Examplify Password:

Estate and Gift Taxation **Fall 2018**
Bogdanski

WRITE YOUR EXAM NUMBER HERE: ________

FINAL EXAMINATION
(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 essay questions in the original envelope in which this set came. If you are using a computer, you must submit your answers using Examplify. If you are writing answers by hand, you must write them all in the bluebook(s) you have been provided, and return the bluebook(s) along with this set of questions in the envelope.

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

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.

For purposes of this examination, unless otherwise specified, assume that all transactions take place after 2017 and before 2026; and that all persons named in the questions are individuals, U.S. citizens, and U.S. residents. Any references to "the Code" mean the Internal Revenue Code of 1986, as amended.

QUESTION ONE
(One hour)

Mimi is a widow. Her wealthy spouse Fujio died years ago, leaving behind a taxable estate of more than $50,000,000, all of which (after taxes) passed to Mimi. Mimi never remarries.

Mimi establishes two irrevocable trusts, Trust No. 1 and Trust No. 2. Trust No. 1 is for the benefit of Mimi's son, Sota, and Sota's daughter, Gina. Trust No. 2 is for the benefit of Gina. Mimi contributes to each trust publicly traded securities with a fair market value on the date of the transfer of $10,000,000, for total transfers of $20,000,000.

The trust instrument of Trust No. 1 provides that all of the income from the trust corpus is to be paid quarterly to Sota for the rest of Sota's life. Mimi retains the power to direct the trustee to accumulate income and add it to corpus rather than distributing it to Sota. By the terms of the trust, however, Mimi can exercise this power only with Sota's consent. Upon Sota's death, the trust is to terminate, and the corpus and any accumulated income are to be distributed to Gina or Gina's estate.

The trust instrument of Trust No. 2 provides that all of the income from the trust corpus is to be paid quarterly to Gina or Gina's estate for the next 20 years. Mimi retains the power, in her sole discretion, to direct the trustee to accumulate income and add it to corpus rather than distributing it currently to Gina. At the end of the 20-year term, the trust is to terminate, and the corpus and any accumulated income are to be distributed to Gina or Gina's estate.

Five years after setting up the trusts, Mimi dies, survived by Sota and Gina. The securities held by the trusts have appreciated substantially over the five-year period.

At the time of Mimi's death, Mimi is a co-owner of the Plant, a commercial building. The other co-owner is Mimi's cousin, Ulla. The co-ownership is in the form of tenancy in common. Ulla had owned the Plant outright for decades before giving Mimi a one-half interest in it as a gift, two years before Mimi's death. At the time of the gift by Ulla, the Plant had a fair market value of $6,000,000. At the time of Mimi's death, the Plant has a fair market value of $7,000,000.

Immediately before Mimi's death, she was also a co-owner, along with her brother Bram, of Blackacre, a parcel of undeveloped real estate with a steady fair market value of $5,000,000. The co-ownership was in the form of joint tenancy with right of survivorship. Mimi and Bram received their co-tenants' interests as gifts from their late father, Pedro. Neither Mimi nor Bram paid any consideration to Pedro. When Mimi dies, Bram, who survives Mimi, becomes the sole owner of Blackacre.

What are the federal gift, estate, and GST tax consequences to Mimi and Mimi'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.

Discuss.

(End of Question 1)

QUESTION TWO
(One hour)

Hugo and Wadi, a well-to-do married couple, have two adult children, Kenta and Liam. Kenta and Liam are the equal beneficiaries of a term life insurance policy on Hugo's life. The death benefit under the policy is $10,000,000. The owner of the policy is Wadi.

The family owns all of the stock of a corporation, Corp. At the start of 2018, Corp has only one class of stock outstanding, voting common stock. Hugo owns 800 shares of the stock, Kenta owns 100 shares, and Liam owns the other 100 shares. Taken together, the 1,000 shares of Corp stock owned by the family have a fair market value of $40,000,000. All three shareholders are active in Corp's business. Corp pays no dividends, but each shareholder draws a reasonable salary.

In a recapitalization of Corp in 2018, all of the shareholders surrender their shares to the company in exchange for newly issued stock. Hugo receives 800 shares of Corp's new Class A common stock, and Kenta and Liam each receive 100 shares of Corp's new Class B common stock. Each share of the new stock has identical rights to dividends and liquidating distributions, and each share is entitled to the same vote that one share of the old common stock had. However, by its terms, the Class A common stock will become nonvoting upon the death of Hugo.

Because of this limitation on voting rights, at the time of the exchange the fair market value of the Class A stock is $8,000,000 less than the fair market value of the original common stock that Hugo surrenders to Corp in the recapitalization exchange. The overall fair market value of the Corp stock owned by the family remains at $40,000,000.

In December 2020, Hugo writes checks to Kenta and Liam as holiday gifts. Each child receives from Hugo a check for $30,000. However, shortly thereafter, before either child can deposit Hugo's check, Hugo dies. After Hugo's death, the children eventually deposit the checks, which are paid out of Hugo's estate's bank account. The children also receive the death benefit on the life insurance policy. Hugo's taxable estate is greatly in excess of the unified credit exemption equivalent under the Code.

At the time of Hugo's death, Hugo was suing Eli, a competitor of Hugo's personal consulting business, for unfair competition. The lawsuit sought $1,000,000 in compensatory damages from Eli. Shortly before Hugo's death, Hugo's lawyer estimated that the lawsuit had an 80 percent chance of substantial success on the merits. With Hugo deceased and unavailable to offer testimony, however, the lawsuit is settled by having Eli pay Hugo's estate a mere $30,000. Wadi, who is the executor of Hugo's estate, uses all of this amount to pay the fee of the attorney who represented Hugo and the estate in the lawsuit.

What are the federal gift, estate, and GST tax consequences – to Hugo, Wadi, and Hugo'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)

Xena is an executive officer of a large corporation, Bigco. Xena and Bigco enter into a contract providing that when Xena reaches retirement age, Xena will receive a specified amount of annual cash retirement benefits from Bigco for 20 years. The contract specifies that if Xena dies before the 20 years' worth of payments are made, the remaining payments are to be made to the beneficiary designated by Xena. However, the contract also provides that if at any time Xena is terminated from employment for cause or competes with Bigco, Xena forfeits all rights to receive future benefits.

Xena is also the beneficiary of a trust established by the will of Xena's father, Val. The trustee is a local financial advisor, Tara. Under the terms of the trust, Xena is to receive all of the income from the trust, payable monthly, for the rest of Xena's life. Upon Xena's death, the trust is to terminate, and the corpus is to be distributed to Xena's child, Cora. Val's will also specifies that during Xena's lifetime, Xena has the power to invade the corpus of the trust at any time for Xena's "comfort, happiness or benefit."

Seven months after Val's death, Xena executes and delivers to the executor of Val's estate a document stating that Xena disclaims Xena's power to invade the corpus of the trust. Five months later, however, Xena's attorney informs Xena that the document Xena signed may not be sufficient under state law to effect a relinquishment of the power. Upon learning this, Xena immediately signs and delivers to the executor of Val's estate another, revised disclaimer document – in the attorney's words, "just to be on the safe side." Under state law, by virtue of the disclaimer, the trust established by Val continues with all of its terms intact, except for the power to invade. Thus, Xena receives all of the income from the trust every month, but no longer has the power.

Eight years after Val's death, Xena dies, survived by Cora and by Xena's spouse, York. Xena's will leaves a substantial portion of Xena's estate to York, but only if York survives Xena by six months. The will provides that if York is not alive six months after Xena's death, the assets designated to pass to York will pass instead to Cora. York in fact outlives Xena by many years.

At the time of Xena's death, Xena is still employed at Bigco. Bigco pays the retirement benefits over 20 years to Cora, whom Xena had specified to Bigco as Xena's beneficiary. When Xena dies, the trust established by Val's will terminates, and Tara pays the corpus out to Cora.

What are the federal gift, estate, and GST tax consequences – to Xena, Tara, and Xena'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.

Discuss.

(End of examination)