

## Chapter 12

# Wealth Transfer Taxes

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### Solutions to Develop Research Skills

Note to Instructor: No research aids or “hints” are provided in the textbook for problems in this chapter. Before the solution to each problem, however, suggested research aids are provided. This allows you to choose whether or not to provide any hints to your students for a particular problem. For problems that can be solved using free Internet sources, you must provide students with the citations in these hints and refer students to Figure 2.2 of Chapter 2 in the text for the URLs to enable them to solve these problems using free Internet sources. Some of the problems require access to *Checkpoint®* or a similar service. The research process for solving a sample problem is illustrated in Appendix A through screen captures for *Checkpoint®*.

58. *Transferee Liability (can be solved using free Internet sources)*

Two years ago, Herbert, a widower, made a gift of marketable securities to his 35-year-old daughter, Sabrina, on which he paid a federal gift tax of \$3 million. When Herbert died in 2013, his estate had been greatly reduced in value due to his having given away most of his assets over his lifetime. Herbert’s executor filed an estate tax return showing an estate tax liability attributable to the gift to Sabrina. The estate tax was not paid because the estate had no liquid assets. The IRS assesses the portion of the estate tax related to this gift that Sabrina previously received against Sabrina under the rules relating to transferee liability. Is Sabrina liable for the estate tax?

Hint: Section 2035, 6324(a)(2), and *Frank Armstrong III*, 114 TC 94 (2000).

**Issue:** Is Sabrina liable for the estate tax?

**Conclusion:** Yes, Sabrina is personally liable for the unpaid estate taxes.

**Discussion of Reasoning and Authorities:** Section 2035(a) provides that if the decedent made a transfer of an interest in any property, or relinquished a power with respect to any property, during the three-year period ending on the date of the decedent’s death, and the value of such property would have been included in the decedent’s gross estate if such transferred interest had been retained by the decedent, then the value of the gross estate shall include the value of any property which would have been included. Under Section 2035(b), the donor-decedent’s gross estate is increased by any gift tax that was paid on any gift made by the decedent during the three-year period ending on the date of the decedent’s death. This provision is known as the gross-up rule and applies to the gift tax triggered by a gift of any type of property during the three-year look-back period.

In the event a decedent’s estate taxes are not paid when due, Section 6324(a)(2) imposes personal liability upon transferees of property included in the decedent’s gross estate, and provides for the imposition of a lien on the transferee’s separate property if the transferee transfers any of the property received from the decedent.

In a similar case, *Frank Armstrong III, et al. v. Commissioner*, 114 TC 94 (2000), the Tax Court agreed with IRS that the donees were personally liable for the unpaid estate taxes to the extent of the gift’s value. The donees tried to argue that there was an insufficient nexus between the stock that they received as gifts and the estate taxes that IRS wanted to collect from them. The Tax Court said that Congress did not restrict transferee liability to those instances where there is an immediate link between an estate tax liability and property transferred to a transferee. As such, Sabrina will be liable for the estate tax.

## 2 Taxation for Decision Makers Research Solutions

59. *Trust Income Used to Pay for Child's Education (can be solved using RIA Checkpoint® or a similar service)*

Samantha is a single parent providing the sole support for her six-year-old daughter, Hillary. They live in an area of Oakland where the public school is known to have problems with drugs and other crimes. Samantha wants to send Hillary to a private school to avoid these problems and provide a better environment for Hillary's educational development. Eight years ago, Samantha set up two trusts to manage the securities she inherited from her grandfather. Samantha is the sole beneficiary of Trust A from which she receives bimonthly distributions each made after approval by the trustee. Hillary is the sole beneficiary of Trust B and all distributions from this trust must be approved by its trustee. If Samantha convinces the trustee to pay for Hillary's tuition, writing a check out of Trust B funds to the school, are there any income tax consequences to Samantha?

Hint: Section 677 and *Frederick C. Braun, Jr.*, TC Memo 1984-285, PH TCM ¶84,285, 48 TCM 210.

**Issue:** Will Samantha be taxed on the funds paid directly for Hillary's tuition?

**Conclusion:** Yes, Samantha probably will be taxed on the trust income used for the education of her dependent child.

**Discussion of Reasoning and Authorities:** Under Section 677(b), the income of a trust is taxable to the grantor to the extent that such income is applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain. In the case of *Frederick C. Braun, Jr.*, (TC Memo 1984-285, PH TCM ¶84,285, 48 TCM 210), all of the income distributed from two trusts was used for the educational expenses of the children. The children were the beneficiaries of the two trusts. The Court ruled that the income from the two trusts was taxable to the petitioners. The Court stated that the income used for the education expenses of the children discharged the support obligation of the petitioner as described in Section 677(b). Therefore, Samantha will probably be taxed on the trust income used for the education of her child.