

Searcy
Estate and Gift Tax
Spring 1989

PROBLEM 1.

Lawyer L's adult Son S worked as a stage hand in a theater. S was mad at Actor A for winning S's girlfriend away from S. To get even with A, S deliberately dropped a 30-pound sandbag from a height of 30 feet, intending to hit A on the knee while A was seated onstage during a rehearsal. The sandbag fell on A's head, killing A. S was charged with a felony (murder).

L and S were estranged and had not spoken to each other for ten years. L was a very successful criminal lawyer. L offered to defend S for no fee on the murder charge if S will immediately make amends with L, come to visit L at least once per month for a full evening and dinner at L's home, and agree to continue doing so for the next year. S agreed, immediately made up with L, and for a year visited cordially with L approximately every three weeks. Under state law, L became legally bound to defend S on the murder charge. The FMV of L's legal work in such a case is \$30,000, and L would have been liable to S for \$30,000 cash if L refused to perform S's legal defense work.

L thereafter defended S on the murder charge and wrote S that S owes L nothing for all of L's legal work.

1a. analyze the extent to which the things which S did for L will prevent anything which L might have transferred to S in return from being a Taxable Gift. Disregard the PDE.

1b. Assume that the things S did for L do not to any extent prevent anything which L might have transferred to S from being a TG. Disregard the PDE and assume that L has

irrevocably parted with dominion and control over the legal work. Analyze the dollar amount of L's TG to S.

1c. L was successful in obtaining a full acquittal from the criminal charges. However, one month after A's death, A's Executor E commenced a wrongful death action against S. Two years after death, a judgement was entered against S. Under local law, wrongful death recoveries are distributed to whomever the decedent may have specified in his will, and wrongful death recoveries are for the loss of the decedant's life and nothing else (e.g., no medical costs, pain and suffering, etc.). A's valid will named B as sole beneficiary of A's estate. S paid the \$200,000 to E two years after A's death. E filed the ET return showing nothing by reason of A's wrongful death claim. Assume that if a Sec. 2033 inclusion in A's GE is required, the correct dollar amount is \$200,000. Analyze the Sec. 2033 includibility of the wrongful death benefit in A's GE, including both the better view and the IRS position.

1d. Three months after the wrongful death judgement was paid by S to E, and while E still held the \$200,000 as an estate asset, B notified E in writing that B irrevocably refuses to accept any of the wrongful death recovery. Assume that B did not and never will accept any benefits of the \$200,000, and that B's refusal is valid under state law, and that as a result of B's refusal state law provides that B's Daughter D will receive the \$200,000 wrongful death proceeds. B knew that his valid refusal would enrich D by the \$200,000, but B took no action to choose D because such choice results from local law. Disregarding the PDE, analyze the extent to which B is considered to have made a TG to D.

PROBLEM 2.

In 1983, Donor D purchased for \$800,000 cash unimproved land. D's income tax cost basis was \$800,000, and the land

was not depreciable; D's Adjusted Basis (AB) for the land was at all times \$800,000.

In 1987, when the FMV of the land was \$1,000,000, D offered to give the land outright to her Nephew N, on condition that N purchase a new \$80,000 luxury car and give it to N's Cousin C. In 1987, N agreed to D's offer, D transferred the land to M, M purchased a new \$80,000 car, and N immediately transferred the \$80,000 FMV car outright to C.

2a. Prior to 1987, N made Taxable Gifts (TG) in excess of \$600,000; N has therefore used up all of N's \$600,000 Gift Tax (GT) "exemption equivalent" (resulting from N's \$192,800 Sec. 2010 Unified Credit). Assuming that one \$10,000 Sec. 2503(b) PDE is available to N for each gift N has made in 1987, state the dollar amount of N's 1987 Taxable Gifts (TG) by reason of N's transfer of the car to C. Explain very concisely, citing precise Reg. authority if you can locate it quickly.

2b. For purposes of computing the dollar amount of D's 1987 TG, state whether the initial focus will be upon the \$800,000 AB of the land or its \$1,000,000 FMV, and cite precise Code authority. Do not discuss.

2c. D never made any TG before 1987. Assume the amount of D's 1987 TG is \$900,000 (this is not a misprint, but is a new and extraneous number) after taking all PDE to which D is entitled. Compute the dollar amount of D's GT liability, i.e., the amount of GT which D must pay.

2d. Assume the GT which D is required to pay for the 1987 TG is \$114,000. D died in February, 1988, before filing her 1987 GT return (which was due April 15, 1988). D's Executor E properly prepared the GT return showing the correct \$114,000 GT due and E paid the \$114,000 with the GT

return, which was filed on time. At the time of D's death, the land had a FMV of \$1,300,000. Analyze the dollar amounts includible in D's GE under Sec. 2035 with respect to all aspects of the land, citing only Code authority.

2e. Assume that the facts are as in parts c and d, and assume that none of the \$1,300,000 date of death FMV of the land is includible in D's GE under Sec. 2035 or any other section, and assume that D owned \$1,000,000 cash in a bank account which is includible in D's GE under Sec. 2033. Disregard the state death tax credit and the credit for estate tax on prior transfers. Compute the dollar amount of Estate Tax (ET) which is due, i.e., which must be paid with D's ET return.

PROBLEM 3

On December 27, 1983, Grantor G transferred \$1,000,000 cash to T as Trustee of a new irrevocable trust. T is required to pay all trust net income monthly to L for L's life or 12 years, whichever period is shorter. After L's interest terminates, T is required to pay all net income monthly to Grantor G for G's life or 5 years after L's interest terminated, whichever period is shorter. After L's and G's income interests have both terminated, T is to deliver all trust property outright to R and his heirs, provided that so long as G is alive G may substitute X for R by notifying T in writing.

3a. Without undertaking to establish the dollar values, and disregarding the actuarial tables and disregarding the PDE, analyze the interests with respect to which G has made 1983 Taxable Gifts (TG) and to whom they were made, citing Reg. authority if you can locate it quickly.

3b. Assume that the 1983 actuarial value of L's life/12 years interest is 0.60, and that this yields a 12/26/83 FMV

of \$600,000. Because G's transfer was on December 26, the trust's 1983 net income was \$2,000, all of which T delivered to L on December 31, 1983. L had no right to demand corpus. Assume that the dollar amount of G's TG to L in 1983 was \$600,000 without regard to the PDE. Analyze the dollar amount of 1983 PDE available to G for G's gift to L, considering only Reg. Sec. 25.2503-3.

3c. During 1984, T distributed all \$90,000 of trust net income to L, who was alive at the end of 1981. Explain G's 1984 TG to L, disregarding the PDE; furnish the rationale for your answer, but do not cite any authority.

3d. In 1988, when L was still alive, G died. L's life/12 year interest had a 1988 actuarial value of 0.40; the FMV of all trust property in 1988 was \$1,200,000, and L's life/12 year interest therefore had a 1988 FMV of \$480,000. G's income interest expired at G's death, and no one will ever receive anything from the trust with respect to G's reserved and now extinguished income interest. Immediately before G's death, G's income interest had a FMV of \$100,000 and the FMV of the remainder was \$620,000. G never took any steps to exercise G's reserved power to substitute X for R as remainderman. Accordingly, G's power to appoint X lapsed at G's death. Although G could not appoint the remainder to himself, his estate, his creditors, or the creditor of his estate, assume for purposes only of this part d that G could appoint himself. Assume that none of the Sec. 2041(b)(1) exceptions applies. Disregard the Sec. 2041(b)(2) "5 or 5" rule. Analyze whether G's power will require inclusion of some amount under Sec. 2041(a)(2), citing appropriate Reg. Sec. 20.2041-1(b) authority if you can locate it quickly. Disregard the dollar amount includible.

3e. Analyze whether Sec. 2036 will require an inclusion in G's GE by reason only of G's right to income which expired before G received any income. Disregard the dollar

amount includible.

3f. Assume that Sec. 2036 does require an inclusion in G's GE by reason of G's income interest. The facts are as in part d (but G had no GPOA). Analyze the dollar amount includible by Sec. 2036 by reason of G's income interest.

3g. Analyze whether G's nonbeneficial right to substitute X for R will require any inclusion in G's GE under Sec. 2036, citing appropriate Reg. authority if you can locate it quickly. Disregard the dollar amount includible.

3h. Analyze whether G's nonbeneficial power to substitute X for R will require an inclusion in G's GE under Sec. 2038. Disregard the dollar amount includible.

3i. The facts are as in part d (but G had no GPOA). Assume that G's power to substitute X for R does require inclusion under Sec. 2038. Analyze the dollar amount includible under Sec. 2038, citing appropriate Reg. authority if you can locate it quickly.

3j. Assume the 1988 FMV of G's reserved reversionary interest exceeds 5% of \$1,200,000. Analyze extremely concisely whether G's reversion will require an inclusion in G's GE under Sec. 2037, citing precise Code authority if you can find it quickly. Disregard the dollar amount includible.

PROBLEM 4.

4a. Local law recognizes joint tenancy with right of survivorship. Father F and Daughter D in 1984 purchased Blackacre (BA) taking title as valid Joint Tenants with Right of Survivorship (JT). F paid \$80,000 and D paid \$20,000 of the \$100,000 total cost. In 1988, when the FMV of BA was \$300,000, F died survived by D. F's executor is

having a very difficult time finding how much F and D contributed individually toward BA.

Analyze the GE consequences to F's estate if E is unsuccessful in finding any contribution information, and if E is successful.

4b. Father F in part a also left \$1,000,000 FMV of property to a testamentary trust, to pay 60% of all net income monthly to his Wife W throughout her life and pay the other 40% of net income to Daughter D during W's life (thus W is the measuring life for both W's and D's income interest). At W's death, all property is to be distributed outright in such shares or amounts as W in her discretion may by her valid will designate among D if living at the death of W, S (D's son by a previous marriage) if living at the death of W, Q (F's sister) if living at the death of W, and W's estate, provided that W may not award more to her estate than she awards to S. The most W could appoint to her estate would thus be one-half of the trust, because she could award 50% to S if he survived her and 50% to her own estate. If S predeceases W, S is not eligible to receive anything from the trust. To the extent W does not validly award trust remainder to or among the four eligible designees, the remainder shall be delivered outright to X and his heirs (i.e., X need not survive anyone in order for his estate to receive trust remainder property).

Analyze the extent to which W's interest violates the Sec. 2056(b)(1) Nondeductible Terminable Interest (NTI) rule. Read part c before beginning to answer this part b.

4c. Analyze the extent to which the gift to the trust avoids the NTI rule by reason of the Sec. 2056(b)(5) exception only.

4d. Analyze the amount includible in W's GE under Sec.

2041(a)(2), assuming that S is alive when W dies.

4e. Repeat part d, except assume S predeceases W.

4f. Assume that the income interest F gave W is a Sec. 2056(b)(7) (B)(ii)(I) Qualifying Income Interest (QII) as to 40% of the trust, per Sec. 2056(b)(7)(B)(iv). Analyze carefully whether W's power to appoint trust corpus will violate the Sec. 2056(b)(7)(B)(ii)(II) requirement, confining your answer to Code Sec. 2056(b)(7) (i.e., do not consider Regs. or other authority).