ESTATE PLANNING
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Fall 2021
Problem Set 4

A

1. Discuss, in general, the taxation of an estate's income (and trust income) under federal income tax law. Who is taxed? When? What is the effect of a transfer of property by the executor of an estate to a person bequeathed or devised the property?

2. Zane dies on 1/01/20. His will leaves $10,000 to Charles and a gold chain (worth $1,000) to Gus. The residue of the estate (including all income earned during probate administration) is left to Rene. Income earned by the estate during the year is $5,000. The executor distributes $2,000 to Charles, the gold chain to Gus, and $3,000 to Rene. What are the income tax consequences to all affected parties?

3. Able dies on 1/01/20. For the year 2020, the estate has taxable income (before deducting any portion of distributions to beneficiaries) of $10,000 and DNI of $7,000. Under the will, all fiduciary accounting income earned by the estate (in this case, $7,000) is to be distributed to Eve. Eve is also entitled to receive part of the residue of the estate. During 2020, Adam, the executor of the estate of Able, transfers $9,000 to Eve and nothing to the other beneficiaries. What are the income tax consequences to all affected parties?

4. An estate with taxable income of $6,000 and requiring current distributions of estate income to the residuary beneficiaries (Anthony and Bartholomew) has DNI of $6,000. The executor distributes $3,000 in cash to Anthony and furniture of the estate worth $3,000 at the testator's date of death (its value as of the distribution date) to Bartholomew. What are the income tax consequences to all affected parties?

5. Under the will of Cathy, the residue of her estate is to be transferred to a trust benefiting Angela and Thomas. Under the terms of the testamentary trust, the trustee shall have the discretion to distribute one-half of the principal (and income therefrom) to Angela, and the same discretion to distribute the other half (and income therefrom) to Thomas. Each share earns $1,000 of income, and the trust has total DNI of $2,000, in year 1. The trustee distributes in year 1 $2,000 to Angela. What are the income tax consequences of these events?

6. Ted's will directs the executor to distribute ABC stock and all dividends on such stock to

Thurgood, and the residue of the estate (including income therefrom) to Antoine. The stock is worth $1,000,000, and the other estate assets are worth $4,000,000. That year, the estate earns income of $200,000, of which $100,000 is attributable to dividends on ABC stock. How much DNI is allocated to the share of Thurgood? How much is allocable to the share of Antoine?

B

Consult sections 671-677 of the Internal Revenue Code in answering the following questions. Who is taxable on income from the following trusts? Explain your answers.

1. Able, a Texas resident, creates a trust, with income payable to son Sam for life, remainder to Sam's children who survive him. If no children of Sam survive him, the remainder shall be paid to Able's wife, Esther. At the time of the creation of the trust, Sam is single and childless.

2. Ben creates a trust with income payable to wife Betty for life. The remainder is to pass to such person as Betty may appoint by will.

3. Same facts as in 2, except that income is payable annually to Ben's Aunt Edna.

4. Same facts as in 3, except that Betty's power of appointment is exercisable by deed, rather than by will, and can be exercised so as to effectuate the transfer of trust corpus even in the lifetime of Edna.

5. Same facts as in 3, except that the objects of the power are limited to the issue of Able and organizations having purposes described in section 170(c) of the Internal Revenue Code.

6. Chris creates a trust with income payable to his adult daughter, Darlene, for life, remainder to such charities as Chris may appoint by inter vivos instrument delivered to the trustee prior to his death. The trustee, who is Chris, has the authority to accumulate trust income, and any income so accumulated shall be distributed to such people whom Darlene may appoint by will.

7. Earl transfers property in trust, income payable to cousin Eunice for life, remainder payable to the issue of Eunice. In addition, the trustee is given the power, in its discretion, to distribute income to Earl, but only if Eunice and her issue consent to such a distribution to Earl.

8. Freda transfers property in trust, naming herself trustee. Income is to be distributed to Freda's sister Jennie for life, remainder to Jennie's children, Farad and Fay. Under the trust instrument, the trustee has the right to distribute such principal to Jennie, Farad and/or Fay as may be necessary for their reasonable medical care.

9. Same facts as in 8, except that the trustee has the right to distribute such principal to Jennie, Farad and/or Fay as may be necessary for their happiness.

10. Same facts as in 9, except that a principal distribution can be made only with the consent of any one beneficiary who will not receive such distribution.

11. Same facts as in 9, except that an unrelated bank is the trustee of the trust. The bank has a long-standing history of doing business with Freda, and is anxious to retain her vast personal savings and checking accounts. What if Freda has the power to remove the trustee?

12. Same facts as in 8, except that the trustee has the right to distribute and apportion trust income among Jennie, Farad and Fay as the trustee deems necessary for their education, maintenance and support.

13. Same facts as in 8, except that (a) Freda's brother Fernando is the trustee, and (b) the trustee has the right to distribute and apportion trust income among Jennie, Farad and Fay as the trustee deems necessary for their education, maintenance and support.

14. Mae creates a trust with income payable to Michele for life, remainder to the issue of Michele. Mae then borrows $50,000 of the trust funds from the trustee (an unrelated, independent bank), and repays the loan by the end of the year.

C

Under what circumstances might you advise a client to establish a so-called "defective grantor trust?" What strategy should be used in doing so?

D

How is trust income taxed in each of the following cases?

1. Gomer creates an irrevocable trust, income payable to his wife Bee for life, remainder to his brother, Barney. In addition, Barney has a power to withdraw five percent of trust principal annually, which right is non-cumulative.

2. Same facts as in 1, except that the income beneficiary of the trust is Mother Mamie.

3. Same facts as in 2, except that the trustee must consent to any withdrawal of principal by Barney. The trustee is an independent bank.

4. Same facts as in 3, except that the trustee is Barney's wife.

5. Yvonne creates a trust providing for the payment of income to Brice for life, remainder to Brice's children. In addition, such portion of the income as may be necessary to support the minor children of Sally (as determined by the trustee) may be paid to them, instead of to Brice. In a year in which one-half of such income is necessary to support Sally's children, the income is so applied. The trustee is Rodney.

6. Same facts as in 5, except that the trustee is Sally.

7. Calvin creates a trust with income payable to his adult daughter, Christi, for life, remainder to her children. In addition, Calvin's other daughter, Dena, is given the power to distribute income to Dena's husband (of whom Calvin is very fond).