

FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS

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FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS

Revised Third Edition

**Teacher's Manual to Accompany the
2011 Supplement**

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PREFACE

The primary thrust of the 2011 Supplement is on how the Tax Act of 2010 impacts the federal transfer tax systems. To that end, I have added several problems based on the Tax Act of 2010 and this Manual provides answers and discussion. Because the Tax Act only changes rules for the tax years 2010-2012, with scheduled reversion in 2013 to the rules in effect in 2001, I think it is important to continue to use some of the existing problems in the casebook, although you will find that I have changed many of the dates in the Problems to 2011.

I have also changed many, but not all, of the casebook problems that were based on a § 7520 rate of 8% to a § 7520 rate of 3% to better reflect the current low interest rate environment. The difference in value between using a 3% and an 8% rate is dramatic. (If you want to use an 8% rate for 2011 problems involving Table S, the Original Manual answers, which were based on an earlier Table S, cannot be relied upon.) The latest actuarial tables are not in print but can be found at <http://www.irs.gov/retirement/article/0,,id=206601,00.html>.

The differing rules, especially differing rate schedules and exemption levels, will inevitably be confusing for students. Although the Supplement sets forth the different rate schedules, and these will likely be contained in the required statutory book, it might make sense to hand out the rate schedules for 2011 and 2012 as well as the rate schedule for 2001 which will be the schedule for 2013 unless Congress acts.

I have also included selected administrative and judicial developments, including new regulations.

I welcome any comments or suggestions: ibloo@albanylaw.edu.

Ira Mark Bloom
July 2011

Chapter 2

OVERVIEW OF FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS

Pages 29-30:

The Example is based on the rate schedule that was in effect prior to 2010. I think it important for students to know how that schedule worked, especially if gridlock results in a return to the schedule in 2013.

Page 30:

Problem 1 on page 30 is designed to illustrate the gift tax cumulation process so you may still want to take it. Problem 1 illustrates the need to consider the specific rules that were in force during a particular year. For example, in 2000 and 2001 the exemption level was only \$675,000. See casebook page 28.

New problems 2-4, which factor in the 2010 Act, also illustrate the cumulative gift taxation if you don't want to take Problem 1.

Problem 2

- a. For gifts in 2010, § 2502 included a rate schedule based on a top rate of 35%. The same gift tax rate schedule applies in 2011 and 2012 but it is incorporated by reference to the unified rate schedule under § 2001(c). See § 2502(a). This schedule is set out on Supplement Pages 9-10.

For the taxable gift of \$500,000, a gift tax of \$155,800 is imposed. In turn, there would be a credit allowed under § 2505 of \$155,800. Technically, the credit under § 2505(a) (as in effect in 2010) would have been a credit equal to the tax on a \$1 Million or \$330,800. However, under § 2505(c), the credit can never exceed the tax imposed, which is \$155,800. Although no gift tax is payable, a gift tax return must be filed. See § 6019.

- b. Applying § 2502(a)(1), the tentative tax on the sum of all taxable gifts, \$5,100,000, is \$1,765,800. The tax on the prior taxable gift of \$500,000 is \$155,800 so that the tax imposed by § 2501 is \$1,610,000. The § 2505 credit amount is \$1,575,000 (\$1,730,800 less \$155,800). The tax is \$35,000 (Tax imposed of \$1,600,000 less § 2505 credit of \$1,575,000). Of course, a gift tax return must be filed with the accompanying payment.
- c. If D made his first and only taxable gift of \$5,100,000 in 2011, the gift tax would also be \$35,000. (Tax imposed of \$1,765,800 less § 2505 credit of \$1,730,800.) In effect, the same gift tax should result regardless of when the gifts are made-hence cumulative gift taxation. (Of course, one minor variance is that less gift tax will result by multiple gifts in different years if the gifts qualify for the gift tax annual exclusion.)

Note: The goal is for students to understand that the first \$5 Million of taxable gifts are exempt and any gifts above that amount will be taxed at the 35% rate. Problem 3 also illustrates this point.

- d. In 2012, the exemption level will be adjusted for inflation in \$10,000 increments. If inflation is in the 2% range, the exemption level would be \$5,100,000 so no gift tax would result. The

exemption amount for 2012 should be known shortly after August 31, 2011. See § 2010(c)(2)(B).

Problem 3

This problem illustrates how the computational system applies in 2011 when taxable gifts were made before 2010.

- a. By applying the rate schedule in effect in 2009, which is the same (for brackets up to \$1.5 Million) as the 2013 rate schedule set forth on Supplement Pages 10-11, the gift tax payable would be \$41,000 (Tax imposed of \$386,800 less § 2505 credit of \$345,800 based on a \$1 Million exemption level in 2009).

Note: This is the same tax amount on the taxable gift of \$1.1 Million in Text Problem 1d, although if gift tax exclusions were allowed the taxable gift of \$1.1 Million would be \$2,000 less in 2009.

- b. Applying § 2502(a)(1), the tentative tax on the sum of all taxable gifts, \$5,100,000, is \$1,765,800. The tax on the prior taxable gift of \$1,100,000 (based on the 2011 rates, not the 2009 rates, see IRC § 2502(a)(2)) is \$365,800 so that the tax imposed by § 2501 is \$1,400,000. The § 2505 credit amount is \$1,400,000 (\$1,730,800 less \$330,800 (the credit that would have been allowable based on \$1 Million exemption if the 2011 rates applied rather than the actual credit of \$345,800 that was allowed in 2009)). The tax is zero (tax imposed of \$1,400,000 less § 2505 credit of \$1,400,000).

In effect, gifts of up to \$4 million can be made in 2011 for the amount of gifts in excess of \$1 million (but no more than \$5 million) that were made before 2011. On the other hand, if gifts of \$1 million or less were made, gift tax will be payable if the aggregate taxable gifts exceed \$5 million. For example, if *D* had made a taxable gift of \$1 million in 2009 (instead of \$1.1 million) and then made a taxable gift of \$ 4.1 million in 2011, a gift tax of \$35,000 would be payable for the 2011 gift.

Note: § 2505(a)(last sentence) effectively prescribes that the 2011 rates be used to determine under § 2505(a)(2) the credit reduction amount. The 2010 Tax Act retroactively provides the same rule for computing gift taxes in 2010, thereby correcting the erroneous provision that existed.

- c. No gift tax would be payable for the reason explained in b. In fact, even if *D* made a taxable gift slightly in excess of \$ 4 million, there may be no gift tax payable in 2012 because for 2012, the \$5 million exemption level will be adjusted for inflation in \$10,000 increments. The exemption amount for 2012 should be known shortly after August 31, 2011. See § 2010(c)(2)(B).

Problem 4

This problem illustrates the uncertainty beyond 2012. If Congress does not act, and that is surely possible because of gridlock after the 2012 elections, then the gift tax system will revert to the 2001 rules, with a top rate of 55% and an exemption level of \$1 Million (which was scheduled to take effect in 2006). The gift tax imposed would be based on the tax on aggregate taxable gifts of \$5,200,000 over the tax on prior taxable gifts of \$5,100,000 or a tax of \$55,000 instead of \$35,000 based on the tax schedule in effect in 2011 and 2012. There would be no § 2505 credit available. (If Congress continues the 2012 system which would entail indexing the \$5 Million exemption for

inflation, the exemption in 2013 may be high enough to allow for a § 2505 credit to zero-out the gift tax imposed.)

Page 35:

Problem 1

The applicable rate schedule for 2002 (for brackets up to \$1.5 Million) is the same as the rate schedule for 2013, which is set forth on Supplement Pages 10-11.

Problem 2

- a. The gross estate would be the same as in Problem 1a.—\$1,215,000.
- b. The taxable estate would be the same as in Problem 1b.—\$1,160,000 as there would be no § 2058 deduction.
- c. About 20 states impose a tax on death, including Massachusetts, New York and New Jersey, based on the credit that was allowable under § 2011 prior to the Tax Act of 2001, which initially reduced the credit and then repealed it beginning in 2005, replacing it with a § 2058 deduction. The Tax Act of 2010 continues repeal for 2011 and 2012 but allows a § 2058 deduction.

Because a state tax would be imposed of \$42,640 (*See Answer to Problem 1c*), there would be a § 2058 deduction in that amount so the taxable estate would be \$1,117,360.

Note: Although no federal estate tax will be imposed in 2011 or 2012 on relatively small estates, state deaths may be imposed, thereby shifting planning strategies to minimizing or eliminating state death taxes. *See Manual Page 8, infra.*

- d. There would be no federal estate tax payable in 2b. or 2c. Technically, a tax would be imposed by § 2001—\$386,000 under 2b. and \$371,055 under 2c.—but the tax imposed under each would be zeroed out by the § 2010 credit. Although § 2010(a) would allow a credit of \$1,730,800, § 2010(c) limits the credit to the amount of the estate tax imposed. In effect, in 2011 no federal estate tax will be payable when the taxable estate (and adjusted taxable gifts) is \$5 Million or less. In 2012, this amount will be increase slightly based on the as yet to be prescribed inflation adjustment.

Note: The inflation-adjustment for 2012 should be available shortly after August 31, 2011. *See § 2010(c)(2)(B).*

- e. No return would be required as the gross estate must exceed \$5 Million. *See § 6018*

Problem 3

- a. The federal estate tax imposed under § 2001 would be \$1,765,800. The § 2010 credit would be \$1,730,800 and tax payable would be \$35,000.

Note: Again, students should know the answer without having to go through the calculations—the first \$5 Million is exempt and anything over \$5 Million is taxed at a flat 35% rate.

- b. Although the estate tax imposed would be the same, the allowable credit will depend on the inflation adjustment which will inform the estate tax liability, if any.

Problem 4

This problem illustrates the uncertainty beyond 2012. If Congress does not act, and that is surely possible because of gridlock after the 2012 elections, then the estate tax system will revert to the 2001 rules, with a top rate of 55% and an exemption level of \$1 Million (which was scheduled to take effect in 2006). The estate tax payable before the § 2011 credit would be \$2,100,000 (tax imposed of \$2,445,800 less § 2505 credit of \$345,800). Assuming the maximum § 2011 credit amount is payable, then the federal estate tax liability would be reduced by \$402,800.

Page 39:

Problem 4

This problem illustrates the uncertainty beyond 2012. If Congress does not act, and that is surely possible because of gridlock after the 2012 elections, then the estate tax system will revert to the 2001 rules, with a top rate of 55% and an exemption level of \$1 Million (which was scheduled to take effect in 2006). Assuming the 2001 regime applies in 2013, then the \$4 Million gift which generated no gift tax liability will likely produce adverse estate tax consequences. The tentative tax base will be \$5 Million, including an ATG of \$4 Million. Although there is some disagreement, many think that there will be no reduction for the gift taxable that would have been payable since the actual credit used in 2011 would apply, thereby resulting in a “0” amount under 2001(b)(2). The resulting estate tax will be \$2,045,000 (disregarding the § 2011 credit). Practitioners refer to this result as the “clawback” or recapture effect. Note that much of the estate tax may not be collectible from the gross estate recipients—there is only that \$1 Million available. However, for gifts within three years of death, § 2035(b)(1)(C) may effectively allow recovery from the donees.

Page 48:

Problem 1

The following answer assumes that the tax year is 2011. (Based on the Tax Act of 2010, the income tax rate tables under the Tax Act of 2001 are continued for 2011 and 2012, subject to inflation-adjustments.)

From Nicole’s GI of \$10,000, a standard deduction of \$950 is allowed, resulting in TI of \$9,050. Under § 1(g), the first \$950 of TI is taxed to Nicole, producing a tax under §1(c) of \$95. The balance, \$8,100, is taxed to Nicole at her parents’ 35% rate, or a tax of \$2,835. Nicole’s tax liability is \$2,930 as contrasted with a tax of \$3,500 had the income been actually taxed to the parents, resulting in a savings of \$570 by the assignment.

Problem 2

If Nicole was 18 (but still a dependent), then her taxable income would have been \$9,050 and her liability would have been \$933 (\$8,500 at 10% and \$550 at 15%).

Page 52:

Problem

The tax is \$7,610 based on the tax year 2011. Had the \$24,700 been taxed at the 35% rate, the tax would have been \$8,645 so \$1,035 was saved by trust creation.

Chapter 3

ESTATE TAXATION BASICS

Page 97:

Note on Problems: The § 7520 rate has dramatically decreased since the Third Edition was written in 2002. I think students should use a 3% rate (indeed you may even want to use a 2% rate, which applies in September 2011) rather than the 8% rate in the Problems. The original manual contains the answers based on an 8% rate, albeit an earlier Table S applied.

Problem 1: Using a 3% rate, the remainder value is \$66,062 ($\$100,000 \times 0.66062$).

Page 98:

Problem 2

Using a 3% rate, the unexpired 5 year term is valued at \$13,739 ($\$100,000 \times 13791$).

Problem 3

Using a 3% rate and assuming an annual payment at year's end, a \$6,000 annuity for 5 years is valued at \$27,478 ($\$6,000 \times 4.5797$). If the annuity is payable on a different basis, Tables J and K under Treas. Reg. § 20.2031-7 provide the appropriate factor to be taken into account. See <http://www.irs.gov/retirement/article/0,,id=206601.00.html> (latest actuarial tables) Although the annuity factors are published in <http://www.irs.gov/retirement/article/0,,id=206601.00.html>, they can also be derived from Table S. See Treas. Reg. § 20.2031-7T (d)((2)(iv), (d)(5), Ex. 3, 4.

In today's low interest environment, it is doubtful that income of \$6,000 would be generated. Indeed, most annuities do not specify the source of payment so that if income is insufficient, then principal will be used to cover the shortfall.

Problem 4

Using a 3% rate and assuming an annual payment at year's end, a \$6,000 annuity for 15 years is valued at \$71,627 ($\$6,000 \times 11.9379$).

Problem 5

- a. Nothing. The contingent remainder ends on B's death.
- b. C's indefeasibly vested remainder is valued at \$66,062. See answer to Problem 1.
- c. The answer is based on a "two-lives" factor which is beyond the course's scope.

Page 99:

The proposed regulations are discussed in Christakos, *Has The IRS Gone Too Far With Its Alternate Valuation Date Proposed Regulations?*, 15 Lewis & Clark L. Rev. 491 (2011).

Page 114:

The 2009 regulations contain many exceptions. If you choose to treat them, you'll find ample meat in the regulations, which include several examples.

Page 115:

Problem 1

Presumably, a deduction would be disallowed for such unenforceable claims under Treas. Reg. § 20.2053-4(d)(4).

Problem 2

Although Treas. Reg. § 20.2053-4(a) would seem to limit the deduction to the amounts actually paid, the post-death demise of the ex-spouse falls under an exception for recurring, noncontingent obligations so a deduction should be allowed for the actuarial value of the monthly payments. See Treas. Reg. § 20.2053-4(d)(6) (last sentence).

Problem 3

In *Estate of Shapiro v. United States*, 634 F.3d 1055 (9th Cir. 2011), the Ninth Circuit allowed a § 2053 deduction for palimony claims.

Page 147:

Portability is extensively disused in President Obama's revenue provisions for 2012. See Description of Revenue Provisions Contained in the President's 2012 Budget Proposal at 499-504 (Staff of The Joint Committee on Taxation, June 2011).

Page 148:

In the **Example**, the time for making a qualified disclaimer has passed.

Page 173:

I like to illustrate the zeroed-out CLAT, which also paves the way to understand the zeroed-out GRAT, which is discussed at Manual Pages 18-20, *infra*. The zeroed-out CLAT will be for a term of years with the annuity set so that its value equals 100% of the trust property. For example, if a CLAT will be created over \$1 Million for 10 years, and the 7520 rate is 3%, then the value of an annuity of \$117,231 for 10 years will equal \$1 Million and the entire \$1 Million will be deductible under § 2055. To obtain, the necessary annuity, simply divide the trust amount by the annuity factor. The longer the term, the smaller the annuity necessary. For example, with a \$1 Million CLAT for 15 years, and a § 7520 rate of 3%, an annuity of “only” \$83,767 will be necessary to get a \$1 Million § 2055 deduction.

Pages 176-78:

If you teach in a state that has an independent death tax system, in effect, has decoupled from § 2011's repeal, you may want to spend some time here. In effect, state death taxation is still very relevant for the smaller estates in 2011 and 2012, as illustrated by the Example on Supplement page 23. Typically, these decoupled states rely on § 2011 as it was in force before 2002; as a result,

the federal estate tax system will be applied even though there will be no federal estate tax because of the \$5 Million exemption levels in 2011 and 2012. One interesting planning gambit is to make deathbed gifts since the § 2011 credit and hence state death tax is based entirely on the federal taxable estate. Lifetime gifts are disregarded. In the smaller estates, it will be possible to avoid state death taxes by denuding the estate; state death tax avoidance or minimization may also result in larger estates by making significant gifts. Of course, a durable power of attorney with appropriate gift-making authority should be in place.

Chapter 4

GIFT TAXATION BASICS

Page 220:

Problem 1 (assuming the gift in 2011 with a \$13,000 annual exclusion)

- c. The amount of the taxable gift is \$10,000. The exclusion applies even if the gift is not small, and the value of the gift may be reduced by the amount of the exclusion.
- d. If, indeed, the gift was to the daughter and her husband jointly, then each received an interest worth \$14,000. Each interest also is a present interest. The donor therefore may claim an exclusion for each, so that only \$2,000 (\$1,000 times 2) constituted a taxable gift. Note that if the gift had been only to the daughter, only a single exclusion would have been available, and \$15,000 would have been a taxable gift.

The problem can easily be expanded to include spousal gifts to married children, so that a donor-couple can give \$52,000 to tax free each year to the donee-couple, using split gifts, if necessary, to each spouse of the donee-couple.

Problem 2

The donor is entitled to an annual exclusion for the interest passing to each recipient of a present interest. In this case, *A* and *B* have present interests. *C* has a future interest in the classic property sense, for which no exclusion is available. Therefore, *S* is entitled to two annual exclusions, subject to valuation. Based on an 8% interest rate under § 7520, the value of the income interest is \$53,681, or \$26,840.50 per donee. Thus, two \$13,000 annual exclusions are available to the donor resulting in a taxable gift of \$74,000.

Based on a 3% § 7520 rate, the value of the interest would be \$25,591, or \$12,796 per donee, so that the full \$13,000 annual exclusion could not be fully used. The taxable gift would be \$74,409. This is a good point at which to discuss the problem of a present gift of less than the maximum annual exclusion, especially in the current low income interest environment.

You might get the students to address the question of why the income interest is not a "future interest," given that only the first year's income is payable currently; *i.e.*, why are future years' income not "future interests?"

Problem 3

Based on a 3% § 7520 rate, the life estate factor is .38830 but only \$13,000 of the present interest gift of \$38,830 qualifies; the total remainder value of \$61,170 does not qualify. The taxable gift is also \$87,000.

Note also that the valuation of the present interest does not depend on the sex of the beneficiary; the tables are unisex tables. Further, the age of the remainder man is irrelevant to the value of the remainder interest.

Page 237:

Problem

M's outright gift of \$8,000 used up \$8,000 of *M*'s \$13,000 exclusion. Thus, only \$5,000 of the \$20,000 § 529 contribution is available for the gift tax annual exclusion. A taxable gift of \$15,000 occurs. The same result likely occurs if *M*'s spouse consented to split the § 529 contribution, but not the \$8,000 gift, because split gift tax treatment must be on an all-or-nothing basis. See Treas. Reg. § 25.2513-1(b).

What about electing the 5-year spread out provision? *M* could have elected to spread out the \$20,000 gift over 5 years, using up only \$4,000 (of the remaining \$5,000 exclusion amount) in 2011. And, if *M*'s spouse consented to split the gift, each could elect to spread out \$10,000 over 5 years.

Page 249:

The Tax Act of 2010 effectively extended the deadline for making a qualified disclaimer to September 19, 2010 for decedents dying in 2010 before September 17, 2010.

Page 250:

Problem 3

Absent a disclaimer, there will be no federal estate tax, nor state death tax liability on *H*'s death as the taxable estate will be zero. But on *W*'s death, avoidable taxes may result absent a partial disclaimer. For example, if *W* dies later in 2011, there will be a federal estate tax payable on \$1 Million, assuming *H*'s unused exclusion amount is ported to *W* by *H*'s executor so electing. Moreover, if *W* dies domiciled in a state that imposes a state death tax, significantly greater taxes will result from not making a partial disclaimer. And, if *W* dies in 2013 but Congress gridlocks so the 2001 regime goes into effect, there will be significantly greater taxes payable than if *W* made a partial disclaimer. In any event, a partial disclaimer can get *W*'s children property without *W* having to make taxable gifts.

Page 251:

You might to discuss the recent firestorm over the Service's intention to determine whether contributions to § 501(c)(4) organizations are gifts based on Rev. Rul. 82-216; 1982-2 C.B. 220, and its apparent caving into pressure by Republicans. See *IRS Suspends Exams on Application of Gift Tax to Contributions Made to Some Exempt Orgs.*, TNT 131-18 (Jul. 7, 2011).

Page 252:

Frank Calculations:

If no gift: 252 shares @ \$6,910 per share \$1,741,320 which is amount that would have been included in gross estate under § 2033. After gift 161 shares @ \$5,528 per share which is amount that was included in gross estate \$890,008 Gift value: 91 shares (252 less 161) @ \$5,528 \$503,048 Total transfer tax value \$1,393,056 Disappearing value \$348,264.

Another way to look at: 252 shares @ \$6,910 per share \$1,741,320 which is amount that would have been included in gross estate under § 2033. Less: 161 shares @ \$5,528 per share which is amount that was included in gross estate \$890,008 Reduction in estate tax value by gift of 91 shares (Footnote 23) \$851,312 Gift tax cost \$503,048 Disappearing value \$348,264

Page 255:

I hand out the manual's discussion of *Jones*.

Page 261:

Denial of the annual exclusion in *Hackl*-type cases, *see, e.g., Price v. Commission*, T.C. Memo. 2010-3, can be avoided by giving the donee a "put" option but the option may reduce the discount. *See Starbuck, FLP Planning in 2011: New Issues and Opportunities*, 2011 TNT 8-8 (Jan. 12, 2011)

Page 264:

Problem 1

Students should ask what is the § 7520 rate?

Here are solutions based on a 3% and 8% rate:

Based on a Section 7520 rate of 3%, the actuarial value of *R*'s initial retained interest was 0.744094 times the initial value of the property transferred to the trust. If the initial value of the trust was \$100,000, the value of the gift to *A* was \$25,591 (\$100,000 minus \$74,409). This transfer qualifies under § 2503(b) as a present interest gift. This value assumes that § 2702 is not applicable. If it is, § 2702 values the reversion at -0- and the gift is \$100,000, less any available annual exclusion.

When *R* gives the reversionary interest to *X*, there remains only eight years until the reversion becomes possessory, and thus, it is more valuable than when it was retained two years earlier. The actuarial factor for the reversion following *A*'s remaining eight-year term interest is 0.789409 and the value of the gift to *X* is \$78,941. This transfer is a future interest and no annual exclusion is available.

Based on a Section 7520 rate of 8%, the actuarial value of *R*'s initial retained interest was 0.46319 times the initial value of the property transferred to the trust. If the initial value of the trust was \$100,000, the value of the gift to *A* was \$53,681 (\$100,000 minus \$46,319). This transfer qualifies under § 2503(b) as a present interest gift. This value assumes that § 2702 is not applicable. If it is, § 2702 values the reversion at -0- and the gift is \$100,000, less any available annual exclusion.

When *R* gives the reversionary interest to *X*, there remains only eight years until the reversion becomes possessory, and thus, it is more valuable than when it was retained two years earlier. The actuarial factor for the reversion following *A*'s remaining eight-year term interest is 0.54027 and the value of the gift to *X* is \$54,027. This transfer is a future interest and no annual exclusion is available.

Page 267:

Problem 1

- a. *G* is deemed to have retained the reversionary interest in the property because he did not transfer it. That interest is worth \$49,400, so that the gift is \$50,600. The income interest should qualify for the § 2503(b) annual exclusion.

- b. The gift is complete for the entire \$100,000. Both interests are vested, and *G* has retained nothing. The income interest should qualify for the § 2503(b) annual exclusion.
- c. The gift is complete as to \$100,000 less the value of *G*'s reversionary interest, which is the value of the remainder (\$49,400) times the probability of *C* not surviving *A*. The latter factor can be obtained from two-life tables available from the Service or an actuary. The income interest should qualify for the § 2503(b) annual exclusion.
- d. The gift is complete as to \$100,000 less the value of *G*'s reversionary interest, which is the value of the remainder (\$49,400) times the probability of all of *C*'s children predeceasing *A*. The latter is an actuarially determinable factor, dependent on the ages of *A* and the three children.
- e. The gift is complete for the entire \$100,000. Because it is not actuarially possible to calculate the possibility of *C* having children, it is actuarially impossible to calculate the probability of *C* having children who survive *A*. It is therefore actuarially impossible to calculate *G*'s right to the return of the property if no child of *C* survives *A*. Therefore, no value may be subtracted for *G*'s interest under the rule of *Robinette*.

Page 269:

Rev.Rul 82-105 has effectively become regulation-ized by Treas. Reg. § 20.2036-1(c)(2), discussed in Chapter 7.

Page 271:

Estate of Morgens v. Commissions, 133 T.C. 402 (2009), holds that § 2035(b) applies to the gift tax payable on remainder gifts under § 2519.

Chapter 5

GENERATION-SKIPPING TRANSFER TAX BASICS

Pages 279-300:

Students find GST taxation exceedingly difficult. The text generally assumes transactions in 2002 when the highest applicable rate was 50%, which makes calculations as simple as possible. In 2011 and 2012, the highest rate will be 35%. I didn't think it made sense to change the text based on a 35% rate but as you go through the text you might point out how calculations would change if GST events occurred in 2011 or 2012 under a 35% regime and at least a \$5 Million GST exemption.

The Tax Act of 2010 created a special situation for GSTs in 2010 by creating an applicable (but not zero) inclusion rate of zero. As a result, absent unusual circumstances, it was not necessary to create a zero inclusion ratio; indeed, opting out of deemed GST allocations was probably advisable. Because GSTs in trust in 2010 are recognized under the Tax Act of 2010, subsequent transfers to close skip persons may not result in a GST based on the move-down rule of § 2653(a), which is discussed in the casebook on pages 297-98.

Page 304:

Creation of intentionally defective grantor trusts (IDGTs) is a popular estate planning gambit. *See generally* Mark L. Ascher, *The Grantor Trust Rules Should Be Repealed*, 96 Iowa L. Rev. 885 (2011) (proposing repeal to prevent tax avoidance by IDGTs)

An IDGT is based on the inclusion of an innocuous grantor trust provision which is not significant enough to require estate taxation. *See* Manual Page 23, *infra* (discussing § 675[4]). In addition, because the grantor will pay the income taxes on trust income, the grantor effectively makes a gift of the income tax to the trust beneficiaries but this is not treated as a gift for gift tax purposes. Nor does § 2036 apply unless the trust is required to reimburse the grantor for the income taxes paid. *See* Rev. Rul. 2006-64, 2004-2 C.B. 7.

Chapter 7

RETAINED INTERESTS

Page 322:

Problem 1

At 3%: The actuarial value of *G*'s retained life estate is \$561,170 and the value of the remainder is \$438,830. *G*'s unified credit should preclude the current payment of any gift taxes on the taxable gift of \$438,830. Problem 1 on Text Page 328 explores the estate tax issues associated with this trust.

When *Y* is *G*'s daughter, § 2702 is applicable. Because *G*'s retained interest is not a qualified interest under § 2702(b), it is valued at zero. Thus, *G* has made a \$1 million gift of a future interest. The gift tax imposed on this \$1 million taxable gift is zeroed-out by the § 2505 credit.

Problem 2

At 3%: Pursuant to Treas. Reg. § 20.2031-7T(d)(iv), the annuity factor of 18.7057 is determined by subtracting remainder factor for age 50 from 1 and dividing that amount by applicable interest rate.

$$\frac{(1.00000 - 0.43883)}{0.03}$$

The value of the retained annual annuity of \$4,000 is \$74,823 (\$4,000 x 18.7057 and is a qualified interest under § 2702(b) so that the zero valuation rule of § 2702(a)(2)(A) does not apply. The remainder gift of \$25,177 is the only taxable gift. *G*'s niece is not a family member within the meaning of § 2702(e). (Section 2702(e) references § 2704(c)(2)).

Although not relevant to solve the problem, *G*'s brother is a family member within the meaning of § 2702(e). Nevertheless, because *G*'s retained interest is a qualified interest, the answers do not change.

Page 322:

Problem 3

This is an example of a grantor retained income trust (GRIT). The retained income interest is not a qualified interest because it is not stated in terms of an annuity or a unitrust amount. Thus, there is a taxable gift of \$100,000. The 3% rate is a red herring.

Walton, which involved a GRAT, rather than the GRIT in this problem, provides authority for the popular zeroed-out GRAT gambit. See Carlyn S. McCaffrey et al., *The Aftermath of Walton: The Rehabilitation of the Fixed-Term Zeroed-Out GRAT*, 95 J. Tax'n 325 (2001).

In *Walton*, the taxpayer transferred \$100 million in Wal-Mart stock to each of two trusts, the terms of which provided that the taxpayer would receive an annuity in the first year of approximately 49% and an annuity of 50% in the second year. If she died during the two-year term,

the remaining annuity payments would be payable to her estate. After two years, the trust terminated and was payable to taxpayer's children.

Relying on Example 5 of Treas. Reg. § 25.2702-3(e), the Service argued that the value of the contingent interest in favor of taxpayer's estate was not retained for purposes of § 2702. The Tax Court disagreed, holding that Example 5 was invalid. As a result, the value of the remainder gift was virtually zero.

Based on *Walton*, taxpayers can create short-term GRATs where the retained interest equals the gifted amount so that there is no value to the remainder gift. If the property appreciates in value and the taxpayer survives the GRAT period, then all appreciation will pass tax-free to the remainder beneficiaries. If it doesn't appreciate, the taxpayer starts over again by creating another 2-year GRAT. Considering that the gift tax exemption is frozen at \$1 million, zeroed-out GRATs may become *de rigueur* for wealthier taxpayers.

Note: Zeroed-out GRATs are extensively discussed on Teacher's Manual Pages 18-20.

Problem 4

G should consider transferring the house to a qualified personal residence trust (QPRT), also known as a House GRIT. Unlike GRATs, QPRTs are excepted from the general rules of § 2702. See § 2702(a)(3)(A)(ii). Thus, it is possible for *G* to retain a reversionary interest in the trust principal (the house) or a power to appoint the trust principal (the house) if *G* does not survive the trust term. The reversionary interest or retained power of appointment is a part of the property not gifted to the *C*. Because the reversionary interest or power of appointment can be actuarially valued, the zero value rule of *Robinette* does not apply. As a result, the remainder gift is lower than a GRAT funded with securities based on the same assumptions (including an 8% annuity payout). If no reversionary interest is retained, as permitted by the QPRT rules, the value for the QPRT and GRAT is the same.

Based on an 8% rate, the value of the retained interest in the \$200,000 house is \$114,214. The taxable gift to *G*'s child is the balance of the \$200,000 or \$85,786. A computer program (Numbercruncher) was used to value the reversionary interest at \$9,790 (\$200,000 times .04895), the retained use of the house at \$104,424 (\$200,000 times .57107), and the remainder at \$85,786 (\$200,000 times .42893). (Students do not have access to the tables necessary to make this computation.)

If *G* did not retain the reversionary interest in the QPRT or a power of appointment over the trust principal, the value of the retained interest is \$107,361 (\$200,000 times 0.536807) and the remainder gift is the same as an 8%, 10-year GRAT: \$92,639 (\$200,000 times 0.463193).

Note that the reversionary interest affects the value of the retained use of the house, but overall, the gift is smaller when a reversion or a power of appointment is retained by *G*.

Page 328:

The answers at 8% are in the original Teacher's Manual in case you want to compare results but the Table S factor in Problem 1 was based on earlier actuarial assumptions. **The answers to Problems 1-3 and 5 based on a 3% rate follow:**

Problem 1

The initial gift of the remainder interest is valued at \$438,830, assuming that *G* is age 50 at the time of the gift. Because *Y* is unrelated to *G*, § 2702 is not applicable. *See* Problem 1 on page 322 of the text.

The trust is includible in *G*'s gross estate because of § 2036(a)(1). It is valued as of *G*'s death, so that \$1.2 million is included. The gift of the remainder interest, however, is not included as an "adjusted taxable gift" under § 2001(b)(1)(B) because the language at the end of § 2001(b) excludes from the definition of "adjusted taxable gift" gifts which are included in the gross estate, as this gift is. However, any gift taxes paid is credited against *G*'s estate taxes. *See* § 2001(b)(2).

This issue will appear in many problems in the remainder of the book. Thus, you should emphasize the distinction between a taxable gift and an adjusted taxable gift.

It should make no difference if *G* is the trustee.

If *Y* is *G*'s daughter, § 2702 applies to the initial transfer and the gift is valued at \$1 million. The taxable gift of \$1 million is not an adjusted taxable gift because of its estate tax inclusion. However, any gift taxes paid is credited against *G*'s estate taxes. *See* § 2001(b)(2).

At the end of the chapter, we discuss Treas. Reg. § 25.2702-6, which requires adjustments to avoid double taxation, including a reduction in the amount of adjusted taxable gifts. That provision will not apply in this problem because the adjusted taxable gifts are zero based on the last sentence of § 2001(b). Also, Treas. Reg. § 25.2702-6 does not apply to reduce the amount includable in the gross estate.

Problem 2

- a. The gift tax consequences depend on whether *C* is a family member for purposes of § 2702. If *C* is not a family member, then § 2702 does not apply. The value of the 10-year retained interest of \$25,591 is not a gift; there is a taxable gift of the remainder amount of \$74,409. If *C* is a family member so that the zero valuation rule of § 2702(a)(2) applies, the entire gift of \$100,000 is a taxable gift.

The value of the assets held in the trust is included in *G*'s estate because she retained the income for a period which did not end before her death. *See* § 2036(a)(1). Because the remainder is included in *G*'s gross estate, the remainder gift is excluded from the definition of adjusted taxable gifts by the last sentence of § 2001(b). Any gift tax payable, however, can be subtracted from the tentative tax under § 2001(b)(1)(B). Because *G* died 4 years after making the gift, § 2035(b) does not apply.

- b. The answers are the same as a, except any gift taxes paid on trust creation are included in *G*'s gross estate under § 2035(b). *See* Text Pages 308-311.
- c. Having survived the term of the trust, the value of the trust is not included in *G*'s estate. The amount of the gift is an adjusted taxable gift.

Problem 3

When the trust is created, the interest retained by *G* is a § 2702(b)(1) qualified interest. The retained interest is valued at \$59,724 using an annuity factor of 9.9540, based on a 3% rate under § 7520. The gift tax value of the remainder is \$40,276.

Because *G* died before the term ended, there is an estate tax inclusion for *G*'s estate. Applying the methodology of Rev. Rul. 82-105 and Treas. Reg. 20.2031-1(c)(2) to the facts of this problem, the \$6,000 annuity is divided by the assumed § 7520 interest rate of 3% so that the amount of the inclusion is \$200,000. The value of the trust is not relevant, unless it is less than the amount computed under Revenue Ruling 82-105, in which event the value of the trust is the maximum inclusion.

The extent to which the taxable gift is an adjusted taxable gift is problematic. Because 2/3rds of the \$300,000 value of the corpus is included in the gross estate (\$200,000/\$300,000), likely only 2/3rds, or \$26,851 of the taxable gift of \$40,276 is not an adjusted taxable gift. The balance of \$13,425 should constitute an adjusted taxable gift.

Note: Contrary to the Service's earlier position that § 2039 applies so that the entire corpus value will always be included, *see, e.g.*, Priv. Ltr. Rul. 9445035 and Priv. Ltr. Rul. 200036012, Treas. Reg. 20.2039-1(e), effective in 2008, provides that § 2039 will not apply to retained annuities.

Problem 4

Unitrust valuation involves exceedingly complex mathematical calculations. John Bogdanski's valuation treatise, *FEDERAL TAX VALUATION* (Warren, Gorham & Lamont), provides a comprehensive discussion of unitrust valuation and other complex valuation problems. In practice, software programs are used for unitrust (and annuity trust) valuations. Page 96 of the original Manual illustrates why computer programs are used.

Note: Contrary to the Service's earlier position that § 2039 applies so that the entire corpus value will always be included, *see, e.g.*, Priv. Ltr. Rul. 9412036, Treas. Reg. 20.2039-1(e), effective in 2008, provides that § 2039 will not apply to retained unitrusts.

Page 337:

Estate of Stewart v. Commissioner, 617 F.3d. 148 (2d Cir, 2010), *rev'g and remdg*, T.C. Memo. 22006-225, is an interesting case. *See* Bogdanski, *Upstairs, Downstairs: Retained Interests and Estate of Stewart*, 2011 TNT 36-7 (Feb. 2011). If you have the class time, you might consider handing out *Stewart* and going over it in class.

Page 338:

Problem 4

Payment of fair rent should negate the conclusion that the transferor retained the enjoyment. *See Estate of Riese v. Commissioner*, T.C. Memo. 2011-60 (involving QPRT); *Estate of Barlow v. Commissioner*, 55 T.C. 666 (1971). On the other hand, payments of less than fair rental value may cause § 2036 inclusion. *See Estate of Disbrow*, T.C. Memo 2006-34. Of course, failure to pay any rent can cause a serious problem. *See, e.g., Estate of Van v. Commissioner*, T.C. Memo 2011-22.

Page 349:

The Supplement adds a new subsection, **[5a] Unwinding the Benefits of Valuation Discounts in Family Controlled Entities: Section 2036(a)(1) as the Weapon of Last Resort**

The issue of § 2036(a)(1) has generated lots of litigation as it is the Service's last hope to undo the benefits of valuation discounts via family business entities which were covered earlier. It probably makes sense to review the discussion of Valuation Discounts on Text Pages 91-96 as well as the discussion of *Frank* (Text Page 254) and *Estate of Jones* (Text Page 255).

Estate of Korby

Estate of Korby illustrates the area in a fairly succinct opinion. The Korbys formed a revocable trust and later KPLP, a FLP which held most of the couple's income producing assets. In return for forming KPLP, the Korbys received a 98% limited partnership interest and the revocable trust a 2% interest as general partner. On transferring their 98% interest to their 4 sons, the Korbys claimed substantial valuation discounts.

When the Korbys died, their gross estates omitted inclusion of their interests in the KPLP. On audit, the Service asserted deficiencies based on including the KPLP assets under § 2036(a)(1). The Tax court agreed and the Eighth Circuit affirmed. § 2036(a)(1) applied because (1) there was an implied agreement that the Korbys retained the benefits of the KPLP assets and (2) the sale was not bona fide because there was no reason to form KPLP other than for tax avoidance purposes. In other words, there was no business nor non-business reason for formation; if one had been found, § 2036(a)(1) would not have applied based on the exception for a bona fide sale for full consideration.

Page 364:

Having looked at how all four tax systems apply to retained interests, I like to spend time illustrating an important estate planning technique: the zeroed-out GRAT. Indeed, Congress has threatened to eliminate the technique but to date the legislation has not succeeded. The latest version is S 1286, introduced on June 11, 2011, which among other requirements would require a minimum 10 year term. GRATs can be very sophisticated as illustrated by John F. Bergner, *Mending Wayward Wealth Transfer Strategies*, 44 PHILIP E. HECKERLING INSTITUTE ON ESTATE PLANNING ¶ 4.01 (2010) (extensive discussion of GRATs).

Note: If you have the time, you might want to discuss another estate planning technique: the installment sale. See generally Blattmachr and Zeydel, *Comparing GRATs and Installment Sales*, 41 Philip E. Heckerling Institute on Estate Planning ch. 2 (2007).

I hand out and spend some time on the following:

The Zeroed-Out GRAT: The Basics

A. The Construct

Parent creates irrevocable trust on the following terms: Parent retains the right to an annuity at the end of year one and at the end of year 2 of the trust, remainder to Child. The trust is structured to meet all of the requirements of Section 2702(b)(1) and the applicable regulations. The annuity is sufficiently high so that it equals or virtually equals the value of the property transferred in trust. As a result, there is no gift or a minimal taxable gift on trust creation. If the property appreciates in value beyond 7520 rate used to value the annuity, then all or virtually all of appreciation will pass free of gift taxation. If property fails to appreciate, Parent simply gets property and any income back and can start over: re-GRAT. Not much downside risk apart from transactional costs.

B. Gift Tax Aspects

1. On February 25, 2005, Treasury published finalized regulations which eliminated an impediment to zeroed-out GRATs. The regulation adopts the holding in *Walton v. Commissioner*, 115 T.C. 589 (2000). Specifically, the last sentence in Treas. Reg. § 25.2702-3(e), Example 5 was deleted and replaced with following sentence:

The interest of A (and A's estate) to receive the unitrust amount for the specified term of 10 years in all events is a qualified unitrust interest for a term of 10 years.

2. To avoid valuation problems, the annuity can be defined by a formula, that is, “a fixed percentage of the initial fair market value of the property transferred in trust, as finally determined for federal tax purposes.” See Treas. Reg. § 25.2702-3(b)(2). By using formula, rather than dollar amount, the amount of any taxable gift will be minimal if hard-to-value asset is revalued.

3. Although it is possible to zero-out GRAT, probably better to virtually zero-out and have minimal taxable gifts for an hard-to-value asset. This avoids possible argument under *Procter* doctrine (Text Page 253-254) that somehow formula violates public policy since IRS would gain nothing by revaluation.

4. Annuity cannot be payable by note from trust. See Treas. Reg. § 25.2702-3(b)(1).

C. Estate Tax Aspects

1. If grantor dies within trust term, Section 2036(a)(1) applies. Amount includible is based on following equation: Amount Includible = Annual Annuity Amount (as adjusted for payments more frequent than annually)/7520 rate based on grantor's death (or an alternate valuation date). Treas. Reg. § 20.2036-1(c)(iii), Example 2 provides an example of amount includible under Section 2036 if grantor dies within GRAT term.

2. In PLRs, Service had claimed that full amount of trust is includible under Section 2039 if amount includible under Section 2036 is less than estate tax value of the trust. See, e.g., PLR200036012. Most thought this position was without merit.

Good news: Treas. Reg. § 20.2039-1(e), effective for decedents dying on or after July 14, 2008, excludes GRATS and the like from inclusion under Section 2039.

D. GST Aspects

GRATs are not good devices for GST purposes because of ETIP rule that will bar GST allocation on trust creation.

E. Income Tax Aspects

1. GRAT should be a grantor trust based on Section 677(a)(1). (In practice, other innocuous grantor trust provisions are used to assure full grantor trust status.) As a result, any income will be taxed to the grantor even though income remains in trust. In effect, grantor makes additional gift by paying income tax, without payment being treated as gift. That's how the Code is structured. (This is one big reason why grantors want to invoke grantor trust status.)

2. Because the GRAT will be a grantor trust, transactions between the grantor and the trust will be ignored. See Rev. Rul 85-13. In effect, grantor is treated as still owning trust assets for income tax purposes so grantor can make interest free loans to trust without application of Section

7872. Also, no gain or loss on sales to and from trust. Thus, trust could use appreciated asset to satisfy annuity without incurring gain.

F. Virtually zeroed-out GRAT Example

Example: Parent transfers \$100,000 worth of property to a 2 year GRAT. The 7520 rate was 3.0%. An annuity of \$52,260 would zero-out the GRAT. Parent decides on an annuity of “only” \$52,200 so that retained interest is \$99,885 (\$52,200 times 1.9135). Instead of retaining dollar amount, Parent retains an annuity equal to 52.2% of the trust property as finally valued for federal tax purposes. Parent makes a taxable gift of \$15.

Assume property increases by 10% each year. At the end of year 1, trust is worth \$110,000. After satisfying annuity obligation of \$52,200 to Parent by distributing property with that value, remaining trust property is \$57,800. At trust termination, based on 10% growth, trust will be worth \$63,580. Child gets \$11,380 at gift tax “cost” of \$15, after satisfying remaining annuity of \$52,200.

Not impressed! Try adding some zeros and think about exploding values-IBOS. How about FLP/LLC interests where annuity will be based on discounted values?

If property fails to appreciate, Parent gets everything back and can start over: re-GRAT. Or can start to re-GRAT when get back distribution of property at end of year one in satisfaction of annuity.

Page 381:

Problem 1

Assuming § 2072 applies:

- a. On creation of the trust, *D* made a taxable gift of \$100,000 because the actual actuarial value of the retained interest, \$38,830, is valued at zero. No annual exclusion is available because the remainder is a future interest.

In year 4 (and assuming *D* had reached age 69), *D*'s gift equaled \$33,938 less an any gift tax annual exclusion, but *D*'s aggregate taxable gifts is reduced by that amount, and not the higher amount that resulted under § 2702. See Treas. Reg. § 25.2702-6(c), Example 1.

- b. If *D* died in year 8, § 2035 does not apply. The amount of the adjusted taxable gifts reflects an adjustment under Treas. Reg. § 25.2702-6.
- c. If *D* died in year 5, § 2035(a) applies, and the full value of the trust is included in the gross estate. In addition, any gift tax paid on the second gift is included under § 2035(b). Because the remainder gift was included in *D*'s gross estate pursuant to § 2035(a), it will not be an adjusted taxable gift. On the other hand, the gifted income interest should be an adjusted taxable gift. See the discussion for c. below where § 2702 does not apply.

Assuming § 2702 does not apply:

- a. On creation of the trust, *D* made a taxable gift of the remainder in the amount of \$61,170. In year 4 when *B* was 69, *B* made a gift of \$33,938 and a taxable gift of \$20,938, if the available annual exclusion is \$13,000.

- b. If *D* died in year 8, § 2035 does not apply. Both gifts are adjusted taxable gifts.
- c. If *D* died in year 5, § 2035(a) applies, and the full value of the trust is included in the gross estate. In addition, any gift tax on the second transfer is included under § 2035(b). Because the remainder gift was included in *D*'s gross estate pursuant to § 2035(a), it will not be an adjusted taxable gift.

On the other hand, the value of the gifted income interest is not included in the gross estate, and thus, it is an adjusted taxable gift. Students find this hard to accept. We explain it this way: Had *D* not gifted his income interest, any income received would have been included in *D*'s gross estate under § 2033. In addition, § 2036(a)(1) catches the value of the trust at date of death. The taxable gift of the income interest substitutes for the present value of the income stream that would have been received by *D* had he not given it away.

Problem 2

- a. There are no gift tax consequences because of the full and adequate consideration. There is no reason to apply *Allen* to the gift tax. If § 2702 had initially applied, there is still not a gift, but the unanswered issue is the modification to aggregate taxable gifts as a result of the disposition of the retained interest. Treas. Reg. § 25.2702-6 addresses the adjustment when the retained interest is disposed of without consideration, but provides no answer when consideration is provided. In all fairness, the aggregate taxable gifts should be reduced by the lesser of the amount of the prior gift that resulted from the application of § 2702 or the consideration received, but the Code and regulations are sometimes neither fair nor logical.
- b. The full value of the property should be includable undiminished by the consideration received for the life estate. The consideration received is the equivalent of the income interest which *D* would have been entitled to if *D* did not transfer his retained income interest. Its payment merely anticipates the payment of the income he would have received. Had it not been paid, any remaining income not consumed before death would have been separately included in the decedent's estate under § 2033. In addition, the entire value of the trust at *D*'s death would have been included under § 2036(a)(1) if he had not sold his income interest shortly before death.

The modifications to adjusted taxable gifts are discussed in the answer to **a.** above.

Problem 3

Revenue Ruling 79-62 concludes that the transferred interest is valued as of the date of the decedent's death, not the date of the transfer, for the purposes of § 2037's 5% limitation. Thus, if it is worth less than 5% at the date of death, § 2037 is not applicable.

If § 2702 applied because either *A* or *B* was a family member, the adjusted taxable gift amount should be lowered to avoid double taxation. See Treas. Reg. § 25.2702-6(b).

Problem 4

- a. Because of the QTIP election, there are no gift tax consequences to *H*. On his subsequent death in year 5, there should be no estate tax consequences either.
- b. When *W* transfers 20% of her income interest, she triggers § 2519. Treasury Regulation § 25.2519-1 provides that a disposition of any part of the life income interest is deemed a disposition of the entire trust corpus, less the value of the income interest.

In addition, *W* is making a gift of the value of the 20% income interest that is transferred.

Applying a 3% § 7520 rate, *W*'s gift of 20% of her income interest is a § 2511 gift of 20% of \$116,490 or \$23,298, less \$13,000. In addition, she makes a gift under § 2519 for the remainder valued at \$183,510.

If *Z* is a family member, application of § 2702 is uncertain. *W* has transferred an interest and retained an interest, but she did not retain an income interest and transfer a remainder. Rather, she transferred a part of an income interest and retained a part of the income interest given to her by someone else. The deemed transfer that results from the operation of § 2519 does not appear to be the type of transfer that § 2702 is aimed at. Moreover, the § 2519 Regulations are rather specific about the amount of gift that is made when a transfer of a portion of the income interest occurs.

When *W* dies in year 6, § 2036 is applicable to the trust corpus that produces the retained income interest. *See* Treas. Reg. § 25.2519-1(a). Thus, \$400,000 (80% of the trust corpus of \$500,000) is included in *W*'s estate. \$36,702 (20% of the gift triggered by § 2519) should be an adjusted taxable gift because the remaining 80% is included in the gross estate. Treasury Regulation § 20.2044-1(e), Example 5, illustrates the § 2036(a)(1) estate tax consequences when § 2519 applies.

Chapter 9

RETENTION OF POWERS OTHER THAN THE POWER TO REVOKE

Page 409:

Problem 1

Because *S* retained the power to substitute or add income beneficiaries, the transfer of the income interest to *A* was incomplete for gift tax purposes. *See* Treas. Reg. § 25.2511-2(c). *B*'s interest, however, was vested in him and was a completed gift. The value of a remainder after a 10-year term is .744094 times the value of the assets, or \$744,094. Because the interest is a future interest, it would not qualify for the annual exclusion.

If *S* is related to *B*, § 2702 is applicable and the value of *S*'s retained interest is zero, and thus, the gift tax value of the transfer is \$1 million. If *S* is related to *A*, but not *B*, § 2702 is not applicable because the only completed transfer is to *B*, who is not related.

Page 448:

Creation of intentionally defective grantor trusts (IDGTs) is a popular estate planning gambit. *See generally* Mark L. Ascher, *The Grantor Trust Rules Should Be Repealed*, 96 Iowa L. Rev. 885 (2011) (proposing repeal to prevent tax avoidance by IDGTs)

An IDGT is based on the inclusion of an innocuous grantor trust provision which is not significant enough to require estate taxation. In addition, because the grantor will pay the income taxes on trust income, the grantor effectively makes a gift of the income tax to the trust beneficiaries but this is not treated as a gift for gift tax purposes. Nor does § 2036 apply unless the trust is required to reimburse the grantor for the income taxes paid. *See* Rev. Rul. 2006-64, 2004-2 C.B. 7.

§ 675(4) has been a favored grantor trust provision for IDGTs. Rev. Rul. 2008-22, 2008-1 C.B. 796 effectively recognizes that estate taxation will not result if a § 675(4) power of substitution is used to create an IDGT.

Chapter 11

ANNUITIES AND OTHER RETIREMENT ARRANGEMENTS

Page 495:

The issue in the lottery cases is whether the annuity tables are required to be used or whether the tables create “unreasonable and unrealistic results. *Shackelford and* the Second Circuit’s 2003 reversal in *Gribauskas*, 342 F.3d 85, held that the tables could not be used. Other circuits, including the Fifth and Sixth, are to the contrary. See *Estate of Cook*, 349 F.3d 850 (5th Cir. 2003); *Negron v. United States*, 553 F.3d 1013 (6th Cir. 2009).

Page 498:

Problem 4

Based on a 3% rate, the annuity factor for annual payments, made at the end of the year, is 12.1317. This factor results in annual payments of \$41,214 (\$500,000 divided by 12.1317).

If the annuity payments are monthly, at the end of the month, the annual annuity factor must be adjusted by 1.0137 to reflect the frequency of payments. The adjusted factor is 12.2980, which results in a monthly payment of \$3,388 (\$500,000 divided by 12.2980 equals \$40,657, divided by 12).

M should be concerned because the annuity payments are unsecured: she may not receive the payment bargained for if *D* runs into creditor problems or is otherwise unable or unwilling to pay. Also, there may be adverse income tax consequences for *M*. *D* should be concerned because she might wind up paying more than anticipated if *M* outlives her actuarial life expectancy.

Page 621:

The Tax Act of 2010 continues the 15-35% brackets for trusts and estates for 2011 and 2012. Unless Congress acts, the 2001 income tax tables will apply.

Page 630:

By reducing the top estate rate to 35% for the years 2010-2012, it may make sense for a personal representative to elect the income tax deduction of administration expenses, at a savings 35% even if federal estate taxes will be imposed where no state death taxes will result but state income taxes will be. Of course, the availability of an estate tax marital or charitable deduction or a nontaxable estate are obvious reasons for the electing the income tax deduction.