INTRA-FAMILY TRANSFER OF BUSINESS AND REAL ESTATE FOR SELF-CANCELING INSTALLMENT NOTE: A POTENTIAL TECHNIQUE FOR CUTTING ESTATE TAXES

by

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On February 19, 2003, the Sixth Circuit Court of Appeals, in reviewing an estate tax assessment by the Internal Revenue Service ("IRS"), rendered a judgment sanctioning an intra-family sale of a family business and investment real estate in exchange for a self-canceling installment note ("SCIN"). In holding for the estate in *Estate of Costanza*,[1] the Sixth Circuit reversed a decision of the United States Tax Court that had sided with the IRS. A superficial analysis of the case might lead one to conclude that the IRS suffered a big loss – and this may yet be the case. However, as this paper will expound, the last word on the matter has not yet been heard.

BACKGROUND

The federal estate and gift tax is a unified tax since the ultimate tax rate applicable depends on the total transfers made by a person during lifetime and at death.[2] Consequently, in computing any gift tax payable, the gift tax rate to be applied in any particular year depends on total lifetime gifts.[3] Similarly, in computing the estate tax, the relevant rate depends on what is included in the gross estate at death plus the sum of the adjusted taxable gifts made during lifetime.[4] The term *adjusted taxable gifts* means the total of the taxable gifts made during lifetime,[5] which in turn means the total amount of gifts reduced by the annual exclusions allowable – for many years $10,000 per donee, per year, but now $11,000 due to an inflation adjustment.[6] Accordingly, to arrive at the so-called *estate tax base*, against which the applicable unified tax rate is to be applied,[7] adjusted taxable gifts must be added to the otherwise taxable estate (gross estate less allowable deductions). Since adjusted taxable gifts must be added in determining the estate tax base, in order to prevent double taxation of the same items, a credit is allowed against the estate tax otherwise payable for any gift tax that is paid during lifetime.[8] Fundamentally, therefore, gift tax payments may be viewed as advance payments against the final transfer tax, which is the estate tax due upon death.

Whether any gift or estate tax is payable, however, depends on whether total lifetime gift and death transfers exceed a person's lifetime applicable exclusion amount. For 2003, the applicable exclusion amount is $1,000,000; it is due to increase incrementally over the coming years.[9] An estate tax return need not be filed if the gross estate is under the applicable exclusion amount.[10] However, for this purpose, the applicable exclusion amount is reduced by adjusted taxable gifts.[11] For example, if adjusted taxable gifts are $400,000, then an estate tax return will have to be filed if the gross estate exceeds $600,000. If the gross estate is $800,000, the estate tax base (before allowable deductions) therefore will be $1,200,000 ($800,000 + $400,000).

If property is transferred for less than adequate and fair consideration in money or money's worth, the amount by which the value of the property transferred exceeds the value of the consideration received is deemed a gift.[12] A gift tax is payable whenever the sum of adjusted taxable gifts made during lifetime exceeds the applicable exclusion amount. As stated, adjusted taxable gifts must be added in determining the estate tax base and a credit may be taken for any gift tax paid.[13]

A SCIN is an installment debt obligation received by a seller as consideration for the sale of property that by its terms is automatically cancelled on the death of the seller. Since the obligation to make further payments on the SCIN is extinguished upon such death, it has been held to have no value at that point.[14] Consequently, although a SCIN might have considerable value immediately prior to the seller-holder's death, it has no value upon death and nothing would be included in the seller-holder's gross estate.

Utilization of a SCIN to transfer assets, such as a family business or investment real estate, to other family members could result in significant estate tax savings where the seller to whom the SCIN was issued dies prematurely. For reasons that will become apparent in this paper, the IRS will closely scrutinize an intra-family SCIN transaction in order to ascertain whether it is bona fide and that the SCIN represents fair and adequate consideration paid for the property interests transferred.

ESTATE OF COSTANZA

Relevant Facts

Dulio Costanza ("the decedent") died on May 12, 1993. He had a long history of heart problems dating back to 1978 and had undergone coronary bypass surgery in 1982. He had been suffering from angina and severe coronary disease since at least April 1991. On January 25, 1993, he entered the hospital for testing. On January 29, 1993, he was diagnosed as

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suffering from angina, congestive heart failure and atherosclerotic heart disease. The medical report stated that the decedent's prognosis was poor and he was advised he needed further bypass surgery. On May 11, 1993, the decedent underwent a second bypass operation. He died unexpectedly the next day, at age 73, as a result of a severe toxic reaction to a drug that had been administered to him

The decedent was born in Italy on October 21, 1919. After immigrating to the United States, he worked in a General Motors plant in Flint, Michigan until 1966. Thereafter, he opened an Italian restaurant in Flint with his wife on property they owned. On other property they owned, they built a small retail/office plaza. The decedent's wife predeceased him in 1991 at which time an appraisal was made of the properties valuing them at $830,000.[15]

In February 1992, General Motors closed its plant in Flint, Michigan. The plant had employed over 4,000 persons and was located about a half mile from the restaurant and office/plaza. About this time, the decedent decided to retire and return to Italy. In December 1992 and January 1993, the decedent carried out a transaction to transfer the restaurant and office/retail plaza to his son, Michael. (The properties were technically held by the decedent's revocable trust and the transfer was to Michael's revocable trust, with respect to both of which Michael was the trustee). For the two properties, upon the advice of the decedent's attorney, Michael executed a SCIN payable to the decedent in the face amount of $830,000 requiring payment of the principal amount over 11 years. The SCIN provided for a reasonable rate of interest and was secured by a recorded mortgage on both properties. Although the documents effecting the transaction (quitclaim deed, mortgage and SCIN) were all dated December 15, 1992, they were not actually signed until late in December or in early January 1993. The quitclaim deed and mortgage were not registered until February 1993.

The first payment under the SCIN was due January 1993. However, Michael did not make a payment in January nor in February of 1993. On March 8, 1993, he wrote three checks each for the agreed upon monthly payment. As originally written, the checks were dated March 8, 1993. However, Michael crossed out this date on the three checks and entered, respectively, January 1, 1993, February 1, 1993, and March 1, 1993, to correspond to the months for which the payments were intended. In his capacity as trustee, on March 8, 1993, Michael deposited all three checks in the decedent's trust account. As to why there was a delay in making payments, Michael testified that his father wanted to be paid on a quarterly basis to ease the burden of having to deposit a check each month. Accordingly, the next check or checks were not due until June. However, since the decedent died in May of 1993, Michael made no further payments on the SCIN. Altogether, the total of the three payments made by Michael amounted to about $26,000.

1. The Decedent's Federal Estate Tax Return

The decedent's Federal estate tax return stated that no tax was due. The return identified the SCIN and included a copy as an exhibit. However, it set a value of zero for the SCIN on the basis that the note was cancelled upon the death of the decedent.[16]

2. The IRS Challenge

The IRS issued a timely notice of deficiency increasing the decedent's gross estate by almost $804,000. The notice explained that the sale between the decedent's revocable trust and Michael's revocable trust was not recognized since it was not a bona fide sale and adequate consideration was not received. Accordingly, the IRS position was that the decedent made a taxable gift to Michael for the full value of the properties ($830,000) minus the three installment payments that totaled about $26,000. In this context, the IRS argued that Michael and the decedent undertook the SCIN transaction only because they presumed the decedent would die before Michael fully satisfied the note. Basically, the IRS was asserting that if it was the intention of the parties for the note actually to be paid off over its 11-year term, they could have used an installment note with no cancellation feature. Considering the decedent's shaky health, this seemed like a strong argument.

As a backup position, however, the IRS asserted in an amended answer that if the sale were held to be valid, it was a bargain sale resulting in a gift to the extent of the bargain. More specifically, the IRS claimed the bargain or gift component was the difference between the purported value of the properties, which was $830,000, and the lower actual value of the SCIN received in exchange for them, and less the $26,000 paid. Accordingly, it asserted that the resulting gift (less the annual exclusion) constituted an adjusted taxable gift that should have been added in determining the estate tax base.

Tax Court's Opinion

In holding for the IRS, the Tax Court observed that "[i]ntrafamily transactions are subject to rigid scrutiny, and transfers between family members are presumed to be gifts."[17] The Tax Court also stated that a sale by a parent to a child for installment notes will not be ' "bona fide' " unless at the time of the sale there existed a ' "real expectation and intent to enforce the collection of the indebtedness.' "[18] Further, the Court noted that although a debt may be legally enforceable, it is not considered a bona fide debt unless there is a clear intention to create a true debtor-creditor relationship.[19]

The Tax Court seemed particularly suspicious of Michael's motives since he backdated the checks and the payments were late. Also, the Tax Court seemed to feel that there was no objective showing that payment would be enforced. On the

contrary, the Tax Court opined that Michael made "haphazard" and "contradictory" payments that fell far short of an arm's length deal.[20] Another factor that the Tax Court took note of was that although the decedent lived on until May 12, 1993, Michael made no further payments on the SCIN.

Accordingly, the Tax Court concluded that the transfer of the decedent's properties to Michael was a gift except to the extent that he made payments, which as noted previously amounted to only about $26,000. Based upon expert testimony presented at trial, the Tax Court found that the properties were worth at least $843,000 on the date of their sale. Accordingly, the amount of the gift to be added to the estate tax base (disregarding the annual exclusion) was determined to be approximately $817,000 ($843,000 - $26,000).[21]

Most significantly, the Tax Court seemed to question the legitimacy of the transaction due to the backdating, the late payment and the simple fact that it was an intra-family compact.

Sixth Circuit's Perspective

As is the rule with appellate review, the Sixth Circuit evaluated the Tax Court's findings of facts under the *clearly erroneous* standard.[22]

1. Bona Fide Transaction.

The Sixth Circuit, referring to the seminal case in this area as authority, *Estate of Moss*,[23] observed that a SCIN is not included in the gross estate of the deceased seller-owner of the SCIN if it is received in a bona fide transaction. As to whether a transaction is bona fide, the Court remarked that the transfer of property in exchange for a SCIN signed by a family member is presumed to be a gift and not a bona fide transaction.[24] Continuing, the Court stated, however, that the presumption is rebutted if it can be shown at the time of the transaction that there existed a real expectation of repayment and intent to enforce collection if payment is not made.[25]

Based upon the foregoing standards, the Sixth Circuit concluded that the estate effectively rebutted the presumption of a gift. First, the Sixth Circuit did not feel that something was awry simply because Michael backdated the checks. Contrary to the Tax Court's perception of his motives, the Sixth Circuit felt Michael was sincere. It believed the record of his testimony adequately addressed the brief delay in making payments by his explanation that his father wanted to be paid only quarterly. As to the backdating of the checks, in the Court's view, this was done only to document the months to which the payments related. Also, the Court apparently believed that Michael had not been surreptitious about the checks since he simply crossed out the old dates and wrote in the new ones. Moreover, the brief delay between the date of the documents and the date they were signed was adequately explained by the fact that they had to be circulated by mail for signature, and such delay was deemed by the Court to be "inconsequential."[26]

Additionally, the Court mentioned that the bona fide nature of the SCIN was buttressed by the fact that the SCIN was fully secured by a mortgage on the properties.[27] Finally, the Sixth Circuit sympathetically honed in on testimony of Michael to the effect that the transfer was not intended as a gift and that his father wanted payment over time so he could retire to Italy.[28]

The Sixth Circuit also addressed the IRS argument that if the parties believed the decedent would outlive the term of the notes, there would have been no reason to use a SCIN as opposed to an unconditional installment note. As to this argument, the Sixth Circuit importantly maintained that this contention basically questions the validity of any SCIN, a viewpoint that the Tax Court long ago rejected, referring to *Estate of Moss*.

Another aspect of the case that the Sixth Circuit addressed was the decedent's health as it existed at the time he signed the SCIN; he suffered from heart disease for the last 15 years of his life. As a result of his long-standing coronary problems, the IRS argued it was reasonable to conclude that the decedent would die within a few years of the execution of the SCIN and it would largely be cancelled. In fact, he died within five months of its execution. Consequently, from the standpoint of hindsight, the IRS asserted there was never an initial intention that the SCIN would be paid off. The Sixth Circuit in rejecting this argument relied on the trial testimony of medical experts that the decedent was expected to live anywhere between 5 and 13.9 years from the time he signed the SCIN. Significantly, it also pointed out that his death from complications was clearly not anticipated.[29]

In conclusion, the Sixth Circuit held that the Tax Court clearly erred in finding that the SCIN transaction was not bona fide.

2. The IRS Backup Argument: Bargain Sale

Another disputed issue was whether the case should be remanded to the Tax Court for a determination as to whether there was a bargain element to the transfer that should increase the estate's adjusted taxable gifts, which, as noted, must be added to the estate tax base against which the estate tax rates are applied. In this regard, the IRS contended that the true value of the SCIN was considerably less than the value of the properties transferred in exchange for it, and therefore less than its face value.

The estate submitted that there was no need to remand the case since, under Treasury Department regulations, for estate tax purposes, the fair market value of notes is presumed to be the amount of the unpaid principal, plus interest accrued to the date of death,[30] and the IRS offered no evidence at trial to rebut this presumption. Moreover, the estate contended that the Court could determine, without remanding the case, whether there was any difference between the value of the properties, which was the subject of considerable testimony in the Tax Court, and the presumed fair market value of the SCIN.

However, the Sixth Circuit noted that the estate did not advance this argument until its reply brief and therefore the IRS did not have a chance to respond. Additionally, it was unclear from the record whether the IRS proffered evidence at trial to rebut the presumption of the presumed fair market value of the SCIN. Accordingly, the case was remanded to the Tax Court for the purpose of resolving the IRS's alternative argument that, although a bona fide transaction, the SCIN deal constituted a bargain sale and thereby a gift to the extent of the bargain component.[31]

One can question the Sixth Circuit's conclusion that the Tax Court's findings of fact were clearly erroneous, a benchmark usually quite difficult to overcome. The reason for setting a high standard for reversing the factual findings of a trial court is that it can evaluate the demeanor and credibility of witnesses whereas an appellate court only has the record on appeal on which to base its determinations.

CONCLUSION

1. The Bona Fide Nature of the Transaction

At first impression, the taxpayer victory in *Estate of Costanza* seems to present a significant estate tax saving opportunity for those considering utilization of a SCIN to transfer a family business, at least in the Sixth Circuit. However, as discussed in more detail hereafter, the last word has not yet been heard since the case was remanded to the Tax Court for it to make a determination on the alternative argument of the IRS.

One of the key findings in *Estate of Costanza* was that the decedent died *unexpectedly* despite his long-existing coronary problems. In other words, he was not found to be terminally ill at the time of execution of the SCIN. This finding was a key factor in the Sixth Circuit's holding that the transaction was bona fide, otherwise the decision probably would have gone the other way. There are, of course, many people who are in quite poor health although not terminally ill. That there is a distinction between poor health and terminal illness is in fact recognized in Treasury Department regulations, which provide that certain mortality tables prescribed under the Internal Revenue Code[32] may not be used to value an interest (annuity, income, remainder, reversionary) if an individual is considered terminally ill. These regulations provide a *bright line* test, arguably ambiguous, for determining whether a person is considered terminally ill.[33]

Although an individual may not be terminally ill, quite often it is a reasonably sure bet that the individual will not survive to normal life expectancy. Such a setting presents the opportunity to achieve considerable estate tax savings. For example, suppose an individual age 70, in poor health but not terminally ill, establishes a charitable lead trust funding it with $1,000,000 and providing for the income to charity for his lifetime with the remainder to his children. The gift to the children under Treasury Department regulations (assuming an applicable federal rate of 5%) would be $531,930 ($1,000,000 x .53193). If the individual dies a year later, he has managed to transfer $1,000,000 of assets at a gift tax value of only $531,930. Of course, whether he was terminally ill at the time of the transfer is a question of fact, but the point is that poor health does not necessarily mean a person is terminally ill. Clearly, the Sixth Circuit in *Estate of Costanza* acknowledged the distinction.

2. The Bargain Element of the Transaction and the Remand

On remand, it perhaps might seem that the IRS will have an insurmountable task in proving that the actual value of the SCIN was less than its face value when issued. As noted, the presumption under Treasury Department regulations is that a note is worth the unpaid principal plus accrued interest.[34] Moreover, the Sixth Circuit sanctified the transaction as being bona fide, the SCIN was fully secured by a mortgage on the properties transferred and there was a finding that the decedent expected to be paid and intended to enforce collection.

Nevertheless, an argument can be made that the initial fair market value of a SCIN is less than a non-cancelable note since the risk of death and the balance thereby not being paid clearly affects the determination of its value. Accordingly, despite the fact that the SCIN in *Estate of Costanza* was held to have been received in a bona fide transaction and was adequately secured, the IRS has a basis for asserting that to equalize the values, the SCIN should have had a higher principal amount or, alternatively, a rate of interest higher than the going rate.[35]

On remand, the Tax Court will have to determine the fair market value of the SCIN. If it determines that its value at the time given was less than the value of the properties transferred there will be a bargain component to the transfer. There is no conclusive way to determine value, however, since it depends on all the facts and circumstances.

The Tax Court previously has considered the proper method of valuing a SCIN. In *Wilson,*[36] it observed that the value of a SCIN depends on what it would sell for. The sale equivalence precept is also set forth in Treasury Department regulations.[37] In this regard, the Court noted that the "price depends on a myriad of factors such as the time value of money,

risks associated with potential nonpayment, the value of the collateral, various transaction costs, prevailing interest rates, supply and demand, and the need for the purchaser to profit on the investment." Also, with respect to the possibility of a SCIN being cancelled on the premature death of the original holder of the SCIN, the Court in *Wilson* mentioned that an investor could insure against premature death by purchasing life insurance on the life of the original holder.[38]

If the Tax Court in *Estate of Costanza* follows the line of reasoning in *Wilson*, the valuation discount on the SCIN might turn out to be minimal. But the cases may be distinguished since there could be testimony that the poor health of the decedent made him uninsurable. In *Wilson*, the recipient of the SCIN was only 68 years old and apparently in good health, which simply points out that each case has its own particular facts and circumstances.

There are other possible approaches to valuing a SCIN. For example, a methodology the IRS might advocate on remand is that the SCIN should be discounted to reflect the actuarial chances of the decedent not surviving until the note is paid off. The decedent in *Estate of Costanza* was 73 years old when he transferred the property for a SCIN to be paid over 11 years. Hence, he would have had to live to age 84 to receive all payments. Treasury Department regulations contain an actuarial table from which the likelihood of living to a certain age may be determined. Under the table existing at the time of the transaction, the likelihood of a person age 73 living to age 84 is about 50%, and therefore the chances of dying before that time would also be 50%.[39] Consequently, the IRS could argue that the face amount of the SCIN should be discounted by 50%. Following this line of reasoning and disregarding any other relevant factors, the SCIN would have a fair market value of $415,000 ($830,000 x 50%). Based upon the Tax Court's adhering to the expert testimony in the Tax Court that the property transferred was worth at least $843,000, and considering the $26,000 paid on the SCIN, the bargain discount using this type of valuation approach comes to $402,000 ($843,000 - $415,000 - $26,000), which would result in adjusted taxable gifts of that amount. Still, this is significantly less than adjusted taxable gifts of $817,000 (both amounts disregarding the annual exclusion), which would have been the result had the IRS won on the issue of whether the transaction was bona fide. This method of valuation is, of course, purely actuarial and does not consider the particular facts and circumstances, specifically the decedent's poor health and the fact that he died five months after the SCIN transaction.

Although the Sixth Circuit found that the SCIN transaction was bona fide despite the precarious health of the decedent, there appears to be no reason why his health status could not be considered in the context of valuing the SCIN. In this regard, there are numerous possibilities. But again, conceptually, no consideration should be given to the fact that the decedent died unexpectedly only five months after executing the SCIN. There was medical testimony in the Tax Court that when the decedent received the SCIN he was expected to live between 5 and 13.9 years. The Tax Court possibly could pick any number between these two. But if it *sliced the baby in half*, the decedent's life expectancy would come to 9.3 years, halfway between 5 and 13.9. Considering its 11-year term, the SCIN would be worth 85% (9.3/11) of its $830,000 face value, or $705,500, again disregarding any other relevant factors. Since, as stated, the Tax Court found the value of the properties to be at least $843,000, under this approach, the bargain discount gift (disregarding the annual exclusion) to be added to adjusted taxable gifts would come to only $111,500 ($843,000 - $705,500 - $26,000).

Further speculations are, of course, possible. It will be interesting to see what facts and circumstances will be considered by the Tax Court and what methodology it will use in valuing the SCIN. Of course, due to the uncertainty of the outcome, the matter might be settled.

3. In General

Under the appropriate circumstances, the transfer of property to family members in exchange for a SCIN may save a considerable amount in estate taxes. However, as explained hereafter, there are income tax considerations to take into account. An additional estate tax consideration is that a transfer of property during lifetime *freezes* its value. Consequently post-transfer appreciation is kept out of the estate of the decedent. If it is anticipated that the property will rise significantly in value, then a present transfer may be financially warranted as contrasted with holding the property until death. An added benefit is that any income derived from the property after the transfer will be kept out of the estate of the decedent.

The object lesson of *Estate of Costanza* is that an attorney or other advisor who advocates using a SCIN in connection with an intra-family transfer must be careful to assure proper documentation of the transaction and to advise the obligor to make timely payments. Securing the SCIN with a mortgage on the transferred property, and providing an adequate rate of interest, also helps in giving the transaction an arm's length coloration.

Another important message from *Estate of Costanza* is that the poor health of the transferor seemingly will not in and of itself prevent an intra-family SCIN transaction from being considered bona fide. Of course, if a person is in fact terminally ill, a *death-bed* transfer might be viewed differently.

The key unresolved issue, however, is determining the value of the SCIN. Clearly, the IRS is unconvinced that an installment note that self-destructs on the death of the seller-creditor is worth face value, especially in an intra-family transaction. In this regard, it may be noted that the sale in *Estate of Moss* was to an unrelated employee. Nevertheless, a transfer of property to a family member in exchange for a SCIN is not automatically iniquitous, and simply means that the transaction is subject to strict scrutiny.[40]

Unfortunately, there are *creative* estate planners who aggressively promote snazzy estate plans, such as a family limited partnership or SCIN, bestowing absolute assurance as to the outcome. Those who are a bit more cautious, however, will undoubtedly hedge their bets.

In summary, all of the facts and circumstances will be considered in determining whether an intra-family SCIN transaction is bona fide in the first place and, even if it is, whether there is a bargain element to the deal.

INCOME TAX CONSEQUENCES

Although an SCIN is not includable in the note holder's gross estate if the transaction is bona fide – though any bargain component would add to the estate tax base – there are income tax consequences that must be considered in deciding whether to use a SCIN. Cancellation of the note on death is considered a taxable disposition of the note and will trigger recognition of the remaining gain inherent in it, which will have to be reported on the estate's *income tax* return (Form 1041).[41] Moreover, the income tax obligation will not be deductible on the estate tax return since it was not a debt of the decedent at the time of his or her death. The gain will be income in respect of a decedent, but no income tax deduction will be allowed for the proportionate share of estate tax attributable to the SCIN[42] since, as stated, it will not be includable in the gross estate of the decedent.

The trade off of potential estate tax reduction for gain recognition usually favors use of a SCIN since income tax rates are lower than the estate tax rates, especially since any recognized gain generally will be taxed at reduced capital gain rates, and the gain will be spread out over the term of the note. Furthermore, the amount of gain inherent in the unpaid balance of the SCIN cancelled at death will depend on the tax basis of the SCIN, which in turn will be based on the tax basis of the property transferred. The smaller the difference between the face amount of the SCIN and its tax basis, the smaller the gain and the less significant the income tax hit on the transaction.

It also should be kept in mind that property held at death receives a stepped-up basis equal to date of death value or, if elected, the alternate valuation date value.[43] Consequently, unrealized gain on property held until death will never be subject to income tax. But the potential estate tax saving resulting from freezing the value of potentially appreciating property by a lifetime transfer, and the possibility of transferring the property at a discounted value using a SCIN, may significantly more than offset any income tax advantage of receiving a stepped-up basis by holding the property until death.

FOOTNOTES

[1] Estate of Costanza v. Commissioner, 320 F.3d 595, 2003 App. LEXIS 2935 (6th Cir. 2003), *rev'g and remanding* T.C. Memo 2001-128, 2001 Tax Ct. Memo LEXIS 156 (2001).

[2] At the time of the decedent's death in *Estate of Costanza*, the estate tax rates ranged from about 37% to 55%. The Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. Law 107-16) reduced the top estate tax rate in stages. For 2003, the rates range from 41% to 50%. The top rate is due to decline as follows: 2004, 48%; 2005, 47%; 2006, 46%; 2007-2009, 45%. The estate tax is repealed for 2010, but unless Congress intervenes with another tax act, the estate tax provisions will thereafter be applied as if the 2001 Act had not been enacted. The gift tax, however, remains in place, but after 2010 the maximum rate will be 35%

[3] I.R.C. § 2502 (2003). Reference to "I.R.C. §" is to the Internal Revenue Code of 1986, as amended.

[4] I.R.C. 2001(b) (2003).

[5] *Id*.

[6] I.R.C. § 2503(b) (2003).

[7] I.R.C. §2001 (2003).

[8] I.R.C. § 2012 (2003).

[9] The applicable exclusion amount increases as follows: 2004 and 2005, $1,500,000; 2006-2008, $2,000,000; 2009, $3,500,000. As noted, the estate tax is repealed for 2010, but unless Congress intervenes with another tax act, the estate tax provisions will thereafter be applied as if the 2001 Act had not been enacted. The applicable exclusion amount for gifts, however, remains at $1,000,000.

[10] I.R.C. § 6018(a)(1) (2003).

[11] I.R.C. § 6018(a)(3) (2003).

[12] I.R.C. § 2512 (2003).

[13] Adjusted taxable gifts are not added in determining the estate tax base if such gifts are otherwise includable in the gross estate on the basis that certain rights or powers over the gifts were retained by the donor. In this regard, *see* I.R.C. §§ 2035-2038.

[14] Estate of Moss v. Commissioner, 74 T.C. 1239, 1247 (1981), *acq*., 1981-2 C.B. 2.

[15] The properties were held by corporations and apparently the transfer was of the stock in the corporations, which was held by the revocable trust, although the case was not clear about this.

[16] Notes held by a decedent are required to be reported in the gross estate even though they are cancelled by the decedent's will (Reg. § 20.2033-1(b)) and have no purported value.

[17] Estate of Costanza v. Commissioner, Tax Ct. Memo LEXIS 156, *9 (2001).
[18] *Id*., citing Estate of Van Anda v. Commissioner, 12 T.C. 1158, 162 (1949), affd. 192 F.2d 391 (2nd Cir. 1951).
[19] Estate of Costanza v. Commissioner, Tax Ct. Memo LEXIS 156, *9 (2001).
[20] *Id*. at *10.
[21] It may be noted that the applicable exclusion amount in 1993 was $600,000.
[22] *See* Downs v. Commissoner, 307 F.3d 423, 425 (6th Cir. 2002).
[23] Estate of Moss v. Commissioner, 74 T.C. 1239, 1247 (1981).
[24] Estate of Costanza v. Commissioner, 320 F.3d 595, 597, 2003 App. LEXIS 2935, *4 (6th Cir. 2003), *citing* Labombarde v. Commissioner, 58 T.C. 745, 755 (1972).
[25] Estate of Costanza v. Commissioner, 320 F.3d 595, 597, 2003 App. LEXIS 2935, *4 (6th Cir. 2003), *citing* Estate of Van Anda v. Commissioner, 12 T.C. 1158, 1162 (1949), *aff'd per curiam*, 192 F.2d 391 (2d Cir. 1951).
[26] Estate of Costanza v. Commissioner, 320 F.3d 595, 597, 2003 App. LEXIS 2935, *7 (6th Cir. 2003).
[27] *Id*. at 598 and *8.
[28] *Id*. at 597 and *5.
[29] Id. at 598 and *8.
[30] Reg. § 20.2031-4 (1958). Reference to "Reg. §" is to Treasury Department regulations interpreting the Internal Revenue Code of 1986, as amended.
[31] I.R.C. § 2512(b) (2003).
[32] I.R.C. § 7520 (2003).
[33] An individual is considered terminally ill if there is at least a 50 percent probability that the individual will die within one year. However, if the individual survives for eighteen months or longer after the date the gift is completed, the individual shall be presumed not to have been terminally ill at the date the gift was completed unless the contrary is established by clear and convincing evidence. Reg. § 25.7520-3(b)(3).
[34] Reg. § 20.2031-4 (1958).
[35] *See* I.R.S. General Counsel Memo ("GCM") 39503.
[36] Catherine Wilson v. Commissioner, T.C. Memo 1992-480, Tax Ct. Memo LEXIS 501, *9.
[37] Treasury Department Regulations (Reg. § 20.2031-1(b) (1965) have long contained language concerning the valuation of property interests:

> The value of every item of property includible in a decedent's gross estate…is its fair market value at the time of the decedent's death.… The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate.… All relevant facts and elements of value are to be considered in every case.

[38] Catherine Wilson v. Commissioner, T.C. Memo 1992-480, Tax Ct. Memo LEXIS 501, *9.
[39] Table 80CNSMT (31,012/61,673), Reg. § 20.2031-7A(e)(4) (2000). Revised tables were issued effective after April 30, 1999. *See* Life Table 90CM, Reg. §20.2031-7(d)(7) (2000).
[40] *See* Estate of Kelley v. Commissioner, 63 T.C. 321, 325 (1974).
[41] Estate of Frane v. Commissioner, 98 T.C. 341 (1992), *aff'd in part, rev'd in part*, 998 F.2d 567 (8th Cir. 1993).
[42] I.R.C. § 691(c) (2003).
[43] I.R.C. § 1014 (2003).