

FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS

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FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS

Revised Third Edition

2011 Supplement

Prepared by

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TABLE OF CONTENTS

Chapter 1 BACKGROUND	1
Chapter 2 OVERVIEW OF FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS	9
Chapter 3 ESTATE TAXATION BASICS	18
Chapter 4 GIFT TAXATION BASICS	25
Chapter 5 GENERATION-SKIPPING TRANSFER TAX BASICS	28
Chapter 7 RETAINED INTERESTS	30
Chapter 11 ANNUITIES AND OTHER RETIREMENT ARRANGEMENTS	36

PREFACE

The primary reason for this 2011 Supplement is to incorporate the dramatic federal transfer tax changes that were enacted by the Tax Act of 2010 in December of 2010. Several new problems based on the Tax Act of 2010 are included in this Supplement. In addition, the 2011 Supplement changes many of the casebook problems based on the year 2002 to the year 2011. Also, many problems based on an 8% rate are changed to a more realistic 3% rate. Selected administrative and judicial changes are included.

I wish to express my appreciation to Jerry Hesch for his comments and to Fredd Brewer and Theresa Colbert, legal assistants at Albany Law School, for their invaluable assistance in preparing this Supplement.

Ira Mark Bloom
July 2001

Chapter 1

BACKGROUND

Pages 8 and 9: Replace Lines 4-end on page 8 and text on page 9 up to **[B] Generation-Skipping Transfer Tax** with the following:

Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Act of 2001)

In May 2001, Congress enacted the Economic Growth and Tax Relief Reconciliation Act of 2001 (Tax Act of 2001) and President Bush signed it into law.¹ The Tax Act of 2001 made two dramatic changes in the estate and gift tax systems, with most of the changes beginning in 2002. First, the Act introduced a schedule of reductions in the top marginal rate applicable to gifts and estate taxes. Second, the Act accelerated and magnified the 1997 increases in the exemption amount for estate (but not gift) taxes. The Act also made significant changes in the generation-skipping transfer (GST) tax system. *See* Supplement Page 2.

The rate and exemption schedule for estate (and GST taxes) under the Tax Act of 2001 were as follows:

<i>Taxable Event in:</i>	<i>Top Rate</i>	<i>Exemption Equivalent</i>
2002	50% (5% surtax repealed)	\$1 million (indexing for \$1 million GST exemption continues)
2003	49%	\$1 million (indexing for \$1 million GST exemption continues)
2004	48%	\$1.5 million (indexing for GST exemption eliminated)
2005	47%	\$1.5 million
2006	46%	\$2 million
2007	45%	\$2 million
2008	45%	\$2 million
2009	45%	\$3.5 million

While doing this, the Act de-unified the gift and estate taxes, beginning in 2004. The gift tax exemption amount was frozen at \$1 million, even though the estate (and GST) tax exemption amounts continued to climb.

In the same time frame, the Tax Act of 2001 phased out the § 2011 state death tax credit, by reducing it to 75% in 2002, 50% in 2003, 25% in 2004, and to nothing in 2005.²

¹ *See* Pub. L. No. 107-16, 115 Stat. 38.

² *See* § 2011(b).

After 2004, an estate will be allowed an unlimited state death tax deduction.³

For 2010, the Tax Act of 2001 called for the repeal of the estate tax for decedents who died in 2010.⁴ For gifts in 2010, the Act also reduced the gift tax rate to the top marginal income tax rate (set by other provisions in the Act at 35%).⁵

NOTE ON SUNSET PROVISION:

Repeal was coupled with a sunset provision that effectively applied the three transfer tax systems to the rules in force before the Tax Act of 2001. Pursuant to Section 901 of the Act, all provisions of the Tax Act of 2001 were scheduled to expire on December 31, 2010. This sunset provision was necessary to comply with the Congressional Budget Act of 1974. As will be discussed below, the Tax Act of 2010 effectively extended most of the sunset provisions of the 2001 Act until December 31, 2012.

For 2010, the Tax Act of 2001 reintroduced carryover basis for property received from a decedent who died in 2010. The details of Section 1022 are discussed on Supplement Pages 16-17. Other 2001 Tax Act changes included liberalizing the deduction under § 2031(c) for certain conservation easements by eliminating certain restrictions, and repealing the § 2057 Qualified Family Owned Business Interest rules for estates of decedents dying after 2003.⁶

Page 10: Add the following new paragraph after footnote 27:

The 2001 Act also made significant changes in the GST tax system, including reducing the rate of tax to correspond with the top estate tax rate and setting the GST exemption amount equal to the estate tax exemption level. The 2001 Act also provided that the GST tax system did not apply to generation-skipping transfers that occurred in 2010.⁷ As discussed in Chapter 5, the Tax Act of 2001 also modified the GST exemption allocation rules and these rules were extended until 2013 by the Tax Act of 2010.

Page 11: Add the following before § 1.02, including new subsection [D]:

Neither the Tax Act of 2001 nor the Tax Act of 2010 made any changes to §§ 671-78.

³ See §§ 2011(g), 2058.

⁴ See § 2210(a).

⁵ See § 2502(a) (gifts after 2009).

⁶ See § 2057(j).

⁷ See § 2664.

[D] The Current State of the Law: The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (Tax Act of 2010)

[1] Background

As discussed above, all of the provisions of the Tax Act of 2001 were due to expire on December 31, 2010 with the reinstatement of the rules in effect in 2001. For example, for decedents dying in 2001 the federal estate tax exemption was scheduled to be \$1 Million with a 55% top rate of tax.

Recognizing that a return to the 2001 rules with resulting higher taxes was politically inexpedient, Congress tried various ways to address the situation. The initial attempt in the mid-2000s was to permanently repeal the estate, gift and GST tax systems.⁸ The attempt failed, however, even though a majority of both houses voted for repeal because 60 votes in the Senate were necessary and that threshold was never met.

In December 2009, the House passed legislation that would have permanently extended the system as it existed in 2009.⁹ However, based on objections by Senate Republicans that the legislation would amount to a tax increase, the Senate failed to act and also refused to consider temporarily extending the 2009 rules.

Because Congress had not acted by December 31, 2009, on January 1, 2010 the final year of the Tax Act of 2001 became effective: the estate tax system was not in existence for decedents dying in 2010 nor were generation-skipping transfers in 2010 subject to GST tax; the gift tax remained in effect but with a top rate of 35%. A modified carryover basis system under § 1022 also applied with respect to property acquired from a decedent in 2010.

For most of 2010, the concern for some (and the hope for others) was that Congress would retroactively do the following: reinstate the estate tax system back to January 1, 2010, tax GST transfers in 2010, provide a 45% gift tax rate and repeal modified carryover basis. Most believed that the Supreme Court would uphold retroactive legislation based on its earlier pronouncement in *United States v. Carlton*,¹⁰ albeit years of legislation would likely have ensued over the retroactivity. Whatever was one's political sentiment,¹¹ incredible confusion abounded among estate planners as well as the public for virtually all of the year 2010. Would retroactive legislation be enacted applying the 2009 rules? Would Congress simply allow the Tax Act of 2001's sunset provision to play out so that starting on January 1, 2011, we would revert to the laws of 2001? Would Congress do something else?

In early December 2010, it became clear that Congress opted for "do something else." Based on back room negotiations between Senate representatives and Vice-President Biden, the Senate agreed to retroactively reinstate the federal estate tax system and GST taxes back to January 1, 2010 but in most surprising ways which will be discussed immediately below. Although there was substantial opposition in the House to the Senate-

⁸ See, e.g., H.R. 8 (Death Tax Repeal Permanency Act of 2005).

⁹ H.R. 4154.

¹⁰ 512 U.S. 26 (1994). *Carlton* is discussed in the casebook on page 14.

¹¹ See § 1.02 in the casebook discussing policy issues. See also Chapter 15 on Policy Considerations.

passed legislation regarding transfer taxation, ultimately the Senate version was passed by the House.

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (Tax Act of 2010) as Public Law 111-312.¹² As the full name implies, the legislation contained not only tax legislation. Indeed, the tax legislation portion also included significant income tax changes, including an extension of the Bush-era tax cuts until January 1, 2013. The complete law and technical explanation of the law can be found in the website links below.¹³

[2] Explanation of Federal Transfer Tax Changes Made by the 2010 Tax Act

As will be seen, the 2010 Tax Act made very dramatic changes in the estate, gift and GST tax areas.¹⁴ But it must be understood from the beginning that these changes only apply for the years 2010-2012. On December 31, 2012, all of the 2010 Tax Act changes, as well as all other tax changes, are legislated to expire.¹⁵ Indeed, unless Congress acts, the federal transfer tax laws starting on January 1, 2013 will revert to the laws that were in effect on December 2001! For example, the top estate tax will be 55% with a \$1 million exemption and the § 2011 credit for state death taxes will apply rather than the current rule of § 2058 which only allows a deduction for state death taxes.

[3] Federal Transfer Tax Changes for 2010

[a] Gift Tax Changes for 2010

Least affected by the Tax Act of 2010 was the gift tax system for 2010, including the \$1 Million exemption level as enacted by the Tax Act of 2001. The 2001 Tax Act changes came into effect on January 1, 2010 and were essentially unchanged by the 2010 Act. Based on the 2001 Act, there was a new rate schedule based on a top rate of 35% for 2010.¹⁶ In fact, there were only two minor changes made by the 2010 Act for gift taxes in 2010. First, there was a glitch in the way that the available credit under § 2505 was computed if prior gifts had been made. This was corrected.¹⁷ The second change was to retroactively repeal § 2011(c).

¹² 124 Stat. 3296.

¹³ The enrolled version of the law can be found at:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4853enr.pdf .

The Joint Committee on Taxation's Technical Explanation of the 2010 law can be found at <http://www.jct.gov/publications.html?func=startdown&id=3716>.

¹⁴ Section 301 of the Act also reinstates the Section 1014 basis rule for decedents dying in 2010 although an election can be made to apply the modified carryover basis rules of Section 1022.

¹⁵ See § 101(a) of the Tax Act of 2010.

¹⁶ See § 2502(a)(2).

¹⁷ See § 2505(a)(2).

[b] Estate Tax Changes for 2010

[i] Retroactive Reinstatement of the Estate Tax for 2010

The 2010 Tax Act dramatically changed estate taxation for 2010. The most significant change was the retroactive reinstatement of the estate tax system for 2010 with a \$5 million exemption level and a top rate of 35%.¹⁸ In addition, the § 2058 deduction for state death taxes was part of estate tax reinstatement.¹⁹ These and other changes are discussed below.

For decedents dying in 2010, an estate tax is imposed (unless an opt-out election is made as discussed below) based on the estate tax rate schedule of § 2001(c), which is set forth on Supplement Pages 9-10.²⁰ For 2010, the estate tax exclusion amount is \$5 Million, up from an exclusion amount of \$3.5 Million in 2009. The \$5 Million dollar exemption level is provided by § 2010(c). The 2010 Act also extended estate tax return filing and payment deadlines,²¹ as well as the deadline for making disclaimers.²² In addition, the Tax Act of 2010 effectively extends the 2001 Tax Act changes for 2010.²³ The most significant change was the repeal of the Section 2011 credit for state death taxes after 2004 and the allowance of a deduction under Section 2058 for state death taxes.

[ii] Election by Executor on 706 to Opt Out of Estate Tax System and Use Modified Carryover Basis Under Section 1022

Under the Tax Act of 2001, a modified carryover basis system under § 1022 was in effect for 2010. The details of § 1022 are provided later on Supplement Pages 16-17.

The 2010 Tax Act authorizes an executor to elect to use the modified carryover basis regime of § 1022 instead of having the estate tax system apply in 2010. On September 13, 2011, the Service issued [Notice 2011-91](#), which extends the filing date for Form 8339, Allocation of Increase in Basis for Property Acquired From a Decedent, until January 17, 2012. On August 5, 2011, the Service issued [Revenue Procedure 2011-41](#), which provides substantive guidance on § 1022.

¹⁸ Retroactive reinstatement of the estate tax in 2010 also includes the application of § 1014 to determine the basis in property acquired from a decedent. *See* § 301(a) of the Tax Act of 2010.

¹⁹ Other minor changes, such as in the conservation easement area, were also reinstated.

²⁰ With a new rate schedule and a top rate of 35%, it was necessary to ensure that Section 2001(b)(2), which allows a reduction in estate tax imposed for gift taxes that would have been payable on prior gifts, was properly determined. This was accomplished by adding Section 2011(g), which is best considered in connection with the Unification Example 3 on Supplement Page 14.

²¹ Section 301(d)(1)(A) and (B) of the Tax Act of 2010 extended the time for filing a federal estate tax return (Form 706) and making payment to 9 months after enactment on December 17, 2010 for decedents dying in 2010 before December 17, 2010. Because September 17, 2011 falls on a Saturday, the actual filing and payment date will be on Monday, September 19, 2011. Pursuant to IRS Notice 2011-91, an extension of time to file and pay the estate tax can be obtained until March 19, 2012, but interest will be payable from September 19, 2011.

²² Section 301(d)(1)(C) of the 2010 Act effectively extends the time for making a qualified disclaimer under § 2518 for decedents dying in 2010 before December 17, 2010 to Monday, September 19, 2011.

²³ *See* § 304 of the Tax Act of 2010.

The decision to elect out of the estate tax system and with it step-up (or step-down) in basis, will be based on the individual facts of a decedent's estate. As a general rule, the election will be made for estates that would have to pay estate taxes. Because the exemption level is \$5 million in 2010, an election out of the estate tax system will not be made for most estates.

[c] GST Tax Changes for 2010

The Tax Act of 2001 created massive confusion under the GST tax system for 2010. For 2010, § 2664 provided that the GST tax system would not apply to generation-skipping transfers that occurred in 2010. The 2010 Tax Act eliminates the confusion by retroactively repealing § 2664 for 2010; in its place, the Act recognizes that a GST event results in 2010 but exempts the GST event from GST taxation in 2010.²⁴

For 2010, the GST tax system is increased from \$3.5 Million in 2009 to \$5 Million even if an executor opts into the modified carryover basis regime.²⁵ Filing requirements for decedents dying in 2010 before December 17, 2010 are effectively extended to September 19, 2011 since September 17, 2011 falls on a Saturday.²⁶ In addition, the many salutary GST changes made by the 2001 Tax Act are continued for 2010 (as well as for 2011 and 2012).²⁷

[4] General Federal Transfer Tax Changes for 2011-2012

Starting in 2011, the estate, gift and GST tax systems will be unified for the first time. Specifically, estate and gift taxes will be imposed under the unified tax rate schedule of § 2011(c).²⁸ This schedule is set forth on Supplement Pages 9-10.²⁹ In addition, there will be a unified exclusion amount of \$5 Million in 2011 for estate, gift and GST tax purposes.³⁰

NOTE ON EFFECT OF \$5 MILLION GIFT TAX EXEMPTION:

The increase of the gift tax exemption amount from \$1 Million to \$5 Million in 2011 (and possibly higher in 2012) will likely result in significantly increased gift-making, including transfers to minimize income taxes and to create GST exempt trusts.

²⁴ See §§ 301(a), 302(c) of the Tax Act of 2010.

²⁵ See § 301(b) of the Tax Act of 2010.

²⁶ See § 301(d)(2) set forth in § 14.03[2], *supra*.

²⁷ See § 101(a) of the Tax Act of 2010.

²⁸ The separate gift tax rate scheduled under § 2502 was repealed and the gift tax will be based on the § 2001(c) rate schedule. See § 2502(a). Estate and gift tax imposition will be based on calculating prior gifts to reflect the new rate schedule and \$5 million exemption level. See §§ 2001(b), (g), 2505(a).

²⁹ GST taxes will be imposed at the rate of 35%.

³⁰ In 2012, the exclusion amount will be adjusted for inflation. See § 2001(c)(2)(B).

[5] Portability During 2011 and 2012

For 2011 and 2012 (but not for 2010), portability, a relatively new concept, will apply. Simply stated, portability allows the surviving spouse to use the last deceased spouse's unused exemption amount, technically referred to as the exclusion amount, provided the deceased spouse's executor elects to permit portability. For 2011 and 2012, portability can avoid the wasting of a spouse's unused exclusion amount. Consider an extreme example: If W died in 2010 with a taxable estate of zero, her exclusion amount of \$5 Million would be wasted. If instead W died in 2011, and her executor elected, her unused exclusion amount could be ported to H, who would then have a \$10 Million exclusion amount which could be used for gifting or at death but only during 2011 and 2012.

Portability is provided for in very technical terms under Section 2010 and Section 2505. The details of portability are best considered in connection with estate planning considerations for married couples. See Supplement Pages 19-20.

[6] Tax Changes for 2013 and Beyond

On December 31, 2012, all of the federal transfer tax changes made by the Tax Act of 2010 expire.³¹ Absent Congressional action, the federal transfer tax laws will simply revert to the laws in effect on December 31, 2001! As of this writing in July of 2011, no one has any idea what action, if any, Congress will take. The simple reason for the uncertainty is that federal transfer taxes have become a political football and until we know the results of the 2012 Congressional and Presidential elections it is very unlikely that Congress will act. Indeed, one scenario is that congressional gridlock will result in Congress doing nothing; at the other extreme, Congress may choose to repeal all federal transfer taxes.³²

The current uncertainty means that actions taken during 2011 and 2012 may have unfortunate tax consequences in 2013 and beyond. For example, if a couple relied on portability to avoid wasting the poorer spouse's unused exclusion amount, the exclusion amount will be wasted unless portability is continued.³³ Another problem could result if large gifts were made in 2011 and 2012 to take into account the \$5 Million basic exclusion amount in those years. If a client dies in 2013 and the 2001 estate tax system is in effect because Congress does not act, then significant estate tax liability may be incurred because the exemption amount will only be \$1 Million and a so-called "clawback" or recapture result may result for lifetime gifts that were exempt based on a \$5 Million exemption.

³¹ See § 101(a) of Tax Act of 2010.

³² One argument for repeal, which is buttressed by recent data, is that it simply isn't worth having a federal transfer tax system that generates so little revenue. In 2009, federal wealth transfer taxes contributed \$22 billion, which was only about 0.9% of the \$2.3 trillion total federal tax revenues for 2009. Statistical Abstract of the United States: 2011 at 317 (table 478) (2010). Of course, greater revenues would be generated with a lower exemption level and higher rates. Other policy issues, both pro and con, are discussed in the casebook on pages 11-13.

³³ Assuming Congress is not tied up by gridlock, it is likely that portability will continue in some form as President Obama has endorsed the concept of permanent portability. See General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals at 123-124 (Dep't of Treasury, Feb. 2011), available at <http://www.treas.gov/offices/tax-policy/library/greenbk12.pdf>.

Page 25: Replace list of Resources with the following:

Wealth Transfer Taxation

BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS (Warren, Gorham & Lamont 3rd ed. 1999).

PAUL L. CARON, ET AL., FEDERAL WEALTH TRANSFER TAX ANTHOLOGY (Anderson 1998).

RICHARD B. STEPHENS, ET AL., FEDERAL ESTATE AND GIFT TAXATION (Warren, Gorham & Lamont 8th ed. 2009).

Income Taxation of Estates, Gifts and Trusts

BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS (Warren, Gorham & Lamont 3rd ed. 1999).

F. LADSON BOYLE & JONATHAN G. BLATTMACHR, BLATTMACHR ON INCOME TAXATION OF ESTATES AND TRUSTS (PLI 15th ed. 2007).

M. CARR FERGUSON, ET AL., FEDERAL INCOME TAXATION OF ESTATES, TRUSTS AND BENEFICIARIES (Aspen Law & Business 3rd ed. 1998).

JOHN L. PESCHEL & EDWARD D. SPURGEON, FEDERAL TAXATION OF TRUSTS, GRANTORS, AND BENEFICIARIES (Warren Gorham and Lamont 3rd ed. 1997).

HOWARD M. ZARITSKY & NORMAN H. LANE, FEDERAL INCOME TAXATION OF ESTATES AND TRUSTS (Warren, Gorham & Lamont 3rd ed. 2001).

Valuation

JOHN A. BOGDANSKI, FEDERAL TAX VALUATION (Warren Gorham & Lamont 1996 & 2010 Supp.).

Estate Planning

A. JAMES CASNER & JEFFREY N. PENNELL, ESTATE PLANNING (CCH 6th ed. 1998).

JOHN R. PRICE, CONTEMPORARY ESTATE PLANNING (CCH 4th ed. 2008).

JEFFREY A. SCHOENBLUM, MULTISTATE AND MULTINATIONAL ESTATE PLANNING (CCH 3rd ed. 2006).

HAROLD WEINSTOCK, PLANNING AN ESTATE (Clark Boardman Callaghan 4th ed. 1995, updated in 2010).

Chapter 2

OVERVIEW OF FEDERAL TAXATION OF ESTATES, TRUSTS, AND GIFTS

Page 28: Delete 2010 Line of the chart and add the following:

<i>Year</i>	<i>Applicable Credit Amount</i>	<i>Exemption Equivalent</i>
2010	\$ 1,730,800	\$ 5,000,000
2011	\$ 1,730,800 ¹	\$ 5,000,000
2012	\$1,730,800, as indexed for inflation	\$5,000,000, as indexed for inflation
2013	\$ 345,800	\$ 1,000,000

NOTE ON GIFT TAX EXEMPTION:

The Tax Act of 2001 froze the gift tax exemption at \$1 Million for the years 2002-2010. The Tax Act of 2010 provides that the gift tax exemption will be the same as the estate tax exemption for 2011 and 2012. Unless Congress acts, the gift (and estate) tax exemption levels will be \$1,000,000 in 2013.

Page 28: Add before § 2.01:

Rate Changes: The Tax Act of 2010 effectively sets the top rate of tax at 35% for the years 2010-2012. Unless Congress acts, the top rate in 2013 will climb to 55%, which was the top rate in 2001.

Rate Schedules: By reducing the top rate to 35%, the rate schedule also needed to be adjusted by eliminating brackets above \$500,000. For the years 2010-2012, the § 2001(c) unified rate schedule is as follows:

Rate Schedule for 2010-2012

**If the amount with respect to which
the tentative tax to be
computed is:**

The tentative tax is:

Not over \$10,000	18 percent of such amount.
Over \$10,000 but not over \$20,000.....	\$1,800, plus 20 percent of the excess of such amount over \$10,000.
Over \$20,000 but not over \$40,000.....	\$3,800, plus 22 percent of the excess of such amount over \$20,000.

¹ Section 303(a) of the Tax Act of 2010 also provides for portability of the decedent spouse's unused exclusion amount in 2011 and 2012. See Supplement Pages 19-20.

Over \$40,000 but not over \$60,000	\$8,200, plus 24 percent of the excess of such amount over \$40,000.
Over \$60,000 but not over \$80,000	\$13,000, plus 26 percent of the excess of such amount over \$60,000.
Over \$80,000 but not over \$100,000	\$18,200, plus 28 percent of the excess of such amount over \$80,000.
Over \$100,000 but not over \$150,000	\$23,800, plus 30 percent of the excess of such amount over \$100,000.
Over \$150,000 but not Over \$250,000	\$38,800, plus 32 percent of the excess of such amount over \$150,000.
Over \$250,000 but not over \$500,000	\$70,800, plus 34 percent of the excess of such amount over \$250,000.
Over \$500,000	\$155,800, plus 35 percent of the excess of such amount over \$500,000.

Unless Congress acts, for 2013 (and beyond), the rate schedule will revert to the rate schedule in effect in 2001, which was based on a top rate of 55%. Hence the 2013 rate schedule will be the same as the rate schedule for 2010-2012 for the first \$500,000 but instead of a flat rate of 35% beyond \$500,000, the rate schedule will have additional brackets up to \$3 Million.

2013 Rate Schedule

If the amount with respect to which the tentative tax to be computed is:

The tentative tax is:

Over \$10,000 but not over \$20,000	\$1,800, plus 20 percent of the excess of such amount over \$10,000.
Over \$20,000 but not over \$40,000	\$3,800, plus 22 percent of the excess of such over \$20,000.
Over \$40,000 but not over \$60,000	\$8,200, plus 24 percent of the excess of such amount over \$40,000.
Over \$60,000 but not over \$80,000	\$13,000, plus 26 percent of the excess of such amount over \$60,000.
Over \$80,000 but not over \$100,000	\$18,200, plus 28 percent of the excess of such over \$80,000.
Over \$100,000 but not over \$150,000	\$23,800, plus 30 percent of the excess of such amount over \$100,000.
Over \$150,000 but not over \$250,000	\$38,800, plus 32 percent of the excess of such amount over \$150,000.

Over \$250,000 but not over \$500,000.....	\$70,800, plus 34 percent of the excess of such amount over \$250,000.
Over \$500,000 but not over \$750,000.....	\$155,800, plus 37 percent of the excess of such amount over \$500,000.
Over \$750,000 but not over \$1,000,000.....	\$248,300, plus 39 percent of the excess of such amount over \$750,000.
Over \$1,000,000 but not over \$1,250,000.....	\$345,800 plus 41 percent of the excess of such amount over \$1,000,000.
Over \$1,250,000 but not over \$1,500,000.....	\$448,300, plus 43 percent of the excess of such amount over \$1,250,000.
Over \$1,500,000 but not over \$2,000,000.....	\$555,800, plus 45 percent of the excess of such amount over \$1,500,000.
Over \$2,000,000 but not over \$2,500,000.....	\$780,800, plus 49 percent of the excess of such amount over \$2,000,000.
Over 2,500,000 but not over \$3,000,000.....	\$1,025,800, plus 53 percent of the excess over \$2,500,000.
Over \$3,000,000.....	\$1,290,800, plus 55 percent of the excess over \$3,000,000. ²

Caveat on applicable year: You will need to pay careful attention to the year or years involved in a particular example or problem as the results will depend on the baseline figures and the rules in force in the particular year or years. Indeed, one other variable over the years involves the amount of the gift tax annual exclusion.

Gift Tax Annual Exclusion: Starting in 1982, the exclusion amount was increased to \$10,000 (from \$3,000 in several prior years) with increases in \$1,000 increments based on inflation after 1998. The following lists the annual exclusion amounts since 1981:

1981-2001:	\$10,000
2002-2005:	\$11,000
2006-2008:	\$12,000
2009-2011:	\$13,000
2012 and beyond:	IRS will provide amount in annual Revenue Procedure.

Page 30: Add at end of the page the following Problems:

2. Assume *D*, a widower, made no prior taxable gifts. Consider §§ 2501, 2502, 2505 and 6019.

a. In 2010, *D* makes his first taxable gift in the amount of \$500,000. What are the gift tax ramifications of the transfer? What is the amount of the gift tax payable? Must *D* file a gift tax return?

² There will also be a 5% surcharge on taxable estates and taxable gifts that exceed \$10 Million. See § 2001(c)(2).

b. In January of 2011, D makes a taxable gift in the amount of \$4,600,000. What are the gift tax ramifications of the transfer? What is the amount of the gift tax payable? Must *D* file a gift tax return?

c. What would be the amount of the gift tax due if D made no gifts before 2011 but made taxable gifts of \$5,100,000 in 2011? What are the gift tax ramifications of the transfer? What is the amount of the gift tax payable?

d. How would answers to b and c change if the taxable gifts were made in 2012 instead of in 2011? Carefully consider § 2010(c)(2)(B) in relation to § 2502(a)(1).

3. Assume *D*, a widower, made no prior taxable gifts. Consider §§ 2501, 2502, 2505 and 6019.

a. In 2009, D made a taxable gift of \$1,100,000. What are the gift tax ramifications of the transfer? What is the amount of the gift tax payable?

b. In 2011, D made a taxable gift of \$4,000,000. What are the gift tax ramifications of the transfer? What is the amount of the gift tax payable?

c. How would answer to b change if the taxable gift was made in 2012 instead of in 2011? Carefully consider § 2010(c)(2)(B) in relation to § 2502(a)(1).

4. Refer to Problem 3. What would be the gift tax payable if D made a taxable gift of \$100,000 on January 1, 2013?

Page 35: Add after Problem 1c the following:

2. Refer to Problem 1 but assume that D died in 2011.

a. What is the amount of *A*'s gross estate for federal estate tax purposes? Consider §§ 2033, 2040, and 2041.

b. What is her taxable estate assuming that her state of domicile imposed no taxes on her death? Consider §§ 2051 and 2053.

c. What is her taxable estate assuming her state of domicile imposed an estate tax equal to the maximum state death tax credit that was allowable under § 2011 before the Tax Act of 2001? Consider §§ 2051, 2053 and 2058.

d. What would be the amount of federal estate tax due under 3b. and 3c.? Consider §§ 2001 and 2010.

e. Would a federal estate tax return be required to be filed by D's executor? Consider § 6018.

3. a. D died in 2011 with a taxable estate of \$5,100,000 having made no prior gifts. What would be the federal estate tax imposed, the amount of the credit allowable and federal estate tax payable? Consider §§ 2001 and 2010.

b. How would answers differ from those in 3a. if D died in 2012 instead of in 2011? Consider §§ 2001 and 2010.

4. D died in 2013 with a taxable estate of \$5,100,000 having made no prior gifts. What will be the federal estate tax consequences?

Page 36: Replace Examples 1 and 2 with the following examples:

Example 1: Prior to 2011, D made no taxable gifts. In 2011, D died with a taxable estate of \$5,100,000.

D's taxable estate and tentative tax rate base are both \$5,100,000 because D made no taxable gifts and hence no adjusted taxable gifts. The tax on this amount is \$1,765,800. Of course, no gift tax is subtracted since there were no gifts that could have generated gift tax liability. From the \$1,765,800, the estate tax unified credit of \$1,765,800 is subtracted, leaving an estate tax payable of \$35,000.

Example 2: In 2010, D made a taxable gift of \$500,000. In 2011, D died with a taxable estate of \$4,600,000. Assume no other gifts.

By applying the unified rate schedule of Section 2001(c), as prescribed by Section 2502(a), the gift tax imposed on the taxable gift of \$500,000 is \$155,800. However, the gift produces no gift tax payable because a unified credit of \$155,800 is allowed under Section 2505. When D dies, his taxable estate of \$4,600,000 is cumulated with \$500,000 in adjusted taxable gifts under Section 2001(b)(1), producing a tentative tax rate base of \$5,100,000. The tax on this amount is \$1,765,800 and no gift tax is subtracted, because none was payable on the \$500,000 gift. From the \$1,730,800, the estate tax unified credit of \$1,730,800 is subtracted, leaving an estate tax payable of \$35,000.

By unifying gift and estate taxes, the same amount of tax is payable in both scenarios. It does not matter whether all property is held until death as in Example 1 or some property is gifted as in Example 2.

Page 36: In next to last line, change \$11,000 to \$13,000 (reflecting the inflation-adjusted amount for 2011).

Page 37: Replace Example 3 with the following:

Example 3: The decedent made a gift of \$1,113,000 in 2009. The gift tax payable was \$41,000. A gift tax of \$386,800 was imposed on a taxable gift of \$1,100,000 (\$1,113,000 minus the \$13,000 exclusion which was allowed in 2009) less the then allowable § 2505 credit of \$345,800. The decedent died in 2011 with a taxable estate of \$4,000,000.

The estate tax imposed under section 2001 on the taxable estate of \$4,000,000 is computed as follows: the adjusted taxable gifts were \$1,100,000 which, when added to the taxable estate, produced a tentative tax rate base of \$5,100,000 and a tentative tax of \$1,765,800. This amount is reduced by \$35,000 (not \$41,000), the gift tax payable that would have been payable on the 2009 gift.³ Because the estate tax imposed and the § 2010 credit will be \$1,730,800, no estate tax will be payable.

Page 37: Delete **Example 4**.

Page 38: Replace **Example 5** and text ending with “transferred at death” with the following:

Example 4: *D*, who is in the 50 percent wealth transfer tax bracket, has \$1 million from which she wants *X* to derive the greatest benefit. Assuming she had used up her gift tax annual exclusion, *D* could transfer \$667,000 to *X* by a taxable gift and pay a gift tax of \$333,000 (50 percent of \$667,000). If, instead, *D* transferred \$1 million at death, an estate tax of \$500,000 would be imposed leaving only \$500,000 for the devisee. In other words, if the applicable rate equals 50 percent, two-thirds of the owner's property may pass to a beneficiary by gift whereas only one-half of the property may pass to the beneficiary if transferred at death.

Note: As will be seen in Chapter 6, § 2035(b) prevents this benefit by including the gift tax amount in the gross estate if a gift tax is payable on a gift made within 3 years of death.

Page 38: Delete footnote 12.

Page 39: Add Problem 4 as follows:

4. In 2011 *D* makes a taxable gift of \$4 Million. In 2013 *D* dies with a taxable estate of \$1 Million. What will be the estate tax liability, if any?

Page 39: Add before text under § 2.04:

Caveat: The following discussion of deunification is of historical interest as the Tax Act of 2010 reunified the gift and estate tax systems for 2011 and 2012.

Page 40: Add the following after “as” in line 3 “before, except for a new rate schedule.” Also replace **Examples 8** and **9** with the following:

Example 8: In 2010, *A* transfers \$5 million to a trust for the benefit of her daughter. The transfer does not qualify for the gift tax annual exclusion. *A* will owe \$1,395,000 in gift taxes (\$1,730,800 tentative tax less the applicable credit amount of \$335,800).

³ The gift tax payable is the gift tax which would have been imposed based on the rate schedule in force when the decedent died, not when the gift was made. See § 2001(b)(2), which incorporates § 2001(g).

If, instead of making the gift, A died in 2010 with a taxable estate of \$5 million (or a greater amount), there would be no estate tax.

Example 9: In 2010, A transfers \$1.5 million to a trust for the benefit of her daughter. The transfer does not qualify for the tax annual exclusion. A will owe \$175,000 in gift taxes (\$505,800 tentative tax less the applicable credit amount of \$330,800). If the income tax basis of the transferred assets is -0-, § 1015 permits the donee to increase the basis by the amount of the gift tax \$175,000.⁴

Page 42-43: Replace [C] and [D] with the following:

[C] Calculation of the GST Tax

The GST tax imposed is calculated under § 2602 by multiplying the taxable amount under the generation-skipping transfer by the so-called *applicable rate*. The applicable rate is the product of the maximum estate tax rate (35% in 2011 and 2012) and the *inclusion ratio* (section 2641). The inclusion ratio is a mechanism designed to allocate the benefit of a \$5 million per transferor GST tax exemption for 2011, with indexing of that amount in 2012. See §§ 2631, 2632 and 2642.

Determining the inclusion ratio (or fraction) first requires that the exclusion ratio (or applicable fraction) be calculated. The exclusion ratio has as its numerator the portion of the GST exemption amount (not to exceed \$5 million in 2011) that is allocated to the transfer; the denominator is the value of the property subject to the generation-skipping transfer. This so-called *applicable fraction* is then subtracted from 1 to determine the fractional amount includable—the inclusion ratio:

Example 1: Grandfather dies in 2011 having made no generation-skipping transfers during lifetime. His will devises \$1 million to a grandchild, and the residue of his estate to a child from which all taxes are payable. The bequest is a generation-skipping transfer (a direct skip) and the executor allocates the entire \$1 million GST exemption to the direct skip.

The amount of the GST tax that will be imposed on the \$1 million depends on the applicable rate, the product of the maximum estate tax rate of 35 percent and the inclusion ratio. The inclusion ratio in turn depends on the exclusion ratio. In this example, the exclusion ratio will be 1 because both the numerator and denominator are \$1 million, in that the numerator is the allocated GST exemption amount of \$1 million, and the denominator is the value of the property which passes pursuant to the generation-skipping transfer, also \$1 million. The inclusion ratio, determined by subtracting the exclusion ratio of 1 from 1, will be zero.

Whenever a zero inclusion ratio applies, there can be no generation-skipping transfer tax imposed. Quite simply, any taxable amount multiplied by zero must always be zero.

⁴ In this example, all of the gift tax paid increases basis because all of the gift tax is attributable to appreciation. If the donor had a basis of \$750,000 in the transferred assets, only half of the gift tax paid would be an addition to basis. See § 1015(d)(6).

If the inclusion ratio is greater than zero, a GST tax will be imposed, as shown in the following example:

Example 2: A grandparent's will bequeaths \$1 million to a grandchild, with all taxes payable from the residue. Assume the GST exemption of \$5 Million was fully allocated by January 2011 and grandparent died in February 2011.

The inclusion ratio in this example is 1 (1 - 0/\$1 million), and the GST tax imposed will be \$350,000, which is the product of the \$1,000,000 taxable amount times 35 percent times the inclusion ratio of 1.

Caveat: If Congress does not act, starting in 2013 the GST rate will increase to 55% (from 35%) and the GST exemption will decrease from \$5 Million, as indexed for inflation, to \$1 Million as indexed for inflation.

[D] Section 2604 Credit

The original GST tax system allowed only one credit—a credit for state GST tax imposed on taxable terminations and distributions. *See* § 2604. This credit was analogous to the § 2011 credit under the estate tax system. In response to the credit, several states enacted a GST tax to pick up the amount creditable under § 2604. Like the § 2011 credit, some states impose a GST tax even though the § 2604 credit was repealed by the Tax Act of 2001.

The Tax Act of 2001's repeal of the § 2604 beginning in 2005 was continued by the Tax Act of 2010 for the years 2011 and 2012. Unless Congress acts, the § 2604 credit will be in force beginning in 2013.

Page 44: In first line, delete “Until 2010 and after 2010”

Page 45: Delete text starting with “The Tax Act of 2001” until end of page. Substitute with the following:

The Tax Act of 2001 resurrected a mandatory carryover basis at death regime for the year 2010. *See* § 1022. Although § 1022 may apply to determine the basis of property when a decedent dies in 2010, the Tax Act of 2010 made § 1022 optional—it will apply only if the executor elects its application. The election is likely to be made only for estates exceeding \$5 Million since only those estates will be required to pay federal estate taxes. In the smaller taxes, the benefit of step-up in basis can be obtained without the necessity to pay estate taxes.

Very briefly, § 1022 will give the transferee a basis in the decedent's assets equal to the lesser of their fair market value on the date of death or their adjusted basis in the hands of the decedent. Thus, the basis in loss assets still step-down, although the step-up in basis for appreciated assets is limited or denied. *See* § 1022(a). Further, the decedent's executor will be permitted to allocate to specific noncash assets an aggregate \$1.3 million basis increase, although the basis of any asset may not be increased above its fair market

value. *See* § 1022(b)(2)(B). Additionally, the basis of property transferred to a surviving spouse can be increased by \$3 million, for assets passing outright or in certain marital trusts. *See* § 1022(b)(c). The \$1.3 million adjustment is increased by any unused capital losses, net operating losses, and certain “built-in” losses of the decedent, and both the \$1.3 million and \$3 million figures are indexed for inflation. *See* § 1022(b)(2)(C).⁵ The basis increase allowed the estates of nonresidents who are not U.S. citizens will be limited to \$60,000 in 2010. *See* § 1022(b)(3).

Page 47: The standard deduction amount in 2011 for dependent children is \$950.

Page 48: As a result of recent changes, the Kiddie Tax generally applies to children under the age of 18 (up from under the age of 14 as in the text) as well as to certain full-time college students under the age of 24. *See* § 1(g)(2).

Page 48:

In Problem 1, assume the applicable standard deduction is \$950.

In Problem 2, assume Nicole was 18 (not 14) and not a full-time college student.

Page 51: After first sentence in paragraph beginning “Once the taxable income,” substitute the following:

The Tax Act of 2001 created five brackets for trusts and estates: 15%, 25%, 28%, 33% and 35%. The Tax Act of 2010 continues these brackets for 2011 and 2012. Unless Congress acts, the brackets starting in 2013 will revert to those that were in force in 2001, including a top rate of 39.6%.

Page 51: In last sentence of paragraph beginning “The creation of trusts” substitute the following for the last sentence:

For example, in 2011, the maximum that could have been saved by having taxable income of \$11,350 taxed at brackets below 35% was \$1,035

⁵ *See* § 1022(b)(2)(C).

Chapter 3

ESTATE TAXATION BASICS

Page 97: After first sentence add the following sentence:

Pursuant to § 7520's mandate, Treasury published updated valuation tables in 2009.¹

Delete **Example** and substitute the following:

Example: Remainder payable at an individual's death. The decedent, or the decedent's estate, was entitled to receive certain property worth \$50,000 upon the death of the decedent's elder sister, to whom the income was bequeathed for life. The decedent died in May 2011. At the time of the decedent's death, the elder sister was 47 years 5 months old. In May 2011, the section 7520 rate was 3.0 percent. Under Table S in paragraph (d)(7) of this section, the remainder factor at 3.0 percent for determining the present value of the remainder interest due at the death of a person aged 47, the number of years nearest the elder sister's actual age at the decedent's death, is .40791. The present value of the remainder interest at the date of the decedent's death is, therefore, \$20,355 (\$50,000 x .4071).²

Page 97: In Problem 1, instead of 8% use a 3% § 7520 interest rate.

Page 98: In Problems 2-5, instead of 8% use a 3% § 7520 interest rate.

Page 99: Add the following before the Problems:

Proposed [Treas. Reg. § 20.2032-1\(f\)](#) would limit the use of the alternate valuation date for post-death events that are not attributable to post-death market conditions. For example, post-death corporate reorganizations would be disregarded, thus depriving an estate the use of valuation reductions as were allowed in *Kohler v. Commissioner*, [T.C. Memo. 2006-152](#) (\$47 Million allowed instead of \$144 Million per IRS)

Page 114: Before the sentence beginning "The deduction for unpaid," add the following:

In 2009, Treasury published final regulations under § 2053. The most significant changes relate to the recognition of post-death events and generally limit the deduction to amounts actually paid. See [Treas. Reg. § 20.2053-1\(d\)\(2\)](#), -4(a). Cases such as *Estate of O'Neal* would have a different outcome under the current regulations-the amount deducted would be limited to the amount actually paid.

¹ See [Treas. Reg. § 20.2031-7T](#) (estate tax regulation), [Treas. Reg. § 25.2512-5T](#) (gift tax regulations adopting estate tax regulations).

² [Treas. Reg. § 20.2031-7T\(5\)](#), Ex. 1.

Page 147: After Problem 4, add the following:

[h] Portability

Although portability is not a marital deduction rule, portability only involves married couples and as will be seen in the next section, may directly impact on marital deduction planning and drafting.

The Tax Act of 2010 introduced the concept of portability but as this legislation sunsets on December 31, 2012, portability only applies for the years 2011 and 2012. Unless Congress acts, portability will not apply beginning in 2013.

Simply stated, portability allows the surviving spouse to use the last deceased spouse's unused exemption amount, which is technically referred to as the exclusion amount, provided the deceased spouse's executor elects to permit portability. Technically, portability is implemented under the estate tax credit provision of § 2010. *See* § 2010(c). In turn, the gift tax credit incorporates the unified credit amount allowed under § 2010(c). *See* § 2505(a).

Consider the following three helpful examples³:

Example 1: Assume that Husband 1 dies in 2011, having made taxable transfers of \$3 million and having no taxable estate. An election is made on Husband 1's estate tax return to permit Wife to use Husband 1's deceased spousal unused exclusion amount. As of Husband 1's death, Wife has made no taxable gifts. Thereafter, Wife's applicable exclusion amount is \$7 million (her \$5 million basic exclusion amount plus \$2 million deceased spousal unused exclusion amount from Husband 1), which she may use for lifetime gifts or for transfers at death.

Example 2: Assume the same facts as in Example 1, except that Wife subsequently marries Husband 2. Husband 2 also predeceases Wife, having made \$4 million in taxable transfers and having no taxable estate. An election is made on Husband 2's estate tax return to permit Wife to use Husband 2's deceased spousal unused exclusion amount. Although the combined amount of unused exclusion of Husband 1 and Husband 2 is \$3 million (\$2 million for Husband 1 and \$1 million for Husband 2), only Husband 2's \$1 million unused exclusion is available for use by Wife, because the deceased spousal unused exclusion amount is limited to the lesser of the basic exclusion amount (\$5 million) or the unused exclusion of the last deceased spouse of the surviving spouse (here, Husband 2's \$1 million unused exclusion). Thereafter, Wife's applicable exclusion amount is \$6 million (her \$5 million basic exclusion amount plus \$1 million deceased spousal unused exclusion amount from Husband 2), which she may use for lifetime gifts or for transfers at death.

³ Description of Revenue Provisions Contained in the President's 2012 Budget Proposal at 500 (Staff of The Joint Committee On Taxation, June 2011) (recommending permanent enactment of portability based on the Tax Act of 2010 provisions).

Example 3: Assume the same facts as in Examples 1 and 2, except that Wife predeceases Husband 2. Following Husband 1's death, Wife's applicable exclusion amount is \$7 million (her \$5 million basic exclusion amount plus \$2 million deceased spousal unused exclusion amount from Husband 1). Wife made no taxable transfers and has a taxable estate of \$3 million. An election is made on Wife's estate tax return to permit Husband 2 to use Wife's deceased spousal unused exclusion amount,⁴ which is \$4 million (Wife's \$7 million applicable exclusion amount less her \$3 million taxable estate). Under the provision, Husband 2's applicable exclusion amount is increased by \$4 million, i.e., the amount of deceased spousal unused exclusion amount of Wife.

Page 147: After [a] In General add:

Tax Act of 2010 Note: The Tax Act of 2010 will dramatically impact on estate planning for married couples who die in 2011 and 2012. First, the exemption level will be \$5 Million for 2011 and \$5 Million as indexed for inflation in 2012. As a result, most married couples will not be concerned about causing unnecessary federal taxes by failing to properly plan for the marital deduction. Indeed, the unused exclusion amount in the deceased spouse's estate will not be wasted if portability is elected by that spouse's executor. However, failure to plan for the marital deduction may result in higher state death taxes because those 20 some states that impose a death tax have not increased the exemption amount nor have they enacted portability.

Unless Congress acts, the estate planning considerations will be the same for 2013 as those discussed in the text. Indeed, simply substitute "2013" for "2002" on page 147 and you will be back to the future.

Page 148: After first paragraph, add:

Note on Portability: For 2011 and 2012, a deceased spouse's unused exclusion amount may be carried over to the surviving spouse.⁵ As a result, using the unlimited marital deduction will not necessarily cause greater federal estate tax liability for the surviving spouse, especially if the surviving spouse dies before 2013 with an estate tax base that will produce an estate tax equal to or less than the surviving spouse's exclusion amount, including the exclusion amount that was ported to her from her spouse.

Page 148: Substitute the following for both the sentence beginning "Consider a worst case scenario" and the **Example**:

⁴ The 2010 Act added new section 2010(c)(4), which generally defines "deceased spousal unused exclusion amount" of a surviving spouse as the lesser of (a) the basic exclusion amount, or (b) the excess of (i) the basic exclusion amount of the last deceased spouse of such surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under section 2001(b)(1) on the estate of such deceased spouse. A technical correction may be necessary to replace the reference to the basic exclusion amount of the last deceased spouse of the surviving spouse with a reference to the application exclusion amount of such last deceased spouse, so that the statute reflects intent. Applicable exclusion amount is defined in section 2010(c)(2), as amended by the temporary provision.

⁵ See Supplement Pages 19-20.

Consider a worst case scenario based on both spouses dying in 2013, when the applicable exclusion amount is scheduled to be \$1 million.

Example: *H* dies in January 2013, with a gross estate of \$2 million, which he devised to *W*. *H*'s taxable estate would be zero, as would the federal estate tax payable. *W* died in December 2013, with a gross estate that consisted of only the marital property devised to her with an estate tax value of \$2 million. For simplicity, assume that neither spouses' estate incurred expenses, or had claims under § 2053.

W's taxable estate would be \$2 million, but only the first \$1 million would be sheltered from federal estate tax by the § 2010 credit. Thus, a federal estate tax of \$435,000 would be payable on the second \$1 million (although that amount could be reduced by the § 2011 credit, if applicable).

Page 149: Footnote 59: In second paragraph, replace “2002” with “2013”

Page 149: In next to last line, replace “2002” with “2013”

Page 150: In third line, replace “2002” with “2013”

Page 150: Delete Lines 4 to end of the **Example**, including footnote 61.

Page 152: Delete last sentence in first paragraph and substitute the following:

For example, if the decedent dies in 2011 or 2012, the credit-shelter disposition amount may equal at least \$5 Million.

Page 167: Delete footnote 72.

Page 170: Delete text in footnote 75 and add the following:

See [Rev. Proc. 2003-57](#) through 2003-60, [2003-2 C.B. 257-274](#) (CRATs) and [Rev. Proc. 2005-56](#) through 2005-59, [2005-2 C.B. 383-412](#) (CRUTS).

Page 172: Add the following sentence to the paragraph ending with “as CLUT.”:

The Service has published sample CLAT and CLUT forms.⁶

Page 173: Add the following Example before first full paragraph:

CLAT Example: The testator creates a charitable lead annuity trust with an annuity of \$15,000 a year payable to a qualifying charitable organization for the life of testator's sister, age 72. The annuity is payable at the end of each year. The applicable § 7520 rate is 3.0%. Under Table S of [Treas. Reg. § 20.2031-7T](#)(d)(7), the remainder factor at 3.0% for an individual aged 72 is 0.69744. The annuity factor at 3.0% for an individual aged 72 is 10.0854(1.00000 - 0.69744), divided by 0.030. The

⁶ See Rev. Proc. 2007-46, 2007-2 C.B. 102 (CLAT form) and 2008-46, 2008-2 C.B. 238 (CLUT form).

aggregate annual amount, \$15,000, is multiplied by the factor 10.0854. The present value of the annuity at the date of the decedent's death is, therefore, \$151, 281 ($\$15,000 \times 10.08534$), which amount is deductible under § 2055.

Page 174: Under § 2058 discussion, delete text starting with “For example” to end and add the following:

The Tax Act of 2010 continues § 2011's repeal for 2011 and 2012 with the allowance of the § 2058 deduction for those 2 years. Unless Congress acts, the § 2058 deduction will not be allowed in 2013 but the § 2011 credit for state taxes will be allowed.

Page 175: Delete all text after the first paragraph and add the following:

The Tax Act of 2010 increased the exemption level, which is effectuated by the § 2010 credit, to \$5 Million in 2011 and \$5 Million, as indexed for inflation in 2012. Unless Congress acts, the exemption level will return to \$1 Million in 2013.

For 2001 and 2012, the § 2010 credit will effectively exempt most estates from federal estate taxation. Unless the decedent has adjusted taxable gifts under § 2001(b), there can be no federal estate tax liability if the taxable (not gross) estate does not exceed the applicable exclusion amount. Application of the § 2010 credit in 2011 can be illustrated as follows:

Example 1: Assume the decedent died in 2011, with a taxable estate of \$5 million. Further assume the decedent made no adjusted taxable gifts. The tax imposed on a taxable estate of \$5 million is \$1,730,800. The § 2010 credit in 2011 of \$1,730,800 eliminates the federal estate tax liability.

The only major limitation on the § 2010 credit is that the credit cannot exceed the estate tax imposed under § 2001. *See* § 2010(d). In effect, the credit can only reduce the liability of an estate. The credit is not refundable.

Example 2: The decedent died in 2011, with a taxable estate of \$1,000,000, having made no gifts. The estate tax imposed under § 2001 is \$330,800. Although the otherwise allowable credit in 2011 is \$1,730,800, the credit allowed will be limited to \$330,800.

Unlike the gift tax unified credit, the § 2010 credit is not reduced by any credit used to reduce the tax on prior taxable gifts made by the decedent. For example, if the decedent made no prior taxable gifts and made a \$100,000 gift in 2010, it would have been tax-free in 2010 because of the § 2505 credit. Assume that he dies in 2011, with a taxable estate of \$4,900,000. Because the \$100,000 gift is cumulated with the \$4,900,000 taxable estate for the purposes of calculating the tentative tax, the tentative tax imposed under § 2001 would be \$1,730, 800. The estate is entitled to subtract only the gift tax that would have been payable on the \$100,000 gift from the \$1,730,800 to determine the estate tax imposed under § 2001. The gift tax payable, however, was zero. Therefore, unless the full \$1,730,800 estate tax credit is allowed, the estate would produce a tax, even though the total assets equal the \$5 million, the amount designed to pass tax-free under the unified credit. Section 2010

recognizes this necessity, and does not require adjustment for the prior use of the gift tax unified credit.

Note on Portability: As seen from the discussion of portability on Supplement Pages 19-20, a surviving spouse's exemption level may exceed \$5 Million in 2011 and \$5 Million, as indexed for inflation, in 2012. Reconsider Example 1 on Supplement Page 19, where the surviving spouse's exclusion amount would be \$7 Million so that the credit allowable when she died (assuming no lifetime use of the credit) would be \$2,430,800 (the basic credit amount of \$1,730,800 and an additional credit of \$700,000 for the additional \$2 million that was ported to her on her spouse's death.)

Page 176: After first sentence, add the following:

Unless Congress acts, the § 2011 credit will be allowed starting in 2013.

Page 176: Delete the next 3 paragraphs.

Page 178: Delete the **Example** to end of text and add the following:

Example: The decedent dies unmarried in 2013. She was a domiciliary of a state that taxes estates in an amount equal to the § 2011 credit but allows a \$1 Million exemption. The decedent's federal taxable estate is \$1.1 million.

In the example, the decedent's taxable estate (\$1.1 million) less \$60,000 equals \$1,040,000. Applying the § 2011(b) table, the maximum credit allowable under § 2011 is \$38,800. The first limitation—a credit that does not exceed the federal estate tax liability after the unified credit—does not apply here because the federal estate tax liability, based on a \$1 Million exemption, before application of the state death tax credit would be \$41,000.⁷ Assuming that the estate actually paid the state death tax, the full \$38,800 § 2011 credit would be allowed resulting in a federal estate tax liability of \$2,200.

The repeal of § 2011 for the years 2005-2012 has produced some curious results. Prior to repeal, most states had imposed a state death tax equal to the maximum credit allowable under § 2011, sometimes referred to as a SOP, sponge tax or pick-up tax, since it sops up the allowable federal credit. Indeed, in a few states, including Florida and California, the death tax is constitutionally limited to the allowable § 2011 credit. In about 60% of the states, repeal of the § 2011 credit has effectively repealed state death taxation for the years 2005-2012. However, about 40% of the states decided to decouple from § 2011's repeal and impose a tax based on a low exemption level.

New York is a good example of de-coupling from § 2011's repeal. New York's SOP tax is pegged to the § 2011 table amount that was in effect in 1998 but with a \$1 Million exemption level. See [N.Y. Tax Law §§ 951\(a\), 952\(a\)](#). As a result, if a New York decedent dies in 2011 with a taxable estate of \$5 Million, New York will impose a tax of \$391,600 even though no federal estate will be payable. If another New York decedent died with a

⁷ By applying the 2013 rate schedule on Supplement Pages 10-11, § 2001 imposes a tax of \$386,800 on a \$1.1 million taxable estate, from which the applicable § 2010 unified credit of \$345,800 can be subtracted, producing a federal estate tax liability of \$41,000.

\$1,100,000 estate in 2011, New York estate taxes of \$33,800 would be payable, being the § 2011 credit that was allowable in 1998 on a taxable estate of \$1.1 Million. *See Example* above.

Page 179: In second full paragraph, substitute “2013” for “2002” and in the **Example**, substitute “2013” for “2002”.

Page 182: In the **Example**, substitute “2013” for “2002” and in the last line, substitute “2013” for “2002”.

Chapter 4

GIFT TAXATION BASICS

Page 191: In last line, delete "(7th ed. 1997)" and substitute "(8th ed. 2002)".

Page 208: Delete the last 2 paragraphs and replace with the following:

Section 2513 is another provision enacted to equalize the tax treatment of donors in non-community property jurisdictions with donors in community property states. In a community property jurisdiction, a gift of community property to a third party is treated as a gift by each spouse of one half of the property, because each spouse owns one-half of the gifted property before the gift. For example, if \$26,000 in community cash is transferred to a couple's son in 2011, each spouse is deemed to have made a gift of \$13,000. Each, therefore, is entitled to a \$13,000 per-donee annual exclusion under § 2503(b) (discussed at § 4.01[B][1], *infra*), and the transfer would pass tax free. In a non-community property state, on the other hand, a gift of \$26,000 of *family assets* titled in one spouse's name is treated as a gift by that spouse. The donor is entitled only to a single \$13,000 annual exclusion in the absence of § 2513, resulting in a taxable gift of \$13,000.

The election to treat a gift as a split gift can produce significant tax savings, given the progressive and cumulative nature of the federal gift tax. Under a split gift, in 2011 each spouse is entitled to exclude \$13,000 per donee of the gift under the annual exclusion contained in § 2503(b).¹ The split gift annual exclusion thereby doubles the available exclusions for married couples. Further, in the case of multiple donees, the effect can multiply.

Page 209: Replace the two examples and intervening test with the following:

Example: In 2011, husband and wife with four adult children can give, free of federal gift tax, annual outright gifts of \$26,000 per child, or an annual total of \$104,000.

Second, gift-splitting also doubles the available unified credit. Each spouse may give gift-tax free his unified credit equivalent, based on the applicable credit amount in effect for the year of the gift. By using the split-gift election, twice the unified credit equivalent can pass because two applicable credit amounts are available.

Example: In 2011, by using gift splitting one spouse can effectively make a gift of \$10,026,000 to a single donee and incur no gift tax liability assuming no prior gifts! Under § 2513, both spouses would be deemed to have transferred \$5,013,000 to the donee. Each would be entitled to a \$13,000 annual exclusion. Thus, each would be treated as having made a gross gift of \$5 million. Assuming no deductions are available, each would be treated as having made a taxable gift of \$5 million. Thus,

¹ Section 2503(b) provides for an annual exclusion of \$10,000 per donee, but indexing for inflation has increased this to \$13,000 in 2011. *See* Rev. Proc. 2010-40, 2010-2 C.B. 663.

the tax on each (assuming no prior taxable gifts) would be \$1,730,800. Each, however, would be entitled to a unified credit of \$1,730,800. As a result, neither spouse would incur gift tax liability. This compares with a net gift tax liability of \$1,759,100 on a gift of \$10,026,000 if made by a single individual.

Page 210: In 2d line, replace “\$11,000 (in 2002)” with “\$13,000 (in 2011)”

Page 210: In first line under **Section 2503(b)**, replace “\$11,000 (in 2002)” with “\$13,000 (in 2011)”

Page 210: Replace last 3 sentences with the following:

The amount of the annual exclusion in 2011 is \$13,000. For purposes of discussion, this text uses \$13,000 as the amount of the exclusion, although in years after 2011, the amount may be larger, depending on the amount of inflation.

Page 220: In Problem 2, also answer based on a § 7520 rate of 3% and in Problem 3, use a 3% § 7520 rate instead of 7% and 8% § 7520 rates.

Page 236: Replace the **Example** with the following:

Example: In 2011, an individual opens a college savings plan and contributes \$65,000 thereto. She could elect to exclude \$13,000 in the year of the gift and treat the balance (\$52,000) as a gift in the next four years. Thus, \$13,000 would be available for the § 2503(b) exclusion in each of the next four years.²

Page 237: Replace the **Example** and the paragraph following with the following:

Example: In 2011, W opens up a college savings account in the amount of \$130,000. If H consents to split-gift treatment, and the 5 year spread-out election is made, the \$130,000 could be entirely excluded from gift taxation. Each spouse would be treated as making a present interest gift of \$13,000 for each of the five years, 2011-2015.

Absent one situation, there will be no estate consequences to the donor-account owner. In such a case, the owner’s estate will include the portion of the contributions that were allocable to years after the year in which the owner died. For example, if the owner contributed \$65,000 in 2011 and made the spread-out election but died in 2012, \$52,000 (the total amount allocable to 2012-2015) would be includible in the account owner’s gross estate. *See* § 529(c)(4)(C). On the other hand, if the designated beneficiary dies while the account is still open, the designated beneficiary’s gross estate will include the value of the interest in the qualified tuition plan. *See* § 529(c)(4)(B).

Page 237: In the **Problem**, replace “2002” with “2011”.

Page 238: In first line, delete “or beneficiary”

² If the exclusion increased to \$14,000 in 2012, then \$1,000 added to the account owner in 2012 would qualify for the gift tax annual exclusion. *See* Prop. [Treas. Reg. § 1.529-5\(b\)\(2\)\(iv\)](#).

Page 250: Replace Problem 3 with the following:

3. H died in 2011 with a gross estate of \$11 Million. His will left everything to W, his surviving spouse and nothing to his children. Assume no deductions other than the marital deduction will be allowed. Why might W consider making a partial disclaimer?

Page 254: Under *Frank* description, change “\$5,558” to “\$5,528” and “\$358,246” to “\$348,264”

Page 261: After last paragraph, add the following:

There may be one disadvantage to gifting interests in family business estates. If the interest is sufficiently restricted, then there be no gift tax annual exclusion allowed even though the entire interest is transferred outright to a donee. *See, e.g., Hackl v. Commissioner*, [335 F.3d 664](#) (7th Cir. 2003).

Page 267: In the Problems, apply a 3% § 7520 rate instead of an 8% § 7520 rate.

Page 269: Replace 2 sentences beginning “Instead, annual” with the following:

Instead, annual exclusion gifts to noncitizen spouses are permitted and the maximum amount of the annual exclusion in 2011 is \$136,000 (\$100,000 as indexed for inflation). *See Rev. Proc. 2010-40*, 2010-2 C.B. 663.

Page 272: Replace the **Example** with the following:

Example: In 2011, S transfers \$50,000 to a qualifying charity and \$20,000 to S’s daughter. Because the gift to the charity qualifies for the gift tax annual exclusion, only a charitable deduction of \$37,000 is allowed as a result of § 2524. After the \$13,000 annual exclusion for the gift to the daughter, a taxable gift of \$7,000 results for the year. If instead a \$50,000 charitable contribution deduction were allowed on top of the annual exclusion for the charitable gift, there would be no taxable gift in 2011—an unacceptable result because there would have been a \$7,000 taxable gift if S only made a gift to the daughter in 2011.

Page 273: In the **Example**, change “2002” to “2011”.

Chapter 5

GENERATION-SKIPPING TRANSFER TAX BASICS

Page 277: Replace the text beginning with “Between 2002 and ending with “on page 8” with the following:

The maximum GST rate for 2010-2012 is 35%. Unless Congress acts, the rate will increase to 55% in 2013. The amount of the GST exemption in 2010 and 2011 is \$5 Million and \$5 Million, as indexed for inflation, in 2012. Unless Congress acts, the GST exemption in 2013 will be \$1 Million, as indexed for inflation.

Page 281: After the second full paragraph add the following new paragraph:

If the Grandparent in Example 3 died in 2011, based on an applicable rate of 35%, the GST tax would be \$25,926.

Page 285: Before the Problems add the following paragraph:

The Tax Act of 2010 continues the repeal of § 2604 for 2011 and 2012. Unless Congress acts, the § 2604 credit will be allowed in 2013.

Page 288: After the sentence ending with “\$3.5 Million in 2009,” add the following:

The Tax Act of 2010 raises the GST exemption amount to \$5 Million in 2010 and 2011 and to \$5 Million, as indexed for inflation in 2012. Unless Congress acts, the GST exemption in 2013 will be \$1 Million, as indexed for inflation.

Page 289: After third paragraph, add the following new paragraph:

The Tax Act of 2010 continues for 2010-2012 the flexible rules that were enacted by the Tax Act of 2001. Unless Congress acts, these rules will not apply in 2013.

Page 290: After 2d line, add the following:

The Tax Act of 2010 lowered the maximum GST rate to 35% for the years 2010-2012. Unless Congress acts, the rate will increase to 55% in 2013.

Page 291: Before [4] **Sample Calculations**, add the following:

The Tax Act of 2010 continues the relief provision of § 2642(a)(3), referred to as the qualified severance provision, for the years 2010-2012. Unless Congress acts, qualified severances will not be permitted in 2013.

Page 292: Under § 2604 discussion, add the following after first full paragraph:

The Tax Act of 2010 continues the repeal of § 2604 for 2010-2012. Unless Congress acts, the § 2604 credit will be allowed in 2013.

Page 296: Delete text in first full paragraph starting with “Third, grandfathering” to end of paragraph and replace with the following:

Third, grandfathering protection for pre-September 26, 1985 irrevocable trusts “does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12.” See [Treas. Reg. § 26.2601-1\(b\)\(1\)\(i\)](#). The validity of this regulation (which became effective in 1999 and was designed to overrule prior case holdings that the exercise of a general power was grandfathered) has been upheld for decedents dying thereafter. See *Estate of Gerson v. Commissioner*, [507 F.3d 435](#) (6th Cir. 2007). As a result, in such cases, a constructive addition will be deemed to have occurred after September 25, 1985. See [Treas. Reg. § 26.2601-1\(b\)\(1\)\(v\)\(A\)](#). Compare *Estate of Timken v. United States*, [601 F.3d 431](#) (6th Cir. 2010), *cert. denied*, [131 S. Ct. 905](#) (2011) (pre-1999 exercises not grandfathered), with *Estate of Simpson*, [183 F.3d 812](#) (8th Cir. 1999) (pre-1999 exercise grandfathered).

Chapter 7

RETAINED INTERESTS

Page 322: In Problems 1-3, answer based on a 3% § 7520 rate instead of an 8% rate. Also, in Problem 2 solve based on a \$4,000 annuity instead of a \$6,000 annuity.

Page 323: Replace **Example 1** and explanation with the following:

Example 1: *G*, age 55, transfers \$100,000 of property to trust. She reserves the income for life and the remainder is distributable to *X*, an unrelated person. *G* later dies when the property in the trust has appreciated in value to \$125,000. On the date of the gift, the applicable interest rate under § 7520 was 3%.

In Example 1, the value of the gift to *X* equals \$49,400 (\$100,000 times the actuarial factor for a remainder after a life interest in someone age 55), for which no present interest gift exclusion is available because *X*'s interest is a future interest. At *G*'s death, the \$125,000 value of the trust property will be included in *G*'s gross estate under § 2036(a)(1), because *G* retained the income from the transferred property for her life.

Page 327: Add before starting “When the donor’s spouse” the following:

Note: [Treas. Reg. § 20.2036-1\(c\)\(2\)](#), effective in 2008, adopts the same methodology as [Rev. Rul. 82-105](#).

Page 328: In Problems 1-3, answer based on a 3% § 7520 rate instead of an 8% rate.

Page 337: Add before first full paragraph:

In *Estate of Stewart v. Commissioner*, [617 F.3d. 148](#) (2d Cir, 2010), *rev'g and remanding*, [T.C. Memo. 2006-225](#), the Second Circuit reversed the Tax Court's finding that the decedent and her son had an implied agreement that she would retain the enjoyment of the residential portion of a NYC brownstone because she did not exclusively occupy the residence. Although affirming the Tax Court's holding that there was an implied agreement to retain the economic benefits in the commercial portion of the brownstone, the Second Circuit reversed and remanded for a determination of the value of the portion retained by the decedent in the commercial portion.

Page 338: Add the following problem:

4. Should § 2036 apply if a residence is transferred to another if the transferor continues to live in the residence but pays fair rental value?

Page 349: Before [6] **Reciprocal Trusts**, add the following new section:

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

In Chapters 3 and 4, you saw the benefits of valuation discounts, including the benefits that can be realized through the creation and utilization of family controlled entities. You should review the discussion of Valuation Discounts in the casebook on pages 91-96, as well as the discussion of *Frank* (page 254) and *Estate of Jones* (page 255). Can the Service unwind these benefits on the death of the decedent who created a family business entity?

ESTATE OF KORBY V. COMMISSIONER
United States Court of Appeals, Eighth Circuit
[471 F.3d 848](#) (2006)

BYE, CIRCUIT JUDGE:

The estates of Edna and Austin Korby, along with the trustee of the Edna and Austin Korby Living Trust (collectively the Korbys), appeal the tax court's decisions finding estate tax due from both estates under [26 U.S.C. § 2036](#) on the grounds the Korbys retained the right to income from property they transferred to a family limited partnership prior to their deaths, and the transfer was not a bona fide sale for consideration. We affirm.

I

Austin and Edna Korby married in 1948. During the course of their marriage, Austin operated a bridge-building construction company. The couple accumulated a modest estate which they desired to pass on to their four sons In 1993, when Edna was sixty-eight and Austin seventy-nine years old, they attended a free estate planning seminar and later met with the attorney who conducted the seminar. The attorney helped the Korbys form a revocable living trust and a family limited partnership as part of their estate planning. In June 1993, the Korbys placed in the living trust their family home, household furnishings, a vacant lot, a money market account, bank accounts, and their monthly Social Security income. In March 1994, the Korbys created the Korby Properties Limited Partnership (KPLP). A year later, the Korbys transferred to KPLP stocks valued at \$1,330,442, state and municipal bonds valued at \$449,378, and savings bonds valued at \$71,043, for a total transfer of \$1,850,863. In return, the Korbys obtained a 98% limited partnership interest from KPLP. In addition, the Korbys' living trust transferred to KPLP a savings account worth \$37,841, to bring the full funding of KPLP to \$1,888,704. In return, the living trust obtained a 2% general partnership interest from KPLP.

In 1995, the Korbys gifted their 98% limited partnership interest in KPLP to four irrevocable trusts created for their sons, with each son's trust receiving a 24.5% KPLP limited partnership interest. The Korbys filed gift tax returns in 1995 claiming a discount of 43.61% on the book value of each gift because the limited partnership interests were minority interests, their transfer was restricted, and they lacked management control.

Thus, while each gift had a book value of \$462,732.48, the gift tax returns reported each gift as being worth \$260,935.

Between 1995 and 1998—the year both Korbys died—KPLP made several distributions to the living trust as general partner, as well as a limited number of distributions to the four sons' trusts as limited partners. KPLP made payments to the Korbys' living trust totaling \$120,795 (\$30,387 in 1995, \$19,334 in 1996, \$32,324 in 1997, and \$38,750 in 1998). The Korbys used these payments to help defray Edna's nursing home costs of over \$30,000 per year¹ and pay the couple's taxes, medical bills, and other expenses. The payments to the limited partners during the same period totaled \$34,562 (\$18,101 in 1996, \$4,400 in 1997, and \$12,061 in 1998), and were intended to pay for the limited partners' income taxes.²

In June 1998, KPLP redeemed the savings bonds the Korbys had contributed to it and received from the United States Treasury two checks for \$43,638 each. One of those two checks was deposited directly into the living trust, which in turn issued a \$10,000 check to each of the Korby sons. The living trust retained the remaining \$3,638, bringing the total amount KPLP distributed to the living trust to \$124,433.

Edna Korby died on July 3, 1998; Austin Korby died on December 2, 1998. Both estates filed tax returns on September 7, 1999. Edna's estate return listed a total gross estate value of \$73,398 listing as jointly owned property the couple's home, the vacant lot, and a checking account. The return also listed half of the general partnership interest in KPLP, or 1%. Austin's estate return reported the couple's home, the vacant lot, the checking account, some personal property, and the full general partnership interest in KPLP, or 2%, as owned by Austin at the time of his death. Neither return included the value of the assets transferred to KPLP in 1995.

The Internal Revenue Service (IRS) issued notices of deficiency as to both their estates on August 29, 2002, determining the full value of the KPLP assets includable in the gross estates on the ground the Korbys retained for their lives "the possession or enjoyment of, or the right to the income from, the property." [26 U.S.C. § 2036](#). The notices of deficiency totaled \$2,175,117 (\$1,104,635 for Edna's estate, and \$1,070,482 for Austin's estate). The estates filed timely petitions for redetermination of the deficiencies in the tax court.

As relevant to this appeal, the tax court decided three issues against the Korbys. First, the tax court found the Korbys retained a right to the assets transferred to KPLP, rejecting the claim that payments from KPLP to the living trust were "management fees" for work performed as the partnership's general partner. The tax court found "an implied agreement existed between Austin, on his own behalf and on behalf of Edna, and the four Korby sons that after the assets were transferred to KPLP, income from the assets would

¹ [2] Edna Korby began living in a nursing home in Pelican Lake, Minnesota, in February 1993 when she was diagnosed with severe Alzheimer's dementia. She lived there until she died on July 3, 1998.

² [3] In June 1998, KPLP redeemed the savings bonds the Korbys had contributed to it and received from the United States Treasury two checks for \$43,638 each. One of those two checks was deposited directly into the living trust, which in turn issued a \$10,000 check to each of the Korby sons. The living trust retained the remaining \$3,638, bringing the total amount KPLP distributed to the living trust to \$124,433.

continue to be available to Austin and Edna for as long as they needed income." The tax court noted the lack of a written management contract between the living trust and KPLP, as well as the fact KPLP made payments to the living trust whenever Austin Korby requested them rather than by a set schedule. In addition, Austin did not keep track of the hours he worked managing the partnership's assets, nor did the payments to the living trust reflect a certain percentage of KPLP's income or assets, which is commonly how management fees are calculated. The tax court also noted Austin did not report the income the living trust received for his services as self-employment income on his tax returns (although the 1998 income tax return filed on behalf of Austin after his death did so).

Second, the tax court determined the transfer to KPLP did not satisfy the § 2036(a) exception for bona fide sales for adequate consideration. The Korbys claimed KPLP was created to protect the family from commercial and personal liability or from liability arising from divorce. The tax court examined the facts and circumstances surrounding the formation of KPLP, such as Austin's involvement with the help of an estate lawyer and without the assistance of the limited partners, and found Austin "essentially stood on all sides of the partnership's formation." The tax court further determined the Korbys had not shown the terms of the KPLP agreement kept its assets beyond the reach of a limited partner's creditors. The tax court concluded credit protection was not a significant reason for forming KPLP, and the real reason for forming KPLP was tax avoidance.

[The final issue involved marital deduction disallowance which has been omitted.]

The tax court assessed deficiencies against both estates totaling \$503,285 (\$124,135 for Edna's estate and \$379,150 for Austin's estate). The Korbys filed timely appeals of the tax court's decisions pursuant to [26 U.S.C. § 7482](#).

II

We review tax court decisions in the same manner as we review civil bench trials held by district courts, that is, conclusions of law are reviewed de novo and findings of fact are upheld unless clearly erroneous. *Black Hills Corp. v. Comm'r*, [73 F.3d 799, 804](#) (8th Cir. 1996). In this case, the question whether the Korbys retained a right to income from KPLP assets for purposes of § 2036 turns on the tax court's determination that "an implied agreement existed between Austin, on his own behalf and on behalf of Edna, and the four Korby sons that after the assets were transferred to KPLP, income from the assets would continue to be available to Austin and Edna for as long as they needed income." That finding is one of fact reviewed for clear error. See, e.g., *Strangi v. Comm'r*, [417 F.3d 468, 476-77](#) (5th Cir. 2005). Similarly, the question whether there was a bona fide sale for an adequate and full consideration is one of fact reviewed for clear error. *Id.* at 479-80. . .

Section 2036 of the Internal Revenue Code provides in relevant part:

The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer . . . by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death . . . the possession or enjoyment of, or the right to the income from, the property.

[26 U.S.C. § 2036.](#)

We find no clear error in the tax court's determination that an implied agreement existed between the Korbys and their four sons which allowed Austin and Edna to retain the right to income from KPLP after its initial funding. As outlined above, KPLP made significant payments to the Korbys' living trust over the remainder of their lifetimes. The lack of a written management contract between the living trust and KPLP, Austin's failure to keep track of the hours he spent managing KPLP, the manner in which the payments were made, and Austin's failure to report the payments as self-employment income, all support the tax court's rejection of the Korbys' management-fee claim. In addition, the evidence considered by the tax court included the fact the Korbys retained less than \$10,000 in assets in the living trust (their only source of income) following the funding of KPLP - despite the fact both of the Korbys were in poor health and could expect to incur living expenses beyond amounts their Social Security benefits would cover.

Several circuits have reviewed decisions from the tax court with similar facts and concluded the tax court did not clearly err in finding a retained right of control. See *Strangi*, [417 F.3d at 477-78](#) (upholding tax court's finding of an implied agreement to retain possession and control where decedent transferred 98% of his wealth to a family limited partnership (FLP) two months before his death, leaving himself just \$762 in liquid assets, and thereafter lived rent free in transferred house and received nearly \$34,000 from FLP to cover living expenses and over \$100,000 to cover funeral payments, estate administration expenses, specific bequests and various personal debts); *Abraham v. Comm'r*, [408 F.3d 26, 39-40](#) (1st Cir. 2005) (upholding tax court's finding of an implied agreement to retain control in similar FLP situation where decedent's children and attorney managing the FLPs testified it was their understanding the income from their FLPs would be available to pay their mother's expenses first regardless of the children's ownership interests); *Thompson v. Comm'r*, [382 F.3d 367, 376](#) (3d Cir. 2004) (upholding tax court's finding of an implied agreement to retain control where decedent transferred 95% of his assets to FLPs and did not retain sufficient assets to support himself for the remainder of his life, and FLPs made significant cash distributions to the decedent in the three years prior to his death). We agree with those decisions, and affirm the tax court's finding that the Korbys retained for their lives the right to the income from the assets transferred to KPLP.

We also find no clear error in the tax court's finding that the KPLP transfer did not satisfy the § 2036(a) exception for bona fide sales for adequate consideration. Section 2036 of the Internal Revenue Code contains an exception for excluding from the gross estate transfers a decedent makes prior to his or her death if the transfer is "a bona fide sale for an adequate and full consideration in money or money's worth." [26 U.S.C. § 2036\(a\)](#). A transfer is typically not considered a bona fide sale when the taxpayer stands on both sides of the transaction. See *Estate of Bongard*, [124 T.C. 95, 118](#) (2005). The transaction must "be made in good faith" which requires an examination as to whether there was "some potential for benefit other than the potential estate tax advantages that might result from holding assets in the partnership form." *Thompson*, [382 F.3d at 383](#). "If there is no discernable purpose or benefit for the transfer other than estate tax savings, the sale is not 'bona fide' within the meaning of § 2036." *Id.*; see also *Strangi*, [417 F.3d at 479](#) ("[A] sale is 'bona fide' if, as an objective matter, it serves a 'substantial business [or] other non-tax' purpose." (quoting *Kimbell v. United States*, [371 F.3d 257, 267](#) (5th Cir. 2004))).

Austin formed KPLP with the help of his estate lawyer and without the involvement of his sons, who testified they were unfamiliar with the terms of the KPLP agreement. Austin alone decided which assets would be included in funding the partnership. As a consequence, the tax court found Austin "essentially stood on all sides of the partnership's formation and approved the provisions of the KPLP agreement without negotiation or input from the limited partners." The tax court also rejected the Korbys' claim KPLP was created to protect the family from commercial and personal injury liability arising from their bridge-building business, as well as liability from divorce, stating "the estate has not shown that the terms of the KPLP agreement would prevent a creditor of a partner from obtaining that partner's KPLP interest in an involuntary transfer." The tax court found "Austin and Edna formed KPLP in order to make a testamentary transfer of their assets to their sons at a discounted value while still having access to the income from those assets for their lifetime." Based on the facts present in this case, we find no basis for concluding that the tax court's factual determinations are clearly erroneous.

III

For the reasons discussed, we affirm the tax court's decisions.

In recent years, the Service has vigorously litigated cases like *Estate of Korby* with mixed results. Compare *Estate of Jorgensen v. Commissioner*, [2011 U.S. App. LEXIS 9203](#) (9th Cir., May 4 2011), and *Estate of Schurz v. Commissioner*, [T.C. Memo. 2010-21](#) (IRS wins), with *Estate of Black Jr. v. Commissioner*, [133 T.C. 340](#) (2009), and *Kimbell v. United States*, [371 F.3d 257](#) (5th Cir. 2004) (IRS loses). Even if the IRS can persuade a court that there was an implied agreement that the decedent would retain the enjoyment of the transferred property, IRS successes have involved cases where the decedent tried to exalt form over substance, with the court concluding, as it did in *Estate of Korby*, that there was no legitimate non-business reason for formation of the business entity. In effect, the only reason for the entity was to exploit valuation discounts.

An apt adage in this area might be: "Pigs get fat while hogs get slaughtered." When an estate can demonstrate an objective non-business reason for the entity, it will win even if tax savings were a primary motive to create the entity; if the estate cannot demonstrate a non-business reason for entity creation, the IRS wins.

Page 381: Answer Problems 1-4 based on a 3% § 7520 rate.

Chapter 11

ANNUITIES AND OTHER RETIREMENT ARRANGEMENTS

Page 498: In Problem 4, use a § 7520 rate of 3% instead of 8%.

Page 500: Add after line “For 2006 \$15,000”:

The Pension Protection Act of 2006 made permanent the 401(k) elective deferral limitations that were enacted under the Tax Act of 2001. Based on indexing for inflation, the limitation for 2010 and 2011 is \$16,500.

Page 502: Add after line “For 2008 \$5,000”:

The Pension Protection Act of 2006 made permanent the maximum IRA contributions that were enacted under the Tax Act of 2001. Based on indexing for inflation, there is a \$5,000 limitation for the years 2009-2012.

Page 502: In line starting “For 2005 and thereafter,” delete “and thereafter” and add the following:

For 2006	\$60,000
For 2007	\$62,000
For 2008	\$63,000
For 2009 and 2010	\$65,000
For 2011	\$66,000

Page 502: Add at the bottom of the page

In 2011 no deduction will be allowed if joint return adjusted gross income is \$110,000 or more.

Page 507: In fifth line, delete “April 2000” and insert “April 2002”.

Page 507: Replace the **Example** with the following:

Example: Alice, who owned an IRA, turned 70 1/2 during 2003. As a result, her first MRD was required no later than April 1, 2004. In 2011, she will mark her 78th birthday. The MRD for 2011 will be the value in the account on December 31, 2010, divided by 20.3 which is the life expectancy factor for a person aged 78 under the Uniform Distribution Table. Assuming the account balance on December 31, 2010 was \$203,000, Alice must receive a MRD of \$10,000($\$203,000/20.3$) in 2011.

Page 507: In the last paragraph, the second sentence should read:

In addition, the surviving spouse has the option to rollover the account so that the spouse becomes the new participant.¹

¹ The Pension Protection Act of 2006 added § 402(c)(11), which allows distributions to inherited individual retirement plan of nonspouse beneficiaries.