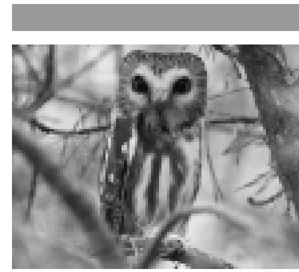

2000 Income Tax School

# GIFTING

Making a gift has not only gift tax consequences but also estate tax, generation skipping tax, and income tax consequences. Any planning for gifts must include an analysis of the effect of all of these taxes on the planned giving.

For purposes of this discussion, the term "**transfer tax**" will be used to refer to the combination of the federal gift tax, federal estate tax, and federal generation-skipping tax rules. "**Taxable gift**" means the amount of the gift after all allowable deductions and exclusions such as the annual exclusion, the medical and education exclusion, the marital deduction, and the charitable deduction have been subtracted.

## ESTATE AND GIFT TAXES

Since 1976, the federal estate and gift taxes have been "unified." In theory, that means that making a gift during one's lifetime has the same transfer tax effect as making the identical transfer at the time of death. The purpose of treating a gift the same as a transfer at death is to eliminate the incentive to avoid the estate tax by making transfers during the donor's life. In practice, the gift tax on a transfer during life is not exactly the same as the estate tax on the same transfer at death, but the effect is similiar enough to substantially reduce the incentive to make a lifetime gift as a means of avoiding the estate tax on a transfer at death.

**Practitioner Note.** There can be a significant difference between the basis of an asset transferred by gift during the donor's lifetime and an asset transferred at death. In many cases, a transfer at death will give the recipient a higher basis, which means less income tax is paid when the asset is sold. These rules are discussed later in this chapter under income taxes.

### SIMILARITIES

The similarities between the federal estate tax and the federal gift tax include the applicable exclusion amount (the amount that can be transferred before any taxes have to be paid) and the rates that are applied to calculate the transfer tax.

**Applicable Exclusion Amount.** The applicable exclusion amount is the amount that each individual taxpayer can transfer tax free under the gift and estate tax rules. For 2000, the amount is set at $675,000. Under current law, it will increase to $1,000,000 in 2006, according to the following schedule:

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| Year | Applicable Exclusion Amount |
|---|---|
| 2000 and 2001 | $ 675,000 |
| 2002 and 2003 | $ 700,000 |
| 2004 | $ 850,000 |
| 2005 | $ 950,000 |
| 2006 and after | $1,000,000 |



The estate and gift tax rules are "unified" with regard to the applicable exclusion amount in that any part of the exclusion amount that is used up during a taxpayer's lifetime is not available for calculating estate taxes on transfers on the death of the taxpayer.

**Example 1.** Prior to 2000, Abner Hanes had made no taxable gifts. In 2000, he gave $100,000 of taxable gifts. He does not have to pay any federal gift taxes on that gift since it is less than the $675,000 applicable exclusion amount available in 2000. He is required to file a gift tax return by April 16, 2001.

In 2004, Abner dies leaving a federal taxable estate of $825,000. Since Abner has "used up" $100,000 of his applicable exclusion amount, his estate must pay taxes on the amount by which his taxable estate exceeds his remaining applicable exclusion amount. In 2004, he has $850,000 – $100,000 = $750,000 remaining applicable exclusion amount. Therefore, his estate will pay taxes on $825,000 – $750,000 = $75,000.

**Planning.** A transfer of the same *amount* during life and at death has the same effect on the exclusion amount. However, transferring the same *asset* during life and at death will **not** have the same effect on the exclusion amount. The asset may change in value between the time of the lifetime gift and the date of death. Therefore, the amount of the exclusion that is used up is different. If the value of the asset goes **up** after the gift, the increase in value does **not** use up any of the exclusion amount. If the value goes **down** after the gift, the decrease in value used up some of the exclusion amount that would not be used up if the transfer had been made at the time of death.

**Example 2.** Pam Olive owns a tract of land that is worth $100,000 on August 1, 2000. If Pam has used up her annual exclusion for 2000 (discussed below) and gives the tract to her son on August 1, 2000, she will use up $100,000 of her exclusion amount. If the tract increases in value to $500,000 by the date of her death in 2010, the amount of the exclusion amount used up by the earlier gift is still only $100,000. By contrast, if she waited to transfer the tract at her death, the transfer would use up $500,000 of her exclusion amount.

**Example 3.** Assume the same facts as Example 2 except that the tract goes down in value to $75,000 by the date of Pam's death in 2010. The gift still used up $100,000 of her exclusion amount.

**Observation**. The exclusion amount gives the taxpayer a credit against transfer taxes that can be used at any time during life or at death. Since the credit does not increase if it is not used, it is like owning an asset that does not earn income and does not increase in value. Using the credit to offset taxes on the gift of an asset that is increasing in value is a way of converting the credit into an asset that does increase in value.



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### Transfer Tax Rates

The transfer tax rates are graduated so that transfers are taxed at a higher rate as the amount that is transferred goes up. See Table A–Unified Rate Schedule in the appendix to this chapter. For purposes of applying these rates, taxable gifts made after 1976 and the amount in the taxpayer's taxable estate at death are accumulated. Therefore, a taxable gift pushes all subsequent gifts and the amount that is in the taxpayer's taxable estate into higher tax brackets.

**Example 4.** Mike Rowave made a taxable gift of $1,250,000 in 2000. The next dollar he transfers, either by taxable gift or at the time of death, will be taxed at a rate of 43%.

**Planning.** The same tax rates apply to transfers made during life as transfers at death. However, it is not true that the same after-tax consequences will not result from a transfer during life as the same transfer at death. That is because the gift taxes paid on a lifetime gift will reduce the donor's estate and therefore his or her estate taxes.

**Example 5.** Assume Mike Rowave from Example 4 has an estate worth $10,000,000 when he makes his $1,250,000 taxable gift in 2000. The gift reduces his estate not only by the $1,250,000 gift, but also by the $227,750 gift tax on that gift. Therefore, if Mike dies without any changes in the value of his estate, his estate will pay taxes on $10,000,000 – $1,250,000 – $227,750 = $8,522,250. The total of transfers subject to the transfer tax is $1,250,000 + $8,522,250 = $9,772,250. By contrast, if Mike waits until death to transfer all of his $10,000,000 estate, the full $10,000,000 is subject to the transfer tax.

**Observation.** The $1,250,000 gift may also increase in value before Mike's death. That increase will also escape the transfer tax.

### Marital Deduction

There is a marital deduction equal to the amount that is transferred to the taxpayer's spouse (if the spouse is a citizen of the United States) for both gift tax and estate tax purposes. Therefore, any amount transferred to a spouse who is a citizen of the United States is gift and estate tax free.

**Example 6.** Dawn Ting owns assets with a value of $2,000,000. Her husband, Richard, owns nothing. Dawn can give $1,000,000 to Richard with no gift tax consequences because of the marital deduction. That gift does not use any of her applicable exclusion amount. Dawn and Richard could each then give $1,000,000 to their children in 2006 or later and not owe any federal gift tax because each has a $1,000,000 applicable exclusion amount that makes the gift tax-free.

**Practitioner Note.** Dawn does **not** have to report the gift to Richard on Form 706, United States Gift (and Generation–Skipping Transfer) Tax Return, since all gifts to a spouse who is a United States citizen are excluded from the reporting requirements.

If Dawn waits until death to pass $1,000,000 to Richard, there is still no transfer tax on that $1,000,000 because of the estate tax marital deduction. Dawn can pass the other $1,000,000 to their children (in 2006 or later) without any estate tax, and Richard can pass the $1,000,000 he received from Dawn (in 2006 or later) without any gift or estate tax.



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Form **706** (Rev. July 1999)
Department of the Treasury Internal Revenue Service

# United States Estate (and Generation-Skipping Transfer) Tax Return

**Estate of a citizen or resident of the United States (see separate instructions). To be filed for decedents dying after December 31, 1998**
**For Paperwork Reduction Act Notice, see page 1 of the separate instructions.**

OMB No. 1545-0015

**Executor**

| 1a Decedent's first name and middle initial (and maiden name, if any) | 1b Decedent's last name | 2 Decedent's Social Security No. |
|---|---|---|
| *Dawn* | *Ting* | *709 06 2056* |

| 3a Legal residence (domicile) at time of death (county, state, and ZIP code, or foreign country) | 3b Year domicile established | 4 Date of birth | 5 Date of death |
|---|---|---|---|
| *Pontiac County, MI 48800* | *1932* | *02/13/19* | *08/18/2004* |

**Part 2.—Tax Computation**

| Line | Description | Sub-line | Sub-amount | Line | Amount |
|---|---|---|---|---|---|
| 1 | Total gross estate less exclusion (from Part 5, Recapitulation, page 3, item 12) | | | 1 | *2,000,000* |
| 2 | Total allowable deductions (from Part 5, Recapitulation, page 3, item 23) | | | 2 | *1,000,000* |
| 3 | Taxable estate (subtract line 2 from line 1) | | | 3 | *1,000,000* |
| 4 | Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b))) | | | 4 | *0* |
| 5 | Add lines 3 and 4 | | | 5 | *1,000,000* |
| 6 | Tentative tax on the amount on line 5 from Table A on page 12 of the instructions | | | 6 | *345,800* |
| 7a | If line 5 exceeds $10,000,000, enter the lesser of line 5 or $17,184,000. If line 5 is $10,000,000 or less, skip lines 7a and 7b and enter -0- on line 7c | 7a | | | |
| b | Subtract $10,000,000 from line 7a | 7b | | | |
| c | Enter 5% (.05) of line 7b | | | 7c | *0* |
| 8 | Total tentative tax (add lines 6 and 7c) | | | 8 | *345,800* |
| 9 | Total gift tax payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions) | | | 9 | |
| 10 | Gross estate tax (subtract line 9 from line 8) | | | 10 | *345,800* |
| 11 | Maximum unified credit (applicable credit amount) against estate tax | 11 | *345,000* | | |
| 12 | Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed $6,000. See page 4 of the instructions.) | 12 | *0* | | |
| 13 | Allowable unified credit (applicable credit amount) (subtract line 12 from line 11) | | | 13 | *345,000* |
| 14 | Subtract line 13 from line 10 (but do not enter less than zero) | | | 14 | *0* |
| 15 | Credit for state death taxes. Do not enter more than line 14. Figure the credit by using the amount on line 3 less $60,000. See Table B in the instructions and **attach credit evidence** (see instructions) | | | 15 | *0* |
| 16 | Subtract line 15 from line 14 | | | 16 | *0* |
| 17 | Credit for Federal gift taxes on pre-1977 gifts (section 2012) (attach computation) | 17 | | | |
| 18 | Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.) | 18 | | | |
| 19 | Credit for tax on prior transfers (from Schedule Q) | 19 | | | |
| 20 | Total (add lines 17, 18, and 19) | | | 20 | *0* |
| 21 | Net estate tax (subtract line 20 from line 16) | | | 21 | *0* |
| 22 | Generation-skipping transfer taxes (from Schedule R, Part 2, line 10) | | | 22 | *0* |
| 23 | Total transfer taxes (add lines 21 and 22) | | | 23 | *0* |
| 24 | Prior payments. Explain in an attached statement | 24 | | | |
| 25 | United States Treasury bonds redeemed in payment of estate tax | 25 | | | |
| 26 | Total (add lines 24 and 25) | | | 26 | *0* |
| 27 | Balance due (or overpayment) (subtract line 26 from line 23) | | | 27 | *0* |

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

Signature(s) of executor(s) ____________________ Date ____________



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**Form 706 (continued)**

## Part 5—Recapitulation

| Item number | Gross estate | | Alternate value | Value at date of death |
|---|---|---|---|---|
| 1 | Schedule A—Real Estate . . . . . . . . . . . . . . . . . | 1 | | *2,000,000* |
| 2 | Schedule B—Stocks and Bonds . . . . . . . . . . . . . . . | 2 | | |
| 3 | Schedule C—Mortgages, Notes, and Cash . . . . . . . . . . . | 3 | | |
| 4 | Schedule D—Insurance on the Decedent's Life (attach Form(s) 712) . . . | 4 | | |
| 5 | Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance) . | 5 | | |
| 6 | Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance) | 6 | | |
| 7 | Schedule G—Transfers During Decedent's Life (att. Form(s) 712 for life insurance) | 7 | | |
| 8 | Schedule H—Powers of Appointment . . . . . . . . . . . . . . | 8 | | |
| 9 | Schedule I—Annuities . . . . . . . . . . . . . . . . . | 9 | | |
| 10 | Total gross estate (add items 1 through 9). . . . . . . . . . . | 10 | | *2,000,000* |
| 11 | Schedule U—Qualified Conservation Easement Exclusion . . . . . . . | 11 | | |
| 12 | Total gross estate less exclusion (subtract item 11 from item 10). Enter here and on line 1 of Part 2—Tax Computation . . . . . . . . . . . . | 12 | | *2,000,000* |

| Item number | Deductions | | Amount |
|---|---|---|---|
| 13 | Schedule J—Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims . . . | 13 | |
| 14 | Schedule K—Debts of the Decedent . . . . . . . . . . . . . . . . . . . . . . | 14 | |
| 15 | Schedule K—Mortgages and Liens . . . . . . . . . . . . . . . . . . . . . . | 15 | |
| 16 | Total of items 13 through 15 . . . . . . . . . . . . . . . . . . . . . . . | 16 | |
| 17 | Allowable amount of deductions from item 16 (see the instructions for item 17 of the Recapitulation) . | 17 | |
| 18 | Schedule L—Net Losses During Administration . . . . . . . . . . . . . . . . . . | 18 | |
| 19 | Schedule L—Expenses Incurred in Administering Property Not Subject to Claims . . . . . . . . | 19 | |
| 20 | Schedule M—Bequests, etc., to Surviving Spouse . . . . . . . . . . . . . . . . | 20 | *1,000,000* |
| 21 | Schedule O—Charitable, Public, and Similar Gifts and Bequests . . . . . . . . . . . . | 21 | |
| 22 | Schedule T—Qualified Family-Owned Business Interest Deduction . . . . . . . . . . . | 22 | |
| 23 | Total allowable deductions (add items 17 through 22). Enter here and on line 2 of the Tax Computation | 23 | *1,000,000* |

Page 3

**Observation.** If Dawn waits until her death to pass $1,000,000 to Richard, she runs the risk of losing his applicable exclusion amount. If Richard dies before Dawn dies, she cannot pass $1,000,000 to him, and his $1,000,000 applicable exclusion amount has not been used.

**Spouses Who Are Not Citizens of the United States.** If the donor's spouse is not a citizen of the United States, there is no gift tax marital deduction. However, the annual exclusion (discussed below) is $103,000 for gifts in 2000 to a spouse who is not a citizen of the United States.

**Practitioner Note.** A bequest to a spouse who is not a citizen of the United States will qualify for the estate tax marital deduction only if the bequest goes into a qualified domestic trust under I.R.C. §2056A. The trustee of such a trust is personally liable for a tax on distributions that is equal to the taxes the decedent would have paid if the marital deduction were not applied.

### Charitable Contribution Deduction

For both gift tax and estate tax purposes, a deduction is allowed for any amount given to a qualified tax-exempt organization. To qualify for the deduction, the organization must be recognized by the IRS as an I.R.C. §501(c)(3) organization.



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**Example 7.** Ike Conn gave $50,000 to his church in 2000. The charitable contribution deduction removes that gift from his taxable gifts for the year. Therefore, it does not use any of his exclusion amount and does not create any gift tax liability.

If Ike waited until his death to pass the $50,000 to his church, his estate has a $50,000 charitable contribution deduction. The result is no estate tax on the $50,000, and it does not use up any of his exclusion amount.



**Observation.** If Ike makes the contribution during his life, he can claim a charitable contribution deduction on his income tax return. If he waits until death to make the transfer, his estate can claim a charitable contribution deduction on its income tax return. If Ike is in a higher income tax bracket than his estate, the deduction saves more in taxes if the contribution is made during Ike's life.

## DIFFERENCES

Two differences in the effect of a gift compared to a transfer at death are illustrated in Examples 2 and 5 above. They are

1. A gift allows the appreciation in value after the date of the gift to escape the transfer tax (Example 2) and
2. A gift allows the gift tax on the gift to escape the transfer tax (Example 5).

### Gift Tax Annual Exclusion

Another difference is the gift tax annual exclusion. There is no equivalent exclusion under the estate tax rules. The gift tax annual exclusion allows $10,000 (in 2000) to pass tax-free from any donor to any donee each year. The exclusion is available for each donee, so a donor can give $10,000 to as many people as he or she chooses, and each gift qualifies for the $10,000 annual exclusion.

**Practitioner Note.** If the donor wants to avoid the gift tax filing requirement and avoid using any of the applicable exclusion amount, it is advisable to make gifts of something less than $10,000, such as $9,500, so that birthday or other gifts during the year do not push the total over $10,000. However, filing a gift tax return may be advisable to run the statute of limitations (discussed below), and using a few dollars of the applicable exclusion amount has very little effect on estate taxes.

**Example 8.** Pat Turne gives $10,000 to **each** of her 10 grandchildren each year. Each of the gifts qualifies for the annual exclusion and they do not use up any of her exclusion amount.



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Form **709** | Department of the Treasury Internal Revenue Service

**United States Gift (and Generation-Skipping Transfer) Tax Return**

(Section 6019 of the Internal Revenue Code) (For gifts made during calendar year 1999)

► See separate instructions. For Privacy Act Notice, see the Instructions for Form 1040.

OMB No. 1545-0020 | **1999**

| 1 Donor's first name and middle initial | 2 Donor's last name | 3 Donor's social security number |
|---|---|---|
| *Pat* | *Turne* | *709 08 2053* |
| 4 Address (number, street, and apartment number) | | 5 Legal residence (domicile) (county and state) |

**Part 3—Taxable Gift Reconciliation**

| | | | | Line | Amount |
|---|---|---|---|---|---|
| 1 | Total value of gifts of donor (add totals from column E of Parts 1 and 2) | | | 1 | *100,000* |
| 2 | One-half of items ______ attributable to spouse (see instructions) | | | 2 | |
| 3 | Balance (subtract line 2 from line 1) | | | 3 | *100,000* |
| 4 | Gifts of spouse to be included (from Schedule A, Part 3, line 2 of spouse's return—see instructions) | | | 4 | |
| | If any of the gifts included on this line are also subject to the generation-skipping transfer tax, check here ► ☐ and enter those gifts also on Schedule C, Part 1. | | | | |
| 5 | Total gifts (add lines 3 and 4) | | | 5 | *100,000* |
| 6 | Total annual exclusions for gifts listed on Schedule A (including line 4, above) (see instructions) | | | 6 | *100,000* |
| 7 | Total included amount of gifts (subtract line 6 from line 5) | | | 7 | *0* |
| | **Deductions** (see instructions) | | | | |
| 8 | Gifts of interests to spouse for which a marital deduction will be claimed, based on items ______ of Schedule A | 8 | | | |
| 9 | Exclusions attributable to gifts on line 8 | 9 | | | |
| 10 | Marital deduction—subtract line 9 from line 8 | 10 | | | |
| 11 | Charitable deduction, based on items ______ less exclusions | 11 | | | |
| 12 | Total deductions—add lines 10 and 11 | | | 12 | *0* |
| 13 | Subtract line 12 from line 7 | | | 13 | *0* |
| 14 | Generation-skipping transfer taxes payable with this Form 709 (from Schedule C, Part 3, col. H, Total) | | | 14 | *0* |
| 15 | Taxable gifts (add lines 13 and 14). Enter here and on line 1 of the Tax Computation on page 1 | | | 15 | *0* |

*(If more space is needed, attach additional sheets of same size.)* Form **709** (1999)

**Practitioner Note**. While most taxpayers use the $10,000 annual exclusion to make gifts to family members, the exclusion is available for gifts to unrelated individuals as well.

Present interest. In order to qualify for the annual exclusion, **the gift must be a "present interest."** That means that the donee's rights to the gift cannot be postponed until a future date.

**Example 9.** Assume that Pat from Example 8 put the $10,000 gifts into a trust. The trust agreement says that the money will remain in the trust until the donee reaches age 25. Pat could **not** claim the $10,000 annual exclusion because her gift is a **future interest.**

There are several options for making a gift of a future interest qualify for the annual exclusion.

*1. Uniform transfers to minors act.* Most states have enacted a Uniform Transfers to Minors Act and/or a Uniform Gifts to Minors Act. These provisions allow donors to make gifts to minors but name an adult as guardian for the gift. The guardian is required to hold the gift and any income from the gift for the benefit of the minor. The guardian can spend money from the gift for the benefit of the minor, but any amount remaining when the minor turns age 18 must be turned over to the minor at that time. If the minor dies before reaching age 18, the gift passes through the minor's probate estate.

I.R.C. §2503(c) allows gifts to minors under the Uniform Transfers to Minor Act or the Uniform Gifts to Minors Act to qualify for the annual exclusion.



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> **Practitioner Note.** I.R.C. §2503(c) is not limited to transfers under the Uniform Transfers to Minors Act or the Uniform Gifts to Minors Act. A gift to any trust that meets the requirements of I.R.C. §2503(c) will qualify for the annual exclusion. For example, if a donor wanted to postpone the donee's right to the gift until he or she reaches age 21, the donor could set up a trust with terms that are the same as the Uniform Transfers to Minors Act except that age 21 is substituted for age 18. A gift to that trust will qualify for the annual exclusion.



*2. Crummey trusts.* Another option for qualifying for the annual exclusion is to make the gift to a trust that gives the beneficiary of the trust a limited time to withdraw the gift from the trust.

**Example 10.** Pat from Example 8 above could set up a trust with the following terms. Whenever a gift is made to the trust, the beneficiary for whom it was made is given notice that he or she has the right to withdraw the gift within 45 days of the gift. If the gift is not withdrawn within those 45 days, the gift becomes a part of the corpus of the trust and cannot be withdrawn until the beneficiary turns age 25. A gift to the trust will qualify for the annual exclusion. Rev. Rul. 83-108, 1983 C.B. 167.

These trusts are called Crummey trusts because of the court case, **Crummey v. Commissioner,** 397 F.2d 82 (9th Cir. 1968), in which the court first agreed with the taxpayer that such gifts qualify for the annual exclusion.

*3. Split gifts.* A husband and wife individually have a $10,000 annual exclusion for the same donee. Therefore, if one of them wanted to make a gift of $20,000 to an individual, he or she could give $10,000 to his or her spouse (which qualifies for the marital deduction) and then each of them could give $10,000 to the individual. However, the intermediate step of giving the $10,000 gift to a spouse is not necessary because the gift tax rules allow a donee to use his or her spouse's annual exclusion if his or her spouse consents by signing the gift tax return. Therefore, **one spouse can make a $20,000 gift and use both spouses' annual exclusion to eliminate any gift tax consequences.** This is called a **split gift.**

**Example 11.** Jack Smith gave $20,000 to each of his three children in 2000. If his wife, Lena, consents, Jack can use her annual exclusion as well as his own to eliminate any gift tax consequences from the $20,000 gifts.

Jack meets all of the following requirements from the instructions for Form 709-A. Therefore, he can file the following Form 709-A to show that Lena consents to Jack's use of her annual exclusion.

1. You are a citizen or resident of the United States and were married during the entire calendar year to one individual who is also a citizen or resident of the United States. Both you and your spouse were alive at the end of the calendar year.
2. Your only gifts (other than qualifying gifts for tuition or medical care) to a third party consisted entirely of present interests in tangible personal property, cash, U.S. Savings Bonds, or stocks and bonds listed on a stock exchange. A "third-party donee" is any donee other than your spouse.
3. Your gifts to any one third-party donee (other than qualifying gifts for tuition or medical care) during the calendar year did not total more than $20,000. If the donee is a charity, no part of that gift may be given to a noncharitable donee.
4. During the calendar year, you did not make any gifts of terminable interests to your spouse.
5. During the calendar year, your spouse did not make any gifts to any of the donees listed on this form, did not make gifts of terminable interests to you, did not make gifts (other than qualifying gifts for tuition or medical care) of over $10,000 to any other donee, and did not make any gifts of future interests to any other donee.



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6. You and your spouse agree to split all of the gifts either of you made during the calendar year.
7. You did not file a Form 709 for this calendar year.

Form **709-A** (Rev. November 1999) Department of the Treasury Internal Revenue Service

**United States Short Form Gift Tax Return**
**(For "Privacy Act" notice, see the Form 1040 instructions)**

Calendar year ..............

OMB No. 1545-0021

| | | |
|---|---|---|
| 1 Donor's first name and middle initial: *Jack* | 2 Donor's last name: *Smith* | 3 Donor's social security number: *709 01 2503* |
| 4 Address (number, street, and apartment number): *101 Sagebrush* | | 5 Legal residence (domicile): *Rattlesnake County, OK* |
| 6 City, state, and ZIP code: *Sooner, OK 74000* | | 7 Citizenship: *United States* |

8 Did you file any gift tax returns for prior periods? . . . . . . . . . . . . . . . . . . . . . . ☐ Yes ☒ No

If "Yes," state when and where earlier returns were filed ▶

| | |
|---|---|
| 9 Name of consenting spouse: *Lena Smith* | 10 Consenting spouse's social security number: *709 02 2503* |

**Note:** *Do not use this form to report gifts of closely held stock, partnership interests, fractional interests in real estate, or gifts for which the value has been reduced to reflect a valuation discount. Instead, use Form 709.*

**List of Gifts**

| (a) Donee's name and address and description of gift | (b) Donor's adjusted basis of gift | (c) Date of gift | (d) Value at date of gift |
|---|---|---|---|
| *Jill Smith 101 Sagebrush Sooner, OK 74000 $10,000 cash* | *$10,000* | *07/01/2000* | *$10,000* |
| *Jimmy Smith 101 Sagebrush Sooner, OK 74000 $10,000 cash* | *$10,000* | *07/01/2000* | *$10,000* |
| *Jason Smith 101 Sagebrush Sooner, OK 74000 $10,000 cash* | *$10,000* | *07/01/2000* | *$10,000* |

Consent

I consent to have the gifts made by my spouse to third parties during the calendar year considered as made one-half by each of us.

**Consenting spouse's signature** ▶ **Date** ▶

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

**Donor's signature** ▶ ............................................ **Date** ▶ ....................

**Preparer's signature** (other than donor's) ▶ ............................................ **Date** ▶ ....................



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**Inflation Adjustment.** The Taxpayer Relief Act of 1997 indexed the annual exclusion to the Consumer Price Index. However, the annual exclusion will be increased only in $1,000 increments. Furthermore, if the inflation adjustment is not an even $1,000, the increase is rounded down to the next lower multiple of $1,000. That means that the annual exclusion will not be increased until there is a 10% or more increase in the Consumer Price Index from the 1997 base that is used for indexing the annual exclusion. **For 2000, the annual exclusion remains at $10,000.**



## EDUCATIONAL OR MEDICAL EXPENSES

Parents often pay for the cost of their children's college education. In some cases, that cost and value of other gifts to the child during the year exceed the $10,000 annual exclusion. Some taxpayers pay for medical care for their children, parents, or other members of their family.

I.R.C. §2503(e) excludes these payments from being treated as gifts for purposes of the federal gift tax if the payments are made **directly** to the institution of higher education or to the person who provides the medical care. They are not reported on Form 709.

**Example 12.** In 2000, Rita Lott, who is not married, paid $15,000 of tuition to Private University for her daughter, Etta. Rita also gave Etta a $12,000 car in 2000. The $15,000 payment qualifies for the tuition exclusion, and the $12,000 car qualifies for the $10,000 annual exclusion. A portion of Rita's Form 709 is shown below.

Form **709** — **United States Gift (and Generation-Skipping Transfer) Tax Return** — OMB No. 1545-0020 — 2000

(Section 6019 of the Internal Revenue Code) (For gifts made during calendar year 1999)

Department of the Treasury
Internal Revenue Service

► See separate instructions. For Privacy Act Notice, see the Instructions for Form 1040.

| 1 Donor's first name and middle initial | 2 Donor's last name | 3 Donor's social security number |
|---|---|---|
| *Rita* | *Lott* | *709 03 2503* |
| 4 Address (number, street, and apartment number) | | 5 Legal residence (domicile) (county and state) |
| *2503 Medical Drive* | | *Harrisburg County, PA* |
| 6 City, state, and ZIP code | | 7 Citizenship |
| *Keystone, PA 17700* | | *United States* |

n

**Part 2—Tax Computation**

| | | Line | Amount | |
|---|---|---|---|---|
| 1 | Enter the amount from Schedule A, Part 3, line 15 | 1 | *2,000* | |
| 2 | Enter the amount from Schedule B, line 3 | 2 | *0* | |
| 3 | Total taxable gifts (add lines 1 and 2) | 3 | *2,000* | |
| 4 | Tax computed on amount on line 3 (see Table for Computing Tax in separate instructions) | 4 | *360* | |
| 5 | Tax computed on amount on line 2 (see Table for Computing Tax in separate instructions) | 5 | *0* | |
| 6 | Balance (subtract line 5 from line 4) | 6 | *360* | |
| 7 | Maximum unified credit (nonresident aliens, see instructions) | 7 | 211,300 | 00 |
| 8 | Enter the unified credit against tax allowable for all prior periods (from Sch. B, line 1, col. C) | 8 | *0* | |
| 9 | Balance (subtract line 8 from line 7) | 9 | *211,300* | |
| 10 | Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions) | 10 | *0* | |
| 11 | Balance (subtract line 10 from line 9) | 11 | *211,300* | |
| 12 | Unified credit (enter the smaller of line 6 or line 11) | 12 | *360* | |
| 13 | Credit for foreign gift taxes (see instructions) | 13 | *0* | |
| 14 | Total credits (add lines 12 and 13) | 14 | *360* | |
| 15 | Balance (subtract line 14 from line 6) (do not enter less than zero) | 15 | *0* | |
| 16 | Generation-skipping transfer taxes (from Schedule C, Part 3, col. H, Total) | 16 | *0* | |
| 17 | Total tax (add lines 15 and 16) | 17 | *0* | |
| 18 | Gift and generation-skipping transfer taxes prepaid with extension of time to file | 18 | *0* | |
| 19 | If line 18 is less than line 17, enter BALANCE DUE (see instructions) | 19 | *0* | |
| 20 | If line 18 is greater than line 17, enter AMOUNT TO BE REFUNDED | 20 | *0* | |

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

Donor's signature ► Date ►

Preparer's signature (other than donor) ► Date ►



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Form 709 (1999) Page 2

**SCHEDULE A** **Computation of Taxable Gifts** (Including Transfers in Trust)

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

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

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

| A<br>Item number | B<br>• Donee's name and address<br>• Relationship to donor (if any)<br>• Description of gift<br>• If the gift was made by means of a trust, enter trust's identifying number and attach a copy of the trust instrument<br>• If the gift was of securities, give CUSIP number | C<br>Donor's adjusted basis of gift | D<br>Date of gift | E<br>Value at date of gift |
|---|---|---|---|---|
| 1 | *Etta Lott*<br>*Medical Drive*<br>*Keystone, PA 17700*<br>*Daughter*<br>*1997 Acura Integra* | *$12,000* | *July 15, 2000* | *$12,000* |

**Part 3—Taxable Gift Reconciliation**

| | | | |
|---|---|---|---|
| 1 | Total value of gifts of donor (add totals from column E of Parts 1 and 2) | 1 | *12,000* |
| 2 | One-half of items ........ attributable to spouse (see instructions) | 2 | |
| 3 | Balance (subtract line 2 from line 1) | 3 | *12,000* |
| 4 | Gifts of spouse to be included (from Schedule A, Part 3, line 2 of spouse's return—see instructions)<br>If any of the gifts included on this line are also subject to the generation-skipping transfer tax, check here ▶ ☐ and enter those gifts also on Schedule C, Part 1. | 4 | |
| 5 | Total gifts (add lines 3 and 4) | 5 | *12,000* |
| 6 | Total annual exclusions for gifts listed on Schedule A (including line 4, above) (see instructions) | 6 | *10,000* |
| 7 | Total included amount of gifts (subtract line 6 from line 5) | 7 | *2,000* |
| | **Deductions** (see instructions) | | |
| 8 | Gifts of interests to spouse for which a marital deduction will be claimed, based on items ........ of Schedule A — 8 | | |
| 9 | Exclusions attributable to gifts on line 8 — 9 | | |
| 10 | Marital deduction—subtract line 9 from line 8 — 10 | | |
| 11 | Charitable deduction, based on items ........ less exclusions — 11 | | |
| 12 | Total deductions—add lines 10 and 11 | 12 | *0* |
| 13 | Subtract line 12 from line 7 | 13 | *2,000* |
| 14 | Generation-skipping transfer taxes payable with this Form 709 (from Schedule C, Part 3, col. H, Total) | 14 | *0* |
| 15 | Taxable gifts (add lines 13 and 14). Enter here and on line 1 of the Tax Computation on page 1 | 15 | *2,000* |

*(If more space is needed, attach additional sheets of same size.)* Form **709** (1999)

### Estate tax provisions for family-owned businesses

The estate tax rules include three provisions that reduce or postpone the estate taxes on the transfer of a family owned business from one generation to the next. There are no equivalent provisions in the gift tax rules.

Special use valuation. I.R.C. §2032A allows the estate to value real property used in a trade or business at its **use value** rather than its fair market value if (among other requirements) the real estate was used in a business by the decedent and is used in a business by a family member after the decedent's death.

Family-owned business deduction. I.R.C. §2057 allows a deduction in calculating the taxable estate if (among other requirements) the decedent's interest in a business is passed to a family member or an employee who has been employed for ten years or more at the time of death. **The deduction combined with the applicable exclusion amount cannot exceed $1.3 million.**



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**Installment payment of estate taxes.** I.R.C. §6166 allows some of the estate taxes to be deferred until 5 years after the decedent's death and then paid in installments over the next ten years if a closely held business made up **more than 35%** of the decedent's adjusted gross estate.

## FILING GIFT TAX RETURNS

The Taxpayer Relief Act of 1997 dramatically changed the effect of filing gift tax returns.



**Prior law.** Prior to the change, there was no statute of limitations on the valuation of gifts for purposes of the estate tax calculation. Consequently, upon death of the donor, the IRS could challenge the reported or unreported value of a gift for purposes of including prior gifts in the estate tax calculation.

**Example 13.** Marshall Law gave 10,000 shares of stock in his closely held company to his daughter Anne in 1990. He reported a value of $110,000 for the stock on a timely filed gift tax return for 1990. The annual exclusion reduced the taxable gift to $100,000 and the unified credit available in 1990 offset the tentative tax on the transfer, so there was no gift tax due. Marshall made no other taxable gifts during his life.

Marshall died in 2000. His will left his entire $700,000 taxable estate to his daughter Anne. As personal representative of his estate, Anne filed the following Form 706 showing $29,250 of estate taxes due.

Form **706** (Rev. July 1999)
Department of the Treasury
Internal Revenue Service

**United States Estate (and Generation-Skipping Transfer) Tax Return**

Estate of a citizen or resident of the United States (see separate instructions).
To be filed for decedents dying after December 31, 1998
For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

OMB No. 1545-0015

**Part 1.—Decedent and Executor**

| | | |
|---|---|---|
| 1a Decedent's first name and middle initial (and maiden name, if any): *Marshall* | 1b Decedent's last name: *Law* | 2 Decedent's Social Security No.: *709 13 6501* |
| 3a Legal residence (domicile) at time of death (county, state, and ZIP code, or foreign country): *Cass County, IA 50022* | 3b Year domicile established: *1951* / 4 Date of birth: *08/18/41* | 5 Date of death: *06/20/2000* |
| 6a Name of executor (see page 4 of the instructions) | 6b Executor's address (number and street including apartment or suite no. or rural route; city, town, or post office; state; and ZIP code) | |
| 6c Executor's social security number (see page 4 of the instructions) | | |
| 7a Name and location of court where will was probated or estate administered | | 7b Case number |
| 8 If decedent died testate, check here ▶ ☐ and attach a certified copy of the will. | 9 If Form 4768 is attached, check here ▶ ☐ | |
| 10 If Schedule R-1 is attached, check here ▶ ☐ | | |

**Part 2.—Tax Computation**

| Line | Description | Sub-line | Sub-amount | Line | Amount |
|---|---|---|---|---|---|
| 1 | Total gross estate less exclusion (from Part 5, Recapitulation, page 3, item 12) | | | 1 | 760,000 |
| 2 | Total allowable deductions (from Part 5, Recapitulation, page 3, item 23) | | | 2 | 60,000 |
| 3 | Taxable estate (subtract line 2 from line 1) | | | 3 | 700,000 |
| 4 | Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b))) | | | 4 | 100,000 |
| 5 | Add lines 3 and 4 | | | 5 | 800,000 |
| 6 | Tentative tax on the amount on line 5 from Table A on page 12 of the instructions | | | 6 | 267,800 |
| 7a | If line 5 exceeds $10,000,000, enter the lesser of line 5 or $17,184,000. If line 5 is $10,000,000 or less, skip lines 7a and 7b and enter -0- on line 7c | 7a | | | |
| b | Subtract $10,000,000 from line 7a | 7b | | | |
| c | Enter 5% (.05) of line 7b | | | 7c | 0 |
| 8 | Total tentative tax (add lines 6 and 7c) | | | 8 | 267,800 |
| 9 | Total gift tax payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions) | | | 9 | 0 |
| 10 | Gross estate tax (subtract line 9 from line 8) | | | 10 | 267,800 |
| 11 | Maximum unified credit (applicable credit amount) against estate tax | 11 | 220,550 | | |
| 12 | Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed $6,000. See page 4 of the instructions.) | 12 | | | |
| 13 | Allowable unified credit (applicable credit amount) (subtract line 12 from line 11) | | | 13 | 220,550 |



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Form 706 *(continued)*

| Part 2. | | | | |
|---|---|---|---|---|
| 13 | Allowable unified credit (applicable credit amount) (subtract line 12 from line 11) | | | |
| 14 | Subtract line 13 from line 10 (but do not enter less than zero) | | 14 | 47,250 |
| 15 | Credit for state death taxes. Do not enter more than line 14. Figure the credit by using the amount on line 3 less $60,000. See Table B in the instructions and **attach credit evidence** (see instructions) | | 15 | 18,000 |
| 16 | Subtract line 15 from line 14 | | 16 | 29,250 |
| 17 | Credit for Federal gift taxes on pre-1977 gifts (section 2012) (attach computation) | 17 | | |
| 18 | Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.) | 18 | | |
| 19 | Credit for tax on prior transfers (from Schedule Q) | 19 | | |
| 20 | Total (add lines 17, 18, and 19) | | 20 | 0 |
| 21 | Net estate tax (subtract line 20 from line 16) | | 21 | 29,250 |
| 22 | Generation-skipping transfer taxes (from Schedule R, Part 2, line 10) | | 22 | 0 |
| 23 | Total transfer taxes (add lines 21 and 22) | | 23 | 29,250 |
| 24 | Prior payments. Explain in an attached statement | 24 | | |
| 25 | United States Treasury bonds redeemed in payment of estate tax | 25 | | |
| 26 | Total (add lines 24 and 25) | | 26 | 0 |
| 27 | Balance due (or overpayment) (subtract line 26 from line 23) | | 27 | 29,250 |

On audit of Marshall's estate tax return, the IRS determined that the value of the stock given to Anne in 1990 was $310,000 rather than $110,000. Therefore, the IRS **increased** the estate tax due by $78,000 as follows:

| | Originally Reported | Adjustment | Adjusted Amount |
|---|---|---|---|
| **1.** Total gross estate less exclusion | 760,000 | -0- | 760,000 |
| **2.** Total allowable deductions | 60,000 | -0- | 60,000 |
| **3.** Taxable estate | 700,000 | -0- | 700,000 |
| **4.** Adjusted taxable gifts | 100,000 | 200,000 | 300,000 |
| **5.** Add lines 3 and 4. | 800,000 | 200,000 | 1,000,000 |
| **6.** Tentative tax | 267,800 | 78,000 | 345,800 |
| **9.** Total gift tax payable | -0- | -0- | -0- |
| **10.** Gross estate tax | 267,800 | 78,000 | 345,800 |
| **13.** Allowable unified credit | 220,550 | -0- | 220,550 |
| **14.** Subtract line 13 from line 10. | 47,250 | 78,000 | 125,250 |
| **15.** Credit for state death taxes | 18,000 | -0- | 18,000 |
| **16.** Subtract line 15 from line 14. | 29,250 | **78,000** | 107,250 |

New law. The new law gives taxpayers a statute of limitations for purposes of the estate tax if the statute has run for purposes of the gift tax.

**Example 14.** Hy Towers gives closely held stock to his daughter Belle in 2000 and **adequately discloses** it as a $100,000 gift on a timely filed gift tax return. The IRS does not challenge the $100,000 valuation. Hy dies in 2010 leaving his $700,000 estate to Belle. The IRS **cannot** challenge the $100,000 valuation of the stock on Hy's estate tax return.

### New Disclosure Rules

While the **new disclosure rules** were enacted to put a statute of limitations on the valuation of gifts for estate tax purposes, they also have an effect on the gift tax statute of limitations in two respects. First, they increase the reporting requirements for starting the running of the statute of limitations. Second, they apply the statute of limitations, not only to the valuation of the gift, but also to the application of the gift tax rules to the gift tax computation. In other words, they impose a **higher burden** for starting the statute of limitations but give the taxpayer **greater protection** if the statute has run.



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There are two separate but related gift tax calculations that are affected by the new disclosure rules. One is calculation of gift taxes due in the year of the gift. A second is the calculation of gift taxes in a later year, when the gift is included as a prior year gift.

Gift taxes in the year of the gift. Under prior law, the three-year statute of limitations began to run on the gift tax liability of a taxpayer if the taxpayer filed a gift tax return for the year of the gift. Therefore, if a taxpayer filed a gift tax return but omitted a gift from the return, the IRS could not assess a gift tax on the omitted gift after the period ending three years after the gift tax return was filed.



**Practitioner Note.** Under **prior law,** if unreported gifts exceeded 25% of the gifts reported on the gift tax return, the statute of limitations was six years rather than three years.

**Example 15—Prior Law.** In **1994,** Hugh Midd gave $400,000 of publicly traded stock to his daughter. He also sold 10% of his business to his son for $100,000. Hugh filed a gift tax return before April 15, 1995 and reported the $400,000 gift to this daughter. There was no gift tax due as a result of the unified credit that was available in 1994. He did **not report** the sale of the 10% interest in his business because he believed the value of the interest was $100,000 and there was no gift.

After April 15, 1998, (three years after the due date of the 1994 gift tax return) the IRS cannot impose additional gift taxes on Hugh even if the IRS can prove the value of the 10% interest in his business is more than $200,000, since the unreported gift ($200,000 – $100,000 = $100,000) is not more than 25% of the $400,000 reported gifts. After April 15, 2001, (six years after the due date of the 1994 gift tax return) the IRS cannot impose additional gift taxes on Hugh regardless of the value it can prove for the 10% interest in his business.

**Practitioner Note.** Under **prior law,** a gift tax return that was **not** required to be filed apparently did not start the statute of limitations. For example, if a donor's only gift was a gift of $9,000, reporting it on a gift tax return did not start the statute of limitations because such gifts did not trigger the filing requirement. Under the **new rules,** filing a gift tax return even when it is not required **will start** the statute if the adequate disclosure requirements are met.

Under the **new law,** the statute of limitations does not run for a gift unless that gift is **adequately disclosed** on a gift tax return or otherwise meets the disclosure requirements.

**Example 16—New Law.** Assume the same facts as Example 15 except that Hugh made his gift to his daughter and sold the 10% interest in his business to his son in **2000.** If Hugh **does not adequately disclose** the transfer of the interest in his business to his son on a gift tax return, **the IRS can assess gift taxes for that transfer at any time.**

**A transfer to a family member in the ordinary course of business is adequately disclosed if both parties report the transaction on their income tax returns. It does not have to be reported on a gift tax return**.

**Example 17.** If Hugh paid his son a salary for working in the business, the statute of limitations begins to run for gift tax purposes on that transfer if Hugh shows the salary as a deduction on his income tax return and his son reports it as income on his return.

**Practitioner Note.** Reporting a transfer of an interest in a business on an income tax return is not adequate disclosure since that transfer is not in the ordinary course of business.



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**Gift Taxes for Year after the Gift.** A gift affects the calculation of gift taxes in a subsequent year because all prior taxable gifts are a part of the gift tax calculation. However, under **prior law** a different rule applied for starting the statute of limitations with respect to valuing the gift for the subsequent year calculation. The IRS could revalue a prior gift unless a gift tax was paid or assessed for the year of the gift, *and* the time had expired for assessing a gift tax for the year of the gift.

**Example 18—Prior Law.** Assume the same facts as in Example 15 above (gift to daughter and sale to son in **1994**) and, in addition, assume that Hugh gave $400,000 of publicly traded stock to his son in **2000.** Since Hugh did not owe any gift tax for his **1994** gift to his daughter, the IRS can revalue his gift to his daughter as well as the transfer of the 10% interest in his business to his son at any time for purposes of including the gifts in a subsequent year gift tax calculation. Assuming the IRS can prove the value of the 10% interest in the business was $200,000, **the gift taxes for 2000 before and after the revaluation of the 1994 transfer are shown below**.

| | Before Revaluation | After Revaluation |
|---|---|---|
| Taxable gift in 2000 | $390,000 | $390,000 |
| Prior taxable gifts | 390,000 | 480,000 |
| Total taxable gifts | $780,000 | $870,000 |
| Tentative tax | $260,000 | $295,100 |
| Less applicable credit amount | 220,550 | 220,550 |
| **Gift taxes due** | **$39,450** | **$74,550** |

Under the **new rules,** if the statute of limitation has run for purposes of the gift tax liability in the year of the gift, it has also run for purposes of the gift tax liability in a subsequent year.

**Example 19—New Law.** Assume the same facts as in Example 16 above (gift to daughter and sale to son in **2000**) and, in addition, assume that Hugh gave $400,000 of publicly traded stock to his son in **2006.** If Hugh **adequately discloses** the transfer of the 10% interest in his business on his **2000** gift tax return, the statute of limitations on challenging the value of that transfer runs for purposes of gift taxes for later years as well as gift taxes in 2000. Therefore, **the IRS could not challenge the value of the 2000 transfer as a prior gift in the 2006 gift tax calculation.**

### Disclosure requirements

A transfer is adequately disclosed on a gift tax return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift, and the basis for the value that is reported. **Transfers reported on the gift tax return as transfers of property by gift are adequately disclosed if the return (or a statement attached to the return) provides the following information:**

1. A description of the transferred property and any consideration received by the transferor;
2. The identity of, and relationship between, the transferor and each transferee;
3. If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument;
4. A detailed description of the method used to determine the fair market value of property transferred. In lieu of this detailed description, a copy of an appraisal of the property can be attached to the return. The appraisal will meet the disclosure requirements *only if* **the appraiser and the appraisal meet specified requirements**.



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**Practitioner Note**. If a partial interest in a business entity is transferred, the taxpayer must either document the value of 100% of the business entity and the value of the portion transferred or demonstrate that the fair market value of the portion transferred is properly determined by a method other than a method based on the net value of the assets held by the entity.

5. A statement describing any position taken that is contrary to any proposed, temporary, or final Treasury regulations or revenue rulings published at the time of the transfer.



#### Effective dates

The **new rules** have effective dates for purposes of calculating current gift taxes on the gift different from those used for purposes of calculating gift taxes for subsequent years and estate taxes.

Current Year Gift Taxes. For purposes of calculating current gift taxes, the new rules are effective for gifts made after December 31, 1996, for which a gift tax return is filed after December 3, 1999.

Gift Taxes for Subsequent Years and Estate Taxes. For purposes of calculating gift taxes in a year after the gift and for purposes of calculating estate taxes upon death of the donor, the new rules are effective for gifts made after August 5, 1997 if the gift tax return for the year of the gift is filed after December 3, 1999.

The **new regulations** under I.R.C. §2504 give the following example (Treas. Reg. §25.2504-2(c) Example 3).

**Example 20.** In 1994, A transferred closely held stock to B and C, A's children. A timely filed a federal gift tax return reporting the 1994 transfers to B and C and paid gift tax on the value of the gifts reported on the return. Also in 1994, A transferred closely held stock to B in exchange for a bona fide promissory note signed by B. A believed that the transfer to B in exchange for the promissory note was for full and adequate consideration and A did not report that transfer to B on the 1994 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

Under I.R.C. §2504(c), in determining A's **2002 gift tax liability,** the value of A's 1994 gifts **cannot be adjusted** for purposes of computing prior taxable gifts because those gifts were made prior to August 6, 1997, and a timely filed Federal gift tax return was filed with respect to which a gift tax was assessed and paid, and the period of limitations on assessment has expired. The provisions of paragraph (a) of this section apply to the 1994 transfers. However, for purposes of determining A's adjusted taxable gifts in computing A's estate tax liability, the gifts may be adjusted. See Treas. Reg. §20.2001-1(a).

#### Filing deadline

Gift tax returns are due by April 15 of the year following the calendar year in which the gift was made. If the donor has been given an extension to file his or her income tax return for the calendar year of the gift, the date for filing the gift tax return is extended to the same date. **There is no penalty for filing a gift tax return late if there is no gift tax due, other than the delay in starting the statute of limitations.**

**Example 21.** Malcolm Tente gave 1,000 units of his LLC to his daughter in 1997. Malcolm valued the 1,000 units at $200,000. As a tax protester, he has not filed income or gift tax returns for several years. Malcolm contacted a tax preparer in 2000 and asked about the consequences of filing a gift tax return for the 1997 gift.



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One effect of filing a gift tax return in 2000 for the 1997 gift is that it will start the three-year statute of limitations running as of the date of filing the return. If the return had been filed by the April 15, 1998, due date, the statute would have expired on April 15, 2001.

**Observation.** Many gifts trigger the gift tax return filing requirement without triggering any gift tax liability because the applicable credit amount ($220,550 in 2000) offsets the gift tax liability.

**There is a penalty for a late payment of gift taxes.** If the gift tax return is filed late, there is a penalty based on the gift taxes due on the return reduced by any gift taxes that were paid on time.

The penalty for a late payment of gift tax is the same as the penalty for late payment of income taxes. It is 0.5% of the taxes due for each month or portion of a month the taxes are paid late, up to a maximum of 25%.

The penalty for filing a gift tax return late is the same as the penalty for filing an income tax return late. It is 5% of the taxes due for each month or portion of a month the return is filed late, up to a maximum of 25%.

**Example 22.** Sally Forth gave $700,000 of stocks and bonds to her two children in 1999. She asked her income tax preparer to get an extension for filing her income tax return for 1999. Sally did not tell her preparer about the gifts until she took her records to him in June 2000. Her preparer filed a Form 709 on June 20, 2000, showing the $700,000 gift and a $1,850 gift tax due.

There is no delinquency penalty for the late filed gift tax return because the due date of Sally's income tax return was extended to August 15, 2000. There is a penalty for the **late payment** of gift taxes. It is 3 months × 0.5% × $1,850 = $27.75. Sally must also pay interest on the late payment of gift taxes.

## INTRODUCTION TO APPLICATION OF THE GENERATION-SKIPPING TAX

As its name implies, the generation-skipping tax is designed to prevent taxpayers from avoiding estate and gift taxes by passing assets to persons who are **more than one generation below** the transferor. When skipping a generation, estate and gift taxes are imposed on one transfer rather than two. The generation-skipping tax requires the transferor to pay a tax as if the asset were transferred from the skipped generation as well. After a $1,000,000 exemption for each transferor, **the generation-skipping tax is imposed at the rate of 55%**–the highest marginal estate and gift tax rate.

**Example 23.** Andrea Garber's will passed $2,000,000 to her three grandchildren, even though her son was living at the time of her death. Since Andrea's son never owned the $2,000,000, there is no transfer from her son to her grandchildren on which to impose estate and gift taxes. The generation-skipping tax taxes the transfer to Andrea's grandchildren as if there were a transfer from her son to her grandchildren. In addition, Andrea's estate must pay estate taxes on the direct transfer to her grandchildren.

### GENERATION-SKIPPING TRANSFERS

There are three "generation-skipping transfers" defined in I.R.C. §2611(a).

1. A **taxable termination** is any termination of an interest in property held in a trust unless
   - **a.** A person who is one generation below the grantor of the trust has an interest in the property immediately after the termination, or
   - **b.** After the termination, no persons more than one generation below the grantor of the trust can receive a distribution from the trust.



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**Example 24.** Brian Fries created a trust for his daughter Melinda and his grandchild Joseph. The terms of the trust allow the trustee to distribute income and corpus to Melinda and/or Joseph as long as Melinda lives. Upon Melinda's death, the principal is distributed to Joseph. **Melinda's death is a taxable termination since Joseph is more than one generation below Brian and there are no remaining beneficiaries in the generation below Brian.**

2. A **direct skip** is a transfer to a person two or more generations below the transferor that is subject to the estate or gift tax.



**Example 25.** Stephanie O'Donnell gave her great-grandchildren $2,000,000. This transfer is a **direct skip.**

A transfer into trust for the benefit of someone two or more generations below the transferor is also a direct skip. For purposes of the direct skip rule only, a person is moved up one generation if his or her parent dies before the transfer is made.

**Example 26.** Andrew Richardson gave his granddaughter, Julie, $1,500,000. Before the gift, Andrew's daughter, Leah, who was Julie's mother, died. **The gift to Julie is not a direct skip because Julie is moved up one generation and therefore is one generation below Andrew.**

3. A **taxable distribution** is any distribution to a person more than one generation below the transferor that is not a taxable termination or a direct skip.

### TAX IMPOSED

The tax imposed on generation-skipping transfers is the highest marginal estate and gift tax at the time of the transfer. That rate is currently 55%. The tax is imposed on the amount of the generation-skipping transfer that exceeds the $1,000,000 generation-skipping tax exemption.

The $1,000,000 exemption can be allocated among transfers from a taxpayer in any manner. Therefore, even the first generation-skipping transfer may be subject to tax if an individual is saving part or all of his or her exemption for later transfers.

## INCOME TAXES

For many taxpayers, the income tax consequences of gifts are more significant than the transfer tax consequences since they will not pay any estate, gift, or generation-skipping taxes. Two significant income tax consequences of a gift are

1. Income from the gift will be taxed to the donee after the date of the gift, and
2. The donor's income tax basis in the asset that is given is carried over to the donee.

### INCOME FROM THE GIFT

**Example 27.** Nan Tucket pays $45,000 per year to support her elderly mother in a nursing home. Her mother has no income, and Nan's income puts her in the 31% marginal income tax bracket. In 2000, Nan decided to sell $20,000 of stock to generate part of the cash she needed to pay the nursing home. The stock has a $4,000 income tax basis.



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If Nan sells the stock, she will owe $3,200 of taxes as a result of the sale.

| | |
|---|---|
| Amount realized | $20,000 |
| Less: Basis | (4,000) |
| Gain | $16,000 |
| Maximum capital gains rate | × .20 |
| **Nan's taxes on the sale** | **$ 3,200** |

By contrast, if Nan gave the stock to her mother, who then sold the stock and used the proceeds to pay part of her nursing home costs, the income taxes due on the sale are $1,465.

| | |
|---|---|
| Amount realized | $20,000 |
| Less: Basis | (4,000) |
| Gain | $16,000 |
| Standard deduction | 1,350* |
| Taxable income | $14,650 |
| Maximum capital gains rate | × .10 |
| **Mother's taxes on the sale** | **$1,465** |

*$250 standard deduction for a dependent plus $1,100 additional deduction for a single person over age 64.

**Observation.** If Nan's husband consents to treating the gift as a split gift, the $20,000 gift to Nan's mother does not use up any of Nan's applicable exclusion amount.

## CARRYOVER BASIS

Assets that are transferred by gift have a carryover basis in the hands of the donee.

**Example 28.** Dick Tum gave 1,000 shares of Web Site, Inc. to his son George in 2000. The shares had a value of $100 each and a basis of $20 each. George's basis in the stock is $20,000. If he sells the stock for $100,000, he must recognize $80,000 of gain.

**Practitioner Note.** If gift tax is due, the portion of the gift tax attributable to the appreciation of the donated asset is **added** to the carryover basis. This rule is rarely applied since the applicable exclusion amount eliminates gift taxes on most gifts.

By contrast, assets that are transferred at the time of death have an adjusted basis in the hands of the recipient equal to the fair market value on the date of death or alternate valuation date.

**Example 29.** If Dick from Example 28 passed the 100 shares of Web Site, Inc. to George as a bequest at the time of Dick's death, George's income tax basis would be $100,000 (assuming the value was still $100,000 on the date of death). George would have no gain to report on sale of the stock for $100,000.

It is advisable to choose assets with a **high basis** to make gifts and to retain assets that have a l**ow basis** for transfer at death.



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**Practitioner Note.** The character of gain that will be realized from sale of an asset should also be considered. If an asset does not qualify for long-term capital gain treatment (for example, it is subject to the depreciation recapture rules), a stepped-up basis at death will be worth more because it will eliminate ordinary income rather than capital gains.

### Depreciable Property



If the gift is depreciable property, the carry-over basis rules apply as with any other gift. Two additional rules apply:

1. If the property is depreciable property in the hands of the **donee,** he or she claims depreciation on the carry over basis using a **new** depreciable life.

**Observation.** In most cases, the gift will reduce the amount of depreciation that can be claimed on the asset since the new life in the hands of the donee is longer than the remaining life in the hands of the donor.

2. Any depreciation claimed by the donor is subject to the depreciation recapture rules upon a subsequent sale by the donee.

**Example 30.** Minnie Apoulos paid $100,000 for a tractor in 1995. She used it in her farming business until she **gave the tractor to her daughter Anne in 1998.** There were no gift taxes due on the gift. Anne has a $49,005 carry over basis from Minnie, calculated as follows:

| | | | | |
|---|---|---|---|---|
| Unadjusted basis of tractor | | | | $100,000 |
| Less depreciation: | | | | |
| 1995: | $100,000 × 10.71% | = | $10,710 | |
| 1996: | $100,000 × 19.13% | = | 19,130 | |
| 1997: | $100,000 × 15.03% | = | 15,030 | |
| 1998: | $100,000 × 12.25% × .5 | = | 6,125 | |
| Total | | | | (50,995) |
| **Adjusted basis of tractor at time of gift** | | | | **$49,005** |

Anne used the tractor in her farming business and then **sold it in 2000** for $55,000. At the time of sale, her total depreciation and adjusted basis are as follows:

| | | | | |
|---|---|---|---|---|
| Unadjusted basis of tractor | | | | $49,005 |
| Less depreciation: | | | | |
| 1998: | $49,005 × 10.71% | = | $5,248 | |
| 1999: | $49,005 × 19.13% | = | 9,375 | |
| 2000: | $49,005 × 15.03% × .5 | = | 3,683 | |
| Total | | | | (18,306) |
| **Adjusted basis of tractor at time of sale** | | | | **$30,699** |

When Anne reports the sale on her Form 4797, she must make the following adjustments to the amounts that she reports on lines 21 and 22. [Treas. Reg. §1.1245-2(a)(4)]:



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1. The depreciation she reports on line 22 includes not only the $18,306 of depreciation that she claimed on the tractor but also the $50,995 that Minnie claimed on the tractor. Therefore she reports $18,306 + $50,995 = **$69,301 on line 22.**
2. Since Anne is required to include the depreciation claimed by Minnie on line 22, Anne is allowed to report Minnie's $100,000 unadjusted basis on line 21. This substitution is necessary to arrive at the proper adjusted basis on line 23.

Part of Anne's 2000 Form 4797 is shown below.

Form 4797 (2000) Page 2

**Part III** Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255

| 19 | (a) Description of section 1245, 1250, 1252, 1254, or 1255 property: | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) |
|---|---|---|---|
| A | *Tractor* | *02/13/98* | *06/20/00* |
| B | | | |
| C | | | |
| D | | | |

| | These columns relate to the properties on lines 19A through 19D. ▶ | | Property A | Property B | Property C | Property D |
|---|---|---|---|---|---|---|
| 20 | Gross sales price (**Note:** *See line 1 before completing.*) | 20 | *55,000* | | | |
| 21 | Cost or other basis plus expense of sale | 21 | *100,000* | | | |
| 22 | Depreciation (or depletion) allowed or allowable | 22 | *69,301* | | | |
| 23 | Adjusted basis. Subtract line 22 from line 21 | 23 | *30,699* | | | |
| 24 | Total gain. Subtract line 23 from line 20 | 24 | *24,301* | | | |
| 25 | **If section 1245 property:** | | | | | |
| a | Depreciation allowed or allowable from line 22 | 25a | *69,301* | | | |
| b | Enter the **smaller** of line 24 or 25a | 25b | *24,301* | | | |

**Observation.** If Anne erroneously reported only her own $18,306 of depreciation on line 22 and her $49,005 unadjusted basis on line 21, she would report the proper $30,699 basis on line 23 and $24,301 gain on line 24, but she would erroneously report only $18,306 of depreciation recapture on line 25b.

### Retained Life Estate

**Example 31.** On February 13, 1992, Carol Ling gave her son, Neil, a remainder interest in her home. Carol retained the right to live in the home for the rest of her life. At the time of the gift, the fair market value of the home was $225,000 and Carol's basis in the home was $150,000. Carol was 72 years old at the time of the gift. Carol died in 1999. At the time of her death, the fair market value of the home was $245,000. Carol also had $500,000 of stocks and bonds on the date of her death. Neil sold the home in 2000 for $250,000.

**Question 31A.** What are the gift tax consequences of the gift of the remainder interest in 1992?

**Answer 31A.** The transfer of the remainder interest without consideration is a gift for gift tax purposes. Therefore, Carol must determine the value of the remainder interest and report it on a gift tax return.

The value of a remainder interest is valued using the tables from Treas. Reg. §20.2031-7. Those tables report the factors for valuing remainder interests based on the age of the life tenant. The interest rate that is used to find the appropriate factor is 120% of the federal mid-term rate for the month of the gift, rounded to the nearest 2/10ths of 1%–the I.R.C. §7520 rate. The full value of the property in which



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the remainder interest was granted is multiplied by the factor from the table to find the value of the remainder interest. In this case, the value of the remainder interest is $105,365 calculated as follows:

| | |
|---|---|
| Fair market value of home on the date of gift | $225,000 |
| Factor from table for 72 year old life tenant and a 7.6% interest rate (February 1992) | × .46829 |
| Value of remainder interest | $105,365 |



Since the remainder interest is not a present interest, the gift does not qualify for the annual exclusion. Therefore, the full $105,365 is a taxable gift. There is no gift tax due because the applicable credit amount for 1992 offsets all of the tentative gift tax. Portions of Carol's gift tax return for 1992 are shown below.

Form **709** Department of the Treasury Internal Revenue Service

**United States Gift (and Generation-Skipping Transfer) Tax Return**

(Section 6019 of the Internal Revenue Code) (For gifts made during calendar year 1999)

▶ See separate instructions. For Privacy Act Notice, see the Instructions for Form 1040.

OMB No. 1545-0020 — 1992

| 1 Donor's first name and middle initial | 2 Donor's last name | 3 Donor's social security number |
|---|---|---|
| Carol | Ling | 709 31 2031 |
| 4 Address (number, street, and apartment number) | | 5 Legal residence (domicile) (county and state) |

**Part 2—Tax Computation**

| | | Line | Amount | |
|---|---|---|---|---|
| 1 | Enter the amount from Schedule A, Part 3, line 15 | 1 | 105,365 | |
| 2 | Enter the amount from Schedule B, line 3 | 2 | | |
| 3 | Total taxable gifts (add lines 1 and 2) | 3 | 105,365 | |
| 4 | Tax computed on amount on line 3 (see Table for Computing Tax in separate instructions) | 4 | 25,410 | |
| 5 | Tax computed on amount on line 2 (see Table for Computing Tax in separate instructions) | 5 | | |
| 6 | Balance (subtract line 5 from line 4) | 6 | 25,410 | |
| 7 | Maximum unified credit (nonresident aliens, see instructions) | 7 | 192,800 | 00 |
| 8 | Enter the unified credit against tax allowable for all prior periods (from Sch. B, line 1, col. C) | 8 | | |
| 9 | Balance (subtract line 8 from line 7) | 9 | 192,800 | |
| 10 | Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions) | 10 | | |
| 11 | Balance (subtract line 10 from line 9) | 11 | 192,80 | |
| 12 | Unified credit (enter the smaller of line 6 or line 11) | 12 | 25,410 | |
| 13 | Credit for foreign gift taxes (see instructions) | 13 | | |
| 14 | Total credits (add lines 12 and 13) | 14 | 25,410 | |
| 15 | Balance (subtract line 14 from line 6) (do not enter less than zero) | 15 | 0 | |
| 16 | Generation-skipping transfer taxes (from Schedule C, Part 3, col. H, Total) | 16 | 0 | |
| 17 | Total tax (add lines 15 and 16) | 17 | 0 | |
| 18 | Gift and generation-skipping transfer taxes prepaid with extension of time to file | 18 | 0 | |
| 19 | If line 18 is less than line 17, enter BALANCE DUE (see instructions) | 19 | 0 | |



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**Form 709 *(continued)***

| | | | | |
|---|---|---|---|---|
| Total of Part 2 (add amounts from Part 2, column E) . . . . . . . . . . . . . . . . . . . . . ▶ | | | | |
| **Part 3—Taxable Gift Reconciliation** | | | | |
| 1 Total value of gifts of donor (add totals from column E of Parts 1 and 2) . . . . . . . . . . . | | | 1 | *105,365* |
| 2 One-half of items ........................ attributable to spouse (see instructions) | | | 2 | |
| 3 Balance (subtract line 2 from line 1) . . . . . . . . . . . . . . . . . . . . . . . . | | | 3 | *105,365* |
| 4 Gifts of spouse to be included (from Schedule A, Part 3, line 2 of spouse's return—see instructions) . . If any of the gifts included on this line are also subject to the generation-skipping transfer tax, check here ▶ ☐ and enter those gifts also on Schedule C, Part 1. | | | 4 | |
| 5 Total gifts (add lines 3 and 4) . . . . . . . . . . . . . . . . . . . . . . . . . | | | 5 | *105,365* |
| 6 Total annual exclusions for gifts listed on Schedule A (including line 4, above) (see instructions) . . . | | | 6 | |
| 7 Total included amount of gifts (subtract line 6 from line 5) . . . . . . . . . . . . . . | | | 7 | |
| **Deductions** (see instructions) | | | | |
| 8 Gifts of interests to spouse for which a marital deduction will be claimed, based on items ................ of Schedule A . . . . . . | 8 | | | |
| 9 Exclusions attributable to gifts on line 8 . . . . . . . . . . . . . . | 9 | | | |
| 10 Marital deduction—subtract line 9 from line 8 . . . . . . . . . . . | 10 | | | |
| 11 Charitable deduction, based on items ........ less exclusions . . | 11 | | | |
| 12 Total deductions—add lines 10 and 11 . . . . . . . . . . . . . . . . . . . . . . | | | 12 | |
| 13 Subtract line 12 from line 7 . . . . . . . . . . . . . . . . . . . . . . . . . . | | | 13 | *105,365* |
| 14 Generation-skipping transfer taxes payable with this Form 709 (from Schedule C, Part 3, col. H, Total) . | | | 14 | |
| 15 Taxable gifts (add lines 13 and 14). Enter here and on line 1 of the Tax Computation on page 1 . . . | | | 15 | *105,365* |

**Question 31B.** What are the consequences of not filing the gift tax return?

**Answer 31B.** Since there is no gift tax liability, there is no delinquency penalty for not filing the gift tax return. There is also no penalty for failure to pay the gift tax. The only consequence of not filing the gift tax return is that the three-year statute of limitations for valuing the gift does not begin to run. In this case, that is of no consequence, since (as shown below) the taxable gift of the remainder interest in 1992 is not included in the estate tax calculation. Therefore, the value of the remainder interest does not affect any tax liability.

**Practitioner Note.** If Carol had used up her exclusion amount during her lifetime, the value of the remainder interest would have affected the amount of gift taxes paid. However, at death, the gift of remainder interest would still not be a part of the estate tax calculation and Carol's estate would get a credit for all of the gift taxes paid. Consequently, the valuation of the remainder interest would not affect the total transfer taxes paid. It would only affect the portion of the total that was paid at the time of the gift.

**Question 31C.** What are the estate tax consequences of the retained life estate?

**Answer 31C.** The retained life estate causes the **full value** ($245,000) of the home to be included in Carol's gross estate upon her death. Therefore, it is included in the amount ($745,000) reported on line 1 of Form 706.

**Practitioner Note.** The amount included on line 1 of Form 706 includes **both** the retained life estate that was not taxed as a gift in 1992 and the remainder interest that was taxed as a gift in 1992. To prevent double taxation of the $105,365, it is not included in the adjusted taxable gifts that are reported on line 4 of Form 706. As with all gifts, the exclusion amount that was used in 1992 to offset the tax on the $105,365 is restored on line 11 of Form 706.



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Form **706** (Rev. July 1999)

Department of the Treasury
Internal Revenue Service

# United States Estate (and Generation-Skipping Transfer) Tax Return

**Estate of a citizen or resident of the United States (see separate instructions).**
**To be filed for decedents dying after December 31, 1998**
**For Paperwork Reduction Act Notice, see page 1 of the separate instructions.**

OMB No. 1545-0015

**Part 1.—Decedent and Executor**

| | | | | |
|---|---|---|---|---|
| 1a Decedent's first name and middle initial (and maiden name, if any): **Carol** | 1b Decedent's last name: **Ling** | | | 2 Decedent's Social Security No.: **709 31 2031** |
| 3a Legal residence (domicile) at time of death (county, state, and ZIP code, or foreign country): **Dane, WI 53713** | 3b Year domicile established: **1950** | 4 Date of birth: **2/13/1927** | | 5 Date of death: **20/10/1999** |

**Part 2.—Tax Computation**

| Line | Description | Sub-line | Sub-amount | Line | Amount |
|---|---|---|---|---|---|
| 1 | Total gross estate less exclusion (from Part 5, Recapitulation, page 3, item 12) | | | 1 | 745,000 |
| 2 | Total allowable deductions (from Part 5, Recapitulation, page 3, item 23) | | | 2 | |
| 3 | Taxable estate (subtract line 2 from line 1) | | | 3 | 745,000 |
| 4 | Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b))) | | | 4 | |
| 5 | Add lines 3 and 4 | | | 5 | 745,000 |
| 6 | Tentative tax on the amount on line 5 from Table A on page 12 of the instructions | | | 6 | 246,450 |
| 7a | If line 5 exceeds $10,000,000, enter the lesser of line 5 or $17,184,000. If line 5 is $10,000,000 or less, skip lines 7a and 7b and enter -0- on line 7c | 7a | | | |
| b | Subtract $10,000,000 from line 7a | 7b | | | |
| c | Enter 5% (.05) of line 7b | | | 7c | |
| 8 | Total tentative tax (add lines 6 and 7c) | | | 8 | 246,450 |
| 9 | Total gift tax payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions) | | | 9 | |
| 10 | Gross estate tax (subtract line 9 from line 8) | | | 10 | 246,450 |
| 11 | Maximum unified credit (applicable credit amount) against estate tax | 11 | | | |
| 12 | Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed $6,000. See page 4 of the instructions.) | 12 | | | |
| 13 | Allowable unified credit (applicable credit amount) (subtract line 12 from line 11) | | | 13 | 211,300 |
| 14 | Subtract line 13 from line 10 (but do not enter less than zero) | | | 14 | 35,150 |
| 15 | Credit for state death taxes. Do not enter more than line 14. Figure the credit by using the amount on line 3 less $60,000. See Table B in the instructions and **attach credit evidence** (see instructions) | | | 15 | 20,160 |
| 16 | Subtract line 15 from line 14 | | | 16 | 14,990 |
| 17 | Credit for Federal gift taxes on pre-1977 gifts (section 2012) (attach computation) | 17 | | | |
| 18 | Credit for foreign death taxes (from Schedule(s) P). (Attach Form(s) 706-CE.) | 18 | | | |
| 19 | Credit for tax on prior transfers (from Schedule Q) | 19 | | | |
| 20 | Total (add lines 17, 18, and 19) | | | 20 | |
| 21 | Net estate tax (subtract line 20 from line 16) | | | 21 | 14,990 |
| 22 | Generation-skipping transfer taxes (from Schedule R, Part 2, line 10) | | | 22 | |
| 23 | Total transfer taxes (add lines 21 and 22) | | | 23 | 14,990 |
| 24 | Prior payments. Explain in an attached statement | 24 | | | |
| 25 | United States Treasury bonds redeemed in payment of estate tax | 25 | | | |
| 26 | Total (add lines 24 and 25) | | | 26 | |
| 27 | Balance due (or overpayment) (subtract line 26 from line 23) | | | 27 | 14,990 |



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Form 706 (Rev. 7-99)

## Part 4—General Information *(continued)*

| *Please check the "Yes" or "No" box for each question.* | Yes | No |
|---|---|---|
| 7a Have Federal gift tax returns ever been filed? If "Yes," please attach copies of the returns, if available, and furnish the following information: | X | |
| 7b Period(s) covered / 7c Internal Revenue office(s) where filed | | |
| **If you answer "Yes" to any of questions 8–16, you must attach additional information as described in the instructions.** | | |
| 8a Was there any insurance on the decedent's life that is not included on the return as part of the gross estate? | | X |
| b Did the decedent own any insurance on the life of another that is not included in the gross estate? | | X |
| 9 Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which **(a)** one or more of the other joint tenants was someone other than the decedent's spouse, and **(b)** less than the full value of the property is included on the return as part of the gross estate? If "Yes," you must complete and attach Schedule E | | X |
| 10 Did the decedent, at the time of death, own any interest in a partnership or unincorporated business or any stock in an inactive or closely held corporation? | | X |
| 11 Did the decedent make any transfer described in section 2035, 2036, 2037, or 2038 (see the instructions for Schedule G beginning on page 11 of the separate instructions)? If "Yes," you must complete and attach Schedule G | X | |

## Part 5—Recapitulation

| Item number | Gross estate | | Alternate value | Value at date of death |
|---|---|---|---|---|
| 1 | Schedule A—Real Estate | 1 | | |
| 2 | Schedule B—Stocks and Bonds | 2 | | 500,000 |
| 3 | Schedule C—Mortgages, Notes, and Cash | 3 | | |
| 4 | Schedule D—Insurance on the Decedent's Life (attach Form(s) 712) | 4 | | |
| 5 | Schedule E—Jointly Owned Property (attach Form(s) 712 for life insurance) | 5 | | |
| 6 | Schedule F—Other Miscellaneous Property (attach Form(s) 712 for life insurance) | 6 | | |
| 7 | Schedule G—Transfers During Decedent's Life (att. Form(s) 712 for life insurance) | 7 | | 245,000 |
| 8 | Schedule H—Powers of Appointment | 8 | | |
| 9 | Schedule I—Annuities | 9 | | |
| 10 | Total gross estate (add items 1 through 9) | 10 | | 745,000 |
| 11 | Schedule U—Qualified Conservation Easement Exclusion | 11 | | |
| 12 | Total gross estate less exclusion (subtract item 11 from item 10). Enter here and on line 1 of Part 2—Tax Computation | 12 | | 745,000 |

**Question 31D.** What is Neil's gain or loss from the sale of the home?

**Answer 31D.** The general rule that gives the donee a carryover basis does **not** apply in this case since the **full value** of the home is included in Carol's estate for estate tax purposes. Treas. Reg. §1.1015-1(d) provides that the basis in property that is included in the estate of the donor is determined by the date-of-death basis rules rather than by the carry-over basis rules. Since I.R.C. §2036(a) requires the full value of Carol's home to be included in her estate for estate tax purposes, Neil's basis is the $245,000 included in her estate. Therefore, Neil's gain is $5,000 calculated as follows:

| | |
|---|---|
| Amount realized | $250,000 |
| Less: Date of death value basis | (245,000) |
| **Neal's Gain on the sale in 2000** | **$5,000** |



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## SELECTED ESTATE PLANNING TOOLS

### REMAINDER TRUSTS

Remainder trusts can reduce the gift and estate taxes owed on the transfer of property because of their effect on the valuation of the gift at the time the trust is created. To get this benefit, a grantor creates an irrevocable trust and retains some rights to the trust such as



1. The right to use the property in the trust or the right to receive the income from the trust—a grantor retained income trust (GRIT),
2. The right to receive an annual fixed dollar amount—a grantor retained annuity trust (GRAT), or
3. A right to receive a percentage of the fair market value of the trust on a periodic (not less often than once a year) basis—a grantor retained unitrust (GRUT).

**Caution.** The taxation of remainder trusts is complex. This discussion is intended as an overview of the subject. The detailed rules must be studied to avoid adverse tax consequences from the use of remainder trusts.

The grantor's rights to the trust terminate either at the end of a specified term, or on the earlier of a specified term or the death of the grantor. When the grantor's rights to the trust terminate, the assets in the trust are distributed to beneficiaries named by the grantor when the trust was set up, or they are retained in trust for the benefit of named beneficiaries. If the grantor dies prior to the termination of the grantor's retained rights, the funds either pass to the remainder beneficiaries or, depending on the specific terms of the trust, may revert to the grantor's estate or be subject to a general power of appointment held by the grantor.

Because the trust is irrevocable, and the grantor retains no right to alter the terms of the trust, the transfer of funds to the trust is a completed gift of the value of the property transferred less the value of the grantor's retained rights in the trust. The greater the value of these retained rights for gift tax purposes, the lower the value of the taxable gift.

**Example 32.** On July 15, 2000, Pete Bogg put $1,000,000 into an irrevocable trust in which he retained the right to receive $100,000 per year for ten years—a GRAT. At the end of ten years, the balance in the trust is to be distributed outright to his daughter, May. If Pete dies before the end of the ten-year period, the remaining annual payments go to his estate.

The remainder interest that Pete transferred to May is valued for gift tax purposes by subtracting the present value of the annuity payments from the $1,000,000 value of the trust on the day it was created. The present value of the annuity payments is computed by multiplying the $100,000 annual payments by 6.71. That is the annuity actuarial factor for the I.R.C. §7520 interest rate for July 2000 (8.0%) and a ten-year term certain. It can be found in Table B of IRS Publication 1457 or can be derived from the remainder factor for a ten-year term certain from Table B of Treas. Reg. §20.2031-7(d)(6). See Treas. Reg. §20.2031-7(d)(2)(iv). **The value of the remainder interest transferred to May is $329,000, computed as follows:**

| | | |
|---|---|---|
| Value of trust on July 15, 2000 | | $ 1,000,000 |
| Less value of retained annuity | | |
| Amount of annual payments | $100,000 | |
| Annuity actuarial factor | × 6.71 | (671,000) |
| **Value of remainder interest** | | **$ 329,000** |



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**Practitioner Note.** The remainder interest does not qualify for the $10,000 annual exclusion because it is a **future** interest.

**Observation.** Increasing the amount of the annuity payment will reduce the value of the remainder interest.

**Example 33.** Assume the same facts as Example 32 except that Pete retains the right to a $149,000 annual payment for the ten-year period. **The value of the retained interest is $210 calculated as follows:**

| | | |
|---|---|---|
| Value of trust on July 15, 2000 | | $1,000,000 |
| Less value of retained annuity | | |
| Amount of annual payments | $149,000 | |
| Annuity actuarial factor | × 6.71 | (999,790) |
| **Value of remainder interest** | | **$ 210** |

If the grantor survives the term of the retained rights, the remaining property in the trust passes to the beneficiaries, free of additional gift or estate tax. The only estate or gift tax cost associated with the transfer is the gift tax imposed when the trust was established.

**Example 34.** Assume the same facts as Example 33 and in addition that the trust investments yielded 10% return per year. Pete died on July 15, 2012. On the date of Pete's death, there was $265,070 in the trust.

None of the $265,070 is included in Pete's estate for federal estate tax purposes. Therefore, the only gift and estate tax cost of transferring the $265,070 to May was the use of $210 of Pete's applicable exclusion amount in 2000 when the trust was created.

**Observation.** If the rate of return on the trust investments is less than the I.R.C. §7520 rate, then the GRAT increases rather than decreases the grantor's transfer taxes.

**Example 35.** Assume the same facts as in Example 34 except that the trust investments yielded a 7% return per year. At the end of 2010, the trust has only $57,501 and cannot make the full $149,000 payment to Pete. At his death the trust has nothing in it. Consequently, Pete used $210 of his applicable exclusion amount and did not transfer any value of his estate to May.

**Observation.** As long as the value of the remainder interest is kept low, the gift and estate tax cost of investment returns below the I.R.C. §7520 rate will be low.

If the grantor dies prior to the expiration of the retained interests, the value of the trust at that time is included in the grantor's gross estate if the retained property interest was an income or use interest.

**Example 36.** Assume the same facts as in Example 34 except that Pete died on July 15, 2008, right after the eighth annuity payment had been made. At the time of his death, the I.R.C. §7520 interest rate is 9.0% and the amount remaining in the trust is $439,641.



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Pete's right to the remaining two annuity payments are included in his estate. At the date of his death, the present value of the right to two $149,000 annual payments is:

| | |
|---|---|
| Amount of annual payments | $149,000 |
| Annuity actuarial factor | × 1.759 |
| **Present value of annuity payments** | **$262,091** |



Therefore, Pete has transferred $439,641 to May but only $210 + $262,091 = $262,301 was included as taxable transfers. The $177,340 remainder ($439,641 – $262,301) was transferred without being subject to the transfer tax.

**Practitioner Note.** If the rights retained by the donor are not a "qualified interest" for purposes of the valuation rules under Chapter 14 of the Internal Revenue Code (I.R.C. §§2701–2704), the gift tax consequences when the trust is created will be significantly increased.

## FAMILY LIMITED PARTNERSHIPS

See the Choice of Business entity chapter for a discussion of minority and marketability discounts on gifts of an interest in a family limited partnership.

## APPENDIX A

Table A—Unified Rate Schedule

| Column A<br>Taxable amount over | Column B<br>Taxable amount not over | Column C<br>Tax on amount in column A | Column D<br>Rate of tax on excess over amount in column A |
|---|---|---|---|
| | | | (Percent) |
| 0 | $10,000 | 0 | 18 |
| $10,000 | 20,000 | $1,800 | 20 |
| 20,000 | 40,000 | 3,800 | 22 |
| 40,000 | 60,000 | 8,200 | 24 |
| 60,000 | 80,000 | 13,000 | 26 |
| 80,000 | 100,000 | 18,200 | 28 |
| 100,000 | 150,000 | 23,800 | 30 |
| 150,000 | 250,000 | 38,800 | 32 |
| 250,000 | 500,000 | 70,800 | 34 |
| 500,000 | 750,000 | 155,800 | 37 |
| 750,000 | 1,000,000 | 248,300 | 39 |
| 1,000,000 | 1,250,000 | 345,800 | 41 |
| 1,250,000 | 1,500,000 | 448,300 | 43 |
| 1,500,000 | 2,000,000 | 555,800 | 45 |
| 2,000,000 | 2,500,000 | 780,800 | 49 |
| 2,500,000 | 3,000,000 | 1,025,800 | 53 |
| 3,000,000 | ----------- | 1,290,800 | 55 |



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# APPENDIX B

Table B Worksheet

| Federal Adjusted Taxable Estate | |
|---|---|
| 1 Federal taxable estate (from Tax Computation, Form 706, line 3) | $ |
| 2 Adjustment | 60,000 |
| 3 Federal adjusted taxable estate. Subtract line 2 from line 1. Use this amount to compute maximum credit for state death taxes in **Table B.** | |

Table B

Computation of Maximum Credit for State Death Taxes
(Based on Federal adjusted taxable estate computed using the worksheet above.)

| (1) Adjusted taxable estate equal to or more than— | (2) Adjusted taxable estate less than— | (3) Credit on amount in column **(1)** | (4) Rate of credit on excess over amount in column **(1)** | (1) Adjusted taxable estate equal to or more than— | (2) Adjusted taxable estate less than— | (3) Credit on amount in column **(1)** | (4) Rate of credit on excess over amount in column **(1)** |
|---|---|---|---|---|---|---|---|
| | | | (Percent) | | | | (Percent) |
| 0 | $40,000 | 0 | None | 2,040,000 | 2,540,000 | 106,800 | 8.0 |
| $40,000 | 90,000 | 0 | 0.8 | 2,540,000 | 3,040,000 | 146,800 | 8.8 |
| 90,000 | 140,000 | $400 | 1.6 | 3,040,000 | 3,540,000 | 190,800 | 9.6 |
| 140,000 | 240,000 | 1,200 | 2.4 | 3,540,000 | 4,040,000 | 238,800 | 10.4 |
| 240,000 | 440,000 | 3,600 | 3.2 | 4,040,000 | 5,040,000 | 290,800 | 11.2 |
| 440,000 | 640,000 | 10,000 | 4.0 | 5,040,000 | 6,040,000 | 402,800 | 12.0 |
| 640,000 | 840,000 | 18,000 | 4.8 | 6,040,000 | 7,040,000 | 522,800 | 12.8 |
| 840,000 | 1,040,000 | 27,600 | 5.6 | 7,040,000 | 8,040,000 | 650,800 | 13.6 |
| 1,040,000 | 1,540,000 | 38,800 | 6.4 | 8,040,000 | 9,040,000 | 786,800 | 14.4 |
| 1,540,000 | 2,040,000 | 70,800 | 7.2 | 9,040,000 | 10,040,000 | 930,800 | 15.2 |
| | | | | 10,040,000 | ------------ | 1,082,800 | 16.0 |



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2000 Income Tax School

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