Donis's gross estate and the amount of estate tax due.

**QUESTION 3**

When Abe transfers $500K to Holdco, he is actually treated as having made a completed gift to Brett. Brett did not pay anything so no consideration flowed back to Abe. But, the value of Brett's shares increased. The value of the gift will likely be 40% of $500K = $200K. (However, Abe might argue for a minority discount since the gift is made to a minority shareholder whose shares won't be worth as much as those of a controlling shareholder).

Since Abe has used all of his gift tax unified credit, the whole $200K will be subject to gift tax
except for $11K (for which Abe will be able to take an annual exclusion). Abe, as the donor, will have to pay the tax.

Under 2703 and 2704, some restrictions apply to valuation discounts taken for shares of family owned companies. These may apply and may also limit Abe's ability to take a valuation discount (as mentioned above).

As for Trust #1, Abe may be stuck with some ugly transfer tax consequences. But, the fact that Brett gave Abe consideration for his remainder interest may be Abe's saving grace.

Under 2702 when a person gives a gift to a family member and retains an interest (e.g., in the trust), the retained interest is treated as a gift (unless the interest is a qualifying interest similar to those that apply for charitable deductions). In such a case, the donor is treated as having made a
gift of the full value of the property transferred.

But, b/c Brett paid the actuary valuation of the remainder of the portion he would eventually get, there may not be a completed gift at all. There is some conflict over whether the actuary value paid by a family member is actually full & adequate consideration. If it is, there is no gift and no gift tax liability will ensue. But, if it is not adequate consideration, Abe would be treated as having made a gift of the full value of the trust (including his retained income interest but minus the value of consideration received in return) and would be liable for the gift tax imposed.

Likewise, Abe’s retained life estate could be a problem in that, at Abe’s death, it might be treated as a 2036(a)(1) string, thus bringing the full value back into his gross estate for estate tax purposes. This would
be a particularly wicked turn of events b/c, although Abe would get credit for the gift tax paid the first time around, he would still be liable for estate tax on the full value of the trust (which seems to have appreciated considerably since its creation). Still, Abe may have a way out of this horrendous imposition of est + gift tax liability b/c of the consideration that flowed back from Brett. Under 2036(a)(1), if the transferor paid the transferor full + adequate consideration for the original transfer, the full value is not dragged back into the transferor's gross estate at death. As mentioned above, there is some conflict over whether the actuary value of the remainder paid at the time of the trust creation is full + adeq consider for 2036(a)(1) purposes. Some would say f/9 consider = d/o/d. Value
be subject to estate tax on the full value of the trust (minus what the consideration was determined to be worth). If this was the case, Abe's est would be liable for paying the estate tax.

If the consid was not found to be f+a. Abe would still not get an annual exclusion for the gift to Brett b/c it was a future interest.

As for Trust #2, when it was established it was a completed gift to Cheryl of the whole thing. Abe could take an annual exclusion for Cheryl's present right to receive income. Since he has used up his Gift Tax Unified Credit, Abe must pay gift tax (as the donor) for the full value of the income interest and the remainder interest.

The only thing in Trust #2 that might have presented an issue was Abe's retained right to invade the corpus for Brett's benefit. This would seem to be a 2035 problem as it looks like a greater retained power to alter who would
receive the benefit of the trust corpus. Such a retained right would be treated as an incomplete gift. Moreover, when Abe died, it would have dragged the value of the trust corpus (and possibly the income int under 2036(a)(2)) back into Abe’s gross estate.

However, Abe was smart and limited his power in so much as he would need Cheryl’s consent to change who would benefit from the trust corpus. B/c Cheryl had an interest in the trust corpus, she is clearly an adverse party. 16 a retained right to change the beneficiaries if a trust is only exercisable through getting consent from an adverse party, it does not work to drag the whole thing back into the gross estate.

So, Abe will have to pay gift tax now (when trust 2 is set up) but will
not have to pay estate tax on #2 later.

When Abe dies, survived by Brett and Cheryl, his gross estate will be determined under 2032 by including all prop in which he had an interest. Deductions may be taken and then Abe's taxable estate will be valued. The 60% of stock in Holdco that Abe died w/o may be subject to a control premium and therefore may be worth slightly more than 60% of the FMV of the company. Depending on the gift tax outcome of trust #1, part of all of that may be included in Abe's gross estate as well. B/c the value of Abe's property has substantially increased (and will probably continue to do so), Abe's would probably not elect to take the 2032 Alt Valuation. But, if Abe's estate did elect to take the 2032 Alt Valuation, it would be all or more each
asm't would be valued individually, it would have to decrease estate value and decrease amount of estate tax due. (b/c the Gift Tax + the Est Tax are mot truly "unified," Abe would be able to use the rest of his Unified Credit against the Est tax imposed. In 2008, that is quite a lot more than the $1 M credit that the gift tax is stuck at.

Thank you! Happy Holidays!!