Estate and Gift Taxation
Spring 2021
Bogdanski

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

QUESTION ONE
(One hour)

In year 1, Asa, a wealthy unmarried person who has made many taxable gifts, establishes an irrevocable inter vivos trust, transferring to it marketable securities with a fair market value of $4,000,000. The trust instrument provides that all of the income from the property held by the trust is to be paid to Asa every year for the rest of Asa's life. Upon Asa's death, the trust is to terminate, and the corpus is to be paid to Asa's adult son, Sam. Asa retains the right to change the remainder beneficiary.

Asa names her brother, Ben, as trustee of the trust. Ben is given the power to appoint all or any part of the corpus of the trust at any time, in his discretion, to Sam or to Asa's other adult child, Dee. Ben is also given the power to distribute corpus from the trust to himself for his own "reasonable support and comfort."

In year 3, Asa amends the trust to eliminate Asa's power to change the remainder beneficiary. At that time, the marketable securities held by the trust have a fair market value of $5,000,000. Asa keeps her income interest in the trust.

Also in year 3, Sam and Dee ask for Asa's help in their struggling business. Specifically, they request that Asa provide funding to Corp, a corporation the stock of which is owned one-half by Sam and one-half by Dee. Asa transfers to Corp $1,000,000 in cash, in exchange for Corp's promissory note in the same amount. By its terms, the note calls for quarterly payments of principal and interest computed at a market rate. Corp continues to have severe financial difficulties, however, and Asa never receives any payments on the note, nor does she take any steps to collect on it.

In year 5, Asa dies, survived by Sam, Dee, and Ben. At the time of Asa's death, the marketable securities held by the trust have a fair market value of $6,500,000. Ben, who has never exercised his powers over the corpus, distributes the securities to Sam in accordance with the trust instrument. Asa's will leaves the Corp promissory note to Corp.

When Asa dies, Dee collects the death benefit from a life insurance policy on Asa's life. Dee was the owner of the policy as well as its sole beneficiary. Over the years, Dee paid a portion of the premiums on the policy with money given to Dee by Asa.

What are the federal gift, estate, and GST tax consequences to Asa, Asa's estate, and Ben 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.

QUESTION TWO
(One hour)

Nora is a wealthy unmarried person who has made many taxable gifts. Nora and her only child, Olivia, form a limited partnership, LP. To establish LP, Nora transfers to LP some corporate stocks and real estate with a combined fair market value of $9,900,000, in exchange for a 1 percent general partner's interest and a 98 percent limited partner's interest in LP. In the same transaction, Olivia transfers to LP $100,000 cash in exchange for a 1 percent limited partner's interest in LP. Under applicable partnership law and the partnership agreement, control of the partnership is vested entirely in the general partner.

A few months after LP is formed, Nora gives Olivia most of Nora's limited partner's interest. After the gift, Nora is the 1 percent general partner and an 18 percent limited partner; Olivia is an 81 percent limited partner. The stocks and real estate held by LP generate substantial income, but LP makes only occasional distributions to the partners, when Nora sees fit.

Nora is also the beneficiary of a trust established by her late mother. The corpus of the trust consists of assets that are constantly increasing in value. Under the terms of the trust, Nora is entitled to, and does, receive a fixed dollar amount from the trust every year for the rest of her life. Upon Nora's death, the trust is to terminate, and the corpus is to be distributed to Olivia or Olivia's estate. However, Nora has the unlimited power, during Nora's lifetime, to appoint all or any part of the corpus to pay Nora's debts.

One day, on the advice of a friend, Nora relinquishes her power to appoint the corpus of the trust to pay her debts. The release of the power is effective under state law. Nora keeps her annuity interest in the trust.

Four years later, Nora dies, survived by Olivia. At the time of her death, Nora is being sued by a local politician, Tevis, for alleged defamation. Tevis's lawsuit claims damages of $1,000,000. Two months after Nora dies, Nora's estate settles the lawsuit by making a cash payment to Tevis of $50,000.

Nora's will calls for a substantial monetary bequest to her neighbor, Claire, in gratitude for help in Nora's senior years. Claire, who is much younger than Nora, assisted Nora with transportation to and from shops and doctors' appointments. The rest of Nora's assets pass to Olivia.

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

QUESTION THREE
(One hour)

Hassan and Wilma are married to each other. They live in a state with a separate property system. None of their property is community property. Hassan and Wilma have an adult daughter, Yvette, and an adult son, Zed.

Hassan and Wilma own a parcel of undeveloped real estate, Sunacre, as tenants in common, one half each, without right of survivorship. Sunacre has a steady fair market value of $1,000,000.

Every year, Wilma makes gifts to Yvette and Zed. In December, Wilma gives each of them her personal check for $30,000.

Wilma establishes an irrevocable inter vivos trust, Trust No. 1. Wilma transfers $2,000,000 in cash to get the trust started. The terms of the trust call for payment of all of the income of the trust to Yvette or Yvette's estate each year for 10 years. If Wilma is alive at the end of the 10 years, then beginning with the following year, all the income is to be paid to Wilma annually for the rest of Wilma's life. At the end of the 10-year term or upon Wilma's death, whichever is later, the trust is to terminate, and the corpus is to be distributed to Zed or Zed's estate.

Four years after establishing Trust No. 1, Wilma dies, survived by Hassan, Yvette, and Zed. Wilma's will establishes a second trust, Trust No. 2. Substantially all of the property Wilma owns when she dies is placed in Trust No. 2, except for her interest in Sunacre, which passes under her will to Zed.

The will requires annual payments of all of the income of Trust No. 2 to Hassan for the rest of his life, with the remainder to be distributed at Hassan's death in equal shares to Yvette and Zed or their respective estates. The family lawyer, Lloyd, is the trustee of Trust No. 2. Wilma's will gives Lloyd the power to distribute any or all of the corpus of Trust No. 2 to Hassan at any time, to the extent Lloyd deems it "necessary or appropriate" for Hassan's "well-being or happiness."

What are the federal gift, estate, and GST tax consequences –to Wilma, Wilma's estate, Hassan, and Lloyd –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)