

Chapter 10: Estate and Gift Tax

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Corrections were made to this workbook through January of 2004. No subsequent modifications were made.

2003 UPDATE

The Economic Growth and Tax Relief Reconciliation Act of 2001 (the “Act”) is bringing major reductions in both estate and gift taxes over the next decade. However, the uncertainty created by the sunset provisions of the Act cause practitioners to remain wary in the estate tax planning area. The Act, as signed into law by President Bush on June 7, 2001, provides for a phased reduction in estate taxes through 2009. Full repeal of the estate tax will occur in the year 2010, but the estate tax will reappear in 2011 (in its current form, with a \$1,000,000 exemption) unless Congress acts to make the repeal permanent or otherwise modifies the scheduled changes.

Two factors cause the phased reductions in estate and gift taxes through 2009. First, **the top rates for estate and gift taxes are declining over time**. Second, for estates, the so-called “**applicable exclusion amount**” (in effect, an **estate tax exemption**) **increases over time**; for gifts, the lifetime gift exemption was increased to \$1,000,000 in 2002, where it remains permanently. Both of these factors are illustrated in the following table, along with the temporary repeal of the estate tax in 2010 and its reappearance in 2011.

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ESTATE AND GIFT TAX EXEMPTIONS AND MAXIMUM RATES

Year	Estate Tax Applicable Exclusion* (Exemption)	Estate Tax Applicable Credit Amount*	Estate Tax Top Rate	Gift Tax Lifetime Exemption (Appl. Excl.)*	Gift Tax Applicable Credit Amount*	Gift Tax Top Rate
2002	\$1,000,000	\$ 345,800	50%	\$1,000,000	\$345,800	50%
2003	1,000,000	345,800	49%	1,000,000	345,800	49%
2004	1,500,000	555,800	48%	1,000,000	345,800	48%
2005	1,500,000	555,800	47%	1,000,000	345,800	47%
2006	2,000,000	780,800	46%	1,000,000	345,800	46%
2007	2,000,000	780,800	45%	1,000,000	345,800	45%
2008	2,000,000	780,800	45%	1,000,000	345,800	45%
2009	3,500,000	1,455,800	45%	1,000,000	345,800	45%
2010	REPEALED	REPEALED	REPEALED	1,000,000	345,800	35%
2011	1,000,000	345,800	55%	1,000,000	345,800	35%

*The applicable credit amount is the amount of credit against the tentative tax needed to shelter the applicable exclusion (exemption) amount from tax payments.¹

Observation. 2010 is the only year for full repeal of the estate tax. Given the uncertainty of a taxpayer's year of death, the increasing exemptions and the looming sunset provisions affecting estate tax repeal make tax planning difficult.

Note. For consistency, this chapter will use the term “exemption” instead of “exclusion” or “applicable exclusion amount” when referring to the amount that passes free of gift or estate tax payments because the applicable credit offsets the tax that would otherwise be paid by the taxpayer.

Estate and gift taxes were unified into one tax system in 1976. This unified estate and gift tax system is, in effect, a **wealth transfer tax** rather than a tax on income. Gift taxes for a donor-taxpayer are calculated based on the accumulated lifetime taxable gifts of the taxpayer-donor. Estate taxes are calculated on the decedent's accumulated taxable gifts plus the decedent's taxable estate at death, and then reduced by any gift taxes paid after 1976. (However, any gift taxes paid within three years of death are included in the gross estate.) To the extent a taxpayer-donor did not use the available lifetime gift exemption (the applicable credit amount of \$345,800) via lifetime gifts, the balance is available to “shelter” assets owned at death from estate tax.

As the table on the previous page illustrates, the unified gift and estate tax rates and exemptions are decoupled in 2004. The gift tax lifetime exemption stays at \$1,000,000, while the estate tax exemption jumps to \$1,500,000 in 2004, \$2,000,000 in 2006, and \$3,500,000 in 2009. Full repeal of the estate tax occurs in 2010. The estate tax provisions will reappear in 2011 as if the Act had never been enacted. The estate tax exemption will return to \$1,000,000 and the maximum estate tax rate will increase to 55%, absent intervention by Congress.

Observation. There have been unsuccessful attempts in Congress to make permanent the repeal of estate taxes. It is expected that Congress will act on this issue during the next few years — hopefully, well ahead of 2011 when the sunset provisions take effect. Economic and political considerations will probably push Congress to do something, perhaps making permanent the estate tax repeal, or perhaps making permanent the more generous rates and exemptions available in 2006 or 2009. The most recent tax legislation by the Jobs and Growth Tax Relief Reconciliation Act of 2003 did not address this issue.

GIFT TAXES

For individual income tax purposes, **outright gifts (as distinguished from charitable contributions) are neither deductible by the donor nor taxable to the recipient.** Further, for gift tax purposes, the donor does not actually **pay** gift taxes until accumulated lifetime taxable gifts exceed \$1,000,000. Finally, as a general rule, gift tax returns are only required when completed gifts exceed the annual exclusion (currently \$11,000, but indexed) to any one individual during the calendar year. A gift is not completed until the donor loses all control over the property gifted. For example, if a parent writes a \$10,000 check to a child, but the child does not cash the check before the death of the parent, the gift is not completed and the \$10,000 would be included in the donor's estate. It is important for tax practitioners to determine the taxpayer-donor's taxable and nontaxable gifts for the current year and the cumulative taxable gifts for prior years. This information will be needed to prepare the current year gift tax return and the taxpayer's estate tax return.

The Act does not repeal the gift tax in 2010. Instead, the gift tax continues indefinitely but with a lower maximum rate (35% beginning in 2010) and with the lifetime gift tax exemption of \$1,000,000. Congress froze the lifetime gift tax exemption at \$1,000,000, rather than having it track the estate tax exemption (which gradually increases to \$3,500,000), in order to discourage individuals from gifting vast amounts of income-producing property to others in lower income tax brackets.

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Under the Act, the maximum gift tax rate decreases through 2010. The highest gift tax marginal rate was 60% in 2001. The maximum rate dropped to 50% in 2002 and 49% in 2003. For 2003 through 2006, there will be four effective gift tax brackets for lifetime taxable gifts exceeding the \$1,000,000 lifetime exemption, as seen in the following chart. For 2007 through 2009, there will be three effective gift tax brackets (the last two brackets will be merged into one 45% bracket beginning at \$1,500,000):

Cumulative Lifetime Taxable Gifts	Gift Tax Rate (2003–2009)
\$1,000,001 to \$1,250,000	41%
1,250,001 to 1,500,000	43%
1,500,001 to 2,000,000	45%
2,000,001 and up	49%*
*dropping to 48% (2004), 47% (2005), 46% (2006), and 45% (2007–2009)	
Source: IRC §2502, 2001(c)	

Beginning in 2010, there will be a 35% flat tax rate for lifetime taxable gifts exceeding \$1,000,000. The estate tax is scheduled for repeal in 2010, but the gift tax will continue at the 35% flat rate.

EXEMPTIONS FROM GIFT TAX

Annual Exclusion

The 2003 annual exclusion amount is \$11,000 for each individual gift recipient (\$10,000, indexed for inflation since 1998 and adjusted in increments of \$1,000).

- To qualify for the annual exclusion, the gift must be of a present interest (recipient must have the right to use the gift immediately rather than sometime in the future), with no strings attached. However, IRC §2503(c) allows gifts to minors under the Uniform Transfers to Minors Act with an adult being named as a guardian for the gift until the recipient reaches the age of 21.
- Another way to qualify for the annual exclusion is to make the gift to a trust that gives the beneficiary a limited time frame to withdraw the gift. Such trusts are commonly referred to as Crummey trusts. In *Crummey*,² the court agreed with the taxpayer that such gifts qualify for the annual exclusion.
- The annual exclusion eliminates the need for reporting de minimis gifts.
- Where the gift actually comes from only one of the spouses and exceeds the annual exclusion, a husband and wife can effectively combine their annual exclusions by filing a gift tax return and electing to split the gift between them for gift tax purposes.

Example 1. Harry Hoag gave his son \$11,000 to help with the down payment for a condo. In this case, no gift tax return is required, assuming Harry does not make other taxable gifts to his son during the same calendar year. Harry and his wife can **each** give their son \$11,000 (\$22,000 total) without any gift tax consequences. But if a \$22,000 gift comes from Harry alone, then Harry must file a gift tax return on which Harry's spouse consents to the \$22,000 gift being split between Harry and his spouse. Even though Harry made the gift, it is treated as coming half from Harry (nontaxable because of Harry's \$11,000 annual exclusion for gifts to the son) and half from Harry's spouse (nontaxable because of the spouse's \$11,000 annual exclusion for gifts to the son).

Example 2. Harry Hoag and his wife, Helga, gave their oldest daughter \$60,000 (\$30,000 from each spouse) to help with living expenses. Harry and Helga have made no prior taxable gifts. Gift tax returns are required because each \$30,000 gift exceeds the \$11,000 annual gift exclusion. Harry and his wife will file gift tax returns (Form 709) by April 15 following the year the gifts were made and each will report the \$19,000 net taxable gift.

If Harry and Helga each gave \$11,000 of the \$30,000 gift to their daughter's husband (each gives \$30,000 total: \$19,000 to daughter, \$11,000 to son-in-law), they would each only report \$8,000 as the net taxable gift. In each of these cases, the net taxable gift starts to consume the taxpayer's \$1,000,000 lifetime gift tax exemption, but no gift tax needs to be paid because lifetime taxable gifts have not yet exceeded \$1,000,000.

Qualified Transfers for Education and Medical Expenses

Payments made **directly** to an educational institution for tuition, or **directly** to a doctor, hospital, or medical provider for medical services are not considered taxable gifts even if such payments are over the \$11,000 annual exclusion. Tax practitioners should caution their clients desiring to make such gifts that the **payments have to be made directly to the school or medical provider** rather than to the individual who incurred such expense. Even if the individual uses the gift proceeds for the intended education or medical purpose, the gift will be deemed a taxable gift to the individual to the extent it exceeds the current \$11,000 annual gift exclusion.

Charitable Contribution Deduction

A deduction is allowed for any amount given to a recognized charity, as defined by IRC §501(c)(3). No gift tax return is required for gifts made to a charity. If an individual makes a charitable gift during her lifetime, the taxpayer can claim a charitable deduction on her individual income tax return. If the transfer to the charity is made by the estate after death, the amount of the charitable contribution is a deduction on the decedent's Form 706 (estate tax return).

Example 3. Greg Goodfellow donated 20 acres of farmland to his church in February 2003. The land was worth \$4,200 per acre for a total of \$84,000, and Mr. Goodfellow's tax basis in this land was \$8,000. As a result of this contribution of property, Mr. Goodfellow will receive a charitable contribution deduction of \$84,000 on his 2003 Form 1040 Schedule A. There is no requirement to file a gift tax return for this charitable gift.

Had Mr. Goodfellow's executor transferred the property to his church after death (as directed by his will), the executor would treat the contribution as an estate tax charitable deduction. By making the charitable contribution while alive, Greg Goodfellow received a double benefit:

- The income tax deduction during life, and
- A smaller gross estate than he would have had if he had kept the farmland until death. The net estate would have been the same if he made the contribution after death or during his lifetime.

Marital Deduction

Gifts made during the year to a taxpayer's spouse are excluded from the total amount of gifts made during the year, since **the amount of the marital deduction is unlimited**. To **qualify** for the marital deduction, the following conditions **must be met**:

- The couple must be married at the time of the gift. A gift to a person who later becomes the donor's spouse does not qualify for the marital deduction. The gift of an engagement ring prior to marriage would not qualify for the marital deduction.
- The spouse receiving the gift must be a U.S. citizen, though the donor-spouse does not have to be a U.S. citizen or resident.
- The gift must be unqualified and unconditional, that is, no strings attached.

Example 4. Ken gives his wife, Barbie, 4,000 shares of Mattel common stock valued at \$21 per share, or \$84,000 total. This gift to Barbie qualifies for the marital deduction, and no gift tax return is required to be filed by Ken.

Observation. Gifting between spouses is often an effective estate tax planning technique in order to ensure that each spouse has sufficient assets in his or her name **to fully utilize the maximum allowable estate tax exclusion**. Estate tax planners will often recommend that one spouse shift (gift) assets to the other spouse to equalize ownership of total marital assets. For example, assume H and W each own \$1,000,000 after one spouse has made gifts to the other to equalize the estates. If either H or W, or both, should die in 2003, each estate can use the \$1,000,000 estate tax exclusion available in 2003 to transfer property to children free of estate tax.

FILING THE GIFT TAX RETURN

When a taxpayer makes a gratuitous transfer of assets during the calendar year, the taxpayer will need to file a gift tax return (Form 709) to report this transfer unless this gift was:

- Made to a qualified charitable organization,
- A transfer of a present interest in property that is not more than the annual exclusion (currently \$11,000),
- A qualified transfer for education or medical expenses, or
- A gift to the taxpayer's spouse.

If a return must be filed, the following should be kept in mind by the person preparing the return:

- The Form 709 gift tax return is due on April 15 following the year of the gift.
- If the donor of a gift dies during the year in which the gift is made, the gift tax return is due no later than the **earlier** of the due date (including extensions) of the donor's estate tax return or April 15. The executor of the donor's estate should file the gift tax return.
- If a donor makes adequate disclosure of the gift under IRC §2504, the IRS has three years to examine the gift tax return. If the gift tax return is not examined, the IRS cannot change the valuation of the gift on a later estate tax return of the donor. The disclosure requirements that are detailed in Treas. Reg. §301.6501(c)-1(f)(2) require the following information:
 1. A description of the transferred property and any consideration received by the transferor
 2. The identity of, and relationship between, the transferor and each transferee
 3. If the property is transferred in trust, the trust's employer ID number and a brief description of the trust or a copy of the trust instrument
 4. A detailed description of the method used to determine the FMV of the property transferred, or a copy of an appraisal of the property
 5. A statement describing any position taken that is contrary to any proposed, temporary, or final Treasury regulations or revenue rulings published at the time of the transfer

Note. There is **no** penalty for filing a gift tax return late (after April 15 following the year of the gift) if no gift tax is owed. The delayed filing date is the starting date of the three-year statute of limitations. Taxpayers should consider filing delinquent gift tax returns in order to start the statute of limitations and comply with the new rules regarding disclosure requirements. Filing gift tax returns may also be desirable even if the gift is under \$11,000 if there could be a question raised at a later date regarding the valuation of the gift.

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Gifts are valued at their FMV at the date of the transfer. The recipient's tax basis is the lesser of the donor's cost or FMV. The recipient also can include the donor's holding period as his own holding period when determining capital gain or loss treatment.

Example 5. Doctor Robin owns 300 shares of Home Depot common stock with an FMV of \$9,000 (\$30 per share). Doc Robin had held these shares for 10 years and has a cost basis of \$2,700. If he sells these shares after May 6, 2003, Doc Robin will have to pay capital gains taxes at a 15% rate on \$6,300. Since the taxpayer desires to give \$9,000 to his son for college expenses, his best tax move is to gift the stock to his son, Ben. Ben can then sell the stock. Since Ben is in a 10% tax bracket, he will be taxed on the gain at the lower capital gains rate of 5%.

The family tax savings of \$630 is computed as follows:

Father's gain	\$6,300	
Father's tax rate	15%	
Father's tax		\$945
Ben's gain	\$6,300	
Ben's tax rate	5%	
Ben's tax		315
Savings		\$630

Note. Taxpayers should consider making gifts of substantially appreciated property to their children who are over the age of 13, and then having each child sell the property. Since children over 13 avoid the "kiddie tax" and are taxed at their own rate, they will only pay capital gain tax at the 5% rate on the gain realized, assuming they remain in the lowest tax bracket. The same strategy works for gifts to dependent parents who are also in lower income tax brackets. For sales of capital assets by those taxpayers in the 10% regular tax bracket in 2008, there will be no tax.

Example 6. June Addington, a widow, has accumulated substantial assets during her lifetime and desires to give a portion of her wealth to her daughter, Carlene. Mrs. Addington has faithfully made annual gifts qualifying for the maximum annual exclusion to her daughter in each of the past 14 years. In 1996, she even exceeded the annual exclusion (then \$10,000) by transferring cash to her daughter in the amount of \$150,000. A 1996 gift tax return was filed to record this transfer. During 2003, Mrs. Addington became more generous by giving Carlene \$1,280,000 in cash plus 5,500 shares of Pfizer stock valued at \$30 per share (cost basis was \$72,500).

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Mrs. Addington's Gifts to Carlene

Year	Gift Amount	Amount Subject to Gift Tax
1990–1995 @ \$10,000 per year	\$ 60,000	\$ 0
1996		
Annual exclusion — \$10,000		
Additional gift — \$140,000	150,000	140,000
1997–2001 @ \$10,000 per year	50,000	0
2002		
Annual exclusion — \$11,000	11,000	0
2003		
Annual exclusion — \$11,000		
Additional cash — \$1,269,000		
Stock gift — \$165,000 (basis of \$72,500)	1,445,000	1,434,000

The tax practitioner will note the prior gift tax return on line 2, part 2, of Form 709. Line 2 summarizes all prior taxable gifts made and serves to reduce the lifetime gift tax exemption available in the current year. The 2003 lifetime gift tax exemption is \$1,000,000, which equates to an applicable credit amount of \$345,800 (line 7). Mrs. Addington's 2003 taxable gifts were \$1,434,000, which will need to be added to her prior taxable gift of \$140,000. Her lifetime cumulative gifting now exceeds the \$1,000,000 lifetime exemption. Her 2003 completed gift tax return shows a gift tax liability of \$243,300. She will pay gift tax of \$243,300 for the 2003 gift tax liability, but she has now reduced the total assets in her estate for future estate tax purposes.

If Mrs. Addington were to die in the year 2006, her estate would contain neither the gifted property nor the gift tax paid. Her available estate tax exemption would be \$954,912 because she paid tax on the \$574,000 in 2003.

Observation. Payment of the gift tax liability of \$243,300 reduces her taxable estate when Mrs. Addington dies. In addition, any future appreciation in the stock gifted in 2003 will be excluded from her estate. If the stock is sold after May 6, 2003, any gain on the sale of the stock, as measured by the FMV at time of sale less Mrs. Addington's basis, will be taxed to the daughter at a maximum capital gain rate of 15%.

Observation. Mrs. Addington's decision to make large gifts exceeding the lifetime gift tax exemption caused her to actually **pay** gift tax. Many taxpayers are reluctant to pay gift tax, given the possibility of estate tax repeal. These taxpayers hope that their estates will be sheltered by repeal of the estate tax or at least the more generous exemptions that are scheduled through 2009.

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For Example 6

Form	709	United States Gift (and Generation-Skipping Transfer) Tax Return (For gifts made during calendar year 2003)	OMB No. 1545-0020 2003
Department of the Treasury Internal Revenue Service		▶ See separate instructions.	

1 Donor's first name and middle initial June A.	2 Donor's last name Addington	3 Donor's social security number 123 45 6789
4 Address (number, street, and apartment number) 8002 Wayside Drive		5 Legal residence (domicile) (county and state) Ford, IL
6 City, state, and ZIP code Thawville, IL 60611		7 Citizenship United States

Part 1—General Information

8 If the donor died during the year, check here <input type="checkbox"/> and enter date of death	Yes	No
9 If you received an extension of time to file this Form 709, check here <input type="checkbox"/> and attach the Form 4868, 2688, 2350, or extension letter	<input checked="" type="checkbox"/>	<input type="checkbox"/>
10 Enter the total number of donees listed on Schedule A—count each person only once	<input checked="" type="checkbox"/>	<input type="checkbox"/>
11a Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b	<input checked="" type="checkbox"/>	<input type="checkbox"/>
11b If the answer to line 11a is "Yes," has your address changed since you last filed Form 709 (or 709-A)?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
12 Gifts by husband or wife to third parties.—Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (See instructions.) (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. If the answer is "No," skip lines 13–18 and go to Schedule A.)		
13 Name of consenting spouse	14 SSN	
15 Were you married to one another during the entire calendar year? (see instructions)		
16 If the answer to 15 is "No," check whether <input type="checkbox"/> married <input type="checkbox"/> divorced or <input type="checkbox"/> widowed, and give date (see instructions) ▶		
17 Will a gift tax return for this year be filed by your spouse? (If "Yes," mail both returns in the same envelope.)		
18 Consent of Spouse —I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.		

Part 2—Tax Computation

1 Enter the amount from Schedule A, Part 4, line 11	1	1,434,000	
2 Enter the amount from Schedule B, line 3	2	140,000	
3 Total taxable gifts (add lines 1 and 2)	3	1,574,000	
4 Tax computed on amount on line 3 (see Table for Computing Tax in separate instructions)	4	589,100	
5 Tax computed on amount on line 2 (see Table for Computing Tax in separate instructions)	5	37,850	
6 Balance (subtract line 5 from line 4)	6	589,100	
7 Maximum unified credit (nonresident aliens, see instructions)	7	345,800	00
8 Enter the unified credit against tax allowable for all prior periods (from Sch. B, line 1, col. C)	8	37,850	
9 Balance (subtract line 8 from line 7)	9	345,800	
10 Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions)	10		
11 Balance (subtract line 10 from line 9)	11	345,800	
12 Unified credit (enter the smaller of line 6 or line 11)	12	345,800	
13 Credit for foreign gift taxes (see instructions)	13		
14 Total credits (add lines 12 and 13)	14	345,800	
15 Balance (subtract line 14 from line 6) (do not enter less than zero)	15	243,300	
16 Generation-skipping transfer taxes (from Schedule C, Part 3, col. H, Total)	16		
17 Total tax (add lines 15 and 16)	17	243,300	
18 Gift and generation-skipping transfer taxes prepaid with extension of time to file	18		
19 If line 18 is less than line 17, enter balance due (see instructions)	19	243,300	
20 If line 18 is greater than line 17, enter amount to be refunded	20		

Sign Here

Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than donor) is based on all information of which preparer has any knowledge.

Paid Preparer's Use Only

Preparer's signature	Date	
Firm's name (or yours if self-employed), address, and ZIP code	Phone no. ()	Check if self-employed <input type="checkbox"/>

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 12 of the separate instructions for this form. Cat. No. 16783M Form 709 (2003)

For Example 6

Form 709 (2003)

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SCHEDULE A Computation of Taxable Gifts (Including transfers in trust) (see instructions)A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," see instructions Yes ☒ No ☐B ☐ Check here if you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified state tuition program as made ratably over a 5-year period beginning this year. See instructions. Attach explanation.**Part 1—Gifts Subject Only to Gift Tax.** Gifts less political organization, medical, and educational exclusions—see instructions

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no.	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1	See attached schedule						

Gifts made by spouse—complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

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Total of Part 1 (add amounts from Part 1, column H) **1,445,000****Part 2—Direct skips**— gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no.	C 2632(b) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1							

Gifts made by spouse—complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

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Total of Part 2 (add amounts from Part 2, column H)

Part 3—Indirect skips— gifts to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no.	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1							

Gifts made by spouse—complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

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Total of Part 3 (add amounts from Part 3, column H)

(If more space is needed, attach additional sheets of same size.)

Form 709 (2003)

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2003 Workbook

For Example 6

June A. Addington 123-45-6789

Attachment to Form 709 Schedule A

Part 1—Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions—see instructions				
A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was made by means of a trust, enter trust's EIN and attach a description or copy of the trust instrument (see instructions) • If the gift was of securities, give CUSIP number	C Donor's adjusted basis of gift	D Date of gift	E Value at date of gift
1	CASH to CARLENE ADDINGTON RYAN (Daughter), #14 SIGMA LANE, HUNTSVILLE, AL 55000	1,280,000	10/15/2003	1,280,000
2	5,500 SHARES COMMON STOCK, PFIZER INC., NYSE, CUSIP NO. BROKER. to CARLENE ADDINGTON RYAN (Daughter), #14 SIGMA LANE, HUNTSVILLE, AL 55000	72,500	10/15/2003	165,000
Total of Part 1 (add amounts from Part 1, column E)				1,445,000

For Example 6

Form 709 (2003)

Page 3

Part 4—Taxable Gift Reconciliation

1	Total value of gifts of donor (add totals from column H of Parts 1, 2, and 3)	1	1,445,000
2	Total annual exclusions for gifts listed on line 1 (see instructions)	2	11,000
3	Total included amount of gifts (subtract line 2 from line 1)	3	1,434,000
Deductions (see instructions)			
4	Gifts of interests to spouse for which a marital deduction will be claimed, based on items of Schedule A	4	
5	Exclusions attributable to gifts on line 4	5	
6	Marital deduction—subtract line 5 from line 4	6	
7	Charitable deduction, based on items less exclusions	7	
8	Total deductions—add lines 6 and 7	8	0
9	Subtract line 8 from line 3	9	1,434,000
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule C, Part 3, col. H, Total)	10	
11	Taxable gifts (add lines 9 and 10). Enter here and on line 1 of the Tax Computation on page 1.	11	1,434,000

SCHEDULE A Computation of Taxable Gifts (continued)**12 Terminable Interest (QTIP) Marital Deduction.** (See instructions for line 4 of Schedule A.)

If a trust (or other property) meets the requirements of qualified terminable interest property under section 2523(f), and

a. The trust (or other property) is listed on Schedule A, and

b. The value of the trust (or other property) is entered in whole or in part as a deduction on line 4, Part 4 of Schedule A,

then the donor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2523(f).

If less than the entire value of the trust (or other property) that the donor has included in Parts 1 and 3 of Schedule A is entered as a deduction on line 4, the donor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on line 6 of Part 4, Schedule A. The denominator is equal to the total value of the trust (or other property) listed in Parts 1 and 3 of Schedule A.

If you make the QTIP election (see instructions for line 4 of Schedule A), the terminable interest property involved will be included in your spouse's gross estate upon his or her death (section 2044). If your spouse disposes (by gift or otherwise) of all or part of the qualifying life income interest, he or she will be considered to have made a transfer of the entire property that is subject to the gift tax (see Transfer of Certain Life Estates on page 4 of the instructions).

13 Election Out of QTIP Treatment of Annuities

☐ Check here if you elect under section 2523(f)(6) NOT to treat as qualified terminable interest property any joint and survivor annuities that are reported on Schedule A and would otherwise be treated as qualified terminable interest property under section 2523(f). (See instructions.) Enter the item numbers (from Schedule A) for the annuities for which you are making this election ►

SCHEDULE B Gifts From Prior Periods

If you answered "Yes" on line 11a of page 1, Part 1, see the instructions for completing Schedule B. If you answered "No," skip to the Tax Computation on page 1 (or Schedule C, if applicable).

A Calendar year or calendar quarter (see instructions)	B Internal Revenue office where prior return was filed	C Amount of unified credit against gift tax for periods after December 31, 1976	D Amount of specific exemption for prior periods ending before January 1, 1977	E Amount of taxable gifts
1996	Kansas City	0		140,000
1 Totals for prior periods		1 0		140,000
2 Amount, if any, by which total specific exemption, line 1, column D, is more than \$30,000		2		
3 Total amount of taxable gifts for prior periods (add amount, column E, line 1, and amount, if any, on line 2). (Enter here and on line 2 of the Tax Computation on page 1.)		3		140,000

(If more space is needed, attach additional sheets of same size.)

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VALUATION DISCOUNTS AND FAMILY LIMITED PARTNERSHIPS: RECENT DEVELOPMENTS

Interest in the family limited partnership (FLP) as a potentially valuable estate planning tool has increased in recent years. The FLP allows a taxpayer to gift property to younger generations, in hopes of reducing the taxable estate of the taxpayer at death. Typically, valuable property is transferred into a business entity (the FLP) and then portions of the FLP are gifted to children or grandchildren. The primary goal is usually to obtain substantial valuation discounts, based on lack of control and lack of marketability, when the values of the gifts are determined for gift tax purposes. In some cases, valuation discounts can be in excess of 40% of the actual FMV of the underlying assets.

Initially, the IRS required a legitimate business purpose for an FLP, but some courts have held that a business purpose is not necessary. Thus, the valuation discounts may apply to gifts of FLP interests where underlying assets are:

- An operating business, and
- Cash, securities, and real estate.

The two discounts potentially available are:

- **Lack of marketability**, which reflects the fact that the partnership agreement will restrict the sale or transfer of the partnership interest so that there is no ready market for the partnership interest.
- **Minority interest**, which provides for a discount in underlying value of the asset due to the inability of the limited partner to compel partnership distributions, or to compel liquidation in order to obtain the limited partner's share of the partnership interests. Revenue Ruling 93-12 held that a minority interest is available with respect to a transfer between family members despite the fact that, after the transfer, control exists as a family unit.

Example 7. Ronald Pour, a widower, is a self-made millionaire. Mr. Pour is now 78 years old and has accumulated assets of \$3,000,000. His desire is to preserve as much of this wealth as possible within his family for the benefit of his three surviving daughters. Mr. Pour met with an attorney and decided to establish the Pour Family Limited Partnership. Mr. Pour and his daughters wish to contribute the following assets to the FLP in exchange for a 40% general partnership interest and 60% limited partnership interests. On the advice of his attorney, Mr. Pour will retain \$300,000 cash outside of the FLP in order to meet his personal day-to-day living expenses. This is wise in light of court cases where the IRS has successfully argued that the FLP was a sham. In one case, the donor continued to pay personal expenses from the income generated by the FLP and did not divest himself of control of the assets within the FLP.

Mr. Pour transferred the following assets, worth \$2,700,000 and with a basis as noted, to the FLP in exchange for a general partnership interest and limited partnership interests:

Asset	Fair Market Value	Basis	Potential Gain
Stocks/Mutual Funds	\$1,650,000	\$ 720,000	\$ 930,000
Farm Land	1,050,000	425,000	625,000
Total	\$2,700,000	\$1,145,000	\$1,555,000

There is no gain or loss from the transfer of the assets into the FLP. Had Mr. Pour sold the assets for cash, his minimum federal tax bill would have been \$233,250 (15% of \$1,555,000) before any alternative minimum tax considerations, and the remaining cash after taxes would still be included in his estate at his date of death.

The estate planning strategy for the Pour Family Limited Partnership is for Mr. Pour to retain a 40% general partnership interest, and to gift to each of his three daughters a 20% limited partnership interest. A gift tax return (Form 709) will be required, but Mr. Pour can take discounts for these gifts for lack of marketability and for minority ownership. Assuming a discount of 40% (which may be quite aggressive considering the

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type of assets in this partnership), the value of the gift to each daughter would almost use up Mr. Pour's entire \$1,000,000 lifetime gift exemption but not create any gift tax liability. The computations regarding these gifts, assuming no prior taxable gifts by Mr. Pour and documentation supporting the discounts, would be as follows:

Value of FLP	\$2,700,000
Retained by Mr. Pour (40%)	(1,080,000)
Total gifts to daughters	\$1,620,000
1/3 gift to each daughter	× .3333
Total gift per daughter (20% of \$2,700,000)	\$ 540,000 (rounded)
Less: Discount (40%)	(216,000)
	\$ 324,000
Less: 2003 allowable exclusion	(11,000)
Taxable gift per daughter	\$ 313,000
Total taxable gifts (\$313,000 × 3)	939,000
Applicable exclusion (lifetime gift exemption) used	(939,000)
Gifts subject to gift tax	\$ 0

The gift tax return for these gifts follows. Assuming no successful challenge by the IRS, Mr. Pour has succeeded in gifting a total of 60% of his estate to his daughters without paying any gift tax, and retaining a 40% interest as a general partner in the FLP (40% of gross value equals \$1,080,000). Furthermore, Mr. Pour still has \$61,000 of his lifetime gift exemption remaining (\$1,000,000 **lifetime** exemption less \$939,000 used in the 2002 gifting process for the FLP). Also, using the \$11,000 per person annual gift exclusion, Mr. Pour may continue to make gifts of partnership interests to each of his three daughters, and perhaps even to his sons-in-law, to divest himself of more assets that would otherwise be in his gross estate. In addition, for estate tax purposes, the estate exemption will be increasing through 2010 so that his future available exemption may be enough to shelter his remaining estate when he dies.

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For Example 7

Form 709	United States Gift (and Generation-Skipping Transfer) Tax Return (For gifts made during calendar year 2003)		OMB No. 1545-0020
Department of the Treasury Internal Revenue Service		2003	
▶ See separate instructions.			
1 Donor's first name and middle initial RONALD D.		2 Donor's last name POUR	
4 Address (number, street, and apartment number) 806 VISTA RD.		3 Donor's social security number 555 : 66 : 1010	
6 City, state, and ZIP code TAYLOR FALLS, IL 60600		5 Legal residence (domicile) (county and state) DUPAGE, IL	
7 Citizenship UNITED STATES			
Part 1—General Information	8 If the donor died during the year, check here <input type="checkbox"/> and enter date of death		Yes No
	9 If you received an extension of time to file this Form 709, check here <input type="checkbox"/> and attach the Form 4868, 2688, 2350, or extension letter		<input checked="" type="checkbox"/>
	10 Enter the total number of donees listed on Schedule A—count each person only once. ▶		<input checked="" type="checkbox"/>
	11a Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b		<input checked="" type="checkbox"/>
	11b If the answer to line 11a is "Yes," has your address changed since you last filed Form 709 (or 709-A)?		<input type="checkbox"/>
	12 Gifts by husband or wife to third parties.—Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (See instructions.) (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. If the answer is "No," skip lines 13–18 and go to Schedule A.)		<input type="checkbox"/>
	13 Name of consenting spouse		14 SSN
	15 Were you married to one another during the entire calendar year? (see instructions)		<input type="checkbox"/>
	16 If the answer to 15 is "No," check whether <input type="checkbox"/> married <input type="checkbox"/> divorced or <input type="checkbox"/> widowed, and give date (see instructions) ▶		<input type="checkbox"/>
	17 Will a gift tax return for this year be filed by your spouse? (If "Yes," mail both returns in the same envelope.)		<input type="checkbox"/>
18 Consent of Spouse —I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.			
Consenting spouse's signature ▶ Date ▶			
Part 2—Tax Computation	1 Enter the amount from Schedule A, Part 4, line 11		1 939,000
	2 Enter the amount from Schedule B, line 3		2
	3 Total taxable gifts (add lines 1 and 2)		3 939,000
	4 Tax computed on amount on line 3 (see Table for Computing Tax in separate instructions)		4 322,010
	5 Tax computed on amount on line 2 (see Table for Computing Tax in separate instructions)		5 0
	6 Balance (subtract line 5 from line 4)		6 322,010
	7 Maximum unified credit (nonresident aliens, see instructions)		7 345,800 00
	8 Enter the unified credit against tax allowable for all prior periods (from Sch. B, line 1, col. C)		8
	9 Balance (subtract line 8 from line 7)		9 345,800
	10 Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions)		10
	11 Balance (subtract line 10 from line 9)		11 345,800
	12 Unified credit (enter the smaller of line 6 or line 11)		12 322,010
	13 Credit for foreign gift taxes (see instructions)		13
	14 Total credits (add lines 12 and 13)		14 322,010
	15 Balance (subtract line 14 from line 6) (do not enter less than zero)		15 0
	16 Generation-skipping transfer taxes (from Schedule C, Part 3, col. H, Total)		16
	17 Total tax (add lines 15 and 16)		17 0
	18 Gift and generation-skipping transfer taxes prepaid with extension of time to file		18
	19 If line 18 is less than line 17, enter balance due (see instructions)		19 0
	20 If line 18 is greater than line 17, enter amount to be refunded		20
Attach check or money order here.	Sign Here Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than donor) is based on all information of which preparer has any knowledge.		
	Signature of donor		Date
	Preparer's signature ▶		Date
	Firm's name (or yours if self-employed), address, and ZIP code ▶		Check if self-employed <input type="checkbox"/>
		Phone no. ▶ ()	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 12 of the separate instructions for this form. Cat. No. 16783M Form **709** (2003)

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For Example 7

Form 709 (2003)

Page **2**

SCHEDULE A Computation of Taxable Gifts (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," see instructions Yes ☒ No ☐

B ☐ Check here if you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified state tuition program as made ratably over a 5-year period beginning this year. See instructions. Attach explanation.

Part 1—Gifts Subject Only to Gift Tax. *Gifts less political organization, medical, and educational exclusions—see instructions*

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no.	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter ½ of column F	H Net transfer (subtract col. G from col. F)
1	See attached schedule						

Gifts made by spouse—complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

--	--	--	--	--	--	--	--

Total of Part 1 (add amounts from Part 1, column H) **972,000**

Part 2—Direct skips— gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the

Ronald D. Pour 555-66-1010

Attachment to Form 709 Part 1

Part 1—Gifts Subject Only to Gift Tax. *Gifts less political organization, medical, and educational exclusions—see instructions*

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was made by means of a trust, enter trust's EIN and attach a description or copy of the trust instrument (see instructions) • If the gift was of securities, give CUSIP number	C Donor's adjusted basis of gift	D Date of gift	E Value at date of gift
1	20% PARTNERSHIP INTEREST IN POUR FAMILY LIMITED PARTNERSHIP. COPY OF PARTNERSHIP AGREEMENT ATTACHED AND COMPUTATION OF FAIR MARKET VALUE OF INTEREST ALSO ATTACHED. to LUCY POUR LAWLESS (Daughter), 14 HAMROCK, IRVING, TX 30000	229,000	8/02/2003	324,000
2	20% PARTNERSHIP INTEREST IN POUR FAMILY LIMITED PARTNERSHIP. COPY OF PARTNERSHIP AGREEMENT ATTACHED AND COMPUTATION OF FAIR MARKET VALUE OF INTEREST ALSO ATTACHED. to LIZ POUR CHAMBERS (Daughter), 1009 KINGS COURT, WILLIAMSBURG, VA 10050	229,000	8/02/2003	324,000
3	20% PARTNERSHIP INTEREST IN POUR FAMILY LIMITED PARTNERSHIP. COPY OF PARTNERSHIP AGREEMENT ATTACHED AND COMPUTATION OF FAIR MARKET VALUE OF INTEREST ALSO ATTACHED. to LORETTA POUR STOTLZ (Daughter), 113 ORLEANS, SUGARLAND, TX 04020	229,000	8/02/2003	324,000
Total of Part 1 (add amounts from Part 1, column E)				972,000

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The practitioner should ensure that all attachments are provided with this gift tax return, including a complete copy of the partnership agreement and a detailed illustration of the computations of FMV of the respective partnership interests gifted by the taxpayer. The discount taken must be substantiated with a thorough appraisal. It is now possible for gift tax returns to be binding for valuation purposes after the three year statute of limitations, provided that the returns meet the adequate disclosure requirements set forth under the regulations for IRC §6501(c)(9).

A word of caution is in order. Although the IRS is less likely to assert the “substance over form” arguments used in its initial attacks on the validity of FLPs, the IRS has had some success challenging FLPs under IRC §2036(a). This section states that the gross estate of a decedent includes property that the decedent transferred by trust or otherwise, if the decedent retained possession or enjoyment of the property, or the right to the income, or if the decedent retained the right to determine who would possess or enjoy the property or receive its income. This is the concept of a grantor transferring a remainder interest and retaining a life estate. Under IRC §2036(a), the FMV of the property in which grantor retained a life estate is included in the grantor’s gross estate for estate tax purposes.

In order to reduce the risk that the IRS will successfully attack the FLP, care must be taken with both the organization and actual operation of the FLP. It was easy for the IRS to apply IRC §2036(a) in the *Estate of Schauerhamer*,³ where Mrs. Schauerhamer ignored the FLP by depositing the partnership income into her personal checking account and continuing to manage her stock portfolio as she did prior to the formation of the FLP. The commingling of partnership income with personal income and the failure to title partnership assets in the FLP name provided the IRS examiner with reasons to include the assets of the FLP in the decedent’s estate, thereby nullifying the intended tax savings.

In a more recent case, *Estate of Theodore Thompson*,⁴ the IRS successfully challenged the FLP under IRC §2036(a). In this case, Mr. Thompson had transferred almost all of his assets for the formation of the FLP and his future living expenses were intended to be withdrawn from the FLP as needed. As with a life estate, Mr. Thompson seemed to retain the right of control and possession of the property, and the right to its income. Since almost all assets were within the FLP, the court reasoned that there had to be some implied agreement between Mr. Thompson and his children that would allow him to withdraw income as needed for living expenses. Thus, the entire value of the FLP was added back into Mr. Thompson’s gross estate for estate tax purposes, no deduction was allowed for discounts (taxpayers had taken a total of 40% discounts of asset valuation at the time the FLP was formed), and the estate owed \$707,054 in additional estate taxes.

Note. See Chapter 15, Rulings and Cases for a thorough analysis of the *Estate of Theodore Thompson* case.

In May 2003, the tax court reversed its earlier position in *Strangi*⁵ on remand from the Fifth Circuit Court of Appeals. Even though the IRS did not raise the IRC §2036(a) issue in its deficiency notice, the Court of Appeals (and the tax court on reconsideration) concluded that the total value of assets transferred into the FLP should be included in the decedent’s gross estate. The court noted four fatal flaws in this FLP arrangement:

- The decedent had transferred nearly all his wealth into the FLP entities, leaving him with just a few liquid assets to meet living expenses.
- The decedent continued to live in his personal residence that had been transferred into the FLP with rent being accrued but not paid for two years.
- FLP funds were used to pay for the needs of the decedent and his estate.
- The FLP arrangement more resembled an estate plan than a joint enterprise, and did not substantially change the decedent’s relationship to the transferred assets.

Observation. Practitioners should pay close attention to recent court decisions involving FLPs. The FLP must be a separate entity, and not serve as a checkbook for the grantor who formed the limited partnership. Assets gifted to the younger generation limited partners must be unrestricted and no longer under the control of the donor. And, without exception, the donor of assets into the FLP should retain sufficient assets in her own name in order to pay day-to-day living expenses, and not tap the FLP for these expenditures. FLPs should only be used with caution and with an awareness that the anticipated tax savings may be challenged by the IRS, either following the gifting of the FLP interests or at the time of the taxpayer's death.

ESTATE TAXES

The final component of the wealth transfer tax is the estate tax. To the extent that a taxpayer used up all or part of the lifetime gift exemption (and the applicable credit amount it represents) during his lifetime, the allowable exemption for the estate is less. (In effect, the corresponding applicable credit amount available to be applied against any estate tax is less.) Currently, the estate tax exemption is \$1,000,000 but will increase to \$1,500,000 in 2004, \$2,000,000 in 2006, and \$3,500,000 in 2009. In 2010 the estate tax is repealed.

Absent further action by Congress, the repeal is for deaths occurring in 2010 only because of the sunset provisions of the act; unless Congress acts to make the repeal permanent or otherwise amend existing law, the estate tax reappears in 2011 based on the tax rates and exemptions that would have been in effect before the Act (e.g., a \$1,000,000 exclusion and 55% maximum tax rate). Most observers believe that Congress will act in some way during the next few years to modify the sunset provisions. Estate planners and concerned taxpayers will be diligently watching to see what changes are actually enacted.

2003–2009 Rate Schedule Where the Taxable Estate (Plus Adjusted Taxable Gifts) Exceeds \$1,000,000

Estate Bracket		Estate Tax Rate
Over	But Not Over	
\$1,000,000	\$1,250,000	41%
1,250,000	1,500,000	43%
1,500,000	2,000,000	45%
2,000,000		49%*
*Drops to 48% (2004), 47% (2005), 46% (2006), and 45% (2007)		
Source: IRC §2001(c)		

PHASEOUT OF STATE DEATH TAX CREDIT

The Act also gradually repeals the credit for state death taxes. Under prior law, a credit was allowed against the federal estate tax for state tax that was paid for any estate, inheritance, or legacy, or for succession taxes paid to a respective state. The maximum credit allowed for taxes paid to a state was determined by a graduated rate table based on the size of the decedent's taxable estate less \$60,000. In practice, most states simply piggybacked on the federal estate computations by imposing a state death tax equal to the maximum federal credit allowed.

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Under the Act, the full allowable credit for state death taxes is phased out as follows:

Year	Maximum State Death Tax Credit Reduced from Prior Law Amounts by
2002	25%
2003	50%
2004	75%
2005	100%

To the extent state death taxes are actually paid during the phaseout years, a partial credit will be allowed to the estate. Beginning in year 2005, only a deduction is allowed, because no credit will be available. IRC §2058 allows a new deduction for state death taxes for decedents dying after December 31, 2004.

Observation. The phaseout of the state death tax **credit** and its replacement with a state death tax **deduction** will raise more revenue for the U.S. Treasury. But many states have enacted a tax equal to the credit provided by the federal estate tax. These states are likely to enact a new state death tax. For example, on May 31, 2003, the Illinois General Assembly passed Senate Bill 1725 amending the Illinois Estate and Generation-Skipping Transfer Tax Act, which provides for the full payment of pre-Act state taxes to Illinois even as the deduction is being phased out for taxable purposes.

THE ESTATE TAX PROCESS

Estate Administration

The process of administering and distributing property from the decedent's estate is very important. If the decedent dies with a will (decedent dies "testate"), the estate is administered in accordance with the decedent's will and the estate administration laws of the state where the decedent was domiciled. If the decedent did not have a will (decedent died "intestate"), the property is generally distributed according to the state law of descent and distribution, and the estate is administered in accordance with state law of the state where the decedent was domiciled.

A will is an important component of almost every estate plan. Some key facts about wills follow:

- The will must be in writing, signed by the individual who makes the will, and witnessed. Applicable state law usually requires at least two witnesses.
- The will should name the personal representative of the decedent's estate, and provide any specific instructions for administering the estate.
- States typically set forth a duty to **file a will with the court**. For example, Illinois law provides that any person possessing the will of a decedent should file the will with the clerk of the court within 30 days of decedent's death. **Persons who willfully secrete a will for more than 30 days after learning of the decedent's death are guilty of a misdemeanor.**
- Once the will is filed, whether a petition should be filed with the court to **admit the will to probate** (a concept different from filing the will with the court) or to formally appoint the personal representative depends on the circumstances. For example, if there is no property to be administered or transferred, either because of limited assets or because the assets are in a trust or in joint tenancy with rights of survivorship, there may be no need to file the petition for probate and appointment of the personal representative.
- If a petition is filed and a **personal representative is appointed** by the court, that person will need to comply with other requirements as set forth in the state's law of estates. It should be noted that many estates are now administered under a simplified process known as independent administration. This process avoids aspects of

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probate that were objectionable to some persons. For example, some people did not want an inventory of their estate to be a matter of public record in the courthouse. Under independent administration, the executor must mail an inventory of the estate to the beneficiaries and heirs of the deceased, but does not file the inventory with the court where it would be a public record. (Instead, the personal representative must report to the court that the inventory was in fact mailed to the interested parties.)

Observation. Probate is the legal process where the Court oversees the distribution of property in accordance with the terms of the Last Will and Testament and applicable law. By design, **a person may avoid the probate process in one's estate by holding property as joint tenants with right of survivorship, having named beneficiaries for property that will pass by operation of law, or by placing property in a trust.** There are advantages and disadvantages to each of these strategies for transferring property at death.

Example 8. Gertie Gocher, a widow, died on March 6, 2003, while a resident of the Seven Pines Nursing Home. Mrs. Gocher had properly executed a Last Will and Testament, which left her entire estate to her two daughters, Candi Gocher and Brenda Gocher. At the time of her death, she had an interest in the following assets:

Asset	FMV at Date	Owner	Beneficiary
1. IRA account — Fifth First Bank	\$280,000	Gertie	Daughters
2. Insurance Policy — Northwestern Life	800,000	Daughters	Daughters
3. Certificate of Deposit — Fifth First Bank	150,000	Gertie and daughters as joint tenants	

In this case, the above assets pass to beneficiaries without being subject to estate administration because the beneficiaries will receive direct distributions. The daughters are named beneficiaries of the IRA and life insurance policy and become sole owners of the certificate of deposit as the surviving joint tenants. Also, a federal estate tax return (Form 706) is not required because the gross estate, for federal estate tax purposes, is under \$1,000,000 in 2003.

Observation. Given the preceding facts, whether this estate must file Form 706 and pay estate tax depends on who “owns” the insurance policy valued at \$800,000. In this example, we assumed that the decedent did **not** have “incidents of ownership” over the insurance policy. If decedent had owned the policy, the taxable estate would have included the value of the policy and would have exceeded \$1,000,000. Then filing a Form 706 and paying some estate tax would be required.

Although the transfers taking effect at death do not generate federal estate tax, the daughters will need to pay income taxes on the inherited IRA. The IRA is income in respect of a decedent (IRD) property that is included in the gross estate of Mrs. Gocher and also taxed for income tax purposes to the beneficiaries.

Real and personal property owned by the decedent obtains a step up in basis to the FMV of the respective asset at date of death, but IRD assets do not receive this step up in value. IRD assets represent those assets owned by the decedent that were never taxed to the individual before death. IRD assets include retirement accounts, installment obligations, accounts receivable of a cash basis taxpayer, and even interest income from U.S. savings bonds for interest accrued but never taxed to the decedent. Since the decedent does not pay income taxes on the income earned on these assets during his lifetime, the beneficiary then takes over this income tax obligation.

Note. The step up in basis at date of death is scheduled to be modified in the year 2010 to coincide with the repeal of the estate tax. The Act provides for a limited step up in basis in the year 2010: only \$1,300,000 in assets are eligible for a step up in basis. Administrators of an estate can pick and chose which assets in an estate will be stepped up to FMV. This provision may be amended before it actually becomes effective, depending on whether the estate tax is permanently repealed or reinstated in some form.

Duties of The Executor

The executor's duties (personal representative or administrator) include carrying out their fiduciary responsibilities to act in the best interests of the estate and its beneficiaries in accordance with state law. The named executor should work closely with the attorney representing the estate (typically the person who drafted the will or trust of the decedent), and with the practitioner who prepared the tax returns or assisted with the estate planning of the decedent. The responsibilities of the executor typically include the following:

1. Locating all documents of the decedent, including trust papers, insurance policies, power of attorney forms, and business agreements in place.
2. Inventorying the assets of the estate:
 - Locating all safety deposit boxes of the decedent and listing the contents of each safety deposit box.
 - Identifying all property, real and personal, and noting how the deceased owned such property. If any property is owned in another state, arrange with the attorney for this property to be probated in that other state.
 - Noting the contents of the personal residence and, if the residence is unoccupied at date of death, making sure that the valuable assets within the home are secure.
 - Making a detailed listing of all securities owned at death and the FMV of the stocks/mutual funds as of date of death; recording accrued dividends, if any, that were later payable to the estate.
 - Gathering all information regarding checking, savings, and certificate of deposit accounts of the deceased. The executor will need to record the date of death balance and note any interest accrued at that date.
 - Examining any partnership interests, ownership interests in closely held corporations, and other business interests of the deceased, and indicating the contact person(s) for each business interest.
 - Listing the make, model, and year of all vehicles owned by the decedent, and locating the titles to the vehicles.
 - Locating all insurance policies and initiating the claim process. A Form 712 from the life insurance carrier must be filed with the estate tax return (Form 706) to document the insurance proceeds received.

Observation. Often the tax practitioner who prepared decedent's prior income tax returns can be of major assistance to the executor. The tax practitioner will have details of income producing assets from prior tax returns, including various bank accounts, brokerage accounts, and business interests. It is also possible that a financial statement of the deceased may have been prepared in recent years. Many tax preparers will save a copy of the date of death closing stock prices from the *Wall Street Journal* to assist in the later estate administration.

3. Preparing to file the estate tax return, if required. After all assets of the decedent have been inventoried, the executor will need to work closely with the attorney to ensure all financial information has been reflected. In addition, the executor duties might include:
- Obtaining an employer ID number for the fiduciary income tax return (Form 1041) for income earned by the estate.
 - Establishing a checking account for the estate.
 - If necessary, filing a claim for any social security or veteran benefits due to the decedent.
 - Providing for the orderly transfer of all assets of the decedent into the estate.
 - Providing for the filing on the final income tax return (Form 1040) of the deceased.
 - Paying all bills and creditors of the decedent, and rejecting improper claims filed against the estate.
 - Identifying all real and personal property in the estate that require appraisals, and selecting a qualified appraiser to accomplish this task. This should be done early in the estate process. Be sure to include works of art and even coin and stamp collections that are the property of the estate.
 - Distributing specific bequests of assets in accordance with the wishes of the decedent in her Last Will and Testament. Partial distributions can also be made to beneficiaries of the estate.
 - Filing Form 56 (Notice of Fiduciary Relationship) with the IRS.
 - Monitoring the stock portfolio of the estate, and working closely with the stockbroker regarding securities needing to be sold for cash needs of the estate after considering tax considerations from the gain or loss on any sales.
 - With the help of the tax practitioner, preparing a detailed accounting of the estate financial activities; the accounting should reflect all receipts of funds (income and principal) and all disbursements of the estate.
 - Determining the best avenue for the deduction of administration expenses — the fiduciary estate income tax return (Form 1041) or the federal estate tax return (Form 706).
 - Locating and assembling copies of all prior gift tax returns (Form 709) for prior taxable transfers made by the decedent.
 - Arranging with the attorney of the estate for newspaper publication of the Letters of Office, and any other notifications required by the state.
 - Notifying the post office to forward mail to either the executor or other responsible party for the estate.
 - If needed, arranging for an executor's bond.
 - Examining the fiduciary responsibility for selling or maintaining the decedent's interest in closely held business activities. Determining if buy/sell agreements were in place, and if so, determining if such agreements should be activated.
 - If the deceased individual had employment contracts in place, determining what amounts are due for such employment and assisting in collecting the funds for the estate, as appropriate.

Elections Available to the Estate

A number of tax-related elections are available to an executor of an estate, and a properly timed election can have a major financial impact on an estate. Administrators need to be cognizant of these elections and work with the legal and tax advisors to ensure proper, timely elections:

1. The election to use the alternative valuation date gives the executor the opportunity to value **all** estate assets in the gross estate at the FMV exactly six months after decedent's date of death. Generally, all assets of the estate are valued on the date of death, but this six-month alternative valuation technique has proved to be beneficial where stock prices have declined. The alternative valuation date can only be elected when the gross estate has declined in value during the six-month period.⁶ This limitation prevents an additional six-month step up in basis. If alternative valuation is used, assets that are disposed of prior to the six-month date are valued as of the date of disposition. An estate tax return, Form 706, is required to be filed in order to use the alternate valuation.

Note. The alternative valuation cannot be used to obtain a step up in basis when assets **increase** in value six months after death and pass to a surviving spouse free of estate tax under the unlimited marital deduction.

Example 9. Crystal Ball invested almost all of her assets in the stock market. She died on January 24, 2001, and her assets were valued at market value. Her executor elected to use the alternative valuation date and reduced the amount of her estate by \$1,480,000.

Stock	Shares	1/24/01		7/24/01	
		Price	Value	Price	Value
Enron	20,000	\$83	\$1,660,000	\$35	\$700,000
Qualcom	15,000	84	1,260,000	63	945,000
Cisco	10,000	37	370,000	16	160,000
Dell	5,000	26	130,000	27	135,000
Cash			10,000		10,000
Personal Effects			5,000		5,000
Total			\$3,435,000		\$1,955,000

2. A QTIP (qualified terminable interest property) election can be made by the executor under IRC §2056(b)(7)(B)(v) to treat certain property (e.g., property in which the surviving spouse receives a life income interest only) as property qualifying for the unlimited marital deduction. This election can allow the executor to "fine tune" the size of the marital deduction and the taxable estate when the first spouse dies. It should be **noted that property qualifying for the marital deduction because of a QTIP election** (property thereby escaping the estate tax at the death of the first spouse) **will be included in the gross estate of the surviving spouse when that person dies.**
3. An election can be made to treat the redemption of closely held corporate stock as the sale of stock under IRC §303 instead of treating the redemption proceeds as dividend income, as normally required under IRC §301 if certain conditions are met:
 - The total value of the stock must be included in the decedent's gross estate, and must exceed 35% of the value of the adjusted gross estate.
 - In the absence of IRC §6166 election, the redemption generally has to take place within four years of death, but not always.
 - The redemption proceeds cannot exceed the amount of estate taxes due plus funeral and administrative expenses that have been paid and are deductible for federal estate tax purposes.
 - Care must be taken to ensure that the 35% test is met in order to qualify the redemption of stock as a sale rather than as a dividend. For example, stock ownership in two or more corporations can be aggregated along with stock held jointly with the surviving spouse for the purpose of meeting the 35% ownership test, if at least 20% of each corporation's stock value is included in the decedent's estate.

4. For qualifying estates, the personal representative can elect IRC §2032A special use valuation for farmland. Special use valuation often results in values for estate tax purposes approximating 40% to 60% of the FMV of qualifying farmland. Certain conditions must be met to qualify:
 - At least 50% of the adjusted value of the gross estate must consist of property being used for the “qualified use” by the decedent (or a member of his family) and such property must pass to a qualified heir of the decedent.
 - The decedent or a member of his family must have a cumulative total of 5 years “qualified use” of the property during the 8-year period preceding death.
 - The decrease in value cannot exceed \$840,000 (in 2003) as a result of this election (the maximum decrease is \$750,000, indexed after 1998, and adjusted in \$10,000 increments).
 - A recapture tax is imposed in full or in part if the qualified heir either disposes of all or a part of the property to a non-family member, or ceases to use such property for its “qualified use,” during the ten year period following the death of the decedent.
5. For qualified estates, the personal representative can elect IRC §2057 (deduction for family-owned business interests) for individuals dying before January 1, 2004. By using this election, a decedent’s estate can transfer up to \$1,300,000 of property without incurring any estate tax liability. In general, the same requirements found under IRC §2032A for both pre-death and post-death use of the property are applicable. This provision is not available beginning January 1, 2004.
6. Installment payments of an estate tax liability are made easier by virtue of IRC §6166. An estate is eligible for installment payments of estate tax if the value of the decedent’s interest in a closely held business exceeds 35% of the adjusted gross estate. If the estate qualifies, and an election is made under IRC §6166, the estate defers payment of principal (but not interest) for the first five years followed by 10 annual payments of principal and interest. The portion of the estate tax eligible for this deferral is the portion of the total estate tax that is attributable to the closely held business. A 2% interest rate is available for a portion of the deferred tax attributable to the closely held business, but is not deductible on either the estate tax return or the income tax return. For example, the 2% interest portion of the deferred tax could not exceed \$484,000 for decedents dying in 2002. Interest on the portion of the tax in excess of the 2% portion is calculated at 45% of the annual rate of interest on underpayments. The 2001 Act greatly expanded qualifications for closely held business interests.

Observation. An owner of farmland who rents the land under a share lease is deemed to be the owner of a closely held business for purposes of IRC §6166. Thus, when the owner dies, the deferred payment of estate tax attributable to the farmland is possible with the proper election, assuming the persons who acquire the farmland from the decedent continue to rent out the farm on a crop share lease.

Example 10. Harrison Pelter, an unmarried retired farmer, died on March 25, 2002, while a resident of the Falling Springs Nursing Home in Urbana, IL. Mr. Pelter’s major asset was prime farmland that was appraised for \$4,000,000 because the property bordered along Interstate 57 and was adjacent to a new interchange under construction.

Two nephews and a niece survived Mr. Pelter. None of his family members plan to continue with the farming operations, so the special use valuation treatment afforded by IRC §2032A will not be a consideration. Prior to entering the nursing home in 2001, Mr. Pelter had been a materially participating landlord and was active in the farm management activities. After entering the nursing home, he reported his farming income on Form 4835 on his federal income tax return. He shared in the crop production with the farm tenant, since he did not cash rent his land.

The executor, Brad Pelter, had assembled the following information for his uncle's estate:

Assets	FMV
1. Farmland appraised value	\$4,000,000
2. 200 shares American Waterworks with dividend due	8,049
3. First National Bank checking	54,811
4. First National Bank CD with accrued interest	102,408
5. Funeral costs	9,310
6. Brad Pelter executor fee	5,000
7. Richard Roundtree, attorney fee	50,000
8. Sly Stigman, accountant	5,000
9. Jake's Appraisal Service for land appraisal	2,500

Brad recognizes that the estate will owe a large amount for estate taxes (both federal and state). He alerts the attorney that the estate is land rich and cash poor. He believes that he will need to mortgage the farm ground in order to pay the estate taxes. But, Mr. Roundtree notes that IRC §6166 would be applicable because more than 35% of the adjusted gross estate was farmland rented out on a share lease, and the farming activity represented the decedent's trade or business. After research on this issue, the attorney is convinced the estate is eligible for the installment payment provisions under IRC §6166.

A completed Form 706 along with the election under IRC §6166 is provided. Part 3, line 3 on page 2 of the Form 706 discloses to the IRS that this election has been made. Since Mr. Pelter died in 2002, only 75% credit is allowed for taxes paid to the state of Illinois as noted in line 13 of page 1 of the Form 706. Since Illinois failed to decouple its death tax from the maximum credit allowed under federal law in 2002, only the computed 75% credit for Illinois death taxes will actually be paid to the state. This Illinois tax can also be paid in installments. A complete copy of the federal Form 706, with all its applicable attachments, must be attached to the Illinois estate tax return (IL-700). Other states may have different filing requirements.

2003 Workbook

For Example 10

Form 706 (Rev. August 2002) Department of the Treasury Internal Revenue Service	United States Estate (and Generation-Skipping Transfer) Tax Return Estate of a citizen or resident of the United States (see separate instructions). To be filed for decedents dying after December 31, 2001, and before January 1, 2003. For Paperwork Reduction Act Notice, see the separate instructions.	OMB No. 1545-0015
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Part 1.—Decedent and Executor	1a Decedent's first name and middle initial (and maiden name, if any) HARRISON A.	1b Decedent's last name PELTER	2 Decedent's Social Security No. 380 : 99 : 5599	
	3a Legal residence (domicile) at time of death (county, state, and ZIP code, or foreign country) CHAMPAIGN COUNTY, IL 61801	3b Year domicile established 1920	4 Date of birth 06/29/20	5 Date of death 03/25/02
	6a Name of executor (see page 3 of the instructions) BRADLEY PELTER	6b Executor's address (number and street including apartment or suite no. or rural route; city, town, or post office; state; and ZIP code) 1 RIVERBEND DRIVE ARLINGTON HEIGHTS, IL 60004		
	6c Executor's social security number (see page 3 of the instructions) 580 : 00 : 9991			
	7a Name and location of court where will was probated or estate administered CHAMPAIGN COUNTY ILLINOIS			7b Case number P02-377

8 If decedent died testate, check here <input checked="" type="checkbox"/> and attach a certified copy of the will.	9 If Form 4768 is attached, check here <input type="checkbox"/>
10 If Schedule R-1 is attached, check here <input type="checkbox"/>	

Part 2.—Tax Computation	1 Total gross estate less exclusion (from Part 5, Recapitulation, page 3, item 12)	1	4,165,268	
	2 Total allowable deductions (from Part 5, Recapitulation, page 3, item 23)	2	71,810	
	3 Taxable estate (subtract line 2 from line 1)	3	4,093,458	
	4 Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b)))	4		
	5 Add lines 3 and 4	5	4,093,458	
	6 Tentative tax on the amount on line 5 from Table A on page 4 of the instructions	6	1,822,529	
	7 Total gift tax payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions)	7		
	8 Gross estate tax (subtract line 7 from line 6)	8	1,822,529	
	9 Maximum unified credit (applicable credit amount) against estate tax	9	345,800	
	10 Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed \$6,000. See page 5 of the instructions.)	10		
	11 Allowable unified credit (applicable credit amount) (subtract line 10 from line 9)	11	345,800	
	12 Subtract line 11 from line 8 (but do not enter less than zero).	12	1,476,729	
	13 Credit for state death taxes (cannot exceed line 12). Attach credit evidence (see instructions). Figure the credit by using the amount on line 3 less \$60,000. See Table B in the instructions. Enter the amount here from Table B 290,120 x .75	13	217,590	
	14 Subtract line 13 from line 12	14	1,259,139	
	15 Credit for Federal gift taxes on pre-1977 gifts (section 2012) (attach computation)	15		
16 Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.)	16			
17 Credit for tax on prior transfers (from Schedule Q).	17			
18 Total (add lines 15, 16, and 17)	18			
19 Net estate tax (subtract line 18 from line 14)	19	1,259,139		
20 Generation-skipping transfer taxes (from Schedule R, Part 2, line 10)	20			
21 Total transfer taxes (add lines 19 and 20)	21	1,259,139		
22 Prior payments. Explain in an attached statement	22			
23 United States Treasury bonds redeemed in payment of estate tax	23			
24 Total (add lines 22 and 23)	24			
25 Balance due (or overpayment) (subtract line 24 from line 21).	25	1,259,139		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer other than the executor is based on all information of which preparer has any knowledge.

Signature(s) of executor(s)	Date
Signature of preparer other than executor	Address (and ZIP code)
	Date

Cat. No. 20548R

For Example 10

Form 706 (Rev. 8-02)

Estate of: **HARRISON A PELTER****380-99-5599****Part 3—Elections by the Executor***Please check the "Yes" or "No" box for each question. (See instructions beginning on page 6.)*

		Yes	No
1 Do you elect alternate valuation?	1		<input checked="" type="checkbox"/>
2 Do you elect special use valuation? If "Yes," you must complete and attach Schedule A-1.	2	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
3 Do you elect to pay the taxes in installments as described in section 6166? If "Yes," you must attach the additional information described on page 9 of the instructions.	3	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
4 Do you elect to postpone the part of the taxes attributable to a reversionary or remainder interest as described in section 6163?	4		<input checked="" type="checkbox"/>

Part 4—General Information (Note: Please attach the necessary supplemental documents. You must attach the death certificate.)
(See instructions on page 10.)

Authorization to receive confidential tax information under Regs. sec. 601.504(b)(2)(i); to act as the estate's representative before the IRS; and to make written or oral presentations on behalf of the estate if return prepared by an attorney, accountant, or enrolled agent for the executor:

Name of representative (print or type) ROBERT R ROUNDTREE	State IL	Address (number, street, and room or suite no., city, state, and ZIP code) FIRST NATIONAL BK BLD SUITE 308
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I declare that I am the ☒ attorney/ ☐ certified public accountant/ ☐ enrolled agent (you must check the applicable box) for the executor and prepared this return for the executor. I am not under suspension or disbarment from practice before the Internal Revenue Service and am qualified to practice in the state shown above.

Signature	CAF number	Date	Telephone number
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- 1 Death certificate number and issuing authority (attach a copy of the death certificate to this return).
2002-DA-CHAMPAIGN COUNTY
- 2 Decedent's business or occupation. If retired, check here ☐ and state decedent's former business or occupation.
FARMER
- 3 Marital status of the decedent at time of death:
☐ Married
☐ Widow or widower—Name, SSN, and date of death of deceased spouse ►
☒ Single
☐ Legally separated
☐ Divorced—Date divorce decree became final ►

4a Surviving spouse's name	4b Social security number	4c Amount received (see page 10 of the instructions)
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5 Individuals (other than the surviving spouse), trusts, or other estates who receive benefits from the estate (do not include charitable beneficiaries shown in Schedule O) (see instructions). For Privacy Act Notice (applicable to individual beneficiaries only), see the Instructions for Form 1040.

Name of individual, trust, or estate receiving \$5,000 or more	Identifying number	Relationship to decedent	Amount (see instructions)
BRADLEY PELTER	580-00-9991	NEPHEW	705,577
RENEE PELTER SIMPSON	580-00-8008	NIECE	705,576
ROBERT D PELTER	800-36-6834	NEPHEW	705,576
ANNA BOATWRIGHT	399-44-7777	FRIEND	500,000

All unascertainable beneficiaries and those who receive less than \$5,000 ►

Total	2,616,729
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Please check the "Yes" or "No" box for each question.

	Yes	No
6 Does the gross estate contain any section 2044 property (qualified terminable interest property (QTIP) from a prior gift or estate) (see page 10 of the instructions)?		<input checked="" type="checkbox"/>

(continued on next page)

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2003 Workbook

For Example 10

Form 706 (Rev. 8-02)

Part 4—General Information (continued)

Please check the "Yes" or "No" box for each question.		Yes	No
7a	Have Federal gift tax returns ever been filed? If "Yes," please attach copies of the returns, if available, and furnish the following information:		<input checked="" type="checkbox"/>
7b	Period(s) covered		
7c	Internal Revenue office(s) where filed		
If you answer "Yes" to any of questions 8–16, you must attach additional information as described in the instructions.			
8a	Was there any insurance on the decedent's life that is not included on the return as part of the gross estate?		<input checked="" type="checkbox"/>
b	Did the decedent own any insurance on the life of another that is not included in the gross estate?		<input checked="" type="checkbox"/>
9	Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which (a) one or more of the other joint tenants was someone other than the decedent's spouse, and (b) less than the full value of the property is included on the return as part of the gross estate? If "Yes," you must complete and attach Schedule E		<input checked="" type="checkbox"/>
10	Did the decedent, at the time of death, own any interest in a partnership or unincorporated business or any stock in an inactive or closely held corporation?	<input checked="" type="checkbox"/>	
11	Did the decedent make any transfer described in section 2035, 2036, 2037, or 2038 (see the instructions for Schedule G beginning on page 12 of the separate instructions)? If "Yes," you must complete and attach Schedule G		<input checked="" type="checkbox"/>
12	Were there in existence at the time of the decedent's death:		
a	Any trusts created by the decedent during his or her lifetime?		<input checked="" type="checkbox"/>
b	Any trusts not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship?		<input checked="" type="checkbox"/>
13	Did the decedent ever possess, exercise, or release any general power of appointment? If "Yes," you must complete and attach Schedule H		<input checked="" type="checkbox"/>
14	Was the marital deduction computed under the transitional rule of Public Law 97-34, section 403(e)(3) (Economic Recovery Tax Act of 1981)? If "Yes," attach a separate computation of the marital deduction, enter the amount on item 20 of the Recapitulation, and note on item 20 "computation attached."		<input checked="" type="checkbox"/>
15	Was the decedent, immediately before death, receiving an annuity described in the "General" paragraph of the instructions for Schedule I? If "Yes," you must complete and attach Schedule I		<input checked="" type="checkbox"/>
16	Was the decedent ever the beneficiary of a trust for which a deduction was claimed by the estate of a pre-deceased spouse under section 2056(b)(7) and which is not reported on this return? If "Yes," attach an explanation.		<input checked="" type="checkbox"/>

Part 5—Recapitulation

Item number	Gross estate	Alternate value	Value at date of death
1	Schedule A—Real Estate	1	4,000,000
2	Schedule B—Stocks and Bonds	2	8,049
3	Schedule C—Mortgages, Notes, and Cash	3	157,219
4	Schedule D—Insurance on the Decedent's Life (attach Form(s) 712)	4	0
5	Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance)	5	0
6	Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance)	6	0
7	Schedule G—Transfers During Decedent's Life (att. Form(s) 712 for life insurance)	7	0
8	Schedule H—Powers of Appointment	8	0
9	Schedule I—Annuities	9	0
10	Total gross estate (add items 1 through 9)	10	4,165,268
11	Schedule U—Qualified Conservation Easement Exclusion	11	0
12	Total gross estate less exclusion (subtract item 11 from item 10). Enter here and on line 1 of Part 2—Tax Computation	12	4,165,268
Item number	Deductions	Amount	
13	Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims	13	71,810
14	Schedule K—Debts of the Decedent	14	
15	Schedule K—Mortgages and Liens	15	
16	Total of items 13 through 15	16	71,810
17	Allowable amount of deductions from item 16 (see the instructions for item 17 of the Recapitulation)	17	71,810
18	Schedule L—Net Losses During Administration	18	0
19	Schedule L—Expenses Incurred in Administering Property Not Subject to Claims	19	0
20	Schedule M—Bequests, etc., to Surviving Spouse	20	
21	Schedule O—Charitable, Public, and Similar Gifts and Bequests	21	
22	Schedule T—Qualified Family-Owned Business Interest Deduction	22	
23	Total allowable deductions (add items 17 through 22). Enter here and on line 2 of the Tax Computation	23	71,810

Page 3

2003 Workbook

For Example 10

Form 706 (Rev. 8-02)

Estate of: **HARRISON A PELTER**

380 - 99 - 5599

SCHEDULE A—Real Estate

- For jointly owned property that must be disclosed on Schedule E, see the instructions on the reverse side of Schedule E.
- Real estate that is part of a sole proprietorship should be shown on Schedule F.
- Real estate that is included in the gross estate under section 2035, 2036, 2037, or 2038 should be shown on Schedule G.
- Real estate that is included in the gross estate under section 2041 should be shown on Schedule H.
- If you elect section 2032A valuation, you must complete Schedule A and Schedule A-1.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	160 ACRES FARM GROUND CHAMPAIGN COUNTY (COPY OF APPRAISAL ATTACHED)			4,000,000

Form 706 (Rev. 8-02)

Estate of: **HARRISON A PELTER**

380 - 99 - 5599

SCHEDULE B—Stocks and Bonds

(For jointly owned property that must be disclosed on Schedule E, see the instructions for Schedule E.)

Item number	Description including face amount of bonds or number of shares and par value where needed for identification. Give 9-digit CUSIP number.	Unit value	Alternate valuation date	Alternate value	Value at date of death
1	200 COMMON SHARES AMERICAN WATERWORKS DIVIDEND RECEIVABLE	40			8,000 49

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2003 Workbook

For Example 10

Form 706 (Rev. 8-02)

Estate of: **HARRISON A PELTER**

380 - 99 - 5599

SCHEDULE C—Mortgages, Notes, and Cash

(For jointly owned property that must be disclosed on Schedule E, see the instructions for Schedule E.)

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	FIRST NATIONAL BANK P O BOX 2704 CHAMPAIGN IL 61801 CHECKING ACCT (#36014501) BALANCE			54,811
2	FIRST NATIONAL BANK P O BOX 2704 CHAMPAIGN IL 61801 CERTIFICATE OF DEPOSIT (#128444) BALANCE ACCRUED INTEREST			100,000 2,408
Total from continuation schedules (or additional sheets) attached to this schedule . . .				
TOTAL. (Also enter on Part 5, Recapitulation, page 3, at item 3.)				157,219

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)
(See the instructions on the reverse side.)

Schedule C—Page 13

For Example 10

Form 706 (Rev. 8-02)

Estate of: **HARRISON A PELTER**

380 - 99 - 5599

SCHEDULE J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims

Note: Do not list on this schedule expenses of administering property not subject to claims. For those expenses, see the instructions for Schedule L.

If executors' commissions, attorney fees, etc., are claimed and allowed as a deduction for estate tax purposes, they are not allowable as a deduction in computing the taxable income of the estate for Federal income tax purposes. They are allowable as an income tax deduction on Form 1041 if a waiver is filed to waive the deduction on Form 706 (see the Form 1041 instructions).

Item number	Description	Expense amount	Total amount
	A. Funeral expenses:		
1	FLAG BROS FUNERAL HOME	8,450	
2	FUNERAL LUNCHEON AND FLOWERS	860	
	Total funeral expenses		9,310
	B. Administration expenses:		
1	Executors' commissions—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)		5,000
2	Attorney fees—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)		50,000
3	Accountant fees—amount estimated/agreed upon/paid. (Strike out the words that do not apply.)		5,000
	4 Miscellaneous expenses:	Expense amount	
1	JAKE'S FAIR APPRAISAL		
	110 SPRING FIELD ROAD		
	CHAMPAIGN, IL 61801		
	APPRAISAL OF FARM GROUND	2,500	
	Total miscellaneous expenses from continuation schedules (or additional sheets) attached to this schedule		2,500
	Total miscellaneous expenses		2,500
	TOTAL. (Also enter on Part 5, Recapitulation, page 3, at item 13.)		71,810

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)
(See the instructions on the reverse side.)

Schedule J—Page 23

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2003 Workbook

IRC §6166 Election. The estate in **Example 10** elects to pay estate tax in installments under the authority of IRC §6166. This notice is given to make the election and to provide the following information required by Treas. Reg. §20.6166-1(b):

1. Decedent's name and taxpayer identification number as they appear on Form 706.

Name: Harrison A. Pelter

SSN: 380-99-5599

2. The amount of tax which is to be paid in installments:
\$1,230,391.
3. The date of the first installment is December 25, 2007, and the first installment amount is
\$123,039.10.
4. The number of annual installments, including the first installment, in which the tax is to be paid is 10.
5. The following properties, identified by Form 706 schedule and item number, constitute closely held business interests:

Schedule	Item #	Type of Entity	Owner	Value in Gross Estate	% of Adjusted Gross Estate
A	1	Farming Proprietorship	1	\$4,000,000	97.7169%

6. The factual basis for this election is:
 - The value of the adjusted gross estate as defined in IRC §6166(b)(6) is:
\$4,093,458.

Observation. It should also be noted that this calculation assumes the state inheritance taxes are paid in full. If the state taxes are paid in installments, then the initial amount of federal estate taxes is higher since the state tax credit is smaller and will increase the amount subject to the installment payments. As the estate taxes are paid, an amended federal estate tax return must be filed to claim the additional state tax credit, resulting in an interrelated calculation in determining which are reallocated from interest to principal.

- The value of the decedent's interest in the closely held business property identified previously exceeds 35% of the adjusted gross estate or, if Section (c) is being utilized, the aggregate values of such interests exceeds 35% of the adjusted gross estate. The more-than-35% requirement also is met after considering any taxable gifts within three years, as required by §2035(c)(2).
7. Maximum amount payable in installments and with 2% interest:
 - Amount of tax eligible for installment payments and deferral of first installment up to five years: \$1,230,391
 - Amount of deferred tax eligible for 2% interest (2% portion) under IRC §6601(j): \$484,000 (for 2002, the maximum 2% portion: estate tax on \$1,000,000 plus \$1,000,000 exclusion amount equals \$829,800. \$829,800 less \$345,800 unified credit equals \$484,000).

Observation. For deaths in 2002, the amount of estate tax that can be deferred at the special 2% interest rate cannot exceed \$484,000. The interest rate on the deferred tax exceeding this amount is figured at 45% of the regular underpayment rate.

Disclaimers

This device represents a proper post-mortem strategy that offers potential savings and benefits to the beneficiaries of an estate. A beneficiary of an estate can refuse to accept an asset or assets from the decedent's estate that would otherwise be conveyed to that beneficiary. Where a qualified disclaimer is made, the property passes as if the disclaimant had predeceased the decedent. IRC §2518 sets forth the following **requirements for qualified disclaimers**:

- The disclaimer must be in writing.
- The executor of the estate must receive the written disclaimer within a 9-month period following death, with an exception for transferees under the age of 21. In the case of transferees under the age of 21, the 9-month period does not begin until the transferee reaches the age of 21.
- The property interest must pass without any direction on the part of the disclaimant.
- The individual disclaiming the asset must not have taken possession of the asset(s) or any of its benefits prior to the disclaimer.
- As a result of the disclaimer, the property must pass to someone other than the individual disclaiming the asset.

Example 11. Darwin Tenting, age 83, died on October 31, 2002. His wife, Martha, and four adult children survived. Mr. and Mrs. Tenting each had separate wills. These wills had been prepared several years ago and could be described as the classic "I love you" wills: Each spouse left all assets to the surviving spouse (or to the children if there was no surviving spouse). All family assets were titled in Mr. Tenting's name alone, with the exception of the personal residence, which was held jointly with rights of survivorship.

David Tenting, the oldest son, was named executor of the estate and completed an inventory of assets for the initial meeting of the attorney representing the estate. Martha Tenting and the other three children attended the meeting as well. The assets of Darwin Tenting are as follows:

Asset	FMV
1. Personal residence	\$ 200,000
2. Cash in bank	500,000
3. 10,600 shares Income Fund of America @ \$16	169,600
4. 4,800 shares of Fidelity Magellan @ \$80	384,000
5. 30,000 shares of Wal-Mart @ \$50	1,500,000
6. Topps baseball card collection	40,000
7. 1995 Honda Civic	2,500
8. IRA balance at Morgan Stanley	480,000
	<u>\$3,276,100</u>

Martha Tenting and her children never realized that Mr. Tenting had amassed so much wealth. The attorney explained that there would be no estate taxes owed because all the assets pass to the surviving spouse, Martha Tenting, under the will and are eligible for the marital deduction. The attorney also explained that significant estate taxes might be due after her death, depending on the date of her death and what future steps, if any, Congress might take regarding the sunset provisions of the Act. The attorney also explained that IRC §2518 allowed Martha to disclaim all or some of the assets (the disclaimed assets would then pass to the children as

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if Martha had predeceased Darwin). If Martha disclaimed assets worth \$1,000,000, these assets would not be subject to estate tax currently because the decedent's \$1,000,000 exemption would shelter them from estate tax; also, these assets, now worth \$1,000,000, would not be in Martha's gross estate at the time of her death because they would already belong to the children.

The attorney invited Martha Tenting to consider the IRC §2518 disclaimer of property worth \$1,000,000 as a post-mortem estate planning tool. Martha and the children liked this idea. The children would get the disclaimed assets worth \$1,000,000. Martha would potentially save estate taxes in her estate, would still have sufficient resources to maintain her standard of living, and would see her children take the disclaimed property free of any estate tax (something she could not guarantee if she died owning these assets).

The executor, the person disclaiming the property, and the attorney should work together to ensure that the disclaimer is properly drafted and the right assets are disclaimed. The IRA would not be a good asset to disclaim; the spouse can roll this amount over into her IRA tax-free. And Martha would probably choose to retain the house and income-producing assets, and disclaim those other assets which provide little or no income. After careful study and consultation, Martha decides to disclaim the Topps baseball card collection, the Fidelity Magellan mutual fund, and 11,520 shares of Wal-Mart common stock. These assets sum to \$1,000,000, the amount needed to take maximum advantage of the \$1,000,000 applicable exclusion available to estates in 2002.

Following is the first page of the Form 706 for the estate of Darwin Tenting. The Form 706 shows a taxable estate of \$1,000,000 with a tentative estate tax of \$345,800 to be fully offset by the applicable credit amount of \$345,800. The timely disclaimer by Martha Tenting used the \$1,000,000 applicable exclusion available to her husband's estate. This opportunity to pass on \$1,000,000 to the kids free of estate tax using Darwin's estate tax exemption would have been lost forever, except for Martha's disclaimer.

Since the income-producing assets were in the husband's name, a fiduciary tax return (Form 1041) will be required to reflect income earned by his estate until such assets are distributed to the beneficiaries. Since all assets in the Tenting estate were distributed to the beneficiaries by April 30, 2003, the first and final fiduciary return will cover the period from October 31, 2002, to April 30, 2003.

The fiduciary tax return for the estate of Darwin Tenting is also shown. All income will be distributed to the beneficiaries in 2003, and each beneficiary will receive a 1041 K-1 transmittal form to reflect their respective share of income earned by the estate. (The following Form 1041 K-1 for David Tenting is representative of the K-1 forms that each of the four children will receive.) As a practical matter, expenses of estate administration should be deducted on the Form 1041 since no tax would be owed on the federal estate tax return. The interest and dividend income earned during the period of estate administration and the allocation among the beneficiaries is as follows.

Asset	Total Income	Martha's Share	Children's Share
1. Cash in banks	\$ 3,400	\$3,400	\$ 0
2. Income Fund of America	2,200	2,200	0
3. Fidelity Magellan	480	0	480
4. Wal-Mart	4,500	2,772	1,728
Totals	\$10,580	\$8,372	\$2,208

Note. Care must be taken to ensure that Martha receives no income from disclaimed assets.

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For Example 11

Form 706 (Rev. August 2002) Department of the Treasury Internal Revenue Service	United States Estate (and Generation-Skipping Transfer) Tax Return Estate of a citizen or resident of the United States (see separate instructions). To be filed for decedents dying after December 31, 2001, and before January 1, 2003. For Paperwork Reduction Act Notice, see the separate instructions.	OMB No. 1545-0015
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Part 1.—Decedent and Executor	1a Decedent's first name and middle initial (and maiden name, if any) DARWIN A	1b Decedent's last name TENTING	2 Decedent's Social Security No. 855 : 00 : 8686	
	3a Legal residence (domicile) at time of death (county, state, and ZIP code, or foreign country) USA, MO 69800	3b Year domicile established 1918	4 Date of birth 11/11/18	5 Date of death 10/31/02
	6a Name of executor (see page 3 of the instructions) DAVID TENTING		6b Executor's address (number and street including apartment or suite no. or rural route; city, town, or post office; state; and ZIP code) 1010 STRAWBERRY PLAINS JEFFERSON CITY, MO 69500	
	6c Executor's social security number (see page 3 of the instructions) 577 : 77 : 0000			
	7a Name and location of court where will was probated or estate administered 10TH JUDICIAL COURT, BOONE COUNTY (MO)			7b Case number P-2002-126
	8 If decedent died testate, check here <input checked="" type="checkbox"/> and attach a certified copy of the will. 9 If Form 4768 is attached, check here <input type="checkbox"/>			
	10 If Schedule R-1 is attached, check here <input type="checkbox"/>			

Part 2.—Tax Computation	1 Total gross estate less exclusion (from Part 5, Recapitulation, page 3, item 12)	1	3,176,100	
	2 Total allowable deductions (from Part 5, Recapitulation, page 3, item 23)	2	2,176,100	
	3 Taxable estate (subtract line 2 from line 1)	3	1,000,000	
	4 Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b)))	4		
	5 Add lines 3 and 4	5	1,000,000	
	6 Tentative tax on the amount on line 5 from Table A on page 4 of the instructions	6	345,800	
	7 Total gift tax payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions)	7		
	8 Gross estate tax (subtract line 7 from line 6)	8	345,800	
	9 Maximum unified credit (applicable credit amount) against estate tax	9	345,800	
	10 Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed \$6,000. See page 5 of the instructions.)	10		
	11 Allowable unified credit (applicable credit amount) (subtract line 10 from line 9)	11	345,800	
	12 Subtract line 11 from line 8 (but do not enter less than zero).	12	0	
	13 Credit for state death taxes (cannot exceed line 12). Attach credit evidence (see instructions). Figure the credit by using the amount on line 3 less \$60,000. See Table B in the instructions. Enter the amount here from Table B <input type="checkbox"/> x .75 <input type="checkbox"/>	13		
	14 Subtract line 13 from line 12	14	0	
	15 Credit for Federal gift taxes on pre-1977 gifts (section 2012) (attach computation)	15		
	16 Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.)	16		
	17 Credit for tax on prior transfers (from Schedule Q)	17		
	18 Total (add lines 15, 16, and 17)	18		
	19 Net estate tax (subtract line 18 from line 14)	19	0	
	20 Generation-skipping transfer taxes (from Schedule R, Part 2, line 10)	20		
	21 Total transfer taxes (add lines 19 and 20)	21	0	
	22 Prior payments. Explain in an attached statement	22		
	23 United States Treasury bonds redeemed in payment of estate tax	23		
	24 Total (add lines 22 and 23)	24		
	25 Balance due (or overpayment) (subtract line 24 from line 21).	25	0	

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer other than the executor is based on all information of which preparer has any knowledge.

Signature(s) of executor(s)	Date
Signature of preparer other than executor	Address (and ZIP code)
	Date

Cat. No. 20548R

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For Example 11

Form	1041	Department of the Treasury—Internal Revenue Service U.S. Income Tax Return for Estates and Trusts	2002	OMB No. 1545-0092
A Type of entity (see instr.): <input checked="" type="checkbox"/> Decedent's estate <input type="checkbox"/> Simple trust <input type="checkbox"/> Complex trust <input type="checkbox"/> Qualified disability trust <input type="checkbox"/> ESBT (S portion only) <input type="checkbox"/> Grantor type trust <input type="checkbox"/> Bankruptcy estate—Ch. 7 <input type="checkbox"/> Bankruptcy estate—Ch. 11 <input type="checkbox"/> Pooled income fund		For calendar year 2002 or fiscal year beginning 10/31 , 2002, and ending 4/30 , 20 03		
B Number of Schedules K-1 attached (see instructions) 5		Name of estate or trust (If a grantor type trust, see page 11 of the instructions.) ESTATE OF DARWIN TENTING		C Employer identification number 37 : 9191911
		Name and title of fiduciary DAVID TENTING, EXECUTOR		D Date entity created 10/31/02
		Number, street, and room or suite no. (If a P.O. box, see page 11 of the instructions.) 7720 BARBARA ANN DR		E Nonexempt charitable and split-interest trusts, check applicable boxes (see page 12 of the instructions): <input type="checkbox"/> Described in section 4947(a)(1) <input type="checkbox"/> Not a private foundation <input type="checkbox"/> Described in section 4947(a)(2)
F Check applicable boxes: <input checked="" type="checkbox"/> Initial return <input checked="" type="checkbox"/> Final return <input type="checkbox"/> Amended return <input type="checkbox"/> Change in fiduciary's name <input type="checkbox"/> Change in fiduciary's address		G Pooled mortgage account (see page 13 of the instructions): <input type="checkbox"/> Bought <input type="checkbox"/> Sold Date:		
Income	1 Interest income	1	3,400	
	2 Ordinary dividends	2	7,180	
	3 Business income or (loss) (attach Schedule C or C-EZ (Form 1040))	3		
	4 Capital gain or (loss) (attach Schedule D (Form 1041))	4		
	5 Rents, royalties, partnerships, other estates and trusts, etc. (attach Schedule E (Form 1040))	5		
	6 Farm income or (loss) (attach Schedule F (Form 1040))	6		
	7 Ordinary gain or (loss) (attach Form 4797)	7		
	8 Other income. List type and amount	8		
	9 Total income. Combine lines 1 through 8	9	10,580	
Deductions	10 Interest. Check if Form 4952 is attached <input type="checkbox"/>	10		
	11 Taxes	11		
	12 Fiduciary fees	12		
	13 Charitable deduction (from Schedule A, line 7)	13		
	14 Attorney, accountant, and return preparer fees	14		
	15a Other deductions not subject to the 2% floor (attach schedule)	15a		
	15b Allowable miscellaneous itemized deductions subject to the 2% floor.	15b		
	16 Total. Add lines 10 through 15b	16		
	17 Adjusted total income or (loss). Subtract line 16 from line 9. Enter here and on Schedule B, line 1 ▶	17	10,580	
	18 Income distribution deduction (from Schedule B, line 15) (attach Schedules K-1 (Form 1041))	18	10,580	
Tax and Payments	19 Estate tax deduction (including certain generation-skipping taxes) (attach computation)	19		
	20 Exemption	20	600	
	21 Total deductions. Add lines 18 through 20	21	11,180	
	22 Taxable income. Subtract line 21 from line 17. If a loss, see page 17 of the instructions	22	-600	
	23 Total tax (from Schedule G, line 7)	23	0	
	24 Payments: a 2002 estimated tax payments and amount applied from 2001 return	24a		
	b Estimated tax payments allocated to beneficiaries (from Form 1041-T)	24b		
	c Subtract line 24b from line 24a	24c		
	d Tax paid with extension of time to file: <input type="checkbox"/> Form 2758 <input type="checkbox"/> Form 8736 <input type="checkbox"/> Form 8800	24d		
	e Federal income tax withheld. If any is from Form(s) 1099, check <input type="checkbox"/>	24e		
Other payments: f Form 2439 ; g Form 4136 ; Total ▶		24h		
25 Total payments. Add lines 24c through 24e, and 24h	25			
26 Estimated tax penalty (see page 18 of the instructions)	26			
27 Tax due. If line 25 is smaller than the total of lines 23 and 26, enter amount owed	27	0		
28 Overpayment. If line 25 is larger than the total of lines 23 and 26, enter amount overpaid	28			
29 Amount of line 28 to be: a Credited to 2003 estimated tax ▶ ; b Refunded ▶	29			
Sign Here	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.			
	Signature of fiduciary or officer representing fiduciary _____ Date _____		EIN of fiduciary if a financial institution _____	
Paid Preparer's Use Only	Preparer's signature _____ Date _____		Check if self-employed <input type="checkbox"/> Preparer's SSN or PTIN _____	
	Firm's name (or yours if self-employed), address, and ZIP code _____		EIN _____ Phone no. () _____	

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11370H

Form **1041** (2002)

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For Example 11

SCHEDULE K-1 (Form 1041) <small>Department of the Treasury Internal Revenue Service</small>		Beneficiary's Share of Income, Deductions, Credits, etc. for the calendar year 2002, or fiscal year beginning <u>Oct 31</u> , 2002, ending <u>Apr 30</u> , 20 <u>03</u> ▶ Complete a separate Schedule K-1 for each beneficiary.		OMB No. 1545-0092 <div style="font-size: 2em; font-weight: bold;">2002</div>
Name of trust or decedent's estate ESTATE OF DARWIN TENTING				<input type="checkbox"/> Amended K-1 <input checked="" type="checkbox"/> Final K-1
Beneficiary's identifying number ▶ 577-77-0000		Estate's or trust's EIN ▶ 37-9191911		
Beneficiary's name, address, and ZIP code DAVID TENTING 1010 STRAWBERRY PLAINS JEFFERSON CITY MO 69500		Fiduciary's name, address, and ZIP code DAVID TENTING, EXECUTOR 7720 BARBARA ANN DR JEFFERSON CITY MO 69500		
(a) Allocable share item		(b) Amount	(c) Calendar year 2002 Form 1040 filers enter the amounts in column (b) on:	
1 Interest	1		Schedule B, Part I, line 1	
2 Ordinary dividends	2	552	Schedule B, Part II, line 5	
3 Net short-term capital gain	3		Schedule D, line 5	
4 Net long-term capital gain: a Total for year	4a		Schedule D, line 12, column (f)	
b 28% rate gain	4b		Schedule D, line 12, column (g)	
c Qualified 5-year gain	4c		Line 5 of the worksheet for Schedule D, line 29	
d Unrecaptured section 1250 gain	4d		Line 11 of the worksheet for Schedule D, line 19	
5a Annuities, royalties, and other nonpassive income before directly apportioned deductions	5a		Schedule E, Part III, column (f)	
b Depreciation	5b		} Include on the applicable line of the appropriate tax form	
c Depletion	5c			
d Amortization	5d			
6a Trade or business, rental real estate, and other rental income before directly apportioned deductions (see instructions)	6a		Schedule E, Part III	
b Depreciation	6b		} Include on the applicable line of the appropriate tax form	

SCHEDULE K-1 (Form 1041) <small>Department of the Treasury Internal Revenue Service</small>		Beneficiary's Share of Income, Deductions, Credits, etc. for the calendar year 2002, or fiscal year beginning <u>Oct 31</u> , 2002, ending <u>Apr 30</u> , 20 <u>03</u> ▶ Complete a separate Schedule K-1 for each beneficiary.		OMB No. 1545-0092 <div style="font-size: 2em; font-weight: bold;">2002</div>
Name of trust or decedent's estate ESTATE OF DARWIN TENTING				<input type="checkbox"/> Amended K-1 <input checked="" type="checkbox"/> Final K-1
Beneficiary's identifying number ▶ 856-00-8585		Estate's or trust's EIN ▶ 37-9191911		
Beneficiary's name, address, and ZIP code MARTHA TENTING 7720 BARBARA ANN DRIVE JEFFERSON CITY MO 69500		Fiduciary's name, address, and ZIP code DAVID TENTING, EXECUTOR 7720 BARBARA ANN DR JEFFERSON CITY MO 69500		
(a) Allocable share item		(b) Amount	(c) Calendar year 2002 Form 1040 filers enter the amounts in column (b) on:	
1 Interest	1	3,400	Schedule B, Part I, line 1	
2 Ordinary dividends	2	4,972	Schedule B, Part II, line 5	
3 Net short-term capital gain	3		Schedule D, line 5	
4 Net long-term capital gain: a Total for year	4a		Schedule D, line 12, column (f)	
b 28% rate gain	4b		Schedule D, line 12, column (g)	
c Qualified 5-year gain	4c		Line 5 of the worksheet for Schedule D, line 29	
d Unrecaptured section 1250 gain	4d		Line 11 of the worksheet for Schedule D, line 19	
5a Annuities, royalties, and other nonpassive income before directly apportioned deductions	5a		Schedule E, Part III, column (f)	
b Depreciation	5b		} Include on the applicable line of the appropriate tax form	
c Depletion	5c			
d Amortization	5d			
6a Trade or business, rental real estate, and other rental income before directly apportioned deductions (see instructions)	6a		Schedule E, Part III	
b Depreciation	6b		} Include on the applicable line of the appropriate tax form	
c Depletion	6c			

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Martha Tenting will file a joint individual income tax return for the 2002 year, and reflect all joint income earned through October 31, 2002, and her individual income earned for the entire year. Income earned by the estate after date of death for the remainder of 2002 will be reported on the previously shown fiduciary tax return. The amount of this income distributed to Martha will be reported on the 2002 Form 1041 K-1 transmittal form and be included on Martha's 2003 individual income tax return. The tax practitioner may have to make nominee distributions of a portion of the interest and dividend income that are reflected under the social security number of Darwin Tenting but are really part of the income earned and reported on the estate fiduciary tax return (Form 1041).

After the Estate of Darwin Tenting closed in April 2003, Martha Tenting met with her attorney to complete a new Last Will and Testament. Her new will provided that her estate would be divided among her four children after first providing a charitable bequest to the local humane society in the amount of \$250,000. The timing of the will update worked out well since Martha Tenting died on December 30, 2003. David Tenting became the executor of his mother's estate.

The assets in the estate of Martha Tenting as of December 30, 2003, included:

Asset	FMV
1. Cash in bank	\$ 470,000
2. Personal residence	200,000
3. 10,600 shares Income Fund of America @ \$18	190,800
4. 18,480 shares Wal-Mart @ \$60	1,108,800
5. IRA balance at Morgan Stanley	430,400
6. 2003 Jeep Cherokee	30,000
Total Assets	\$2,430,000

Following is page 1 of the Form 706 that will be filed for the tax liability due from the Martha Tenting estate. The contribution made to the county humane society of \$250,000 reduced the estate tax liability by \$122,500. This charitable bequest is reflected on Schedule O of the Form 706. The credit for state income taxes in 2003 is only 50% of the allowable amount under prior law, or \$66,600 as credited on line 13 page 1 of Form 706.

Note. If Mrs. Tenting had lived two more days, the exemption amount would have increased from \$1,000,000 to \$1,500,000, and the top rate of tax would have dropped from 49% to 48%.

The executor will file a final Form 1040 for his mother, which will not only account for her income earned during 2003 but also her share of the fiduciary income earned from the estate of Darwin Tenting. In addition, another fiduciary return will be needed to account for the estate interest and dividend income earned on the estate assets of the mother. The fiduciary period will commence on December 30, 2003, and extend into 2004, when the estate can be closed.

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For Example 11

Form 706 (Rev. August 2002)		United States Estate (and Generation-Skipping Transfer) Tax Return		OMB No. 1545-0015		
Department of the Treasury Internal Revenue Service		Estate of a citizen or resident of the United States (see separate instructions). To be filed for decedents dying after December 31, 2001, and before January 1, 2003. For Paperwork Reduction Act Notice, see the separate instructions.				
Part 1.—Decedent and Executor	1a Decedent's first name and middle initial (and maiden name, if any) MARTHA M (SCHMERSAL)	1b Decedent's last name TENTING		2 Decedent's Social Security No. 977 : 80 : 4545		
	3a Legal residence (domicile) at time of death (county, state, and ZIP code, or foreign country) USA, MO 69500	3b Year domicile established 1920	4 Date of birth 02/12/20	5 Date of death 12/30/03		
	6a Name of executor (see page 3 of the instructions) DAVID TENTING	6b Executor's address (number and street including apartment or suite no. or rural route; city, town, or post office; state; and ZIP code) 1010 STRAWBERRY PLAINS JEFFERSON CITY, MO 69500				
	6c Executor's social security number (see page 3 of the instructions) 577 : 77 : 0000					
	7a Name and location of court where will was probated or estate administered JUDICIAL COURT BOONE COUNTY (MO)					
	7b Case number 2003-P-0052					
	8 If decedent died testate, check here <input checked="" type="checkbox"/> and attach a certified copy of the will. 9 If Form 4768 is attached, check here <input type="checkbox"/>					
10 If Schedule R-1 is attached, check here <input type="checkbox"/>						
Part 2.—Tax Computation	1 Total gross estate less exclusion (from Part 5, Recapitulation, page 3, item 12)			1	2,430,000	
	2 Total allowable deductions (from Part 5, Recapitulation, page 3, item 23)			2	250,000	
	3 Taxable estate (subtract line 2 from line 1)			3	2,180,000	
	4 Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b)))			4		
	5 Add lines 3 and 4			5	2,180,000	
	6 Tentative tax on the amount on line 5 from Table A on page 4 of the instructions			6	869,000	
	7 Total gift tax payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions)			7		
	8 Gross estate tax (subtract line 7 from line 6)			8	869,000	
	9 Maximum unified credit (applicable credit amount) against estate tax			9	345,800	
	10 Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed \$6,000. See page 5 of the instructions.)			10		
	11 Allowable unified credit (applicable credit amount) (subtract line 10 from line 9)			11	345,800	
	12 Subtract line 11 from line 8 (but do not enter less than zero).			12	523,200	
	13 Credit for state death taxes (cannot exceed line 12). Attach credit evidence (see instructions). Figure the credit by using the amount on line 3 less \$60,000. See Table B in the instructions. Enter the amount here from Table B 113,200 x X .50			13	56,600	
	14 Subtract line 13 from line 12			14	466,600	
	15 Credit for Federal gift taxes on pre-1977 gifts (section 2012) (attach computation)			15		
	16 Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.)			16		
	17 Credit for tax on prior transfers (from Schedule Q)			17		
18 Total (add lines 15, 16, and 17)			18			
19 Net estate tax (subtract line 18 from line 14)			19	466,600		
20 Generation-skipping transfer taxes (from Schedule R, Part 2, line 10)			20			
21 Total transfer taxes (add lines 19 and 20)			21	466,600		
22 Prior payments. Explain in an attached statement			22			
23 United States Treasury bonds redeemed in payment of estate tax			23			
24 Total (add lines 22 and 23)			24			
25 Balance due (or overpayment) (subtract line 24 from line 21).			25	466,600		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer other than the executor is based on all information of which preparer has any knowledge.

Signature(s) of executor(s) _____ Date _____

Signature of preparer other than executor _____ Address (and ZIP code) _____ Date _____

Cat. No. 20548R

FILING FORM 706

For 2003 deaths, the executor (or personal representative) of an estate must file an estate tax return if the sum of the gross estate and adjusted taxable gifts of the decedent exceeds \$1,000,000. Generally, the federal estate tax and the estate tax return are due nine months after the date of death. If filed late without an extension of time to file, penalties and interest are assessed.

By using Form 4768, the time for filing can be extended for up to 6 months after the 9-month period following death if it is impossible or impractical for the executor to complete the return within the 9-month period. Even if the IRS grants the extension of time to file, payment of taxes should be made within the 9-month period if there are sufficient liquid assets available to pay the expected estate tax.

Various elections available to the executor are made on the estate tax return. In addition, the executor may also include a Prompt Audit Request as provided by IRC §2044. This request is not an invitation for the IRS to examine the estate tax return, but to seek an early audit if the return were selected for examination. This request is made to seek an early closing letter from the IRS so that the estate can be closed and the distribution of all estate assets can be made to the beneficiaries. Executors can also include a written request for a Discharge of Personal Liability under IRC §6905 and a request for a Prompt Assessment under IRC §6501(d). Again, the executor is seeking to bring the estate to closure as quickly as possible.

Once the federal Form 706 and related state tax forms are complete, the executor will want to ensure that all necessary attachments are included with the federal (and state) estate tax return. Required attachments include:

- Certified copy of the death certificate
- Copy of Last Will and Testament
- Copies of all trusts, including any revocable living trusts of the decedent
- Appraisals made for any real or personal property and the business interests of the deceased
- Detailed calculations to support any elections made for the computation of current tax or any tax deferred
- Original receipt for payment of state death taxes for which a credit and/or deduction was claimed on the federal estate tax return

Note. Some states require that state death taxes be paid at the county courthouse in the county where the decedent was domiciled. The receipt from the county serves as evidence of payment of state death taxes, and can be used to document the payment of taxes for the estate tax returns for both federal and state purposes. Generally, the state requires the same attachments as the federal return, and also requires a complete copy of the federal return.

ENDNOTES

- 1 IRC §§2001(c), 2010, 2502, 2505
- 2 *Crummey v. Commr.*, 397F.2d 82 (9th Cir., 1968)
- 3 *Estate of Schauerhamer*, TC Memo 1997-242
- 4 *Estate of Thompson*, TC Memo 2002-246
- 5 *Strangi v. Commr.*, TC Memo 2003-145 (on remand)
- 6 IRC §2032(c)

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