Searcy
Estate and Gift Tax
Fall 1984

Problem 1

Decedent D was a world famous artist whose work consisted of modern impressionistic paintings. D's will left all of his estate to his brother Ben. D's will stated that his primary objective was to avoid paying any federal estate tax, and D's will provided that in the event that D's Taxable Estate (TE) would be larger than the amount sheltered by the sec. 2010 Unified Credit (UC) in effect for the year of his death then D's executor shall destroy a sufficient quantity of D's paintings such that the Fair Market Value (FMV) at the date of D's death of the paintings not destroyed shall exactly equal the amount sheltered by the sec. 2010 UC. The only assets in D's estate consisted of $1,000,000 FMV of paintings made by D. Disregard administration expenses, debts, the sec. 2054 loss deduction, and all other deductions; accordingly, D's Gross Estate (GE) will exactly equal his TE.

D died in 1987, when the UC was $192,000, which will shelter $600,000 from the Estate Tax (ET). Executor E complied with the requirement in D's will and destroyed $400,000 FMV of D's paintings shortly after D's death. Assume that E's act was lawful and proper under state law.

E argues that by reason of the requirement that $400,000 of the paintings be destroyed, the total net amount which could be transsmitted by reason or D's death was $600,000, and that sec. 2033 will impose a tax only on $600,000 of Gross Estate. Analyze the correct amount of D's sec. 2033 GE.

Problem 2.

Donor D, age 53, transferred corpus of $100,000 cash in 1984 to Trustee T, with instructions to invest the corpus and pay income to D's Father F, age 75, for F's life, remainder to be delivered outright to Donor's adult son S, age 20, or his heirs, provided that until D reaches age 60 or F dies, whichever occurs first, D may substitute himself for Son S as remainderman. Disregard the sec. 2503 PDE throughout this Problem.

2a. Analyze D's Taxable Gifts (TG) with respect to D's 1984 transfer to T.

2b. Six years later, in 1990, when D was age 59, F died at a time when D had never taken any steps to substitute himself for Son S as remainderman. In accordance with the terms of the trust instrument, T delivered all trust property outright and permanently to S. The FMV of the trust corpus was $156,000 throughout 1990. Concisely analyze the amount includible in F's GE with respect to the trust property under sec. 2033 and sec. 2036.

2c. The facts are as in 2b, and prior to F's death in December 1990 T had paid all 1990 trust income, consisting of $13,000, to F. Analyze D's TGs during this year of F's death, including but not limited to T's payment of $13,000 to F.

2d. Disregard 2b and 2c. The facts are as in 2a. In December, 1990, when D was age 59, D died while F and S were still living. T properly paid all $13,000 of 1990 trust income to F in 1990. Because D never gave T any instructions to substitute D for S as remainderman, T properly continued to hold the trust corpus and T will properly deliver corpus outright to S at such future as F dies. The FMV of trust corpus was $150,000 throughout 1990.

Analyze whether sec. 2036 requires inclusion in D's GE, and if any inclusion is so required analyze the dollar amount includible in D's GE.

2e. The facts are as in 2d. Repeat both analyses, except utilize § 2038 instead of § 2036.

2f. The facts are as in 2d and 2e. T properly paid all income to F each year, consisting of zero in 1984, $10,000 each in 1985 and 1986, $11,000 each in 1987 end 1988, and $13,000 each in 1989 and 1990 ($68,000 aggregate income). Assume that § 2036 does not require any inclusion in D's GE, and that § 2038 does require an inclusion in D's GE. Analyze the dollar amount of D's § 2001(b) Adjusted Taxable Gifts (ATG). You must include the relevance of the $150,000 FMV of corpus at the 1990 date of D's death, and of the $68,000 actual income payments by T to F. Remember to disregard the PDE, and you nay refer to your answer to 2c.

Problem 3

In 1981, Donor D established and funded an irrevocable inter vivos trust which validly provided that all of income shall be accumulated for eleven (11) years and shall then be distributed (in 1992) to Beneficiary B. The trust further provided that after making such a distribution in 1992 of all accumulated income to B , all trust corpus shall be distributed to Remainderman R. The trust contained the following provision:

During any calendar year in which Donor D makes a transfer of corpus to this trust, Beneficiary B may demand that Trustee T distribute immediately and outright to B the corpus which D has that year transferred, provided that B may not demand in any calendar year more than the $10,000 FMV of such corpus.

D planned to make annual gifts of corpus to the trust. The trust instrument proceeded to establish appropriate requirements that T notify D (and B's guardian during any period of B's incapacity) promptly of any transfers of corpus by D to the trust, and that S (or his guardian) shall have 60 days after receiving such notice to demand the distribution in writing.

During July 1983 when the trust had nine (9) years of term remaining, D transferred $30,000 cash new corpus to the trust; T notified B (age 13) and both of B's parents of B's right to withdraw $10,000 cash. No guardian had ever been appointed for B. No one gave T any demand for any distribution, and the $30,000 thus became permanent trust corpus. During 1983 the trust corpus out of which T could have satisfied any demand which B mjight have validly made was $120,000.

3a. Explain, citing appropriate authority, the primary objective for inclusion in the trust instrument of the provision which is indented above, and why such a provision is needed in this particular trust.

3b. Analyze the effectiveness of the indented provision and related provisions in accomplishing the objective, including the acceptability to the IRS of this provision to accomplish the objective.

3c. Assume that B is not entitled to any § 2503 PDE for any Taxable Gifts (TG) that B may have made. Analyze thoroughly B's 1983 TG. Present your answer in a well organized and complete manner.

Problem 4

Husband H died; H's will left $1,000,000 to Trustee T free of all inheritance and estate taxes and free of any share of administration or other expenses. The trust is required to distribute all income annually or more frequently to Surviving Spouse W. Upon W's death, all income received from the last distribution until the date of W's death shall be paid to W's estate and all trust corpus shall be distributed outright and equally among the children of the H-W marriage who are living at that time, provided that W may by her will (but not during her life) change the shares among the H-W children living at her death as she deems appropriate in her absolute discretion.

Assume that W's interest in this trust "passes" to her, that all property rights so passing are included in H's Gross Estate (GE), and that W's interest in the trust is a Terminable Interest (TI) which violates the § 2056(b)(l) Nondeductible Terminable Interest (NTI) rule. Disregard the dollar amount of any MD which is allowable.

4a. Concisely analyze whether W's interest qualifies for the Marital Deduction (MD) in H's estate without H's Executor E taking any action or steps other than normal duties of any executor.

4b. Assuming H's estate may not obtain any MD without E taking some action or steps, analyze whether the nature of each party's rights is such that E may, by taking some action or steps, obtain the MD for H's estate.

Problem 5

Donor D transferred $400,000 cash corpus to Trustee T of a newly formed irrevocable trust. T is required to pay one-third of all net income to Beneficiary A. T has discretion to distribute up to one-half of trust net income to Beneficiary B to provide for B's education and support; T is not required to distribute any amount to B regardless of B's education and support needs. T also has discretion to distribute corpus to Beneficiary C for any reason that T deems appropriate, without any guiding standards whatever. The trust instrument validly provides that capital gains are allocable to corpus and that all trustee's fees are allocable half to corpus and half to income.

In 1984 the trust received:

$30,000 Taxable interest income

20,000 Long Term Capital Gain

10,000 Tax exempt § 103(a) interest income

In 1984 the trust paid $4,000 Trustee's Fees, $1,000 to X for an investment advisory service devoted exclusively to tax exempt bond selections, and $2,000 to Y for an investment advisory service devoted exclusively to selection of stocks which pay no current dividend or other income whatever but which have maximum potential for Long Term Capital Gain.

During 1984 T distributed to A exactly the amount that T was supposed to pay, and T validly exercised his discretion to distribute to B the maximum amount of income that T was permitted to distribute, and T validly distributed to C an amount of corpus exactly twice the dollar amount of income which T distributed to B. All of these distributions were properly made in cash.

"Compute" means do not answer with a narrative discussion. "Compute" means 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 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. If you need a dollar amount which is not given and cannot be computed from the given facts, make any reasonable assumption necessary to continue with your computation, but be sure to identify your assumed facts as assumptions. Your method is important.

5a. Compute the amount of money which T distributed to A, B, and C in 1984.

5b. Compute T's Distributable Net Income (DNT) in 1984.

5c. Compute the dollar amount and tax character of all amounts received by A, B, and C from the trust.