Question #1

Gift Taxes

Myra's setting up of Trust No. 1 was a completed gift under §2511. The ability of the trustee to invade corpus for Gwen's benefit does not keep this from being a completed gift of the future interest of the remainder. The trustee's power is also not a general power of appointment under either §§2041 or §2514. The trustee does not have the power to invade corpus for himself, his estate, his creditors, or the creditors of his estate, so the power is a special power of appointment, and has no gift or estate tax consequences for the trustee. The value of Myra's gift of Trust No1. is $950,000 (the fair market value (FMV) of the stock at the time of the transfer. Although ~~§2402~~ §2503(c) allows future interest gifts to minor to be considered as present interests, it also requires that the trust terms require the corpus be paid out to the minor upon reaching age 21. That is not the case here. Hence the gift of Trust No1. is not eligible for the annual exclusion under §2503(b). The full value of the property is taxed as a gift despite the retained life income interest because the remainder was given to a lineal descendant of Myra and §2702(a)(2)(A) values this retained interest at zero. The $950,000 exceeds the Unified Credit under §2505, which in 1998 was $625,000. That means that $325,000 would yield at 39% a gift tax of $126,750 in 1998 for Trust No. 1.

Trust No 2. was not a completed gift at the time it was set up. Under the rule from Estate of

Sanford, the retention by the grantor of the ability to change a beneficiary makes the gift incomplete. Once that power is relinquished in 2001, the gift does become complete. The value of the gift is somewhat complicated. Although it appears that §2702(a)(2)(A) would apply to Myra's retained interest making it zero, §2702(a)(3)(A)(ii) allows for Qualified Personal Residence Trusts to be excepted from this zero valuation, instead using the actuarial value of the retained interest. In this case, the actuarial values use the interest rate, under §7520(a) of 20% and the actuarial tables of the code to determine the value of Myra's retained interest based on the fact that she was 63 with 12 years left to run on her estate. The right to rent the property following the trust's termination would also be difficult to measure. The burden is on the taxpayer to show the value of her ~~estate~~ retained interest. If it cannot be determined through generally accepted ~~accounting~~ valuation principles, the value will be taken to be zero. Since Myra had used up her unified Credit in 1998, only the additional $50,000 in Unified Credit increase for 2001 would be used against her gift, the rest would be taxed in the 43% bracket. There were also no present interests in Trust No2. that would make the gift eligible for an annual exclusion. Under §2502 Myra is responsible for all the gift tax.

Estate Tax

The Estate Tax consequences for Myra are the only ones involved here. The executor of her estate would be liable for them under §2002. The value of trust

No.1 is in Myra's estate. ~~Although~~ Because she retained a life income interest in the property, the full FMV of the trust at death is included in Myra's estate (1.8 million). The value of Trust No 2 is also in Myra's estate under §2036(a)(1) because she died before the term of years on her Qualified Personal Residence Trust expired which was within 3 years of her death. §2035(a) would also have included the property because the final gift was less than 3 years before her death. §2038 would not have applied directly, but §2035 would have allowed the remainder to be brought back into Myra's gross estate even if §2036 did not. §2035(b) also would bring the gift tax paid in 2001 back into the gross estate. Although in 2003 the Unified Credit under §2010 would be $700,000, Myra has long since passed this amount, and an estate tax on both the $1.8 million + $625,000 trusts would be due.

Generation Skipping Transfer Tax - (GST)

Under §2612, a taxable termination has occurred on Myra's death. Gwen is a skip person as defined under §2613. If at the time of the setting up of Trust No. 1, Myra elected to have her $1 million allocation from §2631 allocated to the trust, the result would be no GST tax due. If she instead had the $1 million allocated as dictated by §2632, since there were no other generation skips, the result would be the same.

Gwen and Susan have no Federal Estate, Gift, or GST tax liabilities in this problem.

Question 2

Hank is the only person who has made gifts subject to the Federal gift tax in this problem. Bob, although retaining a power of appointment which lapses, has the power limited to an ascertainable standard, and also does not have the power to appoint to himself, his estate, or the creditors of either. Hank has not made any taxable gifts through the trust. The present interest is to his wife, so the marital deduction under §2523. The remainder interest to his children if they survive him and his wife, makes the gift incomplete as to them. (T. Reg. §25.2511-2(c)). Because Wendy's interest in the estate is terminable, in order to get the §2523 tax benefit, she would have to make a QTIP election if the gift had been complete. Since it was only for Wendy's life estate, and Hank retained the reversionary interest, the election was necessary and since the contingent remainder was to his children, §2702(a)(2)(A) would make Hank's reversionary interest zero. The gift would be for $5 million (it is possible to argue for a blockage discount as well because there are so many shares, and this number may be reduced possibly by 20%). The entire value of the gift would be taxed at 55%. (Note: the blockage discount might be able to counterbalance the control premium that is likely to be on this large of a block of stock). * See pg 8.

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Hank's estate would probably have to pay estate tax on the full value of the stock at the time of his death ($6 million) less the value of his wife's life estate. §2037 applies to transfers in which the grantor retained a reversionary interest greater than 5% of the value of the gift, if enjoyment of the property would pass to another by reason of his death. Here, the actuarial value of outliving his wife is probably much higher than 5%.

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It would again be possible to argue for a blockage discount of the stock. The IRS would be likely to argue that the stock should be valued at a premium for either controlling interest, or effective control of the company.

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When Wendy dies, her estate will have to pay estate taxes as well. Since Wendy made the QTIP election (most likely) when the gift was made, the value of the stock would be in her estate under §2044. Although typically under §2002, Wendy's executor would be liable for the estate tax, there is also the possibility that the kids could be forced to pay at least the estate tax on the stock they recieve under §2207A.

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Since there are no people more than a generation apart as defined under §2613, there are no Generation Skipping Transfers involved in this problem.

Question #3

Gift Tax Consequences

In 1995, the gift from Diane to Sarah of the life insurance policy was a completed gift. The value of the life insurance policy would be determined under T. Reg. §25.2512-6. We have no other information in the problem to determine the value. It is likely that the value is high; close to or over the $600,000 Unified Credit available in 1995.

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Eleven months after Diane's death, the disclaimer by Sarah of the trust property, resulted in a gift by Sarah to the college and church. Sarah's disclaimer did not satisfy the requirements of §2518 to be a "qualified disclaimer," because it was not within 9 months of the transfer. There would probably not be any gift tax consequences for Sarah however because of the fact that the reversionary interests are both charitable organizations (~~most likely~~) under §2522(a)(2). There is also a gift from Sarah to Diane's estate (see below)

Estate Taxes

Diane's estate will include, among a portion of the other things she placed in the testamentary trust, the $1 million value of the life insurance policy on her life. §2042 includes the value of the life insurance if the benefits are payable to the executor of her estate. ~~if the decedent has the power~~ The ownership of the policy is irrelevant, except to the extent that Sarah should have simply changed the beneficiary to herself, instead of Diane's estate. Because she did not, there is also a gift from Sarah to Diane's estate of $1 million. The $1 million from the life insurance policy may be taxed twice; once in Diane's estate, and once as a gift from Sarah! Duh!

The property in the testamentary trust will be eligible for §2055(a) charitable deduction treatment. The trust is a unitrust with a charitable remainder (Charitable remainder unitrust). Only the value of Sarah's 5% for life would be included in Diane's gross estate.

Diane's gross estate may be able to deduct the $100,000 cost of the auctioneer under §2053. Even though the probate court determined that the cost of the auctioneer was reasonable, and deductible under §2053, in a similar case, a court held otherwise. In Estate of Smith v. Commissioner the estate deducted the commissions paid to a gallery for the sale of sculptures even though the NY probate court had allowed the expense as reasonable under §2053. The IRS challenged this decision citing to Commissioner v. Estate of Bosch, stating that lower court decisions are not binding on the Tax Court if the Tax Court decides that the highest state court would have ruled differently. The court agreed with the IRS in Smith, and stated that the sculptures could have been given directly to the beneficiaries, and the could have sold them at their own expense. This is still an unsettled point of law as to whether or not those type of commissions are a "reasonable expense," under §2053, and the IRS often challenges this type of deduction. Furthermore, as executrix of Diane's estate, under §2002 Sarah is liable for the deficiency should the IRS pursue this.

There are no generation skipping transfer taxes in this problem.

Question 2 * addition:

Because of Wendy's QTIP election, none of the stock gift would be taxed at this 55% rate at the time of the gift. If she did not make the QTIP election, the tax would be due that tax period. This may be an option that some taxpayers would choose, if the property was very rapidly gaining in value. The payment of tax at the time of the gift would freeze the value of the gift for the couple's estate & gift tax purposes.