~~[illegible]~~ QUESTION II

A

M loans $200K to S

This transaction is a gift loan (§7872). It is a demand loan whose interest is less than the federal rate, therefore a below-market loan ((e)(1)) and foregoing the interest is in the nature of a gift ((f)(3)). This can be assumed because it is mother-to-son — not an arm's length business transaction. The amount of the gift is the foregone interest which is the difference between interest paid and interest due under AFR ((e)(2)). ~ ((a)(1)(a)). The gift is made annually ((a)(2)). So the amount of the gift will be the 8% interest on $200K for 1 year which has been compounded semi-annually ((8% x $200K) + (8% x ($200K + (8% x $200K))). Assuming she hasn't given S anything else that year, M will get the $10K annual exclusion & if her life gifts dont add up to $600K, she will get the $2505 unified credit & not have to pay any tax.

Because loan made mid-year, the 1996 tax charge will be 8% x $200K. Then M dies & loan debt forgiven on 06/30/1997. The gift ~~tax~~ ~~bill~~ for 1997 on this will be 8% x $200K + (8% x $200K)).

3

2

2

M dies

- M will get §2010 unified credit + standard credits/deductions. But the gift tax paid on the loan to S will be kicked back into her estate §2035(c) because gift was made within 3 years of her death.

2

Power of Appointment

4

The amount of the trust is in M's gross estate. Under §2041, she had a general pwr of appt. exercisable in her favor (creditors, etc.) ((b)(1)). Prior to Billy's death, the power fit into exception (b)(1)(c)(i) grantor must give permission to exercise. But since his death, M has unilateral power to exercise. Therefore, full amount of trust is in M's gross estate

M forgives loan to S

4

The $200K is included in ~~$~~ M's gross estate. It is treated as if S ~~[illegible]~~ repaid the loan then M left him $200K because the $200K is an "unsettled" claim of M's estate, therefore includable

B

principal residence

· probably valued by "comparable sales" method
- look at what comparable property is going for.
The difficulty is if there is no comparable property

personal effects

These will be valued by their subsequent sale price at an estate sale or even a garage sale.

commercial real estate

This will be valued according to the income capitalization method. Look at the asset as a thing which generates benefits then reduce future benefits to the present value. The numbers used to figure this out are all projection or speculation.

$$\text{Present Value} = \frac{\text{annual income} \times X}{1 + \text{discount rate}}$$

The riskier the venture, the higher the discount rate

equipment

This would be valued by the replacement cost method.
This usually doesn't reflect wear + tear & depreciation
can be subtracted