

## I. Introduction to Transfer Taxation

### A. Historical Perspective

#### 1. History

- a. 1916 – Federal estate tax enacted
  - i. Parent of current estate tax
  - ii. Around WWI
  - iii. Assessed tax on transfer of property at death
  - iv. Solution — give property away during lifetime
- b. 1924 – Federal gift tax enacted
- c. 1926 – Federal gift tax repealed
- d. 1932 – Federal gift tax reenacted
  - i. Parent of current gift tax
  - ii. Intervivos transfers are subject to tax
- e. Many years – estate tax & gift tax
  - i. Solution – Give property directly to grandchildren to avoid paying estate tax again at child's death
- f. 1986 – Generation Skipping Transfer tax enacted
  - i. Tax on transfers that skip generations @ highest marginal rate
  - ii. Imposes a “shadow” tax
  - iii. Estate & gift tax assessed at the same time

#### 2. The Taxes

- a. 4 Taxes
  - i. Estate tax – transfers at death
  - ii. Gift tax – transfers during life
  - iii. GST tax – transfers that skip generations
    - A) Pay estate tax and/or GST tax
    - B) OR Pay gift tax and/or GST tax
  - iv. Income tax — no income tax on gifts
- b. Relationship Between Taxes
  - i. Estate/gift tax & GST tax are unrelated
  - ii. Income tax unconnected to gift tax

- iii. Estate & gift tax are interrelated
  - A) Share progressive rate structure (as high as mid-40s)
    - 1) Progressive rates follow TP thru life to death
    - 2) TP gets benefit of each tax bracket one-time during life
    - 3) At each gift TP starts at new tax bracket — need to know gifting history to file 709
    - 4) At death must know what bracket TP left off at
  - B) Both have exemption – an amount that can be transferred that is not subject to tax

3. Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)

a. Changes to Federal Transfer Tax System

- A) Reduced highest marginal rates applicable to lifetime/death transfers
- B) Estate/gift tax exemption amounts increase over time
- C) No federal estate tax in 2010
- D) BUT §1014 repealed in 2010 — No step-up in basis
- E) 2011 – exemption is \$1 million & maximum rate is 55%

b. Result

- i. Fewer people pay tax
- ii. AND amount of tax paid is less

4. Possibility of Repeal of Estate Tax

- a. Total repeal requires supermajority b/c of revenue loss
- b. Prior to Hurricane Katrina & war there was huge support for repeal
- c. Most feel need some change to maximum rate & exemption

B. Policy Considerations

1. Revenue from Estate Tax

- a. \$22 billion per year – affects only ~ 20,000 taxpayers per year
- b. 1.25% of Treasury's revenue

2. Cons of Estate Tax

a. Double taxation

- i. Argument – Estate tax is 2<sup>nd</sup> tax on same property earned as income
- ii. Response – income tax & estate tax different
  - A) Income tax = taxes privilege of earning money
  - B) Estate tax = taxes privilege of transferring money

- b. Damages small businesses & farms — appears to be legend that family businesses & farms must be sold to pay estate tax

- c. Discourages savings & success
    - i. Many wealthy people not discouraged by estate tax
    - ii. Incentive to earn more to give to heirs after tax
3. 2010 – No estate tax; No carryover basis
- a. Congress won't let it happen
  - b. Very difficult to keep track of basis
  - c. Easy to determine DOD value for carryover basis

C. Basic Structure of the Present Statutory Framework

1. Following Gifting

- a. §2501(a)(1) – Tax imposed on transfers of property by gift  
*See* §25.2501-1(a)(1)
- b. §2502 – Tentative Gift Tax is calculated under §2001(c)
- c. §2001(c) – Tentative tax on \$1 million transfer = \$345,800
- d. §2505 – Credit against gift tax equal to amount of tax paid on \$1 million (\$345,800)
- e. Debit Card Concept
  - i. IRS is only payee
  - ii. Card has \$345,800
  - iii. Most will not use Card during life
  - iv. BUT most will use Card at death
- f. Whether Gift Tax is due depends on how much of Card has been used
  - i. If \$1 million transferred & it is 1<sup>st</sup> transfer ever
    - A) TP must surrender Card and balance would be “0”
    - B) AND tax due out-of-pocket is “0”
  - ii. If under \$1 million transferred & it is 1<sup>st</sup> transfer ever
    - A) Card balance would decrease
    - B) AND tax due out-of-pocket is “0”
  - iii. If \$500,000 transferred in year after \$1 million transfer – To determine gift tax ...
    - A) Add Net Transfer + Net Transfers from all prior years
    - B) Calculate tentative tax on all transfers
    - C) Apply \$345,800 Credit
- g. Preparing Gift Tax Return – Form 709
  - i. Obligation to file 709 anytime TP makes transfer in excess of annual exclusion

- ii. \* Ask TP for every 709 or at least most recent 709
  - A) Can request lost returns from IRS
- iii. 709 due on April 15<sup>th</sup> (same as income tax return)
  - A) Extending income tax return due date also extends 709 due date
  - B) Calendar year return

2. Effect of Gifting on Estate Tax

- a. §2001(a) – Tax imposed on transfers of taxable estate of decedent
- b. §2010(c) – Credit against estate tax ...
  - i. In 2006-2008 is equal to amount of tax paid on \$2,000,000
  - ii. In 2009 is equal to amount of tax paid on \$3,500,000
- c. §2001(c) – Tentative tax on \$2 million transfer = \$780,800
- d. To determine estate tax ...
  - i. Determine Net Estate by subtracting deductions from Gross Estate
  - ii. Add back Aggregate Transfers
  - iii. Apply credit for tentative tax
  - iv. Subtract any out-of-pocket tax paid during life
- e. Preparing Estate Tax Return – Form 706
  - i. \* Ask for every 709 or at least most recent 709 filed for decedent
  - ii. Due 9 months after death
    - A) Can obtain 6-month extension to file almost automatically
    - B) Extension does not extend time to pay
      - 1) Interest & penalties if estate tax not paid w/in 9 months of death
      - 2) Strategy – make conservative estimate & pay tax w/in 9 months
      - 3) Interest & penalties on any underpayment

3. GST Tax and the Estate/Gift Tax

- a. If transfers to grandchild or more remote descendant — may have to do GST calculation in addition to estate/gift tax

D. The Role of State Law

- 1. Fundamental Problem in Tax System — many words in Code & Regulations are undefined
- 2. IRS is bound by state statutory law that defines a relationship
  - a. Marriage license is incontrovertible evidence for marital deduction

b. Common-law Marriage

- i. IRS looks to circumstantial evidence for purposes of marital deduction
  - A) Filing joint tax return
  - B) Holding out to public as husband & wife
  - C) Wearing rings
  - D) Executor asks what IRS wants & tries to prove it

- ii. State court decision that is a result of adversarial process is sufficient

*A & B get order from state ct to get A's insurance to cover B b/c of common law marriage*

- iii. Declaratory judgment by state court NOT enough b/c no one to challenge the assertion

*Executor petitions for judgment that Decedent & B had common-law marriage*

3. State Court Decisions on State Law Questions

- a. State Supreme Court decision characterizing property interest is binding on IRS

- b. IRS must give "proper regard" to decisions of other state courts

- i. IRS determines whether state court decision would be overturned in the next highest court in the state & applying the same standards as that ct would apply

- ii. Proper regard = what would appellate court say under state rules about quality of opinion

*Com'r v. Bosch's Estate – H created tst FBO W w/ general POA; state ct says W's release of POA b/f H's death was faulty*

E. Constitutional Concerns

- 1. Estate & gift tax are only constitutional as an indirect tax

- a. Indirect tax =

- i. IRS look excise tax on an act
- ii. NOT a tax on an individual

- 2. Indirect tax on the act of transferring property

- a. The "act" that triggers the estate tax

- i. §2001(a) – Tax imposed on transfer of taxable estate of decedent

3. Transfers Subject to Estate Tax

§2031(a) – Gross estate includes the value of all property, to the extent provided in Part III

- a. §2033 – Property only taxed to extent of decedent’s interest in property
  - i. §20.2033-1 – Gross estate includes value of all property beneficially owned by decedent at the time of his death
  - ii. §20.2031-1(a)(1) - §2033 concerned mainly w/ property passing thru decedent’s probate estate (i.e. by Will or intestacy)
- b. Decedent must have “beneficial interest” in property — Subjective determination
  - i. Not measured by decedent’s title to property  
*Trustee has title BUT does not have beneficial interest in trust property*
  - ii. Beneficiary has beneficial interest in trust – may or may not be subject to tax
  - iii. Contingent beneficiaries also have interest in trust – may or may not be subject to tax
- c. Property that passes thru decedent’s probate estate under §2033
- d. Joint Property
  - i. Tenants-in-Common Interest
    - A) No right of survivorship
    - B) Deceased co-owner’s property passes thru decedent’s estate
    - C) Surviving co-owner has only his proportionate share
    - D) Under §2033 – decedent’s proportionate interest is taxed in estate
  - ii. Joint Tenant w/ Rights of Survivorship
    - A) Does not pass thru probate estate — so does not fall under §2033
    - B) §2040 shows tax consequences
- e. Insurance - §2042
- f. Pensions - §2039
- g. Powers of Appointment - §2041

**II. The Estate Tax – Property Owned at Death**

A. Interests Included in the Gross Estate under IRC §2033

1. Dominion and Control

- a. Transfer of property is taxable under §2033 where decedent possesses substantially all attributes of ownership in property

*Helvering v. Safe Deposit – Decedent had general POA over tst property — Ct says decedent properly treated as owner of property for purposes of §2033 b/c at death he possessed substantially all attributes of ownership*

- b. Helvering interpreted to have broader effect — if transfer not clearly taxable under §2033 cannot be taxed at all
      - i. Congress enacted §2041 after Helvering
- 2. Possession
  - a. Possession of property can be economic equivalent of ownership
    - i. Right to enjoy
    - ii. Right to possess
  - b. Full value of contraband included in estate — No deduction allowed as a matter of policy
 

*Marijuana Ruling – D died in plane crash w/ bales of marijuana — IRS says marijuana included in D’s estate b/c D had economic equivalent of ownership*
  - c. Legal title to property not necessary for it to be included in estate
 

*Art Ruling – IRS says stolen art included in Ds estate b/c family enjoyed art for years*
- 3. Interests in Property at the Time of Death
  - a. Property to which Decedent has no legally enforceable right NOT subject to estate tax
 

*Barr’s Estate v. Com’r – D’s employer paid \$\$\$ to W at death — Ct says NOT subject to tax b/c D had no legally enforceable right to property since in employer’s discretion to make payments*

*Checks that haven’t cleared at DOD — D has legally enforceable right to full amount b/c D could stop payment b/f death*
  - b. Dividends
    - i. If decedent dies b/f record date — dividend NOT included in estate
    - ii. If decedent dies after record date — dividend included in estate
  - c. Causes of Action Related to Death
    - i. Settlement from wrongful/survival death action NOT included in estate
    - ii. EXCEPT for pain & suffering AND medical costs
 

*Connecticut Bank v. US – D dies in car accident; survival action brought — Ct says settlement for survival/wrongful death action not included in estate EXCEPT for pain & suffering & medical costs*
- 4. Accrued Payments
  - a. Income in Respect of a Decedent
    - i. Legally enforceable right at death BUT not received until after death
    - ii. Included in decedent’s estate for estate tax purpose
    - iii. NOT included in decedent’s income
    - iv. Taxable to estate for income tax purpose

- b. Deduction for estate tax associated with IRD
  - i. §691(a) – IRD is gross income not properly includible on decedent’s final income tax return
  - ii. §691(c) – Recipient of IRD allowed deduction for estate tax attributable to having income included in estate
  - iii. Problem: Deduction may result in more or less tax depending on tax bracket of beneficiary

### III. The Gift Tax

#### A. In General

- 1. §2501(a)(1) – Tax imposed on transfers of property by gift
- 2. §2501-2505 – Calculation of the gift tax
- 3. §2511(a) – a gift includes ...
  - a. Transfer in trust or otherwise
  - b. Direct or indirect transfer
  - c. Real or personal property
  - d. Tangible or intangible
- 4. §2512(b) – Gift defined
  - a. Where property is transferred for less than adequate & full consideration in money or money’s worth
  - b. Amount by which value of property transferred exceeds value of consideration is a gift

#### B. Transfers for Consideration

- 2. Donative Intent
  - a. Typically when a gift is made — NO consideration is received in return
  - b. §25.2511(g)(1) – Donative intent on the part of transferor is not an essential element in application of gift tax
    - i. To determine whether there is adequate consideration in money or money’s worth
      - A) Donor’s subjective intent is not considered
      - B) Objective facts of the transfer & circumstances – what was given & what was received in return
  - c. §25.2511(g)(1) – Gift tax is NOT applicable to ...
    - i. A transfer for full and adequate consideration in money or money’s worth
    - ii. OR ordinary business transactions

- d. §25.2512-8 – Promise to marry is not adequate consideration in money or money's worth

*Com'r v. Wemyss* – TP gave fiancée \$\$\$ in consideration for fiancée's loss in trust property, if she promised to marry him; TP argues it was business deal — Ct says intent does not matter; promise is not consideration in money or money's worth; TP received nothing in return

- e. §25.2512-8 – Relinquishment of marital rights is NOT adequate consideration in money or money's worth

*Merrill v. Fahs* – TP creates trusts FBO fiancée in exchange for her promise to marry & her giving up rights in TP's as wife or widow — Ct says release of right to property as wife or widow does not constitute adequate consideration; TP could not have done this at death under estate tax provision in §2043(b)(2)

### 3. Payments to Discharge Support Obligations

- a. Transfers that satisfy a support obligation are free of gift tax

- i. What constitutes obligation to support?

- A) Food, clothing, shelter
- B) When does it change from support to a gift?

- ii. Obligation of support is not clear BUT IRS does not have to define support obligation

- A) Annual exclusion - §2503(b)

- 1) \$12,000 per donor per donee per annum

- B) Medical & education exclusion - §2503(e)

- 1) Transfers for education & medical expenses are NOT gifts

- a) Can pay medical/education expenses in any amount for as many ppl as often as you want
- b) Can pay medical insurance premium or unreimbursed medical expenses

- 2) BUT must pay facility or school directly

- C) Marital deduction - §2523

- 1) Outright transfer to spouse is free of gift tax

### 4. Property Settlements in Contemplation of Divorce or Separation

- a. Transfer of property pursuant to separation agreement

- i. NOT taxable gift if value of transferred property equals the value of support rights surrendered by the transferee spouse

- A) Taxable gift to extent value of property transferred exceeds value of support rights

B) BUT if spouse's obligation to pay stems from court order — NO gift

*Harris v. Com'r – H & W transfer property pursuant to divorce; H gets more — Ct says no gift b/c W's obligation to pay stems court order*

ii. §2516 – Transfers in exchange for release of marital rights NOT subject to gift tax even if value of property transferred exceeds value of support rights IF

A) Transfer incident to written agreement

B) AND divorce occurs w/in 3 yr period beginning on the date 1 year before agreement is entered into

1) Divorce then agreement w/in one year after divorce

2) OR agreement then divorce w/in two years after agreement

b. Estate tax consequences

i. If transferor dies prior to transfer of property pursuant to separation agreement

ii. Deduction in transferor spouse's estate if pursuant to §2516 agreement

5. Business Transfers

a. Transfer in the ordinary course of business ...

i. Considered as made for adequate consideration

ii. NOT a gift

*Anderson v. Com'r – TP transfers own stock to employees; value given is more than what TP got back — Ct says no gift*

b. Rebuttable presumption that transfers b/t family members ...

i. NOT business transactions

ii. Transfers are gifts

6. Political Contributions

a. §2501(a)(4)

i. Transfers to political organizations/campaigns NOT gifts

ii. Check must be payable to organization/campaign NOT a person

b. No separate deduction for income tax or estate tax purposes

B. Definition of "Property"

1. Promises and Gifts to be Completed in the Future

a. A legally enforceable right is "property" for gift tax purposes

*Com'r v. Copley – TP agrees to transfer \$\$ to fiancée in prenup; fiancée gives up her marital rights; TP argues he gave the right to money & right arose in 1931 when there was no gift tax — Ct says transfer of property took place in 1931 when there was no gift tax; doesn't matter when payment was actually made*

- b. *Rev. Rul. 98-21*
2. Uncompensated Services
    - a. Services are not property for gift tax purposes
 

*Com'r v. Hogle – TP transferred \$ to tst & acted as investment advisor; IRS argues TP transferred profits to trust — Ct says cannot make taxable gift of services*
  3. Interest-Free Loans and Rent-Free Use of Assets
    - a. Use of property is property to which a transfer tax attaches
 

*Dickman v. Com'r – TP transferred \$ to son; son gave interest-free demand note in return — Ct says even if principal returned there is gift of foregone interest*
    - b. §7872 – Transfer of money made “low or below market interest rate” — gift valued at market interest-rate
      - i. To determine market interest rate — apply applicable federal rate (AFR)
    - c. Tax consequences of interest-free loans
      - i. Parent
        - A) Parent treated as receiving income at AFR
        - B) Parent treated as making gift of income valued at AFR
      - ii. Child
        - A) Child has interest deduction if loan qualifies as mortgage
        - B) Child will have income if he actually earns income
    - d. Types of Notes
      - i. Term Note = note with fixed repayment date
        - A) For income tax purposes
          - 1) Use AFR for month in which note issued
          - 2) Same AFR applies each year loan is outstanding
        - B) For gift tax purposes
          - 1) Single gift tax in year transfer made
          - 2) Gift tax = net present value of the stream of imputed gifts to child
      - ii. Demand Note = note repayable on demand
        - A) For income tax purposes
          - 1) AFR varies each year
          - 2) Use short-term AFR for last month in which note was outstanding for the taxable year

- B) For gift tax purposes
  - 1) Must file gift tax return every year loan is outstanding
  - 2) Use AFR in last month in which note was outstanding in that taxable year
- e. Early payment of interest-free loan
  - i. Parent must still pay gift tax even if child repays early
  - ii. Child is treated as making gift to parent for use of money for remaining number of years in term
- 4. Disclaimers
  - a. §2518(a) – When a person makes a qualified disclaimer & property passes to someone else — Person will not be treated as having made a gift
    - i. If you make qualified disclaimer you won't be treated as having made a transfer of property that belonged to you
  - b. §2518(b); §25.2518-2(a) – Requirements for Qualified Disclaimer
    - i. Must be irrevocable
    - ii. Refusal to accept property must be in writing & given to transferor
    - iii. Must be delivered to transferor w/in 9 months of transfer
      - A) 9 months from DOD or date of gift
      - B) Applies even if disclaimant unaware transfer has been made
      - C) §25.2518-2(d)(3) – If under 21, disclaimant has 9 months from date of 21<sup>st</sup> birthday to disclaim
      - D) If after 9 months period — disclaimant treated as making a gift
    - iv. Cannot have accepted or enjoyed an interest in property to be disclaimed
      - A) §25.2518-2(d)(1) – Acts Indicative of Acceptance
        - 1) Using property or interest in property
        - 2) Accepting dividends, interest or rents from property
        - 3) Directing others to act w/ respect to property or interest in property
    - v. Cannot receive consideration for disclaimer
    - vi. §25.2518-2(e)(1) – Property must pass to someone else w/o any direction from disclaimant
      - A) All states – property passes as if disclaimant predeceased transferor
      - B) Document may also designate who gets property if disclaimer
  - c. Disclaimer of partial interests allowed
    - i. Usually b/c disclaimant has enjoyed the property

- d. Chain of disclaimers is allowed
  - i. Disclaimant's power to control disposition of property is insufficient to disqualify disclaimer

C. Incomplete Transfers

1. Retained Powers to Revoke

- a. §25.2511-2(c) – Where donor retains beneficial interest (i.e. right to revoke) — Gift incomplete

- i. §25.2511-2(f) – When donor gives up right to revoke (i.e. dominion & control) — gift complete

*Bernette v. Guggenheim* – TP puts money into revocable trust & later gives up right to revoke — Ct says gift not complete until TP gave up right to revoke; didn't give up dominion & control over trust property until it was irrevocable

- ii. §25.2511-2(f) – During period where transfer is revocable — gift complete if distribution is made

- iii. §25.2511-2(e) – Where exercise of donor's right to revoke requires consent of a substantially adverse person — Gift complete

*Camp v. Com'r* – TP creates trust; trust revocable only w/ consent of one-half brother or mother — Ct says gift to trust complete only if deciders' interests are substantially adverse to what TP is asking them to do; Ct says one-half brother & mother are not adverse b/c consent from both was not required

2. Retained Nonbeneficial Power to Alter or Amend

- a. §25.2511-2(c) – Where donor retains right to change beneficiaries — Gift incomplete

- i. §25.2511-2(f) – When donor releases right to change beneficiaries — gift complete

*Sanford's Estate v. Com'r* – TP creates trust & gives up right to revoke but retains right to change beneficiaries — Ct says transfer incomplete until TP released right to change beneficiaries

- ii. §25.2511-2(f) – If distribution is made — gift complete

- iii. §25.2511-2(e) – Where exercise of donor's right to change beneficiaries requires consent of a substantially adverse person — Gift complete

- iv. §25.2511-2(c) – If power to change beneficiaries is limited by fixed or ascertainable standard — gift complete

A) §25.2511-1(f)(2) – Fixed or ascertainable standard = clearly measurable standard under which holder of a power is legally accountable

- 1) Power to distribute corpus for health, education, maintenance or support
- 2) For reasonable support and conform
- 3) To enable beneficiary to maintain accustomed standard of living

B) Pleasure, desire or happiness — NOT fixed or ascertainable — gift incomplete

C) If donor is beneficiary & someone else is trustee

1) Ascertainable — incomplete

2) Non-ascertainable — complete

v. §25.2511-2(d) – Where donor ONLY reserves right to change manner or time of enjoyment — gift complete

A) If donor can only affect the time when the beneficiary receives property — gift complete

*Income to A whenever I feel like it for 10 yrs; remainder to A — gift complete b/c can only affect time when A receives property*

vi. If donor names trustee & retains right to change w/ himself or anyone “related or subordinate” — gift incomplete

*Right to Replace Trustee Ruling – Donor named trustee but retained right to replace w/ self — Gift incomplete if donor retains right to replace trustee w/ anyone related or subordinate b/c donor deemed to retain too much control*

A) “Related or subordinate” — employee

B) Most common language — donor retains right to replace trustee w/ anyone in the world except self or anyone related or subordinate

b. Analyzing non-beneficial enjoyment

i. Must look at powers actually retained by donor NOT necessarily what document says

ii. If trustee has absolute discretion — may be a problem

iii. If donor retains right to change/fire trustee — may be a problem

D. Annual Exclusion

1. §2503(b) – Annual Exclusion

a. Motivated by public policy

i. Gov’t doesn’t want to deal w/ this administratively

ii. Cushion for support – way to keep TP from being concerned where the line is

b. First \$10,000 per year/ per donee, limit is inflation adjusted to \$12,000 — no gift tax consequences

i. If single & 12 kids/grandkids — could give \$144,000 per year

ii. If married & 12 kids/grandkids — could give \$288,000 per year

c. Effect — NO gift & NO need to file 709

2. Present Interest Requirement

- a. Only interests of present value in property qualify for annual exclusion
  - i. §25.2503-3(b) – Present Interest in Property = an unrestricted right to the immediate use, possession or enjoyment of property or the income from property
    - A) Life estate
    - B) Term certain
    - C) Outright transfer
  - ii. Congress defines “present interest” — a current right to property
- b. §25.2503-3(a) – Future interests do not qualify for annual exclusion
  - i. Reversion
  - ii. Remainder
  - iii. Vested or contingent — No present interest exclusion for vested remainders
  - iv. Other interest in property that has possession, use or enjoyment at future point in time
- c. Income interest w/ distributions at trustee’s discretion — does NOT qualify for present interest exclusion
- d. Transfer of non-income producing property — may not qualify for annual exclusion

*Maryland Bank v. US – TP transferred interest family real estate pship to trust w/ 17 beneficiaries w/ right to income & set proportions for distributing income — Ct says gift did not qualify for present interest exclusion b/c there was no income for beneficiaries to enjoy*

3. Power to Demand Payment

- a. Transfer to trust where trustee has broad discretion to distribute P & I — does NOT qualify for present interest exclusion
- b. BUT addition of Crummey Powers generates a present interest
  - i. Each time contribution made to trust — Beneficiary has right to withdraw the lesser of \$12,000 or the proportionate amount of contribution
  - ii. Creates present interest b/c beneficiary has unrestricted right to immediate possession of the property
    - A) Trustee must pay if beneficiary requests money
    - B) BUT no one ever exercises power
  - iii. Can put time limit on Crummey powers (15 to 30 days) BUT must give beneficiary actual notice
  - iv. Crummey withdrawal right generates an annual exclusion

*Crummey v. Com’r – TP creates trust w/ minors as beneficiaries — Ct says parent may exercise withdrawal right on behalf of minor*

4. Ways to Generate Annual Exclusion for Adults
  - a. Outright transfer
  - b. Term of years or life estate
  - c. Crummey power
  
5. Present Interest Transfers to Minors
  - a. Outright transfers
  - b. Crummey Trusts
  - c. Uniform Transfer to Minors Act = UTMA – Statutory Trust
    - i. Primary way to make transfers to minors of property other than small amounts of cash
      - A) Qualifies for annual exclusion EVEN though kid doesn't have right to money immediately
      - B) Policy driven
    - ii. Each state has own UTMA – UTMA sets forth ...
      - A) When distributions can be made to beneficiary
      - B) Rights of beneficiary
      - C) Rules applicable to custodians
    - iii. Custodians
      - A) Obligations during trust term
        - 1) Right to transfer money to/for the HEMS of beneficiary
        - 2) If beneficiary gets money from other sources to satisfy HEMS — don't have to distribute
      - B) Obligations after trust term
        - 1) Majority — property must be distributed at age 21
        - 2) Minority — property must be distributed at age 18
      - C) Money paid to estate of beneficiary if he dies b/f trust term complete
      - D) Parents/grandparents afraid to let kids have money at age 18 or 21 so they spend money quickly for purposes described in statute
  - d. 529 Plans = IRC Statutory Trusts
    - i. Can transfer money to an account for own benefit or for someone else — to be used for education
      - A) Under §529 — transfers are completed gifts
      - B) Under §529 — transfer qualifies for annual exclusion
      - C) Can frontload 5 years of annual exclusion gifts in 1 year

- ii. ONLY for post-secondary education
    - A) If beneficiary dies or doesn't go to school
      - 1) Can change beneficiary
      - 2) Can take money out & pay income tax
    - B) Can only be used for education w/in the family
  - iii. When you fund account — all growth is tax-free
    - A) Income tax avoidance expires at the end of 2010
- e. 2503(c) Trust
- i. If you make transfer to a trust for the benefit of someone under 21 & the trust satisfies certain rules — transfer qualifies for annual exclusion
    - A) Very rigorous requirements – §25.2503-4
    - B) Prior to 21 — property must be expended for donee
      - 1) Can only have 1 beneficiary
    - C) At 21 — property passes to donee
    - D) If donee dies b/f 21 — property payable to donee's estate or as he appoints
  - ii. Advantages of 2503(c) Trust over UTMA
    - A) Used in states where UTMA property distributed at 18
    - B) Donee has right to extend the term of the trust
    - C) Inaction will allow money to stay in the trust
    - D) Donor can choose contingent beneficiary
    - E) Spending is left to discretion of trustee provided there are no substantial restrictions
- f. Guardian of Estate
- i. If you make an outright transfer to child BUT child cannot take title to property under state law — must go to court & get guardian appointed
  - ii. Guardian manages property for benefit of child
    - A) Bound by statute
    - B) Limited people can be appointed – CANNOT be family member
    - C) Regular accountings
    - D) Must petition for distribution
    - E) Expensive & time-consuming

#### IV. Back to the Estate Tax

- A. §2034 – Property passing to the surviving spouse — included in gross estate
1. Dower & curtesy – right to property from your spouse at death
  2. Property to surviving spouse satisfies state dower & curtesy laws
  3. Enacted in response to TP’s arguing that there was no transfer at death b/c of obligation to provide for surviving spouse attached at marriage
- B. The Power to Alter, Amend, Revoke or Terminate
1. §2038(a)(1) – Revocable transfer outstanding at death — included in gross estate
    - a. Decedent must transfer property during lifetime (by trust or otherwise)
    - b. Enjoyment of property at DOD was subject to change thru exercise of a power to revoke
  2. §2038(a)(1) – Transfer of property to irrevocable trust where grantor retains power to alter, amend or terminate trust — included in gross estate
    - a. Applies to non-beneficial interests – ability of donor to affect interests of beneficiaries  
*Porter – D retained right to make distribution to anyone other than himself or his estate — property included in D’s estate under 2038*
    - b. If decedent retains right to alter interest — property included in estate  
*Chase – D created trust & limited the people to whom a distribution could be made to issue — Ct says includible in D’s estate under 2038*
    - c. If decedent retains power to terminate trust — property included in estate  
*Holmes – D created trust & had the right to withhold income & right to terminate trust & distribute corpus to beneficiaries — Ct says trust included in D’s estate b/c D’s power to terminate was equivalent to power to revoke, alter or amend*
  3. Grantor’s Power is Unrestricted
    - a. §20.2038-1(a) – Where grantor ONLY retains power to affect time or manner of enjoyment — trust property included in estate
    - b. Transfer ALSO complete for gift tax purposes b/c donor ONLY reserved right to change manner or time or enjoyment — RESULT ...
      - i. Transfer to trust — pay gift tax
      - ii. At death — pay estate tax on appreciation
      - iii. Prepaid estate tax by paying gift tax
      - iv. Per se malpractice b/c making interest-free loan to gov’t  
*Lober v. US – D created irrevocable trust for each child; principal distribution at his discretion until age 25; entire trust to child at 25; if child dies b/f 25 to child’s estate — Ct says included in D’s estate even though child will receive property no matter what*

4. Grantor's Power is Restricted

a. Where donor can ONLY make distributions according to ascertainable standard — NOT included in estate

i. Ascertainable standard found in trust document

ii. OR state law

A) Ability to affect investments NOT a connection

B) Beneficiary has state law right to ask trustee to invest in something else

*Jennings v. Smith – TP set up trusts for sons; TP & sons are trustees; distributions can be made to maintain sons' station in life — Ct says ascertainable standard cuts connection b/t TP & trust for estate tax purposes*

b. Existence of adverse co-trustees is irrelevant for estate tax purposes

c. Interjection of a condition that does NOT exist at time of death — NOT included in estate

*Distributions can only be made at the end of the year; grantor dies in middle of year — NOT included in estate*

i. BUT power to alter, amend, revoke or terminate exist on DOD even though exercise of power is subject to precedent giving of notice; whether or not notice has been given - §2038(b)

5. 2038 Analysis

a. Piecemeal — not all or nothing

b. Look at how donor is connected to property at death

c. Cut all the strings you can

d. Is what donor is still connected to enough to pull property back into estate

C. Transfers with Retained Life Estates

§2036(a), (b)

1. Retention of the Possession and/or Enjoyment of the Property

a. §2036(a)(1) – Deals w/ decedent's beneficial interest in property

i. Gross estate includes value of all property that decedent transferred where decedent w/o paying adequate consideration retained ...

A) Possession or enjoyment of property

B) OR right to income from property

ii. Decedent's interest in property must be continuous from moment of transfer until death

A) Any break cuts off inclusion under §2036

- iii. Included under §2036 if decedent retained beneficial interest for ...
  - A) Decedent's life
  - B) Any period not ascertainable w/o reference to decedent's death – life estate pur autre vie
  - C) OR any period that does NOT in fact end b/f decedent's death
- b. If decedent transfers property to family member & retains sole possession of property after the fact —
  - i. Almost irrefutable presumption that it was prearranged
  - ii. AND property will be included in decedent's estate under §2036(a)(1)

*Linderme Estate v. Com'r – TP transfers title to home to 3 sons; TP made complete gift of property; TP lived alone in house until he went to nursing home; house vacant when TP died — Ct says includible in estate under §2036(a)(1); don't need legal right to possession or enjoyment; a preexisting understanding that there would be possession or enjoyment is enough for inclusion*

- c. If decedent gives adequate consideration in money or money's worth for retained beneficial interest — not included in estate under §2036

*Maxwell v. Com'r – D transferred house to son; D received note from son; son leased house to D for fair market rent; on same day of sale; D forgave annual exclusion amt as gift; & forgave annual exclusion amount each year until she died; at death she forgave remainder of loan in a Will drafted 3 days after sale; Rent payment & mortgage interest matched each other — Ct says no adequate consideration b/c rent payments lacked substance b/c they matched mortgage payments & D & son never intended mortgage to be paid*

## 2. Retention of the Right to Control the Possession or Enjoyment of Property

- a. §2036(a)(2) – Deals w/ decedent's non-beneficial interest in property
  - i. Gross estate includes value of all property that decedent transferred where decedent retained right to designate person who will ...
    - A) Possess or enjoy property
    - B) OR receive income from property
- b. If decedent can affect enjoyment of income of property —
  - i. All principal that is generating income is included in estate — decedent's connection to income pulls principal back in
  - ii. If decedent chooses to accumulate income — accumulated income included in estate
  - iii. All or nothing approach

*US v. O'Malley – TP set up trusts; income to beneficiaries at trustee's discretion; any income not distributed accumulates — Ct says includible in TP estate b/c TP made transfer to trust of income he chose not to distribute & continuously had ability to affect income*

c. §2036(b) – Retention of the right to vote shares of stock = retention of enjoyment of transferred property — stock included in estate

i. Enacted in response to Byrum — BUT only solves Byrum issue

ii. Wildly overbroad

iii. Underinclusive b/c

- A) Can give away stock & retain majority as long as you don't keep right to vote
- B) Only deals w/ stock in corporations

*US v. Byrum – TP had voting control in 3 corps; transferred stock in corps to trust; TP retained voting power over stock transferred — Ct says voting control connection does not make shares includible in TP's estate*

d. Family Limited Partnerships

i. Advantages

- A) Value of property is discounted due to lack of control & marketability
- B) Family control of transferred property
- C) Removes property from estate of transferor

ii. Strangi Scenario – Turning gold to straw

- A) TP transferred \$ to corp for 47% interest;
- B) Kids transferred \$ to corp for 53% interest;
- C) Corp transferred holdings to FLP for 1% general pship interest;
- D) TP transferred \$ to FLP for 99% limited pship interest;
- E) TP's executor took 33% discount for TP's interest in FLP due to lack of control & marketability —

iii. 2036(a)(1) Inclusion

- A) Implied agreement b/t TP & kids to allow TP to retain economic benefit of the property
- B) TP retained full possession & enjoyment of income & right to income
- C) Full value of transferred property included in estate

iv. 2036(a)(2) Inclusion — TP retained right to affect other beneficiaries' interests

- A) TP had power to terminate FLP b/c unanimous consent required
- B) TP had power to determine distributions thru his attorney-in-fact
- C) TP's right to control NOT the same as in Byrum b/c TP fiduciary duty only ran to 1 outside s/h

v. Valuation Issues

- A) Taking something easy to value & turning it into something difficult to value
- B) Limited partnership interest not as marketable as FLP underlying assets — valuation discounts

e. Reciprocal Trust Doctrine

i. Elements to prove trusts are reciprocal

A) Each settlor creates trust for the benefit of the other settler

B) The 2 trusts are interrelated; AND

- 1) Between family members
- 2) Tax benefit (reduction in taxes)
- 3) Executed contemporaneously
- 4) Substantially similar terms (very few words different)

C) The transfer must leave the settlors in approximately the same economic position as before the transfer

- 1) Not necessary to find that each trust was created as a quid pro quo for the other
- 2) Subjective intent of parties to avoid estate tax — irrelevant
- 3) Only economic value is relevant
- 4) Does not matter that transferred properties were different in character

ii. Effect of finding reciprocal trusts

A) Same tax consequences as if donors were flipped — BUT only to extent of mutual consideration

- 1) 2036(a)(1) inclusion
- 2) Maybe 2038 inclusion
- 3) Applies gift & estate purposes
- 4) Applies to annual exclusion gifts

*US v. Grace's Estate – H & W created trusts for each other's benefit w/ substantially same terms — Ct says value of trust created by W included in H's estate b/c trusts were reciprocal so included in H's estate under 2036(a)(1)*

3. Chapter 14 – Valuation of Taxable Transfers

a. Grantor Retained Income Trusts (GRITs)

i. Scenario: Irrevocable transfer; income to grantor; remainder to family member — Gift of remainder to family member

ii. Problem — TPs leverage gift tax payments by investing in something that will outperform AFR AND completing the gift early

iii. Solution – Valuing Remainder under §2702(a)

A) The value of interest retained by grantor = 0 if NOT a qualified interest

1) Cannot reduce value of transfer by actuarial value of retained interest UNLESS interest is qualified

2) Retained income interest NOT a qualified interest

B) Applies to GRITs for family members

- C) Can still use GRITs for non-family members
    - iv. Advantages of Tiered GRITs
      - A) Tiered GRITs = Series of GRITs w/ differing lengths
      - B) Allows easing into investment
      - C) To play off AFRs (short-term, mid-term, long-term)
      - D) If grantor dies during term of GRIT — entire trust in grantor's estate under 2036(a)(1)
      - E) You only pay gift-tax on the remainder
  - b. §2702(b) – Qualified Interest
    - i. §2702(b)(1) – Grantor Retained Annuity Trust (GRAT)
      - A) Fixed payment = qualified interest
      - B) Pays a fixed amount (an annuity) to grantor
      - C) Remainder to family member
      - D) Pay gift tax on remainder only
    - ii. §2702(b)(2) – Grantor Retained Unitrust Trust (GRUT)
      - A) Payment of fixed percentage of FMV = qualified interest
      - B) Pays a fixed percentage of FMV of trust to grantor
      - C) Remainder to family member
      - D) Pay gift tax on remainder only
      - E) If investment increases — benefits grantor
      - F) NOT as popular as GRAT b/c harder to get money to remainderman
  - c. In Practice – Advise client to call CPA or investment advisor after creating GRAT or GRUT
  - d. Qualified Personal Residence Trust (QPRT)
    - i. Another 2702 exception related to the kind of property transferred
    - ii. TP can use actuarial tables to value remainder interest in personal residence
    - iii. Downside — volatile market
- D. Transfers Taking Effect at Death
  - 1. §2037 Scenario
    - a. Grantor creates trust
      - i. Income to S for life
      - ii. Reversion to grantor if he survives
      - iii. If grantor does not survive — remainder to X
    - b. Grantor makes gift of ...
      - i. Everything except Reversionary interest – Life estate to S AND Contingent remainder to X

- ii. Look at 2031 to value
- iii. Need to know relative ages of S and grantor to value gift

*Smith v. Shaughnessy* – TP creates trust; income to W for life; reversion to TP; remainder to W's heirs — Ct says TP made gift of everything except reversionary interest

- c. If grantor dies after S — appreciated value of property to the extent grantor hasn't consumed it — included in grantor's estate
- d. §2037 created to address situation where grantor dies b/f S
- e. Reversionary interest = possibility that D's transferred property may return to D or D's estate

*Thacher v. Com'r* – H creates trust for W; W's income interest could end if divorce — Ct says H had reversionary interest b/c of possibility of divorce

## 2. Valuation of the Reversionary Interest

- a. §2037 – If D has reversion — value of the property that goes to remainderman is included in D's estate
  - i. Remainder Value =
    - A) Value of property at D's death
    - B) MINUS S's remaining income interest
  - ii. Pulls back contingent remainder into D's estate
  - iii. Credit for gift tax paid on contingent remainder
- b. §2037 can also arise if no disposition of property after S's income interest

## E. "Adequate and Full Consideration" Exception

- 1. §§2036, 2037 & 2038 have exception for adequate & full consideration
- 2. If D makes a transfer & keeps a connection & no appropriate tax consequence associated w/ transfer — will be included in D's estate

*D'Ambrosio v. Com'r* – D transferred stock to corporation & received retained income interest & an annuity in return — Ct says sale of remainder interest for FMV constitutes full & adequate consideration

## F. Survivor Annuities

- 1. §2039 – Gross estate includes value of any annuity or other payment under any form of contract or agreement
  - a. "Other payment" = ANY other payment after death
    - i. Lump sum
    - ii. Annuity payment

- b. Must have a contract or agreement under which ...
  - i. D has right was receiving payment OR possessed right to receive payment
  - ii. AND someone else gets payment at D's death
- c. Thing being transferred is a right under a contract

*Schelberg's Estate – D's wife receive payment after death — Ct says no contract or agreement that provided D w/ some benefit & the benefit to D's wife at his death so not taxable under 2039*

- 2. §2039 applies to ...
  - a. Survivor annuities = transfer sum of money & in return receive payments for your life & your spouse's life
    - i. At first spouse to die's death — property passes pursuant to contract
    - ii. Joint & survivor payment usually made in connection w/ employment
  - b. Private annuities
  - c. Employment benefits
  - d. Most retirement benefits taxed under §2039 are qualified plans

#### G. Jointly-Held Interests in Property

- 1. §2040(b) – Spousal Joint Interests
  - a. Property owned jointly w/ spouse ONLY — one-half included in D's gross estate
  - b. None subject to tax b/c of unlimited marital deduction for outright transfers
  - c. §2040(b) necessary b/c of adjustment in basis received for D's interest in property
- 2. §2040(a) – Non-Spousal Joint Interests
  - a. Gross estate includes value of all property owned as JTROS to extent of D's interest therein
    - i. Applies where property is owned by 2 joint tenants (non-spouses) or more than 2 joint tenants
    - ii. Interest does not pass by Will or intestacy under 2033
  - b. Rebuttable presumption: Entire value is in D's estate EXCEPT to extent Executor can show property originally belonged to someone else
    - i. Must trace back acquisition of property to original consideration
    - ii. If Executor can show equal contribution (50/50) to buy property — one-half included in D's estate
  - c. §20.2040-1(c) – Tracing Examples
    - i. M gives stock to C; later M & C open joint account; M gives cash & C gives stock — everything included in M's estate
    - ii. Unrecognized Gain – M gives stock to C worth \$100; M & C open joint account; M gives cash & C gives stock now worth \$200 — all in M's estate; no credit for appreciation while stock owned by C

- iii. M gives stock to C; M & C open joint account; M give \$100 cash & C gives \$10 dividend on stock — only \$100 included in M's estate
- iv. Recognized Gain – M give house to C worth \$25,000; M & C open joint account: M gives cash & C gives proceeds from sale of house worth \$32,000 — only cash from M included in estate

*Goldsborough's Estate – M gave house to C worth \$25,000; M puts cash in joint account; C puts proceeds of sale of house in joint account(\$32,000) — Ct says post gift appreciation is C's independent consideration; by selling house C mitigated inclusion of appreciation in the estate*

- v. For income tax purposes — TP will be taxed on 100% of income if TP contributed 100%

*Friedman v. Com'r – M put her stock in casino into acct w/ son (JTROS); stock soled at huge profit; M included only one-half on income tax return — Ct says 100% M b/c she contributed everything*

taxable to

## H. Powers of Appointment

### 1. General Power of Appointment

- a. §2041(a)(2) – Gross estate includes any property w/ respect to which D had at the time of his death a general POA
  - i. §2041(b)(1) – General POA = power which is exercisable in favor of D, his estate, his creditors or the creditors of his estate
  - ii. If any one of these is authorized under trust document — all included in D's estate
  - iii. Power to make withdrawals for any reason = General POA
  - iv. Limited POAs not included in estate

*Estate of Kurz v. Com'r – H creates 2 trusts for W; H dies; Trust 1 income to W & principal whenever W asks; Trust 2 income to W & 5% of principal whenever but only if Trust 1 depleted — Ct says Trust 1 is general POA & in W's estate & 5% of Trust 2 b/c W was solely responsible for removing impediment b/t her & Trust 1*

- b. §2041(b)(1) – Three Exceptions to General POA Rule

- i. Ascertainable standard related to HEMS — NOT general POA
- ii. Require approval of distributions by settler
- iii. Require approval of substantially adverse person

### 2. Release and Lapse of Power

- a. If you do NOT want a general POA ...
  - i. Disclaimer (but must be w/in 9 months)
  - ii. Take money out of trust & dispose of it (but gift tax consequences)

- iii. Release = Unqualified Disclaimer
- b. Release
  - i. Property will go where trust says it will go
  - ii. §2514(b) – Exercise or release of general POA is transfer of property — gift
  - iii. Lapse of power = Release
- c. Lapse of General POA
  - i. Crummey power = lapse of general POA
    - A) Lapse of Crummey withdrawal right = gift to trust by Crummey beneficiary
  - ii. §2041(b)(2) – De minimis safe harbor for lapses
    - A) When general POA lapses — you make a release which is a gift back to the trust ONLY to the extent the amount of your release exceeds the greater of
      - 1) \$5,000
      - 2) OR 5% of the trust
    - B) Lapse = Release = Gift only to the extent lapse exceeds greater of \$5000 or 5% of trust
- d. §2041(a)(2) – If as a result of exercise or release appointed property ends up in a vehicle that would have been in your estate if you had used your own money — included in estate

*A has general POA & exercises power by telling trustee to take property from old trust & put it into new trust; new trust – income to A for life; remainder to B — included in A's estate under §2036(a)(1)*