Estate and Gift Taxation

Units I and II

Overview of the Transfer Tax Structure

Following is the assignment for the first two days of class. The remaining assignments will be posted only on TWEN. Please be sure to log onto TWEN and add our class to your course list; you will need to do so to access some of the readings for this assignment.

On August 23, we will briefly discuss the history of and policy justifications for the estate tax before diving into an overview of its structure. For background for this discussion, please read the excerpt from *Charitable Contributions in an Ideal Estate Tax* and the excerpt from *Federal Estate and Gift Taxation in a Nutshell* (both on TWEN). You may skim the article excerpt, but read the Nutshell more carefully, as it will also give you context for tackling questions 1 and 2.

After that, please do question 1, using the approach described in the *Note on Calculating Estate and Gift Tax Liability* (also on TWEN). For question 1, you should also read the sections of the supplement to *Stephens Lind* indicated below, as well as the assigned Code sections. Here's what I think will be most efficient: Look at the Note and *Stephens Lind*, and then see how the Code matches up to them. The Nutshell may also help you make sense of what is going on. Don't look at the Code until you have a sense from the other readings of what the Code is trying to accomplish.

On August 25, we will tie up any loose ends from question 1 and do question 2.

<u>Assignment</u>:

Code:	Skim §§ 1014(a) and (b), 1015(a) and (b), and 1022(a)-(c)(2). Read carefully §§ 2001(a)-(c) and (g), 2010, 2501(a)(1), 2502, 2503(a)-(b), 2505.
Stephens Lind:	From the supplement, not the main book, read ¶¶2.01, 3.02 and 9.03
Additional Readings on TWEN:	Excerpt from *Charitable Contributions in an Ideal Estate Tax*; Excerpt from *Federal Estate and Gift Taxation in a Nutshell*; Note on *Calculating Estate and Gift Tax Liability*.

<u>Questions</u>:

1. For purposes of questions (1)(a) and (2), please use the rates and exemption and credit levels contained in the current versions of §§ 2001, 2010, and 2505, regardless of when the transactions described below occurred.

Aaron, who is single and has no children of his own, is quite fond of his two nieces. Aaron made no taxable gifts prior to 2003. In 2003, Aaron made gifts of appreciated stock to each of his two nieces. The stock transferred to each niece had a fair market value of $113,000 on the date of the transfer. After subtracting Aaron's annual exclusion under IRC § 2503(b), the amount of the taxable gift to each niece was $100,000 (for a total of $200,000).

In 2005, Aaron contributed $5,000,000 to a trust established for the benefit of his two nieces. The transfer did not qualify for the annual exclusion under IRC § 2503(b), so the amount of the taxable gift was $5,000,000.

Aaron died in 2011. His taxable estate consisted of $3,200,000 of cash, stock, and other liquid assets. His will disposed of his estate in equal shares to his two nieces. Assume that Aaron's estate is not entitled to any deductions and that the state in which Aaron was a resident did not have an estate or inheritance tax. Using the approach in the *Note on Calculating Estate and Gift Tax Liability*, please answer the following questions.

a. What is Aaron's gift tax liability for 2003? And for 2005?

b. What is Aaron's federal estate tax liability?

c. Very generally, what would be the tax consequences to Aaron's estate and his heirs if he died in 2013 instead of 2011?

d. Brainteaser: What would Aaron's gift tax liability for 2003 and 2005 have been under the rates and exemption and credit levels originally established by EGTRRA and that were actually in effect between the years 2001 and 2009? Would that change his estate tax bill in 2011 under the law in effect in 2011? In other words, if Aaron's executor came into your office today and told you about the past gifts made by Aaron, how would you calculate his estate tax bill?

2. Bonnie has $10,000,000 that she would like to transfer to her daughter Christine. She comes to you for advice as to whether she should (a) give Christine the money while Bonnie is still alive or (b) wait and bequeath the money to Christine in her will. Assume that this transfer will be fully taxable under either the gift or estate tax, as applicable (that is, assume that Bonnie has already used her unified credit and that the annual exclusion will not apply). Use a flat rate of 35% for simplicity and consider the following alternative scenarios:

- Bonnie gifts the $10 million to Christine now. She has enough other money to pay any gift tax due and to live off until her death, but no more. Thus, she dies with no assets. How much will Christine receive? How much will the government get? How much has actually left Bonnie's hands?
- What if Bonnie does not gift the $10 million to Christine during her life. She keeps the $10 million, plus the amount of tax that would have been due had she made a gift. She thus dies with

$11,750,000 in her estate. How much will Christine receive? How much will the government receive?

- Bonnie dies with exactly $10 million, which she leaves to Christine. How much of the $10 million will Christine actually receive? How much does the government get?
- If Bonnie had wanted Christine to actually receive $10 million after taxes upon her death, what size would her pre-tax estate have to have been?

What do you suggest to Bonnie?

What tax and non-tax considerations might influence Bonnie's decisions?