Exam #9220 20 21 22

Question #1

Trust #1

Because the trust is irrevocable, it is a complete gift of the remainder interest to Gwen when it is set up. There is no gift of the income interest b/c Myra is the income beneficiary and you cannot make a gift to yourself. The value of the remainder gift to Gwen is the full $950k b/c under §2702 she is a family member so Myra's retained interest is valued at zero. Because Gwen's interest is a future interest Myra is not entitled to an annual exclusion for the gift. Nor is she entitled to any type of discount for marketability or control issues since the trust is funded with stock that is traded on a public stock exchange. If she owned huge blocks of stock in one company then there might be blockage discounts or control premiums at issue, however we have no facts indicating that that is the case. If she chooses to allocate her entire $625k unified credit to this gift then she will only have to pay gift tax on the remaining balance.

There are no GST implications at the time this is set up b/c it is not a direct skip b/c Myra is not a skip person. Because Myra retains an interest in the trust, she is also not entitled to allocate GST exemption at the time it is set up.

If the trustee exercises his power to invade corpus for Gwen, then this would be a taxable distribution and Gwen would be responsible for paying tax at that time. The tax would simply be on the value of the distribution, not the value of the entire corpus.

When Myra dies the entire $1.8m is going to be brought back into her gross estate under §2036 because she retained the income interest until she died. Whatever unified credit was not used on previous gifts can be used to reduce the amount of tax

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she will owe. The unified credit in 2003 is $1m. She will also get credit for any gift tax that would have been paid on previous gifts

Since GST exemption was not allocated during her life b/c of her retained income interest, her $1m exemption will be applied now b/c her death is a taxable termination. GST tax on $1.8m is $990,000 so the trustee will owe no tax on this b/c it is covered by the exemption.

§2035 will not pull the gift tax paid on this gift back into her estate b/c it was paid more than three years before her death.

Trust #2

When this trust is set up there is no complete gift because Myra retains the right to change the remainder beneficiary so Sam may never get anything. When she releases the right in 2001 then there is a complete gift of the remainder interest. Even though Sam is a family member, §2702(a)(3)(ii) allows her to deduct the amount of her term of years from the value of the gift. So she will only have to pay gift tax on the remainder interest. Since she will be 75 when her term of years ends, the value of the remainder interest is $550k times .53904 or $296472.

The value of the house is going back in Myra's estate when she dies for a number of reasons. First of all when she retained the right to live in the house she effected its present enjoyment and §2036 applies. Also, b/c she retained the right to change beneficiaries §2038 applies b/c she could have revoked the remainder at any time. Because she died before her term of years expired and she released §2038 powers less then 3 years before her death, §2035 is going to bring the entire $625k value of the house into her estate. Also, any gift tax that was paid on the gift of the

2 remainder will get dragged back into her estate under §2035. The fact that the trust said that she could rent the house from Sam at fair rental value only would have effected §2036 if she had outlived her term of years and really rented the house. In that case §2036 wouldn't apply b/c it would have been a bona fide arms length business transaction.

/ Sam – there are no tax consequences to Sam at any time b/c he is simply a beneficiary that could have been changed at any time until the power was revoked.

Question #2

When trust is set up this is a complete gift b/c it is irrevocable and the grantor has no right to effect either the income interest or the beneficiaries. The income interest to his wife is terminable interest and if a QTIP election is not made then gift tax will be owed on the $5m that is transferred in trust by using the tables to figure out the value of 2 Wendy's life estate and the value of the remainder to his kids. Since there is no value placed on his contingent reversion under §2702, the entire value of the remainder after / Wendy's life estate is the gift to the kids. The remainder to the kids is not entitled to split gift annual exclusions b/c it is a future interest. However, if a Q-tip election is made then the entire property is treated as going to Wendy and there is no tax owed when the 3 gift is made. This trust qualifies for the Q-tip election because the income is payable to / Wendy at least annually and the corpus cannot be appointed to anyone other then Wendy.

4 The value of the gift will be something less then the full $5m b/c of a blockage or market absorption problem. If all 1m shares of this stock were sold the market would

not be able to handle it b/c only about 100k shares trade hands each month. B/c of this restriction on the marketability of the stock Hank should be able to get a discount.

There are no GST consequences to the transaction b/c there are no skip persons involved.

/ If Bob's power to invade corpus for Wendy is limited by an ascertainable standard, he is not making a gift if he exercises the power. He is also not responsible for any taxable terminations b/c this is not a GST.

When Hank dies the value of the trust is $6m. Because Hank kept a contingent life estate in the property then §2036 is going to bring back the value of the remainder after Wendy's life estate. Since it was a contingent life estate the entire value of the corpus is not dragged back. However, he also kept a reversionary interest so §2037 is going to drag back the value of the reversion if it is more than 5% of the value of the property. This 5% value cannot be determined by the tables and must be figured out by an actuary. If the value is less than 5% then §2037 does not apply and the only value that is going to be brought back is the value of the remainder after Wendy's life estate.

§2035 is not going to bring back any gift tax that was paid when the trust was set up because it was not set up less than three years before Hank died.

When Wendy dies the trust is worth $6m and the full value of the trust is going to be in her gross estate if a Q-tip election is made by the trustee. If the election is not made then her interest terminates and the remainder goes to the kids. However, when valuing the trust a discount should still be allowed for the same blockage or market absorption problems.

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If the remainder of her estate is going to someone other then H's kids then the executor should be able to go after Ken and Karen for the estate tax that is owed. Because why should her devisees have to pay tax on something that is going to his kids. So Ken and Karen may be on the hook for the estate tax on the trust because they are getting the beneficial interest

Question #3

When Diane gave the policy to her sister this was a completed gift b/c she gave up all incidents of ownership including the power to change the beneficiaries. The value of the policy would have been based either on the premiums that Diane paid for it or the interpolated terminal reserve which is generally its cash value. She would have been entitled to an annual exclusion even though a life insurance policy is generally not considered income producing property. If the value of the policy was more then her unified credit or if she chose not to use her unified credit then she paid gift tax.

When she dies the entire $1m value of the policy is in her gross estate even though she was not the owner. Because the beneficiary of the policy was her estate §2042(1) drags back in the whole value of the policy.

Because she died more than 3 years after the gift of the policy was made, the gift tax is not dragged back into her estate by §2035.

Her estate will also be allowed a charitable deduction under §2055 for the remainder of the unitrust that is established by her will. In order to be a valid unitrust the payment terms must be for the life of an individual beneficiary (in this case Sarah) the annual payment to the non-charitable beneficiary must be a fixed % between 5 and 50 of the fair market value of the property (in this case 5%) and the trust must be valued

at least annually (in this case by independent appraisal experts). The fact that the income is to be divided in equal shares to two different charities does not make this an invalid unitrust.

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The estate is not going to be allowed a deduction for the value of Sarah's life estate in the trust b/c her disclaimer is invalid under §2518 b/c it was not received by the executor within nine months of the trust being established. The fact that it is valid under local law and in all other respects is a valid disclaimer does not except it from §2518. So the estate is not going to be allowed the deduction.

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Under §2053 the estate is allowed a deduction for administrative expenses involved in selling property of the estate. However the expenses must be necessary and it can be argued that this $100k was not necessary b/c Sarah was selling it because she didn't like the items not b/c she needed to liquidate the estate for any reason. However, if she needed the money for debts of Diane or the estate then this would be a necessary expense and according to the facts was reasonable amount.

The fact that the amount was approved by the probate court does not make this a necessary and reasonable deduction for estate tax purposes b/c the tax court is not bound by the laws of the local state unless they are adjudicated by the highest court of the state. The IRS could argue that this expense was not necessary for the estate b/c the items could have been distributed to the beneficiaries and they could have sold them off, incurring the costs.