REG
Regulation
Roger Philipp, CPA
REGULATION

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Estates, Trusts and Gift Taxes

The following is an excerpt from the Roger CPA Review Text books, which are included with purchase of the Roger CPA Review course. Written and updated by your instructor, Roger Philipp, CPA, the textbooks are the perfect companion to our dynamic lectures.
Estates, Trusts & Gift Taxes

Individuals and corporations file tax returns. There are two artificial entities that also file tax returns, they are Trusts and Estates. The Fiduciary Income Tax Return (Form 1041) must be filed on an annual basis for both entities. The beneficiaries must also pay taxes when the income is distributed to them.

Trusts are typically established for the purpose of benefiting specific individuals or charities without giving them current control of the principal (corpus) of the trust.

Estate Income tax return (1041)

Alive (1040)

DIE - Estate (Value)

Alternative Valuation Date (AVD – 6 mo’s)

9 Months – Estate TAX Return (706)
- Valuation Tax –

Trusts are created at the time of a person’s death to temporarily hold the property of the decedent until it can be distributed to the heirs (An estate kicks in, when a person kicks OUT!!) Since the deceased person’s investments still generate interest, dividends and rental income, the estate must pay income taxes on the earnings. The Executor is responsible for filing the income tax return. Can die with a Will, or without a Will.

- Intestate - When someone dies without a written Will.
- Testate – When someone dies with a Will.
Do not confuse the fiduciary income tax return of an estate (Form 1041) with the estate tax return (Form 706). The former is to report income of the estate received after the decedent’s date of death, while the latter is a form of property tax on the value of the decedent’s estate at the time of death. Estate taxes are discussed later.

**Operation**

At the time a person dies, their property generally is transferred to a successor legal entity known as the *estate of the decedent*. This doesn't apply to property that is held in joint tenancy or some other form of ownership that provides right of survivorship, however. Such property automatically goes to the survivors and bypasses the estate.

The process of settling an estate is called *probate*. The personal representative in charge of the estate is known as the *executor* (if named by the decedent’s will - Testate) or *administrator* (if named by the courts). The responsibilities of the personal representative include:

- Paying the debts of the decedent out of estate assets.
- Filing all necessary tax returns.
- Distributing remaining assets to the appropriate beneficiaries.

The personal representative has a *fiduciary duty* to the estate, its creditors, and beneficiaries. This means the representative must act in a loyal manner in the best interests of these parties. They may not engage in *self-dealing*, which includes personally borrowing money from the estate or entering joint business ventures with it. They are expected to carry out the wishes of the decedent as expressed in the will as best as possible, subject to the legitimate claims of creditors (including government tax authorities). If the decedent died *intestate* (without a will), the administrator will distribute assets based on applicable state law in the jurisdiction the decedent resided at the time of death.

A trustee has the same *fiduciary responsibility* to the trust that the personal representative has to the estate. Additionally, the trustee is responsible for ensuring that the income and principal of the trust are properly assigned to the income and remainder beneficiaries, respectively.

**Trustee – fiduciary duty**

- Act loyally
- Due care
- Distribute income and principal according to the trust terms
- Keep accurate records

The allocation between the income and remainder beneficiaries can be tricky. The corpus of the trust will eventually go to the remainder beneficiaries, and the Income will go to the income beneficiaries.

- **Remainder** - Receives principal of trust (including capital gains allocable to corpus).
  - All assets contributed to the trust (Trust property).
  - Property acquired in exchange for trust corpus.
  - Proceeds from the sale of the corpus.
  - Capital gains
  - Stock dividends
  - Mortgage premium payments
  - Capital improvements
  - Insurance proceeds
Income includes most of the items that are reported as income on accrual financial statements (regardless of whether it is reported for tax purposes). Notice, however, that the proceeds from the sale of corpus are allocated entirely to corpus, so that gains and losses on asset sales are not income.

- **Income** - Receives **earnings** of trust (but not net capital gains)
  - Cash dividends
  - Interest income
  - Rental income, expense
  - Property taxes
  - Insurance premiums
  - Depreciation
  - Municipal Bond Interest

For example, if a trust is formed with a contribution of $100,000 cash, the cash is classified as corpus. When the cash is used to purchase common stock, the stock is corpus. A cash dividend paid on the common stock is income (a stock dividend or split remains in corpus, though, since it is not reported on an accrual basis income statement). If the stock is subsequently sold for $350,000 cash, all of the cash is corpus, since it represents the proceeds from the sale of corpus.

<table>
<thead>
<tr>
<th>Income (Income Statement Items)</th>
<th>Principle (Balance Sheet Items)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rental Income/Expense</td>
<td>Original Property</td>
</tr>
<tr>
<td>Interest/Dividend Income</td>
<td>Bonds (accrued interest)</td>
</tr>
<tr>
<td>Cash Dividend</td>
<td>Capital Gains</td>
</tr>
<tr>
<td>Mortgage Interest Payments</td>
<td>Mortgage Principle Payments</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>Stock Dividends/Splits</td>
</tr>
<tr>
<td>Royalty Income</td>
<td></td>
</tr>
</tbody>
</table>

**Creation of Trusts**

One legal arrangement that is often used is known as a trust. Assets transferred into a trust by a living person will not be part of the estate of that person upon their death. These living trusts are known as **inter vivos** trusts. A trust can also be established at the time of someone’s death, usually to provide for minor children of the deceased. These trusts set up from the assets of a decedent are known as **testamentary** trusts.

In order for a trust to be a **Valid Express Trust**, it must satisfy **five conditions** (BRATS):

- **Beneficiary** - The trust must identify who will receive the benefits deriving from the trust. A trust often identifies an income beneficiary to receive the earnings of the trust, and a remainder beneficiary to receive the principal of the trust when it terminates.

- **Reasonable intent** - There must be a valid purpose (tax savings do not qualify) for the existence of the trust. This is usually the separation of control of the assets from benefits, so a trust with a single individual serving as both trustee and sole beneficiary will usually fail. A trust will also fail when its purpose is impossible to fulfill.

- **Assets** - The trust must contain some **corpus** or property. A trust without corpus has no earnings for the income beneficiaries or principal for the remainder beneficiaries.
- **Trustee** - A trustee must be in place to exercise control over the assets in the trust. This person does not need to be named in any legal document, however: they can be selected by the court or personal representative of the estate in the case of a testamentary trust. A successor trustee is not needed, and can simply be selected in the event the trustee can no longer serve.

- **Specified life** - A trust must have an identifiable termination point, expressed in years or in the length of a life in being at the time the trust is created.
  a) Private Trust = cannot live forever – lives until purpose is satisfied (i.e. established for college, after graduation → trust ends.
  b) Charitable Trust = lives forever (perpetuity)

There are some special **types of trust** arrangements occasionally discussed on the exam:
- **Intervivos trust** – Created between living people
- **Testamentary trust** – Created through the execution of a will.
- **Spendthrift trust** - A trust that prohibits assets from being pledged to pay the debts of a beneficiary. This arrangement is designed to prevent an irresponsible beneficiary from borrowing money from others and promising to use trust assets to repay the debt, thereby defeating the purpose of the trust
- **Resulting trust** - A trust that is created by the courts due to the failure of an express trust and is intended to achieve a purpose that the creator of the express trust might have chosen had they known of the failure. For example, if a testamentary trust is established to put the decedent's daughter through college, and the daughter dies before completing college, the assets might be placed in a resulting trust that is to benefit the infant son of the daughter.
- **Cy pres trust** - A trust that is established due to the failure of a charitable trust, and that is designed to achieve a similar goal. For example, if a trust is established to find a cure for a particular disease, and a cure is found, the remaining assets might be placed in a trust to find a cure for a similar disease.
- **Totten or Tentative Trust** – A trust created when the settlor opens a bank account in his own name “as trustee” for another. The trust may be revoked by the settlor by withdrawing the funds from the account. Once the settlor dies, the trust becomes irrevocable. If the beneficiary dies before the settlor, the trust terminates.
- **Constructive Trusts** – A court will impose a constructive trust when there has been abuse of a confidential relation or where actual fraud or duress is considered an equitable ground for creating the trust. For example, if an agent acquired title to property, he is obligated to transfer it back to the principal because the acquisition was by breach of a fiduciary duty.
- **Real Estate Investment Trust (REIT)** – A trust created by a transfer of the legal title to real estate to a trustee. The trustee manages the trust property for the benefit of specified beneficiaries. The trust doesn’t pay corporate taxes, the beneficiaries do. The major portion of the trust’s income must be derived from real estate (rent, interest on mortgages, and gains on sale of real property). The certificates of ownership must be freely transferable. Must have a minimum of 100 certificate holders during each year and no fewer than 6 may own 50% or all outstanding certificates.
Trusts are irrevocable, unless:
- Reserve rights
- End of term
- Occurrence of an event (death)
- Purpose accomplished
- Consent of trustor & all beneficiaries, remainderman & courts

When a trust allocates income and/or remainder to offspring, the creator must decide if the allocation will be **per capita** or **per stirpes**.

- **A per capita** allocation is equal to each person (Each Beneficiary). If there are three children, each is allocated 1/3. If one of the children dies during the term of the trust, and the decedent had two children (grandchildren of the trustor), the allocation is now 1/4 to each of the surviving children and each of the offspring of the deceased child.

- **A per stirpes** allocation is equal at the level of the first generation (Each Group). If there are three children, each is allocated 1/3. If one child dies with two offspring, the allocation to each surviving child remains 1/3, and each of the offspring of the deceased child is allocated 1/6.

When Die without a Will (Intestate), the assets will be distributed in the following order:
- Spouse
- Decedent (Children/Grandchildren)
- Ascendant (Parent/Grandparents)
- Collaterals (Brothers/Sisters)

**Fiduciary Tax Return (1041)**

**Fiduciary income tax return**
- Filed annually by estates and trusts to report the income earned by the entity.
  - Similar to form 1040, but no standard deduction is given and different exemptions exist.
- **Trusts** are normally planned in advance, so federal law requires that they adopt a calendar year for the reporting of taxable income.
  - **Calendar year** taxpayer due 4/15. Trusts must pay **quarterly estimated** taxes.
- **Estates** result from the death of a person and are not as controllable, so federal law permits the personal representative of the estate to adopt any tax year, with the return due by the 15th day of the 4th month following the end of the tax year (3 ½ months after the close of the reporting year). Since most estates are settled in less than a year, the executor of the estate typically chooses a year-end once the processing of the estate assets has been virtually completed. For example, if the decedent’s death occurs on 7/22/X1, and the executor completes the distribution of assets on 1/17/X2, a tax year ending January is typically chosen. This way, only a single fiduciary income tax return needs to be filed to report estate income from 7/22/X1 through 1/17/X2. The 4th month following the end of the tax year (January) is May, so the return is due 5/15/X2.
  - A **fiscal or Calendar year** is acceptable for an Estate, usually starting on the deceased’s date of death. The tax return is due 3 ½ months after the close of the reporting year. **Estimated quarterly tax payments** are **not** required during the first two years, but are required thereafter.
• **Types of Trusts**

  o **Grantor (revocable) trust** – This is a trust whose creator (grantor) reserves the right to withdraw assets at any time.
    - Tax code ignores this trust. The income is taxed on the Grantor’s Form 1040, as if the trust did not exist.

  o **Simple trust** – One that makes annual distributions exactly equal to DNI (Distributable Net Income) to taxpaying beneficiaries each year.
    - Form 1041 must be prepared every year.
    - Taxable income normally reduced to $0 by distributions
      - Net capital gains can result in retained income.
      - Personal exemption is $300.

  o **Complex trust** – Any that fails to meet the criteria for a simple trust and is allowed to make distributions that are:
    - Less than Distributable Net Income (DNI),
    - Distributes more than DNI (from trust principal or corpus),
    - Makes charitable contributions.
    - Personal exemption is only $100.
    - Often pays taxes on undistributed income.

  o Trusts and estates cannot claim standard deductions or dependent exemptions. **Personal exemptions** available are:
    - Complex trusts - $100
    - Simple trusts - $300
    - Estates - $600

  o The IRS has reduced the extension period for form 1041 from six months to five months. The purpose of the change is to help individuals better meet their filing obligations who must report information from *Schedules K-1* and similar documents on their individual tax returns (same change for 1065 P/S returns).
Income Taxation of Trusts and Estates (1041)

<table>
<thead>
<tr>
<th>Trusts/Estates</th>
<th>DNI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax Return</td>
<td>= Max amount that can be taxed to beneficiaries as income. Rest considered a distribution of principal. (Payable Profits)</td>
</tr>
</tbody>
</table>

**Gross Income** (same as Indiv.)
- Interest
- Dividends
- Rental income
- Capital Gains

All income rules same between individuals and trust

**Gross Income**
- + Municipal Bond Interest
- (no Capital Gains)

Distributable net income (DNI)

**Deductions** = Same (except 3 rules)

1. **Trustee Management Fees** (Fiduciary Fees) – Accountants, attorney’s, income tax preparation (only deduct based on % of taxable income)

2. **Charity** – Can give 100% away (trust); individuals only up to 50% of AGI

3. **Income Distribution Deduction** – Taxed once and only once! No double taxation. Either stays or gets distributed to K-1 → Sch E → 1040

**Distributions Paid Deduction**
- 0-

**Exemptions**
- Simple = $300
- Complex = $100
- Estates = $600

= Taxable Income
= DNI (Maximum amount that’s taxable)

Income Taxation of Trusts and Estates

Calculate distributable net income (DNI) – Maximum amount that can be taxed to the beneficiary, the rest is a tax free distribution of principal (Payable Profits)

- Different from taxable income in certain ways:
  - Includes tax-exempt income (Municipal bond interest).
  - Excludes net capital gains.
  - Actual distributions of DNI reduce taxable income (100% deductible).
    - Such distributions reported on recipients’ returns.

Distributable net income identifies the income that is available to distribute to the income beneficiaries of the trust each year. It is based on the income and expenses reported on the income tax return of the trust, with two adjustments:

- **Tax-exempt income** is included in DNI since it is available to distribute, even though it is not subject to taxation. (Municipal bond interest)
- **Net capital gains** are not included in DNI since, under trust law, they are treated as adjustments to the corpus.
The calculation of income on a fiduciary income tax return is almost identical to the determination of income on an individual return. The most significant differences that apply are:

- There is no limit on charitable deductions (they must be authorized in the trust instrument or will of the decedent). Can give an Unlimited amount to charity.
- Income paid to an estate that was earned by the decedent prior to death (such as the final paycheck of the taxpayer from their employer) must be included in the fiduciary income tax return (Form 1041) and also reported as a receivable on the estate tax return of the decedent (Form 706). This is known as income in respect of a decedent (IRD).
- Fees paid to the trustee (Fiduciary Fees) and other costs of administering the trust are generally deductible. Fees paid to administer an estate can only be deducted on the fiduciary income tax return if the executor waives the right to deduct these costs on the estate tax return.
- A deduction is claimed for all distributions of DNI to beneficiaries of the trust or estate. The beneficiaries report the income on their personal tax returns. Distributions of corpus are not deductible and not taxable to the beneficiaries.
**Form 1041**

**Department of the Treasury—Internal Revenue Service**

**U.S. Income Tax Return for Estates and Trusts 2009**

<table>
<thead>
<tr>
<th>A</th>
<th>Type of entity (see instr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decedent's estate</td>
<td></td>
</tr>
<tr>
<td>Simple trust</td>
<td></td>
</tr>
<tr>
<td>Complex trust</td>
<td></td>
</tr>
<tr>
<td>Qualified disability trust</td>
<td></td>
</tr>
<tr>
<td>ESRT (S portion only)</td>
<td></td>
</tr>
<tr>
<td>Grantor type trust</td>
<td></td>
</tr>
<tr>
<td>Bankruptcy estate—Ch. 7</td>
<td></td>
</tr>
<tr>
<td>Bankruptcy estate—Ch. 11</td>
<td></td>
</tr>
<tr>
<td>Pooled income fund</td>
<td></td>
</tr>
</tbody>
</table>

**For calendar year 2009 or fiscal year beginning,** 2009, and ending, 20 | **C Employer identification number** |

**Name of estate or trust (if a grantor type trust, see page 14 of the instructions.)**

**B** Number of Schedules K-1 attached (see instructions) |

<table>
<thead>
<tr>
<th>F</th>
<th>Check applicable boxes.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial return</td>
<td></td>
</tr>
<tr>
<td>Final return</td>
<td></td>
</tr>
<tr>
<td>Amended return</td>
<td></td>
</tr>
<tr>
<td>Change in fiduciary</td>
<td></td>
</tr>
<tr>
<td>Change in fiduciary's name</td>
<td></td>
</tr>
<tr>
<td>Change in trust's name</td>
<td></td>
</tr>
<tr>
<td>Change in fiduciary's address</td>
<td></td>
</tr>
</tbody>
</table>

**G** Check here if the estate or filing trust made a section 6664 election.

**Income**

<table>
<thead>
<tr>
<th>1</th>
<th>Interest income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2a</td>
<td>Total ordinary dividends</td>
</tr>
<tr>
<td>b</td>
<td>Qualified dividends allocable to: (1) Beneficiaries</td>
</tr>
<tr>
<td>(2) Estate or trust</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Business income or (loss), Attach Schedule C or C-EZ (Form 1040)</td>
</tr>
<tr>
<td>4</td>
<td>Capital gain or (loss), Attach Schedule D (Form 1041)</td>
</tr>
<tr>
<td>5</td>
<td>Rents, royalties, partnerships, other estates and trusts, etc, Attach Schedule E (Form 1040)</td>
</tr>
<tr>
<td>6</td>
<td>Farm income or (loss), Attach Schedule F (Form 1040)</td>
</tr>
<tr>
<td>7</td>
<td>Ordinary gain or (loss), Attach Form 4797</td>
</tr>
<tr>
<td>8</td>
<td>Other income. List type and amount</td>
</tr>
<tr>
<td>9</td>
<td>Total income. Combine lines 1, 2a, and 3 through 8</td>
</tr>
</tbody>
</table>

**Deductions**

<table>
<thead>
<tr>
<th>10</th>
<th>Interest. Check if Form 4952 is attached</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>Taxes</td>
</tr>
<tr>
<td>12</td>
<td>Fiduciary fees</td>
</tr>
<tr>
<td>13</td>
<td>Charitable deduction (from Schedule A, line 7)</td>
</tr>
<tr>
<td>14</td>
<td>Attorney, accountant, and return preparer fees</td>
</tr>
<tr>
<td>15a</td>
<td>Other deductions not subject to the 2% floor (attach schedule)</td>
</tr>
<tr>
<td>b</td>
<td>Allowable miscellaneous itemized deductions subject to the 2% floor</td>
</tr>
<tr>
<td>16</td>
<td>Add lines 10 through 15b</td>
</tr>
<tr>
<td>17</td>
<td>Adjusted total income or (loss). Subtract line 16 from line 9</td>
</tr>
<tr>
<td>18</td>
<td>Income distribution deduction (from Schedule B, line 15), Attach Schedules K-1 (Form 1041)</td>
</tr>
<tr>
<td>19</td>
<td>Estate tax deduction including certain generation-skipping taxes (attach computation)</td>
</tr>
<tr>
<td>20</td>
<td>Exemption</td>
</tr>
<tr>
<td>21</td>
<td>Add lines 18 through 20</td>
</tr>
</tbody>
</table>

**Tax and Payments**

<table>
<thead>
<tr>
<th>22</th>
<th>Taxable income. Subtract line 21 from line 17. If a loss, see page 23 of the instructions</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>Total tax (from Schedule G, line 7)</td>
</tr>
<tr>
<td>24a</td>
<td>Payments: a 2009 estimated tax payments and amount applied from 2008 return</td>
</tr>
<tr>
<td>b</td>
<td>Estimated tax payments allocated to beneficiaries (from Form 1041-T)</td>
</tr>
<tr>
<td>c</td>
<td>Subtract line 24b from line 24a</td>
</tr>
<tr>
<td>24d</td>
<td>Tax paid with Form 7004 (see page 24 of the instructions)</td>
</tr>
<tr>
<td>e</td>
<td>Federal income tax withheld. If any is from Form(s) 1099, check</td>
</tr>
<tr>
<td>24e</td>
<td>Other payments: f Form 2439; g Form 4136; h Form 1040; i Form 4136; j Form 1043; k Form 4136; l Form 1043</td>
</tr>
<tr>
<td>24h</td>
<td>Total</td>
</tr>
<tr>
<td>25</td>
<td>Total payments. Add lines 24c through 24e, and 24h</td>
</tr>
<tr>
<td>26</td>
<td>Estimated tax penalty (see page 24 of the instructions)</td>
</tr>
<tr>
<td>27</td>
<td>Taxes due. If line 25 is smaller than the total of lines 23 and 26, enter amount owed</td>
</tr>
<tr>
<td>28</td>
<td>Overpayment. If line 25 is larger than the total of lines 23 and 26, enter amount overpaid</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>29</th>
<th>Amount of line 28 to be a: a Credited to 2010 estimated tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>b Refunded</td>
</tr>
</tbody>
</table>

**Sign Here**

Signature of fiduciary or officer representing fiduciary [ ]

Date [ ]

EIN of fiduciary if a financial institution [ ]

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.

May the IRS disclose this return with the preparer chosen below? (see instr.): [ ]

Preparer's signature [ ]

Date [ ]

Check if self-employed [ ]

Preparer's SSN or PTIN [ ]

Firm's name (or your if self-employed), address, and ZIP code [ ]

EIN [ ]

Phone no. [ ]

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11371M

Form 1041 (2009)

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### Schedule A  Charitable Deduction

Do not complete for a simple trust or a pooled income fund.

1. Amounts paid or permanently set aside for charitable purposes from gross income (see page 25).
2. Tax-exempt income allocable to charitable contributions (see page 25 of the instructions).
3. Subtract line 2 from line 1.
4. Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes.
5. Add lines 3 and 4.
6. Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes (see page 25 of the instructions).
7. Charitable deduction. Subtract line 6 from line 5. Enter here and on page 1, line 13.

### Schedule B  Income Distribution Deduction

1. Adjusted total income (see page 26 of the instructions).
2. Adjusted tax-exempt interest.
3. Total net gain from Schedule D (Form 1041), line 15, column (1) (see page 26 of the instructions).
4. Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion).
5. Capital gains for the tax year included on Schedule A, line 1 (see page 26 of the instructions).
6. Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number.
7. Distributable net income. Combine lines 1 through 6. If zero or less, enter -0-.
8. If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law.
9. Income required to be distributed currently.
10. Other amounts paid, credited, or otherwise required to be distributed.
11. Total distributions. Add lines 9 and 10. If greater than line 8, see page 27 of the instructions.
12. Enter the amount of tax-exempt income included on line 11.
14. Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-.
15. Income distribution deduction. Enter the smaller of line 13 or line 14 here and on page 1, line 18.

### Schedule C  Tax Computation

(see page 27 of the instructions)

1a. Tax on taxable income (see page 27 of the instructions).
1b. Tax on lump-sum distributions. Attach Form 4972.
1c. Alternative minimum tax (from Schedule I (Form 1041), line 56).
1d. Total. Add lines 1a through 1c.
2a. Foreign tax credit. Attach Form 1116.
2b. Other nonbusiness credits (attach schedule).
2c. General business credit. Attach Form 3800.
2d. Credit for prior year minimum tax. Attach Form 8801.
3. Total credits. Add lines 2a through 2d.
4. Subtract line 3 from line 1d. If zero or less, enter -0-.
5. Recapture taxes. Check if from: □ Form 4255 □ Form 8611.
6. Household employment taxes. Attach Schedule H (Form 1040).
7. Total tax. Add lines 4 through 6. Enter here and on page 1, line 23.

### Other Information

1. Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses Enter the amount of tax-exempt interest income and exempt-interest dividends.
2. Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement?
3. At any time during calendar year 2009, did the estate or trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country?
4. During the tax year, did the estate or trust receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the estate or trust may have to file Form 3520. See page 30 of the instructions.
5. Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see page 30 for required attachment.
6. If this is an estate or a complex trust making the section 663(b) election, check here (see page 30).
7. To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here (see page 30).
8. If the decedent’s estate has been open for more than 2 years, attach an explanation for the delay in closing the estate, and check here.
9. Are any present or future trust beneficiaries skip persons? See page 30 of the instructions.
United States Gift (and Generation-Skipping Transfer) Tax Return

(For gifts made during calendar year 2009)

1. Donor’s first name and middle initial  
2. Donor’s last name  
3. Donor’s social security number  
4. Address (number, street, and apartment number)  
5. Legal residence (domicile)  
6. City, state, and ZIP code  
7. Citizenship (see instructions)  
8. If the donor died during the year, check here □ and enter date of death ___________________________  
9. If you extended the time to file this Form 709, check here □  
10. Enter the total number of donees listed on Schedule A. Count each person only once. □  
11a. Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If “No,” skip line 11b  
11b. If the answer to line 11a is “Yes,” has your address changed since you last filed Form 709 (or 709-A)?  
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 15 is “No,” check whether □ married □ divorced or □ widowed/deceased, 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.

Consenting spouse’s signature □ Date □

Part 1—General Information

1. Enter the amount from Schedule A, Part 4, line 11 □  
2. Enter the amount from Schedule B, line 3 □  
3. Total taxable gifts. Add lines 1 and 2 □  
4. Tax computed on amount on line 3 (see Table for Computing Gift Tax in separate instructions) □  
5. Tax computed on amount on line 2 (see Table for Computing Gift Tax in separate instructions) □  
6. Balance. Subtract line 5 from line 4 □  
7. Maximum unified credit (nonresident aliens, see instructions) □  
8. Enter the unified credit against tax allowable for all prior periods (from Sch. B, line 1, col. C) □  
9. Balance. Subtract line 8 from line 7 □  
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) □  
11. Balance. Subtract line 10 from line 9 □  
12. Unified credit. Enter the smaller of line 6 or line 11 □  
13. Credit for foreign gift taxes (see instructions) □  
14. Total credits. Add lines 12 and 13 □  
15. Balance. Subtract line 14 from line 6. Do not enter less than zero □  
17. Total tax. Add lines 15 and 16 □  
18. Gift and generation-skipping transfer taxes prepaid with extension of time to file □  
19. If line 18 is less than line 17, enter balance due (see instructions) □  
20. If line 18 is greater than line 17, enter amount to be refunded □

Part 2—Tax Computation

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  
May the IRS discuss this return with the preparer shown below? □ Yes □ No

Preparer’s signature □ Date □  
Check if self-employed □  
Preparer’s SSN or PTIN □

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 12 of the separate instructions for this form.
Form 706
(Rev. September 2009)

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, 2008, and before January 1, 2010.

OMB No. 1545-0015

<table>
<thead>
<tr>
<th>Part 1—Decedent and Executor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1a Decedent’s first name and middle initial (and maiden name, if any)</td>
</tr>
<tr>
<td>2 Decedent’s Social Security No.</td>
</tr>
<tr>
<td>3b Year domicile established</td>
</tr>
<tr>
<td>5 Date of death</td>
</tr>
<tr>
<td>6a Name of executor (see page 5 of the instructions)</td>
</tr>
<tr>
<td>6c Phone no. ( )</td>
</tr>
<tr>
<td>7b Case number</td>
</tr>
</tbody>
</table>

1 If decedent died testate, check here ☐ and attach a certified copy of the will. 9 If you extended the time to file this Form 706, check here ☐

10 If Schedule R-1 is attached, check here ☐

Part 2—Tax Computation

| 1 Total gross estate less exclusion (from Part 5—Recapitulation, page 3, item 12) | 2 Tentative total allowable deductions (from Part 5—Recapitulation, page 3, item 22) |
| 3a Tentative taxable estate (before state death tax deduction) (subtract line 2 from line 1) | 3b State death tax deduction |
| 3c Taxable estate (subtract line 3b from line 3a) | 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)) |
| 5 Add lines 3c and 4 | 6 Tentative tax on the amount on line 5 from Table A on page 4 of the instructions |
| 7 Total gift tax paid or payable with respect to gifts made by the decedent after December 31, 1976. Include gifts by the decedent’s spouse for 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) | 8 Gross estate tax (subtract line 7 from line 6) |
| 9 Maximum unified credit (applicable credit amount) against estate tax | 10 Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed $6,000. See page 6 of the instructions.) |
| 11 Allowable unified credit (applicable credit amount) (subtract line 10 from line 9) | 12 Subtract line 11 from line 8 (but do not enter less than zero) |
| 13 Credit for foreign death taxes (from Schedule(s) P) (Attach Form(s) 706-CE.) | 14 Credit for tax on prior transfers (from Schedule O) |
| 15 Total credits (add lines 13 and 14) | 16 Net estate tax (subtract line 15 from line 12) |
| 17 Generation-skipping transfer (GST) taxes payable (from Schedule R, Part 2, line 10) | 18 Total transfer taxes (add lines 16 and 17) |
| 19 Prior payments. Explain in an attached statement | 20 Balance due (or overpayment) (subtract line 19 from line 18) |

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.

Sign Here

Signature of executor

Date

Signature of executor

Date

Paid Preparer’s Use Only

Preparer’s signature

Date

Check if self-employed □

Preparer’s SSN or PTIN

Firm’s name (or yours if self-employed), address, and ZIP code

EIN □

Phone no. ( )

For Privacy Act and Paperwork Reduction Act Notice, see page 30 of the separate instructions for this form.

Cat. No. 20548R Form 706 (Rev. 9-2009)
Class Questions

1. The standard deduction for an estate in the fiduciary income tax return is
   a. $0
   b. $100
   c. $300
   d. $600

2. An executor of a decedent’s estate that has only US citizens as beneficiaries is required to file a fiduciary income tax return, if the estate’s gross income for the year is at least
   a. $400
   b. $500
   c. $600
   d. $1,000

3. For income tax purposes, the estate’s initial taxable period for a decedent who died on October 24th
   a. May be either a calendar year, or a fiscal year beginning on the date of the decedent’s death.
   b. Must be a fiscal year beginning on the date of the decedent’s death.
   c. May be either a calendar year, or a fiscal year beginning on October 1 of the year of the decedent’s death.
   d. Must be a calendar year beginning on January 1 of the year of the decedent’s death.

4. Astor, a cash-basis taxpayer, died on February 3. During the year, the estate’s executor made a distribution of $12,000 from estate income to Astor’s sole heir and adopted a calendar year to determine the estate’s taxable income. The following additional information pertains to the estate’s income and disbursements for the year:

   **Estate income**
   Taxable interest $65,000
   Net long-term capital gains allocable to corpus 5,000
   Municipal Bond interest 1,000

   **Estate disbursements**
   Administrative expenses attributable to taxable income 14,000
   Charitable contributions from gross income to a public charity, made under the terms of the will 9,000

For the calendar year, what was the estate’s distributable net income (DNI)?
   a. $39,000
   b. $43,000
   c. $58,000
   d. $65,000
5. A distribution to an estate’s sole beneficiary for the 20X3 calendar year equaled $15,000, the amount currently required to be distributed by the will. The estate’s 20X3 records were as follows:

**Estate income**
$40,000 Taxable interest

**Estate disbursements**
$34,000 Expenses attributable to taxable interest

What amount of the distribution was taxable to the beneficiary?

a. $40,000  
b. $15,000  
c. $6,000  
d. $0

6. Which of the following credits may be offset against the gross estate tax to determine the net estate tax of a US citizen dying during 20X3?

<table>
<thead>
<tr>
<th>Unified Credit</th>
<th>Credit for gift taxes paid on gifts made after 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>b. No</td>
<td>No</td>
</tr>
<tr>
<td>c. No</td>
<td>Yes</td>
</tr>
<tr>
<td>d. Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

7. If the executor of a decedent’s estate elects the alternate valuation date and none of the property included in the gross estate has been sold or distributed, the estate assets must be valued as of how many months after the decedent’s death?

a. 12  
b. 9  
c. 6  
d. 3

8. During 20X3, Blake transferred a corporate bond with a face amount and fair market value of $20,000 to a trust for the benefit of her sixteen-year old child. Annual interest on this bond is $2,000, which is to be accumulated in the trust and distributed to the child on reaching the age of twenty one. The bond is then to be distributed to the donor or her successor-in-interest in liquidation of the trust. Present value of the total interest to be received by the child is $8,710. The amount of the gift that is excludable from taxable gifts is

a. $20,000  
b. $11,000  
c. $8,710  
d. $0
Solutions

1. (a) The requirement is to determine the amount of standard deduction for a trust or an estate in the fiduciary income tax return (Form 1041). No standard deduction is available for a trust or an estate on the fiduciary income tax return. On the other hand, a personal exemption is allowed for an estate or trust on the fiduciary income tax return. The personal exemption is $600 for an estate, $300 for a simple trust (i.e., a trust required to distribute all income currently), and $100 for a complex trust (i.e., a trust other than a simple trust).

2. (c) The requirement is to determine when a fiduciary income tax return for a decedent’s estate must be filed. The executor of a decedent’s estate that has only US citizens as beneficiaries is required to file a fiduciary income tax return (Form 1041) if the estate’s gross income is $600 or more. The return is due on or before the 15th day of the fourth month following the close of the estate’s taxable year.

3. (a) The requirement is to determine the correct statement for income tax purposes regarding the initial taxable period for the estate of a decedent who died on October 24. For income tax purposes, a decedent’s estate is allowed to adopt a calendar year or any fiscal year beginning on the date of the decedent’s death. Answer (b) is incorrect because an estate may adopt a calendar year and is not restricted to a fiscal year. Answer (c) is incorrect because the estate’s first tax year would begin on October 24, not October 1. Answer (d) is incorrect because an estate is not restricted to a calendar year, and if it adopted a calendar year, its initial year would begin with the date of the decedent’s death (October 24).

4. (b) The requirement is to determine the estate’s distributable net income (DNI). An estate’s DNI generally is its taxable income before the income distribution deduction, loss deduction, and tax-exempt income (reduced by related expenses), and decreased by any net capital gain allocable to corpus. Here, the estate’s DNI is the $65,000 of taxable interest plus the $1,000 of municipal bond interest (which is NOT included in the tax return as taxable income, but is part of DNI) reduced by the $14,000 of administrative expenses attributable to taxable income and the $9,000 of charitable contributions. Charitable contributions are allowed as a deduction if made under the terms of the decedent’s will and are paid to qualified charitable organizations from amounts included in the estate’s gross income.

5. (c) The requirement is to determine the amount of the estate’s $15,000 distribution that is taxable to the sole beneficiary. The maximum amount that is taxable to the beneficiary is limited to the estate’s distributable net income (DNI). An estate’s DNI is generally its taxable income before the income distribution deduction, increased by its exemption, a net capital loss deduction, and tax-exempt interest (reduced by related nondeductible expenses), and decreased by any net capital gains allocable to corpus. Here, the estate’s DNI is its taxable interest of $40,000, reduced by the $34,000 of expenses attributable to taxable income, or $6,000.

6. (d) The requirement is to determine which of the credits may be offset against the gross estate tax in determining the net estate tax of a US citizen for 20X3. In computing the net estate tax of a US citizen, the gross estate tax may be offset by the unified transfer tax credit, foreign death taxes, and prior transfer taxes. For 20X3, a unified transfer tax credit is allowed against gift and estate taxes and is equivalent to an exemption of the first $1,000,000 of taxable gifts or $2,000,000 of taxable estate from the unified transfer tax. Only taxable gifts made after 1976 are added back to a donor’s taxable estate in arriving at the tax base for the application of the unified transfer tax at death. To the extent these taxable gifts exceeded the exemption equivalent of the unified credit and required the payment of a gift tax during the donor’s lifetime, such tax is then subtracted from a donor’s tentative estate tax at death in
arriving at the gross estate tax. Thus, although post-1976 gift taxes reduce the net estate tax, they are not subtracted as a tax credit from the gross estate tax.

7. (c) If the executor of a decedent’s estate elects the alternate valuation date and none of the assets have been sold or distributed, the estate assets must be included in the decedent’s gross estate at their FMV as of six months after the decedent’s death.

8. (d) The requirement is to determine the amount of gift that is excludable from taxable gifts. Since the interest income resulting from the bond transferred to the trust will be accumulated and distributed to the child in the future upon reaching the age of twenty-one, the gift (represented by the $8,710 present value of the interest to be received by the child at age twenty-one) is a gift of a future interest and is not eligible to be offset by an annual exclusion.
Simulation #1

<table>
<thead>
<tr>
<th>Situation</th>
<th>Type of Gift</th>
<th>Generation-Skipping Tax</th>
</tr>
</thead>
</table>

During 20x9, various clients went to Rowe, CPA, for tax advice concerning possible gift tax liability on transfers they made throughout 20x9.

<table>
<thead>
<tr>
<th>Situation</th>
<th>Type of Gift</th>
<th>Generation-Skipping Tax</th>
</tr>
</thead>
</table>

For each client, indicate whether the transfer of cash, the income interest, or the remainder interest is a gift of a present interest, a gift of a future interest, or not a completed gift.

Answer List
P. Present Interest
F. Future Interest
N. Not Completed

Assume the following facts:

Cobb created a $500,000 trust that provided his mother with an income interest for her life and the remainder interest to go to his sister at the death of his mother. Cobb expressly retained the power to revoke both the income interest and the remainder interest at any time.

Items to be answered

1. The income interest at the trust's creation. (P) (F) (N)
2. The remainder interest at the trust's creation. (P) (F) (N)

Kane created a $100,000 trust that provided her nephew with the income interest until he reached forty-five years of age. When the trust was created, Kane’s nephew was twenty-five. The income distribution is to start when Kane’s nephew is twenty-nine. After Kane’s nephew reaches the age of forty-five, the remainder interest is to go to Kane’s niece.

3. The income interest. (P) (F) (N)

During 20x9, Hall, an unmarried taxpayer, made a $10,000 cash gift to his son in May and a further $12,000 cash gift to him in August.

4. The cash transfers. (P) (F) (N)

During 20x9, Yeats transferred property worth $20,000 to a trust with the income to be paid to her twenty-two-year-old niece Jane. After Jane reaches the age of thirty, the remainder interest is to be distributed to Yeats' brother. The income interest is valued at $9,700 and the remainder interest at $10,300.

5. The income interest. (P) (F) (N)

6. The remainder interest. (P) (F) (N)

Tom and Ann Curry, US citizens, were married for the entire 20x9 calendar year. Tom gave a $40,000 cash gift to his uncle, Grant. The Currys made no other gifts to Grant in 20x9. Tom and Ann each signed a timely election stating that each made one-half of the $40,000 gift.

7. The cash transfers. (P) (F) (N)

Murry created a $1,000,000 trust that provided his brother with an income interest for ten years, after which the remainder interest passes to Murry's sister. Murry retained the power to revoke the remainder interest at any time. The income interest was valued at $600,000.

8. The income interest. (P) (F) (N)
9. The remainder interest.

<table>
<thead>
<tr>
<th>Situation</th>
<th>Type of Gift</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Generation-Skipping Tax</td>
</tr>
</tbody>
</table>

Determine whether the transfer is subject to the generation skipping tax, the gift tax, or both taxes. Disregard the use of any exclusions and the unified credit.

_Annual List_
A. Generation-Skipping Tax
B. Gift Tax
C. Both Taxes

Martin's daughter, Kim, has one child, Dale. During 20x9, Martin made an outright $5,000,000 gift to Dale.
Simulation #2

Scott Lane, an unmarried US citizen, made no lifetime transfers prior to 20x9. During 20x9, Lane made the following transfers:

- Gave a $13,000 cash gift to Kamp, a close friend.
- Made two separate $10,000 cash gifts to his only child.
- Created an *irrevocable* trust beginning in 20x9 that provided his aunt with an income interest to be paid for the next five years. The remainder interest is to pass to Lane’s sole cousin. The income interest is valued at $26,000 and the remainder interest is valued at $74,000.
- Paid $25,000 tuition directly to his grandchild’s university on his grandchild’s behalf.
- Created an *irrevocable* trust that provided his brother with a lifetime income interest beginning in 2011, after which a remainder interest passes to their sister.
- Created a *revocable* trust with his niece as the sole beneficiary. During 20x9, the niece received $14,000 interest income from the trust.

For items 1 through 7, determine whether the tax transactions are fully taxable, partially taxable, or not taxable to Lane in 20x9 for gift tax purposes after considering the gift tax annual exclusion. Ignore the transfer tax credit when answering the items. An answer may be selected once, more than once, or not at all.

**Gift Tax Treatments**

- F. Fully taxable to Lane in 20x9 for gift tax purposes.
- P. Partially taxable to Lane in 20x9 for gift tax purposes.
- N. Not taxable to Lane in 20x9 for gift tax purposes.

1. What is the gift tax treatment of Lane’s gift to Kamp?  
2. What is the gift tax treatment of Lane’s cash gifts to his child?  
3. What is the gift tax treatment of the trust’s income interest to Lane’s aunt?  
4. What is the gift tax treatment of the trust’s remainder interest to Lane’s cousin?  
5. What is the gift tax treatment of the tuition payment to Lane’s grandchild’s university?  
6. What is the gift tax treatment of the trust’s income interest to Lane’s brother?  
7. What is the gift tax treatment of the $14,000 interest income that Lane’s niece received from the revocable trust?
Simulation Solution #1

<table>
<thead>
<tr>
<th>Situation</th>
<th>Type of Gift</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Generation-Skipping Tax</td>
</tr>
<tr>
<td>Skipping Tax</td>
<td></td>
</tr>
</tbody>
</table>

For items 1 through 9, candidates were asked to determine whether the transfer of cash, an income interest, or a remainder interest represents a gift of a present interest (P), a gift of a future interest (F), or not a completed gift (N).

1. The income interest at the trust’s creation. (P) (F) (N) ○ ○ ●
2. The remainder interest at the trust’s creation. ○ ○ ●
3. The income interest. ○ ● ○
4. The cash transfers. ● ○ ○
5. The income interest. ● ○ ○
6. The remainder interest. ○ ● ○
7. The cash transfers. ● ○ ○
8. The income interest. ● ○ ○
9. The remainder interest. ○ ○ ●

Explanation of solutions

1. (N) Since Cobb expressly retained the power to revoke the income interest transferred to his mother at any time, he has not relinquished dominion and control and the transfer of the income interest is not a completed gift.
2. (N) Since Cobb expressly retained the power to revoke the remainder interest transferred to his sister at any time, he has not relinquished dominion and control and the transfer of the remainder interest is not a completed gift.
3. (F) Kane’s transfer of an income interest to a nephew and a remainder interest to a niece are completed gifts because Kane has relinquished dominion and control. Since Kane’s nephew was twenty-five years of age when the trust was created, but income distributions will not begin until the nephew is age twenty-nine, the transfer of the income interest is a gift of future interest and does not qualify for the annual exclusion.
4. (P) Since Hall’s gifts of cash to his son were outright gifts, they are gifts of a present interest and qualify for the annual exclusion.
5. (P) Yeats’ gift of the income interest to her twenty-two-year-old niece is a gift of a present interest qualifying for the annual exclusion since Jane has the unrestricted right to immediate enjoyment of the income. The fact that the value of the income interest does not exceed $13,000 does not affect its nature (i.e., completed gift of a present interest).
6. (F) Yeats’ gift of the remainder interest to her brother is a completed gift of a future interest since the brother cannot enjoy the property or any of the income until Jane reaches age thirty.
7. (P) Tom’s gift of $40,000 cash to his uncle is an outright gift of a present interest and qualifies for the annual exclusion. Since gift-splitting was elected and Tom and Ann would each receive a $13,000 annual exclusion, Tom and Ann each made a taxable gift of $20,000 – $13,000 exclusion = $7,000.
8. (P) Murry’s gift of the income interest to his brother is a completed gift because Murry has relinquished dominion and control. It is a gift of a present interest qualifying for the annual exclusion since his brother has the unrestricted right to immediate enjoyment of the income.
9. (N) Since Murry retained the right to revoke the remainder interest transferred to his sister at any time, the transfer of the remainder interest does not result in a completed gift.
<table>
<thead>
<tr>
<th>Situation</th>
<th>Type of Gift</th>
</tr>
</thead>
</table>

For this item, candidates were asked to determine whether the transfer is subject to the generation-skipping tax (A), the gift tax (B), or both taxes (C).

Martin’s daughter, Kim, has one child, Dale. During 20x9, Martin made an outright $5,000,000 gift to Dale.

(A) (B) (C)

Explanation of solution

(C) Since Martin made an outright gift of $5,000,000 to Dale, the transfer is a gift of a present interest and is subject to the gift tax. Since Dale happens to be Martin’s grandchild, the gift also is subject to the generation-skipping tax. The generation-skipping tax on the transfer of property is imposed in addition to federal gift and estates taxes and is designed to prevent individuals from escaping an entire generation of gift and estate taxes by transferring property to, or in trust for the benefit of, a person that is two or more generations younger than the donor or transferor. The tax approximates the transfer tax that would be imposed if the property were actually transferred to each successive generation.
Simulation Solution #2

<table>
<thead>
<tr>
<th>Situation</th>
<th>Gift Tax Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>For Items 1 through 7, candidates were asked to identify the federal gift tax treatment for each item by indicating whether the item is fully taxable (F), partially taxable (P), or not taxable (N) to Lane in 20x9 for gift tax purposes after considering the gift tax annual exclusion.</td>
<td></td>
</tr>
</tbody>
</table>

1. What is the gift tax treatment of Lane’s gift to Kamp? (F) (P) (N) o o ●
2. What is the gift tax treatment of Lane’s cash gifts to his child? (F) (P) (N) ○ ● o
3. What is the gift tax treatment of the trust’s income interest to Lane’s aunt? (F) (P) (N) ○ ● o
4. What is the gift tax treatment of the trust’s remainder interest to Lane’s cousin? (F) (P) (N) ● o o
5. What is the gift tax treatment of the tuition payment to Lane’s grandchild’s university? (F) (P) (N) ● o o
6. What is the gift tax treatment of the trust’s income interest to Lane’s brother? (F) (P) (N) ○ o o
7. What is the gift tax treatment of the $14,000 interest income that Lane’s niece received from the revocable trust? (F) (P) (N) ○ ● o

Explanation of solutions

1. (N) There is no taxable gift because the $13,000 cash gift is a gift of a present interest and is fully offset by a $13,000 annual exclusion.
2. (P) The $20,000 of cash gifts given to his child would be partially offset by a $13,000 annual exclusion, resulting in a taxable gift of $7,000.
3. (P) The gift of the income interest valued at $26,000 to his aunt is a gift of a present interest and would be partially offset by an $13,000 annual exclusion, resulting in a taxable gift of $13,000.
4. (F) Since the remainder interest will pass to Lane’s cousin after the expiration of five years, the gift of the remainder interest is a gift of a future interest and is not eligible for an annual exclusion. As a result, the $74,000 value of the remainder interest is fully taxable.
5. (N) An unlimited exclusion is available for medical expenses and tuition paid on behalf of a donee. Since Lane paid the $25,000 of tuition directly to his grandchild’s university on his grandchild’s behalf, the gift is fully excluded and not subject to gift tax.
6. (F) Since Lane created the irrevocable trust in 20x9 but his brother will not begin receiving the income until 2011, the gift of the income interest to his brother is a gift of a future interest and cannot be offset by an annual exclusion. As a result, the gift is fully taxable for gift tax purposes.
7. (P) The creation of a revocable trust is not a completed gift and trust income is taxable to the grantor (Lane). As a result, a gift occurs only as the trust income is actually paid to the beneficiary. Here, the $14,000 of interest income received by the niece during 20x9 is a gift of a present interest and would be partially offset by a $13,000 annual exclusion.
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