Searcy
Estate and Gift Tax
Fall 1983

Problem 1

For simplification purposes, throughout this Problem disregard the § 2503 PDE, and disregard the Generation Skipping Tax, and assume that there are no ascertainable standards, and disregard § 2035, and disregard "Adjusted Taxable Gifts" [§ 2001(b) last sentence]. You may round any actuarial factor to two decimal places if you wish.

On December 31, 1978, Donor D, a 50 year old male, transferred $100,000 cash to independent Trustee T, a bank, to hold in a newly created trust. During the life of L, a 70 year old female, T is to pay one-third of trust net income monthly to L. Capital gains are excluded from trust net income. In addition, D's Nephew N (a 45 year old male) during the life of L may demand up to one-sixth of trust net income by notifying T to distribute such amount to N. D reserved the right to substitute his Grandson C (a 30 year old male) for L as the person entitled to one-third of the income so long as G and L are alive. D's exercise of this right will not in any way affect N's rights in the trust. In any event, L will continue to he the sole measuring life of the income interest. Income which is not distributed to L, G, or N is to be added to Corpus as an accumulation, to be distributed to R upon L's death. Upon L's death, T is to immediately distribute all trust property outright to R or his heirs. Except as noted above, the trust was irrevocable.

1a. Analyze the dollar amount of D's 1978 Taxable Gifts (TC).

1b. During 1979, the trust produced $6,000 of net income. During 1979 T properly distributed $2,000 of net income to L, and N demanded of T and was paid by T $1,000. The FMV of all trust property was $100,000 throughout 1979. D gave no instructions to T. Analyze the dollar amount of D's 1979 TG.

1c. In 1980, while L was still alive and receiving one-third of the trust net income, G died. The FMV of all trust property was $100,0OO at all times in 1980. Analyze the dollar amount of D's 1980 TG, disregarding actual distributions.

1d. Disregard part c; that is, assume that L, G, N, and R are all still living. D died in 1981, never having given T any instructions. The FMV of all trust property was $100,000 throughout 1981. Very concisely explain the dollar amount included in D's Gross Estate (GE) under § 2041 only.

1e. The facts are as in d. Analyze the dollar amount included in D's GE under § 2056 only.

1f. Repeat e, except under § 2338 only.

1g. Explain the correct dollar amount included in D's GE under §§ 2036 and 2038 only.

1h. In 1982 (after G's 1980 death and D's death in 1981), N died while L is living; N had never exercised any of his rights under the trust. Assume that some amount is included in N's GE under § 2041; that is, do not discuss the meaning of GPOA, or any other aspect of § 2041 which determines its applicability. Analyze the dollar amount included in N's GE under § 2041 only.

Problem 2

Decedent Husband H provided in his will that $600,000 cash be left free of any death or other taxes or expenses to

B Bank as trustee, to be held in trust to pay all income quarterly to my Wife W' during her lifetime. Upon W's death, B shall pay all income from the last income distribution date through the date of W's death to her estate, and shall distribute all other remaining trust property outright equally among A, B, and C, who were the children of H by his first marriage to D, provided that H's Nephew shall have a non-general power of appointment to at any time after H's death appoint any amount of corpus outright to A, B, or C in any proportion or share that N may deem appropriate. W survived H.

2a. Disregarding the Nondeductible Terminable Interest (NTI) rule and its exceptions, analyze whether H's estate is entitled to the Marital Deduction (MD).

2b. Assume that disregarding the NTI Rule, H's estate is entitled to the MD. Disregard N's POA. Analyze whether the interest passing to W upon H's death violates the NTI provisions of § 2056(b)(l), without regard to any other numbered paragraph of § 2056(b).

2c. Do not disregard N's POA. Assume that the interest of W does violate the § 2056(b)(1) NTI Rule. Analyze the availability of an exception which will cause the gift to qualify for the MD. Analyze any election necessary to qualify the gift for the MD, and assuming such election is validly made analyze the collateral future estate tax consequences of having made such an election.

2d. How would your answer to c change if N's nongeneral power of appointment had instead been exercisable only to change the relative shares which A, B, and C; will receive in the trust after W's death, and N could not accelerate the distribution to any beneficiary.

Problem 3

This Problem deals primarily with income taxation of a trust and its beneficiaries. Disregard § 644; there are no ascertainable standards; disregard the throwback rules; disregard the §ll6 exclusion of some dividends (and in 1981 of some interest) income from GI.

In 1980, Donor D transferred $300,000 cash to disinterested independent bank Trustee T of a new written irrevocable trust in which D retained no direct or indirect interest or power whatsoever.

T is required to distribute monthly trust net income 10% to A and 60% to R. The remaining 30% of trust net income from the current year and all undistributed (accumulated) trust net income from all previous trust years may be distributed in T's discretion at any time to C. The trust instrument validly provides that all capital gains are to be included in trust net income for each year. In addition, T may in T's discretion distribute up to $50,000 per year noncumulativelv of corpus in cash or in kind to X; any distribution in kind is to be valued at its Fair Market Value (FMV) on the date of distribution.

The trust will terminate in 14 years, at which time T is required to distribute all trust property in kind (including any accumulated trust net income from the 14-year trust term) to R (or R's heirs if R is then dead).

The trust instrument validly allocates all trustee's fees to corpus.

In 1980, trust transactions and expenditures were as follows:

$ 10,000 Tax Exempt §103(a) Ohio Rond interest Income

20,000 Fully taxable certificate of deposit Interest Income

30,000 Long Term Capital Gain (do not be concerned with how the gain became long term instead of short term)

6,000 Trustee's Fee Paid

3,000 Personal property tax paid to Ohio - intangible tax upon only the taxable certificate of deposit, fully deductible under §164(a)(2) as a tax (not as a §212 expense) ; none of the $3,000 is disallowed by §265 because none of the $3,000 is allocable to tax-exempt income.

The applicable §1202 "LTCG deduction" for 1980 on these facts is 60% of $30,000 = $18,000.

In 1980, T distributed the correct amount of money to A and B, i.e., 10% and 60% respectively of net income; net income and Fiduciary Accounting Income (FAI) are the same. In addition, T in its discretion properly paid 20% of FAI to C, and T in its discretion properly distributed common stock to X which had a FMV of $40,000 on the date of distribution and an Adjusted Basis to T of $35,000 at that time.

3a. Concisely analyze whether T's distribution of the common stock to X is an income taxable event to T giving rise to a realization of gain [$40,000 Amount Realized minus $35,000 Adjusted Basis equals $5,000 Gain Realized].

3b. Assume throughout the entire balance of this Problem that T's proper distribution to X was $40,000 of cash (rather than $40,000 of common stock), thus eliminating the issue raised in part a from this Problem. Concisely analyze whether the $30,000 LTCG realized by T in 1980 is included in FAI. Also, concisely analyze the extent to which the

$6,000 Trustee's fee is deductible in computing FAI.

3c. Assuming that the $30,000 LTCG is included in FAI, very concisely analyze whether the 60% LTCG deduction is allowed in computing FAI.

3d. Throughout the remaining parts of this Problem, whenever the instructions say "compute", you are to

> list in logical order the dollar amount of each item which enters the calculation of the answer, together with a descriptive label (understandable abbreviations are fully acceptable) for each item. Do not answer with a narrative discussion. Do not list any authority for the inclusion of any item in your answer. Be sure to include the algebraic sign (plus or minus) before each item. Your method is important.

Compute 1980 FAI. [This is the amount which will be distributed 10% to A, 60% to B, and 20% (discretionary) to C.]

3e. Concisely analyze whether this is a simple trust or a complex trust.

3f. Assume that this is a complex trust. Analyze the extent to which the $30,000 LTCG will be included in §643(a) Distributable Net Income (DNI), and analyze the extent to which the $18,000 §1202 LTCG deduction will be deductible in determining DNI.

3g. Assume that the LTCG is included in DNI and the §1202 deduction is not allowable in computing DNI. Analyze the allocation of the $6,000 Trustee's fee in determining DNI. Include in your analysis the tax reason that T and the beneficiaries will want to allocate some of the Trustee's fee toward or away from the LTCC. Then compute DNI.

3h. The entire $40,000 cash distribution to X was properly labeled out of "corpus" in accordance with the direction in the trust instrument. Analyze the extent to which this $40,000 will be considered a "tier two" [§662(a)(2)] distribution.

3i. Assume that all $40,000 of the cash corpus distributed To X is considered a "tier two" distribution. Compute the amount and tax character of all distributions received by A, B, C, and X. A columnar presentation in table form may be the most efficient manner to write your answers. Include the amount of §1202 LTCG deduction to which A, B, C, and X are entitled.