

ID # _____

Gift and Estate Taxation

Massachusetts School of Law- Spring 2016
Professor McLellan

FINAL EXAMINATION

PLEASE READ THE INSTRUCTIONS CAREFULLY BEFORE YOU BEGIN THE EXAM.

1. You have 3 hours to complete this exam. This is an closed book exam. However, you may use the Internal Revenue Code and a calculator.
2. Write your MSL identification number, rather than your name, on your blue book.
3. Write all of your answers in the blue book. Please write only on one side of the page in the blue book, and remember to write legibly. It is helpful to plan your answers before writing them. You may answer the questions in any order you wish, as long as you number your answers clearly.
4. **For the purposes of this exam, assume that the applicable exclusion amount is \$5,000,000 and the tax rate for estates is a flat 40%. You can also assume that annual gift tax exclusion is \$14,000 and the Marital Deduction for Non-US citizen or resident spouses is \$160,000.**
5. The final exam will comprise 50% of your class grade. There are 2 questions. Each question has multiple parts and is worth **25 points**.
6. Please think through your answers to demonstrate your knowledge of the topics. Your score on the final exam will be combined with your midterm and your paper grades to produce a final grade for the semester.
7. Whenever asked, you should provide rationale for your answers and support your answers with legal authority, such as Internal Revenue Code sections, Treasury regulations, and cases. However, if you know an answer, but can't find the authority, you should still put down your answer.
8. If you feel that it is necessary, you may indicate or suggest the need for additional facts to answer a question, but briefly explain why you believe additional facts are necessary and the result of assuming them.
9. Any mention of the tax consequences refers to the U.S. federal income, gift, and estate tax consequences.

FINAL EXAM

1. Jay and Corrine are married and have 3 children. Corrine is from Haiti and is not currently a U.S. citizen, but is thinking about becoming one. Justin and Joe are over 18 years old and Charlene is 12. Justin is married and has one child. Jay has about \$10 million in cash plus a house. Jay's brother, Karl, is an attorney. He helped Jay establish two trusts.

The first trust (Prospect Lane Trust) states that it is irrevocable and Corrine is the Trustee. If she can't act, Karl will serve as the successor Trustee. The trust owns their home located on Prospect Lane by a deed dated March 9, 2012. The trust states that during Jay's lifetime, Corrine and the kids can live in the house. If no one is living in the house, then the Trustee will rent it out and the income will be distributed to Corrine. At Jay's death, if Corrine survives him, she can live in the house for her lifetime. At the death of both Jay and Corrine, the house will be distributed to the three kids and the trust will terminate. Currently, Jay and Corrine live in the home with Charlene. Joe sometimes live there during the summers.

The second trust is the Jay-Cee Revocable Trust. Corrine is the Trustee. If Corrine can't serve as Trustee, then Jay can appoint someone else. While Jay is alive, he can add assets to the trust. He can also write a letter to the Trustee demanding a distribution and the Trustee must comply. He can amend the trust, but only if Corrine agrees.

At Jay's death, the trust divides into two shares. Half of the assets will go into a trust for Corrine. She receives all of the income that trust produces. She can receive principal for health, maintenance and support. She can serve as Co-Trustee as long as there is another Trustee serving. At her death, she has the right to determine which of their descendants receive the remainder of the trust assets.

The other half of the assets go into a trust established for their descendants. The Trustee has complete discretion to distribute the assets amongst the descendants in equal or unequal proportions, for any reason. Justin is the sole Trustee of this trust. Joe is the successor Trustee. If either son cannot serve, then a bank will take over as Trustee.

While Karl is an attorney, he is not an estate planning attorney. Joe wants you to explain the estate tax consequences of each trust. What happens at Joe's death? What if Corrine dies first? What if Justin predeceases his parents? Which assets are excluded or included in each person's estate? If you see any problems with the way the trusts are drafted, please make recommendations as to how to improve the trusts.

- 2(a). After legal costs and bank administration fees, Prince's estate was worth \$15 million. Prince had one sister and 7 half siblings. He never created an estate plan. Six months after his death, a person filed for spousal benefits in court based on a claim of being his alienated spouse. The "spouse" had a marriage certificate from Mexico to prove it. The attorney for the siblings felt that this spouse had a good case and could end up with the entire estate. So, the beneficiaries settled the lawsuit by giving the "spouse" the spousal elective share which was a 1/3 share of the assets. The settlement and distribution to the spouse were made within 9 months of Prince's death, prior to the timely filed estate tax return. The remaining property was distributed amongst Prince's blood relatives. Who is responsible for paying the estate tax if the marital deduction is allowed? Will the share that goes to the "spouse" qualify for the marital deduction?
- 2(b). During his lifetime, Prince opened a bank account which was joint with his sister. He initially put \$250,000 into the account. She was able to use it whenever she ran into financial problems. He kept track of it and would replenish it when necessary. Last year, for the first time, she put \$10,000 into the account. At his death, it had \$210,000. How much would be included in his taxable estate and why?
- 2(c). Prince purchased life insurance on his own life which had a \$1 million death benefit. He had one manager/business partner for many years. In 2014, when the life insurance policy was worth \$100,000, he transferred it to his partner. After the transfer, his business partner made all of the payments. At Prince's death in 2016, the business partner received \$1 million from the life insurance company. How much, if any, is included in Prince's estate at his death? Do you need to know any other information to make this determination? If so, what would you like to know and why? What happens at the death of the business partner (for estate tax purposes and value), if the business partner had died prior to Prince, when the value of the policy was \$150,000?

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MIDTERM EXAM

PLEASE READ THE INSTRUCTIONS CAREFULLY BEFORE BEGINNING THE EXAM.

Instructions:

1. This exam makes up 30% of your class grade for the semester.
2. Write your id number for identification on the top of this page of the exam and in your blue book.
3. You have 1 hour and 20 minutes to complete this exam. As a guideline, you may spend 10 minutes per question.
4. This is a closed book exam. You may use only your income tax code and a calculator.
5. This exam is composed of 9 short-answer questions. You should pick any 8 questions to answer. Most questions will involve a short answer of one to three sentences. Some questions will require more or less time than others.
6. Each question is worth 4 points.
7. **Please assume that the annual gift tax exclusion amount is \$14,000 and the applicable lifetime exclusion amount for the gift and estate tax is \$5,000,000.**
8. Please provide rationale for your answers or support your answers with legal authority, such as Internal Revenue Code sections, Treasury regulations, and cases, if you have time.
9. If you feel that it is necessary, you may indicate or suggest the need for additional facts to answer a question, but briefly explain why you believe additional facts are necessary and the result of assuming them.
10. Except as otherwise indicated, you may assume that all taxpayers use the cash receipts and disbursements method of accounting and use the calendar year as their taxable year. Any mention of the tax consequences refers to the U.S. federal gift and estate tax consequences.
11. Please make sure your handwriting is legible.

1. A gave B \$25,000 because B was starting a business. B agreed to give back \$15,000 once the business made a profit. B could keep the rest. Was a gift made? If so, how much? If not, explain why.

2. C left D 100 shares of GE stock in C's will. E challenged the will in the Massachusetts probate court because there was evidence of undue influence and the case was settled. D received 75 shares and E received 25 shares. Is the transfer of 25 shares a gift from D? Does it matter whether it was a settlement agreement or if it was adjudicated? Briefly explain your answer.

3. F's husband died leaving her \$20 million, his entire estate, outright to her through his will. He did not make any lifetime taxable gifts and did not use any of his unified credit. F has 3 kids and wants to make gifts to them. She is also contemplating marrying G. Before F marries G, what is the maximum amount she could gift to her 3 children without paying any gift or estate taxes? Briefly explain your answer.

4. J sets up a trust to transfer assets to J's children. J has 3 grown children and 7 grandchildren. At J's death, the trust will be divided into 3 shares- one for each child. If a child dies before receiving their share, then it is distributed to their children (the grandchildren) instead. J writes a check for \$100,000 to the trust (\$10,000 for each child and grandchild). The trust directs the Trustee to send Crummey letters to all 10 of the relatives notifying them of the gift. The Crummey beneficiaries have 30 days to withdraw the money. If the beneficiaries don't withdraw the funds, the Trustee will use the money to purchase a life insurance policy that is owned by the trust. None of the beneficiaries withdraw the funds. Will these gifts qualify for the annual gift tax exclusion amount? What is the gift tax consequence to the beneficiaries?

5. In the questions above, what if the Crummey letters also went to 3 friends of J who were listed as Crummey beneficiaries, but are not beneficiaries of the trust. Will these gifts qualify for the annual gift tax exclusion amount?

6. What would the gift tax consequence be, in question number 4, if a grandchild withdraws his \$10,000? Will the gift from J qualify for the annual exclusion amount? Is there any gift or estate tax consequence for the grandchild?

7. K put a rental property, that K owned, into a trust. The trust gave the rental income to K for life. At K's death, the real estate goes to M. K has a power to appoint (give) the trust property to anyone, including M's children.

a) Is the gift complete when the trust is set up?

b) Is the gift complete when K irrevocably exercises the power of appointment so that the property goes to M's kids?

8. N died, leaving 100 shares of Microsoft stock to P in N's will. The will provides that if P predeceases N, the stocks go to P's children. P wants his children to get the stock, but P does not want to use any of his unified credit. What can P do?

9. Q is 94 years old and has about \$5million in savings that she will never use. She wants to give her grandchildren assistance with school. Please explain three ways she can gift money to them and how they can use it.

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FINAL PROJECT

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The Assignment:

The purpose of the final project is to give you an opportunity to put together what you have learned over the course of the semester by applying your knowledge of gift and estate taxation to a particular set of facts. You will be doing a short presentation in class where you will have about 10-15 minutes to present what you have come up with and get some feedback. You will also write a brief description of your work which should be 3 to 5 pages double spaced. The written component of your final project will be due by 9 p.m. on the night of your scheduled exam and will account for 20% of your class grade. Please have an office or library staff member place your exam in my mailbox located in the main office or you can send it to me via email.

Your assignment is to take the information you have been given on a particular client and come up with a gifting plan or estate plan for your client. You can make up any additional facts you deem necessary in order to make your plan as comprehensive as possible. You should not draft actual documents. However, you should come up with at least one trust that you could use to accomplish your client's goals.

Often when consulting with clients and their accountants, they will choose or refuse a plan because of non-tax reasons including the level of complexity regarding the administration of the trust. There are also circumstances when tax considerations are significant enough to make one estate plan much more desirable than another. You can take complexity into account as you design your trust.

Presentation:

You will have approximately 10-15 minutes to present to the class a synopsis of your clients, their particular goals, and your choice of trust to address their goals. If we have time, your classmates will ask you questions about your recommendations and we will have a general discussion as to whether this was the best choice for your client's particular situation.

Final Paper:

Your paper should have a written description of your proposed trust. You should include your rationale for choosing that trust, what tax benefits your clients will receive, what personal planning issues arose and how you addressed them, any tax code issues that you addressed.

Keep in mind that this is a tax paper and try to incorporate into your analysis a few areas of the tax code that you addressed and some of the estate and gift tax considerations that we discussed in class.

Some topics you may want to address:

- Promissory notes
- Joint ownership
- Installment sale
- Powers of Appointment
- Planned use of Disclaimers
- Annual Gift Exclusion
- Income Interests vs. Principal
- Crummey Withdrawal Rights
- \$5,000 x 5% Withdrawal Powers
- Estate Tax Planning
- Unused Spousal Unified Credit and Portability
- Education and Medical Deduction
- Charitable Planning and Deduction
- Split Interest Trusts
- Assets of a Business or Creating a Business to Transfer Wealth
- Use of Life Insurance
- Powers that the Grantor or Beneficiary Retained
- Revocable Living Trust Planning
- QTIP or QDOT Planning
- Life Estates
- Transfers within 3 Years of Death
- Generation-Skipping Transfer Tax