exs. 3 & 4; 25.2702-6(a)(1) & (b)(1)

Textbook: Chapter 36

Questions:

Basic Facts: Grantor and Spouse are married, Arnold, Bonnie and Christine are their children, Grandchild is their grandchild, and Mother is Grantor’s mother. Describe the transfer tax consequences in each of the following variations.

1. On January 1, 2002, Grantor creates an irrevocable trust by transferring to it $1 million worth of securities. Grantor retains the right to all the income from the trust for 10 years, with the remainder to Christine.

2. Suppose in (1) that Grantor retained the right to change the remainderman to Grandchild.

3. Suppose in (1) that Christine pays Grantor the full fair market value for the remainder.

4. Suppose in (1) that Spouse is the income beneficiary for life, remainder to Christine.

5. Suppose in (1) that three years after the creation of the trust, Grantor assigns her remaining income interest in the trust to Christine.

6. Suppose in (1) that Grantor retained the right to an annuity of $80,000 (payable quarterly) for 10 years, remainder to Christine. Further Question: What if Grantor dies in 2005?

7. Suppose in (1) the terms of the trust were as follows: Income to Mother for her life, reversion to Grantor.

8. Same as (7) except Mother is entitled to an annuity (payable semi-annually) in amount equal to 8% of the value of the corpus determined as determined on January 1 of each year. At her death the corpus will revert to Grantor.

9. Suppose in (1) the terms of the trust were as follows: Income to Arnold, Bonnie, and/or Christine, as Grantor directs, remainder to her grandchildren.

10. Grantor and Christine jointly purchase Blackacre, commercial real estate, for $1 million. According to their agreement, Grantor pays $600K of the purchase price for a term of years of 10 years and Christine pays $400,000 for the remainder. Both Grantor and
Christine paid fair market value for their respective interests. **Further Question:** What if Grantor dies in 2004 when Blackacre is worth $1.5 million?

11. Suppose in (10) that Blackacre is a personal residence that Grantor plans to live in. Upon purchase, Blackacre is immediately placed in a trust. Under the trust agreement, Grantor is entitled to income for 10 years, remainder to Christine. **Further Question:** If you were advising Grantor and Christine with respect to this transaction, what would you suggest?
Federal Estate & Gift Taxation

Problem 9

Disclaimers § 2518

Assignment:

Code: § 2518. See also § 2046

Regs: §§ 25.2518-1 through -3.

Textbook: Chapter 26

Questions:

Basic Facts: On January 1, 2004, Gordon creates a trust with income payable quarterly to Anna. Anna is also given a general testamentary power of appointment. If Anna fails to exercise this power, Ben or Ben’s estate will take by default. On January 1, 2008, Anna dies. In each of the following variations assume all the requirements of § 2518(b) are met except those described.

1. On August 1, 2004, Anna disclaims both her income interest and her testamentary power of appointment.

2. On August 1, 2004, Anna disclaims her ability to appoint ½ the property.

3. On August 1, 2004, Anna disclaims her right to appoint the property to herself or her estate, thereby converting the power to a special power.

4. On August 1, 2004, Anna disclaims her testamentary power of appointment and on January 1, 2005, Ben disclaims his interest in the trust. Further question: Would it have made any difference if Anna’s power had been a special power of appointment?

5. On January 1, 2008, Anna dies exercising the power of appointment in favor of Claudia. On March 1 of that year, Claudia disclaims the remainder interest in the property, but retains the right to the income from it for life.
Federal Estate & Gift Taxation

Problem 10

The Annual Exclusion, Life Insurance Trusts
and Crummey Powers

Assignment:

Code: §§ 2503; 2514 (omit (d)). Glance at §§ 6019(a) & 6075(b).

Regs: §§ 25.2503-1, -3, -4, -6

Textbook: Chapter 27

Questions:

1. Gretchen, appointing an independent trustee, creates a trust with income to Andy for life, remainder to Beth or Beth’s estate. In each of the following alternatives determine if Gretchen made a gift of a “present interest.”

   a. Andy’s income interest is subject to a spendthrift clause.

   b. The trustee has the power, in her discretion, to accumulate income.

   c. The trustee has the power to invade corpus for Andy’s benefit.

   d. The trustee, in her sole discretion, can allocate the income to either Andy or Beth.

2. Gail creates a trust for the benefit of her minor child, Catherine. On Catherine’s 21st birthday, the corpus of the trust is to be distributed to Catherine. Gail appoints an independent trustee. In each of the following alternatives determine if Gail has made a gift of a “present interest.”

   a. The trustee is directed to accumulate all income until Catherine reaches the age of 21.

   b. The trustee, in her sole discretion, may accumulate income or expend it for Catherine’s benefit.

   c. The trustee is directed to accumulate all income except to pay for Catherine’s college education.

   d. Same as (b) except the corpus will terminate and be distributed to Catherine when she is 18. What if the trust terminated when she is 25?

3. This year, Dorothy gave her granddaughter $30,000 to reimburse her for her tuition at NYU School of Law. What is the “total amount of gifts” by Dorothy as a result of this reimbursement? If Dorothy had asked you for advice, what would you have suggested?
4. Several years ago, Greg took out a whole-life life insurance policy on his own life. The annual premium on the policy is $11,000. On December 1, 2004, he assigned all right, title and interest in the policy to Caroline, his child. The value of the policy at the time of the assignment was $80,000. Each year thereafter, Greg pays the $11,000 premium on the policy. What is the “total amount of gifts” by Greg as a result of this assignment? **Further Question:** What are the gift tax consequences, if any, that result from Greg paying the annual premium on the policy?

5. Same as (4), except that Greg assigned all right, title and interest in the policy to a trust. Under the terms of the trust, upon the death of Greg, the trustee is directed to invest the insurance proceeds and distribute the income therefrom to Caroline for life, the remainder to George, Greg’s 5 year old grandchild. Each year Greg contributes an additional $11,000 to the trust.

   a. Suppose that Caroline and George were each given annually the unrestricted, noncumulative right to withdraw $5,000 from the trust during December. During George’s lifetime, these rights are never exercised.

   b. Same as (a) except that Caroline (and not George) is given the unrestricted, noncumulative right to withdraw $11,000 from the trust during December. **Further Question:** Upon Caroline’s death, will there be an inclusion of all or any portion of this trust in Caroline’s estate?
Federal Estate & Gift Taxation

Problem 11

General Problems in the Valuation of Business Interests

Assignment:

Code: ● ● 2031, 2044, 2051, 2053, 2056(a), (b), 2512, 1014(a), (b)(1), (9).

Regulations: ● ● 20.2031-1 through 20.2031-3 (Regs. ● ● 25.2512-1 thru 25.2512-3 on the gift tax side of things are substantially identical).

McDaniel: Chapter 34 and Chapter 35

Materials:

● Estate of Brownell v. Commissioner, TC Memo 1982-632
● Propstra v. United States, 680 F.2d 1248
● Estate of Bonner v. United States, 84 F.3d 196
● Ahmanson v. United States, 674 F.2d 761
● Estate of Curry v. United States, 706 F.2d 1424
● Estate of Chenowith v. Commissioner, 88 T.C. 90
● Estate of Mellinger, 112 T.C. 26

Questions: In each question, determine the value of the assets included in D's gross estate, assuming that:

(1) W is D's spouse, C is D's child.

(2) D died on September 1, 2004. The assets owned by D on the date of death, together with data necessary to determine their value for estate tax purposes, are as described below.

1. ● General principles.

D owned a diamond ring that has been in the family for 5 generations. D bequeaths the ring to C. The ring has such great sentimental value that D would not have sold, and C would not sell, it for less than $1 million. Recall our earlier encounter with the case of a couple traveling on a
doomed plane; an insurance policy on the life of husband was owned by wife. (Rev. Rul. 77-181).

2. - Blockage. D owned 300,000 shares of Z Corp, the shares of which, on the date of death, traded on the New York Stock Exchange at a mean price of $64 per share. The average daily trading volume of Z on the NYSE during the 6 months before and after death was about 1,200 shares.

3. - Minority & non-marketability discounts. D and C own all the shares of Y Corp. D owns 600 shares and C owns 400. The whole company, fairly valued, is worth $6,000,000 ($6,000 per share).

   a. D gives 200 shares to C, bringing C's total holding to 600 shares. If D dies thereafter and bequeathes his remaining 400 shares to C, what is the value of the shares for estate tax purposes?

   b. Suppose D makes no gifts of Y Corp shares and dies owning 600. What is their value for estate tax purposes?

4. - Other issues regarding fragmentation. D and W own all the shares of R Corp. D owns 750 shares and W owns 250 shares. D dies and bequeathes 450 shares to C and 300 shares in a trust for W's benefit as to which D's executor elects Q-TIP treatment under § 2056(b)(7), thereby qualifying the trust for the estate tax marital deduction under § 2056(a). The whole company, fairly valued, is worth $6,000,000 ($6,000 per share) at D's death and at W's death.

   a. Assuming D dies first, at W's later death, what is the value of the 550 Y Corp shares included in W's gross estate (250 owned outright and includible under § 2033, plus 300 shares owned by the Q-TIP trust and includible under § 2044)?

   b. What was the value of D's 750 shares when D died? What was the amount of the marital deduction to which D's estate was entitled?
5. - Fragmentation & multiple classes of stock. T Corp has 500 voting common shares (1 vote per share) and 500 non-voting common shares outstanding. Except for voting rights, the two classes of stock are identical. D owns 250 voting common and W owns 250 voting common. D owns all 500 of the non-voting common. D dies and bequeathes his 250 voting common shares to W and his 500 non-voting common shares in a trust for W's benefit as to which D's executor elects Q-TIP treatment under \(2056(b)(7)\), thereby qualifying the trust for the estate tax marital deduction under \(2056(a)\). The whole company, fairly valued, is worth $6,000,000 at D's death and at W's death.

a. What is the value of D's 250 voting and 500 non-voting common shares at D's death? What is the amount of the marital deduction to which D's estate is entitled?

b. At W's later death, what is the value of the 1,000 Y Corp shares included in W's gross estate (500 voting shares owned outright and includible under \(2033\), plus 500 non-voting shares owned by the Q-TIP trust and includible under \(2044\))?

6. - Publicly traded stock. D owned 1,000 shares of common stock of Z Corp. During 2004, shares of Z Corp listed on the New York Stock Exchange traded between 84 5/8 and 60 3/8. On 9/1/2004, at D's death, 1,470 shares were traded between 64 1/4 and 63 3/4. The closing price was 64 1/4.

a. What if, on 9/1/2004, the Z shares spurted 10 points on a rumor of takeover interest by a group of corporate raiders, but the next day it dropped again on a firm denial of the rumor? (I.e., the value at which the stock traded was $54 per share on 8/31/2004 and 9/2/2004, but $64 on 9/1/2004.)

Learning Outcomes:

Students should, as a result of taking the course 1) become familiar with the structure of the Code and the Regulations in terms of the estate and gift tax provisions; 2) understand the relationship between the gift tax and the estate tax; 3) understand how to determine what is includible in the gross estate; and 4) understand in a general way the underlying foundation for various estate-planning techniques.