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By Michael S. Arlein & William H. Frazier

The Net, Net Gift

It's an often overlooked technique that will reduce gift tax on lifetime transfers

Practitioners are well-aware that lifetime gifts are more tax-efficient than transfers at death. But during the past seven years there's been a possibility that the estate tax might be permanently repealed, so it's been out of vogue for practitioners to advise clients to make taxable gifts that exceed the lifetime gift exemption and require tax payments. Now that permanent repeal of the estate tax seems ever more unlikely, taxable gifts are making a comeback.

Donors, especially older parents who wish to make substantial lifetime transfers to their children, can make those transfers using a technique that reduces the gift tax payable in connection with the transfer. This technique, which is a variation on a traditional net gift, requires the donee to assume liability not only for the gift tax attributable to the gift, but also for the contingent estate tax liability that arises under Internal Revenue Code Section 2035(b) if the donor dies within three years of making the gift. We call this technique a "net, net gift."

The Traditional Net Gift

Under IRC Section 2502(c), a donor is liable for payment of gift tax. But, if a gift is made subject to the condition that the donee must pay the gift tax liability, the gift is a so-called net gift, meaning the amount of the gift is determined by deducting the gift tax attributable to the transferred property from the value of the transferred property. Determining the amount of the net gift and the gift tax requires a circular computation, because these two variables are mutually dependent.

In Revenue Ruling 75-72, 1975-1 C.B. 310, the Internal Revenue Service provided a simple formula for performing the calculation. The first step is to calculate the tentative tax on the transferred property, which is the gift tax that would be due if the gift were not a net gift. The tentative tax then is divided by the sum of one plus the rate of tax. The resulting amount is the true tax, which is the actual amount of tax due.[1] (See "Calculating a Net Gift," p. 3.)

Traditionally, a net gift does not offer any tax savings. The gift tax is the same whether the donor (1) makes a gift to the donee of the net amount and pays the gift tax herself, or (2) transfers the gross amount to the donee and requires the donee to pay the tax.

The Net, Net Gift

In a traditional net gift, the donee assumes the gift tax liability arising in connection with the gift. But if the donor dies within three years of making the gift, a taxable gift also gives rise to a contingent estate tax liability under IRC Section 2035(b), which adds back to the donor's gross estate any gift tax paid. What if the


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donee assumes not only the gift tax liability, but also this contingent estate tax liability?

In *McCord v. Commissioner*, the Tax Court and the U.S. Court of Appeals for the Fifth Circuit considered just this question. Charles T. and Mary S. McCord established a family limited partnership, then made gifts of limited partnership interests to their children. The gifts were structured as net gifts, with the children assuming liability for all federal and state transfer taxes resulting from these gifts, including any estate tax liability arising under Section 2035(b) if either of the parents were to die within three years of making the gifts. The value of the contingent estate tax liability was determined by an appraiser, and the gifts were reduced accordingly.[2]

When structuring a net gift, prepare a "net gift agreement" that memorializes the donee's assumption of liability for taxes in connection with the gift.

The Tax Court[3] rejected the taxpayer's argument that the Section 2035(b) liability should be taken into account when valuing the net gifts, finding this liability too speculative. The court cited two prior cases— *Murray v. United States*[4] and *Armstrong v. United States*,[5] for the proposition that "in advance of the death of a person, no recognized method exists for approximating the burden of the estate tax with a sufficient degree of certitude to be effective for Federal gift tax purposes."

The Tax Court acknowledged that neither of these cases was directly on point. Indeed, there are significant differences between the facts in *Murray* and *Armstrong* on the one hand, and *McCord* on the other.

In *Murray,* unlike *McCord*, the donees' liability for estate taxes was not limited to just the Section 2035(b) liability. The donor made gifts to trusts and charged the trusts with payment of all estate taxes due at the donor's death. The donor died shortly after making the gifts, and the estate taxes due with respect to his estate completely wiped out any value in the trusts. The donor's personal representative claimed that the value of the gifts to the trusts should be reduced by the estate tax liability, in effect reducing the gifts to zero. The U.S. Court of Claims rejected this argument on the grounds that, at the time of the gift, the donor's overall estate tax obligation was unknown and not susceptible to valuation, given that the amount due depended on the size of his estate and the tax rates in effect at his death.

In *Armstrong*, the donees' liability for estate tax arose by statute and not by agreement. The donor died within three years of making gifts of stock in a privately held company to his children. The donor's estate was insolvent; consequently, pursuant to principles of transferee liability, his children were liable for the estate tax due under Section 2035(b). The children argued that they had entered into the transaction with the donor knowing that he had not retained sufficient assets in his estate to cover the Section 2035(b) liability and that, by implication, he had made payment of the liability a condition of the gifts. The U.S. Court of Appeals for the Fourth Circuit rejected the children's argument and disallowed any deduction for the Section 2035(b) liability, finding the liability too speculative and noting a lack of evidence that the children had agreed to assume the Section 2035(b) liability as a condition of the gift.

In *McCord,* the Tax Court focused on the fact that it was impossible to determine the Section 2035(b) liability on the date of the gift, because estate tax rates and exemptions may change or the tax may be repealed within the subsequent three years. "For that reason alone," the Tax Court stated, "we conclude that petitioners are not entitled to treat the mortality-adjusted present values as sale proceeds (consideration received) for purposes of determining the amounts of their respective gifts at issue."[6] The Tax Court also cited the "estate depletion" theory of the gift tax, which states that the benefit to the donor in money or money's worth rather than the detriment to the donee is what determines whether any consideration provided by the donee should be taken into account in offsetting a gift. In that regard, the court found that the donees' payment of the Section 2035(b) liability did not offer the donor any tangible benefit.

The Tax Court's decision in *McCord* was appealed to the Fifth Circuit,[7] which overturned the ruling on the Section 2035(b) issue. In its decision, the Fifth Circuit analyzed whether the Section 2035(b) liability was "too speculative" as a question of whether a willing buyer would take it into consideration. The court considered a number of factors, including whether an estate tax would be due upon the donors' death and what estate tax rate would apply, what discount rate should be applied in determining the present value of the Section 2035(b) liability and what discount should be applied for determining the actuarial likelihood that a donor would die within three years.

The Fifth Circuit found that a willing buyer would apply the estate tax rates in effect when the gift was made. Rejecting the Tax Court's argument that potential future changes in estate tax laws must be considered, the Fifth Circuit cited income tax cases holding that potential future changes in income tax laws are not contingencies that a willing buyer would take into consideration. Likewise, the Fifth Circuit found that the appraiser appropriately used the IRC Section 7520 rate as a discount factor and Table 80CNSMT to determine life expectancy. The appellate court said, "[W]e are convinced as a matter of law that a willing buyer would insist on the willing seller's recognition that—like the possibility that the applicable tax law, tax rates, interest rates, and actuarially determined life expectances of the Taxpayer could change or be eliminated in the ensuing three years—the effect of the three-year exposure to § 2035 estate taxes was sufficiently determinable as of the date of the gifts to be taken into account."[8]

The Fifth Circuit's opinion provides the cornerstone for the net, net gift. While we believe that the Fifth Circuit opinion in *McCord* is well-reasoned, practitioners should obviously be mindful of the contrary authority when deciding whether to recommend a net, net gift to a client.

Valuing the 2035(b) Liability

In *McCord,* the Fifth Circuit approached the question of how to value the IRC Section 2035(b) liability in accordance with the familiar willing buyer/willing seller test. Under this test, the "seller" of the liability must pay the "buyer" fair market value of the liability to step into the seller's shoes and assume the liability. Based upon market rates of return, risk factors and the financial characteristics of the liability, how much should the

Calculating a Net Gift

The Internal Revenue Service has provided the formula. See how it works. Note that it provides no tax savings

Let's assume that the donor is an 85-year-old resident of New York who transferred $15 million to her son, the donee, on Dec. 31, 2007. The donor transferred this amount pursuant to a net gift arrangement whereby the donee agreed to assume liability for all federal gift tax due with respect to the gift. For ease of computation, we will assume that the donor has not made any prior taxable gifts and we will disregard the annual gift exclusion.

Gross Transfer to Donee	$15,000,000
Tax on Gross Transfer	6,630,800
Less: Available Unified Credit	(345,800)
Tentative Gift Tax	6,285,000
Tentative Gift Tax	6,285,000
Divided By: 1+ Rate of Tax	1.45
True Tax	4,334,483
Gross Transfer to Donee	15,000,000
Less: True Tax	(4,334,483)
Net Gift to Donee	**$10,665,517**

BOTTOM LINE: NO TAX SAVINGS

Donor could (1) make a gift of $10,665,517 and pay gift tax of $4,334,483 or (2) transfer $15 million to donee as a net gift. Either way, donee will receive $10,665,517 and the gift tax will be $4,334,483.

— Michael S. Arlein and William H. Frazier

seller expect to pay a buyer (assumer) of the liability? There are four steps to make this determination:

(1) Determine annual mortality rates—In valuing a liability, what matters most is the interest rate of the debt, the term and the risk of collection. But the Section 2035(b) liability is conditional or speculative, because it may never be an actuality. What the willing buyer is essentially doing is providing a guarantee or insurance. If the donor dies within three years, the buyer will step in and honor the obligation to pay the estate tax. Thus, the first step in valuing the liability is to calculate the probability that the donor will die in each of the three years following the gift. Use the actuarial life expectancy factors contained in the Treasury Regulations under IRC Section 2031.

The Fifth Circuit's well-reasoned opinion in *McCord* provides the cornerstone for the net, net gift—but be mindful of contrary authority.

(2) Determine present value factors—Table 80 of the Treasury regulations under IRC Section 2031 requires use of an interest-rate factor to determine the present value of a future liability. In *McCord,* the appraiser used the IRC Section 7520 rate in effect on the date the gift was made as the factor for discounting the potential future liability to a present value. The court said that Section 7520 mandated the use of that factor, but Section 7520 deals only with valuing term interests and does not directly apply to discounting potential future liabilities. Nonetheless, the IRS did not dispute the use of the Section 7520 rate as the discount rate in *McCord,* and its use seems reasonable for that purpose.[9]

(3) Determine the applicable tax rate—A deduction should be available for both federal and state estate tax assumed by the donee.[10] Consistent with the Fifth Circuit's opinion, the tax rates in effect at the time the gift was made should be taken into account. Under current law, the federal estate tax will be repealed in 2010 and reinstated in 2011 at rates in effect prior to the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). As unlikely as it seems that Congress will allow these provisions to take effect, the *McCord* case suggests that they should be taken into account in valuing the Section 2035(b) liability—until they are changed.[11]

Obviously, at the time the gift is made it's impossible to foresee what the exact size of the donor's gross estate will be when she dies. But it is reasonable to assume that, at the very least, federal estate tax will be computed on the sum of (a) the donor's "adjusted taxable gifts" and (b) the gift tax included in the donor's gross estate under Section 2035(b) if she dies within three years of the gift. Consequently, if a net, net gift arrangement involves a large enough gift—that is, a gift that exceeds the applicable exclusion amount under IRC Section 2010—then for purposes of valuing the IRC Section 2035(b) liability, it should be reasonable to assume that the gift tax included in the donor's gross estate will be taxed at the highest marginal estate tax rate (currently 45 percent), without any offset for the unified credit.[12]

(4) Perform the circular computation—The final step is to calculate the true tax taking into account the deduction for the Section 2035(b) liability. This calculation will reduce the true tax which, in turn, necessitates a recalculation of the Section 2035(b) liability which, in turn, necessitates a recalculation of the true tax, and so on. This circular calculation ultimately results in an equilibrium. Fortunately, financial spreadsheet software contains functions which make this calculation instantaneous. (See "Valuing the IRC Section 2035(b) Liability," next page.)

Tax Advantages

Let's assume that an 85-year-old has $15 million with

Valuing the IRC Section 2035(b) Liability

It takes four steps

Let's assume that the donor is an 85-year-old resident of New York who transferred $15 million to her son, the donee, on Dec. 31, 2007. The donor transferred this amount pursuant to a net gift arrangement whereby the donee agreed to assume liability for all federal gift tax due with respect to the gift—as well as the Internal Revenue Code Section 2035(b) liability. For ease of computation, we'll assume that the donor has not made any prior taxable gifts and we'll disregard the annual gift exclusion.

How do we value the IRC Section 2035(b) liability for purposes of determining the net gift?

STEP 1: DETERMINE ANNUAL MORTALITY RATES.

Here's how to calculate the probability that the donor will die in each of the three years following the gift:

Year	Age	X Factor [a]	X+n Factor [b]	Annual Mortality Rate 1 - ([b]/[a])
1	86	28687	25638	10.63%
2	87	25638	22658	11.62%
3	88	22658	19783	12.69%

Note: The "X factor" and "X+n factor" are found in Life Table 90CM under Treasury Regulations Section 20.2031-7(d)(7), which is applicable to valuation dates after April 30, 1999.

STEP 2: DETERMINE THE PRESENT VALUE FACTORS.

Here's how to calculate the present value factors for each of the three years following the gift in our example, based on the IRC Section 7520 rate for December 2007:

Year [n]	Section 7520 Rate [r]	PV Factor [=1/(1+r)^n]
1	5.0%	0.95238095
2	5.0%	0.90702948
3	5.0%	0.86383760

STEP 3: DETERMINE THE APPLICABLE TAX RATE.

For ease of computation, let's disregard the possibility that the estate tax actually will be repealed in 2010 and assume that a combined 53.8 percent federal and state estate tax rate is applicable in each of the three years following the gift.

STEP 4: PERFORM THE CIRCULAR COMPUTATION.

The final step is to calculate the true tax taking into account the deduction for the IRC Section 2035(b) liability. This calculation will reduce the true tax which, in turn, necessitates a recalculation of the IRC Section 2035(b) liability which, in turn, necessitates a recalculation of the true tax, and so on. This circular calculation ultimately results in an equilibrium:

Transfer to Donee	$15,000,000
Less: IRC Section 2035(b) Liability	(700,515)
Total	**14,299,485**
Tax on Gross Transfer	6,315,568
Less: Available Unified Credit	(345,800)
Tentative Gift Tax	**5,969,768**
Tentative Gift Tax	5,969,768
Divided By: 1+ Rate of Tax	1.45
True Gift Tax	**4,117,082**
Gross Transfer to Donee	15,000,000
Less: True Gift Tax	(4,117,082)
Less: IRC Section 2035(b) Liability	(700,515)
Net Gift to Donee	**10,182,403**

True Gift Tax [a]	Estate Tax Rate [b]	Estate Tax [a x b = c]	Annual Mortality [d]	PV Factor [e]	IRC Section 2035 Liability [= c x d x e]
$4,117,082	53.8%	$2,214,990	10.63%	0.95238095	$224,210
4,117,082	53.8	2,214,990	11.62	0.90702948	$233,521
4,117,082	53.8	2,214,990	12.69	0.86383760	242,784
				Total	**$700,515**

—Michael S. Arlein and William H. Frazier

Sample **Net Gift Agreement**

Make sure everything is laid out clearly. Like this:

This Net Gift Agreement (the "Agreement") is made and entered into as of the _____day of _____, 200_ (the "Effective Date"), by and between _____ ("Donor") and _____ ("Donee").

Recitals

A. Donor wishes to make a gift of _____($_____) (the "Gift Property") to Donee.

B. In consideration of the gift, Donee desires to assume Donor's federal gift tax liability related to the Gift Property.

C. In consideration of the gift, Donee also desires to assume the federal and state estate tax liability of the executor of the estate of Donor (the "Executor" and the "Estate", respectively) related to the Gift Property should Donor die within three (3) years after the Effective Date.

AGREEMENT

NOW THEREFORE, in consideration of the foregoing and of the following mutual promises and other good and valuable consideration, the parties agree as follows:

1. TRANSFER. Not later than thirty (30) days after the Effective Date, Donor hereby agrees to transfer to Donee the Gift Property. Donor hereby agrees to undertake promptly all actions deemed necessary to give full force and legal effect to the transfer. For all purposes of this Agreement, Donor's transfer to Donee of the Gift Property shall be treated as being made as of the Effective Date.

2. FEDERAL GIFT TAX.

a. Assumption of Federal Gift Tax Liability. Donee hereby agrees to assume and pay the Gift Tax Liability to Donor. The Gift Tax Liability is defined as all federal gift tax liability assessed pursuant to Chapter 12 of the Internal Revenue Code of 1986, as amended (the "Code"), for Donor's taxable year ending December 31, 200_, that is directly attributable to Donor's transfer of the Gift Property, including all penalties and interest which accrue upon such gift tax liability except such penalties and interest that are directly attributable to actions or delays committed by Donor. For purposes of determining and allocating the Gift Tax Liability, (i) the value of all taxable gifts shall be as finally determined for federal gift tax purposes, (ii) the only gifts taken into account in the calculation shall be Donor's transfer of the Gift Property to Donee and Donor's prior gifts, and (iii) Donee shall bear one hundred percent (100%) of the Gift Tax Liability.

b. Notification of Gift Tax Liability. Donor promptly and timely shall notify Donee of the amount of the Gift Tax Liability and of any notices received from any taxing authority relating to the Gift Tax Liability.

c. Preparation and Filing of Gift Tax Return. Donor shall assume full responsibility for all matters relating to the preparation of Donor's federal gift tax return for Donor's taxable year ending December 31, 200_ (the "Gift Tax Return"). Donor shall file the Gift Tax Return with the proper taxing authorities on or before the Gift Tax Return due date, and shall deliver to Donee a full and complete copy of the Gift Tax Return, together with proof of filing with the proper taxing authorities.

3. FEDERAL AND STATE ESTATE TAX.

a. Assumption of Federal and State Estate Tax Liability. Donee hereby agrees to assume and pay the Estate Tax Liability to the Executor. The Estate Tax Liability is defined as all additional federal and state estate tax liability assessed pursuant to Code Section 2035(b) (i) if Donor does not survive for three (3) years following the Effective Date and (ii) that is directly attributable to Donor's transfer of the Gift Property, including all penalties and interest which accrue upon such estate tax liability except such penalties and interest that are directly attributable to actions or delays committed by the Executor. For purposes of determining and allocating the Estate Tax Liability, (i) the value of all additional tax shall be as finally determined for federal estate tax purposes, (ii) the only gift tax taken into account in the calculation shall be the gift tax on Donor's transfer of the Gift Property to Donee, and (iii) the Donee shall bear one hundred percent (100%) of the Estate Tax Liability.

b. Notification of Estate Tax Liability. The Executor promptly and timely shall notify Donee of the amount of the Estate Tax Liability and of any notices received from any taxing authority relating to the Estate Tax Liability.

c. Payment of Estate Tax Liability.

i. Donee's Payment to Executor. Donee shall deliver to the Executor the Estate Tax Liability under this Agreement, by certified check made payable to the United States Treasury, no later than thirty (30) days before the due date for payment of the Estate Tax Liability, or, if later, as soon thereafter as the Executor notifies Donee of the amount of the Estate Tax Liability.

ii. Executor's Payment to Taxing Authorities. The Executor shall assume full responsibility for the payment of the Estate Tax Liability to the proper taxing authorities on or before the due date for payment of the Estate Tax Liability.

d. Preparation and Filing of Estate Tax Returns. The Executor shall assume full responsibility for all matters relating to the preparation of the Estate's federal and state estate tax returns ("Estate Tax Returns"). The Executor shall file the Estate Tax Returns with the proper taxing authorities on or before the Estate Tax Returns due date, and shall deliver to Donee full and complete copies of the Estate Tax Returns, together with proof of filing with the proper taxing authorities.

4. OTHER PROVISIONS.

a. Binding Agreement. This Agreement, all statements contained herein, or in any instrument delivered pursuant to this Agreement, and all representations, agreements and covenants made hereunder, shall survive the termination, death or incapacity of any party to this Agreement. All of the terms of this Agreement and the rights and obligations conferred under this Agreement shall be binding upon, shall inure to the benefit of and shall be enforceable by, the respective legal representatives, successors and assigns of the parties, including without limitation the executor of the parties' respective estates.

b. Governing Law. This Agreement shall be governed by the internal laws of the State of _____.

c. Entire Agreement. This Agreement constitutes the full and entire understanding and agreement among the parties with regard to the transactions contemplated hereby and supersedes and cancels all prior agreements, arrangements and understandings relating to the subject matter hereof.

THE PARTIES HAVE SIGNED THIS AGREEMENT AS OF THE EFFECTIVE DATE.

DONOR: _____

DONEE: _____

—Agreement sample provided by Michael S. Arlein and William H. Frazier

which to make a gift to her son and pay the resulting gift tax. If she makes a traditional gift or net gift, she will be able to transfer $10,665,517 to her son and there will be $4,334,483 of gift tax due. Alternatively, if she structures the transfer as a net, net gift, she will be able to transfer $10,882,918 to her son and there will be $4,117,082 of gift tax due, a tax savings of $217,401. (See "Gift Tax Savings," this page.) Practitioners should bear in mind that this is additional tax savings over and above the usual tax savings achieved when property is transferred by lifetime gift rather than at death.[13] For comparison, if the donor had not made a gift and had instead bequeathed $15 million to her son at her death, the estate tax due would be $7,289,200, assuming a 53.8 percent combined federal and state estate tax rate and a $2 million applicable exclusion, which is nearly twice the gift tax due in our example.

In addition to gift tax savings, there's also a potential secondary tax benefit of structuring a gift as a net, net gift. If the donor dies within three years of making the gift, the amount of gift tax includible in the donor's estate under IRC Section 2035(b) is reduced, reducing estate taxes. If the 85-year-old in our example were to die within three years of making the gift to her son, the net, net gift technique would result in estate tax savings of $116,962. (See "Estate Tax Savings," this page.)

It's important to note that under most circumstances the donee's assumption of the IRC Section 2035(b) liability does not actually increase the donee's tax exposure. If the donee is the residuary beneficiary of the donor's estate and the donor's will directs that all estate taxes be paid out of the residue, the Section 2035(b) liability would be borne by donee regardless of his assumption of the liability pursuant to the net gift agreement. Likewise, in the absence of a direction under the donor's will, most state tax apportionment statutes would allocate the Section 2035(b) liability to the donee.[14]

The Net Gift Agreement

For a transfer to qualify as a net gift, the donor must show that the donee's payment of the tax is a condition

Gift Tax Savings

The net, net gift technique reduces the gift tax and increases the amount passing to the donee

Based on our example of a donor who has $15 million with which to make a gift and pay gift tax, here's the advantage of structuring the arrangement as a net, net gift:

	Traditional Gift	Traditional Net Gift	Net, Net Gift
Received By Donee	$10,665,517	$10,665,517	$10,882,918
Reported As Gift	10,665,517	10,665,517	10,182,403
Gift Tax Due	4,334,483	4,334,483	4,117,082
Gift Tax Savings			$217,401

—Michael S. Arlein and William H. Frazier

Estate Tax Savings

The net, net gift technique results in tax savings—even if the donor dies within three years of making the gift

Based on our example of a donor who has $15 million with which to make a gift and pay gift tax, here is a comparison of the estate tax due on the gift tax includible in the donor's gross estate, assuming a combined federal and state estate tax rate of 53.8 percent:

	Traditional Gift	Traditional Net Gift	Net, Net Gift
Gift Tax Includible	$4,334,483	$4,334,483	$4,117,082
Estate Tax Due	2,331,952	2,331,952	2,214,990
Potential Estate Tax Savings			$116,962

—Michael S. Arlein and William H. Frazier

of the transfer. A conditional or speculative obligation to pay the gift tax is not sufficient to qualify a transaction as a net gift.[15] Thus, when structuring a net gift, practitioners must be sure to prepare a written contract between the donor and the donee—a so-called "net gift agreement"—that memorializes the donee's assumption of liability for taxes in connection with the gift.

The net gift agreement should clearly set forth exactly which liabilities the donee is assuming, such as federal and state gift taxes, estate taxes and penalties and interest. The agreement also should include mechanisms for payment of the tax and for preparation and review of tax returns. If possible, this agreement also should specify remedies for breach. (See "Sample Net Gift Agreement," p. 6.)

It also may be a good idea for the donor and the donee to retain separate counsel to advise on the net gift agreement, particularly when the tax liabilities are substantial. Practitioners representing the donee in a net gift transaction must be particularly careful to analyze the liabilities their clients are assuming.

For Your Toolbox

The net, net gift presents an opportunity for tax savings, particularly for older clients who wish to make large gifts to their children. While it's not entirely clear that the IRS won't challenge a net, net gift, *McCord* offers a strong endorsement of the principles on which the technique is based. Because repeal of the estate tax looks highly unlikely, practitioners should keep the net, net gift option in mind when recommending taxable gifts to their clients. TE

Endnotes

1. Revenue Ruling 75-72 also explains how to calculate the true tax in a situation where the gift is subject to multiple tax brackets, which is more complicated.
2. William H. Frazier, ASA, a co-author of this article, served as the appraiser for the taxpayer.
3. *McCord v. Commissioner,* 120 T.C. 358 (2003).
4. *Murray v. United States,* 687 F.2d 386 (Ct. Cl. 1982).
5. *Armstrong v. United States,* 277 F.3d 490 (4th Cir. 2002).
6. *McCord v. Commissioner, supra* note 3 at 402.
7. *Succession of McCord v. Comm'r,* 461 F.3d 614 (5th Cir. 2006).
8. *Ibid* at 631.
9. *See* discussion in Steve R. Akers, "*McCord v. Commissioner:* Fifth Circuit Upholds Defined Value Gift and Allows Offsetting Gift Value by Contingent Assumed Liability for Estate Tax if Donor Dies Within Three Years" (Bessemer Trust, August, 2006).
10. In Rev. Rul. 80-111, 1980-1 C.B. 208, state gift taxes payable by the donee under state law were taken into account in valuing a net gift. There does not appear to be any reason why state estate taxes assumed by the donee should not similarly be taken into account.
11. The current uncertainties regarding estate tax rates and exemptions in 2010 and beyond add an additional element of "speculation" to calculation of the IRC Section 2035(b) liability. However, this is likely a short-term concern, because it's widely anticipated that Congress will address the issue of estate tax rates and exemptions after the 2008 election.
12. In the case of state estate taxes computed with reference to the donor's "adjusted taxable estate" under the former state death tax credit regime of IRC Section 2011, the analysis may be more complicated because the "adjusted taxable estate" does not include adjusted taxable gifts. Thus, the appropriate assumption to make concerning what estate tax bracket to apply under IRC Section 2011 will depend on the amount of gift tax that would be included in the donor's gross estate under IRC Section 2035(b) if the donor dies within three years of the gift.
13. This tax savings is achieved because the estate tax is "tax inclusive," meaning that the tax is applied not only to the amount received by an heir, but also to the amount used by the estate to pay the resulting estate tax; whereas the gift tax is "tax exclusive," meaning that the gift tax is applied only to the amount actually received by the donee, but not to the amount used to pay the resulting gift tax. There is additional savings associated with gifts versus bequests in states, such as New York, where there is no state gift tax but there is a state estate tax.
14. For example, the New York tax apportionment statute, Section 2-1.8 of the New York Estates Powers and Trusts Law, provides that any estate tax attributable to property included in a decedent's gross estate "shall be equitably apportioned among the persons interested in the gross tax estate, whether residents or non-residents of this state, to whom such property is disposed of or to whom any benefit therein accrues."
15. *See* Revenue Ruling 75-72, 1975-1 C.B. 310; *Armstrong v. United States,* 277 F.3d 490 (4th Cir. 2002).