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Question I**A. Tom**

Upon creating the irrevocable trust, Tom has made a complete gift that will be subject to the gift tax. A gift has been made because no consideration in money or money's worth has been paid to Tom for the creation of the trust interests. Because the income interest in the trust is held by Tom's granddaughter, Greta, it appears as though the the transfer may also be subject to the generation skipping transfer (GST) tax; but because Rita's power to invade the corpus is so broad, this trust is really a gift to Rita with Rita's subsequent gifts (of a lapse in her power over trust property) to Greta and Steve as distributions are made from the trust.

If Tom and Wilma decide not to make a split gift election, then the entire gift (essentially to Rita) is made by Tom. Tom will be able to take several annual exclusions off the top: an exclusion for Rita, an exclusion for Steve, exclusions for Steve's siblings. Tom can take an exclusion for Rita because she has the right to demand the full corpus at any time, so she has a present interest for which an annual exclusion is appropriate under § 2503. Steve and his siblings have so-called Crummey powers—the right to demand payment of the annually excludable amount for a set period of time after the creation of the trust. These *Crummey* powers are present interests under § 2503 as well (the entire purpose of the *Crummey* power is to take more annual exclusions). The only problem these facts present with respect to the *Crummey* power is that the powers lapse after only 8 days. It is possible that a court would decide that this is too short a period of time. Another court, however, has found that 15 days was sufficient, so 8 may be as well. After these annual exclusions are accounted for, the taxable amount of Tom's gift will be \$3million less \$44k, or \$2.956million. All of this would be taxable.

Tom's single biggest mistake in the creation of this trust is giving Rita, his sister, unfettered control over the trust assets. Because of this, although Tom will not have to pay generation skipping transfer tax, Rita will as she makes payments of the income out to Greta.

Note finally that there is no annual exclusion for Greta because Rita has a right to invade the corpus and effectively destroy Greta's income interest before she realizes one cent of that interest. Because Greta has no right to demand payment from Rita (because Rita can take the entire corpus), Greta does not have a "present interest" under the meaning of § 2503.

B. Wilma (and Tom and Wilma where a split gift election is made)

Unless Tom and Wilma agree to make the creation of the trust a split gift (half of the assets being transferred by each of them), there are no tax consequences for Wilma. Tom and Wilma should be advised to make a split gift election under § 2513, however, because they will be able to use both Tom's and Wilma's annual exclusions.

2 If Wilma and Tom elect to split the gift, then Tom and Wilma will *each* have to pay gift tax on \$1.5million less several annual exclusions. The same annual exclusions will apply for Wilma as applied for Tom in the case where no split gift election was made. In particular, both Tom and Wilma will each get to exclude \$44k (four annual exclusions) from their gifts of \$1.5million each. Thus Tom and Greta will *each* have to pay gift tax on \$1.456million. Since both of their lifetime gift tax credits are used up (the credit currently stands at the \$1million exclusion equivalent), tax *will be due* on the \$1.456million.

C. Greta

In this case, Greta is a skip person with respect to Rita. Upon making payments of the income to Greta, Rita's interest in the income (through her ability to invade the entire corpus) lapses in part, and those lapses are gifts from Rita to Greta. Since Greta's father is still alive, the lapses in part, and those lapses are gifts from Rita to Greta.

“orphan rule” does not apply, and Greta, being a lineal descendant of the grandparent of Rita who is two or more generations below that of Rita, will be a skip person with respect to Rita. In the case of a direct skip, though, GST tax is the liability of the transferor, and so there are no tax consequences to Greta.

D. Rita

Rita is in a bad position. First, so as to minimize tax liability for the whole family, Rita should promptly disclaim her power to invade the corpus “to support her ongoing needs and sensible desires.” This power is essentially a general power of appointment, not limited by any ascertainable standard (desire sounds like “happiness,” which is not an ascertainable standard), and so ultimately Rita will be treated as owning the *entire corpus of the trust*. If Rita disclaims her general power of appointment within 9 months of its creation, then she will not be treated as owning the corpus. If Rita disclaims, then Greta will have to pay the generation skipping transfer tax that Rita would otherwise have to pay (if Rita did not disclaim). If Rita disclaims, Greta will have to pay the GST tax because the payments out of the trust to Greta will be taxable distributions, and it is the distributee’s responsibility to pay the GST on such distributions. [Note that initially, Tom should never have given Rita the unrestrained power to invade the corpus, Tom and Wilma should have made a split gift election, and both of them should have fully allocated their GST exclusions toward the formation of the trust. In that case, there would be no GST at all.]

If Rita does not disclaim her general power of appointment, each distribution to Greta will be a taxable gift (equal to the amount of income paid to Greta), *and will be subject to the GST tax* because Greta is a skip person with respect to Rita. In this case, the skip will not be a taxable distribution, it would be a direct skip from Rita to Greta, and so Rita would have to pay

the GST tax on the transfer. Rita at this point could choose to use her GST exemption towards these payments to Greta (which is the default rule), or Rita could elect not to apply the exemption to these payments. If Rita elected not to apply the exemption to these payments, the GST tax would apply. The GST tax applies at the highest marginal estate tax rate—currently 48%.

If Rita has not disclaimed her general power of appointment, when the trust is terminated (when Greta reaches age 25), Rita will have to pay gift tax on the value of the trust assets transferred to Steve. Presumably, Rita will get an annual exclusion for this transfer, and she may also be able to use her gift tax lifetime exclusion (if she has not already exhausted this credit), but regardless, since the assets are valued at \$3.8 million when the trust is terminated, Rita will have to pay gift tax on at least some of the transferred amount.

E. Rita's estate

If Rita disclaims her general power of appointment in a timely manner, there will be no consequences for Rita's estate. However, if Rita did not disclaim her general power of appointment, then, although Rita will have paid gift tax on the transfer to Steve, the amount of gift tax paid by Rita on this transfer (and on any other transfers occurring within the last three years of Rita's life) will be dragged back into Rita's gross estate by § 2035. The appreciated value of the former trust property will not be pulled into the gross estate, but the gift tax will.

F. Steve

First, Steve has a *Crummey* power that terminated on October 28, 2004. The lapse of that *Crummey* power is a gift to Rita (the present interest-holder of the "trust"). This *Crummey* power is a general power of appointment over \$11k, and when the GPOA lapses, § 2514 treats the lapse as a gift. § 2514(e) provides safe harbor for Steve, though, because his power of

appointment is over only \$11k. § 2514(e) provides that lapses of GPOAs over the greater of 5% of the total assets out of which the power could be exercised (in this case, 5% of \$3million = \$150k) or \$5k will be ignored. Here, because Steve's power over \$11k is clearly below the 5% threshold of \$150k, Steve's lapsed power will result in no tax consequences for Steve.

G. Steve's Siblings

Like Steve, his siblings have *Crummey* powers that will lapse when they are not exercised. The result is exactly the same for Steve's siblings as it is for Steve.