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Proper Premortem Allocation of Assets to Maximize Estate and Income Tax Planning—Part 1

Louis S. Harrison

Here is a full discussion of strategies for reallocating assets that can minimize estate and income taxes while providing protection to those assets.

A commonality between asset protection and estate tax planning is the required reallocation of asset ownership. Often, distribution of assets for estate planning purposes will achieve a desired creditor protection. Although reallocation of assets is most typically required when there may be an estate tax, the strategy is also prevalent in nonestate tax situations, such as to achieve a step-up in income tax basis for a deceased spouse's assets. Accordingly, a review of the related estate and income tax strategies is essential.

This first part of this article addresses the reallocation of assets necessary to realize benefits from the unified credit, the generation skipping transfer tax exemption, and lifetime gifting to trusts. The second part of the article, which will appear in an upcoming issue of the *Journal*, will discuss partnership strategies in gift-giving and step-up in basis rules.

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Planning for Spouses

Credit Shelter Trusts. When an individual passes away (the decedent), the decedent is allowed under current law to pass a total of $600,000 free of estate and gift tax, regardless of who receives the property. This is because of the unified credit against taxes of $192,800, which in effect shields the estate tax on $600,000. (There is legislation, proposed as of the time of writing, that would increase this amount to $750,000.) Any amount in excess of $600,000 is subject to an estate tax beginning in the 37% range and increasing, as the amount of wealth increases, to 55%.

In addition to this $600,000, there are two exceptions as to transfers that do not cause an estate tax: the marital deduction and the charitable deduction. If property passes to the individual's spouse, either outright or in a qualified trust, that amount is free of estate tax and does not count against the $600,000. The same

result follows for property passing to qualified charitable organizations.

At first glance, then, most married couples believe there is minimal, if any, estate tax planning that should occur until one of them passes away. A decedent could leave all of his or her property to the spouse and be free of any estate tax at the decedent's death. However, this would not maximize tax savings. The decedent in this case has wasted their unified credit.

One strategy is to allow the $600,000 amount (reduced by any lifetime gifts) to pass free of estate tax at both the passing of the first spouse and the subsequent passing of the surviving spouse. The $600,000 amount cannot pass outright to the surviving spouse because it will be included in the surviving spouse's gross estate. To use that credit properly, the decedent should set up a trust, and fund it with essentially $600,000, for the benefit of their surviving spouse. The trust should be structured in such a way that the surviving spouse does not have ownership for estate tax purposes. Property would then not be included in the surviving spouse's estate even though the surviving spouse, through the trust, had the control and use of the property. This type of trust is often referred to as a "credit shelter trust."

Upon the death of the surviving spouse, the credit shelter trust will also pass free of estate tax because it is not part of the surviving spouse's estate. In fact, as long as the credit shelter trust remains in existence, it will not be subject to estate taxes. If the spouse is a beneficiary of the credit shelter trust this *does not* preclude the spouse from acting as trustee. However, if the spouse acts as trustee, the standard of principal distributions needs to be limited to an ascertainable one relating to health, support, maintenance, or education. Further, the spouse should be given no express general power of appointment, nor should the spouse have the possibility of using the funds to discharge a legal obligation of support or other creditor obligation.

The document creating the credit shelter trust tends to be involved. Clients would like to see a document that has the $600,000 amount set out in the document as a gift to a nonspousal beneficiary, such as the credit shelter trust. Unfortunately, given the number of factors that could increase or decrease the $600,000 amount at death—including lifetime gifting, income tax elections, and changes in the law—a formula is used to carve out this amount.

There are various formulas to choose from, each having their own postmortem effect. Accordingly, often the planner will pick and choose which formula to use based on either their comfort with their forms or their client's anticipated asset make-up. A careful review of this formula in the document is always necessary, although a discussion of the postmortem planning implications and results with a client is not essential.

Generation Skipping. A decedent can, in effect, transfer up to $1,000,000 for the benefit of the spouse and children and skip estate tax at a child's level. Because such a transfer skips a generation, that type of trust must also be structured to avoid what is known as the generation skipping tax (GST).

Each person enjoys an exemption of $1,000,000 from the GST. However, this exemption cannot be shared among taxpayers, and its full use requires thoughtful planning. Using the full GST exemption in the context of an estate plan requires careful drafting and allocation of assets. In the standard marital deduction estate plan the credit shelter trust consists of the exemption equivalent and the marital deduction consists of the remainder of the property. Assuming that expenses of administration, including attorney fees and executors' fees, are deducted for federal estate tax purposes, the actual value of the credit shelter trust will generally be $600,000. Thus, allocation of a portion of the client's $1,000,000 GST exemption to the credit shelter trust will shelter it completely from the generation-

"If the spouse is a beneficiary of the credit shelter trust this does not preclude the spouse from acting as trustee."

skipping tax as well as estate taxes. The client, however, still would have a substantial unallocated GST exemption ($400,000). Must this be lost? Not necessarily.

One choice is to allocate the remaining $400,000 of the client's exemption at death to a qualified terminable interest property (QTIP) trust. The Internal Revenue Code (IRC) provides that if the marital deduction is in the form of a QTIP trust (even if a QTIP election is made for *estate* tax purposes), for generation-skipping tax purposes, the remaining GST exemption of the deceased spouse may be allocated to the QTIP trust. The QTIP trust will then be treated for GST purposes as if the QTIP election had not been made (i.e., as if the assets in the QTIP were taxed in the deceased spouse's estate and, therefore, covered by the deceased spouse's available GST exemption).

"The designated beneficiary cannot then put the assets into a credit shelter trust."

Funding of the Credit Shelter and Generation Skipping Trusts. If the documents are drafted to create credit shelter or generation skipping trusts, a client's assets most likely will need to be rearranged to ensure the proper funding of the trust. These trusts are set up under the estate plan documents, to which the most attention is paid. Occasionally, minimal attention is paid to the actual funding or assets that will eventually go into the trust.

A basic issue is often overlooked: When the decedent passes away, which assets will be available to fund his or her credit shelter and generation skipping trusts? One difficulty with the answer is that as between husband and wife, one cannot predict who will be the first decedent. Further, if property passes other than pursuant to the estate plan documents, that property will not be available to fund the credit shelter or generation skipping trust.

The credit shelter trust will be set up under a will or a living trust. However, jointly held property will not pass to either of these testamentary devices. Jointly held property passes to the surviving joint tenant, outright. Consider a house, for example, in joint tenancy with the right of survivorship between husband and wife. If husband dies first, that property will pass to the wife, outright, not to the trust. Further, an interest in a qualified plan will pass to the designated beneficiary, which will often be the surviving spouse. That interest may not be available to go to the credit shelter trust. The same result occurs with property that has a specific beneficiary designation, including life insurance, retirement plans, and payable-on-death accounts, among others. These assets automatically go to the designated beneficiary. The designated beneficiary cannot then put the assets into a credit shelter trust. The assets must pass directly from the deceased spouse to the credit shelter trust.

The first objective, then, is to ensure that there is $600,000, or $1,000,000 if generation skipping planning is to occur, in each spouse's name that will pass pursuant to the testamentary documents. The second focus is, by not knowing which spouse will pass first, to have assets properly allocated between husband and wife. One may be inclined to believe that proper estate planning is thus merely a matter of reallocating assets between husband and wife. However, reallocation of assets is not straightforward in most situations. For example, it is difficult to predict who will pass away first. That spouse is the one that needs $600,000 to create the credit shelter trust or $1,000,000 to create generation skipping exempt trusts. As a result, both husband and wife need to have assets that approximate $600,000 (or $1,000,000 to fund generation skipping exempt trusts).

Two concerns are often encountered in these situations. First, what if the aggregate family assets equal less than, say, $1,200,000? In that situation, one approach would be for one spouse to have the full $600,000 worth of assets if the family wants to predict which spouse will predecease the other. For example, if a married couple's assets consist of a house ($400,000) and a life insurance policy ($400,000) on the husband's life for a total

of $800,000, the couple must compromise in the allocation of assets. The husband could be the owner of the house and could designate the credit shelter trust under the will as the primary beneficiary of the life insurance. This will assure the funding of the credit shelter trust should husband predecease wife.

But what happens if wife predeceases husband? There are no assets in the wife's name to fund the credit shelter trust under her documents. In effect, the family then has wasted the $600,000 credit if the wife dies before the husband.

In this situation, a compromise solution may be desirable. This would involve reallocation of assets by perhaps transferring the house to the wife's name. In that event, each spouse will have $400,000 in his or her name. Although neither spouse will fully fund their credit shelter trust, they have leveraged the risk as to who will pass away first. Provided their assets and estate do not grow in value, they will have zeroed out their estate tax liability.

A second difficulty is that one spouse may not want to transfer assets to the other spouse. A transfer may have the effect of changing the character of property for divorce purposes. For example, the transfer by wife of the residence to her husband may transmute the property from her separate property to her husband's separate property. Similarly, the wife may just not like the idea of husband having this property or the transferee spouse may have creditor concerns that militate against the spouse holding property. So pragmatic considerations, not just tax issues, must be discussed.

Selecting Assets for the Trusts

There is an order of preference as to which assets to retitle in particular names. Typically, the easiest assets to transfer are homes, marketable assets, and insurance. As to a home, transfer can be done via a quit claim deed, typically. Ownership can either be in either spouse's name, alone, or it can be jointly. When ownership is held jointly, the title must be as tenancy in common and not joint tenancy; if title is in joint tenancy, the property will pass automatically to the surviving spouse. With tenancy in common, one half of the real estate interest will pass to the deceased spouse's estate. Accounts at brokerage houses can be split into two separate accounts without too much difficulty.

Life insurance is another asset that cannot be broken between the two spouses. For purposes of funding a credit shelter trust, the owner should be the insured. And in this regard, a joint life policy will not function to fund a credit shelter trust or generation skipping trusts.

"For purposes of funding a credit shelter trust, the owner should be the insured."

An issue that arises in the reallocation of assets is that certain assets are more easily transferred than others. For example, an often-encountered example is when the family's aggregate wealth is $1 million, but $900,000 of this is represented by an individual retirement account (IRA) on the husband's life. The husband has no ability to transfer 50% of the IRA to his wife. The IRA is owned by the husband and, for all practical purposes, must remain with the husband during his life.

Further, not all assets are preferable for funding a credit shelter or generation skipping exempt trust. For example, assets with inherent income tax concerns are less preferable to fund these trusts than assets with no inherent income tax concerns. In this regard, compare an IRA, with a face value of $600,000, with cash equivalents equal to $600,000. If the IRA is used to fund the credit shelter trust the trust is not realizing full value. Eventually, income tax on the $600,000 must be paid. At 40% this leaves only $360,000 remaining in the trust. That is to be contrasted with $600,000 of cash, which has no inherent income tax concerns.

Qualified Plans and Credit Shelter and Generation Skipping Trusts

Not all assets receive a step up in basis at death. Accordingly, certain assets will have inherent income tax concerns, even postmortem. Generally, all assets receive a step-up in basis other than a species of assets known as "income in respect of a decedent." The most typical type of income in respect of a decedent (IRD) are interests in qualified and other retirement plans.

Accordingly, when planning for the funding of the credit shelter trust, non-IRD property should be used. If only IRD property is available—for example, the family has a large portion of its assets in IRAs—two negative income tax concerns need to be reviewed. First, the funding of the credit shelter trust may accelerate the inherent income in the IRA (or other IRD) even though no payments are received from the IRA (or other IRD). This is more of a technical result than one based on logic. It will occur if the formula used to set up the credit shelter trust is what is known as a "pecuniary credit shelter formula." This is where the formula says that the credit shelter trust is to be "an amount" or a "sum equal to _____" as opposed to the residue of the estate or a fraction of the estate. Accordingly, if IRD is to be used to fund the credit shelter trust, the estate planning documents should be carefully reviewed (or drafted) so that there is not a pecuniary credit shelter formula.

"A credit shelter or QTIP trust may be the beneficiary of an IRA but rollovers then would not be permissible."

Second, having the trust designated as the beneficiary of an IRA may interfere with maximizing the income tax deferral usually associated with an IRA. For example, if the spouse is the designated beneficiary, then upon the first spouse's passing the surviving spouse can roll over the IRA into his or her own IRA and can achieve the income tax benefit of continued deferral. However, the results are less certain with regard to a trust designated as the beneficiary.

A credit shelter or QTIP trust may be the beneficiary of an IRA but rollovers then would not be permissible. In that situation, distributions could be over the life expectancy of the beneficiary or beneficiaries of the trust provided the trust meets four requirements:

1. The trust is valid under state law (or would be but for the fact there is no corpus);
2. The trust is irrevocable;
3. The beneficiaries are identifiable; and
4. A copy of the trust instrument is provided to the plan.

These requirements must be met by the later of the date on which the trust is named as a beneficiary *or* the RBD. If the IRA owner dies before the RBD, these requirements pose no significant problem and a trust designated as a beneficiary can be structured to allow continued deferral. (When the settlor dies prior to the RBD, the trust becomes irrevocable on the death of the settlor.)

If death occurs after the RBD, the irrevocability requirement is one that may pose a problem when the credit shelter trust or living trust is named as a beneficiary. These trusts are typically created under a revocable living trust or will and are *revocable* until the settlor dies. As a result, when a settlor dies *after* the RBD and has named one of these trusts as the beneficiary of an IRA, the IRA owner is considered *not* to have named a designated beneficiary. The entire account must be distributed within five years after death. There is no designated beneficiary to elect the exception to the five-year rule.

If the qualified plan is the only asset that is available to fund the credit shelter trust, then the practitioner might advise a wait-and-see approach. Under the wait-and-see approach, the spouse is the initial beneficiary and the credit shelter trust is named as the contingent

beneficiary. This allows the spouse, if the economics of an estate tax deferral justify a full funding of a credit shelter trust (and in almost all cases they will), to disclaim the spouse's interest in the plan. The contingent beneficiary, being the credit shelter trust, will then receive the proceeds.

Lifetime Gifting

Typically, when lifetime gifting is discussed, minimal attention is paid to the necessary reallocation of assets. But gifting, by definition, is the retitling of asset ownership to a third party.

Certain types of gifts involve the person who gives away the property—the "donor"—retaining no interest in the assets given. Other strategies allow the donor to retain an interest. In either type or strategy, a future creditor of the donor can receive only those assets the donor owns or receives. Accordingly, an asset in which the donor is divested of ownership is not likely to be reachable by a creditor absent fraudulent conveyance concerns.

In estate planning, the two most prevalent gifting strategies in which the donor retains no control are annual exclusion gifts and united credit gifts. The most prevalent retained interest strategies include grantor retained trusts funded with personal residences, grantor retained annuity trust, and retained interest and discount partnerships.

Annual Exclusion Gifts. Issues usually arise in December with a desire by the client to make annual exclusion gifts before the end of the year. The basics are generally well-known by both practitioners and clients. A donor can give up to $10,000 per donee per year without any gift tax implications. A few of the nuances and the underlying law supporting the annual exclusion are less well-known.

- *Total limits.* Legislation proposed in 1987 would limit the total number of annual exclusion gifts to $30,000. This legislation is dormant and not likely to be passed in the immediate future although this is an area which may be addressed in a future tax bill.
- *Joint husband and wife gifts.* Because of the $10,000 per donee allowance, husband and wife, as a unit, can give $20,000 per year per donee. To make these gifts, the assets do not necessarily have to be given by husband and wife from their separate accounts or from a joint account. Either husband or wife can give the full $20,000 per donee and avail themselves of the other spouse's maximum annual exclusion. However, to do so, a gift tax return must be filed by the following April 15 indicating the spouse's consent to a split gift election. The noncontributing spouse needs to actually sign the contributing spouse's gift tax return consenting to the split gift election. In certain circumstances,[1] the noncontributing spouse also will need to file a separate return, which must be signed by the contributing spouse.
- *Gifts in trust.* Gifts in trust usually invoke complexities with regard to qualifying for the annual exclusion. For annual exclusion gift tax purposes, the gift is not to the trust but rather to the donees of the trust. However, gifts in trust generally constitute gifts of future interests. Under Section 2503(b), gifts of future interests do not qualify for the annual exclusion and are therefore taxable gifts.

Three strategies are used to avoid taxation of gifts to trusts. One is the so-called *Crummey* power, which is a judicially made device (i.e., not statutory).[2] Based on prior case law,[3] *Crummey* holds that if a beneficiary of a trust has a current right to withdraw the assets gifted to the trust, such withdrawal right, in effect, turns a future interest into a present interest, and gifts to the trust subject to the right of withdrawal will qualify for the annual exclusion.

"An asset in which the donor is divested of ownership is not likely to be reachable by a creditor absent fraudulent conveyance concerns."

The case law and IRS rulings have defined what is necessary in order to have an effective withdrawal right. The more *Crummey* power holders—i.e., donees of the trust entitled to withdraw property from the trust—the greater the number of annual exclusions.

A second exception to the future interest concern is statutorily made, contained in IRC Section 2503(c). This section provides that gifts in trust for a minor beneficiary will qualify for the annual exclusion provided certain standards are followed. To comply with these standards, only one donee (the minor beneficiary) can be the beneficiary of each trust (or subtrust). A *Crummey* trust can be used for any beneficiary, even if they are not minors. A 2503(c) trust is limited to minors. A potential benefit (and detriment) with a 2503(c) trust is that the beneficiary does not have any withdrawal rights until the beneficiary is age 21, at which time he or she is entitled to receive all of the trust assets. In a *Crummey* trust, the withdrawal rights must be immediate. Is this really a meaningful difference? In one sense no, in that withdrawal rights in a *Crummey* trust can be exercised (or not exercised) by the guardian for the beneficiary even if the guardian is the donor making the gift. But perhaps this distinction makes *Crummey* trusts more palatable because the withdrawal rights are less likely to be exercised by a minor than a 21-year-old.

"A GRIT could be created and valued under pre-Section 2702 law if funded solely with a personal residence."

A third way to make gifts to a minor is through a custodial account. Custodial accounts, for income tax purposes, treat the property as the minor's own property. Custodial accounts qualify ab initio for the annual exclusion. The downside with the use of this technique is that property must be distributed to the minor at a certain age, usually 21, while with *Crummey* and 2503(c) trusts it is possible to retain the assets in trust indefinitely.

Unified Credit Gifts. An understanding of gift and estate tax mechanics is necessary to deal with the question of whether it is better to make gifts during life or at death. The sidebar provides a primer on the unification of the estate and gift tax.

Based on the unification of lifetime and at-death gifts, lifetime use of the unified credit is generally more effective then postmortem use. The following example illustrates this concept:

> *Example.* Donor *A* gratuitously transfers assets currently worth $600,000 to her daughter, *D*. Over the next 20 years, the value of these assets in *D*'s hands grows from $600,000 to $3,000,000. At the end of this 20-year period, *A* dies. At the time the gift is made, *A* is treated as having made a taxable gift of $600,000, which results in a gift tax owed of $192,800 (which may be entirely covered by the unified credit). At the time *A* dies, 20 years after the transfer, no additional estate or gift tax is owed as to the transfer of these assets.

In other words, *A* froze the value of the assets for transfer tax purposes at $600,000 by transferring the assets 20 years before she died. Comparatively, if *A* had not made the transfer at that time and instead held on to those assets, worth $3,000,000 at *A*'s passing, then *A* would have incurred an estate tax on $3,000,000.

Grantor Retained Income Trusts (GRITs). Since the passage of Chapter 14 in 1990, the qualified personal residence trust (QPRT) has become a topic of discussion among estate planners and in the press. Also in 1990, IRC Section 2702 was enacted to correct valuation abuses associated with GRITs. Section 2702 now applies in determining the gift tax value of a transfer of certain interests in trust to or for the benefit of a member of the transferor's family when the transferor retains an interest in the trust. Those valuation rules are not conducive to achieving estate and gift tax savings.

Importantly, the new valuation rules set forth in Section 2702 do not apply to certain transfers of interests in a personal residence.[4] A GRIT could be created and

valued under pre-Section 2702 law if funded solely with a personal residence. The grantor could retain both the right to use the trust property for a fixed term and the right to receive the trust property (or direct where the trust property goes) if the grantor died during that term. In that situation, these retained interests would be valued pursuant to Treasury Regulation Section 25.2512-5 and IRC Section 7520.

This exception to Section 2702 is narrow in scope; it applies only to personal residences. A "personal residence" must be either a principal residence of the term holder, as defined in IRC Section 1034, any other residence of the term holder, as intended by IRC Section 280A(d)(1) (but without regard to Section 280A(d)(2)), or an undivided fractional interest in either of these.[5]

Additions of cash to the trust are allowed, and the trust is permitted to hold cash but not in excess of the amount required for expenses already incurred or reasonably expected to be incurred within any six-month period, for improvements to the residence to be paid for in six months and, generally, for purchase of a personal residence within three months.[6] As a result, a personal residence subject to a mortgage can be contributed to a GRIT.[7]

An individual may not be the holder of a term interest in more than two personal residence trusts nor may a personal residence trust include household furnishings or other personal property. A personal residence must be used exclusively as the term holder's residence "when occupied by the term holder." However, the residence may be rented, provided the requirements of Section 280A(d)(1) are satisfied. Further, a personal residence may include appurtenant structures used for residential purposes and adjacent land "not in excess of that which is reasonably appropriate for residential purposes."

Without the application of the new Section 2702 valuation rules, both the retained use and reversionary (or power of appointment) interests will be ascribed a value for gift tax purposes, thereby reducing the value of the remainder interest in the GRIT. Because both of these interests are given value, the personal residence GRIT can achieve transfer tax savings.

> *Example.* Penelope is age 60 and is willing to relinquish the right to use her personal residence after 10 years. Accordingly, Penelope retains the right to use the residence for the next 10 years and a reversion to her estate if she should die prior to the expiration of 10 years. The value of the residence transferred to the GRIT is $500,000 and the Section 7520 rate for the month of the proposed transfer is 10.8%. Pursuant to the valuation rules set forth in Treasury Regulation Section 25.2512-5, the value of the remainder interest for each one dollar transferred to this type of GRIT is .2923, or for the $500,000 transferred, $146,150. Penelope would thus owe a gift tax on a gift equal to $146,150 even though the value of the residence was $500,000. By retaining the right to use the property for 10 years, Penelope would be treated as owning an interest valued at $353,850. At the end of the 10 years, the then value of the residence, which includes any increase in the residence's value experienced during that 10-year period, passes to the remainderpeople free of additional gift or estate tax cost.

The key points to understanding the QPRT are as follows:

- To make it work from a tax perspective, the grantor must outlive the retained interest term (and generally for these purposes this strategy works easier if there is only one grantor as opposed to both spouses).
- The tax savings must take into account the loss of a step-up in basis under Section 1041; a strategy can be worked out to achieve a buyback of the residence without capital gains in order to take advantage of this basis step-up. For that strategy to work, the grantor must have sufficient cash.

"A personal residence must be used exclusively as the term holder's residence 'when occupied by the term holder.'"

- At some point after the retained interest term expires, the property will be owned by one other than husband or wife (this can either be the trustee of a trust or the adult children outright). Use of the residence at this point must be with the permission of the then owners or, if use is going to be on a continual basis, rent payments must be made.
- For this strategy to be implemented, there are fairly complicated documents and calculations to be made for the client.

Understanding the Unification of Estate and Gift Taxes

If an individual makes a taxable gift during lifetime, the value of this gift for gift tax purposes is the value on the date the gift is made. If an individual makes a gift at death, the value of this gift for estate tax purposes is the value at the time of death (or alternate valuation date). Importantly, regardless of whether made during life or at death, gifts are subject to the same transfer tax rates. Upon the individual's death, the amount of all taxable gifts will be added to that individual's taxable estate for purposes of "grossing up" the taxable estate—that is, pushing the estate into a higher tax bracket.[8] However, the donor will be entitled to subtract from this grossed up estate the amount of gift tax payable on these "adjusted taxable gifts" included in the tax base when the individual's estate tax is calculated.[9]

For example, when an individual who gratuitously transfers $1,000,000 during life dies with $1,000,000 more in her gross estate, that additional $1,000,000 is not taxed at the lower 18% through 39% brackets applicable to the first $1,000,000 in taxable transfers. Rather, it is taxed at the 41% through 45% rates. After the estate tax has been calculated, that individual is allowed a credit for the amount of gift tax that "would have been payable" with respect to gifts made by the decedent after December 31, 1976.[10]

Therefore, the total transfer taxes paid (gift tax plus estate tax) by the individual who transfers $1,000,000 the day before she dies, and dies with an additional $1,000,000 in her estate, will be the same as the total transfer taxes (just estate taxes) paid by the individual who dies with $2,000,000 in her gross estate.

The IRC accomplishes this by equating the amount with respect to which the tentative tax is to be computed to the taxable estate (i.e., the property included in an individual's estate for tax purposes minus allowable deductions) plus the amount of adjusted taxable /gifts.[11] Adjusted taxable gifts are taxable gifts made after 1976, other than gifts which are includible in the gross estate of the decedent. Thus, although the decedent in this example died with a gross estate of only $1,000,000, all taxable gifts that she made during her lifetime (other than gifts that are included in the gross estate) are added to the gross estate for purposes of determining how much estate tax will be paid. Therefore, the person who transfers $1,000,000 during her life, and thereafter dies within three years with a gross estate of $1,000,000, will compute her estate tax based on the $2,000,000 amount (the gross estate plus adjusted taxable gifts) and pay the same amount of transfer taxes as a person who waits until death to give away the entire $2,000,000. ■

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[1]See Treas. Reg. 25.2513.
[2]DC Crummey v. CIR, CA-9, 68-2 USTC ¶ 12,541, 397 F2d 82 (1968).
[3]See Kierckhefer v. CIR, CA-7, 51-1 USTC ¶ 10,812, 189 F2d 118 (1951).
[4]IRC § 2001(b)(1)(A).
[5]IRC § 2001(b)(1)(B).
[6]IRC § 2001(b)(2).
[7]IRC § 2001(b)(1).
[8]IRC § 2701(a)(3)(A)(ii); Treas. Reg. § 25.2702-5(a).
[9]Treas. Reg. §§ 25.2702-5(b)(2), 25.2702-5(c)(2). See also PLR 9151046 (form of ownership of the residence in a cooperative housing corporation does not preclude qualification as a personal residence).
[10]Treas. Reg. § 25.20702-5(c)(5)(ii)(A).
[11]See Treas. Reg. §25.2702-5(c)(2)(ii).