ESTATE PLANNING
Professor Johnny Rex Buckles
Fall 2021

PROBLEM SET 9

A

Your client, Abe Aged, owns land (worth $1 million) in West Texas. Abe paid $100,000 for the land twenty years ago. Abe is thinking about various ways of transferring title to the land to his daughter, Yvonne Young. Abe is considering the following options:

1) Option 1. Sell the land to Yvonne in exchange for a note providing for periodic payments of market interest, and a balloon payment of principal fifteen years from the date of sale. Yvonne would then lease the land to Abe, who would pay Yvonne rent.

2) Option 2. Same as Option 1, except that Yvonne must pay yearly installments of principal due under the note (in addition to interest). In addition, the note would provide that any outstanding indebtedness under the note would be cancelled upon the death of Abe.

3) Option 3. Sell the land to Yvonne for it fair market value in exchange for a private annuity issued by Yvonne.

Advise Abe of the relevant income, estate, and gift tax issues arising from each option.

B

{Note: Carefully read Code section 2702 before answering problems B through E.}

Dad wants to transfer $100,000 worth of stock in a small company (which has issued only one class of stock) to BankTwo as trustee. Dad thinks that the company will probably go public in a couple of years, and that the stock may appreciate exponentially as a result. Dad desires to retain the right to receive the income from the trust for life, with the principal payable to his son, Junior, at the end of the trust term. Dad believes that, based upon his life expectancy (fifteen more years), the actual present value of Junior's remainder interest is quite small. Hence, Dad thinks that when he sets up the trust, the amount of the gift to Junior should be valued low for gift tax purposes. *Is Dad right? Do you have any advice for Dad as to how he should draft the trust terms if his desire is to minimize his gift tax liability upon transferring the property in trust?* In advising Dad, assume that he does not wish to give Junior a present power to invade the trust. *What consequences follow if Dad retains the right to revoke the trust?*

C

Same facts as in B, except that Dad wants his nephew, Nate, to be the remainderman. *What are the transfer tax consequences of this transaction?*

D

Same facts as in B, except that the trust res is greenacre, a piece of prime real estate. *What are the transfer tax consequences of this transaction?*

E

Dad transfers his collection of gold coins to his son, but retains the right to use the coins for display purposes for fifteen years. *What are the transfer tax consequences of this transaction?*

F

Analyze the following trust instrument. Assume that the trust has been prepared for your client by an associate at your law firm. You are the supervising attorney. Be prepared to comment upon what provisions are advisable, and what provisions should be amended or deleted. The goal is to qualify the trust for favorable treatment under section 2702.

TRUST AGREEMENT

This Trust Agreement (this "Agreement") is entered into by and between Mable Maybury ("Grantor") and First Bank of Oilville, Texas ("Trustee").

ARTICLE I
Grantor's Annuity

1. <u>Annuity to Grantor.</u> The Trustee shall pay the "annuity amount" (as hereinafter defined) to the Grantor for a period beginning on the date of this Agreement and ending on the first to occur of the .... (.......) anniversary of the date of this Agreement (the "Fixed Term") or the death of the Grantor. The annuity amount shall be paid annually on the day preceding the anniversary of the date of this Agreement each year until the termination of the trust under this Article as herein provided.

The annuity amount shall be paid from income.

The annuity amount for each year shall be .... percent (.......%) of the net fair market value of the trust assets determined as of the date of this Agreement by stipulation of the parties hereto, such stipulation to be binding for all purposes of law, both now and hereafter.

2. Incorrect Valuation of Trust Assets. If the net fair market value of the trust assets is hereafter found to have been incorrectly determined, then the Trustee shall make no adjustment in the amount of any payment to the Grantor.

3. Taxable Year. The taxable year of the trust shall be the calendar year.

4. Additional Section 2702 Requirements. Until the termination of the trust, the Trustee shall not pay over or apply any portion of the income or principal of the trust to or for the benefit of any person other than the Grantor or such person as she shall appoint by written instrument delivered to the Trustee. The Grantor's interest shall not be commuted without the consent of the remainderman. No additional contributions shall be made to the trust, and the Trustee shall not accept any such contributions.

Notwithstanding anything herein contained to the contrary, although no additional contributions may be made to the trust, if any transfer is deemed made to the Trustee for any reason by any person such transfer shall be held by the Trustee in a separate trust upon the same terms and conditions as the original contribution to the trust created hereunder and such transfer shall not form a part of the original trust.

5. Substitution Power. The Grantor shall have the power, at any time and from time to time, acting in a nonfiduciary capacity, without the approval or consent of any person, to acquire the assets of any trust held under this Article I hereof by substituting other property of an equivalent value. The Grantor may release such power at any time by delivery of an acknowledged written instrument to the Trustee, any such release to be irrevocable.

6. Grantor Trust. It is the Grantor's intention that during the term of the trust under this Article I, the Grantor be treated as the owner of the entire trust under this Article I under the so-called "grantor trust" income tax rules of subpart E of part I of subchapter J of subtitle A ("Grantor Trust Rules") of the Internal Revenue Code of 1986 as amended, or any successor thereto ("Code"), and the Grantor directs that this Agreement shall be construed and the trusts hereunder administered accordingly. With respect to the trust under this Article I, to the extent not inconsistent with Section 2702 of the Code and/or the regulations thereunder, the Trustee is directed to distribute each year to the Grantor in addition to the annuity amount for the year that amount equal to the income tax owed by the Grantor for the year attributable to income of the trust for the year under the Grantor Trust Rules in excess of the annuity amount payable to the Grantor for the year.

7. Disposition Upon Death of Grantor or Expiration of Fixed Term. The trust shall terminate upon the first to occur of (i) the death of the Grantor or (ii) the expiration of the Fixed Term, and thereupon the trust estate shall be disposed of as follows:

A. If the trust terminates by reason of the Grantor's death prior to the expiration of the Fixed Term, the trust estate shall be transferred, conveyed and paid over to or for the benefit of such person or persons or corporation or corporations or the Grantor's estate or the creditors of the Grantor's estate, to such extent, in such amounts or proportions, and in such lawful interests or estates, whether absolute or in trust, as the Grantor may, by the Grantor's Last Will and Testament appoint by specific reference to this power. If the power of appointment is for any reason not effectually exercised in whole or in part by the Grantor, the trust estate shall be transferred, conveyed and paid over to the Grantor's executor or administrator, to be disposed of as a part of the Grantor's estate.

B. If the trust terminates by reason of the expiration of the Fixed Term, then upon the expiration of the Fixed Term the trust estate shall be conveyed and paid over to the Grantor's then living descendants, per stirpes.

ARTICLE II
Grantor's Intent

This Agreement shall be construed, payments shall be made to the Grantor, and the trusts created hereunder shall be administered, in all respects so that the Grantor's interest constitutes a qualified annuity or unitrust interest within the meaning of Section 2702(b)(1) of the Code and the regulations thereunder. If such section or regulations, or any successor section or regulations, or any ruling, notice or other administrative pronouncement issued thereunder, at any time requires that a qualified annuity interest must contain provisions that are not expressly set forth herein, such provisions shall be incorporated into this Agreement by reference and shall be deemed to be a part of this Agreement to the same extent as though they had been expressly set forth herein. The Trustee shall have the power, acting alone, to amend any trust created under Article I hereof in any manner required for the sole purpose of ensuring that the Grantor's interest constitutes a qualified annuity or unitrust interest within the meaning of Section 2702(b)(1) of the Code and the regulations thereunder.

Mable Maybury

[Name and Title of Officer], First Bank of Oilville, Texas

G

Discuss the purpose of a QPRT, and the key terms that must govern a QPRT.

H

Dad and his daughter purchase separate interests in an apartment complex from an unrelated third party. Dad purchases a life estate in the property, and daughter buys the remainder. They each pay the price that a willing buyer negotiating the purchase of the applicable interest at arm's length would pay. *What are the transfer tax consequences of this transaction? How (if at all) would your answer change if Dads purchases the entire interest in the property and then sells daughter the remainder interest therein for its fair market value?*