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 25, we will briefly discuss the history of and policy justifications for the estate tax before diving into an overview of its structure. To that end, I suggest you start by reading the portions of the assignment that I have indicated are for background. After that, please do question 1, using the approach described in the Note on Calculating Estate and Gift Tax Liability. For question 1, in addition to the readings indicated below as relevant, please read the assigned Code sections.

On August 27, we will tie up any loose ends from question 1 and do question 2.

Assignment:

Code: §§ 1014(a) and (b), 1015(a) and (b), 1022(a)-(c)(2), 2001(a)-(c), 2010, 2501, 2502, 2503(a)-(b), 2505 (questions 1 and 2).

Casebook: Pages 7-10 (background); 107-116 (question 1); 325 (question 2)

Nutshell: Pages 13-16 (background and question 1); 23-25 (question 1); 398-404 (question 1); 421-24 (question 2)

Additional Readings on TWEN: Obama Plans to Keep Estate Tax; Bid to Block Estate Tax Repeal, and excerpt from Charitable Contributions in an Ideal Estate Tax (background); Note on Calculating Estate and Gift Tax Liability (question 1)

Questions:

1. Aaron made no taxable gifts prior to 2003. In 2003, Aaron made gifts of appreciated stock to each of his two children. The stock transferred to each child had a fair market value of $461,000 on the date of the transfer. After subtracting Aaron’s annual exclusion under IRC § 2503(b), the amount of the taxable gift to each child was $450,000 (for a total of $900,000).

In 2005, Aaron contributed $400,000 to a trust established for the benefit of his two children. The transfer did not qualify for the annual exclusion under IRC § 2503(b), so the amount of the taxable gift was $400,000.
Aaron dies in 2009. 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 children. 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? (Hint: Read § 2001(c)(2) extremely carefully. How does the phase-down of the maximum rate in § 2001(c)(2)(B) affect the rate schedule in 2001(c)(1)? Try to figure out how each line of the rate schedule relates to the previous line.)

c. Very generally, what would be the tax consequences to Aaron’s estate and his heirs if he died in 2010 instead of 2009?

2. Bonnie has $5,000,000 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 45% for simplicity.

Please read page 325 of the casebook and pages 421-424 of the nutshell and consider the following alternative scenarios:

- Bonnie gifts the $5 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 $5 million to Christine during her life. She keeps the $5 million, plus the amount of tax that would have been due had she made a gift. She thus dies with $7,100,000 in her estate. How much will Christine receive? How much will the government receive?
- Bonnie dies with exactly $5 million, which she leaves to Christine. How much of the $5 million will Christine actually receive? How much does the government get?
- If Bonnie had wanted Christine to actually receive $5 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?