

Issue Outline
Estate & Gift Tax Exam
Fall 2019

Question 1

The establishment of the trust is a completed gift by Cher of the remainder interest. Because the trust qualifies as a qualified personal residence trust, Cher's retained interest is not valued at zero under section 2702. The value of the retained interest is subtracted from the value of Beachacre in determining the amount of the gift. The value of the retained interest is determined using the tables under section 7520. The gift of the remainder interest is not eligible for the gift tax annual exclusion because it is a gift of a future interest.

The joint purchase of Mountacre is in part a gift by Cher to Daya. For gift tax purposes, assuming that the joint tenancy is unilaterally severable by each co-tenant, each half interest with right of survivorship is valued at one half of the overall value of the property, with no discount. Because Cher paid \$750,000 and received an interest worth only \$500,000, Cher is treated as making a gift of \$250,000 to Daya. The gift is eligible for the gift tax annual exclusion.

At Cher's death, the full fair market value of Beachacre, as of the date of death, is included in Cher's gross estate under Section 2036(a), because Cher retained the enjoyment of Beachacre for a period that did not end before her death. Cher's estate will receive credit for any gift tax paid when the trust was established.

At Cher's death, Mountacre is included in her gross estate, at the value on the date of death, under section 2040. However, there is excluded from the gross estate the portion of the property for which Daya paid consideration not traceable to Cher. The excluded portion is a fraction, the numerator of which is the consideration furnished by Daya (\$250,000) and the denominator of which is the total consideration paid (\$1,000,000). Therefore, one quarter of the \$1,200,000 value of Mountacre is excluded from Cher's gross estate. The other \$900,000 is included, with no discount. Cher's estate will receive credit for any gift tax paid when the property was purchased.

The condominium and the marketable securities are included in Cher's gross estate at their date-of-death fair market values under section 2033. The cash is also included.

The executor fee is deductible as an administrative expense under section 2053(a)(2). The expenses for renovating the condominium, and the property taxes and insurance premiums paid during the renovation project, may not be deductible because they may not be necessary for the administration of the estate.

Cher is entitled to use the unified credit to offset gift and estate tax. There are no GST tax issues presented in this question.

Question 2

An initial question is whether the transaction between Fran and Noel is a loan or a gift. If Fran did not expect repayment from Noel at the time the funds were advanced, the entire \$200,000 is an immediate gift. Assuming that the transaction is a bona fide loan, it is a below-market loan covered by section 7872. The foregone interest is treated as a gift from Fran to Noel. Because it is a demand loan, the gift occurs annually during the term of the loan. Here, the balance is \$200,000 and the applicable federal rate is 2 percent, so that the annual gift is \$4,000. This gift is eligible for the gift tax annual exclusion.

At Fran's death, assuming that the transaction was a loan, Noel's promissory note is included in Fran's gross estate at its fair market value on the date of death.

The establishment of the trust is a completed gift of Noel's income interest, but an incomplete gift of the remainder. Moira retains the right to change the remainder beneficiary in conjunction with Ara, a nonadverse party. Moreover, Moira has the right to remove Ara and substitute herself as the trustee. The administrative powers to change investments and allocate gains to income or corpus are not sufficient to render the gift incomplete. The completed gift of the income interest is eligible for the gift tax annual exclusion.

The powers granted to Moira's sisters are completed gifts. Although the sisters have no other interests in the trust, the transfers may qualify for gift tax annual exclusions under the *Crummey* line of cases. If Moira and Fran elect to split their gifts under section 2513, annual exclusions of \$30,000 per sister would be available.

The lapses of the powers are treated as exercises of powers of appointment, and therefore gifts, by the sisters. However, the gifts are likely covered by the "5 or 5" exception for lapses in section 2514(e).

At Moira's death, the remainder interest in the trust is included in her gross estate under section 2038. The remainder interest is valued based on the fair market value of the trust corpus and Noel's life expectancy when Moira dies.

The wrongful death proceeds are probably not includible in either decedent's gross estate, because neither had a property interest in those proceeds. The IRS may challenge this conclusion if wrongful death awards under the applicable state law include recoveries for pain and suffering suffered by the deceased.

Ara does not hold a general power of appointment over the remainder interest so long as Moira is alive, see section 2514(c)(3)(A). However, upon Moira's death, the power may become exercisable by Ara alone, in which case it could potentially cause adverse gift or estate tax consequences to Ara in the future.

All parties in this question may use their respective unified credits to offset gift and estate tax. There are no GST tax issues presented in this question.

Question 3

The transfer of the Corp stock from Jan to Emi is a completed gift. The value adjustment clause is likely to be challenged by the IRS, but under trends in case law, it may control the valuation of the stock for gift tax purposes. The gift tax annual exclusion may also be challenged by the IRS, because the stock pays no dividends. The outcome of such a challenge may depend on additional facts not addressed in the question.

The transfer of securities by Jan to Zeke is a gift for gift tax purposes, but because the transfer does not take place until after Jan and Zeke are married, it is likely deductible under the unlimited marital deduction. See section 2523.

The transfer to the trust is a completed gift. Jan's retained interest is valued at zero under section 2702; therefore, the value of the gift is the full \$2,000,000 of cash transferred. Jan is entitled to an annual exclusion for Billy's income interest, but not for the contingent remainder transferred to Galen, which is a future interest.

The payments by Jan of Owen's medical bills are excludable under section 2503(e), but only to the extent that the payments are made directly to medical care providers. Reimbursements paid to Owen are not eligible for the section 2503(e) exclusion, although they are eligible for the annual exclusion under section 2503(a).

Jan and Zeke can elect to split their gifts under section 2513, in which case the potential use of the gift tax annual exclusion is effectively doubled.

At Jan's death, Jan's gross estate includes the 80 percent of the Corp stock that Jan owns, under section 2033. The decline in value of the stock may make an alternate valuation date election, under section 2032, attractive. In determining the fair market value of the stock, a key person discount and a control premium may be taken into account.

Under section 2035(b), any gift tax paid on gifts within the last three years of Jan's life is included in the gross estate. Under section 2036(a), the IRS may argue that the 20 percent of the Corp stock transferred to Emi should be included, at its value on the applicable estate tax valuation date, in Jan's gross estate, because of her use of corporate funds for Jan's personal expenses. Under that theory, the estate would receive credit for any gift tax paid when this stock was given to Emi.

Under section 2037, Galen's remainder interest is included in Jan's gross estate based on the value of the trust corpus on the applicable estate tax valuation date and on Billy's life expectancy at Jan's death. The estate receives credit for any gift tax paid with respect to the remainder interest when the trust was established.

Galen is a skip person as to Jan. The establishment of the trust and Jan's death are not taxable events for GST tax purposes, because Billy, a nonskip person, holds an interest in the trust. However, upon Jan's death, it becomes clear that the trust will experience a future taxable

termination, when Billy dies and the trust corpus is distributed to Galen. Assuming that the termination is not covered by an allocation of Jan's GST tax exemption, the GST tax must be paid at that time by Kashco.

The facts of this question do not create any gift, estate, or GST tax consequences for Billy.