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YOUR 2012 GIFT PLANNING SURVIVAL GUIDE

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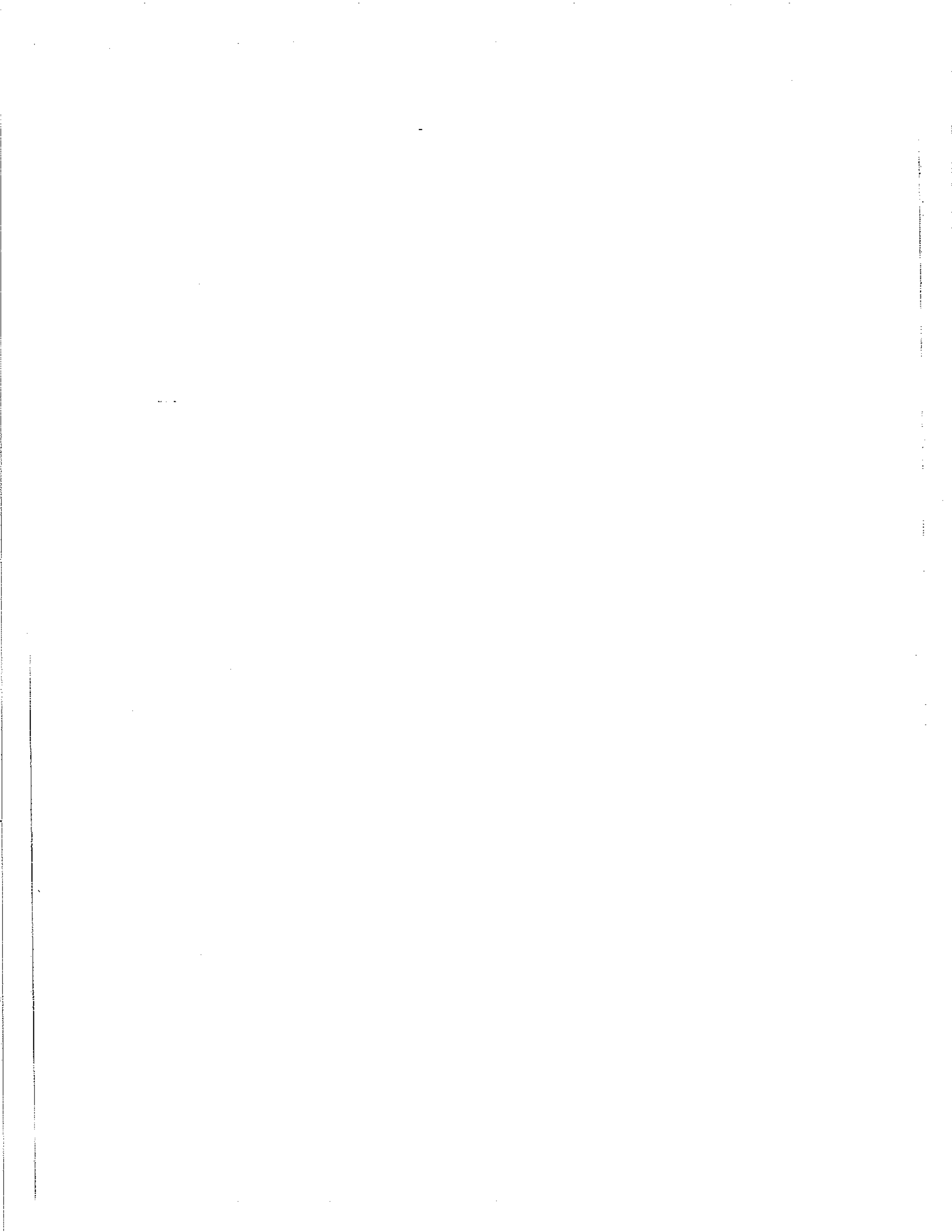
Presented by

Leo J. Cushing, Esq., CPA, LLM
Cushing & Dolan, P.C.
Attorneys at Law
10 Tremont Street
3rd Floor, Suite 9
Boston, MA 02108
www.cushingdolan.com
lcushing@cushingdolan.com
Tel: 617-523-1555 Fax: 617-523-5653



YOUR 2012 GIFT GIVING TAX GUIDE

PART 1:
Lifetime Giving Revisited, What's the Hold-Up?!?!

Presented by

Leo J. Cushing, Esq., CPA, LLM
Cushing & Dolan, P.C.
Attorneys at Law
10 Tremont Street
3rd Floor, Suite 9
Boston, MA 02108
www.cushingdolan.com
lcushing@cushingdolan.com
Tel: 617-523-1555 Fax: 617-523-5653

I. Introduction & Overview

a) On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Authorization and Jobs Creation Act of 2010, known as the "2010 Act."

b) The 2010 Act increased and extended the federal estate and GST tax exemptions for two years, 2011 and 2012, and for the first time increased the federal gift tax exemption to $5,000,000 per person.

c) The gift estate tax exemptions were indexed for inflation so that, in 2012, the exemption is $5,120,000 per person.

d) The following chart shows the federal and state estate and gift GST tax exemptions for 2003 to 2013.

YEAR	MA Exemption	Federal Estate & GST Tax Exemption	Federal Gift & GST Tax Exemption
2003	$700,000	$1 million	$1 million
2004	$850,000	$1.5 million	$1 million
2005	$950,000	$1.5 million	$1 million
2006	$1 million	$2 million	$1 million
2007	$1 million	$2 million	$1 million
2008	$1 million	$2 million	$1 million
2009	$1 million	$3.5 million	$1 million
2010	$1 million	No Federal Estate Tax	$1 million
2011	$1 million	$5 million	$5 million
2012	$1 million	$5.12 million*	$5.12 million*
2013	$1 million	$1 million	$1 million

NOTE: Massachusetts does not have a gift tax
***as indexed for inflation beginning in 2012**

II. Gift Giving Tax Considerations – The Basis Rules

a) Compare the tax consequences of a step-up in basis attributable to inherited property vs. carryover basis in the case of lifetime gifts.

(1) Basis of property acquired from the decedent.

A. IRC § 1014 provides:

"Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passes from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person be – (1) the fair market value of the property on the date of the decedent's death." IRC § 1014(a)(1)

B. IRC § 1014(b) provides:

"For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

1. Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent; IRC § 1014(b)(1)

2. Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust;" IRC § 1014(b)(2)

3. "Property passing without full and adequate consideration under a general power of appointment exercised by the decedent by will;" IRC § 1014(b)(4)

4. "In the case of decedents dying after December 31, 1953, property acquired from the decedent by reason of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate." IRC § 1014(b)(9)

5. "Property includible in the gross estate of the decedent under section 2044 (relating to certain property for which marital deduction was previously allowed)." IRC § 1014(b)(10)

C. Exception:

IRC § 1014 prohibits a step-up acquired from a decedent if appreciated property was acquired by the decedent by gift during the one year period ending on the date of the

decedent's death and such property is acquired from the decedent (or passes from the decedent to) the donor of such property (or the spouse of such donor). In such a case, the basis of such property in the hands of the donor or donor's spouse shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent. IRC § 1014(e)(1)

(2) Basis of Property Acquired by Gifts and Transfers in Trust § 1015

If property is acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor (or the last preceding owner) by whom it was not acquired by gift, except that if such basis is greater than the fair market value of the property at the time of the gift, then, for the purpose of determining loss, the basis shall be such fair market value.

Example:

	Property
FMV	$90,000
AB	$100,000

*If sold for $95,000, no gain or loss because the FMV is used to determine loss and no gain since basis is $100,000

(3) Increased Basis for Gift Taxes Paid

IRC § 1015(b) provides:

"If the property is acquired by gift on or after September 2, 1958, the basis shall be the basis determined under subsection (a) (carryover basis) increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid with respect to such gifts."

PLANNING NOTE

The Regulations provide that in allocating the gift tax paid to increase the basis of property acquired by gift, the tax adjustment must be allocated pro rata, which seems to prohibit the allocation to any particular asset for the purpose of selling the asset. 1.1015(b)(2)(iii)

(4) Gift Splitting

Gifts may be treated as made one-half by each spouse. Reg. 25.2513-1. A Spouse who consents to split gifts under IRC § 2513 is not considered a transfer for purposes of IRC § 2038 with respect to property actually owned and transferred by the donor. Rev. Rul. 74-556.

PLANNING NOTE
The donor's spouse who consents to a gift may nevertheless be a discretionary beneficiary in a trust into which the assets were transferred without causing the assets to be includible in the donor's spouse's estate upon the death of the donor's spouse. Rev. Rul. 74-556.

(5) Holding Period

A. Inherited Property

In the case of property acquired from a decedent (within the meaning of IRC § 1014(b), if the basis of such property in the hands of the person is determined under IRC § 1014 and such property is sold or otherwise disposed of by such person within one year after the decedent's death, then such person shall be considered to have held such property for more than one year. IRC § 1223 (9)

B. Gifted Property

In determining the holding period of property which has been acquired by gift, the holding period of the grantor will be added to the holding period of the donee for purpose of determining gain or loss from the seller exchange to the extent the donee was required to use the donor's basis as his basis. IRC § 1223 (2)

PLANNING NOTE
If the fair market value at the time of the gift is used as the donee's basis, such as when property is sold for a loss, the holding period starts the date after the gift is made. IRS Publication 544

EXAMPLE #1

- Assume single decedent with $5,000,000 in zero basis assets and is considering an irrevocable gift in 2012.
- Assume also that property will be sold shortly after death at a price equal to the fair market value on the date of death. Assume a combined capital tax rate of 20% (15% federal; 5% state)

	NO GIFT	GIFT
FMV	$5,000,000	$5,000,000
BASIS	0	0
	SALE AFTER DEATH	
SALE PRICE	$5,000,000	$5,000,000
BASIS	$5,000,000	$ 0
GAIN	$ 0	$5,000,000

TAX 20%	$ 0	$1,000,000
FEDERAL ESTATE TAX	$ 0	$ 0
STATE ESTATE TAX	$ 391,600	$ 0
INCOME TAX	$ 0	$1,000,000
TOTAL TAXES	$ 391,600	$1,000,000

Gift is a bad idea!

(6) Don't forget the Gallenstein decision.

A. How do you determine the basis of property inherited by a surviving spouse rather than children?

This depends upon how the property was owned on the date of death, but in the case of jointly owned property, if the property was acquired after 1976, one-half of the fair market value of the property is includible in the estate of the first spouse to die so that the surviving spouse would receive a partial step-up equal to that amount includible in the estate of the first spouse to die. This would then be added to one-half of the original cost to determine the surviving spouse's basis. There is a special rule, however, which may be applied in the case of property acquired by a couple before 1977.

If the property was acquired before 1977 and is held jointly on the date of the death of the first spouse to die, the full fair market value of the property would be includible in the estate of the first spouse so that the surviving spouse would acquire a "full" step-up in basis. Gallenstein v. United States, 91-2 U.S.T.C. ¶60,088 (ED KY 1991), aff'd 975 F.2d 286 (6th Cir. 1992). See also, Patten, 96-1 U.S.T.C. ¶60,231 (DC CA 1996) and Anderson, 96-2 U.S.T.C. ¶60,235 (DC MD 1996). In both of these cases, the estate tax return was filed incorrectly, but the Tax Court ruled that the amount reported on the decedent's estate tax return was not determinative of basis, rather, basis is equal to the amount that should have been includible had the estate tax return been filed properly.

B. Memorandum In Support of Taxpayer's Position

The taxpayer submits that in this case the property obtained a full step-up in basis and the case of Treat v. Commissioner, 52 Mass. App. Ct. 208 (2001) does not apply.

In Treat v. Commissioner, the Massachusetts Appeals Court declined to follow the general rule of Gallenstein v. United States, 575 F.2d 286 (6th Cir. 1992) where the Sixth Circuit Court of Appeals found that, with respect to real estate owned jointly by a husband and wife acquired before 1977, the surviving spouse obtained a step-up in basis equal to the full fair market value of the property on the date of the decedent's death rather than a basis equal to one-half of the fair market value on the date of the decedent's death plus one-half of the taxpayer's original cost.

The basis for the ruling by the Sixth Circuit Court of Appeals stems from IRC § 1014(a), which provides that the basis of property acquired from a decedent is equal to the fair market value of the property that is includible in the decedent's estate for federal estate tax purposes. Moreover, as to property owned jointly between a husband and wife, IRC § 2040(b) provides that, at least with respect to property acquired prior to 1977, the surviving joint tenant obtains a so-called full step-up in basis because the property was includible in the estate of the decedent at 100% of its value.

Following the decision in _Gallenstein_, the Massachusetts Appeals Court addressed the basis of property acquired by a surviving spouse in the case of a decedent who died in 1993. In _Treat v. Commissioner_, the Court ruled that, since the Massachusetts estate tax system required that only 50% of the value of the property owned by the decedent and his spouse be includible pursuant to General Laws chapter 65C, §1, the surviving spouse would acquire only a 50% step-up in basis.

The taxpayer's position in this case is that the _Treat_ case does not apply to the facts of this case inasmuch as General Laws chapter 65C, § 1 became applicable by virtue of the changes in the Massachusetts estate tax for decedents dying on or after January 1, 1997. In this case, the decedent died in 1999.

The decision in _Treat_ is based upon General Laws chapter 65C, § 1(d), which is applicable to deaths occurring before January 1, 1997. This section provides:

> "Federal Gross Estate, the gross estate, as defined under the Code, except that (1) notwithstanding Section 2035 of the Code, the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has, at any time made a transfer, relinquished the power or exercised or released a general power of appointment, except in case of a bona fide sale for adequate and full consideration in money or money's worth, by trust or otherwise, during the three year period ending with the date of the decedent's death, provided, however, the value of such property or interest therein so transferred or subject to the power so relinquished, exercised or released, exceeds $10,000 for any person during a calendar year, and (2) notwithstanding Section 2040 of the Code, one-half of the value of any interest in any property shall be included in the gross estate if such interest is held by the decedent and the decedent's spouse as tenants by the entirety or joint tenants with rights of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

This Section, however, does not apply to the decedents who died on or after January 1, 1997. Under current law, the Massachusetts Estate Tax is based upon the Federal Estate Tax Credit for estate taxes pursuant to IRC § 2011.

For deaths occurring prior to January 1, 1997, Massachusetts followed the general Federal Rules of includibility, subject to the two foregoing exceptions, i.e., in the case of transfers made by a decedent within three years of the date of death and for property

owned jointly between a husband and a wife, where the husband and wife were the only owners.

For deaths on or after January 1, 1997, no adjustments are made to the federal gross estate to determine the amount of the Massachusetts estate tax, which is equal to the federal estate tax credit for state death taxes, pursuant to IRC § 2011. (The Massachusetts statute was amended again for estates of decedents who died on or after January 1, 2003, in which case the Massachusetts estate tax was decoupled from the federal estate tax as it was modified by the federal Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA). As the Massachusetts estate tax stands today, the Massachusetts estate tax is to be computed pursuant to the provisions of the federal estate tax in effect on December 31, 2000, with the amount of the tax equal to the sum equal to the amount of the credit for state death taxes that would have been allowable to the decedent's estate, as computed under IRC § 2011, as in effect on December 31, 2000.)

While it is true that, General Laws chapter 65C, § 1(d) remains on the books, it is no longer applicable to decedents who die on or after January 1, 1997. The instructions to the Massachusetts Estate Tax Return for decedent's dying on or after January 1, 1997, make it clear that this is the result intended.

Since Massachusetts now requires that the Federal Rules of includibility be followed and the Massachusetts estate tax is based upon the exact amount of the state death tax credit allowable, the principles of Gallenstein now apply to determine Massachusetts basis as well as federal basis, since 100% of the property is includible in the estate of the first spouse to die on the facts of this case.

As an additional basis for the refund, it should be noted be noted that Massachusetts incorporates federal income tax provisions to determine the basis of property acquired from a decedent, which, under IRC § 1014, defines the basis of property as the fair market value at the time of death. Specifically, General Laws chapter 62, § 6F of the Massachusetts Income Tax Statute, sets forth the method to determining the basis in property. Here, § 6F(b)(2)(C), provides that:

> "Notwithstanding subparagraphs (A) and (B), in the case of property acquired from a decedent within the meaning of IRC § 1014 of the Internal Revenue Code, the initial basis of such property shall be determined under Section 1014 of the Code.

In Treat, the Court acknowledged the link between the federal basis and Massachusetts basis but, nevertheless, declined to follow the specific language of General Laws chapter 62, § 6F, since, in the Court's opinion, it would lead to an unfair result. This analysis no longer is valid inasmuch as for decedents dying on or after January 1, 1997, full includibility is required in the estate of the first spouse to die under Code Section 2040(b).

For the foregoing reasons, the refund claim should be allowed.

C. Don't Forget the Estate of Gwynn – Does Property Have to be Inherited in Order to Obtain a Step-Up in Basis?

Generally, yes, but there are certain exceptions when property was given away during life and the decedent either retained a "life interest" or "life estate" or merely continued to use the property without paying rent. IRC § 2036(a)(1) requires that the fair market value of the property be includible in the decedent's estate for estate tax purposes, even though the property would not be includible for probate purposes. This can actually provide a benefit as long as the value of the property included in the decedent's estate does not exceed either the Massachusetts or federal estate tax thresholds.

In Rev. Rul. 70-155 and *Estate of Guynn*, 437 F.2d 1148 (4th Cir. 1971), it was ruled that the transfer by the decedent of property before death was includible in the decedent's estate for estate tax purposes if the donor continued to use the property before death and did not pay fair rent. On the theory that there was an "implied life estate."

This theory has been followed recently in the *Estate of Maxwell*, 98 T.C. 39 (1992) in which the decedent had "sold" property to his children before death and had received approximately 50% of the sale proceeds, but continued to live in the property after the purported sale. The decedent's Will forgave the note at death and the decedent was canceling $20,000 of the note each year. The Tax Court ruled that the full fair market value of the property was includible and that the sale transaction should be ignored under IRC § 2036 using an implied life estate theory. This retained life estate may be avoided if the decedent owned property as a tenant in common with his children within the theory of *Estate of Powell v. Commissioner*, 63 T.C.M. 3192 (1992). See also, *Estate of Wineman*, 79 T.C.M. 2189 (2000).

These rules can provide potentially good news to heirs who are selling property after the donor died, but where the property was gifted before death. Usually, the donee's basis is equal to the donor's basis, increased by any gift taxes paid under IRC § 1015.

III. Eliminate Confusion Over the Various Three-Year Rules

a) For federal and Massachusetts estate tax purposes, properties transferred within three years of the date of death are not includible in the decedent's estate unless property transferred would have otherwise been an includible revocable transfer under IRC § 2036 (relating to transfers with retained interests), IRC § 2037, IRC § 2038, or IRC § 2042 (relating to life insurance), IRC § 2035(a)(1), (a)(2)

b) Exception for transfers from revocable trusts

IRC § 2035(e) provides an exception for transfers with in three years from revocable trusts, provides:

For purposes of this Section and Section 2038, any transfer from any portion of a trust during any period that such portion was treated under Section 676 (relating to revocable trusts) as owned by the decedent by reason of a power in the grantor (determined without regard to Section 672(e)) shall be treated as a transfer made directly by the decedent.

c) Payment of Gift Taxes on Gifts Made by the Decedent or His Spouse Within Three Years of the Date of Death

The amount of the decedent's gross estate shall be increased by the amount of any gift tax paid by the decedent or his estate on any gift made by the decedent or his spouse within the three year period ending on the date of the decedent's death. IRC § 2035(b)

PLANNING NOTE
This is the Code Section that tries to equitize gift giving and inheritances by recognizing that the gift tax is so-called "exclusive" and the estate tax is so-called "inclusive."

EXAMPLE #2

- Assume the decedent has $10,000,000 in assets and has utilized all of his exemption. Assume the gift and estate tax is 50% (although since the actual gift tax rate is 35% this year, even greater leverage is possible by making lifetime gifts.) Consider the difference:

	NO GIFT	GIFT
TOTAL ASSETS	$10,000,000	$10,000,000
GIFT	$ 0	$ 6,607,000
ESTATE TAX (50%)	$ 5,000,000	$ 0
GIFT TAX (50%)	$ 0	$ 3,333,000
NET TO FAMILY	$ 5,000,000	$ 6,607,000

DETERMINATION OF BASIS

	ESTATE	GIFT
GIFT (§1015)		$ 6,607,000
GIFT TAXES PAID		$ 3,333,000
TOTAL BASIS		$10,000,000
*But not above FMV		
ESTATE (§1014)	$10,000,000	
TOTAL BASIS	$10,000,000	$10,000,000

No benefit if decedent dies within 3 years of the gift. § 2035(b)

IRC §2035(b)	$ 3,333,000
ESTATE TAX (50%)	$ 1,667,000
TOTAL TAXES	$ 5,000,000

d) The Massachusetts Three-Year Rule Still Causes Confusion

There is no separate three-year rule with includibility for Massachusetts estate tax purposes. This problem stems from General Laws Chapter 65C, §1(d), which is applicable only for deaths occurring before January 1, 1997. This section provides:

"Federal Gross Estate, the gross estate as defined under the Code, except that: (1) notwithstanding Section 2035 of the Code, the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has every time that a transfer, relinquishment of power, or exercise or release the general power of appointment, except in the case of a bona fide sale for adequate or full consideration in money or money's worth, by trust or otherwise, during the three year period ending with the date of the decedent's death, provided, however, the value of such property or interest therein so transferred is subject to the power so relinquished, exercised, or released, exceeds $10,000 for any period during any calendar year, and (2) notwithstanding Section 2040(b) of the Code, one half of the value of any interest in any property shall be included in the gross estate if such interest is held by the decedent and the decedent's spouse as tenants by the entirety or joint tenants with rights of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants.

PLANNING NOTE

This Section does not apply to decedents who died on or after January 1, 1997.

IV. Treatment of Prior Completed Gifts

a) A claw-back problem was raised as a result of the way estate taxes are computed and completed gifts are added back to the estate (solely for the purpose of computing the estate tax rate applicable to the estate).

b) In order to determine the estate tax due, completed gifts made after December 31, 1976 (other than gifts that are includible in the decedent's gross estate), are added to the decedent's taxable estate to determine the so-called "taxable base." This is very different than including the asset as an asset of the estate which would provide a step-up in basis. The purpose of this computation was to simply push the estate into a higher bracket (although this is no longer relevant since the maximum rate would be 35%).

c) The net effect of this computation is a realization that lifetime gifts other than discounted gifts remove only the appreciation with respect to that asset for federal estate tax

purposes but, since lifetime gifts are not added back for purposes of determining the Massachusetts estate tax, a permanent savings will result.

V. Claw-Back is Not a Problem (but BNA has not picked up on it yet)

a) Lifetime Giving and the Claw-Back Issue Remains:

A claw-back issue was thought to arise if a taxpayer makes a gift in excess of $1,000,000 in 2011 or 2012 and dies in 2013 with no taxable estate and the exemption reverts to $1,000,000. If the estate tax return computation is followed literally, the taxpayer would wind up owing estate taxes even though the decedent did not have any assets as of the date of death. This problem arises from the way the estate tax is computed, which requires that gifts in excess of the annual exclusion amount made after 1976 must be added back to the decedent's taxable estate (primarily to determine the applicable rate).

If we assume a $5,000,000 gift in 2011 and a 35% bracket, this would give rise to an estate tax of $1,750,000 if the taxpayer died in 2013, since the credit is allowed based upon the estate tax applicable to the exclusion amount in effect in the year of death (presumably $1,000,000). This would give an estate tax credit of only $350,000 with a tax due of approximately $1,400,000. This was clearly not intended by Congress and may or may not be a legitimate problem.

<u>See</u>: Form 706 & 709

Sample Computations of Gift & Estate Tax Computations to Show Potential Claw-Back Using 2009 Forms

Form 709 (Gift)

Line 3	Amount of Gift	$5,000,000
Line 4	Tax on Gift (35%)	$1,750,000
Line 12	Unified Credit (Gift Tax on $5,000,000)	$1,750,000
Line 19	Gift Tax Due	– $0 –

706 Estate Tax Computation (Using 706, 9/09)

Line 3(a)	Total Assets at Death	– $0 –
Line 3(b)	State Death Tax Deduction	– $0 –
Line 3(c)	Taxable Estate	– $0 –
Line 4	Adjusted Taxable Gifts Made After December 31, 1976 (Other than Gifts that are Includible in the Decedent's Gross Estate)	$5,000,000

Line 5	Total	$5,000,000
Line 6	Tentative Tax (Assume 35%)	$1,750,000
Line 7	**Total Gift Tax Paid (or Payable)**	**– $0 –**
Line 8	Gross Estate Tax	$1,750,000
Line 9	Maximum Unified Credit ($1,000,000 x 35%)	$ 350,000
Line 11	Allowable Unified Credit	$ 350,000
Line 16	Tax Due (Line 8 minus Line 11)	$1,400,000

PLANNING NOTE

According to Professor Pennell, there is no Clawback as he writes:

> "And that there is a credit for gift tax paid even though the taxpayer did not pay any gift tax inter vivos. (This is the infamous Form 706 Line 7 calculation.) Here's why – and this is the linchpin to understanding why claw back does not apply even if the unifies credit declines.
>
> The Code provisions that generate these rules are section 2001(b)(2) and (g). The former gives the credit for gift tax paid by saying that the credit is
>
> "the aggregate amount of tax which would have been payable under chapter 12… if the modifications described in subsection (g) had been applicable at the time of such gifts."
>
> And then section 2001(g) says:
>
> "the rate of tax… in effect at the decedent's death shall, in lieu of the rates of tax in effect at the time of such gifts, be used both to compute – (1) the tax imposed by chapter 12 with respect to such gifts, and (2) the credit allowed against such tax under section 2505, including in computing – (A) the applicable credit amount under section 2505(a)(1), and (B) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2)."
>
> The reason this differs from what might seem more straightforward is because it anticipates the change in rates that also will occur after 2012 (if Congress does not further amend that law). And it means that the credit for gift tax paid is calculated as if the $2 million gift in the example was made when the exclusion amount was only $1 million – because that is the law at the date of death. In which case $680,800 of gift tax would have been calculated on a $2 million gift, and a unified credit of $330,800 would have been applied against that tax bill (that being the tax on $1 million, which would be the exclusion amount in the year of death), *and $350,000 of gift tax would have been payable*. That "would have been payable" amount is the credit at death, *not* the amount that *actually* was paid.
>
> This means that an inter vivos transfer that was tax free (because the unified credit was large enough to avoid the need to pay tax) does not become taxable in the future if the

exclusion amount is reduced. And the same result applies under the gift tax rules in section 2505 because similar language was added there in 2012 as well.

This is pretty complex, and the significance of these rules is lost if the unified credit concept is confused by thinking of an exemption – as if the first $5 million in today's context was not taxable. The reality is that everything is taxable, but the tax is not paid until the credit is exhausted. That may appear to be the same as an exemption – for street lingo purposes the "exemption" terminology is easier for casual observers to understand – but the Code calculation is very different. And it means that claw back is not a real issue."

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PLANNING NOTE

There is no gift tax in Massachusetts and there is no longer a rule requiring assets transferred within three years of the date of death be includible in the decedent's estate (except as may be required under IRC § 2035). For deaths occurring on or before January 1, 1997, the following rule applied to create differences between the federal and state gross estates. G.L. c.§65C, §1(d) provides the following:

"**Federal Gross Estate**, the gross estate, as defined under the Code, except that (1) notwithstanding Section 2035 of the Code, the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has, at any time made a transfer, relinquished the power or exercised or released a general power of appointment, except in case of a bona fide sale for adequate and full consideration in money or money's worth, by trust or otherwise, during the three year period ending with the date of the decedent's death, provided, however, the value of such property or interest therein so transferred or subject to the power so relinquished, exercised or released, exceeds $10,000 for any person during a calendar year, and (2) notwithstanding Section 2040 of the Code, one-half of the value of any interest in any property shall be included in the gross estate if such interest is held by the decedent and the decedent's spouse as tenants by the entirety or joint tenants with rights of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants."

VI. Discounts, Discounts, and More Discounts

This is a summary of discount cases followed by the Internal Revenue Service:

a) *Lappo v. Commissioner*, T.C. Memo 2003-258:

Taxpayer gifted limited partnership interests in a partnership consisting primarily of marketable securities (principally municipal bonds) and certain parcels of Michigan real estate that was subject to a long term lease. The Tax Court allowed a 15% minority interest and a 24% marketability discount, computed as follows:

TOTAL NAV (NET ASSET VALUE)

AS OF DETERMINATION DATE	$3,156,882
1% OF NAV	$ 31,569
LESS: 15% MINORITY INTEREST DISCOUNT	(4,735)
	$ 26,834
LESS: 24% MARKETABILITY DISCOUNT	(6,440)
FMV OF 1% INTEREST	$ 20,394
FMV OF 69.4815368% INTEREST	$1,417,006

b) *Peracchio v. Commissioner*, T.C. Memo. 2003-280

Taxpayer formed limited partnership and transferred limited partnership interests to family members where the assets of the partnership consisted primarily of cash and marketable securities with a designated value of $2,013,765. The Tax Court allowed discounts of 6% for the minority interests and 25% for the marketability discount, computed as follows:

TOTAL NAV	$2,010,370
1% OF NAV	$ 20,104
LESS: 6% MINORITY INTEREST DISCOUNT	(1,206)
MARKETABLE VALUE	$ 18,898
LESS: 25% MARKETABILITY DISCOUNT	(4,725)
FMV OF 1% INTEREST	$ 14,173
FMV OF 45.47% INTEREST	$ 644,446
FMV OF 53.48% INTEREST	$ 757,972

c) Reg. 25.2512-1

The IRS will no longer deny discounts simply because transfers are made between family members understanding that there should be no aggregation of interest.

Example:

Decedent owns property, such as an LLC or an S corporation, worth $10,000,000 and gifts 20% to each of the 5 children. If the decedent dies, the asset would be worth $10,000,000. However, if the assets are transferred, the fair market value of the gift would be approximately $6,000,000, assuming a 40% discount. The question is what is the value of each 20% interest based upon the general rule that value is equal to the price of listed property to change hands assuming that a willing buyer and a willing seller and both parties had reasonable knowledge of all of the relevant facts and circumstances and neither party is under a compulsion to either buy or sell.

d) Real Estate

The fair market value of fractional interests in real estate can range from a low of 17% to a high of 44%.

1. *Ludwick v. Commissioner*, T.C. Memo. 2010-104

Taxpayers, a married couple, separately transferred a tenancy in common interest in a vacation home to qualified personal residence trusts using a discount of 30% of net asset value ($7,250,000 x 50% x 70% = $2,537,500). The IRS was willing to allow a discount of 15% but in Tax Court argued that the discount should be no more than 11%. The Tax Court determined that a 17% discount would be appropriate relying on expert testimony as to how much a "partition" proceeding would cost.

In the case of a fractional interesting property, the value should be determined by reference to the "cost to partition" rather than using a "going concern" value.

2. *Lefrak v. Commissioner*, T.C. Memo. 1993-526 (1993)

The Tax Court allowed a discount of 20% for lack of control and 10% for lack of marketability rejecting a cost of partition approach.

3. *Estate of Barge v. IRS*, 73 T.C.M. 2615 (1997)

The Tax Court allowed a 28% discount for an undivided interest in timberland noting that the Tax Court valued the land using a capitalization of income approach using a 10% capitalization rate.

4. *Estate of Williams v. IRS*, 75 T.C.M. 1758 (1998)

The Tax Court allowed a 44% discount for a fractional interest of jointly owned real estate gifted to the donor's wife's niece finding that there should be a discount of 20% for lack of marketability and 30% for lack of control (44% in total net).

PLANNING NOTE

In TAM 199943003, the IRS agrees that the estimated cost to partition is only one method of determining the appropriate discount.

e) Consider Promissory Notes

The gift tax value of a promissory note may be significantly less than the face amount of the note and perhaps forgiveness should be considered, although income tax ramifications of forgiveness should be considered if the note is not between a grantor and an intentionally defective grantor trust.

Reg. 20.2031-4 provides that the value of a note included a decedent's gross estate is presumed to be the amount of unpaid principal less accrued interest on the valuation date, unless the note is shown to have a lesser value or to be worthless. Discounts are appropriate attributable to uncollectability, lack of security, interest rates, and terms. The IRS and the courts have applied this Regulation to promissory notes between family members as well as notes between unrelated persons (even if money will be inherited enough to pay off the note and the cancellation of indebtedness is based on cash loans.). *Estate of Berkman v. Commissioner*, T.C.M. 1979-46; TAM 9240003

VII. Consider Net Gifts - Revenue Ruling 75-52

a) Gift tax paid by the donee may be deducted from the value of the transferred property where it is expressly shown or implied that the payment of the tax by the donee or from the property itself is a condition of the transfer.

b) To determine the gift tax due, divided the tentative tax by the rate of tax plus 1 to find the amount of the gift tax. The gift tax then is deducted from the value of the property to determine the amount of the net gift. Assume $10,000,000 in assets with no remaining exemption. Assume the gift tax rate is 35%. The actual gift tax will be $2,592,000 rather than $3,500,000. In this case, the gift tax would be $2,592,000 and the family would receive $7,408,000.

EXAMPLE #3

AMOUNT OF ASSETS	$10,000,000
TENTATIVE GIFT TAX (35%)	$ 3,500,000
NET GIFT TAX ($3,500,000 ÷ 1.35)	$ 2,592,000
AMOUNT TO FAMILY	$ 7,408,000

c) Issues

(1) Gift tax must be paid in cash – Consider having the grantor make a loan to the donee trust taking back the promissory note in the amount of the gift tax paid. In this example, the gift would be $7,408,000 while the loan would be $2,592,000.

PLANNING NOTE
This allows the donor to receive the income attributable to the property transferred without a triggering an IRC § 2036 problem.

(2) Possibility of Capital Gain – To the extent the gift tax liability exceeds the donor's adjusted basis in the property transferred, the donor will recognize capital gain, but this would not be recognized to the extent that the gift is made to an intentionally defective grantor trust if the donor dies within 3 years of making the gift.

d) S Corporation Considerations

The requirement of an electing small business trust (ESBT) is that no interest in the trust was acquired by purchase. Reg. 1.1361-1(m)(1)(iii). The Regulations make it clear that the prohibition applies to purchases of a beneficiary's interest in the trust, not to purchases of property by the trust. As such, a net gift of a beneficial interest in a trust where the beneficiary pays the gift tax, would be treated as a purchase of a beneficial interest under these rules, while a net gift to the trust itself, when the trustee of the trust pays the gift taxes, would not be so treated. T.D. 8994 IRD 2002-23 (June 10, 2002)

e) Consider using a self-cancelling note if the net gift transaction is financed by a loan from the grantor to the trust. In such a case, no amount attributable to the note will be includible in the decedents estate under <u>*Frane v. Commissioner*</u>, 998 F.2d 767 (8th Cir. 1993)

f) One analysis would be how much can be gifted if the taxpayer is willing to pay the gift tax of $10,000,000.

<u>EXAMPLE 4</u>

<u>Assets:</u>

	$50,000,000 in low basis assets
	<u>$10,000,000</u> in Cash
Total:	$60,000,000

<u>Assumptions:</u>

Federal gift tax rate of 35%
No State gift tax
Federal estate tax rate of 45%
State death tax rate of 10%
Federal capital gains tax rate of 15%
State capital gains tax rate of 5%

1. Q: How much can be gifted if you are willing to pay a gift tax of $10,000,000?

A: Assuming no discounts, $28,570,000
$10,000,000 ÷ 35% = $ 28,570,000

2. Q: Using a discount of thirty percent (30%), how much can be gifted if you are willing to pay a gift tax of $10,000,000?

   A: $40,814,000 can be gifted.
   $28,570,000 ÷ 70% = $ 40,814,000
   Discounts are allowed for transfers, even between family members. See Lappo and Peracchio cases.

3. Q: If we use a net gift, could we decrease the gift tax liability?

   A: Yes, the gift tax liability on a net gift would fall to $7,407,000. This is an effective tax rate of twenty-six percent (26%). See Revenue Ruling 75-72.
   $10,000,000 ÷ 1.35 = $ 7,407,000

4. Taxpayer would then loan the funds to the trust(s) to pay the gift tax in April 2013.

5. The Trust(s) must be grantor trusts to avoid any capital gains tax. Otherwise, Taxpayer will have recognized a gain on the amount by which the gift tax liability exceeds her basis in the property. See Revenue Ruling 85-13.

6. The Trust(s) must also include disclaimer language in case the estate tax is repealed.

7. If death occurs within three (3) years of making the gift, the gift tax paid is includable in Taxpayer's gross estate under IRC 2035(b).

8. The cash flow from the promissory note to pay the gift tax will provide income for Taxpayer.

9. The applicable federal rates (AFR) for May, 2012 (compounded annually):

Short-Term (3 years or less):	0.28%
Mid-Term (more than 3, but 9 or less):	1.30%
Long-Term (more than 9):	2.89%

10. The Tax Court has determined that a long-term buy-and-hold investment strategy of is a legitimate business purpose of a family limited partnership. See Schutt and Black cases.

VIII. Grantor Retained Annuity Trust (GRAT)

a) Description Of Technique

Donor transfers the property into a trust reserving the right to be paid an annuity every year until the term of the GRAT ends. The technique is governed by IRC § 2702, which was enacted in 1990 as part of Chapter 14 to eliminate a perceived abuse with grantor

retained Income Trusts, in which property was given away and a "retained income interest" is retained, but no amounts were actually paid to the grantor.

b) IRC § 2702 forces the use of an annuity rather than merely an income interest creating a special valuation rule.

c) IRC § 2702(a) provides that the value of the retained interest shall be zero unless the retained interest is a qualified interest.

d) A qualified interest is where a fixed annuity or a "unitrust" amount that must be paid every year. IRC § 2702(b)

This section does not apply to transfers between nieces and nephews, but only to transfers between family members defined as the Donor's spouse, ancestors and lineal descendants of the Donor and the Donor's spouse, and siblings of the Donor and their spouses (but not children of siblings). IRC § 2702(e) referring to IRC § 2704(c)(2).

EXAMPLE

Assume a $10,000,000 asset. The grantor is age 60. The grantor is considering a 10 year GRAT.

May, 2011, IRC § 7520 Rate = 3.00% (120% Federal Mid-term AFR Rate). IRC § 2702(a)(2)(B)

FAIR MARKET VALUE	GRAT	GRIT
Fair market Value	$10,000,000	$10,000,000
Annual Annuity	$ 1,000,000	$ 0
Present value of Annuity Payments	$8,530,200	n/a
Gift	$1,469,800	$10,000,000

e) Advantages

- The value of the gift can be zeroed out following the case of *Walton v. Commissioner*, 115 T.C. 41 (2000). In *Walton*, Walmart stock worth $100,000,000 was transferred to a two-year GRAT with the first payment equal to $49,350,000 and the second annual payment in the amount of $59,220,000 for a total of $108,570,000. The value of the stock declined so that none of the wealth was transferred to the trust beneficiary at the end of the two year term. Even though no benefit was realized, the IRS assessed a taxable gift of $3,822,000

consisting of the Estate's contingent interest of $2,938,000 and the remainder interest $838,522. The Tax Court ruled in favor of the taxpayer.

- The amount of the gift can be adjusted by increasing the term of the retained interest or the amount of the annuity. In the prior example, an annuity for ten years of $1,249,328 would zero out the GRAT

- The valuation risk in a uni-trust can be eliminated in a GRAT since the amount of the annuity will adjust automatically if there is a valuation adjustment. Reg. 25.2702-3(c)(2)

PLANNING NOTE

This advantage over outright gifts or sales to intentionally defective trusts has virtually been eliminated as a result of Wandry v. Commissioner, T.C. Memo. 2012-88. In Wandry, for the first time, the Tax Court approved a gift of LLC units at a value to be determined by an appraisal, subject to adjustment for the IRS audited return. The Tax Court held that the number of units transferred would be based on its decision and that no adjustment would be made for the dollar value of the gift. The exact language was as follows: "I hereby assign and transfer as gifts, a sufficient number of my units, as a member of LLC, so that the fair market value of such gifts for federal gift tax purposes, shall be as follows:

Name	*Gift Amount*
Kenneth D. Wandry	*$ 261,000*
Cynthia K. Wandry	*$ 261,000*
Jason K. Wandry	*$ 261,000*
Jared S. Wandry	*$ 261,000*
Grandchild A	*$ 261,000*
Grandchild B	*$ 11,000*
Grandchild C	*$ 11,000*
Grandchild D	*$ 11,000*
Grandchild E	*$ 11,000*
Total	*$1,099,000*

Although the number of units gifts is fixed on the date of the gift, that number is based on the fair market value of the gifted units, which cannot be known on the date of the gift, but must be determined after such date based on all relevant information as of that date. Furthermore, the value determined is subject to challenge by the Internal Revenue Service (IRS). I intend to have a good faith determination of such value made by an independent third party professional experienced in such matters and appropriately qualified to make such a determination.

Nevertheless, if, after the number of gifted units is determined based on such valuation, the IRS challenges such valuation and a final determination of a different value is made by the IRS or a court of law, the number of gifted units shall be adjusted accordingly so that the value of the number of units gifted to each person equals the amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermined by the IRS and/or a court of law."

f) Disadvantages

- The full value of the property transferred to the trust will be included in the grantor's estate if the grantor dies during the term. IRC § 2036(c); Regs. 20.2036-1(c)(2)

- The GRAT is not an effective generation skipping transfer technique since generation skipping transfer tax exemption cannot be allocated until the closing of the so-called estate tax inclusion period (ETIP), per section Regs. 25.2632-1(c)(3). (Any allocation of GST exemption to such property cannot be made before the close of the estate tax inclusion. IRC § 2642(f)(1).)

  This means that in the case of the 10 year $10,000,000 GRAT, the value of the gift currently is $1,469,800, but if the property appreciates to $20,000,000 in 10 years and then is paid to grandchildren, a generation skipping tax will be imposed to the extent the transfer exceeds the generation skipping transfer tax exemption.

Example:	FMV	$20,000,000
	Less GST Exemption	$ 5,000,000
	Taxable GST Termination	$15,000,000
	GST Tax (35%)	$ 5,250,000

- The Donor (and no one else) is entitled to the Annuity during the term. Regs. 25.2702-3(d)(3)

- Additional contributions to the GRAT must be prohibited. Regs. 25.2702-3(b)(5)

- Commutation of the term interest must be prohibited. Regs. 25.2702-3(d)(4)

- Cannot use a Note or other debt interest to pay the annuity. Regs. 25.2702-3(d)(6)

See *Simches v. Simches*, 423 Mass 683 (1996) (A Massachusetts case in which a reformation proceeding permitted to change a QPRT remainder beneficiaries from grandchildren to children.)

PLANNING NOTE
In order to minimize mortality risks and to affect market conditions, a series of two-year GRATs usually will be recommended instead of a single ten-year type term GRAT.

- Multiple GRATs require ongoing significant legal fees each year.

- The property subject to the GRAT must be valued each year if the income generated from the property is not sufficient to pay the annuity amount.

PLANNING NOTE
A GRAT will be an intentionally defective grantor trust so that the use of an asset to pay the annuity will not be considered a capital gain transaction. It is a transaction between the grantor and a grantor trust. Rev. Rul. 85-13

g) Other Considerations

- As a grantor trust, the grantor is taxed on the income generated by the GRAT.
- A GRAT is permissible with discounted assets.
- To be successful, the rate of return must exceed the IRC § 7520 rate. (1.60% for the month of May, 2012)

IX. Sale of Assets to an Intentionally Defective Irrevocable Grantor Trust

a) Summary of Transaction

- Grantor establishes an irrevocable trust that is excluded from the estate for estate tax purposes.
- Income and principal may be payable to Donor's spouse and issue in trustee's discretion during the term.
- The trust can, and should be, set up for perpetuity or at least as long as the applicable estate law of perpetuities permits.
- The trust is a grantor trust for income tax purposes by including the power of substitution under IRC § 675(4)(C), which provides: "The grantor shall have the right to reacquire trust corpus by substituting property of an equivalent value."

PLANNING NOTE
The provision has been approved by the Internal Revenue Service in connection with an intentionally defective trust where the IRS ruled that such a clause would not cause the trust assets to be includible in the decedent's estate under IRC § 2038 and IRC § 2041. Rev. Rul. 2008-22 as well as under IPC § 2042 (Rev. Rul. 2011-28) (relative to life insurance).

- If working with an S corporation, recapitalize the S corporation with voting and nonvoting shares in a 9 to 1 nonvoting stock dividend.

- Determine the value of the nonvoting shares by taking into account applicable discounts for lack of marketability and lack of control.

PLANNING NOTE

If possible, work with Limited Liability Companies and Limited Partnerships to avoid any built in gain problem or possible gain on the distribution of appreciated property from the company to its owners. See, IRC § 311(b), which provides: that the distribution of appreciated property from a corporation (including an S corporation) will be considered a sale for fair market value and a distribution of the proceeds.

- Fund/Seed the trust with an amount equal to 10% above the assets being purchased." (There is no statutory or regulatory basis for this, but seems to be an accepted standard.) See, Petter v. Comm., T.C. Memo. 2009-280 (Defined value formula permitted in a case where 10% seed money was used.)

PLANNING NOTE

With a $5,000,000 lifetime giving exemption, this could equate to a sale of $50,000,000 in stock. This would be the equivalent of an $80,000,000 company on a discounted basis.

- Determine whether to use one of the following techniques:

  (1) an installment note (FMV of Note included in Donor's estate)

  (2) a self-cancelling installment note see, *Frane v. Comm.*, 998 F.2d 567 (8th Cir. 1993) (FMV of Note not included in Donor's estate.)

  (3) a private life annuity See, GCM 39503; Rev. Rul. 86-72

- Determine applicable interest rate using applicable federal rate, which is as follows for the month of May:

Term	Applicable Rate	Annual Rate
3 years or less	federal short term rate	0.28%
4 to 9 years	federal midterm rate	1.44%
9 years or greater	long term rate	2.89%

  See, *Frazee v. Comm.*, 98 T.C. 554 (1992)

  IRC § 1374(d)

- Prepare amortization schedule and be sure cash flow from enterprise is sufficient to pay the principal.

- Obtain solid valuation and to minimize valuation adjustments, consider using a formula purchase price. See, *Petter v. Comm.*, T.C. Memo. 2009-280 (The Donor gifted to a trust as seed money before the sale of LLC units equal to 10% of the value of the total units held in the trust after the sale.) See, also, *Knight v. Comm.*, 115 T.C. 506 (2000) (A gift was made to children in an amount equal to those number of FLP units having a value of $300,000.); *McCord v. Comm.*, 461 F.3d. 614 (5th Cir. 2006); *Estate of Christiensen*, 586 F.2d. 1061 (8th Cir. 2009) Aff'g. 130 T.C. (Formula value allocations between trusts permitted.) *Wandry v. Comm.* TS. Memo 2012.88.

- Avoid IRC § 2036 problems by having automatic wire transfers to make a distribution of funds to the owners and then a corresponding payment of the promissory note by the trust.

- The payment of principal which would otherwise be subject to the capital gain to the grantor is taxable since the transaction is between a grantor and a grantor trust. Rev. Rul. 85-13

- The payment of interest is not taxable to the grantor even though it is a transaction between a grantor and a grantor trust. Rev. Rul. 85-13

- The grantor must pay the income taxes attributable to the income allocated to the IDGT. Rev. Rul. 2004-64

PLANNING NOTE
Revenue Ruling 2004-64 provides that the independent trustee can reimburse the grantor each and every year for his or her incremental income tax.

- If income from the enterprise is insufficient to pay the annuity, then consider using either membership interests or S corporation shares to pay amounts due under the note.

- Consider distributing low basis appreciated assets from the enterprise (at least in the case of a partnership) to the trust, which can be used to repay the note on a non-discounted basis.

PLANNING NOTE
This will not work in the case of an S corporation because of Code Section 311(b). The trust's basis is a carryover basis since no taxable gain was recognized at the time of the sale. Consider using a self-cancelling installment note or a private annuity.

- An installment note is not a retained interest subject to IRC § 2702. PLR 9535026 and PLR 9436006

- Consider Using a Self-Cancelling Installment Note

a) No amount attributable to the note is includible in the decedent's estate.

b) At the time of the sale, a premium must be built in to either the interest rate or the principal payment. (This could be a disadvantage if death does not occur within the anticipated term.)

- Consider Using a Private Annuity

  a) Use IRC § 7520 rate to determine the appropriate annuity to avoid excess gift.

  b) No amount is includible in the decedent's estate upon death since the private annuity terminates and no portion of it passes to any other person.

X. Income Tax Consequences On Termination Of Grantor Status Uncertain

- In the *Estate of Frane*, the self cancelling promissory note in question was between the settlor and an individual so that, while no amount was included in the decedent's estate, the amount of the deferred gain was recognized on death and became taxable to the estate as part of the fiduciary income tax return.

- The same rule would apply in the case of a regular note.

- In the case of a sale to an intentionally defective trust, there is no specific authority.

PLANNING NOTE
There is no dispositive authority indicating how the termination of grantor trust status should be treated where, at that time, the trust continues to owe a debt to the grantor. In Reg. 1.1001-2(c), Example 5, the grantor is required to recognize a gain because the property held in trust at the time grantor trust status terminates is encumbered by a debt owed to a third party (not the grantor) that exceeds the grantor's basis in the assets.

Clearly, the example was designed to confirm the result in *Madorin*, 84 TC 667 (1985), and Rev. Rul. 77-402, 1977-2 CB 222, in order to prevent tax payers owning a "burnt out" tax shelter from disposing of it without recognizing the "recapture" income.

Similarly, in TAM 200011005 (which, of course, is not precedential authority), at the time grantor trust status terminated, the trust owes a debt to a third party. And, unlike Example 5, the debt did not arise in a tax-shelter context, but rather as a result of a loan taken by the trustee. The IRS concluded that the transaction was "substantially similar" to the one posited in Example 5 and that, as a result, the grantor had to recognize gain on the excess of the debt over basis. However, in neither Example 5 nor the TAM was the debt owed to the grantor. Thus no authority clearly determines the treatment of the grantor in connection with the trust's debt to the grantor where grantor trust status terminates during the grantor's life.

PLANNING NOTE
Try to pay the note off before death.

XI. Consider Using A Domestic Asset Protection Trust

- In most states, the settlor cannot be a beneficiary, otherwise the assets in the trust are included in the decedent's estate. Ware v. Gulda, 331 Mass. 68 (1954); State Street Bank & Trust Company v. Reiser, 7 Mass. App. 663 (1979); Rev. Rul. 76-103; Rev. Rul. 77-378

- Generation skipping transfer exemption can be allocated at the time of the sale and the trust will forever be free of generation skipping transfer and can last literally forever.

- In connection with paying the annuity, amounts under the trust will include children, grandchildren, and great-grandchildren, and will automatically be added as new members arrive, all of whom would be eligible for the annual exclusion gifts.

- Consider using annual exclusion gifts to forgive the note and reducing the amount that needs to be paid back to the grantor by including Crummey trust provisions.

PLANNING NOTE
Crummey withdrawal powers does not change from the grantor to the beneficiaries under IRC § 678(a) by virtue of IRC § 678(b)

- Consider using a state which has repealed the self-settled rule, such as New Hampshire, Rhode Island, or Delaware (and also repealed the rule of perpetuities).

- Such a trust requires that the trustee be a resident of the applicable state.

- All statutes also allow the appointment of a trust advisor who is responsible for telling the trustee where to invest the assets (and when and if to make distributions).

XII. Income Tax Reporting Prior To And After Grantor's Death

- The trust does not pay any income taxes and merely fills out Form 1041 identifying it as a grantor trust and sending a tax letter to the grantor advising the grantor to include the items of income, deduction, and credit on his or her personal income tax return.

- After death, the trust will become a complex trust, with income taxable to the trust unless income is distributed under the income distribution rules of IRC § 661 and IRC § 662.

- If the irrevocable trust owns S corporation stock, be sure to monitor the period to avoid an inadvertent termination of the S election.

- IRC § 1361(c)(2)(A)(ii) provides that for the first two years after death, since the trust was considered wholly owned by the grantor, it remains an eligible S corporation shareholder.

- Thereafter, it must convert to either a qualified subchapter S trust or to an electing small business trust. (ESBT)

- It is unlikely that the trust is eligible as a qualified subchapter S trust since it can only have one income beneficiary and where it will likely default to an electing small business trust. See, IRC § 1361(d).

- As an ESBT, a separate sub-share is effectively created within the irrevocable trust to hold the S corporation shares.

- A new identification number will be issued relative to such share.

- In computing taxable income of the trust, the income distribution rules do not apply and all income attributable to the S corporation will be taxed at the highest applicable federal rate.

PLANNING NOTE
Funds actually distributed from the S corporation will be consolidated with the remaining trust assets, which will be subject to the usual fiduciary income tax rules (i.e., taxable to the trust unless money is actually distributed from the trust to a beneficiary).

XIII. Sample Income Tax Compliance

(Form 1041 – before Death)

XIV. Qualified Personal Residence Trust (QPRT vs. Home Security Trust)

a) INTRODUCTION TO QPRT

- This is similar to the GRAT, but no amount is required to be paid pursuant to the terms of the QPRT. Regs. 25.2702(5)(c)

- This is an exception to the IRC § 2702 rules for a home and a second home.

- Very ineffective for allocation of generation skipping transfer tax exemption since the ETIP rules apply. IRC § 2642(f)(3), (4); Reg. 26.2632-1(c)(2)

- Ineffective if the property has a mortgage since the payment of mortgage represents an addition to the trust.

- No step-up for GST purposes in the case of a child who dies after creation of the trust since the "deceased parent exception" is measured at the time the gift is complete.

- The property will be included in the Donor's estate if the Donor dies during the term of the trust. IRC § 2036(a)(1)

- The QPRT (and any residual grantor trust) must prohibit the reacquisition of the property by the Donor. Regs. 25.2702-5(c)(9)

b) INTRODUCTION TO HOME SECURITY TRUST

- As an alternative consider transferring outright over a number of years the property to an irrevocable intentionally defective grantor trust using Crummey withdrawal notices.

- If the value of the property exceeds $5,000,000, have the grantor take back a promissory note.

- The property must be rented by the grantor for fair rent in order to avoid estate tax inclusion.

- The payment of rent to the IDGT is income tax free.

- The receipt of payments under the installment note are income tax free.

- The trust takes a carryover basis so consider having the grantor repurchase the property before death for cash so the decedent dies with low basis property to take advantage of a step up in basis.

PLANNING NOTE
This provision is so important that it is prohibited to be included in the terms of a qualified personal residence trust or in any trust into which the property flows after the termination of the qualified personal residence trust. See Reg. 25.2702-5(c)(9)

- So, what's the hold-up?

  Lack of control and concern about loss of income and access to the funds gifted.

  (1) As to loss of control, based on the case of a business and/or rental real estate, use a limited liability company or an S corporation with voting and nonvoting shares and give away nonvoting shares and keep the voting shares.

  (2) In the case of a couple, have one spouse create a lifetime credit shelter trust where income and principal is payable to the class consisting of the donor's spouse and

the donor's issue of all generations. No marital deduction would be allowable should an intervivos marital deduction be utilized since the intent is to make it a completed gift couple this with the nonvoting shares so that the asset being transferred to the irrevocable credit shelter trust would be the nonvoting shares. As long as the couple stays married, income and principal can be reallocated to the grantor's generation.

PLANNING NOTE

The trust should provide that, in the event of a divorce, the term "spouse" would exclude the divorcing spouse since this is considered an act of independent significance that would not cause the trust assets to be includible in the decedent's gross estate. Rev. Rul. 80-255; Estate of Tully v. U.S. 78-1 US Tax Cases (CCH ¶ 13.228 (ct.ct 1978)

Consider having husband and wife each establish an irrevocable credit shelter trust for each other. The trust would be an irrevocable trust at lease as to income under Section 677, but probably should be a wholly grantor trust by including a provision under Section 675(4)(c) to reacquire trust corpus by substituting property of an equivalent manner.

- Will this technique must avoid the reciprocal trust technique?

In *United States v. Grace*, 395 U.S. 316 (1969), the husband and wife created trusts for each other which were identical, created at the same time and the trust were of equal value. After the first spouse died, the IRS sought to include in the decedent's estate assets that had been transferred to her irrevocable trust. The question according to the Court was "whether the trust created by the settlors placed each other in approximately the same objective economic position as they would have been if each had created his own trust with himself rather than the other as life beneficiary." The reciprocal trust doctrine can be avoided if the two trusts are not substantially identical.

Estate of Levy v. Commissioner, 46 T.C.M. 910 (1983) (one trust gave broad inter vivos special power of appointment and the other did not); Letter Ruling 200426008 (citing and apparent acceptance of Levy). The factual differences between the trusts included (a) power to withdraw specified amounts after one son's death, and (b) separate powers of appointment, effective at specified times, to appoint trust principal among an identified class of beneficiaries.

In *Estate of Bischoff v. Commissioner*, 69 T.C. 32 (1977), the reciprocal trust doctrine was applied to Section 2036(a)(2) and 2038. In Exchange *Bank & Trust Company of Florida v. U.S.*, 694 F.2d 1261 (Fed. Cir. 1984), TAM 8019041 (applied doctrine to trusts created by two brothers naming each other as trustee with right to distribution powers). To the contrary, see, *Estate of Green v. Commissioner*, 68 F.3d 151 (6th Cir. 1995) (reciprocal trust doctrine did not apply to powers).

CAVEAT
If the reciprocal trust doctrine applies, the value to be included in either grantor's estate cannot exceed the value of the smaller trust. *Estate of Cole v. Commissioner*, 140 F.2d 636 (8th Cir. 1944).

PART 2:
Irrevocable Grantor Trusts Demystified: Why IGITs Should Be Used For Gifting

I. Intentionally Defective Irrevocable Grantor Trusts

- Understand the difference between Code Sections 2031 through 2042 and Code Sections 671 through 679

- Estate tax includibility is governed by Code Sections 2031 through 2042.

- Grantor trust rules are governed by IRC § 671 through 679

- Many grantor trusts are includible in the decedent's gross estate, such as a revocable trust under IRC § 2036 and which also is a grantor trust under IRC § 676.

- The purpose of this section is to create an irrevocable trust that is out of the decedent's estate but yet defective for income tax purposes, also known as an intentionally defective irrevocable grantor trust.

EXAMPLE

A grantor creates an irrevocable trust with a person other than the grantor as trustee (CPA, Attorney, Bank) with general trust provisions that state, "during the term of the trust, income and/or principal is payable to the class consisting of the donor's issue of all generations."

- How long can the trust last?

  This depends upon the applicable state law rule of perpetuities. In New Hampshire perpetual, in Massachusetts 90 years after the date of formation, or 21 years after the death of the lives in being at the time of creation of the instrument.

- Can the Donor be a beneficiary?

  No, in Massachusetts, since the principles of Ware v. Gulda and State Street Bank & Trust Company v. Reiser, debtors can attach a donor's interest in a so-called self-settled trust and therefore the trust assets would be includible in the grantor's estate under IRC § 2036.

- Generation skipping considerations

  The generation skipping tax exemption is $5,120,000 as is the gift tax exclusion exemption. In the case of a transfer to a trust which will continue for one or more generation members below that of the grantor, a gift tax return should be filed and generation skipping tax exemption shall be allocation.

- Is the generation skipping tax exemption automatically be allocated?

  The answer is confusing, so a gift tax return should be filed in any event to either allocate GST or opt out of the automatic GST allocation rules.

- What are the GST automatic allocation rules?

  IRC § 2632 provides that if any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

- What is an indirect skip?

  IRC § 2632(c) provides that the term "indirect skip" means any transfer of property (other than a direct skip) made to a so-called GST trust.

- What is a GST trust?

  IRC § 2632(c)(3)(B) provides that a "GST Trust" means a trust that could have a generation skipping transfer with respect to the transferor unless... the trust is a trust, any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer. (IRC § 2632(c)(3)(B)(iv))

PLANNING NOTE

In the example above, so-called "Crummey Notices" were not included so this provision would not be applicable but the result would be different if the trust included so-called Crummey withdrawal powers to make gifts to the trust eligible for the annual exclusion. In such a case, the following provisions of IRC § 2632 may change the result.

> IRC § 2632(c)(3)(B) provides that "the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in IRC § 2503(b) ($13,000) with respect to any transferor and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

PLANNING NOTE

This means that if the irrevocable trust contains so-called Crummey withdrawal powers, and those powers are held by a non-skip person such as the children, even if also held by grandchildren, IRC § 2632(c)(3)(B)(iii) and (iv) can get out of the automatic allocation rules, but the remaining Section § 2632 kept this by stating that essentially Crummey withdrawal powers, to the extent they do not exceed $13,000 per annum, will be ignored thereby bringing it back into a so-called GST trust and thereby resulting in an automatic allocation. The problem

here is where the Crummey withdrawal beneficiaries have the right to withdraw greater than $13,000 attributable to a carryover from the prior year, in which case the trust would not be considered a GST trust and would not be eligible for the automatic allocation.

- Resolution:

  File a gift tax return and either elect in or elect out of a GST treatment.

Sample Withdrawal Powers:

(1) From and after the addition by gift of any property to the trust, who's beneficiary shall be entitled to withdraw a pro rata share of the gift for 30 days. Each such beneficiary shall be provided reasonable notice to make this withdrawal.

(2) Notwithstanding the foregoing, a beneficiary's right to withdraw property from the trust in any one calendar year shall not expire as to more than the greater of $5,000 or 5% of the aggregate value of the assets out of which or the proceeds of which a beneficiary's withdrawal right may be satisfied. To the extent of such excess, the withdrawal power shall not lapse, but rather shall be continued into the next succeeding calendar year.

PLANNING NOTE
This so-called 5 and 5 limitation is derived from Code Section 2514(e), which recognizes the right to withdraw is the equivalent of ownership and failure to exercise the right to withdraw represents a gift back to the trust and therefore would be a gift by the donee beneficiary not eligible for the annual exclusion.

- Will this cause adverse gift tax consequences to the donee beneficiaries who do not withdraw their funds?

  IRC § 2514(e) provides that there would only be a gift by the donee beneficiary with respect to the lapse of the powers during any calendar year only to the extent of the property which could have been appointed by exercise of such lapsed power exceeds in value the greater of the following amounts, $5,000, or 5% of the aggregate value of the assets out of which, or the proceeds of which the exercise of the lapsed powers could be satisfied.

II. Flexibility of Irrevocable Trusts

- Can the donor reserve the right to remove and replace a trustee?

  Yes. Pursuant to Rev. Rul. 95-58, the donor may reserve the right to remove and replace a trustee provided the replacement trustee must be an individual or an entity not related to or subordinate to the donor within the meaning of Section 672(c) of the Internal Revenue Code.

- Can the donor retain any powers of appointment to affect the final disposition of the property?

  No. Pursuant to IRC § 2036, the gross estate of the donor shall include all property to the extent of any interest therein transferred of which the decedent has at any time made a transfer by trust or otherwise, under which he has retained for his life… either (1) the possession or enjoyment of or the right to the income from the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

- Based on the foregoing provisions, is this an intentionally defective grantor trust?

  No, as to the provisions as to the donor. It likely would be an intentionally defective grantor trust as to the beneficiaries under IRC § 678. IRC § 678(a) provides that "A person other than the grantor shall be treated as the owner of any potion of a trust with respect to which: (1) such person has a power exercisable solely by himself to invest the corpus of the income therefrom in himself, or (2) such person has previously partially released or modified such a power and, after the release or modification, retained such control, with in the principles of Section 671 through 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

- Analysis

  While the beneficiaries have the power to withdraw, they would be considered the grantor under IRC § 678(a). To the extent such person has "partially released or otherwise modified such a power, and after the release and modification retained such control within the principles of Section of 671 through 677, inclusive, subject to grantor of a trust for treatment as the owner thereof", the beneficiary would remain grantor trust.

  Here, however, there is an open question as to whether the failure to exercise a withdrawal power is the same as either "partially releasing or otherwise modifying" such a power. While the IRS does not seem to make a distinction between the two in certain Private Letter Rulings, it seems unfair to make the beneficiaries with grantor trust status when they do nothing rather than take an affirmative act to either partially release or otherwise modify such power.

- How do you make it a grantor trust as to the grantor where there are Crummey withdrawal powers?

  IRC § 678(b) provides that "Section 678(a) will not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom 679 applies) is otherwise treated as the owner under the provisions of this subpart, other than this section."

PLANNING NOTE
It is important that the trust be a "wholly grantor trust" as to the grantor.

- How do you make an irrevocable trust a "wholly grantor trust" as to the grantor using the power of acquisition under IRC § 675?

  Under IRC § 675, the grantor shall be treated as the owner of any portion of the trust with respect to which a power of administration is exercisable in a non-fiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity to "(C) reacquire the trust corpus by substituting other property of an equivalent value."

- Are you sure that the power to reacquire trust corpus will not result in estate tax includibility?

  Yes. In Rev. Rul. 2008-16, the IRS ruled that, when the grantor of an inter vivos trust has a non-fiduciary power to substitute property held in trust, the value of the trust corpus is not includible in the gross estate under 2036 or 2038 as long as the trustee has some fiduciary obligations that insure the grantor's compliance with the trust terms. It has been held to determine there is a fiduciary obligation to assure that the property is exchanged for its equivalent value and the trustee has a duty of impartiality concerning the trust beneficiaries.

- Would the answer be the same if the trust held life insurance governed by IRC § 2042?

  Yes. In Rev. Rul. 2011-28, the IRS ruled that the grantor's retention of the power, exercisable in a non-fiduciary capacity, to acquire an insurance policy held in trust by substituting other assets of an equivalent value will not, by itself, cause the value of the insurance policy to be includible in the grantor's gross estate under Section 2042, provided the trustee has a fiduciary obligation (under local law of the trust instrument) to insure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are, in fact, of equivalent value and further provided that the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries.

- Pursuant to Rev. Rul. 85-13, a transfer between a grantor and his wholly owned grantor trust is not an income taxable event, with the following tax consequences.

  (1) While the transferee trust takes a carryover basis, the sale to the trust is income tax free.

  (2) Any interest paid by the trust to the grantor pursuant to the promissory note also is income tax free.

  (3) If the trust owns property and the grantor is paying rent, the payment of rent to the trust is income tax free.

(4) The transferor can reacquire trust assets by substituting property of an equivalent value to obtain a step-up in basis upon death by exchanging cash for zero or no basis assets.

- Will a grantor trust be considered the insured for purposes of the transfer for value rules?

  Yes. In Rev. Rul. 2007-13, the IRS ruled that the transfer (by sale) of a policy from one wholly irrevocable grantor trust to another as well as a policy from a non-grantor trust to a wholly grantor trust would be ignored since it was a transaction between the grantor and the grantor trust.

- If the trust owns the individual's home and the home is sold, the trust does not report the gain but, rather, the gain is reported on the transferor's personal tax return and therefore would be eligible for the $250,000 (or $500,000 capital gain tax exclusion in the case of a married couple filing jointly). PLR 199912026

- Who pays income taxes with respect to income earned by the irrevocable trust?

  The grantor. Pursuant to IRC § 671, all items of income, deductions, and credit will not be reported on the trust income tax return, but, rather, shall be reported on the return of the grantor.

- A wholly grantor trust is an eligible S corporation shareholder without the need to make any election. IRC § 1361

- What about life insurance trusts?

  Under § 677(a)(3), the grantor shall be treated as the owner of any portion of the trust, whether or not he is treated as such owner under 674, who's income, without the approval or consent of any adverse party, is or, in the discretion of the grantor or a non-adverse party, or both, may be… applied to the payment of premiums of policies of insurance on the life of the grantor or the grantor's spouse."

PLANNING NOTE
In Iverson v. Commissioner, 3 T.C. 756 (1944), the Tax Court ruled that this provision would apply only to the extent the trust actually owned a life insurance policy and used income to pay premiums. (Caveat, this section would certainly make the trust a grantor trust as to the grantor as to "income" but probably not as to principal and therefore would not be sufficient to allow this trust to be an eligible S corporation shareholder as a "wholly grantor trust.")

- What if my spouse is a beneficiary?

Under 677(a)(1), the grantor shall be treated as the owner of any portion of the trust whether or not he is treated as such owner under 674, who's income, without the approval or consent of any adverse party, is, or under the discretion of the grantor or a

non-adverse party, or both, may be distributed to the grantor or the grantor's spouse. This would be the case where a grantor sets up an irrevocable trust where the provisions provide that income and principal may be payable to or for the benefit of the class consisting of the surviving spouse and the issue, in an independent trustee's sole and absolute discretion.

PLANNING NOTE
There are other ways to make a trust an intentionally defective grantor trust, but these do not have the protections of Private Letter Rulings as to the estate tax includibility under IRC § 675(4)(C).

- What if the grantor does not have sufficient funds to pay the income tax attributable to the grantor trust earnings?

  More good news! Under Rev. Rul. 2004-64, the IRS ruled that a trustee, or any other individual who is not related to or subordinate to the donor as defined in IRC § 672(c), in the trustee's or such person's sole and absolute discretion may make distributions to the donor in order to satisfy any federal estate income tax liability incurred by the donor pursuant to the laws of the United States of America or any state which is attributable to income of the trust or any share thereof. The amount of such payments shall not exceed the excess of the donor's personal income tax liability over his or her income tax liability computed as if the trust was not a grantor trust under IRC § 671, et seq.

III. S Corporations

- Qualified S Corporation Shareholders

  In connection with a gift giving program, it is extremely important that the S election be preserved since in all likelihood a trust will be the donee, it is important to be sure the trust is structured to be an eligible S corporation shareholder both during the life of the donor as well as thereafter.

- Applicable Code Sections

  IRC § 1361 priovides that an S corporation must have only so-called eligible S corporation shareholders and generally must be an individual or one or more trusts as set forth in IRC § 1361(c)(2). Pursuant to this section, an eligible S corporation shareholder is as follows:

  (1) A trust, all of which is treated as owned as an individual who is a citizen or resident of the United States (meaning a wholly grantor trust). IRC § 1361(c)(2)(A)(i)

(2) A trust which was a wholly owned trust immediately before the death of the deemed owner and which continues in existence after such death, but only for the two year period beginning on the date of the deemed owner's death. IRC § 1361(c)(2)(A)(ii)

(3) A trust with respect to stock transferred to it pursuant to the terms of a Will, but only for the two year period beginning on the day on which such stock is transferred to it. IRC § 1361(c)(2)(A)(iii)

(4) An electing small business trust (ESBT). IRC § 1361(c)(2)(A)(v)

In addition to the foregoing, IRC § 1361(d) provides for a so-called qualified subchapter S trust. A qualified subchapter S trust is a trust which, according to the terms of the trust, satisfies the following requirements;

i. all trust income must be distributed currently to a single income beneficiary;
ii. the current income beneficiary must be a U.S. citizen or resident;
iii. the trust instrument must provide that during the life of the current income beneficiary, there may be only one income beneficiary;
iv. the trust must restrict principal distributions made during the income beneficiary's life to the current income beneficiary;
v. the trust instrument must provide that the beneficiary's income interest will terminate upon the earlier of the beneficiary's death or the trust's termination; and
vi. the trust instrument must provide that if the trust terminates during the current income beneficiary's lifetime, all trust assets must be distributed to the current income beneficiary.

PLANNING NOTE
In general, a QTIP trust will satisfy this requirement. In the case of a lifetime credit shelter trust, it will be a wholly grantor trust, provided the power to reacquire trust assets pursuant to Section 675(4)(c) is included.

PLANNING NOTE
In addition to the foregoing, a QSST election must be made by the current income beneficiary with respect to each subchapter S corporation in which the trust has an interest. This must be made within 60 days after the date the trust receives the S corporation stock.

- Income Tax Treatment

In the case of a qualified subchapter S trust, the single beneficiary is treated as the owner and will be taxed on all income attributable to the S corporation pursuant to IRC § 1361(d)(1)(B), which provides:

"For purposes of Section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which a QSST election is made." IRC § 1361(d)(2)

- Electing Small Business Trusts

An ESBT is defined as any trust excluding QSSTs provided such trust (1) does not have a beneficiary, any person other than an eligible individual, an estate (or certain tax exempt organizations), (2) no interest in such trust was acquired by purchase, and (3) an election was made to have it treated as an ESBT.

- Income Tax Treatment for the ESBT

The income tax on the ESBT share is computed without any deductions, including the deduction for distribution to beneficiaries, other than a deduction for administrative expenses or state or local income taxes that are allowed, such that the income of the ESBT share is taxed at the highest individual rate on all items of income, loss, or deduction. IRC § 641(d)(2)

Exhibits

Exhibit A

Estate Tax Calculation

Year of Death:	2011
Adjusted Gross Estate:	$1
Pre-1977 Taxable Gifts:	$0
Adj. Taxable Gifts (After '76):	$5,000,000
Unified Credit Used by Gifts:	$345,800
Estate Tax Calculations:	2009 Rates in 2009+
State:	MA

State Tax Calculations (MA)

Exclusion Amount for Pickup Tax:	$1,000,000
Estate Tax:	$0
State Death Tax:	$0

Federal Tax Calculations

Taxable Estate (2011):	$1
Adjusted Taxable Gifts:	$5,000,000
Tentative Tax Base:	$5,000,001
Tentative Tax:	$2,130,800
Gift Tax Paid:	$1,785,000
Gross Federal Estate Tax:	$345,800
Unified Credit:	$1,455,800
Net Federal Estate Tax:	$0
Total Federal and State Tax Payable:	$0
Net Estate Remaining:	$1
Taxes as Percentage of Taxable Estate:	0.00%

Exhibit B

$5,000,000

Estate Tax Calculation

Year of Death:	2011
Adjusted Gross Estate:	$5,000,000
Pre-1977 Taxable Gifts:	$0
Adj. Taxable Gifts (After '76):	$0
Unified Credit Used by Gifts:	$0
Estate Tax Calculations:	2009 Rates in 2009+
State:	MA

State Tax Calculations (MA)

Exclusion Amount for Pickup Tax:	$1,000,000
Estate Tax:	$391,600 ✓
State Death Tax:	$391,600

Federal Tax Calculations

Taxable Estate (2011):	$5,000,000
Deduction for State Death Tax (MA):	$391,600
Tentative Tax Base:	$4,608,400
Tentative Tax:	$1,954,580
Gross Federal Estate Tax:	$1,954,580
Unified Credit:	$1,455,800
Net Federal Estate Tax:	$498,780
Assumed State Death Tax:	$391,600
Total Federal and State Tax Payable:	$890,380
Net Estate Remaining:	$4,109,620
Taxes as Percentage of Taxable Estate:	17.81%

Exhibit C

	Pay Estate Taxes	Gift All Assets and Pay Gift Tax (assume all cash gift)	Sell Securities to Generate Cash, then Gift All Assets	Sell Securities to Pay Gift Tax, Gift Remaining Securities (no liquidation after gift)	Sell Securities to Pay Gift Tax, Gift Remaining Securities and then Liquidate Securities
Assets	$10,000,000	$10,000,000	$10,000,000	$10,000,000	$10,000,000
Total Estate Amount	$10,000,000	$0	$0	$0	$0
Total Gift Amount	$0	$7,410,000	$5,928,000	$6,900,000	$6,900,000
Less Estate Tax (50%)	$5,000,000	$0	$0	$0	$0
Less Gift Tax (35%)	$0	$2,590,000	$2,072,000	$2,415,000	$2,415,000
Net After Taxes	$5,000,000	$7,410,000	$5,928,000	$6,900,000	$6,900,000
Liquidation of Assets					
Sale Price	$5,000,000	$0	$10,000,000	$3,100,000	$6,900,000
Basis	$5,000,000	$0	$0	$0	$0
Gain	$0	$0	$10,000,000	$3,100,000	$6,900,000
Less Capital Gains Tax (20%)	$0	$0	$2,000,000	$620,000	$1,380,000
Net After CG Taxes	$5,000,000	$0	$8,000,000	$2,480,000	$5,520,000
Total Taxes					
Estate Tax	$5,000,000	$0	$0	$0	$0
Gift Tax	$0	$2,590,000	$2,072,000	$2,415,000	$2,415,000
CG Tax	$0	$0	$2,000,000	$620,000	$2,000,000
Total Taxes	$5,000,000	$2,590,000	$4,072,000	$3,035,000	$4,415,000
Reconciliation					
Net to Family	$5,000,000	$7,410,000	$5,928,000	$6,900,000	$5,585,000
Total Taxes	$5,000,000	$2,590,000	$4,072,000	$3,035,000	$4,415,000
	$10,000,000	$10,000,000	$10,000,000	$9,935,000	$10,000,000