ESTATE PLANNING
Professor Johnny Rex Buckles
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PROBLEM SET 5

A

Thelma, a fifty-five-year-old resident of Texas, is married and has two adult children, Louise and Oran. Thelma's husband has a heart condition and has a life expectancy of less than ten years. Thelma is healthy. She and her husband have been married happily for 37 years, and have no children outside of their marriage. Thelma is a successful antiques dealer operating the business out of her home. Some of her assets are her separate property (SP), whereas others are community property (CP). Thelma's son is a real estate speculator and developer (who is subject to the highest marginal income tax rate), and her daughter is a cash-poor, struggling actress.

Thelma and her husband have already fully utilized their unified credits against gift and estate taxes, and they maximize cash gifts to their children so as to take full advantage of the annual exclusion. Whereas Thelma and her husband own considerable community property (including assets not described herein), her husband owns very little separate property. Thelma owns the following assets that she is considering giving outright to her two children:

Description	Adjusted Basis	Fair Market Value
18th century grandfather clock (SP)	\$20,000	\$50,000
Her CP interest in mutual funds	\$10,000	\$100,000
IBM stock (SP)	\$70,000	\$50,000
Stock in EXXON/Mobil (SP)	\$35,000	\$85,000
Raw land in West Texas (SP)	\$10,000	\$50,000
Gold coins (held for investment) (SP)	\$10,000	\$60,000

Assume that the applicable gift tax rate is 41%. Thelma wants to make an outright gift of property worth approximately \$50,000 - \$60,000 to each child. Thelma wants to minimize the payment of gift tax because she currently is in a bit of a cash-flow pinch (although she is in the highest income tax bracket). Although her daughter is always out of money, her son has plenty of cash.

What assets would you recommend giving to whom? What assets are probably not good candidates for gifts, or at least not as attractive as others? Consider the gift tax and income tax implications of the various options.

B

Joe is 45 years old, is married, his son is 25 years old, and his daughter is 20 years old. In addition, Joe and his wife have not begun a pattern of transferring any portion of their wealth. All of the property is Joe′s separate property. Joe′s will currently provides that all of his property remaining after the payment of debts and taxes will be distributed to each of his children, share and share alike. *What advice for life-time gifts do you offer?*

C

Same facts as in **B**, above, except that Joe′s wife is independently wealthy and has already given $7 million to her five children of a previous marriage. *What advice for life-time gifts do you offer?*

D

Discuss, as a general matter, when gift-splitting can adversely affect the non-donor spouse, both in the near and distant future.

E

Your client, Red Rhidinghoode, a Texas resident, has exhausted his unified credit through generous lifetime gifts. Which of the following transfers, or parts thereof, contemplated by Red are taxable gifts when made? *{Hint: Read carefully section 25.2511-2 of the Treasury regulations.}*

1. Gift in trust with income payable to Uncle Ben for life, remainder to the Boy Scouts of America. The trust is silent as to Red′s powers to alter, amend or revoke the trust.

2. Gift in trust with income payable to Uncle Ben for life, remainder to the Boy Scouts of America. The trustee, an independent bank, is given the discretion to invade corpus for the benefit of Uncle Ben in its absolute discretion. The trust is expressly made irrevocable.

3. Same as in 2, above, except Red names himself as the trustee.

4. Same as in 2, above, except Red retains a general power of appointment over trust assets.

5. Same as in 2, above, except Red retains a power to appoint trust principal only among his descendants.

6. Same as in 2, above, except Red names himself as a co-trustee.

7. Create a trust with an independent bank as trustee. The income may be paid to Red for life, or accumulated and added to principal, in the discretion of the trustee. Principal is payable upon the death of Red to Uncle Ben.

8. Create a trust with income payable to income beneficiary for life, as necessary for his health, education, maintenance and support. Upon his death, principal shall be payable to Uncle Ben. Assume that an independent bank is trustee, and the income beneficiary is Red.

9. Same as in 8, above, except that Red is the trustee, and his friend Barney is the income beneficiary.

10. Same as in 9, above, except that income distributions to the life income beneficiary are made in the absolute discretion of the trustee.

11. Create a trust, income payable to Barney for 20 years, principal payable to Barney upon the expiration of such period of time. The trustee has the absolute discretion to accumulate income and add it to principal, rather than pay income currently. Red names himself as trustee.

12. Delivery of personal check to daughter Deanne on December 29. Deanne deposits the check on December 31, and it clears the bank on January 2 of the following year.

13. Delivery of Red′s nonnegotiable promissory note to daughter Deanne. The note is paid the following year.

14. Delivery of endorsed stock certificates in year 1 to Red′s broker with instructions to change the record ownership of the stock to the name of Red′s daughter, Deanne. The corporate books do not reflect the change in record ownership until year 2.

F

Red is exasperated after your advice in Part E, above. Red wants you to summarize techniques that he can use to maintain some degree of control over his property, yet not be faced with any resulting inclusion of gifted property in his gross estate as a result of his control. What do you tell Red?

G

Evelyn, a successful plaintiff′s attorney married to a stay-at-home-dad, desires to establish a trust and take advantage of gift-splitting with her husband and the annual exclusion for gifts. In view of these goals, advise Evelyn as to the gift tax implications of the following options that she is considering:

Option 1: Create a trust with income payable to her friend Joan for life, and with the remainder payable to each of Evelyn′s three children, share and share alike.

Option 2: Create a trust with income payable to Joan for life, remainder payable to Evelyn's husband.

Option 3: Create a trust with income payable to Joan and her husband Jim for life, remainder payable to Evelyn's husband. In addition, the trustees shall have one or more of the following powers: (i) the power to accumulate income or distribute it; (ii) the power to allocate income between Joan and Jim; and (iii) the power to invade corpus for the benefit of any one or more of the beneficiaries of the trust.

Option 4: Create a trust with income payable to Joan for life, remainder to Evelyn's children. In addition, the trustee shall have the power to invade corpus for the benefit of Joan during her life.

Option 5: Create a trust with income payable to Joan for life, remainder payable to Evelyn′s children. In addition, Evelyn′s husband is given a power to appoint trust property to whomever he so desires.

H

Ray is a 75 year-old widower of modest means and wants to provide for the education of his three grandchildren (the children of his deceased son), one of whom is 3 years of age, one of whom is 16 years of age, and the eldest of whom is 21 years of age. The middle child is very responsible and plans to attend the University of Houston in a couple of years. The eldest child is currently attending Baylor University, and is generally quite irresponsible with money. Ray has $30,000 (about 10% of his net worth) that he would like to give or devise to or for the benefit of his three grandchildren, in equal shares. Ray′s grandchildren are currently living with their maternal aunt and uncle (who have four children of their own) in Waco, because their parents are both deceased. Although Ray is not wealthy, he is currently named as the beneficiary of a generous life insurance policy purchased by his younger sister. What options would you suggest to Ray, and why?

I

Gertrude is worth millions of dollars. She has a nephew, George, and a niece, Mary, of whom she is very fond. Gertrude wants to make annual gifts for the benefit of her niece and nephew and maximize her annual exclusions. Gertrude desires to make sure that the money is not immediately expended by George and Mary, but that they benefit from her gifts for many years. George and Mary are both twelve years old. Gertrude prefers that a professional trustee manage her gifts in trust with a great deal of investment flexibility, as well as some degree of flexibility over the timing of income distributions. She is undecided as to whether to give the trustee complete discretion over distributions, or to limit distributions to the health and education of her niece and nephew. A financial planner has recommended that she consider a section 2503(b) trust (i.e., a trust creating present interests sufficient to cause a portion of the value of property transferred in trust to qualify for the annual exclusion), a section 2503(c) trust, or a trust with withdrawal rights by the beneficiaries. Gertrude seeks your advice on these alternatives.

J

Assume the same facts as in **Part A**. Also assume that Thelma decides to give the EXXON/Mobil stock to her son and require him to pay the gift tax. What are the income and gift tax consequences to each?