

ESTATE & GIFT TAX ISSUE OUTLINE
Spring 2021

QUESTION ONE

The creation of the trust is not a completed gift because Asa retains the right to change the remainder beneficiary. Upon amendment of the trust to relinquish that right, Asa completes the gift of the remainder. No annual exclusion is available for this future interest. Under Section 2702, because Asa's retained interest is neither an annuity interest nor a unitrust interest, it is valued at zero. Therefore, under the subtraction method of valuation, the value of the remainder is the full value of the securities. That value is determined as of the date on which the gift is completed.

At Asa's death, the full value of the securities is included in her gross estate under Section 2036(a)(1), because she retained the right to the trust's income; or alternatively under Section 2035(a) because she relinquished the right to change the beneficiary (which would have implicated Section 2038) within three years of her death. The value is determined at the date of death or, if elected, the alternate valuation date specified in Section 2032. In computing the estate tax, the lifetime gift in trust will not be considered an adjusted taxable gift. Therefore, the estate will in effect receive credit for the gift tax paid when the gift became complete.

The purported loan is a gift for gift tax purposes if the funds were advanced with no expectation of repayment. The proper characterization depends on whether the promissory note was genuine, and if so, its fair market value. If a gift is present, an annual exclusion may be available. If the note is genuine, then it is included in Asa's gross estate under Section 2033.

The proceeds of the life insurance policy are not included in Asa's gross estate because her estate was not the beneficiary, and Asa retained no incidents of ownership in the policy. The gifts of money to Dee are subject to gift tax, except as excluded by the annual exclusion.

Does Ben have a general power of appointment? If so, the establishment of the trust is likely a completed gift of the trust corpus by Asa to Ben. Moreover, if the power is a general power of appointment, lapses of the power (such as when income is paid from the trust and when the trust terminates at Asa's death) are treated as gifts by Ben, subject to the "5-or-5" exception in Section 2514(e) (and subject to the annual exclusion).

The language creating Ben's power is close to, but not exactly the same as, language in the regulations illustrating powers that are not general powers of appointment because they are "limited by an ascertainable standard" relating to health, education, maintenance, or support. It is not entirely clear, however, whether the power meets this standard.

Asa and her estate are entitled to the unified credit for gift and estate tax purposes. Ben is entitled to the unified credit for gift tax purposes.

QUESTION TWO

The IRS may argue that formation of the family limited partnership was an indirect gift by Nora to Olivia. However, the taxpayer will argue that the transfer by Nora was in exchange for full and adequate consideration, in that she received 99 percent of the interests in LP in exchange for assets having 99 percent of the value of all assets transferred to LP.

The subsequent gift of partnership interests by Nora to Olivia is subject to gift tax. In determining the fair market value of the interests transferred, discounts for lack of control and lack of marketability may be appropriate. Is an annual exclusion available? The IRS may argue (citing *Hackl* and similar cases) that the transferred interests are not “present interests” because of the partnership’s record of making only occasional distributions.

When Nora dies, the IRS is likely to argue that the assets Nora transferred to LP are included in her gross estate under Section 2036(a), on the ground that Nora retained an implied right to the income from those assets. The fact that distributions were made only when Nora saw fit might indicate such an implied right. However, Section 2036(a) is inapplicable if Nora’s transfer of assets to LP was a bona fide sale for full and adequate consideration. The estate will point to the \$100,000 cash contribution by Olivia as evidence that Nora’s transfer was such a bona fide sale.

If the IRS does not successfully apply Section 2036(a), then only Nora’s retained interests in LP are included in her gross estate. Those interests would be valued with a discount for lack of marketability.

Nora’s power over the corpus of her mother’s trust is a general power of appointment. Nora’s release of the power constitutes a gift by Nora to Olivia of the remainder interest in the trust. In valuing the remainder, Section 2702 is inapplicable, because Nora’s interest in the trust is a qualified annuity interest. Valuation of the remainder is performed according to the valuation tables under Section 7520.

Upon Nora’s death, a portion of the corpus of her mother’s trust is included in Nora’s gross estate under Section 2041, because Nora released a general power of appointment while retaining for life an interest described in Section 2036. The amount included in her gross estate is the amount of corpus needed to generate her annuity interest every year indefinitely, but not more than the actual value of the corpus of the trust when Nora dies.

Nora’s estate can deduct Tevis’s claim. Under the regulations, the amount of the deduction is generally limited to the amount actually paid, and not the total amount being claimed.

Depending on Nora’s and Claire’s ages, the bequest by Nora to Claire may be a direct skip, subject to the generation-skipping-transfer tax. Nora’s estate may be able to use Nora’s GST tax exemption to reduce or eliminate this tax.

Depending on the movement of values of the assets in the gross estate, the estate may be eligible for the alternate valuation date election under Section 2032. Nora and her estate are entitled to the unified credit for gift and estate tax purposes.

QUESTION THREE

Wilma's annual gifts of checks are not completed gifts until they are deposited by Yvette and Zed. They are eligible for annual exclusions. Wilma and Hassan may elect to have their gifts for any year treated as being made one-half by each of them, thus in effect doubling the annual exclusion for either of them.

The creation of Trust No. 1 is a completed gift of the current income interest and the remainder. The gifts are valued by subtracting from the entire corpus the value of Wilma's retained interest. Because Wilma's interest is not a qualified interest, under Section 2702, it is valued at zero. An annual exclusion is available for the gift of the present interest to Yvette, but not for the gift of the future interest to Zed.

At Wilma's death, her retained secondary life estate results in a portion of the corpus of the trust being included in her gross estate under Section 2036(a). The includible amount is the value of Zed's remainder, computed as of the date of Wilma's death. The earlier gift of the remainder will not be treated as an adjusted taxable gift for estate tax purposes; thus, Wilma's estate will get credit for any gift tax paid on the remainder when Trust No. 1 was established.

Wilma's one-half interest in Sunacre is included in her gross estate under Section 2033. In valuing the interest, a discount may be available for shared control.

Trust No. 2 presents issues relating to the marital deduction. Because Hassan's interest is terminable, it does not qualify for the marital deduction unless it fits within one of the exceptions in Section 2056(b). Hassan's interest qualifies for the qualified terminable interest property (QTIP) election under Section 2056(b)(7). Lloyd's power to transfer the corpus to Hassan does not diminish his right to all of the income from the trust property annually for life, and so it does not disqualify the trust from eligibility for the QTIP election. Under the election, the entire value of the property passing to Trust No. 2 is deductible by Wilma's estate.

There are no wealth transfer tax consequences to Lloyd by virtue of his holding the power over the trust corpus. It is not a general power of appointment.

Depending on the movement of values of the assets in the gross estate, Wilma's estate may be eligible for the alternate valuation date election under Section 2032. Wilma and her estate are entitled to the unified credit for gift and estate tax purposes, and her estate may elect to have any unused exemption equivalent for credit purposes "ported" (that is, transferred) to Hassan.