TAXATION OF ESTATES & GIFTS

Spring 1995
Redding

Directions

<u>Before you begin answering any question, lift up the bottom of the page and check that you have pages numbered 1 though 9. Write your examination number on each page of the examination.</u>

This is a MODIFIED open book exam. You may only have with you the <u>Federal Estate & Gift Taxes Code and Regulations</u> and an outline you prepared or helped to prepare. No other materials (such as your notes) may be brought into the exam room; leave them outside. Materials may not be shared. Calculators may be used. The exam must be turned in no later than 5:05 p.m.

Questions are to be answered on the examination itself. Put an arrow to indicate when your answer continues on the back. You may use extra paper of your own as scratch paper. The scratch paper need not be turned in.

BASIC ASSUMPTIONS FOR ALL QUESTIONS

Except as otherwise expressly provided in a particular question, make the following assumptions:

(1) There have been no prior gifts.
(2) When prior gifts are indicated, they were made in cash, are irrevocable, and are made to adult donees.
(3) All stock is traded on an established market.
(4) The grantor of a trust is not a trustee of the trust.
(5) Use the § 25.2512-5(f) tables and assume that trust income accrues at 10% per year.
(6) Parties are not related.
(7) Optional elections have not been made.
(8) All transfers occur after 1992.
(9) There are no relevant transactions except those set out.

If one or more additional assumptions must be made in order to answer a question, state what assumption(s) you are making and why it is necessary to do so. Do not make assumptions which are contrary to the facts given. Explain each answer. Show your calculations, where appropriate. NO credit will be given for an answer without an explanation.

Examinations may be written only in the classroom that has been assigned to us, Classroom A. If you find it necessary to leave the room during the examination, close your exam and leave it face down. The examination, your outline, and your code must remain in the examination room until you have completed your exam.

Exam Number ____

PART I: Short Answer with Brief Explanation (50 per cent)

Directions: Write the answer in the blank provided and explain your answer briefly in the space provided. (For #5, write a brief answer only.)

1. (10 per cent) Donor (D) transfers Widget, Inc. stock worth $40,000 to his Son (age 34) and Son's wife (age 30) in their joint names. D's wife consents to splitting the gift. The amount of gift tax due under § 2001 is

________________.

2. (5 per cent) A violent storm in the Gulf of Mexico badly damaged D's boat before throwing it against the rocks on shore along the Florida mainland. The salvage operation revealed an illegal cargo of heroin, which was confiscated. Under Florida law, an individual's possession of personal property is prima facie evidence of the individual's ownership of the personal property. D's executor properly values the heroin at $500,000 and includes it in D's gross estate, bringing the total of the gross estate to $2 million. The amount the estate may claim as a

deduction for the value of the confiscated drugs is ________________.

3. **(5 per cent) D (50 years old) transfers $100,000 to a trust, income for D's life to D, remainder to R. The amount of D's"total gifts" is ___________.**

4. **(5 per cent) D (75 years old) transfers $100,000 to a trust, income to D's son, S (50 years old), for S's life, remainder to D or D's estate. The amount of D's "total gifts" is ________________.**

5. **(5 per cent) In 1990, D transfers $100,000 to a trust, income to L for L's life and remainder to R or R's estate. D, as the trustee, retained the power to accumulate income. D paid any applicable gift tax due. When D dies in 1995, when the corpus is worth $110,000, his gross estate will include ________________.**

6. (10 per cent) Grandfather makes a gift of $750,000 in 1993 to Grandson (GS) and uses any means or makes any elections available to reduce his wealth transfer taxes. He then makes another gift to GS in 1995 of $500,000, once again acting to minimize his wealth transfer taxes. Grandson's parents are both alive. In 1995, the amount of gift

tax due will be ____________.

7. (10 per cent) At his death in 1995, D was a widower and a resident of Georgia. D never made any inter vivos taxable gifts. At his death, D had the following assets and liabilities:

(a) Home: valued at $200,000, but subject to a $50,000 nonrecourse mortgage.

(b) Widget, Inc. stock held in joint title with adult Son with right of survivorship, valued at D's death at $40,000. (Son had purchased the stock and given D joint ownership on D's 60th birthday.)

(c) Car and other personalty valued at $60,000.

(d) Life insurance (face amount $100,000) on D's life payable in equal shares to D's two adult children.

(e) A charitable bequest that qualifies under § 2055 in the amount of $20,000.

(f) Funeral and administrative expenses and valid claims against the estate that satisfy § 2053 in the amount of $10,000.

(g) Georgia estate tax in the amount of $2,000. (Assume this is the correct amount.)

The amount of federal estate tax payable by D's estate is ________________.

 Exam Number ____

PART II: Problem-Solving Essay (50 per cent)

Directions: Answer the following questions by writing a lawyerly answer.

8. To what extent, if at all, will there be "total gifts" by D if D places cash in trust, and the trust instrument contains the following alternative provisions:

   (a) (5 per cent) Income for A's life to A and B in such proportions as the trustee designates, remainder to C. D is the trustee.

   (b) (5 per cent) Same as (a) above except that the trustee also has the power to accumulate income. In the first year, the trust earns $25,000 income. D as trustee pays $15,000 of the income to A and $7,000 to B. $3,000 is added to corpus for C's ultimate benefit since D did not distribute it.

9. To what extent, if any, will the following give rise to a marital deduction if the executor makes the QTIP election whenever it is available? Explain.

(a) (3 per cent) After D's death, Surviving Spouse's (SS) attorney files suit in Probate Court. The Court awards SS $20,000 as one year's statutory support, which the executor pays a month after D's death.

(b) (4 per cent) By his will, D transferred income-producing property to a trust. Under the terms of the trust, Surviving Spouse (SS) will receive the income paid monthly for her life or until her remarriage, remainder to D's adult children from his first marriage or their estates equally. Moreover, if D's sister is widowed during SS's lifetime, the trustee is then authorized to make distributions to his sister for her health, support, maintenance, and education.

(c) (3 per cent) Attorney has drafted D's will so that D will bequeath his entire estate, which consists of income-producing property, to a trust. Under the terms of the trust, if the executor makes a QTIP election within 6 months of D's death, Surviving Spouse (SS) will receive the income to be paid monthly, remainder to the adult children of D's first marriage or their estates equally.

 Exam Number ____

10. To what extent will the following transactions result in any property being included in D's estate for federal estate tax purposes when he dies in 1995? If something will be included in D's gross estate, explain to what extent there will be an inclusion and under what code section maximum inclusion would be required. If there will be no inclusion, so state.

(a) (3 per cent) In 1990, D transfers Blackacre to a trust, the right to possession and enjoyment (including the right to rental income) to L for L's life, remainder to R or R's estate. However, D retains the right, exercisable in his will, to provide for the remainder to go to Z instead. There is no such provision in D's will at his death.

(b) (3 per cent) In 1992, D transfers Widget, Inc. stock to a trust, half of the income to D for his life, remainder to R or R's estate.

(c) (4 per cent) In 1992, D transfers $100,000 to a trust, income to D, remainder to adult Child. In 1994, D sells his life estate to Child, who pays D its FMV of $60,000. D spends the entire $60,000 so that none remains to be included in his gross estate.

11. (5 per cent) Attorney has devised the following plan in an attempt to insure that there will never be any generation skipping transfer tax under Chapter 13. D will transfer $2,000,000 to a trust, with income to Brother's adult child (BC) for life, paid annually, remainder to BC's children or their estates equally. Two weeks later Brother will transfer $2,000,000 to a trust, with income to D's adult son (S) for his life, paid annually, remainder to S's children or their estates equally.

QUESTION: Will the plan be successful? Explain.

12. (15 per cent) In January 1994, Father irrevocably transfers $100,000 ~~to~~ a trust for Daughter (D). Under the terms of the trust,

(a) D (who is 30 years old) has the right to the trust income, paid quarterly, for her life;
(b) trustee in her absolute discretion may appoint corpus to D;
(c) D has the noncumulative right to withdraw the greater of $5,000 or 5% of the trust each year on December 1; and
(d) D has the power to appoint by will any part of all of the trust to anyone other than herself, her estate, or the creditors of either. In default, at D's death the remainder is to be distributed to D's siblings or their estates equally.

D receives a check for $5,000 when she exercises her right to withdraw in December 1994. D unexpectedly dies on March 1, 1995, when the corpus (enhanced by accumulated interest) is worth $107,000.

QUESTION: Explain what amount will be included in D's gross estate.