Doris's gross estate and the amt of estate tax due.

QUESTION 3

When Abe transfers $500K to Holdco, he is actually treated as having made a completed gift to Brett. Brett did not pay anything so no consideration flowed back to Abe. But, the value of Brett's shares increased. The value of the gift will likely be 40% of 500K = $200K. (However, Abe might argue for a minority discount since the gift is made to a minority shareholder whose shares won't be worth as much as those of a controlling shareholder).

Since Abe has used all of his gift tax Unified Credit, the whole gift will be subject to gift tax

except for $11K (for which Abe will be able to take an annual exclusion). Abe, as the donor, will have to pay the tax.

Under 2703 and 2704, some restrictions apply to valuation discounts taken for shares of family owned companies. These may apply and may also limit Abe's ability to take a valuation discount (as mentioned above).

As for Trust #1, Abe may be stuck w/ some ugly transfer tax consequences. But, the fact that Brett gave Abe consideration for his remainder interest may be Abe's saving grace.

Under 2702 when a person gives a gift to a family member and retains an interest (eg, in the trust), the retained interest is treated as Ø value (unless the interest is a qualifying interest similiar to those that apply for charitable deductions). In such a case, the donor is treated as having made a

gift of the full value of the property transferred.

But, b/c Brett paid the actuary valuation of the remainder of #1 the portion he would eventually get, there may not be a completed gift at all. There is some conflict over whether the actuary value paid by a family member is actually full + adequate consideration. If it is, there is no gift and no gift tax liability will ensue. But, if it is not adequate consideration, Abe would be treated as having made a gift of the full value of the trust (including his retained income interest but minus the value of consideration received in return) and would be liable for the gift tax imposed.

Likewise, Abe's retained life estate could be a problem in that, at Abe's death, it might be treated as a 2036(a)(1) string, thus bringing the full value back into his gross estate for estate tax purposes. This would

be a particularly wicked turn of events b/c, although Abe would get credit for the gift tax paid the first time around, he would still be liable for estate tax on the full value of the trust (which seems to have appreciated considerably since its creation).

Still, Abe may have a way out of this horrendous imposition of est + gift tax liability b/c of the consideration that flowed back from Brett. Under 2036(a)(1), if the transferee paid the transferor full + adequate consideration for the original transfer, the full value is not dragged back into the transferor's gross est at death. As mentioned above, there is some conflict over whether the actuary value of the remainder, paid at the time of the trust creation, is full + adeq consid for 2036(a)(1) purposes. Some would say f/a consid = d.o.d. value

be subject to estate tax on the full value of the trust (minus what the consideration was determined to be worth). If this was the case, Abe's est would be liable for paying the estate tax.

If the consid was not found to be f+a, Abe would still not get an annual exclusion for the gift to Brett b/c it was a future interest.

As for Trust #2, when it was established it was a completed gift to Cheryl of the whole thing. Abe could take an annual exclusion for Cheryl's present right to receive income. Since he has used up his Gift Tax Unified Credit, Abe must pay gift tax (as the donor) for the full value of the income interest and the remainder interest.

The only thing in Trust #2 that might have presented an issue was Abe's retained right to invade the corpus for Brett's benefit. This would seem to be a 2038 problem as it looks like a grantor retained power to alter who would

receive the benefit of the trust corpus. Such a retained right would be treated as an incomplete gift. Moreover, when Abe died, it would have dragged the value of the trust corpus (and possibly the income int under 2036 (a)(2)) back into Abe's gross estate).

However, Abe was smart and limited his powers, in so much as he would need Cheryl's consent to change who would benefit from the trust corpus. B/c Cheryl had an interest in the trust corpus, she is clearly an adverse party. If a retained right to change the beneficiaries of a trust is only exercisable through getting consent from an adverse party, it does not work to drag the whole thing back into the gross estate.

So, Abe will have to pay gift tax now (when trust ② is set up) but will

not have to pay estate tax on #2 later.

When Abe dies survived by Brett + Cheryl, his gross estate will be determined under 2033 by including all prop in which he had an interest. Deductions may be taken and then Abes taxable estate will be valued. The 60% of stock in Holdco that Abe died w/ may be subject to a control premium and therefore may be worth slightly more than 60% of the FMV of the company. Depending on the gift tax outcome of trust #1, part or all of that may be included in Abes gross est as well.

B/c the value of Abes property has substantially increased (and will probably continue to do so), Abes estate would probably not elect to take the 2032 Alt Valuation. But, ~~if he were~~, Abes estate did elect to take the 2032 Alt Valuation, it would be all or none each

asset would be valued individually, it would have to decrease gross estate value and decrease amt of est tax due.

B/c the Gift Tax & the Est Tax are not truly "unified," Abe would be able to use the rest of his Unified credit against the est tax imposed. In 2008, that is quite a lot more than the $1 M credit that the gift tax is stuck at.

Thank you! Happy Holidays!!