• Policy of Estate Tax –
  o For – Revenue; Redistribution of Wealth; Encourages Socially Desirable Giving; Reduces Incentives for Heirs; Vast Disparities in Wealth Could Create Social Problems
  o Against – Double Taxation; Disincentive to Saving; Decrease Productivity; Harmful to Work Ethic; Trap for Unwary; Costs of Estate Planning

• Estate of Bosch p. 16-- “Where the federal estate tax liability turns upon the character of a property interest held and transferred by the decedent under state law, federal authorities are not bound by the determination made of such property interest by the state trial court.” The federal government might be bound by a state proceeding if it were a party, if there was a real dispute, or if the decision is by the state supreme court.

• 2031 – Value of the gross estate is the fmv value at the time of death of all property, real or personal, tangible or intangible, wherever located. The gross estate is made up of all assets drawn in by 2033-2044.

• 2033 – “The value of the gross estate shall include the value of all property to the extent of D’s interest at the time of his death.” Property is kept fluid – one definition would be Property is everything of value that a person owns and is subject to sale.

• Under 2033, an illegal interest in property (illegal drugs or stolen artwork) can be taxed by 2001.

• 2034 – “The value of the gross estate includes the full value of property without deduction for dower, curtesy, or elective/forced share. However, in community property states each spouse has a vested ½ ownership interest in property, so only that ½ interest of D is included in the gross estate.

• 1014(b)(6) – equalizes treatment between common law and community property by giving the surviving spouse in a community property state a stepped up basis to the fmv value of the property at the date of death. This is the same treatment that the Tax Code would give a surviving spouse who got a fee simple in property through the will of a deceased spouse. But, for tenancy in common ownership, the surviving spouse does not get to step up the deceased’s ownership interest – no special rule. Also,
1014(b)(9) if there is a survivorship right, then the surviving spouse’s interest is not taxed.

- 2041 – Forces inclusion of property that D had a general power of appointment over either by will, trust, or other device. This statute forces inclusion even if D was incapable of exercising the POA because of infirmity or incapacity. However, there are a number of exceptions –

- 2041(b)(1)(A) – A power to consume, invade, or appropriate property for the benefit of the D which is limited by an ascertainable standard connected to the health, education, support, or maintenance of the D is not a general POA. 2041(b)(1)(C) – if the POA is only exercisable in conjunction with another person, and subject to other limitations.

- The ascertainable standard of 2041(b)(1)(A) has been read broadly and p. 66 offers a test – (a) is the standard for invasion “ascertainable” and (b)does the ascertainable standard relate to the D’s health, support, or education? You need an ascertainable standard to allow enforcement of fiduciary duties under state law.

- Powers of Appointment – Are defined for federal tax purposes in 2041, but state law can define powers of appointment as well.
  
  - general power of appointment – a power exercisable in favor of the decedent, his estate, his creditors, or the creditors of the estate.
  
  - Special power of appointment – Are either inter vivos – can be exercised during the life of the donee or testamentary – are created by will and D must appoint someone by will.

- For tax purposes, we look to the document creating the power of appointment – not to D’s capacity or desire to exercise the power. Only property subject to a GPOA is includible under 2041(a)(2) – this includes a testamentary POA b/c D can use that power to benefit their estate. Special POA can be taxed under 2041(a)(3).

**Valuation Issues**

- 2031 -- forces valuation at the time of death; 2032 – allows an executor to elect to value the estate six months after D’s death; 2032A – Provides special valuation for estates that hold large amounts of real estate used for farming or in a family business. 2057 – deduction for family owned businesses. Use of 2032 and 2057 requires a
family member to run the business or farm the land for ten years or it will be retaxed – 2032A(c) and 2057(f).

- **Common Valuation Discounts**
  - Minority Ownership – lack of control depress value (rev. rul. 93-12 (p. 78)
  - Blockage – flooding the market depresses value (§20.2031-2(e))
  - Restricted Market – fmv determined by comparision to actual market
  - Liquidation Restrictions – inability to sell shares/partnership – see 2704
  - Partial Interests – either concurrent (Estate of Bonner p. 118) or successive (see § 7520 for actuarial valuation)

- T often try to create valuation discounts through dividing the ownership between trusts and other family members – there is no constructive attribution to eliminate a valuation discount.

- § 2031(b) – tells how to value stock in close corporations.

**Deductions**

- **§ 2053** – Gross estate can be diminished by administration expenses (atty fees, fees for selling property), funeral expenses, claims against the estate, and unpaid mortgages.

- There can be a difference between “allowed” expenses under state law and “allowable expenses” under 2053 – ex: executor that sells off estate assets over years might not get to deduct the fees paid to sell all of the assets. (p. 94) This is not totally accepted.

- Furthermore, an estate can not deduct fees paid to settle non-deductible claims ex: a claim by a relative that the decedent promised him money. Generally, the estate may deduct administration expenses in connection with property includable in the gross estate, but not subject to probate – ex: attorneys fees and trustees’ commissions.

- **Funeral Expenses** – if local law allows, then funeral expenses can be deducted.

- **Claims and Mortgages** – estate can deduct enforceable claims against the estate that are personal obligations of the decedent or on mortgages or property within the estate. The liability must be a bona fide debt and in community property only ½ of the debt or fee is deductible.
• **2053(c)(1)(a)** – only allows claims based on full and adequate consideration to qualify rather than claims for gratuitous gifts or other valid K under state law to prevent depletion of the estate.

• **2054** – lets the executor deduct casualty losses that occur after death that are not compensated for by insurance.

• **2055** – The Marital Deduction equalizes treatment between community and common law property jurisdictions by only taxing what was transferred. To get the marital deduction you need (1) decedent and surviving spouse are US citizens (2) surviving spouse still exists (3) property or an interest therein must pass to surviving spouse (5) property transferred must be included in the gross estate (6) surviving spouse must have deductible interest.

• If the surviving spouse is not a US citizen, then 2056A creates a Q-DOT for them.

• A deduction is disallowed under 2056(b)(1) if the surviving spouse’s interest will terminate or fail with the passage of time, if the property has passed for less than full consideration, or once the spouse’s interest terminates then another party gets the property. There are a number of exceptions to the terminable interest rule in 2056.

• **2056(b)(3)** – allows D to condition receipt of property to spouse surviving deceased for six months and lets D condition acceptance on spouse’s death from causes other than a common disaster with D.

• **2056(b)(5)** – permits a trust to qualify for the estate tax deduction if (a) trust income is payable to spouse (b) no other party is a beneficiary if spouse is alive (c) spouse has general power of appointment for the spouse or spouse’s estate – there can be no substantive restriction to qualify under 2056(b)(5).

• **2056(b)(7)** – allows a deduction for qualified terminable interest property dispositions. This is created when spouse has exclusive right to income from the trust property for life, the executor elects to put estate property in the QTIP trust, and no person can appoint any interest in the property to anyone but the spouse. However, D controls who can inherit the property and the appointment of property can be made after D, so the executor can decide the best treatment for the estate.

• **2044** – Is a special taxation section set up to include the value of the QTIP property in the surviving spouse’s estate – the QTIP is tax deferral, not forgiveness. If the
surviving spouse tries to give away her interest in the trust, then 2519 will tax the QTIP property under the gift tax. There is a special exception for the QTIP property— if D gives the spouse a non-income producing property like art, then the spouse must have the power to make the assets income producing or it will not qualify for the deduction.

- To get a deduction for non-income producing property, the D can convey property into an estate trust. The surviving spouse has the only beneficial interest in the trust and the assets pass into the spouse’s estate.

- A QTIP plan can create a valuation discount by allowing the value of property to be split up between a surviving spouse and the trust, but then when the spouse dies the fractions will be reunited in the heirs, but since value is assessed at death there will be a discount because ownership is split up.

- When a surviving spouse does not insist on the full value of the marital deduction, a taxable transfer can result for the amount that the spouse declined to take. Ex: Will calls for $200K to go to W, but to pay that amount the executor will have to sell of the house. W declines to take $200K and only takes $140K. W has made a gift to the heirs of $60K, but the estate gets the $200K deduction.

- Valuation can be problematic with the marital deduction because the value of the marital deduction is value of property going to the surviving spouse is the net value of any deductible interest – very confusing see p. 123. See 20.2056(b)-4(d).

- 2055 – allows for an estate deduction for some transfers to qualifying charitable organizations. The structure of the transfer is controlled by the statute.
  - A split-interest devise – portion not left to the charity exists to benefit a non-charitable beneficiary – but only a portion of the devise qualifies for deduction
  - Charitable Remainder Trust – makes a distribution at least annually to at least one non-charitable beneficiary for a term of years with an irrevocable remainder to go to charity – the trust will not qualify if a person has the power to alter the amount paid to the non-charitable beneficiary.
  - Charitable Remainder Annuity Trust – D devises property to trust providing an annuity for the benefit of at least one noncharitable beneficiary w/ the
remainder going to charity. The trust has to pay a certain sum to one noncharitable beneficiary.

- **Charitable Remainder Unitrust** – D devises a present interest in a qualified unitrust to a noncharitable beneficiary with the remainder to a charitable organization. Strict valuation rules and there is a variable annual payment.

- **Charity and QTIP** – A D could make a QTIP 2056(b)(8) with the remainder going to a charity – the QTIP property is included in the spouse’s estate, but then is removed due to the charitable deduction.

- **Pooled Income Fund** – D devises property to the fund providing a life income interest in the property to the fund, providing a life income interest in the property for at least one noncharitable beneficiary and contributing the remainder to a 50% charitable organization as defined in 170(b)(1)(A).

- **Partial Interest Contributions** – To get a deduction the devise of a remainder interest in a personal residence cannot be in trust – the devise must be of the property itself, not the proceeds of the sale or the property.

### Credits

- **2010** – exempts “small estates” from taxation by comparing the present estate’s tax from the statutory exemption level. **The major credit.**
- **2011** – allows a credit against the federal estate tax for payment of state death taxes paid on property in the gross estate – this is a form of revenue sharing between the states and federal gov’t. **But, 2011(b)(2) shrinks the credit for state taxes**
- **2012** – in certain circumstances an estate can get a credit for certain gift taxes paid during D’s life – must be a gift under 2035-2040 or 2042.
- **2013** – a tax on prior transfers (TPT) might be applicable if D has gotten property from a person whose estate paid an estate tax on a prior transfer of property.
- **2014** – an estate can get a credit for taxes paid to another country for property located in that country.

### GIFTS

- **Comm v. Wemyss** – “Gift” for gift tax purposes means any transfer at less than adequate consideration – there is no question of donative intent. This is reinforced by
the fact that the estate and gift tax systems are intended to be viewed together, so the consideration paid must benefit the donor or decedent in an amount equal to the property transferred. The gift tax also helps backstop the progressive nature of the income tax along with the transferred basis of the donor.

• A gift becomes final and thus locks in its value and creates an obligation to pay a tax when the donor/settlor gives up all control to alter the gift. “The donor must relinquish sufficient dominion and control so that it (the gift) is not long subject to his will.” Estate of Sanford and Burnet v. Guggenheim, p. 165.

• Both cases tell us to view the estate and gift tax as pari materia.

• The gift tax only applies if there has been a transfer or property that is a gift – thus, when a parent makes an interest free loan to a child it is a gift and 7872 treats the child as transferring an imputed amount of interest to the parent, and then the parent gifting it back to the child. Further, the gift of services is not taxable since the services are not property.

• For there to be a taxable gift, there must be some act by D that qualifies as a transfer in property. But, 2514 – treats an exercise or relapse of a general power of appointment as a transfer of property and 2515 -- any generation skipping transfer tax on direct skip transfers are added to the value of the transferred property

**Exclusions**

• 2513 – lets married taxpayers treat gifts to 3rd parties as being made one-half by each, so this allows a couple to give $20K in a year and double the annual unified credit equivalent.

• 2516 – exempts transfers of property caused by a divorce settlement from gift tax.

• 2503(b) – allows a donor to exclude $10K per donee for a gift of a present interest. Gifts of future interests do not get any deduction – the test is can the donee/beneficiary demand its present distribution? If the donee can control a contingency that will make an interest “present”, then it gets the present interest exclusion.

• 2503(e) – excludes from gift tax payments of tuition to qualified educational institutions or expenses paid to the providers of medical services

• 2501(a)(5) – exempts transfers to political organizations from the gift tax
• Generally, a gift into a trust for someone’s benefit is generally a future interest – there are two main ways around this rule
  • **Crummey Trust** – (p. 194) a transfer into a properly drafted trust that allows the donee to withdraw, for a limited period of time, each new transfer into the trust made by the settlor. The donee needs sufficient notice and a reasonable time to exercise the withdrawal power. The exclusion will not be allowed if there is any evidence that withdrawal by the donee is discouraged or barred by other means.
  • § 2503(c) – makes any transfer to a minor qualify for present interest treatment
  • **Disclaimers** – 2518 and 2045 apply to disclaimers for transfers under the estate and gift tax. Disclaimers can be very important because they can act as post-mortem estate planning. Children can disclaim an inheritance that then passes to the mother and taxation is deferred by the marital deduction. This allows both estates to use the unified credit. Another option is that an executor in high income tax bracket (who is the heir of the D) can disclaim his fee (which is taxable) and get the money; however, the executor can not disclaim any interest in property and have the interest pass to his self.
  • 25.2511-1(e) – If the donor gives a gift and retains an interest in the property and the retained interest is not susceptible of measurement based on accepted valuation techniques, then it is taxed on the entire value of the property.
  • 2702 – provides valuation rules for certain grantor retained interests – the rule is that unless the grantor retained interest is one of the ones listed in the statute, then the retained interest is given a zero value. The rule applies if the retained interest is retained by the grantor, his spouse, or the ancestors of either. Qualifying interests
    • an interest like an annuity -- the right to get fixed amounts at least annually
    • an interest consisting of the right to get payments not less than annually that constitute a fixed percentage of the fmv of the property
    • a noncontingent remainder after an annuity or unitrust interest
  • These “qualified interests” are valued using 7520 so the gift is the difference between the value of the transferred property and the value of the retained interest.
  • 2702(a)(3)(A)(ii) – creates an exception for a trust consisting of a personal residence used by persons holding term interests in the trust.
• **2701** – prevents the tax free transfer of value of stock in family companies.

**Gift Tax Deductions**

• **2522** – allows a deduction for most gifts to qualified charities – the problem occurs with split interest transfers. For example, if donor transfers an income interest to a child and the remainder to charity – the income interest is taxable based on actuarial valuation.

• **2523** – Donor can deduct the value of all gifts of property to the donee spouse without limit, as long as the spouse is a US citizen and the interest passes the terminable interest test. You can have a QTIP trust for gifts, and 2519 taxes any transfer of a spouse’s QTIP interest. The donor can retain an income interest in the QTIP assets and like the estate QTIP control the power of appointment. P. 217

• **2524** – limits deductions to the extent that gifts are included in the amount of gifts against which such deductions are applied. So you can give a gift to your wife and get a $10K credit.

• Gifts that are improperly valued can be included in the gross estate at the death of the donor at the fmv at the date of death even if the SOL on tax on the gift has expired. **6501** forces a filing of a return for gift tax – IRS has a three window to challenge. If you never file, then there is no SOL. If you do not provide adequate disclosure but do file, the IRS can not challenge after three years. See 2001(f). 301.6501(a)-1(f)(2) – provides the def of adequate disclosure.

**GST p.220**

• **2601** – imposes a tax on generation skipping transfers after Oct. 1986. 3 transfers
  • **direct skip** – a transfer to a skip person of an interest in property that is subject to gift/estate tax 2612(c)(1). Transfers in trust can also count as direct skips.
  • **taxable termination** – 2612(a)(1) – the termination of an interest in property (2652) held in trust is a taxable termination unless immediately after such termination a non-skip person has an interest in such property or the rare exception of 2612(a)(1)(B). Entire corpus is usually taxed under 2622(a).
  • **taxable distribution** – any distribution from a trust to a skip person (other than a taxable termination or a direct skip). 2612(b) – the trust’s payment of GST taxes
on the taxable distribution from the trust constitutes an additional taxable
distribution 2621(b)

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<td>2623</td>
<td>2603(a)(3) tax exclusive</td>
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<tr>
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<td>2612(b)</td>
<td>2621(a)+(b)</td>
<td>tax inclusive 2603(a)(1)</td>
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- **2602** – tax is imposed by multiplying the transfer’s taxable amount by the rate
- **2652** – we must identify the transferor – one who was last subject to estate/gift tax
- **2613** – we must find out info on the skip person – anyone 2+ generations under 2651
- **2612(c)(1)** – direct skip is a transfer to a skip person of an interest in property that is subject to gift/estate tax. Example of how a direct skip is taxed
  - Grandparent, having exhausted the GST exclusion, gives $100K to a grandchild. GP is in the 55% tax bracket. Grandparent as donor incurs $55K in gift taxes on the transfer. Also the transfer of $100K is taxable under GST and Grandparent owes $55K for GST purposes. However, 2515 requires any taxable gift to be increased by any GST tax owed by the transferor on a direct skip gift. So under 2515, the taxable gift is $155,000 and the gift tax imposed is $85,250 (the original $55K plus a $30,250 gift tax on the amount of the $55K GST tax). Thus, the total tax is $140,250, so GP had to expend $240,250 for the grandchild to get $100K. **Note** this is the same result that would be reached if GP transferred $155K to Child and pays a tax of $82,250, then Child transfers the $155K to child and pays $55K in gift taxes.

- **Exceptions to GST**
  - Direct skips that excludable gifts 2642(c)
  - Transfers for Medical Care or educational purposes 2642(c)/2611(b)(1)
  - Transfers to children of deceased child 2651(e)
  - Lifetime exception from GST 2631(a)
Transfers Near Death

- **2035** – looks back at transfers made by D in the prior three years if the interest would have been includable under 2036, 2037, 2038, or 2042.
- **2035(b)** – requires inclusion into the gross estate of the amount of gift tax paid by the D within 3 years of date of death.
- **2702** – If a grantor transfers a remainder interest in property to a member of the grantor’s family, while retaining some interest in or control over property, 2702 applies to value the grantor’s retained interest at 0 – this only applies when there is an incomplete gift or there was a gift of only part of the grantor’s interest. There are a number of exceptions to 2702 – see pg. 260.
- **2036(a)(1)** – taxes property whether the retained interest is (1) for the life of the D (2) for a period not ascertainable without reference to D’s death or (3) for a period which does not end before his death. The most common example is when a donor keeps a life estate in gifted property – 2036(a)(1) will include the full fmv value of the property in donor’s estate when donor dies.
- **1014(e)** – prevents basis laundering – ex: A gives property to a relative who is near death – relative devises property to A upon death, so A’s basis is stepped up to fmv at date of relative’s death – 1014(e) prevents this.
- **20.2036-1(a)** – In a secondary life estate situation, that the gross estate includes the value of the entire trust property “less only the value of any outstanding income interest which is not subject to the D’s interest or right and which is actually being enjoyed by another person at the time for the D’s death.
- **Gokey v. Comm** (p. 269) – D created two trusts for his children with income to be dispersed by the trustee for the beneficiary’s “support, care, welfare, and education.” Since this trust would satisfy the parental obligation of D, if D refused to support the children, then the corpus of the trust is includable under 2036(a)(1) and 20.2036-1(b)(2) as “support trusts.” Similarly, D can not create a trust corpus to B, but an income interest in the trust to creditors of D – D has retained the benefit of the trust.
- What happens if the trustee can distribute income to D although there is no obligation to do so? If it is only discretion, then the corpus is not included when D dies under
2036(a)(1), but D can not instruct the trustee on who to pay without inclusion under 2036(a)(2). There are income tax consequences to discretionary trusts under 677.

- **McNichol v. Comm** (p.273) – D conveyed the property in question away, but per an oral agreement with child continued to get the income from the property. Under 2036(a)(1) the property was included in D’s estate b/c he retained the benefit of the property.

- **Wheeler v. United States** (p.278) – Although the Service disagrees, the court approved excluding a life estate from the gross estate that was created in a sale to adopted children. The children paid the actuarial value for the remainder to D at the time of sale. So, under 2036(a) they gave full consideration for the sale b/c the amount paid should have equaled the entire fmv value of the property at the time of sale when D died. This is just like 2512 for the gift tax where consideration equal to the actuarial value of the remainder interest is adequate consideration.

- **Estate of Grace** (p. 290) – When H and W create interrelated trusts, the Sup. Court says that we should look through the transaction to see what is really going on.

- **Estate of Spiegel** (p. 305) – Through poor drafting, D left an implicit reversion in a trust document. Under the former version of 2037, the full value of the trust had to be included – this has been changed in the current version of 2037 that would only have included the corpus if (a) the reversion was explicit and (b) had a value worth 5% of the corpus.

**Revocable Transfers**

- Retaining the power to revoke makes the transfer an incomplete gift 25.2511-2 and **Burnet v. Guggenheim**. Examples of this would be life insurance policies where the beneficiary is changeable. The biggest problem here is when a donor gives a personal check to a donee as an annual exclusion gift – see pg. 318.

- If you tie the right to inherit to something closely connected with the death of the settlor then courts will look at “substance over form” and use 2037.

- **Income Tax** -- When a donor retains a power of revocation there is no completed gift, and Congress treats this just like fee simple ownership – income from the property is taxable to the donor under 676. But what happens if there is some restriction on the power of revocation?
• **For gift tax purposes**, Camp on p. 320 and 20.2511-2(e) control – If someone holds a substantial adverse interest, then there might have been a completed gift. However, the result is totally different under the estate tax, 2036(a)(2) and 2038(a) do not care what restrictions are placed on it – the value is included in the gross estate.

**Contingent Power of Revocation**

• Income Tax – 676(b) – look at probability of revocation – if it seems likely then donor has a conditional reversion and the income is taxable to donor and is a gift to the donee.

• Gift Tax – If you can take it back, has there been a completed gift? Sort of – courts reduce the fmv value of the gift based on the possible reversion to create a reduced value gift.

• Estate Tax – This situation falls between 2038(a) and 2036(a)(2), but when a settlor retained the power to change the trustee and the trustee could designate the beneficiaries, then under 2036(a)(2) the trust was included. See 20.2036-1(b)(3)

**Power to Change Beneficial Interests**

• 2038 is triggered even if D only can amend or alter the terms of the trust under trust law, then 2038 will force inclusion of the corpus. 20.203-1(b)(3) says the same thing. Even retaining oversight on who and how beneficiaries take is enough for estate tax inclusion

• When powers are retained, there is a difference between unrestricted powers by a trust settlor to distribute corpus or retain income as trustee and keeping those powers subject to an ascertainable standard. If the power is limited by an ascertainable standard, then there will be no inclusion under 2036(a)(2) or 2038. (Pg. 348)

**Considerably litigated.**

• Even when the trustee’s income and principal beneficiaries are the same group of people, the ability of the trustee/settlor to close the trust or pay out income as he wished was subject (at settlor’s death) to change – so 2038 forces inclusion. Uncertainty if 2036(a)(2) applies b/c there can be no right of designate the taking. Lober on 360.

• What happens when S retains the power to remove or appoint the trustee? Is this includable in the estate? If limited to an ascertainable standard and S can not appoint
self to be a trustee – then there is no inclusion. If there is unlimited power and the settlor could name self as trustee, then there is inclusion under 2038 or 2036 (p. 366)

**Policy Considerations**

- **Wealth tax – Pro** – It would be a constant tax on accumulated wealth more so than the surprise of the estate tax or the inconstancy of the income tax; wealth would not be transferred to other generations as easily as it is in the estate tax; liquidation of assets would not be as common as when estate tax is assessed; the frequency of assessment should avoid the valuation disputes b/c of the change in stakes (lower rates, regular assessment); **Con** – Death taxes are administratively easier to assess; death taxes only touches “unneeded” income b/c its owner has died; taxes wealth not necessarily being transferred to another generation.

- **Accessions Tax – Pro** – Might encourage widespread wealth transfers from a D rather than concentrated transfers p. 632

- **Taxing Gifts and Bequests as Income** – p. 636

- **Consumption Tax** – p. 639

- **State Tax Credits** – p. 146 – see new changes in Code

- **Changing the Charitable Deduction** – either you give to Charity or give to the Federal Govt. – see Notes on Charitable Deduction.