ESTATE & GIFT TAXATION FINAL EXAMINATION
PROFESSOR DEWEY SPRING, 1990

Total time for exam three (3) working hours

Examination Suggestion

1.Please write every other line in the blue books – it facilitates effective communication.
2.Please respond to the Questions in the order set forth in the exam to avoid the omission of a question or a part thereof by inadvertence. The Questions are of equal weight in grading process.
3.Three (3) working hours will be allowed for exam completion.
4.Please do not strive to make your exam response a triumph of Biology brevity. Discuss the issues fully - the idea in this exam is to reveal and not to conceal your conceptual depth.
5.Please respond to the issues of the precise Question. Do not respond with mere legal-surfing abstractions.
6.Please express rationale for concepts discussed, judicial views expressed as applicable to the Question and for arguments presented as an advocate.
7.Please complete cover page of each blue book used.
8.Please do well on the exam.
9.Please do accept that this is an essay exam and not "multiple guess."

10.Thanks for you rapt attention. Serving as a Professor of Law has been for me the "consummate privilege".

11.May the Lord bless you and your families. Of course, be competent and ethical attorneys and strive to make a difference in the secular society by helping to combat poverty, hunger, the hopelessness of homelessness and the cancer of racism and sexism.

QUESTION NO. 1

Agnes created in 1985 a purported irrevocable trust for the benefit of her daughters Jane and Gloria and nieces, Mary and Zelda, who all legally survived Agnes.

Agnes was named as the co-trustee of the trust and she served in that capacity until her death in 1989.

Jane and Gloria were designated as the beneficiaries of all the trust income for their lives with the remainder of the trust corpus to be distributed to Mary and Zelda who are nieces of Agnes at a time provided for in the trust.

The trust granted the following discretionary powers to the trustees:

1.To withhold so much of the net income in any year as they do not believe to be necessary for the well-being and maintenance in health and comfort of Jane and Gloria.
2.In addition to all other powers, the trustees were authorized in their sole discretion to distribute to Jane for the purpose of providing Jane with funds for a home, business, or for any other purpose believed by the trustees to be for Jane's

benefit, all or any part of the principal of the trust corpus.

3.Pay over to the trust beneficiaries at any time any and all of the trust assets.

4.Discretion to pay the life income beneficiaries the trust income or to accumulate such income, in which case, it became part of the trust corpus.

In essence, Section 2036, I.R.C. includes in the decedent's gross estate the value of all property to the extent of the following retained interest therein by the decedent (except in the case of a bona fide sale for an adequate and full consideration in money or money is worth) which does not in fact end before his death relative to:

(a)the possession or enjoyment of, or the right to the income from the property, or

(b)the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income there from.

With reference to Section 2038 of the Internal Revenue Code, the Supreme Court of the United States has stated:

"A donor who keeps so strong a hold over the actual and immediate enjoyment of what he puts beyond his own power to retake has not divested himself of that degree of control which (Section 2038 IRC) requires in order to avoid the tax."

It is contended by IRS that the fair market value of the trust assets at the death of Agnes in 1989 is includible in her gross estate as a "retained interest" pursuant to Section 2036 and 2038 of the Internal Revenue Code. Will an appropriate federal court sustain this contention of IRS?

QUESTION NO. 2

Mary in her capacity as executor of the estate of her husband, Ted, challenges the United States Tax Court's determination that bequests and devises to Mary under her late husband's will, did not qualify for the marital deduction under Section 2056 of the Internal Revenue code.

Ted died on January 3, 1989. Ted's duly executed will was properly admitted to probate in the state of Ted's domicile.

Mary legally survived Ted and the probate of Ted's estate. Ted's Will as here relevant provided.

1. I hereby will everything that I have to my wife, Mary, for so long as she may live provided she survives the probate of my estate.
2. I direct that all property in my estate be used by my wife, Mary, to the best of her ability for as long as she may live provided she survives the probate of my estate.
3. I give all of my estate to my wife, Mary, for life or until she remarries with the right to encroach if she desires provided she survives the probate of my estate.

Assume that all property in Ted's probate estate was owned in fee simple by Ted, and that the will of Ted further provided that any property which Mary received under Ted's will which Mary had at her death was to be distributed to Ted's brother, John, who legally survived Ted.

Upon the death of Ted, Mary, as fiduciary, timely filed a federal estate tax return and claimed a marital deduction in the estate of Ted in the amount of four (4) million dollars. Upon audit, the Commissioner of Internal Revenue disallowed the marital deduction for the estate of Ted and, accordingly, the Commissioner issued a substantial estate tax deficiency assessment against the estate of Ted. This decision was based upon the Commissioner's contention that Ted's will granted his wife, Mary, only a life estate without a general (taxable) power of appointment over the principal. The United States Tax Court affirmed the deficiency assessment.

Section 2056 (a), Internal Revenue Code (hereafter referred to as I.R.C.) provides that the value of the taxable estate of a spouse shall be determined by deducting from the value of the gross estate an amount equal to the value (unlimited) of any interest in property which passes from the decedent (Ted) to his surviving spouse (Mary) which is includible in determining the value of Ted's gross estate.

The terminable interest rule embodied in Section 2056(b), I.R.C., mandates that no marital deduction shall be allowed where, on the lapse of time, or on the occurrence of an event or contingency or failure thereof, an interest passing to the surviving spouse will terminate or fail.

Section 2041, I.R.C. provides that the term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors or the creditors of his estate.

Section 2056(b) (5), I.R.C. provides in essence that the marital deduction is allowed if the decedent spouse by death transfer passes to the surviving spouse a life estate in the income of the property and a general power of appointment as to the remainder of the property.

Assume that Mary, as the fiduciary of Ted's estate timely and properly perfects an appeal to the appropriate United States Court of Appeals for a decision of the merits. Further assume that in its responsive opinion the Court stressed that the "marital deduction" is only a "tax respite and not a tax absolution."

Will the decision of the Tax Court be affirmed or reversed?

QUESTION NO. 3

Ned's valid divorce decree required him to maintain his minor children as beneficiaries of Ned's substantial life insurance policies. Under state law where Ned is domiciled and his divorce granted, the children of Ned had enforceable third party beneficiary rights in the divorce decree, assuring Ned's proper legal compliance therewith.

Of course, after the children reached the legal age of 18, Ned was free to designate any other beneficiary.

Ned died before any of the children reached the legal age of 18, and said children received the proceeds from Ned's life insurance policies per the divorce decree.

Ned died in 1989 when the automobile that Ned owned and was driving was involved in a collision. Under the state law of the state of Ned's domicile, an owner of a motor vehicle registered in such state must carry no-fault insurance for the payment of benefits specified in the no-fault insurance statute.

Ned fully complied with the law of the state of his domicile by purchasing the proper no-fault automobile insurance policy.

Under the terms of Ned's no-fault insurance policy, the insurance company is to pay only those benefits specified in the statute, one of which is the survivors' loss benefit, payable when the insured dies as a result of an automobile accident. The survivors' loss benefit consists of statutorily prescribed amounts of money that the specified dependent would have received from the insured for support during dependency.

It is conceded that the children of Ned qualify under the no-fault insurance coverage state statute as the only dependents of Ned. Ned's children thus became, under the statute, legally entitled to receive substantial monetary benefits under the no-fault insurance policy.

Section 2042, I.R.C. provides that the value of the gross estate of the insured shall include the value of all property to the extent of the amount receivable as insurance under policies on the life of the decedent-insured (Ned) by: (1) the executor (fiduciary of estate of decedent-insured), and (2) all other beneficiaries, with respect to which the decedent- insured (Ned) possessed at his death any of the incidents of ownership in the policies, exercisable either alone or in conjunction with any other person.

Section 2033, I.R.C. provides that value of the gross estate shall include all property to the extent of the interest therein of the decedent at the time of his or her death.

(1). Are the proceeds of the insurance policy on the life of Ned includible in the gross estate of Ned under the federal estate tax law?

(2). Are the survivors' loss benefits paid to the children of Ned under that state law mandated no-fault insurance policy includible in Ned's gross estate under the federal estate tax law?

QUESTION NO. 4

In 1986, Ned, a wealthy and vigorous entrepreneur, moved to Las Vegas, Nevada. It is conceded that Ned possessed illimitable charisma.

Not long after his arrival in Las Vegas, Ned became interested in making large investments and acquisitions in Las Vegas. Anticipating opposition to many of his purchases, Ned sought to acquire local radio, television and newspaper interests in order to create a favorable public image by manipulating the press. During this time period, Ray was the owner, publisher and editor of the Las Vegas Sun newspaper and the owner of KLAS-TV Channel 8 in Las Vegas.

Ned, in 1986, offered to buy from Ray at a herculean sum of money the newspaper and radio and TV stations. However, Ray refused to sell these properties to Ned.

Still much concerned about the newspaper's and radio and TV potential influence on local public opinion, but realizing that he (Ned) could not obtain direct control of the media outlets owned by Ray, Ned sought to acquire indirect control by offering Ray a seven (7) million dollar interest-free loan. Ray accepted this generous offer from Ned with the “understanding” that Ned expected friendly and helpful media and press coverage in exchange for the interest-free loan. The loan term agreed upon was 35 years. It is conceded that the interest-free loan was a bona fide legal debt.

Section 2501 and 2511, I.R.C. provide also that the federal gift

tax applies whether the gift made by an individual is “direct or indirect.”

The Treasury Regulations interpreting and implementing the federal gift tax law further provide that:

“a taxable gift may be effected by . . . the forgiving of a debt and all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax.”

The Treasury Regulations under the federal gift tax law further provide:

“Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the gift tax is based on the objective facts of the circumstances under which it is made, rather than on the subjective motives of the donor. The gift tax is not applicable to a transfer for a full and adequate consideration in money or money’s worth, or to ordinary business transactions as transactions which are bona fide, at arm’s length, and free from any donative intent.”

The Treasury Regulations interpreting and implementing the federal gift tax law conclude as here pertinent:

“A sale, exchange, or other transfer of property made in the ordinary course of, business (a transaction which is bona fide, at arm’s length, and free of any donative intent), will be considered as made for an adequate and full consideration in money or money’s worth. A consideration not reducible to a value in money or money’s worth, as love and affection or promise to marry is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift.”

Assume that Ned had previously made a plethora of gifts to donees subject to the federal gift tax law and that these taxable gifts exceeded Ray’s lifetime exemption of $600,000 in value.

Assume that the United States Tax Court, upon proper appeal by Ned, invalidated the gift tax deficiency assessment imposed upon Ned by the IRS Commissioner. Further assume that the IRS Commissioner has timely and properly perfected an appeal to the appropriate United States Court of Appeals for a decision on the merits.

Will the federal gift tax deficiency assessed against Ned be held valid or invalid?