

Question 3 Lucky Nick

Hubert makes a completed gift of the remainder in Trust 1 to Nick when he sets the trust up. The value of this remainder, using the tables specified by §7520, would be \$283,790, and that is the gift taxable value; no \$10K exemption because it's a future interest.

It's a good thing Nick is his nephew, not his son. If Nick were Hubert's son, §2702 would make the value of Hubert's grantor-retained interest, since it's not a qualifying annuity or unitrust interest, 0, so the whole \$1,000,000 would be a taxable gift on the spot. But Nick is not a family member as set out in §2704c2, so Hubert is OK.

Next, the cost of the insurance policy, \$700,000, is a gift when Hubert transfers ownership to Nick. You have to use the cost, not the cash surrender value, because the Supreme Court says insurance policies are like bundles of sticks, and the cost more clearly reflects the value of the whole bundle. Since there is cash value, this is a present interest, so you can take a \$10K exclusion. Cold comfort, but Hubert is pushing a 55% rate here, so take what you can get.

Both of these gifts are direct generation skips only if Nick is 37.5 years younger than Hubert. So far, we're under the \$1-million exclusion, so Nick isn't going to eat any GST either way.

Unfortunately, Hubert didn't last long enough, so his estate is going to include the insurance proceeds because he "cut the string" within the last three years

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So § 2035 will bring it back in, plus all the gift tax he paid. Then, the gross estate will include the full corpus of Trust 1 under § 2036, because Hubert transferred the property while retaining a life interest. Again, § 2035 is going to bring the gift tax paid back into Hubert's estate as well.

§ 2036 is not going to get Hubert on Trust 2, because Wendy's income interest is measured by her life, not Hubert's, and because he didn't retain anything.

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Assuming Hubert can and does make the applicable election, Wendy's trust may be eligible for the marital deduction as qualifying terminable interest property.

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This would mean no gift tax on this transfer, and the property would be taxed in her estate under § 2044 rather than in Hubert's.

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The possible fly in this ointment is the silliness about giving the first year's income out of Wendy's life estate to Nick. To be QTIP property, there can't be anyone behind Wendy, or anyone who will get any of her interest. If I'm the revenue agent, I will assert that this is not a qualifying life estate because Wendy didn't have the whole income interest for her whole life. If I win on this, that stunt to keep the Jan. 1 to Wendy's death income away from her estate will cost, since Hubert's estate is fixing to pay large estate tax, and doesn't need another two mil in the gross estate because the marital deduction goes away.