

Searcy
Estate and Gift Tax
Fall 1985

Problem 1.

Throughout this Problem, disregard the Sec. 2503 PDE and assume that all interests for a period of time or after a period of time are valued using actuarial tables. LT on 1-1-80 purchased a fee simple absolute in Blackacre BA consisting of unimproved land for its FMV of \$300,000 cash. The land was nondepreciable and was used as a parking lot, producing \$40,000 of net income in 1980 and \$90,000 in 1984. On 12-31-84 BA had a FMV of \$1,000,000. On 12-31-84 LT sold a Remainder Interest RI to R for \$500,000 cash, reserving to himself, LT, a Life Estate LE. This transaction was entirely valid under state law and was not a trust or any other equitable title arrangement. After the transaction, LT owned a legal LE, i.e., for the period ending with his death LT had the right to all income from BA and the duty to pay all expenses and property taxes, and upon LT's death BA will be owned outright by R, who may thereafter have all the income forever. LT's LE and R's RI are fully alienable (by sale, gift, bequest, etc.) at all times after the 12-31-84 transaction, and neither party needs to consult the other or obtain the other's consent before alienating. Both LT's LE and R's RI are fully vested and R need not survive LT. In other words, if R predeceases LT then R's estate or the beneficiary of R's estate will acquire the RI; of course LT will continue in possession until LT dies. If LT alienates his LE, the transferee will have the right to all net income so long as LT is alive. At the time of the 12-31-84 transaction LT and R are brother and sister, LT is a 50 year old male and R is a 35 year old female, and both are fully informed of the FMV of all interests in BA.

1a. Analyze the dollar amount of LT's and R's 1984

Taxable Gifts TG. Remember to disregard the PDE.

1b. Consistently with your answer to 1a, analyze whether Sec. 2036(a) would require an inclusion in LT's Gross Estate GE if LT died in 1985 survived by R. Do not consider the dollar amount of any inclusion.

1c. Disregard 1b; assume everything through 1a is in effect. Assume that ten (10) years later on 12-31-94 R died survived by LT and R's will left R's RI to Beneficiary B; of course B must wait until LT died to enter BA and to receive any income. R also held two other property interests at the time of his death. R owned a valid 25% Tenancy in Common T/C interest with her Cousin C, who owned the other 75% T/C interest, in an Airplane AP which was purchased in 1982 for its FMV of \$600,000, 100% of which was furnished by Cousin C. The airplane AP had a FMV on R's date of death d/d of \$1,000,000. R's will provided that his AP shall be left to X.

R also was an equal one-third (1/3) fully partitionable Joint Tenant with Right of Survivorship JTW/RS of a Mansion House MH family home which cost \$900,000 in 1985, which consideration was provided \$300,000 by each Joint Tenant; the other JTs were J and T, R's sisters. R's will provided that her interest in MH shall be left to Y. The MV of MH was \$1,200,000 on R's death.

Analyze the includibility and dollar amount of R's Gross Estate GE separately with respect to:

- i. R's RI in BA
- ii. R's T/C interest in AP
- iii. R's JTW/RS interest in MH

1d. Analyze the includibility and dollar amount of R's

Sec. 2001(b)(1)(B) Adjusted Taxable Gifts from each of the occurrences in all previous portions of this Problem 1 except part 1b, which is to be disregarded.

1e. Assume that the correct answer to 1a is that R made a TG of \$400,000 in 1984. Compute R's 1984 GT which R must pay with her 1984 GT return. Remember to disregard the PDE.

1f. Assume that R made the 1984 TG of \$400,000 and paid the GT that you computed in 1e, and made no other TGs in her life, and assume that R's GE was \$1,000,000 at her 12-31-1994 death and that R's estate is entitled to aggregate ET deductions of \$100,000. Compute the dollar amount of Estate Tax ET which must be paid with R's ET return.

Problem 2

On January 2, 1984, Donor D gratuitously transferred \$100,000 cash irrevocably to independent Trustee T to pay all net income monthly to L for 15 years and then distribute all remainder to R and his heirs. L was D's 14 year old son, and R was D's 16 year old daughter. Because L was a minor D's Sister S was properly and validly appointed sole guardian of L's property. The local probate court supervises and approves in advance all guardianship disbursements. Local law permits income of a minor to be used for his support in the probate court's discretion. T properly paid all \$10,000 net income to S in 1984 and all \$12,000 in 1985. S properly used \$3,000 each year to pay for food and clothing for L, and S properly retained the balance in a bank account in the name of "S as guardian for L". Corpus remained at all times \$100,000. The total amount of L's support costs for each year was \$8,000 (including the \$3,000 paid by S). D died on 12-31-85. Assume that D's transfers in 1984 were to some extent Taxable Gifts TG, and that D paid a correct \$15,000 Gift Tax GT with respect to D'S 1984 TGs from these facts.

2a. Analyze the dollar amount included in D's Gross Estate GE with respect to these facts under sec. 2035 only, disregarding sec. 2035(b) only.

2b. Disregard question 2a and any sec. 2035 GE inclusion. Analyze whether any interest is includible in D's GE under sec. 2036(a) only. Disregard the dollar amount includible.

2c. Assuming an interest is includible in D's GE under sec. 2036(a), analyze the dollar amount includible.

2d. If guardian S had died in 1985 survived by D, T, L, and R, explain two (2) reasons why there would be no sec. 2041 inclusion in S's GE.

Problem 3.

Wife W dies in 1988 survived by her spouse H. W's will left outright to H "an amount of money equal to that minimum dollar amount necessary to to assure that my estate will owe no federal estate tax." The balance of W's estate was left outright to her adult Son S. W's will went further to provide that W's Executor E may in his discretion fund the marital gift to H in cash or in kind, and that any property transferred to H in kind by E shall reduce the amount due H by the FMV of the property as of W's date of death d/d. State law provides that funding clauses shall be applied as written. The will provided that gifts to H shall not bear any share of federal estate tax or administration expenses. At the time of her death, rights in a Life Insurance LI contract with an interpolated terminal reserve value plus unearned premium immediately before death \$200,000 and face amount \$300,000 Payable and paid by the insurance company directly to H as named beneficiary. These \$300,000 LI proceeds were not subject to probate. W also owned outright:

Property	W's Adjusted Basis Before d/d	D/death FMV	D/distribution FMV
Realty	\$100,000	\$400,000	\$1,200,000
Securities	500,000	600,000	300,000
	\$600,000	\$1,000,000	\$1,500,000

For purposes of simplicity, assume that W's estate has no deductions other than the MD.

3a. Assuming that E may transfer any amount of either property to H and that whatever is transferred to H will qualify in full for the MD in an amount equal to its FMV at date of distribution in kind to H, explain how much of each property E should transfer to H and S in order to minimize future ET payments of H, assuming also that H and S agree to whatever choices E makes.

3b. Assume that E transfers the amounts which you answered in 3a to H and to S. IRS Auditor A tells you that the allowable MD for W's estate should be zero. Explain his most likely rationale and his supporting authority whether or not you agree with them, and then analyze the correct amount of MD for W's estate.

3c. This is a new fact situation. Decedent D died survived by his Surviving Spouse SS. His will left \$1,000,000 cash which he owned at death to Trustee T, to invest in appropriate assets and pay all net income monthly to SS for her life. Upon SS's death, T is to pay any income derived from the last income distribution date until SS's date of death d/d to SS's estate, and distribute all remaining trust assets to C who is D's child by his previous

marriage. Assume that this gift to T for the partial benefit of SS meets the sec. 2056(a) requirements for the MD except assume that it violates the NTI rule sec. 2056(b)(1) only requirements. Concisely explain how this trust may qualify for the MD in D's estate, and the future consequences of such qualification.

3d. Concisely explain how your answer in 3c would change as a result of D's will and trust provisions establishing that:

i. SS is entitled to current distributions of income only if D's Executor E has taken appropriate steps to obtain the MD with respect to the trust; otherwise income is to be accumulated and paid to SS's estate,

and ii. D's Trustee T has uncontrolled discretion to distribute corpus to SS each year in an amount equal to the greater of \$5,000 or 5% of the trust corpus FMV. [T will continue to be required to at all times to distribute all income monthly to SS].

Problem 4.

D was a commission salesman of real estate, earning 5% of the selling price. D had a listing agreement with property Owner O for a 90-day period to sell Blackacre BA for \$800,000, during which period D procured Prospective Purchaser PP and introduced PP to O. PP offered O \$600,000, which O refused. After the 90-day listing period expired, PP went directly to O, without D's knowledge, and offered O \$700,000, which O accepted. D died shortly thereafter, unaware of the sale by O to PP. When D's ET return was filed, Executor E was also unaware of these facts and of course honestly included nothing in D's Gross Estate GE with respect to these facts. After the ET return was filed, E learned of these facts and brought suit against O for \$35,000 [5% of \$700,000]. O defended on the grounds that the

sale was made after the listing period had expired, and that D never procured any buyer who offered the \$800,000 listing price. E and O's Lawyer L both recognized that the case might go either way and was an all-or-nothing case for \$35,000 or zero. Both parties were unwilling to risk losing entirely, so E and O agreed to settle the case for \$25,000, which O paid to E 20 months after D's death.

4a. Should E file an amended ET return to include the claim against O?

4b. Assume that the correct answer to 4a is that E should amend the ET return. Explain how much should be added to the GE.

4c. Assume that \$w (this is not a typographical error) is properly added to the GE in question 4b, and that this increases the ET by \$y. The ET on the original return was \$x, so total ET paid is now $\$x + \y . Explain the income tax basis in E's hands of E's claim against O immediately before E collected the claim 20 months after D's death, assuming that the claim is not depreciable. Then explain the income tax consequences to E of receiving the claim from D and of collection of \$25,000 from O.

4d. This is a new fact situation. Assume that a sec. 651 simple trust has some fully taxable interest income, some fully Tax Exempt Interest TEI income, some expenses properly allocable only to taxable interest, and some trustee's fees all of which are chargeable to income. Concisely explain the manner in which the fully TEI income is included in simple trust Distributable Net Income DNI:

i. under sec. 643(a),

and ii. for purposes of computing the trust's sec. 651 distribution deduction.