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ESTATE AND GIFT TAX
FALL 2024
BOGDANSKI

<u>FINAL EXAMINATION</u>
(Three hours)

INSTRUCTIONS

This examination consists of three essay questions, each of which will be given equal weight in determining grades. Three hours will be permitted for this examination. At the end of the three hours, you must turn in this set of questions in the original envelope in which this set came. You must submit your answers using Examplify.

No credit will be given for anything written on this set of questions. Only your electronic answer file will be graded.

Use of any electronic device during this exam, other than a device on which you are taking the exam using Examplify, is strictly prohibited. If you need it, the calculator function in Examplify is activated.

Pay close attention to the final portion, or "call," of each question. Failure to respond to the matters called for will result in a low score for the question. On the other hand, discussion of matters outside the scope of the call of the question will not receive credit.

Be sure to explain as thoroughly as possible your answers to the questions posed. Your reasoning, discussion, and analysis are often as important as any particular conclusion you reach.

The suggested time limit for each question is one hour. Experience has shown that failure to budget one's time according to this limit can result in a drastic lowering of one's overall grade on this examination.

Unless otherwise specified, assume that:

- all persons named in the questions are individuals, U.S. citizens, and U.S. residents;
- all transactions and events described in the questions take place in 2024; and
- the federal wealth transfer tax laws in effect in 2024 remain in effect permanently.

Any references to "the Code" mean the Internal Revenue Code of 1986, as amended.

QUESTION ONE
(One hour)

Mona, a wealthy individual, has three adult daughters, Eloise, Gert, and Ilona. Mona is unmarried, having survived her deceased spouse, Sully. Mona has already utilized all of her unified credit for federal gift tax purposes, including all of the credit that was "ported" to her from Sully when Sully died.

In December 2024, Mona engages in several transactions, as follows:

- Mona transfers $300,000 cash to Buxco, a holding company the stock of which has been owned, since Buxco's formation, entirely by Eloise. In exchange for the money, Mona receives newly issued Buxco stock. As a result, immediately after the exchange, Mona owns 10 percent of the outstanding shares of Buxco; Eloise owns the other 90 percent. Buxco has only one class of stock. Counting Mona's infusion of cash, Buxco holds investment assets with an aggregate fair market value of $4,000,000; Buxco, which does not pay dividends but focuses on growth, has no debt.

- Mona transfers rental real estate with a fair market value of $3,000,000 to a newly formed irrevocable trust, Trust No. 1. Under the terms of the trust, all of the trust income is to be paid every year to Eloise for the rest of Eloise's life; upon Eloise's death, the trust is to terminate, and the corpus is to be distributed to Eloise's estate. The trustee, a family friend, is given complete discretion to withhold income from Eloise and add it to the corpus. The trustee never exercises this power.

- Mona transfers $200,000 cash to another newly formed irrevocable trust, Trust No. 2. Under the terms of the trust, all of the trust income is to be paid every year to Gert for the rest of Gert's life; upon Gert's death, the trust is to terminate, and the corpus is to be distributed to Ilona or Ilona's estate. Gert is given a lifetime power of appointment over the corpus. The power allows Gert to appoint the corpus to anyone, including Gert herself.

In 2025, Gert renounces her power of appointment over the corpus of Trust No. 2. In 2025, the trustees of the two trusts distribute substantial amounts of trust income to Eloise and Gert.

What are the federal gift tax consequences to Mona, Eloise, and Gert of each of the transactions and events just discussed, with and without all available tax elections? Be sure to discuss the amount and timing of each item.

Discuss.

(End of Question 1)

QUESTION TWO
(One hour)

Wynn and Han are a wealthy married couple, living in a separate-property state (as opposed to a community-property state). Wynn is the chief executive officer of a public company, Broco, and draws a large salary. Han manages the couple's several sprawling homes and cares for the couple's child, Carey, born in 2006. Under state law, parents are responsible for the support of their children until age 21.

In 2022, Wynn establishes an irrevocable trust, naming Han as trustee. Wynn transfers to the trust Broco stock with a fair market value of $1,000,000 at the time of the transfer. Carey is the sole beneficiary of the trust. The trust instrument contains the following provision:

> Until the beneficiary becomes 21 years of age, the Trustee shall use such part or all of the net income of the trust for the support, care, welfare, and education of the beneficiary, payments from such net income to be made to such beneficiary or in such other manner as the Trustee deems to be in the best interest of the beneficiary, and any unused income shall be accumulated and added to the principal of the trust. After the beneficiary becomes 21 years of age, the Trustee shall pay to the beneficiary, in convenient installments, the entire net income of the trust. In the Trustee's discretion, said income payments may be supplemented at any time with payments of principal from the trust whenever the Trustee deems any such payments necessary for the support, care, welfare, or education of the beneficiary.

The trust is to terminate when Carey dies or reaches the age of 32; at that time, the corpus is to be distributed to Carey or Carey's estate. As trustee, Han spends some of the trust income, but none of the corpus, on Carey's education; the rest of the income is accumulated in the trust.

In 2024, Wynn, in keeping with his annual practice, hands his personal check for $18,000 to Carey, as a birthday gift.

A week later, Wynn dies in an automobile crash, survived by Han and Carey. Wynn's will leaves most of Wynn's estate to Han, but only if Han survives Wynn by at least six months. If Han dies within the six-month period, the assets left to Han in the will are to be transferred instead to Carey's trust. Han in fact lives for 40 more years. At the time of Wynn's death, the trust's Broco stock has a fair market value of $1,200,000, and the trust's other assets have a combined fair market value of $100,000.

As executor of Wynn's estate, Han pays numerous taxes. These include federal and state estate taxes, federal and state income taxes, county property tax, and federal gift tax on several gifts that Wynn made before Wynn died.

What are the federal gift and estate tax consequences to Wynn and Wynn's estate of each of the transactions and events just discussed, with and without all available tax elections? Be sure to discuss the amount and timing of each item.

Explain.

(End of Question 2)

QUESTION THREE
(One hour)

Grace is a wealthy unmarried individual. She was divorced in 2013 and has never remarried.

In 2024, Grace establishes an irrevocable trust, naming her lawyer, Leo, as trustee. The trust calls for payment of all of the income from the trust to Grace's son, Sean, annually for the rest of Sean's life. Upon Sean's death, the trust is to terminate and the corpus is to be distributed to Sean's daughter, Darcy. In the trust agreement, Grace retains the right, during her lifetime, to substitute her niece, Nadia, for Darcy as the holder of the remainder; however, in order to change the beneficiary in this way, the trust provides that Grace must obtain the consent of Sean. Grace transfers $1,000,000 cash to Leo to get the trust going. Leo invests the money in income-producing property.

Also in 2024, Grace lends $500,000 to Nadia to enable Nadia to buy a yacht. The loan is a demand loan. The loan documents call for repayment of principal only, with no interest. Nadia gives Grace a security interest in the yacht to secure the loan. Although Nadia intends to take out a bank loan and repay the principal if it is ever called for, Grace never demands repayment.

In 2025, Grace and her much younger sister, Alicia, join together to buy a condominium unit at a vacation resort. Grace and Alicia each pay $300,000 toward the $600,000 purchase price. They take title as joint tenants with right of survivorship. To raise Alicia's share of the cash to make the purchase, Alicia sells her stock in a corporation, XYZ, to her father, Finn, for its fair market value, $300,000. Grace comes up with Grace's share of the purchase price by liquidating a part of her municipal bond portfolio, purchased with profits from her business.

Grace's health deteriorates suddenly, and in 2025, she dies, survived by Sean, Darcy, Nadia, and Alicia. In her will, Grace leaves Nadia's $500,000 promissory note to Nadia; the rest of Grace's assets, after payment of debts and expenses, pass to Sean. Grace never exercises her right to change the holder of the future interest in the trust she established. When Grace dies, the corpus of the trust has a fair market value of $1,300,000, and the condominium unit has a fair market value of $660,000.

In 2030, Sean dies. Still alive when Sean dies are Darcy, Nadia, and Alicia. At that point, the trust established by Grace terminates, and Leo distributes the corpus, consisting of $1,500,000 of marketable securities, to Darcy. Sean is unmarried at the time of his death. After payment of debts and expenses, all of the assets in Sean's estate pass to Darcy.

What are the federal gift, estate, and GST tax consequences to Grace, Grace's estate, Sean, Sean's estate, Darcy, and Leo of each of the transactions and events just discussed, with and without all available tax elections? Be sure to discuss the amount and timing of each item.

Discuss.

(End of examination)