Estate and Gift Taxation **Fall 2019**
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)

Cher's spouse died 15 years ago, and Cher has not remarried. Cher has two adult children, Sai and Daya. Cher owns a seaside home, Beachacre, which is her principal residence. She also owns a condominium apartment in an inland city, where she spends some of her time. In year 1, Cher transfers Beachacre to an irrevocable trust, with Daya as the trustee. Under the terms of the trust, Cher retains the right to live at Beachacre for 10 years. At the end of the 10 years, or upon Cher's death if it occurs sooner, the trust is to terminate, and Beachacre is to be distributed to Sai and Daya as one-half tenants in common. At the time it is transferred to the trust, Beachacre has a fair market value of $2,000,000.

Also in year 1, Cher and Daya together buy from an unrelated party another parcel of real property, Mountacre. Mountacre is undeveloped property that Cher and Daya hold for investment. Cher and Daya take title to the property as one-half joint tenants with right of survivorship. The purchase price for Mountacre is $1,000,000. Cher puts up $750,000 of cash, and Daya puts up $250,000 of cash, to make the purchase.

In year 6, Cher dies, survived by Sai and Daya. At the time of Cher's death, the real property has the following fair market values:

Property	*Fair Market Value*
Beachacre	$ 2,400,000
Condominium apartment	1,000,000
Mountacre	1,200,000

At the time of her death, Cher also holds cash and a portfolio of marketable securities with a fair market value in excess of $20,000,000.

As executor and personal representative of Cher's estate, Daya spends $300,000 of estate funds on a substantial renovation of the condominium apartment. The project takes nearly a year, after which the apartment is sold to an unrelated party for $1,500,000 cash. The estate pays property taxes and insurance premiums on the apartment up to the time of its sale. Following the sale, the estate is closed, and final distributions are made to Sai and Daya as takers under Cher's will. Daya collects a fee from the estate as executor. All of the expenditures and distributions of estate funds and other assets are approved by the local probate court.

What are the federal gift, estate, and generation-skipping-transfer tax consequences to Cher and Cher'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)

Moira and Fran, a wealthy married couple, have one child, Noel. Noel, a recent medical school graduate, is starting her own professional practice. On January 1, 2019, Fran lends Noel $200,000 to buy equipment for use in the new business. The loan, evidenced by a promissory note duly executed by Noel, is a demand loan bearing no interest. Fran makes no demand, and Noel makes no payment, on the loan.

Also in 2019, Moira establishes an irrevocable trust, transferring to it cash of $300,000 and marketable securities with a fair market value of $1,700,000. The terms of the trust call for annual payments of all of the income of the trust to Noel for the rest of Noel's life. At Noel's death, the trust instrument calls for the trust to terminate, and the entire corpus to be distributed to Noel's estate. However, the trust instrument grants to the trustee of the trust, Moira's attorney Ara, the power, during the term of the trust, to change the beneficiary to whom the corpus is to be distributed at the end of the trust term. To exercise this power, Ara must obtain the written consent of Moira.

The trust instrument also provides that Moira retains the right, in Moira's discretion, to remove Ara as trustee and appoint as successor trustee any person or corporation of Moira's choosing, including Moira or Fran. The successor would have all of the powers of Ara, including the power to change the investments of the trust and to allocate gains to income or corpus.

In establishing the trust, Moira grants to her three sisters the power to withdraw $30,000 each from the cash that Moira contributes to the trust corpus. The withdrawal power expires 30 days after the transfers by Moira to the trust. None of the sisters exercises this withdrawal right.

In 2023, Moira and Fran die in an automobile accident. The executor and personal representative of their estates brings a wrongful death lawsuit against the driver of another vehicle involved in the crash. In 2024, the defendant's insurance company settles the lawsuit by paying the estate $1,000,000, which is distributed to Noel under the parents' wills along with $30,000,000 worth of other assets. At the time of the fatal accident, Ara remains the trustee of the trust established by Moira.

Assume that the federal short-term rate in effect under section 1274(d) of the Code is 2.0 percent throughout the time covered by the facts of this question.

What are the federal gift, estate, and GST tax consequences – to Fran, Moira, Ara, Moira's sisters, Fran's estate, and Moira'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)

For many years, Jan has owned all of the stock of a corporation, Corp, which is engaged in a construction business. Jan transfers to her adult child, Emi, 20 percent of the only outstanding class of stock of Corp. Emi provides no consideration for the stock. At the time of the gift, Jan and Emi believe that the stock has a fair market value of $1,200,000. Jan and Emi enter into an agreement under which, if the Internal Revenue Service successfully establishes that the fair market value of the stock is greater than $1,200,000 at the time of the gift, Emi will transfer some of the stock back to Jan so that the fair market value of the stock retained by Emi, as of the time of the gift, was $1,200,000. Corp does not pay any dividends on its stock. As controlling shareholder, Jan sometimes uses corporate funds for Jan's personal needs.

Jan was divorced several years ago; the transactions involved in the divorce were properly excluded from taxable gifts by section 2516 of the Code. Now Jan and Jan's new life partner, Zeke, are discussing getting married to each other. Jan and Zeke enter into an agreement whereby Jan will transfer to Zeke $500,000 worth of marketable securities in exchange for (a) Zeke's marrying Jan and (b) Zeke's releasing any rights that Zeke may have in Jan's property upon any divorce. The agreement is signed before Jan and Zeke's wedding, and it takes effect as soon as they are legally married. Jan transfers the securities to Zeke a few weeks after the wedding.

A few months later, Jan sets up an irrevocable trust. The terms of the trust call for quarterly payments of all of the income of the trust to Jan's sibling, Billy, for the rest of Billy's life. At Billy's death, the trust instrument calls for the trust to terminate, and the entire corpus to be distributed to Jan if Jan is still alive. If Jan has predeceased Billy, then upon Billy's death the trust is to terminate with the entire corpus to be distributed to Billy's grandchild, Galen, or Galen's estate. Jan retains no power over the trust. The trustee is a bank, Kashco. Jan funds the trust with $2,000,000 cash.

At about the same time as the establishment of the trust, Galen's parent (and Billy's child), Owen, suffers a serious physical injury. Jan helps Owen with some of Owen's doctor and hospital bills. In some cases, Jan herself pays the health care providers; in other cases, Jan reimburses Owen for Owen's out-of-pocket medical expenses.

Two years later, Jan dies, survived by Emi, Zeke, Billy, Owen, and Galen. At the time of Jan's death, the trust corpus has a fair market value of $2,200,000. Jan's death adversely affects Corp's operations. Jan's 80 percent of the Corp stock passes, under Jan's will, to Emi.

Assume that Jan had completely used up Jan's unified credit under Section 2505 of the Code before the time of the facts of this question. Disregard any additional unified credit arising due to inflation adjustments.

What are the federal gift, estate, and GST tax consequences – to Jan, Billy, Kashco, and Jan'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)