Instructions

1. Permitted Materials: Any printed or written material may be consulted during the exam. You may consult or refer to any resource you consider appropriate except, you may not consult or discuss the exam with any other person. Use of an electronic calculator is permitted.
2. Computations: Show and identify necessary computations. Be advised, however, that computations alone will not be considered adequate. If a computation is required it should be undertaken but, whether undertaken or not, be sure to explain your conclusions. An error in computation is not serious if your explanation shows that it was arithmetic only, but YOUR EXPLANATION IS ALL IMPORTANT.
3. Citations: Your answers should be as concise as possible without sacrificing thoroughness and should cite relevant authority where appropriate. Apply current law.
4. Ambiguities: I have tried to eliminate all ambiguities, but if you find the facts given to be insufficient to answer a question, state any additional facts you wish and answer the question as though your facts were a part of it. DO NOT MAKE THE MISTAKE OF CHANGING THE QUESTION BY CHANGING THE FACTS.
5. Identification: Write your exam number on the front cover(s) of your blue book(s). Neither your name nor any other identifying mark, other than your exam number, should appear anywhere on your answer. You may retain this examination for your records or for any other purpose.
6. Time Allocation: You have three hours to complete the exam.
7. ASSUMPTION: WHENEVER A QUESTION TELLS YOU THAT A TRUST EXISTS AND THE QUESTION DOES NOT ASK YOU TO DETERMINE IF IT IS A GRANTOR TRUST, THEN IT IS NOT A GRANTOR TRUST.
8. Neatness: Make certain that your answers are legible. Just remember, NEATNESS COUNTS. If I can't read it, I can't grade it!
9. Final Comment. The questions are intended to test your knowledge of the subject and, at times, to test subtleties or more unique aspects. Many questions deal with five points that I and others face in practice. The questions are not intended to trick you.

GOOD LUCK!

Question 1

For calendar year 1994, an irrevocable trust has the following receipts and expenses.

Receipts		
Dividends	$50,000	
Taxable Interest	50,000	
Tax-Exempt Interest	20,000	
Rent	15,000	
S corporation distribution (see below)		4,000
Long-Term Capital Gains	20,000	
Short-Term Capital Gains	25,000	

Expenses	
Rental operating expenses	$10,000
Property taxes of rental property	9,000
Commissions allocable to principal	3,000
Commissions allocable to income	3,000
State income taxes	10,000
Federal income taxes	30,000
Depreciation (allowable for tax purposes)	5,000

The trust is a shareholder of an S corporation and has received a Schedule K-1 from the S corporation for 1994 allocating $10,000 of ordinary income to the trust. Notwithstanding the allocation of income, the trust has only received $4,000 from the S corporation as noted above.

The trust instrument provides that a reasonable reserve required for depreciation and the trust has determined $6,000 is a reasonable reserve. The trust instrument contains following provision:

> "The Trustee, in its sole and absolute discretion, may distribute so much or all of the income and principal comprising the trust estate to any one or more of my children, William and Mary, and any charitable organization described in Section 170(c) of the Internal Revenue Code as the Trustee determines.
>
> Notwithstanding the above, when a child of mine attains the age of 25 years, the Trustee shall distribute to him or her the sum of $10,000."

During 1994, Mary turned 25, and the Trustee, First National Bank, made the following distributions.

Mary	$40,000 (including the $10,000 for turning 25)
William	$60,000
Charity	$20,000 From the above information compute the following:

1. Trust accounting income.

2. Taxable income before the distribution deduction.

3. Distributable net income (DNI).

4. The individual items that comprise DNI.

5. The distribution deduction.

6. Taxable income after the distribution deduction.

7. Tax consequences to Mary.

Question 2

John's Will provides for a specific bequest to his son Jim of $50,000 and for the residue of his estate to pass equally among all of John's children. The estate distributes to Jim in satisfaction of his specific bequest marketable securities that have a fair market value of $50,000 and a basis of $30,000. No other distributions are made. Ignoring this distribution to John for 1994, the estate has DNI of $50,000 and the taxable income before the distribution deduction is $50,000. What are the tax consequences to the estate and to Jim resulting from the distribution of stock to Jim?

Question 3

Assume the same facts in the above question, but the executor distributes to Jim an item of income in respect of a decedent worth $50,000. What are the tax consequences to the estate and to Jim resulting from the distribution of the item of IRD to Jim?

Question 4

John establishes an irrevocable trust and the trust

instrument requires the trustee to distribute all of its income at least annually. With respect to each situation below indicate whether or not the trust would be characterized as a simple trust for the year. Assume that, with respect to each situation, all other facts needed to have the trust be a simple trust exist.

1. The trust distributed in the year all of its accounting income but did not distribute all of its taxable income.
2. The trustee decides that the beneficiary does not need the income and retains the income in the trust.
3. As a matter of practical necessity the trustee distributes a portion of the income after the end of the year.
4. The trustee is required to establish a depreciation reserve and retains income for this purpose.
5. The trustee distributes a portion of the income to charity.
6. The trustee retains capital gains.
7. The trustee distributes $100 of principal in addition to all the income.

Question 5

The following questions deal with the grantor trust rules. In the following situations determine whether or not the trust is a grantor trust and, if yes, by virtue of which section or sections. Please assume that the facts stated are the only relevant facts. For example, if the facts do not state that the trust is revocable, do not answer what would occur if the trust was revocable.

1. Mary establishes a trust under which she is the trustee. The trust provides that the trustee may distribute principal to provide for the support of her children, Molly and Melissa ages 10 and eight respectfully. No distributions have been made.
2. Same facts as #1 above, but Mary makes a distribution.
3. Mary establishes a trust under which Mary and two friends are trustees. The trust provides that the trustee may distribute principal for the benefit of Mary's two children for any purpose.
4. Same facts as #3 above, except that the trustees are Mary's husband, Marty, and Mary's two friends.
5. Same facts as #3 above, except that the trustees are Mary's sister, Maggie, and her two friends.
6. Mary establishes a trust under which a bank is the trustee. The trust fund consists of securities in which the holdings of Mary and the trust are significant from the viewpoint of voting control. The trust provides that Mary may veto proposed investments or reinvestments.
7. Mary establishes a trust. The trust does not permit loans, but Mary may borrow principal or income without adequate interest or security.
8. Mary establishes a trust under which the trustee is authorized to make loans to any person without regard to interest or security. Mary has borrowed funds that remain due and

outstanding.

9. Same facts as in #8 above, except that Mary pays the loan in full prior to the end of the year.