

Searcy

ESTATE AND GIFT TAX

Fall 1990

## INSTRUCTIONS

There are 3 hours (180 minutes) allowed, and 180 points on this exam. It is suggested that you allocate to each Problem a number of minutes equal to the number of points on that Problem. The subparts within a Problem are not weighted an equal number of points. It is part of your task to determine which subparts are simple and thus require only a very short answer, and which are more difficult or complex and require more elaboration.

There may be very rare instances in which the question cannot be answered correctly without furnishing additional facts. State any assumptions or facts necessary to answer such questions, but do not assume away an issue. When a fact seems to have been omitted, a safe procedure is to supply alternative facts, permitting you to analyze the results both ways.

For most of the questions asked, there is one correct result, and in those questions you should reach the correct conclusion, supported by appropriate lawyerlike reasoning and authority.

"Analyze" means verbally explain the result and rationale, together with specific Code citation and, if appropriate, case authority. Ultraprecise Regulations citations are very often necessary. If resolution of an issue turns on a few Code or Regulation words, quote the words and explain the proper interpretation thereof. You must apply the facts to the law. Use any understandable abbreviations that you wish.

"Compute" means for each item which might be needed for the calculation, write the title of the item (using abbreviations) and the dollar amount of the item on a separate bluebook line. Each line should be the systematic next step in the calculation. Narrative verbal explanation is neither needed or expected. Do not cite any authority.

"Assume" means accept the correctness of the statement of law or the new fact without discussion and without prejudice to the correctness of any of your answers to previous subparts.

Each student may bring into the exam:

1. The Internal Revenue code of 1986 and applicable Regulations.

2. One sheet of paper 8-1/2 x 11 inches, on both sides of which may be written or otherwise reproduced in any order or arrangement:

a. Code and Regulation section numbers and Code and Reg. page numbers.

b. Quotations from and summaries of Code and Regulation language without restriction as to length.

c. Any number of case names and ruling numbers, together with not more than five (5) words with respect to each case or ruling.

3. An electronic calculator.

4. Pen (preferably ballpoint) or pencil. (Please do not use felt-tip pens)

5. Erasers. (Cross-outs are entirely permissible.)

Disregard Sec. 2032 and 2032A (special valuation provisions).

All trusts, estates, and individuals are calendar year, cash method income taxpayers. Unless otherwise indicated, all individuals are unmarried adults who are unrelated to one another by blood, marriage, living together agreements, or otherwise, and no one has any legal obligation to support anyone else.

Assume that no consideration is furnished for any transfer unless the context suggests that consideration is an issue in that particular problem. Assume that the words "if any" follow each question asked. For example, "Analyze the dollar amount of the ..." should be understood to mean "Analyze the dollar amount, if any, of the ..." In other words, there may be Problem subparts in which the correct amount includible or deductible is zero. Assume that all actuarial allocations may employ the 10% tables in Reg. Sec. 25.2512-5(f) or in the multi-rate actuarial tables.

You may answer the Problems in any order you wish. In any event, begin each new Problem at the top of a bluebook page, and skip a line between each problem subpart. Answer all the subparts of each Problem in order. You may write on both sides of the bluebook page if you wish.

Unless you are directed to the contrary, answer question subparts consistently with your previous answers to other subparts, and without repeating your previous analysis or answers to other subparts. It is almost always wise for you to read all subparts of the Problem before beginning to answer the first subpart.

Math errors do not count off. In any mechanical calculation, after you have entered and properly labeled the correct given figures, you may rough in the mathematical

calculations if you wish. The objective is to test your knowledge of the proper method to solve for the answer, not your addition and multiplication skills.

Be very careful to answer only the specific questions asked. Nonresponsive answers almost always receive zero credit, and time spent writing nonresponsive answers reduces the amount of time that you have to devote to answering the remainder of the exam questions.

Because of the time pressure during the exam, almost all of your answers will have to be brief and concise, never rambling and rarely lengthy. The most important advice applicable to this exam is: Pace yourself carefully. If you find yourself "hung up" on a small issue or on finding Regulation authority to cite, it is usually better to abandon that item and proceed to the other subparts of the exam. Unanswered questions receive zero point credit, which may have a disastrous impact upon your letter grade. If time runs short, it is usually better to furnish ultraconcise answers to all the remaining questions than to fail to write anything on some of the questions.

Place your student exam number on both your bluebook and the questions. You may separate the pages of the questions, but hand all exam questions in with your bluebook.

End of Instructions. The exam questions begin on the next page.

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## PROBLEM 1

In 1984, Donor D gave his Son S, Blackacre BA, consisting of land and 1 warehouse building. D's Adjusted Basis AB for BA was \$100,000 in 1984, and its 1984 FMV was \$250,000. The gift was a sec. 2501(a)/2503(a) Taxable Gift

TG which did qualify for a \$10,000 sec. 2503(b) Per Donee Exclusion PDE, causing D to have a \$240,000 net TG to S. Because D had never made any prior TG in his life, D's 1984 sec. 2010(b) Unified Credit UC caused D to owe zero Gift Tax GT in 1984.

1a. Analyze S's aggregate basis for BA at the 1984 time S received ownership, assuming there were no accrued but unpaid rents. Disregard allocations of basis between land and buildings.

1b. In 1990, when the FMV of BA was \$450,000, S died and left BA by will to his Cousin C, together with any accrued but unpaid rents which may then be due. At the time of S's death, there were \$4,000 of accrued but unpaid rent, which had a FMV of \$3,000 at S's date of death d/d. S, as a cash method income taxpayer, had properly included nothing in his income tax Gross Income with respect to the unpaid rent, and S's AB for the claim for unpaid rent was zero. Nothing with respect to this unpaid rent was included in the \$450,000 FMV of BA listed above. At the time of S's death, S's AB for BA (the land and building) was \$170,000.

Under local law, a testamentary transfer of realty and any unpaid rents thereon are considered to descend to the beneficiary at the moment of death, and the decedent's estate and executor do not have any interest in such items. During 1991, Tenant T, who was in arrears, properly paid the \$4,000 in past due rent directly to C.

i. Analyze C's aggregate basis immediately after S's death for BA(the land and building).

ii. Analyze C's basis immediately after S's death for the claim against T for accrued but unpaid rent.

iii. Analyze the amount included in S's Gross Estate

GE under sec. 2033 with respect to the claim against T for accrued but unpaid rent.

iv. Analyze the amount of income tax GI which C must include in 1991 by reason of collecting \$4,000 from T for rent which was accrued but unpaid at the time of S's death.

v. In one sentence, citing precise Code authority but without explaining any of the details or workings of the rule, describe a technique for mitigating the problem caused by your responses to iii and iv.

## PROBLEM 2

Donor Mother M on 1-1-83 gave her adult Daughter D \$100,000 cash, which D placed in a special bank savings account in her own (D's) name earning 10% interest per annum. The account history was as follows (you are to disregard income tax):

	Balance Beginning Of Year	Interest Earned During Year	Balance At End Of Year
1983	\$100,000	\$10,000	\$110,000
1984	110,000	11,000	121,000
1985	121,000	12,100	133,100
1986	133,100	13,310	146,410
1987	146,410	3,690*	150,000*

TOTAL INCOME		\$50,000	
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\* Partial year to April 2, 1987

On April 2, 1987, D withdrew the \$150,000 from the bank and used it to purchase shares of XYZ Corp. as an investment held solely in D's name. By 1989, the XYZ shares had risen to \$350,000 FMV, at which time D sold them, realizing \$200,000 Long Term Capital Gain (again, disregard income tax).

D contributed \$425,000 cash on April 3, 1987, toward the purchase of Blackacre BA, which had a FMV and total cost of \$1,275,000. The other \$850,000 was furnished by Mother M. Title to BA was taken in the names of M and D as Joint Tenants with Right of Survivorship JT, which is fully valid under state law as a common law JT. Each JT has a right while both tenants are alive to one-half the income, one-half of any sale proceeds, and to sever at any time without the consent of the other. Upon severance by transfer to a third party, the transferee becomes an equal Tenant in Common T in C with the nontransferring JT, and upon petition for partition the court will divide the property in equal value portions between the Joint Tenants or will order the property sold and the net proceeds divided equally between the Joint Tenants. At death of one JT, the other succeeds to undivided sole ownership of a fee simple absolute in BA.

In 1991, when the FMV of BA was \$1,800,000, Mother M died, survived by Daughter D, who became sole owner of BA through survivorship. The executor of M's estate is M's Friend F, who has been correctly advised that M's probate estate contains nothing with respect to BA because, as Norman Dacey's book clearly states, JT property avoids probate.

2a. Analyze the amount of Mother M's 1987 Taxable Gifts TG by reason of her 1987 establishment of the JT in BA, disregarding the sec. 2503(b) Per Donee Exclusion PDE. Also, analyze the amount included in M's Gross Estate GE by reason of BA, disregarding sec. 2033. You may feel free to answer the GE question before the TG question if you wish.

2b. Daughter D wishes to avoid as much GT and ET consequences with respect to BA as possible by disclaiming her survivorship interest four months after Mother M died. You have researched local law and found that one JT may disclaim a JT survivorship interest by notifying the deceased JT's executor (here Friend F) in writing, and that the disclaimer is considered to relate back to the time the decedent died, and that disclaimed JT property shall pass as if it was owned in equal Tenant in Common shares. When any T in C dies, his interest passes to his executor, who becomes a T in C owner with the nondeceased T in C. M's valid will left all of her estate to Uncle U.

You research the tax law and find Reg. 20.2518-2(c)(4) (i) clearly providing that Daughter D may not make a qualified disclaimer of the survivorship interest more than 9 months after the transfer creating the interest, which was 1987. Reg. 25.2518-2(c)(5) Ex.(8) illustrates this rule. Because it is now 1991, in order for D to succeed in avoiding GT, D must convince a court that the Reg. is invalid. The Reg. is interpretative (as opposed to legislative) in nature, and assume that in order to establish that it is invalid you must show that the Reg. is an unreasonable interpretation of the Code sec. 2518(b)(2) (A) clause.

Explain your argument(s) that the Reg. is invalid. You may wish to begin with the general purpose behind sec. 2518 and also behind sec. 2518(b)(2)(A), and then review the JT characteristics under state law that were noted in part a. This might be followed by enumerating what rights D obtained

in 1987 and what rights D would have received in 1991 but for the disclaimer. Develop your argument(s). Your task is one of legal reasoning and advocacy.

### PROBLEM 3

Father F owned a \$1,000,000 FMV and face amount and Adjusted Basis bond which paid 8% per annum interest. F proposed to his Son S in 1990 that F would transfer the bond to a new irrevocable trust which provided all income annually to Son S for S's life, remainder at S's death outright to S's children per stirpes, if none, then remainder to X, provided S would pay F \$200,000 cash. S agreed and paid \$200,000 to F; in return, F transferred the bond to Trustee T of the new irrevocable trust in 1990. Son S died in 1998 when the FMV of the bond was \$1,200,000, and the Trustee held \$50,000 of net income accumulated since the last annual income distribution; T properly delivered the bond plus the \$50,000 to S's Daughter D.

3a. Assume the applicable sec. 7520 interest rate for valuing Life Estates LE and remainders is 10%. Using either the Reg. 25.2512-5(f) actuarial tables or the multi-rate latest actuarial tables, compute the dollar value of Son S's LE at two different times: 1990, and 1998 the moment before his death, disregarding the fact of S's death. S was a male age 60 in 1990 and age 68 in 1998. Do not provide any citation.

3b. Make the IRS's best argument for inclusion of some of the trust in S's GE under sec. 2036(a)(1) only. Make S's estate's best argument that sec. 2036(a)(1) does not require any inclusion at all. Explain whether 2036(a)(1) will require an inclusion. Disregard the dollar amount includible.

3c. Assuming sec. 2036(a) (1) does require an inclusion in S's GE, analyze the dollar amount includible. Include in

your discussion the relevance of the LE factors you employed in part a.

#### PROBLEM 4

Wealthy Wife W desired to provide for her Husband H by making an inter vivos trust arrangement for H but without permitting H to control at any time the corpus. W was correctly advised by another attorney that if she established an irrevocable trust in which H is given a sec. 2523(f)(2)(B) QII and W properly elects QTIP treatment for the trust, then the full amount transferred to the trustee will qualify for the Gift Tax GT Marital Deduction MD. Assume that sec. 2523(f)(3) makes the Estate Tax ET provisions in sec. 2056(b)(7)(ii) defining QII applicable to the GT. W consults you before establishing the trust.

4a. W proposes that she transfer \$1,000,000 cash to the trust, which distributes all income quarterly to H for his life, and at H's death corpus shall be distributed outright per stirpes among W's children by her marriage to her first husband, Louse L. She also proposes that a clause be included that requires that all income from the previous distribution up through the date of death of H be distributed to the estate of H.

Analyze whether the trust contains a QII.

4b. How would your answer to part a change if W retains a secondary life estate, i.e., if the trust provides that if H should predecease W then W shall have all income for her life, and that her children's remainder shall become possessory only upon the death of the later to die of H and W?

4c. How would an otherwise valid QII be affected by a provision that upon divorce from W, the amount of income to

which H is thereafter entitled shall be one-third of all trust income? Explain the maximum dollar amount of GT MD for which W could elect, assuming the inter vivos trust was funded with \$1,000,000.

4d. Assume that the trust in part b is in all respects a QTIP trust and that W properly elected QTIP treatment, thus obtaining the GT MD for the full \$1,000,000. Nine years later, when the FMV of trust corpus was \$1,500,000, H died, at which time his LE expired and W began collecting the income. Concisely explain the sec. 2044 GE consequences to H's estate of W's prior QTIP election.

4e. Assume that disregarding the fact that this is a QTIP inter vivos trust for which W elected full MD treatment, W's part b reserved secondary LE would definitely cause a sec. 2036(a)(1)/20.2036-1(b)(1)(ii) inclusion in W's GE if W had predeceased H. Assume that the amount includible would have been the value of the corpus minus the actuarial value of H's outstanding LE presently being enjoyed.

Make an argument that this accepted sec. 2036 treatment should not apply to a trust for which the grantor, here W, elected and received QTIP MD treatment.

END OF EXAMINATION