Chapter 2: Individual Taxpayer Issues

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Note. Corrections were made to this workbook through January of 2025. No subsequent modifications were made. For clarification about terms used throughout this chapter, see the **Acronyms and Abbreviations** section following the index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

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RE-EVALUATING THE NET INVESTMENT INCOME TAX

Over the years since the inception of the net investment income tax (NIIT), the number of taxpayers subject to the additional tax has more than doubled. For instance, 7.1 million filers were subject to the NIIT in tax year 2021,[1] compared to the 3.1 million filers in tax year 2013.[2] As more taxpayers become subject to the NIIT, practitioners may expect the additional tax to impact more of their clients. This section reacquaints practitioners with the nuances and characteristics of the NIIT by exploring what triggers the tax, identifying what types of activities and income are subject to the tax, and providing considerations and potential planning tips on how to avoid the tax.

APPLICABILITY[3]

The NIIT was included as a revenue-raising component[4] of the Health Care and Education Reconciliation Act of 2010[5] as an amendment to the Patient Protection and Affordable Care Act of 2010 (ACA).[6] The tax is an additional 3.8% tax on net investment income (NII), which includes **passive** activity income from a trade or business and other income not derived from the ordinary course of a trade or business. The NIIT, calculated and reported on Form 8960, *Net Investment Income Tax — Individuals, Estates, and Trusts*, applies to individuals, estates, and trusts whose 2024 modified adjusted gross income (MAGI) or adjusted gross income (AGI) exceeds specified thresholds as follows.[7]

Filing Status	Threshold Amount
Married Filing Jointly	$250,000 MAGI
Qualifying Surviving Spouse	250,000 MAGI
Married Filing Separately	125,000 MAGI
Single or Head of Household	200,000 MAGI
Estates and Trusts	15,200 AGI

1. See *Table 3.3. All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2021 (Filing Year 2022)* available at *SOI Tax Stats — Individual Statistical Tables by Size of Adjusted Gross Income.* Jan. 31, 2024. IRS. [www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income] Accessed on Mar. 28, 2024.
2. See *Table 3.3. All Returns: Tax Liability, Tax Credits, and Tax Payments, by Size of Adjusted Gross Income, Tax Year 2013* available at *SOI Tax Stats — Individual Statistical Tables by Size of Adjusted Gross Income.* Jan. 31, 2024. IRS. [www.irs.gov/statistics/soi-tax-stats-individual-statistical-tables-by-size-of-adjusted-gross-income] Accessed on Mar. 28, 2024.
3. IRC §1411.
4. *The 3.8% Net Investment Income Tax: Overview, Data, and Policy Options,* p. 1. Jun. 30, 2023. Congressional Research Service. [crsreports.congress.gov/product/pdf/IF/IF11820] Accessed on Dec. 21, 2023.
5. *Health Care and Education Reconciliation Act of 2010,* PL 111-152.
6. *Patient Protection and Affordable Care Act*, PL 111-148.
7. 2023 Instructions for Form 8960; Instructions for Form 1041-ES.

However, the NIIT does not apply to the following.

- Nonresident aliens (NRAs)
- Dual-resident individuals claiming a benefit of a tax treaty between the United States and their country of residence[8]
- Dual-status individuals residing in the United States for only a part of the year[9]
- The following types of trusts[10]
  - Charitable trusts and qualified retirement plan trusts exempt from tax under IRC §501
  - Charitable remainder trusts exempt from tax under IRC §664
  - A trust for which all unexpired interests are devoted to one or more of the following purposes under IRC §170(c)(2)(B): religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (providing none of the activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals
  - Grantor trusts under IRC §§671–679
  - Trusts not classified as trusts for federal income tax purposes, such as real estate investment trusts and common trust funds
  - Electing Alaska native settlement trusts described in IRC §646
  - Perpetual care (cemetery) trusts described in IRC §642(i)

IDENTIFICATION OF NII

In reporting and calculating NIIT, the first fundamental step is distinguishing what constitutes NII from what does not. This section describes the composition of NII, what is excluded from NII, and other considerations in characterizing NII.

Income Included in NII

Generally, NII comprises the following types of income.[11]

- Gross interest, dividends, annuities, royalties, rents, and substitute interest or dividends
- Other income derived from a passive activity or a trade or business trading in financial instruments or commodities
- Net capital gains attributable to the disposition of property that is not held in a trade or business

Example 1. Scott Eberly wants to start a petting zoo business but is unable to find resources to invest in the business. He asks his father, Doug Eberly, if he would either invest in his business or loan the money Scott needs to start the business. After careful consideration, Doug opts to invest in his son's business, resulting in the formation of an S corporation with Scott and Doug as equal shareholders. Scott manages the day-to-day operations of the business, while Doug has no involvement except for asking Scott how the business is going. Doug's participation in this activity is passive, and therefore, the income that Doug receives from the S corporation could be subject to NIIT.

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8. Treas. Regs. §§1.1411-2(a)(2)(i) and 301.7701(b)-7(a)(1).
9. Treas. Reg. §1.1411-2(a)(2)(ii).
10. Instructions for Form 8960.
11. IRC §1411(c)(1)(A).

Income Excluded from NII

The following types of income are **not** considered NII for purposes of calculating NIIT.[12]

- Wages
- Unemployment compensation
- Operating income from a nonpassive business
- Social security benefits
- Alimony
- Tax-exempt interest
- Self-employment (SE) income
- Alaska permanent fund dividends
- Qualified IRC §§401(a), 403(a), 403(b), 408, 408A, and 457(b) plan distributions
- The gain on the sale of a personal residence excluded under IRC §121

Example 2. Use the same facts as **Example 1.** After several years of receiving Schedule K-1 (Form 1120-S), *Shareholder's Share of Income, Deductions, Credits, etc.*, showing relatively little income, Doug tells Scott he has ideas on how to financially improve the business and decides to take over the financial operation of the business. Due to his increased involvement and time devoted to the business, Doug's participation is no longer passive. Therefore, any net income from the business after this change is not subject to the NIIT.

Rental Income

The income that a taxpayer derives from an activity may be subject to the NIIT if their involvement in that activity is passive. Because distinguishing passive from nonpassive income is critical in determining the applicability of the NIIT, some activities require guidance to categorize the taxpayer's involvement as passive or nonpassive.

For instance, the categorization of rental income under IRC §469 determines whether the NII rules under IRC §1411 apply. Generally, rental income is considered passive under §469. However, if the taxpayer is a real estate professional, rental income is considered **nonpassive.**[13] A taxpayer is a real estate professional if they meet both of the following tests.[14]

1. More than half of the personal services the taxpayer performs during the year involve real estate trades or businesses in which the taxpayer materially participates.
2. The taxpayer spends more than 750 hours per year in real property trade or business activities in which they materially participate.

Note. See Treas. Reg. §1.469-9 for additional guidance on real estate professionals and the §469 rules for rental income.

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12. *Questions and Answers on the Net Investment Income Tax*. Oct. 23, 2023. IRS. [www.irs.gov/newsroom/questions-and-answers-on-the-net-investment-income-tax] Accessed on Dec. 21, 2023.

13. IRC §469(c)(7).

14. IRC §469(c)(7)(B); Treas. Reg. §1.469-9(c)(1).

If the rental income is considered nonpassive under §469 and it is derived in an IRC §162 trade or business, that rental income is not part of the taxpayer's NII for the year because the business exception applies. The proposed regulation states that a real estate professional is **not necessarily** engaged in a trade or business with regard to rental real estate activities.[15] However, a safe harbor exists that allows gross rental income and gains or losses from the disposition of property used in such rental real estate activity to be deemed as derived from an ordinary course of a trade or business if the taxpayer meets **one** of the following two tests.[16]

1. The taxpayer participates in a rental real estate activity for over 500 hours during the tax year.
2. The taxpayer participated in a rental real estate activity for over 500 hours during any five tax years during the last ten tax years. The five years do not need to be consecutive.

Even if a taxpayer does not meet either test, their real estate income might still not be subject to the NIIT in certain situations. These tests are not the sole indication of their activity being a real estate trade or business.[17]

> **Example 3.** Agatha works full-time as a mortician. Her filing status is single, and her MAGI is over the $200,000 threshold. She owns a second home, which she rents out to a tenant. In 2024, she receives $7,000 in net rental income. For the 2024 tax year, Agatha's rental income is considered passive income under the §469 rules because she is not a real estate professional. Therefore, Agatha's rental income is classified as NII for 2024 and is subject to the 3.8% NIIT. Agatha's NIIT liability is $266 (3.8% × $7,000).

> **Example 4.** Use the same facts as **Example 3,** except that Agatha is a real estate professional who works more than 500 hours during 2024 in her job. Because Agatha satisfies the first safe harbor test, her rental income is nonpassive under the rules of §469. Under the NII rules, if the rental income is derived in the ordinary course of a business, then the rental income is not NII for 2024. Accordingly, the 3.8% NIIT does not apply to Agatha's $7,000 of rental income.

Grouping Activities under §469

Categorizing income as passive or nonpassive under §469 is necessary **before** applying the NII rules of §1411. Generally, only passive activities generate NIIT, as discussed previously. Such a group of activities is considered nonpassive under §469 and is therefore not considered part of the taxpayer's NII. However, these activities are still considered passive and constitute part of the taxpayer's NII.[18] This is the case if the income is from a §162 "trade or business" that is not in the business of trading financial instruments or commodities.[19]

A taxpayer may participate in multiple activities, none of which meet the material participation tests of Temp. Treas. Reg. §1.469-5T. If those activities collectively form an appropriate economic unit, they can be grouped together. When grouped, the activities are considered a **single activity** that may meet the material participation tests.[20]

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15. Preamble to REG-130507-11 (Dec. 5, 2012), p. 72,612.
16. Treas. Reg. §1.1411-4(g)(7)(i).
17. Treas. Reg. §1.1411-4(g)(7)(iii).
18. *Net Investment Income Tax Surprise: Significant Participation Rule Trumping Material Participation Tests*. Stamper, Dustin. Jan. 31, 2015. AICPA. [www.thetaxadviser.com/issues/2015/feb/tax-clinic-08.html] Accessed on Mar. 20, 2024.
19. As defined in IRC §475(e)(2).
20. See Treas. Reg. §1.469-4(c).

Example 5. In addition to being the CEO of a financial consulting agency, Courtney has a public speaking business and owns a credit valuation business. The credit valuation business analyzes consumer asset portfolios and businesses and operates as a sole proprietorship. Courtney spends 520 hours in management in the credit valuation business in 2024. Her public speaking business runs as a joint venture. In 2024, she spends 85 hours in the public speaking business while her business associate spends 125 hours.

Because Courtney does not meet the material participation requirements for her speaking business, the net income from it is generally considered passive. She meets the material participation requirement for her valuation business.

Under the rules of §469, Courtney can group the two businesses to meet the material participation requirement for both if the activities constitute an appropriate economic unit. If she elects to group the two businesses as a single activity, the net profit from the speaking business is considered nonpassive under §469. Under the NII rules, if the speaking activity is a trade or business (under §162) and is not a covered business engaged in trading financial instruments or commodities, the income is not considered NII for Courtney for 2024. Consequently, it is not subject to the 3.8% NIIT.[21]

Passive Activity Loss Recharacterization Rules

Regulations under the passive activity loss rules of §469 have several "recharacterization rules" that serve to classify certain types of income as nonpassive that otherwise might be considered passive.[22] Income considered nonpassive under a recharacterization rule is not part of the taxpayer's NII if it is from a trade or business under §162 that is not a covered trade or business. This is because §469 is used within the definition of NII in determining whether income is passive and, therefore, part of the taxpayer's NII for the year.

One such recharacterization rule is the significant participation passive activity rule. A significant participation passive activity is one in which the taxpayer participates for more than 100 hours during the tax year but does not materially participate under any of the seven material participation tests found in Temp. Treas. Reg. §1.469-5T(a).[23]

Example 6. During 2024, Neil participates in three different trade or business activities. Each of these activities is a trade or business under §162. The following table provides a description of the type of interest, the type of activity, and other relevant data in connection with the 2024 tax year.

	S Corporation Interest (Event Coordinator)	Partnership Interest (Golf Club)	Sole Proprietorship (Apparel Retail)	Total
Hours of participation during the year	110	140	165	
Gross passive income	$7,000	$11,000	$6,000	$24,000
Passive activity deductions	(1,000)	(4,000)	(9,000)	(14,000)
Net passive income	$6,000	$7,000	($3,000)	$10,000

Neil's participation in each of the business activities is more than 100 hours and he does not meet any of the seven material participation tests in Temp. Treas. Reg. §1.469-5T. Therefore, each of the three activities constitutes a significant participation passive activity. Neil's gross income from significant participation passive activity exceeds his total significant participation passive deductions by $10,000 for the year.

Under Temp. Treas. Reg. §1.469-2T(f)(2)(i), the $10,000 of total net passive income is treated as income that is nonpassive. Accordingly, it is also considered nonpassive under NII rules because each business constitutes a trade or business under §162, and none of the businesses are in the business of trading financial instruments or commodities. Therefore, the $10,000 is excluded from Neil's 2024 NII.

21. Treas. Regs. §§1.1411-5(a), (b), and (c).

22. Temp. Treas. Reg. §1.469-2T(f).

23. Temp. Treas. Reg. §1.469-2T(f)(2).

Pass-Through Entity Stock and Interest Dispositions

S corporation shares and partnership interests are not considered property held in an active business.[24] Accordingly, any gain recognized on the taxpayer's sale of such an interest is subject to the NIIT.[25] However, an exception applies to active interests in S corporations and partnerships, where gains on the disposition of such interests are included in NII only to the extent of such a disposition's net gain being subject to the NIIT had the entity sold all its property immediately before the disposition of the ownership interest.[26] Taxpayers making adjustments for such an exception on Form 8960 must attach to their income tax return a statement including the following information.[27]

- The transferred partnership's or S corporation's name and tax identification number
- The transferor's gain or loss on the interest disposition for regular income tax purposes (included on Form 8960, line 5a)
- Information received by the transferor from the S corporation or partnership pertaining to the disposition, if applicable
- Any amount of the gain or loss adjustment resulting from basis adjustments for ownership in certain controlled foreign corporations (CFCs) or qualified electing funds (QEFs)

Example 7. Lenny is a passive investor in Gibson City Corp., an S corporation. Gibson City Corp. is not in the business of trading financial instruments or securities and there is no indebtedness owed to Lenny by the S corporation. Lenny sells his stock for a net gain of $2.8 million in 2023. Because he does not actively participate in Gibson City Corp., the entire $2.8 million is subject to NIIT. Lenny reports the investment income on the following Form 8960.

Form **8960** — Department of the Treasury, Internal Revenue Service

Net Investment Income Tax— Individuals, Estates, and Trusts

Attach to your tax return.

Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227 — **2023** — Attachment Sequence No. **72**

Name(s) shown on your tax return: **Lenny King** — Your social security number or EIN: *****-**-5252**

Part I Investment Income ☐ Section 6013(g) election (see instructions) ☐ Section 6013(h) election (see instructions) ☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	
2	Ordinary dividends (see instructions)			2	
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, trades or businesses, etc. (see instructions)	4a			
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	
5a	Net gain or loss from disposition of property (see instructions)	5a	2,800,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	2,800,000
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	2,800,000

24. IRC §1411(c)(1)(A)(iii).

25. Preamble to REG 130507-11 (Dec. 5, 2012), p. 72,613.

26. IRC §1411(c)(4)(A).

27. Instructions for Form 8960.

Example 8. Use the same facts as **Example 7,** except Lenny actively participates in Gibson City Corp. Lenny's sale of Gibson City stock of $2.8 million is not subject to NIIT. Accordingly, Lenny includes an adjustment of –$2.8 million on line 5c of Form 8960 to zero out the investment income subject to NIIT.

Form **8960** | Department of the Treasury Internal Revenue Service

Net Investment Income Tax— Individuals, Estates, and Trusts

Attach to your tax return.

Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227 | **2023** | Attachment Sequence No. **72**

Name(s) shown on your tax return: **Lenny King** | Your social security number or EIN: *****-**-5252**

Part I Investment Income ☐ Section 6013(g) election (see instructions) ☐ Section 6013(h) election (see instructions) ☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	
2	Ordinary dividends (see instructions)			2	
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, trades or businesses, etc. (see instructions)	4a			
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	
5a	Net gain or loss from disposition of property (see instructions)	5a	2,800,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c	(2,800,000)		
d	Combine lines 5a through 5c			5d	0
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	0

Lenny attaches the following statement to his income tax return explaining the adjustment he reported on Form 8960, line 5c.

Entity Name: Gibson City Corp.
Entity EIN: 12-3456789

Gain or loss from disposition: 2,800,000

Adjustments to gain or loss due to basis adjustments for certain CFCs and QEFs: 0

Taxpayer Lenny King sold equity interest in the S corporation in which he materially participated. The company is not in the business of trading financial instruments or securities. There is no indebtedness owed to the taxpayer by the business; therefore none of the gain is attributable to such indebtedness.

SE Income

NII for the year does not include any net business income subject to SE tax.[28]

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> **Note.** It is not possible for the taxpayer to receive income that is subject to both the SE tax and the NIIT.[29] Additionally, while a taxpayer may be subject to both the NIIT and additional Medicare tax of 0.9%, the same type of income is not taxed by both. The additional Medicare tax is assessed on wages, compensation, and SE income over specified thresholds. However, it does **not** apply to income included in NII.[30]

Other types of income that the Code specifically excludes from SE income may be part of the taxpayer's NII and subject to the NIIT. The Code specifically excludes the following types of income from SE income.

- Certain types of real estate net rental income, including rental income from personal property leased with real estate[31]
- Dividends and interest[32]
- A limited partner's distributive share (other than a guaranteed payment for services rendered)[33]
- Gains or losses from the sale or exchange of capital assets[34]

Although the Code excludes these types of income from SE income, they are subject to NIIT if they meet the definition of NII (discussed previously) and if the taxpayer's income exceeds the applicable NIIT threshold for the year.[35]

> **Note.** IRC §1402(a)(3)(A) states that gains or losses from the sale of capital assets are not included in SE net earnings and are therefore not subject to SE tax. IRC §1411(c)(6) states that NII does not include amounts that are subject to SE tax. When a self-employed taxpayer sells capital assets that could result in NII, these two provisions are important in determining what amounts are subject to NIIT rules.

Example 9. Shania is an engineer and a general partner in Evanescent Partners, LLP (EP). EP completes major construction projects worldwide. For 2024, Shania's distributive share from EP is $900,000. This amount includes her share of capital gain from the sale of land, $300,000. The remaining $600,000 of Shania's distributions constitutes SE income for the year and is subject to SE tax but not NIIT.

IRC §1402(a)(3)(A) excludes the $300,000 capital gain from SE earnings and SE tax. However, for 2024, assuming all other requirements for the NII are satisfied, the $300,000 capital gain constitutes NII for Shania. If Shania's MAGI exceeds the applicable threshold for her filing status, she has NIIT liability on the $300,000 capital gain.

28. IRC §1411(c)(6).

29. *Questions and Answers on the Net Investment Income Tax*. Oct. 23, 2023. IRS. [www.irs.gov/newsroom/questions-and-answers-on-the-net-investment-income-tax] Accessed on Dec. 21, 2023.

30. *Find out if Net Investment Income Tax applies to you.* Feb. 10, 2023. IRS. [www.irs.gov/individuals/net-investment-income-tax] Accessed on Dec. 21, 2023.

31. IRC §1402(a)(1).

32. IRC §1402(a)(2).

33. IRC §1402(a)(13).

34. IRC §1402(a)(3).

35. IRC §1411(a)(1)(B).

EXPENSES REDUCING NII

NII is gross investment income less the following types of expenses to the extent that these expenses are allocable to gross investment income items.[36]

- Investment advisory fees
- Brokerage fees

> **Caution.** Under the Tax Cuts and Jobs Act (TCJA), investment advisory fees and brokerage fees are not deductible as miscellaneous itemized expenses and therefore are not as allowed as a deduction against at NIIT.[37]

- Investment interest expense
- Rental expenses
- Royalty expenses
- State and local income taxes

Example 10. Adam and Amy are Illinois residents who file their Form 1040, *U.S. Individual Income Tax Return,* jointly for 2023. They itemize their deductions on Form 1040, Schedule A, *Itemized Deductions*. Both are age 70, retired, and have the following income in 2023.

Interest income	$ 28,500 [a]
Tax-exempt interest (nontaxable for federal tax purposes)	59,100
Ordinary dividends	12,700 [a]
Net capital gain from sales of securities (reported on line 7, Form 1040)	84,700 [a]
Individual retirement arrangement (IRA) distributions	48,500
Pension income	125,000
Net rental real estate income (farmland rental)	10,000 [a]
Taxable social security income	22,400
Total 2023 income	$390,900

[a] These items represent investment income for Form 8960 purposes. The other income items do not represent investment income and are omitted when completing Form 8960.

Adam and Amy's 2023 AGI shown on their Form 1040 is $331,800 ($390,900 – $59,100 of tax-exempt interest).

Their Illinois base income, as shown on their 2023 Form IL-1040, *Individual Income Tax Return*, is $195,000, which is calculated as follows.

Federal AGI reported on 2023 Form 1040	$331,800
Plus: tax-exempt interest	59,100
Less: IRA distributions	(48,500)
Less: pension income	(125,000)
Less: taxable social security income	(22,400)
2023 Form IL-1040 base income	$195,000

36. *Questions and Answers on the Net Investment Income Tax*. Oct. 23, 2023. IRS. [www.irs.gov/newsroom/questions-and-answers-on-the-net-investment-income-tax] Accessed on Jan. 8, 2024.

37. Instructions for Form 8960.

Adam and Amy's 2023 Illinois state income tax deduction on Form 1040, Schedule A is $9,275, of which $6,464 is attributable to investment income reported in part 1 of their 2023 Form 8960. The amount of Adam and Amy's Illinois base income attributable to investment income is calculated as follows.

2023 Form IL-1040 base income	$195,000
Less: tax-exempt interest	(59,100)
Balance of 2023 Form IL-1040 base income	$135,900

The portion of the $9,275 total 2023 Illinois state income tax attributable to investment income reported on Adam and Amy's 2023 Form 8960 is expressed in the following fraction.

$$\textbf{State income tax attributable to investment income} = \frac{\$135{,}900}{\$195{,}000} \times \$9{,}275$$

$$= \$6{,}464$$

Adam and Amy's 2023 Form 8960 is prepared as shown on the following page.

For Example 10

Form **8960** Department of the Treasury Internal Revenue Service

Net Investment Income Tax— Individuals, Estates, and Trusts
Attach to your tax return.
Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227
2023
Attachment Sequence No. **72**

Name(s) shown on your tax return	Your social security number or EIN
Adam and Amy Andrews	*** - ** -6789

Part I Investment Income ☐ Section 6013(g) election (see instructions) ☐ Section 6013(h) election (see instructions) ☐ Regulations section 1.1411-10(g) election (see instructions)

1	Taxable interest (see instructions)			1	28,500
2	Ordinary dividends (see instructions)			2	12,700
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, trades or businesses, etc. (see instructions)	4a	10,000		
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b	0		
c	Combine lines 4a and 4b			4c	10,000
5a	Net gain or loss from disposition of property (see instructions)	5a	84,700		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b	0		
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c	0		
d	Combine lines 5a through 5c			5d	84,700
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	135,900
Part II	**Investment Expenses Allocable to Investment Income and Modifications**				
9a	Investment interest expenses (see instructions)	9a			
b	State, local, and foreign income tax (see instructions)	9b	6,464		
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	6,464
10	Additional modifications (see instructions)			10	
11	Total deductions and modifications. Add lines 9d and 10			11	6,464
Part III	**Tax Computation**				
12	Net investment income. Subtract Part II, line 11, from Part I, line 8. Individuals, complete lines 13–17. Estates and trusts, complete lines 18a–21. If zero or less, enter -0-			12	129,436
	Individuals:				
13	Modified adjusted gross income (see instructions)	13	331,800		
14	Threshold based on filing status (see instructions)	14	250,000		
15	Subtract line 14 from line 13. If zero or less, enter -0-	15	81,800		
16	Enter the smaller of line 12 or line 15			16	81,800
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			17	3,108
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a			
b	Deductions for distributions of net investment income and charitable deductions (see instructions)	18b			
c	Undistributed net investment income. Subtract line 18b from line 18a (see instructions). If zero or less, enter -0-	18c			
19a	Adjusted gross income (see instructions)	19a			
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b			
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c			
20	Enter the smaller of line 18c or line 19c			20	
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			21	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59474M Form **8960** (2023)

Adam and Amy's $59,100 of tax-exempt interest is not investment income and is therefore not subject to the 3.8% NIIT. Furthermore, their $6,464 of state income tax shown on line 9b of Form 8960 does not affect the computation of their $3,108 of NIIT. This is because their MAGI exceeds the threshold amount by only $81,800 (line 15), which is less than their NII of $129,436 (line 12).

TAXATION OF LAWSUIT SETTLEMENTS

Lawsuit settlement payments represent an income tax consideration for taxpayers and practitioners, primarily in identifying whether the lawsuit settlement is taxable. Because the taxability of a lawsuit settlement generally depends on the nature of the underlying claim and the types of damages awarded, **taxpayers must assess the facts and circumstances surrounding such payments.** This section identifies when and what type of lawsuit settlements are taxable, what types of income the settlements may represent, and how to report such income on a tax return.

ORIGIN OF THE CLAIM

The taxability of settlement payments and the deductibility of expenses incurred in obtaining settlement payments or paying settlement claims are dependent on the **origin of the claim.**[38] This doctrine looks at the underlying reason for which compensation is sought, identifying the reason the taxpayer went to court as stated in their complaint. While the Code and IRS guidance identify specific causes for settlements as taxable and nontaxable, the origin of the claim must be used to determine into which category the settlement falls.

If the origin of the claim is not clearly specified or easily determined, the next area to assess is the payor's **intent.**[39] As opposed to examining the claimant, this test focuses on the **payor,** primarily concerning the reasoning behind making the payment. Evidence examined during the trial, the resulting judgment, the fact pattern leading to the payment agreement, and other facts may be used in assessing the character of the payment.[40] Settlement payments may include multiple elements, such as back pay, emotional distress, and attorney fees. The allocation of these multiple elements in a payment is made in an agreement between the parties that the IRS generally does not challenge if the allocation is consistent with the substance of the settled claims.[41]

Physical Sickness or Injury

Damages for **physical** sickness or injury are generally excluded from gross income.[42] The key consideration in identifying the origin of these claims is the "physical" requirement. While the IRS has not formally defined what constitutes a physical injury, the agency has provided examples of non-physical injuries, including emotional distress, defamation, and humiliation.[43] The resulting implication is that physical injuries constitute visible and observable bodily harm.[44]

While settlement payments for claims for physical sickness or injury are generally excluded from gross income, taxpayers must be mindful of allocations of the payment to medical expenses. If the taxpayer receives a settlement payment that includes a portion attributable to medical expenses that the taxpayer deducted on a prior year's tax return under IRC §213, that portion of the settlement must be included in gross income to the extent the deduction provided a tax benefit.[45] This should be reported on line 8z of Form 1040, Schedule 1, *Additional Income and Adjustments to Income.*

> **Note.** For information about determining whether the recovery of previously deducted expenses provided a tax benefit, see Recoveries in IRS Pub. 525, *Taxable and Nontaxable Income*.

38. *U.S. v. Gilmore*, 372 U.S. 39 (1963).
39. *Knuckles v. Comm'r*, 349 F.2d 610, 613 (10th Cir. 1965).
40. *Green v. Comm'r*, 507 F.3d 857, 868 (5th Cir. 2007).
41. IRS Pub. 4345, *Settlements — Taxability*.
42. IRC §104(a)(2) and Treas. Reg. §1.104-1(c).
43. *Tax Implications of Settlements and Judgments*. Oct. 16, 2023. IRS. [www.irs.gov/government-entities/tax-implications-of-settlements-and-judgments] Accessed on Jan. 9, 2024.
44. *Ten Rules Every Lawyer — and Client — Should Know about Taxes on Legal Settlements*. Wood, Robert W. Apr. 27, 2017. The American Bar Association. [americanbar.org/groups/business_law/resources/business-law-today/2017-april/ten-rules-every-lawyer-and-client-should-know-about-taxes-on-leg] Accessed on Jan. 9, 2024.
45. IRS Pub. 4345, *Settlements — Taxability*; IRC §104(a).

Emotional Distress

The taxability of settlement payments for emotional distress depends on the reason for the emotional distress. If the taxpayer's emotional distress is attributable to physical sickness or injury, the payment is excluded from gross income.[46]

However, if the taxpayer's emotional distress is not attributable to physical sickness or injury, the payment is included in gross income. For example, emotional distress attributable to disparate treatment discrimination is taxable.[47] The amount of the payment that is included in gross income may be reduced by medical expenses that the taxpayer did not previously deduct on their income tax return or receive a tax benefit for.[48] This should be reported on line 8z of Form 1040, Schedule 1.

Lost Wages or Profits

The portion of settlement payments in employment-related lawsuits that are attributable to lost wages, including severance pay, back pay, and front pay, are taxable wages.[49] Such payments are subject to employment tax withholding by the payer, including social security and Medicare taxes. Ideally, the payer would also withhold the employee portion of the employment taxes from the payment. Recipients should report these amounts as wages on line 1a of Form 1040.[50]

The portion of settlement payments attributable to lost profits is subject to income tax as well as SE tax. Recipients should include the income on Schedule C, *Profit or Loss from Business,* which flows to Schedule 1 and then to Form 1040 as part of gross income. To report the portion of income subject to SE tax, recipients should include the income on Schedule SE, *Self-Employment Tax*.[51]

Damaged or Destroyed Property[52]

Settlement payments for damaged or destroyed property are generally treated as a return of capital.[53] If the award is less than the taxpayer's adjusted basis in the property, the payment is not taxable and excluded from income tax return reporting. The taxpayer's basis in the damaged property is reduced by the amount of the award. However, if the award exceeds the taxpayer's adjusted basis in the property, the basis is reduced to zero, and the excess amount is taxable income. If the damaged property was used in the taxpayer's trade or business, the taxpayer reports the gain on Form 4797, *Sale of Business Property*. For all other property, the taxpayer reports the capital gain on Form 1040, Schedule D, *Capital Gains and Losses*.

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46. Treas. Reg. §1.104-1(c)(1).
47. Rev. Rul. 96-65, 1996-2 CB 6.
48. IRS Pub. 4345, *Settlements — Taxability.*
49. Rev. Rul. 96-65, 1996-2 CB 6; TAM 200244004 (Nov. 1, 2002).
50. IRS Pub. 4345, *Settlements — Taxability.*
51. Ibid.
52. Ibid.
53. Rev. Rul. 81-277, 1981-2 CB 14.

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Punitive Damages

Courts assess punitive damages as a way of punishing defendants for harmful behavior. Punitive damages differ from compensatory damages, which are assessed to compensate a plaintiff for the harm they experienced from the defendant's actions. Punitive damages are included in gross income[54] unless awarded in civil wrongful death actions, where punitive damages are the only remedy under state law.[55] Taxpayers report punitive damages income on line 8z of Schedule 1 for Form 1040.[56]

Caution. It is important to assess the multiple allocations of a settlement payment when assessing the taxable portion(s) of the awarded damages. Even in settlements for personal physical injuries or sickness, for which compensatory damages are excluded from gross income, the portion of the awarded damages attributed to punitive damages is included in gross income.[57] Thus, practitioners should not only identify the underlying cause for why the taxpayer sought damages but also identify all allocable components of the awarded damages when preparing tax returns for taxpayers who received lawsuit settlement payments.

Practitioner Planning Tip

A tax practitioner working with a client who received a settlement from a lawsuit should request a copy of the client's claims, as stated in their pleadings, as well as the court's final decision. Because of the time needed to thoroughly review these documents, receiving them well before tax season is preferable.

ATTORNEY FEES

As attorney fees are common expenses during litigation proceedings, the deductibility of attorney fees to offset settlement income is a key consideration. Before the enactment of the TCJA, attorney fees were deductible as miscellaneous itemized deductions subject to the 2% AGI limitation. As a result of the TCJA, attorney fees, along with all other itemized deductions subject to the 2% AGI limitation, are suspended for tax years 2018 through 2025.[58] Consequently, taxpayers who receive settlement payment income from lawsuits not involving their trade or business are unable to deduct attorney fees on their individual income tax returns.

Caution. Because settlement payments are often net of expenses such as attorney fees, practitioners must exercise caution in reporting the correct amount of settlement income on a taxpayer's return. The practitioner must know the **gross income** from the settlement and cannot rely on the net amount provided on the check the taxpayer received.[59]

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54. IRC §104(a)(2).
55. IRC §104(c).
56. IRS Pub. 4345, *Settlements — Taxability.*
57. Ibid.
58. IRC §67(g).
59. *New Tax on Litigation Settlements, No Deduction for Legal Fees*. Wood, Robert W. Dec. 4, 2019. Marin County Bar Association. [marinbar.org/news/article/?type=news&id=500] Accessed on Jan. 10, 2024.

If the taxpayer is engaged in a trade or business and receives awarded damages from a lawsuit **pertaining to that trade or business,** the taxpayer may deduct attorney fees for the portion of damages included in the taxpayer's income.[60] Consequently, an allocation may be needed to calculate the deductible portion of the attorney fees if the settlement payment includes multiple elements, particularly when some are included in income and others are not. The deductible portion of the expense is reported on Form 1040, Schedule C, which flows through to Form 1040, Schedule 1.

Caution. Taxpayers should be mindful of Form 1099-MISC, *Miscellaneous Information*, filing requirements for payments made to attorneys. See the instructions to Form 1099-MISC for details on when a Form 1099-MISC should be issued.

Example 11. Rita acted on the advice of her tax professional, Derrick. The advice turned out to be erroneous, so Rita files a lawsuit against Derrick and is awarded $100,000 in damages. In 2024, she receives a check for $70,000 after a deduction for attorney fees totaling $30,000. The full $100,000 is included in Rita's gross income for 2024, and she is unable to deduct any attorney fees to offset the income.

GIFT TAX

Historically, transferring property from one individual to another was an attempt to avoid incurring estate tax. To prevent such avoidance, Congress unified the estate and gift taxes into one tax system in 1976.[61] This unified estate and gift tax system is effectively a wealth transfer tax rather than a tax on income. Estate taxes are calculated on the decedent's accumulated taxable gifts plus the decedent's taxable estate at death and then reduced by any gift taxes paid after 1976. Consequently, taxpayers must file gift tax returns for tax years in which they make taxable gifts.

Because the estate and gift tax is a more specialized and nuanced area of taxation, taxpayers may not be aware of the rules or requirements for gift tax returns. Consequently, practitioners may be unaware of their client's situations that require filing a gift tax return. This section explains the nuances and requirements for filing gift tax returns and identifies key issues of gift taxation.

TAXATION OF GIFTS

Understanding gift taxation is crucial for practitioners. They need to be familiar with what constitutes a taxable gift, how to value a gift, and what avenues may limit the taxability of a gift. Because gifting is a common practice among taxpayers who may not be aware of any associated tax implications, practitioners can play an important role in informing and advising their clients making gifts.

Identifying Taxable Gifts[62]

Taxable gifts consist of total gifts a taxpayer makes during a calendar year, excluding certain deductions and exclusions. However, taxpayers may not actually need to pay gift tax on taxable gifts due to the unified credit, discussed later.

60. IRS Pub. 535, *Business Expenses*; IRS Pub. 529, *Miscellaneous Deductions*.

61. *Tax Reform Act of 1976*, PL 94-455, §2001.

62. IRC §2503.

Deductions. Deductions are subtracted from total gifts to arrive at taxable gifts and include gifts made to the taxpayer's spouse.[63] Taxpayers do not report transfers made to charitable IRC §501(c)(3) organizations[64] and political organizations[65] as gifts made during a calendar year.

> **Caution.** There are certain gifts to a taxpayer's spouse that are subject to the gift tax. Gifts of a **terminable interest** (e.g., a life estate, one that terminates with the death of the beneficiary) where a non-spouse recipient receives interest in the gifted property following termination of the donee spouse's interest must be closely examined. Such gifts are excluded from taxable gifts only when the spouse is entitled for life to all income from the entire interest, such income is paid at least annually, the spouse may appoint the entire interest at their discretion, and none of the interest is subject to another person's power of appointment.[66] For more information on terminable interests, see the 2022 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 4: Tax Considerations in the Distribution of Estate Assets.

Exemptions from Taxable Gifts. In addition to deductions to arrive at taxable gifts, there are exemptions from gift tax for practitioners to keep in mind.

Annual Exclusion.[67] Taxpayers can exclude a dollar amount for each gift recipient per tax year to eliminate the need to report de minimis gifts. For 2024, the annual gift tax exclusion is $18,000 ($17,000 in 2023).[68] For the gift to qualify for the exclusion, it must be of a **present interest,** where the recipient has the immediate right to use the gift with no strings attached, rather than sometime in the future. However, when an adult is named as a guardian until the recipient reaches age 21, gifts to minors do not constitute a future interest that would disqualify the gift from the annual exclusion.

> **Note.** Taxpayers can get around the present interest requirement for gifts to be eligible for the annual exclusion by applying **Crummey powers** to a gift.[69] A Crummey power is named after a 1968 federal court opinion that allowed contributions to an irrevocable trust to qualify for the annual gift tax exclusion because the beneficiaries (typically the donor's grandchildren) are given an unrestricted right to withdraw the contributions for a specified period of time. The Crummey power has become a standard estate planning tool, the benefits of which increase through leveraging the annual exclusion to maximize the amount of gift-tax-free transfers to an irrevocable trust.

Married taxpayers can double their annual exclusion to a gift recipient by electing to **split their gifts** to that recipient, provided each spouse is a U.S. citizen or resident when making the gift.[70] To make the election, both spouses must each file a Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return,* on which they identify and report the gifts made by their spouses for gifts they are splitting under Schedule A, *Computation of Taxable Gifts (including transfers in trust)*.[71]

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63. IRC §2523.
64. IRC §2522(a)(2).
65. IRC §2501(a)(4).
66. IRC §2523(e).
67. IRC §§2503(b) and (c).
68. Rev. Proc. 2023-34, 2023-48 IRB 1287; Rev. Proc. 2022-38, 2022-45 IRB 445.
69. *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968).
70. Treas. Reg. §25.2513-1(a).
71. Instructions for Form 709.

Taxpayers who are divorced or widowed and do not remarry during the year can elect to split their gift if the gift was made before the date of death or divorce.

Part 1—General Information

		Yes	No
8	If the donor died during the year, check here ☐ and enter date of death ______________ , ______ .		
9	If you extended the time to file this Form 709, check here ☐		
10	Enter the total number of donees listed on Schedule A. Count each person only once		
11a	Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b		
b	Has your address changed since you last filed Form 709 (or 709-A)?		
12	**Gifts by husband or wife to third parties.** Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? See instructions. (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. **If the answer is "No," skip lines 13–18.**)		
13	Name of consenting spouse — **14** SSN		
15	Were you married to one another during the entire calendar year? See instructions		
16	If line 15 is "No," check whether ☐ married ☐ divorced or ☐ widowed/deceased, and give date. See instructions		
17	Will a gift tax return for this year be filed by your spouse? If "Yes," mail both returns in the same envelope		
18	**Consent of Spouse.** I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.		
	Consenting spouse's signature — **Date**		

This election is also helpful to married taxpayers making gifts exceeding the annual exclusion, where the excess amount reduces each spouse's unified credit against the estate tax, discussed later, by half instead of reducing a given spouse's credit by the entire amount.

Example 12. Eduardo and Cecilia are a married couple. In 2024, Eduardo gifts $36,000 to his son Daniel. If Eduardo does not split his gift with Cecilia, Eduardo's taxable gift to Daniel for 2024 is $18,000 ($36,000 gift − $18,000 annual exclusion). However, if Eduardo splits the gift with Cecilia, each is considered to have gifted $18,000 to Daniel. Because Eduardo and Cecilia are each entitled to a $18,000 annual exclusion per gift recipient, the $36,000 gift to Daniel would not be a taxable gift.

Caution. Married taxpayers must file gift tax returns to split gifts with their spouses, **regardless** of the gift amount.[72]

Exclusion for Educational and Medical Expenses.[73] Payments made on behalf of an individual **directly** to an educational institution for tuition or **directly** to a doctor, hospital, or medical provider for medical services are not considered taxable gifts, even if such payments are over the annual gift tax exclusion.

Practitioner Planning Tip

Tax practitioners should caution their clients making such gifts that the payments must be made **directly** to the school or medical provider rather than the individual who incurred the expense. Even if the individual uses the gift proceeds for the intended education or medical purpose, the IRS will deem the gift a taxable gift to the extent it exceeds the applicable annual gift tax exclusion.

72. Instructions for Form 709.

73. IRC §2503(e).

Valuing Gifts[74]

In calculating taxable gifts or assessing the applicability of the annual gift tax exclusion, the value of a gift is its fair market value (FMV) as of the date of the transfer. While this amount is easily determinable for cash gifts, other types of gifted property may not be as simple in calculating the FMV. FMV is the price at which a willing, knowledgeable buyer and seller agree to exchange. Depending on the type of gifted property, the application of this principle can vary. For example, when determining the FMV of a stock or bond, the taxpayer uses the average between the highest and lowest selling prices quoted on the date of the transfer. The FMV of real property, on the other hand, is best indicated by the sale of the property in an arm's-length transaction on the date of transfer. If no such transaction of real property occurred, the next best method to use would be a comparable sales method, factoring in necessary adjustments such as differences in size, scale, and location. For some gifts, it may be most practical to have an appraiser perform an appraisal. For any reported gifts where a taxpayer used an appraiser to determine the FMV of the gift, the taxpayer must either attach a copy of the appraisal to their filed gift tax return or provide a detailed explanation of how they determined the value of the gift on Form 709, Schedule A.

Valuation Discounts.[75] Often used in conjunction with family limited partnerships (FLP) as an estate planning tool to gift property to younger generations, valuation discounts can be used to factor in reductions to a gift's value when considering lack of marketability and minority interest. **Lack of marketability** reflects the fact that the sale or transfer of an ownership interest is restricted, resulting in no ready market for the interest. **Minority interest** provides a discount for gifts of non-majority ownership interests to reflect the limitation of control and decision-making power associated with minority ownership. This discount is available to FLPs with transfers between family members, even though control exists within the family unit after the transfer.[76] The percentage of these valuation discounts may be substantial depending on given facts and circumstances. Consequently, valuation discounts are under increased scrutiny by the IRS, requiring taxpayers to be diligent in maintaining documentation supporting their calculation of the discounts.[77] If a taxpayer applies any valuation discounts to the gifts they make in an applicable year, they must mark Box A "yes" and attach a written statement and support explaining such discounts.

Form 709 (2023) Page **2**

SCHEDULE A **Computation of Taxable Gifts** (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . . ☐ Yes ☐ No

... you elect under section 529(c)(2)(B) to treat any contributions made this year to a qualified tuition ...

> **Note.** For an in-depth analysis of the fundamentals of FLPs and valuation discounts, see the 2017 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 6: Beneficiary and Estate Issues. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

74. Instructions for Form 709.

75. *Discount for Lack of Marketability: Job Aid for IRS Valuation Professionals*. Sep. 25, 2009. IRS. [www.irs.gov/pub/irs-utl/dlom.pdf] Accessed on Oct. 11, 2023.

76. Rev. Rul. 93-12, 1993-1 CB 202.

77. *The FLP Valuation Discount Is Here to Stay…for Now*. Frazier, William H. Nov. 10, 2021. WealthManagement.com. [www.wealthmanagement.com/high-net-worth/flp-valuation-discount-here-stay-now] Accessed on Oct. 12, 2023.

Generation-Skipping Transfer Tax

When making gifts to individuals, taxpayers should be aware of the possibility that intended recipients are **skip persons.** A skip person is an individual who is two or more generations below the transferor (if the recipient is not a relative, they are a skip person if they are more than 37½ years younger than the transferor[78]) or a trust that either comprises only beneficiaries who are skip persons or is prohibited from making distributions to non-skip persons.[79] Gifts made to skip persons are subject to the generation-skipping transfer tax (GSTT).[80] The GSTT is significant in distinguishing between regular estate tax, as the tax rate for the GSTT is the maximum federal estate tax rate, regardless of the dollar amount of the transfer (with some exclusions discussed later).[81] The GSTT was implemented to prevent gift and estate tax avoidance by skipping one or more generations.

However, each taxpayer has a lifetime GSTT exemption amount available to them to offset GSTT.[82] The exemption amount equals the unified credit amount against gift tax.[83] The GSTT exemption is automatically allocated to gifts made to direct skip persons. For gifts made in 2001 and later, the GSTT is automatically allocated to gifts to **indirect skips.**[84] Indirect skips are transfers where intermediate steps occur before the skip person receives the property.[85] An example of an indirect skip includes a trust that has or may eventually have a beneficiary who is a skip person to whom assets may be distributed. GSTT is calculated on Form 709, Schedule D, *Computation of Generation-Skipping Transfer Tax*.

Estate Tax Inclusion Period. The estate tax inclusion period (ETIP) is the period of time for which a transfer would be included in the taxpayer's gross estate should they die.[86] This is a concept that applies to transfers to trusts for which the grantor has a retained interest, and one or more of the beneficiaries of the trust is a skip person. While the taxpayer must report the gift portion of the transfer on Form 709, Schedule A at the time of the transfer, the taxpayer does not report the generation-skipping transfer (GST) portion on Schedule D to calculate the GSTT and applicable exemption until after the ETIP ends, which is the earlier of when the GST is complete, or the taxpayer dies.[87] Consequently, the GSTT exemption is calculated based on the value of the transferred assets at the end of the ETIP, thus subjecting any appreciation in the value of those assets to the GSTT.

Unified Credit Against Gift Tax[88]

The unification of the estate and gift tax in 1976 resulted in the two taxes being intrinsically related. Perhaps the most evident illustration of this concept is the unified credit against gift tax. Often referred to as a taxpayer's **lifetime exemption,** the credit represents the tax credit every decedent is entitled to use in offsetting both estate value and gift taxation.[89] A taxpayer's lifetime exemption is reduced by the amount of taxable gifts the taxpayer makes during their lifetime. This results in taxpayers who make taxable gifts that collectively do not exceed their lifetime exemption not owing or having to pay tax on the gifts when filing their gift tax return.

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78. Instructions for Form 706-GS(T).
79. IRC §2613(a).
80. IRC §§2601 and 2611(a).
81. IRC §2641.
82. IRC §2631(a).
83. IRC §2631(c).
84. Treas. Reg. §26.2632-1(b).
85. IRC §2632(c)(3).
86. IRC §2642(f)(3).
87. Ibid.
88. IRC §§2505(a) and 2010(c).
89. IRC §2010(a).

When a taxpayer makes **taxable** gifts, they report the taxable gifts on Form 709, which includes Schedule B, *Gifts From Prior Periods*, where the history of all taxable gifts the taxpayer made during their lifetime up until that tax year is reported. In the event a deceased taxpayer must file Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, the total taxable gifts of the decedent must be disclosed to calculate how much, if any, remaining lifetime exemption is available for the taxpayer to use in offsetting their federal estate tax.

The lifetime exemption changes annually. Normally, the lifetime exemption is set at a specified dollar amount and adjusted for inflation each year. However, with the passage of the TCJA, Congress changed the amount of the lifetime exemption, nearly doubling it from $5.6 million to $11.18 million.[90] For 2024, the lifetime exemption is $13.61 million.[91] If provisions of the TCJA are not extended, the lifetime exemption drops to its lower pre-TCJA amount beginning January 1, 2026.

> **Note.** For further information regarding the impact of the potential expiration of the TCJA on the lifetime exemption, see the 2024 *University of Illinois Federal Tax Workbook*, Chapter 12: Planning for the Sunset of the TCJA.

Deceased Spousal Unused Exclusion. A decedent's lifetime exemption may more than cover the amount of estate tax for which they are subject. The **excess amount** of the exclusion may be transferred to the decedent's spouse through an election known as **portability.**[92] The decedent's executor can make this election by preparing and filing a Form 706, even if they are not otherwise required to file one.[93] The amount of excess exclusion that is transferred to the surviving spouse is known as the **deceased spousal unused exclusion (DSUE).** While the amount is calculated on the decedent's Form 706, the surviving spouse must also identify the amount of DSUE available to them for the year in which they make taxable gifts on Form 709, Schedule C, *Deceased Spousal Unused Exclusion (DSUE) Amount and Restored Exclusion*.[94] The amount of a taxpayer's DSUE is applied against any estate and gift tax **before** their own lifetime exemption.[95] Consequently, practitioners must be aware of any DSUE available to taxpayers for whom they are preparing a gift tax return.

Practitioner Planning Tip

A taxpayer's financial situation may change dramatically (e.g., winning the lottery) after their spouse dies. It may be advisable to offer to prepare a Form 706 electing portability any time a spouse dies, to capture the benefit of the DSUE. If the taxpayer declines, the practitioner should document the decision in the client's file.

90. *Estate and Gift Tax FAQs*. Oct. 23, 2023. IRS. [www.irs.gov/newsroom/estate-and-gift-tax-faqs] Accessed on Oct. 23, 2023.
91. Rev. Proc. 2023-34, 2023-48 IRB 1287.
92. Treas. Reg. §20.2010-2.
93. Treas. Reg. §20.2010-2(a).
94. Instructions for Form 709.
95. Treas. Reg. §25.2505-2(b).

Late Portability Election.[96] Relief for a late portability election is available for estates that are not required to and did not file an estate tax return for a decedent meeting the following criteria.

- Survived by a spouse
- Died after December 31, 2010
- Was a citizen or resident of the United States when they died

Such estates may qualify for relief for a late portability election by preparing and filing Form 706 by the fifth anniversary of the decedent's date of death. The top of Form 706 must include the language “filed pursuant to Rev. Proc. 2022-32 to elect portability under §2010(c)(5)(A).”

PREPARING FORM 709[97]

Taxpayers must file Form 709 for tax years in which they make one of the following types of gifts.

- Gifts to recipients in excess of the annual exclusion
- Gifts of future interests
- Gifts that were split with a spouse, regardless of the amount

As taxpayers are unable to file joint gift tax returns, spouses must file their own Form 709 for gifts that they made for the applicable year.

The form contains two parts and four accompanying schedules. Form 709, part 1, *General Information*, requires taxpayers to provide general information, such as their name, address, and social security number (SSN). This section is also where a taxpayer identifies whether they filed a previous gift tax return and whether they are electing to split gifts with their spouse, providing their spouse’s name and SSN. Form 709, part 2, *Tax Computation*, discussed later, consists of calculating the gift tax.

Completing Form 709, Schedule A

A taxpayer reports gifts they made through the applicable tax year on Schedule A of Form 709. Schedule A is organized into four parts, with the first three parts identifying the following information.

- Donee’s name and address
- Description of gift
- Donor’s adjusted basis in the gift
- Date of the gift
- Gift’s value at the time of the transfer
- Gifts made by the taxpayer’s spouse if electing to split gifts with them

Information about the donee must include their name, address, and relationship, if any, to the donor. The information regarding the gift must include a description of the property gifted. If any securities were gifted, Form 709 must provide their identifying numbers as established by the Committee on Uniform Securities Identification Procedures (CUSIP).[98] If equity in a closely held entity is gifted, the donor must provide its employer identification number (EIN).

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96. Rev. Proc. 2022-32, 2022-30 IRB 101.

97. Instructions for Form 709.

98. These numbers are commonly referred to as “CUSIP numbers.” See *CUSIP Number,* Apr. 27, 2015. U.S. Securities and Exchange Commission. [www.sec.gov/answers/cusip] Accessed on Mar. 14, 2024.

In part 1, *Computation of Taxable Gifts (Including transfers in trust),* donors disclose gifts that are subject only to the gift tax and are not subject to the GSTT. These gifts are made to recipients who are neither direct nor indirect skip beneficiaries. Instead, taxpayers use part 2, *Direct Skips,* to disclose gifts made to direct skip persons and part 3, *Indirect Skips and Other Transfers in Trust,* to report gifts made to indirect skip persons and other transfers in trust. Such gifts are subject to both the gift tax and the GSTT. If the taxpayer elects to split gifts with their spouse, the bottom portion of each of the first three parts in Schedule A is where the taxpayer identifies gifts made by their spouse.

Schedule A, part 4, *Taxable Gift Reconciliation,* calculates the amount of taxable gifts made for the calendar year for which the taxpayer is filing. The taxpayer enters the total gifts they made from the preceding three parts of Schedule A on line 1. If the taxpayer elects to split gifts with their spouse, the taxpayer includes only the gifts they made on line 1 and excludes the portion of gifts made by their spouse. The taxpayer then reduces the total value of gifts reported on line 1 by the total annual exclusions for those gifts that the taxpayer may claim. Subsequently, the taxpayer subtracts any deductions, including charitable deductions, and adds the payable GSTT calculated in Schedule D, discussed later, to arrive at taxable gifts to report on line 1 of Form 709.

Example 13. Ted and his wife Karen jointly give $50,000 to each of their three adult children and $50,000 to their grandson, Edward, on June 30, 2023. Thus, Ted and Karen collectively gave these four recipients a total of $200,000 ($50,000 per gift × 4 recipients). They made gifts in the same amount in 2022 but no other taxable gifts in prior years. Ted and Karen elect to split their gifts in 2023, as they did the preceding year. In preparing their separate gift tax returns, Ted prepares Form 709, Schedule A, for his return as follows.

For Example 13

Form 709 (2023) Page **2**

SCHEDULE A **Computation of Taxable Gifts** (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . . ☐ Yes ☒ No

B ☐ Check here if you elect under section 529(c)(2)(B) to treat any contributions made this year to a qualified 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 Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1	**Nancy Harrington, daughter, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
2	**Michael Wheeler, son, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
3	**Holly Wheeler, daughter, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 1. Add amounts from Part 1, column H							**75,000**

Part 2—Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1	**Edward Harrington, grandson, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 2. Add amounts from Part 2, column H							**25,000**

Part 3—Indirect Skips and Other Transfers in Trust. Gifts to trusts that are indirect skips as defined under section 2632(c) or to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1							
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 3. Add amounts from Part 3, column H							

(If more space is needed, attach additional statements.) Form **709** (2023)

Because Ted's grandson, Edward, is a skip beneficiary, Ted completes part 2 of Schedule A in addition to part 1. Karen's separate Form 709, Schedule A, follows.

Form 709 (2023) Page **2**

SCHEDULE A **Computation of Taxable Gifts** (Including transfers in trust) (see instructions)

A Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation . . . . ☐ Yes ☒ No

B ☐ Check here if you elect under section 529(c)(2)(B) to treat any contributions made this year to a qualified 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 Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1							
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
1	**Nancy Harrington, daughter, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
2	**Michael Wheeler, son, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
3	**Holly Wheeler, daughter, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
Total of Part 1. Add amounts from Part 1, column H							**75,000**

Part 2—Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1							
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
1	**Edward Harrington, grandson, cash**		**50,000**	**6/30/23**	**50,000**	**25,000**	**25,000**
Total of Part 2. Add amounts from Part 2, column H							**25,000**

Part 3—Indirect Skips and Other Transfers in Trust. Gifts to trusts that are indirect skips as defined under section 2632(c) or to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP no. • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract col. G from col. F)
1							
Gifts made by spouse—*complete **only** if you are splitting gifts with your spouse and he/she also made gifts.*							
Total of Part 3. Add amounts from Part 3, column H							

(If more space is needed, attach additional statements.) Form **709** (2023)

Ted's part 4 of Schedule A is as follows.

Form 709 (2023) Page **3**

Part 4—Taxable Gift Reconciliation

1	Total value of gifts of donor. Add totals from column H of Parts 1, 2, and 3			1	100,000
2	Total annual exclusions for gifts listed on line 1 (see instructions)			2	68,000
3	Total included amount of gifts. Subtract line 2 from line 1			3	32,000
Deductions (see instructions)					
4	Gifts of interests to spouse for which a marital deduction will be claimed, based on item numbers ______ of Schedule A	4	0		
5	Exclusions attributable to gifts on line 4	5	0		
6	Marital deduction. Subtract line 5 from line 4	6	0		
7	Charitable deduction, based on item numbers ______ less exclusions	7	0		
8	Total deductions. Add lines 6 and 7			8	0
9	Subtract line 8 from line 3			9	32,000
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule D, Part 3, col. G, total)			10	0
11	**Taxable gifts.** Add lines 9 and 10. Enter here and on page 1, Part 2—Tax Computation, line 1			11	32,000

The annual exclusion applied to the 2023 gifts that Ted made to his three children and grandchild totals $68,000 ($17,000 annual exclusion × 4 recipients). Because Ted has no other deductions, the amount of taxable gifts he made in 2023 is $32,000 ($100,000 gifts − $68,000 annual exclusions).

Completing Form 709, Schedule B

A taxpayer identifies the amount of taxable gifts that they made in prior years and any amount of their lifetime exemption they used to offset the gift tax on those gifts on Schedule B, *Gifts From Prior Periods*. Taxpayers use the table at the beginning of the schedule to list and separately report each calendar year that the taxpayer made taxable gifts and prepared a Form 709. Column A of the table identifies the calendar year, and column B identifies the IRS office where the return for that year was filed. The taxpayer uses column C to report the amount of lifetime exemption they used against taxable gifts made after December 31, 1976, and column D to report the amount of exemption the taxpayer used against gifts made before January 1, 1977. Finally, the taxpayer reports the amount of taxable gifts for that prior reported year in column E.

Practitioner Planning Tip

To complete Schedule B, practitioners must obtain copies of the taxpayer's previously filed Forms 709. Ideally, those returns contain completed Schedules B, and the practitioner may roll forward the prior Schedule B filed. To include the prior return's applicable tax year information on Schedule B of the return that the practitioner is preparing, the practitioner completes the table in Schedule B using page 1 of the previously filed Form 709. In some circumstances, the practitioner must request transcripts of previously filed Forms 709 with Form 8821, *Tax Information Authorization*, or Form 2848, *Power of Attorney and Declaration of Representative.*

After completing the table, the taxpayer reports the amount of calculated total taxable gifts from prior periods on line 2 of Form 709.

Example 14. Use the same facts as **Example 13.** Because Ted and Karen made taxable gifts in 2022, they each prepare a Schedule B to report the gifts' amounts and the applicable credit they used for tax year 2022. On Ted's Schedule B, he reported taxable gifts that he made in 2022 totaling $36,000, consisting of the $100,000 gifts he made to his three children and grandchild less the $64,000 annual exclusions he applied against it ($16,000 annual exclusion for 2022 × 4 recipients). The amount of applicable credit used against the 2022 taxable gifts was $7,320 (reported on line 12 of their 2022 Form 709). A copy of Ted's Schedule B is as follows.

SCHEDULE B **Gifts From Prior Periods**

If you answered "Yes" on line 11a of page 1, Part 1, see the instructions for completing Schedule B. If you answered "No," skip to the Tax Computation on page 1 (or Schedule C or D, if applicable). Complete Schedule A before beginning Schedule B. See instructions for recalculation of the column C amounts. Attach calculations.

A Calendar year or calendar quarter (see instructions)	B Internal Revenue office where prior return was filed	C Amount of applicable credit (unified credit) against gift tax for periods after December 31, 1976	D Amount of specific exemption for prior periods ending before January 1, 1977	E Amount of taxable gifts
2022	**Kansas City, MO 64999**	**7,320**	**0**	**36,000**
1 Totals for prior periods	**1**	**7,320**	**0**	**36,000**

2 Amount, if any, by which total specific exemption, line 1, column D, is more than $30,000	**2**	**0**
3 Total amount of taxable gifts for prior periods. Add amount on line 1, column E, and amount, if any, on line 2. Enter here and on page 1, Part 2—Tax Computation, line 2	**3**	**36,000**

(If more space is needed, attach additional statements.) Form **709** (2023)

Completing Form 709, Schedule C

If a taxpayer is the surviving spouse of a decedent whose executor elected portability, a DSUE may be available to them to offset estate and gift tax. When making taxable gifts in years following their spouse's death, they must complete Schedule C of any Form 709 they file. Schedule C contains two parts, identifying the taxpayer's last deceased spouse and the applicable DSUE in part 1, *DSUE Received From Last Deceased Spouse,* and any spouses to whom the taxpayer was married prior to the last deceased spouse who elected portability, if any, in part 2, *DSUE Received From Predeceased Spouse(s)*. The amount of DSUE that a taxpayer may use to offset gift and estate tax is limited to the amount of DSUE of their last deceased spouse.[99] The amount of the taxpayer's DSUE is combined with their own lifetime exclusion amount to calculate the applicable credit to offset estate and gift tax reported on line 7 of Form 709.

Form 709 (2023) Page **4**

SCHEDULE C Deceased Spousal Unused Exclusion (DSUE) Amount and Restored Exclusion

Provide the following information to determine the DSUE amount and applicable credit received from prior spouses. Complete Schedule A before beginning Schedule C.

A Name of deceased spouse (dates of death after December 31, 2010, only)	**B** Date of death	**C** Portability election made?		**D** If "Yes," DSUE amount received from spouse	**E** DSUE amount applied by donor to lifetime gifts (list current and prior gifts)	**F** Date of gift(s) (enter as mm/dd/yy for Part 1 and as yyyy for Part 2)
		Yes	No			
Part 1—DSUE RECEIVED FROM LAST DECEASED SPOUSE						
Part 2—DSUE RECEIVED FROM PREDECEASED SPOUSE(S)						
TOTAL (for all DSUE amounts applied from column E for Part 1 and Part 2)						

1	Donor's basic exclusion amount (see instructions)	1	
2	Total from column E, Parts 1 and 2	2	
3	Restored Exclusion Amount (see instructions)	3	
4	Add lines 1, 2, and 3	4	
5	Applicable credit on amount in line 4 (see *Table for Computing Gift Tax* in the instructions). Enter here and on line 7, Part 2—Tax Computation	5	

Computation of Generation-Skipping Transfer Tax

[99] Treas. Reg. §25.2502-2(a).

Completing Form 709, Schedule D

Not only must taxpayers who made gifts to direct skip beneficiaries complete part 2 of Schedule A, but they must also complete Schedule D to calculate the GSTT and exemption to use against it. The taxpayer begins by completing the table in part 1, *Generation-Skipping Transfers,* where the taxpayer lists each gift from Schedule A, part 2. They must also include any gifted transfers for which the ETIP has ended and apply any applicable annual exclusion to them to calculate the net transfer of the gifts. The taxpayer calculates the GST exemption in part 2, *GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election,* and the GSTT in part 3, *Tax Computation,* of Schedule D. The taxpayer reports the calculated GSTT from Schedule D on page 1, line 16, of Form 709.

> **Example 15.** Use the same facts as **Example 13.** Ted made a gift to his grandson, Edward, who is a direct skip beneficiary. Ted completes Schedule D accordingly, reporting the $50,000 gift made to Edward in 2023. Because he elects to split gifts with Karen, Ted identifies his portion of the split gift. Therefore, the net transfer for Ted in 2023 is the $25,000 gift ($50,000 total gift − $25,000 Karen's split) less the $17,000 annual exclusion to equal $8,000.

Part 2—Tax Computation 5

SCHEDULE D Computation of Generation-Skipping Transfer Tax

Note: Inter vivos direct skips that are completely excluded by the GST exemption must still be fully reported (including value and exemptions claimed) on Schedule D.

Part 1—Generation-Skipping Transfers. List items from Schedule A first, then items to be reported on Schedule D, including any transfers subject to an Estate Tax Inclusion Period (ETIP).

A Item number (from Schedule A, Part 2, col. A, then ETIP transfers, if any)	B Description (only for ETIP transfers)	C Value (from Schedule A, Part 2, col. H, or close of ETIP described in col. B)	D Nontaxable portion of transfer	E Net transfer (subtract col. D from col. C)
1		25,000	17,000	8,000
Gifts made by spouse (for gift splitting only)				

(If more space is needed, attach additional statements.) Form **709** (2023)

> When completing part 2, Ted identifies his allowable exemption to be used against the GSTT, which is $12,920,000 for 2023.[100] He also identifies the amount of the exclusion he used in prior periods, which solely consisted of the prior year's gift he made to Edward in 2022. This amount was $9,000 ($25,000 Ted's split − $16,000 annual exclusion for 2022), leaving Ted with $12,911,000 of exclusion to apply against 2023 gifts ($12,920,000 − $9,000). This is more than enough to cover the $8,000 of 2023 net transfer, resulting in zero GSTT payable for 2023.

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100. Instructions for Form 709.

For Example 15

Part 2—GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election

Check here ☐ if you are making a section 2652(a)(3) (special QTIP) election. See instructions.

Enter the item numbers from Schedule A of the gifts for which you are making this election

1	Maximum allowable exemption (see instructions)	1	12,920,000
2	Total exemption used for periods before filing this return	2	9,000
3	Exemption available for this return. Subtract line 2 from line 1	3	12,911,000
4	Exemption claimed on this return from Part 3, column C, total below	4	8,000
5	Automatic allocation of exemption to transfers reported on Schedule A, Part 3. To opt out of the automatic allocation rules, you must attach an "**Election Out**" statement. See instructions	5	
6	Exemption allocated to transfers not shown on line 4 or line 5 above. **You must attach a "Notice of Allocation."** See instructions	6	
7	Add lines 4, 5, and 6	7	8,000
8	Exemption available for future transfers. Subtract line 7 from line 3	8	12,903,000

Part 3—Tax Computation

A Item number (from Schedule D, Part 1)	B Net transfer (from Schedule D, Part 1, col. E)	C GST exemption allocated	D Divide col. C by col. B	E Inclusion ratio (Subtract col. D from 1.000)	F Applicable rate (multiply col. E by 40% (0.40))	G Generation-skipping transfer tax (multiply col. B by col. F)
1	8,000	8,000	1.000	0.000	0.000	0
Gifts made by spouse (for gift splitting only)						
Total exemption claimed. Enter here and on Part 2, line 4, above. May not exceed Part 2, line 3, above		8,000	**Total generation-skipping transfer tax.** Enter here; on page 3, Schedule A, Part 4, line 10; and on page 1, Part 2—Tax Computation, line 16			0

(If more space is needed, attach additional statements.)

Form **709** (2023)

Completing Form 709, Part 2

With the applicable schedules completed, the taxpayer calculates the gift tax on Form 709, part 2. The taxpayer begins by calculating the estate tax for both current and prior-year taxable gifts. The gift tax is calculated using the following table.[101]

Column A Taxable Amount Over…	Column B Taxable Amount Not Over…	Column C Tax on Amount in Column A	Column D Rate of Tax on Excess Over Amount in Column A
$ 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	—	345,800	40%

The taxpayer then calculates the applicable credit against the gift tax. The applicable credit consists of the credit on the lifetime exclusion amount and any DSUE available to the taxpayer. The applicable credit cannot exceed the amount of gift tax calculated on current and prior year gifts. The resulting balance is added to any GSTT calculated in Schedule D to calculate the total tax. After taking into account the total gift tax and GSTT the taxpayer paid during the lifetime, the remaining balance due is shown at the end of the form.

Example 16. Use the same facts as **Example 13.** Ted reports a total of $68,000 taxable gifts that he has made during his lifetime, which consists of $32,000 of taxable gifts he made in 2023 calculated in part 4 of Schedule A and $36,000 of taxable gifts he made in prior periods disclosed on Schedule B. The tax on these gifts totals $15,080 ($13,000 tax on threshold + (($68,000 taxable gifts − $60,000 threshold) × 26% excess rate)).[102] The amount of tax on Ted's prior gifts is $7,320 ($3,800 tax on threshold + (($36,000 taxable gift − $20,000 threshold) × 22% excess rate)), resulting in a tax of $7,760 on his 2023 gifts ($15,080 tax on lifetime gifts − $7,320 tax on prior period gifts).

The total applicable credit available to Ted in 2023 is $5,113,800.[103] Having already used $7,320 of his credit for gifts made in prior periods, Ted is left with $5,106,480 of credit to offset the tax on gifts he made in 2023 ($5,113,800 total credit − $7,320 credit applied to prior periods' gift tax). Therefore, Ted can use $7,760 of his credit to offset the gift tax of $7,760 on his 2023 gifts. Page 1 of Ted's Form 709 follows.

101. Instructions for Form 709.

102. Ibid.

103. Ibid.

For Example 16

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

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

Go to *www.irs.gov/Form709* for instructions and the latest information.

(For gifts made during calendar year 2023)

OMB No. 1545-0020 — **2023**

Part 1—General Information

1 Donor's first name and middle initial: **Ted**	2 Donor's last name: **Wheeler**	3 Donor's social security number: *****-**-6789**
4 Address (number, street, and apartment number): **2530 Piney Wood**		5 Legal residence (domicile): **Indiana**
6 City or town, state or province, country, and ZIP or foreign postal code: **Hawkins, IN 46974**		7 Citizenship (see instructions): **Citizen of the United States**

		Yes	No
8	If the donor died during the year, check here ☐ and enter date of death ______ , ______ .		
9	If you extended the time to file this Form 709, check here ☐		
10	Enter the total number of donees listed on Schedule A. Count each person only once **4**		
11a	Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b	×	
b	Has your address changed since you last filed Form 709 (or 709-A)?		×
12	**Gifts by husband or wife to third parties.** Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? See instructions. (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. **If the answer is "No," skip lines 13–18.**)	×	
13	Name of consenting spouse **Karen Wheeler** — 14 SSN **xxx-xx-1234**		
15	Were you married to one another during the entire calendar year? See instructions	×	
16	If line 15 is "No," check whether ☐ married ☐ divorced or ☐ widowed/deceased, and give date. See instructions		
17	Will a gift tax return for this year be filed by your spouse? If "Yes," mail both returns in the same envelope	×	
18	**Consent of Spouse.** I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.		
	Consenting spouse's signature — **Date**		
19	Have you applied a DSUE amount received from a predeceased spouse to a gift or gifts reported on this or a previous Form 709? If "Yes," complete Schedule C		×
20	Does any gift or other transfer reported on this Form 709 include a digital asset (or a financial interest in a digital asset)? See instructions		×

Part 2—Tax Computation

1	Enter the amount from Schedule A, Part 4, line 11	1	32,000
2	Enter the amount from Schedule B, line 3	2	36,000
3	Total taxable gifts. Add lines 1 and 2	3	68,000
4	Tax computed on amount on line 3 (see *Table for Computing Gift Tax* in instructions)	4	15,080
5	Tax computed on amount on line 2 (see *Table for Computing Gift Tax* in instructions)	5	7,320
6	Balance. Subtract line 5 from line 4	6	7,760
7	Applicable credit amount. If donor has DSUE amount from predeceased spouse(s) or Restored Exclusion Amount, enter amount from Schedule C, line 5; otherwise, see instructions	7	5,113,800
8	Enter the applicable credit against tax allowable for all prior periods (from Sch. B, line 1, col. C)	8	7,320
9	Balance. Subtract line 8 from line 7. Do not enter less than zero	9	5,106,480
10	Enter 20% (0.20) 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. Do not enter less than zero	11	5,106,480
12	Applicable credit. Enter the smaller of line 6 or line 11	12	7,760
13	Credit for foreign gift taxes (see instructions)	13	0
14	Total credits. Add lines 12 and 13	14	7,760
15	Balance. Subtract line 14 from line 6. Do not enter less than zero	15	0
16	Generation-skipping transfer taxes (from Schedule D, Part 3, col. G, 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	
19	If line 18 is less than line 17, enter **balance due**. See instructions	19	
20	If line 18 is greater than line 17, enter **amount to be refunded**	20	

Attach check or money order here.

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

May the IRS discuss this return with the preparer shown below? See instructions. ☐ **Yes** ☐ **No**

Signature of donor — Date

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name			Firm's EIN	
Firm's address			Phone no.	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see the instructions for this form. Cat. No. 16783M Form **709** (2023)

When to File Form 709[104]

Form 709 is a calendar-year, annual return. Filers must submit Form 709 no later than **April 15** or the next business day following the Saturday, Sunday, or legal holiday on which April 15 falls. The return may be extended for six months by filing an income tax return extension or filing Form 8892, *Application for Automatic Extension of Time To File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax*. **Form 709 is not available for electronic filing** and must be mailed to the following address.

Department of the Treasury
Internal Revenue Service Center
Kansas City, MO 64999

For donors that die during the tax year in which they made a taxable gift, the due date for Form 709 is the earlier of the following.

- The due date (including extensions) of the donor's Form 706
- April 15 of the following tax year, or the extended due date

The due date of a decedent's Form 706 is nine months from the date of death.[105]

Late filing and payment penalties apply for Form 709 under IRC §6651. The late filing penalty is 5% of the unpaid tax for each month the return is late, not to exceed 25%.[106] The late payment penalty is 0.5% of the unpaid tax for each month the payment is late, not to exceed 25%.[107] The IRS may abate the penalties for reasonable cause provided by the taxpayer in a statement attached to the submitted Form 709.

Practitioner Planning Tip

Because the late filing and payment penalties are assessed on unpaid tax, and the higher exclusion amount provided by the TCJA has generally resulted in fewer instances of gift tax being due with a filed Form 709, it may be tempting to not prioritize preparing and filing the gift tax return. However, it is important to disclose gifts and transfers in a timely manner to begin running the statute of limitations of three years.[108]

RECIPIENT CONSIDERATIONS

While reporting requirements are generally the responsibility of the donor regarding gift and estate taxation, there are taxable considerations for the recipients of gifts. This section covers the basis implications of gifted assets as well as reporting requirements for the receipt of foreign gifts from the recipient's perspective.

104. Ibid.
105. Instructions for Form 706.
106. Instructions for Form 8892.
107. Ibid.
108. IRM 4.25.1.2.1.2 (2020); IRC §6501.

Basis of Gifted Property

In determining the recipient's basis in property received as a gift, the donor's adjusted basis in the property at the time of the gift, the FMV of the property at the time of the gift, and any gift tax paid on the gift must be known.

Donor's Adjusted Basis is Less Than or Equal to FMV. If the donor's adjusted basis in the gifted property is **less than or equal to the FMV** of the property at the time of the gift, the recipient's basis in the gifted property is equal to the donor's adjusted basis.[109] If the donor paid gift tax on the transfer of the property, the recipient's basis is increased by the amount of gift tax paid to the extent that such an adjustment does not result in the basis exceeding the FMV of the property at the time the gift was made.[110] The recipient's basis in the property subsequent to its receipt is increased or decreased for adjustments appropriately as any other held asset, such as the basis increasing for any improvements.[111]

> **Example 17.** Teresa gifted Mark a parcel of land on June 30, 2024. At the time of the gift, Teresa's adjusted basis in the land was $50,000, and its FMV was $75,000. Teresa did not pay any gift tax on the transfer when filing her Form 709 for the tax year. Mark's basis in the land is equal to Teresa's adjusted basis of $50,000.

Donor's Adjusted Basis Exceeds FMV.[112] If the donor's adjusted basis in the gifted property **exceeds** the FMV of the property at the time of the gift, the recipient's basis in the gift depends on whether they have a gain or a loss when disposing of the property. If the donor's adjusted basis exceeds the property's FMV, the following two rules guide the computation of gain or loss.

1. The recipient's **gain** on the disposal of the gifted property is calculated using the **donor's adjusted basis** when they made the gift. This basis is adjusted for any increases or decreases while the recipient owned the property.
2. The recipient's **loss** on the gifted property is calculated using the **property's FMV** as the initial basis when the donor made the gift. This basis is also adjusted for any increases or decreases while the recipient owned the property.

> **Note.** If using the donor's adjusted basis for the recipient basis results in a loss and using the gifted property's FMV for the recipient's basis results in a gain, then the recipient's basis is equal to the proceeds received from the disposal of the property so that neither a gain nor loss is recognized.

> **Example 18.** Use the same facts as **Example 17,** except that Teresa's basis in the land was $80,000. If Mark sells the land on October 1, 2025, for $100,000, Mark's basis in the land sold is equal to Teresa's adjusted basis of $80,000, resulting in a $20,000 gain ($100,000 proceeds − $80,000 basis).

> **Example 19.** Use the same facts as **Example 18,** except that Mark sells the land for $70,000. Mark's basis in the land sold is equal to the FMV of the land at the time Teresa gifted it to Mark of $75,000, resulting in a $5,000 loss ($70,000 proceeds − $75,000 basis).

> **Example 20.** Use the same facts as **Example 18,** except that Mark sells the land for $77,000. If calculating for a gain and using Teresa's adjusted basis in the land of $80,000, Mark would have a loss of $3,000 ($77,000 proceeds − $80,000 Teresa's adjusted basis). If calculating for a loss and using the land's FMV of $75,000, Mark would have a gain of $2,000 ($77,000 proceeds − $75,000 FMV). Therefore, Mark's basis in the property sold must equal the selling proceeds of $77,000 so that he would not recognize a gain or loss on the disposal ($77,000 proceeds − $77,000 basis).

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109. IRC §1015(a).

110. IRC §1015(d)(1)(A).

111. *Property (Basis, Sale of Home, etc.)*. Jun. 15, 2023. IRS. [www.irs.gov/faqs/capital-gains-losses-and-sale-of-home/property-basis-sale-of-home-etc] Accessed on Jan. 12, 2024.

112. Ibid.

Receiving Foreign Gifts

While the responsibility of reporting domestic gifts falls on the donor, recipients of gifts from a non-U.S. source may be subject to a reporting requirement. A recipient subject to this reporting requirement is a U.S. citizen or resident who in the current tax year:[113]

2

- Received more than $100,000 of gifts from a foreign individual or estate;
- Received more than the IRC §6039F threshold amount ($19,570 in 2024),[114] adjusted for inflation, of gifts from foreign corporations or partnerships;
- Received distributions from a foreign trust;
- Received a loan of cash or marketable securities from a foreign trust;
- Received the uncompensated use of foreign trust property; or
- Is an owner or beneficiary of a foreign trust holding an outstanding qualified obligation to the owner or beneficiary, or a related party to the owner or beneficiary.

Such recipients are required to file Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.*[115] Unlike Form 709, Form 3520 is an informational form for which no tax is assessed. Form 3520 must be mailed to the following address.

Internal Revenue Service Center
P.O. Box 409101
Ogden, UT 84409

Form 3520 is required to be filed by the 15th day of the fourth month following the recipient's tax year or the next business day following the Saturday, Sunday, or legal holiday on which the 15th day of the fourth month falls.[116] **If the recipient fails to file the form on time, a penalty is assessed equaling 5% of the foreign gift for each month the return is late, not to exceed 25%.[117]** The IRS may abate the penalties for reasonable cause provided by the taxpayer if they can prove their noncompliance did not result from willful neglect.[118]

Form 3520 includes multiple sections used for the following purposes.

- Report the recipient's general information
- Identify foreign trusts held by the recipient
- Disclose transfers to and from those foreign trusts
- Disclose gifts received from foreign persons in excess of $10,000

The recipient uses Form 3520, part IV, *U.S. Recipients of Gifts or Bequests Received During the Current Tax Year From Foreign Persons*, to disclose the gifts they received from foreign persons. Page 1 of Form 3520 and part IV follow.

113. Instructions for Form 3520.
114. Rev. Proc. 2023-34, 2023-48 IRB 1287.
115. IRC §6039F(a).
116. Instructions for Form 3520.
117. IRC §6039F(c).
118. Ibid.

Form **3520**
(Rev. December 2023)
Department of the Treasury
Internal Revenue Service

Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts

Go to *www.irs.gov/Form3520* for instructions and the latest information.

OMB No. 1545-0159

Note: All information must be in English. Show all amounts in U.S. dollars. File a **separate** Form 3520 for **each** foreign trust.

For calendar year 20 , or tax year beginning , 20 , ending , 20

A Check appropriate boxes: ☐ Initial return ☐ Final return ☐ Amended return

B Check box that applies to person filing return: ☐ Individual ☐ Partnership ☐ Corporation ☐ Trust ☐ Executor

C Check if any excepted specified foreign financial assets are reported on this form. See instructions . . . . ☐

Check all applicable boxes. See applicable instructions.

☐ You are **(a)** a U.S. transferor who, directly or indirectly, transferred money or other property during the current tax year to a foreign trust; **(b)** a U.S. person who (1) during the current tax year, transferred property (including cash) to a related foreign trust (or a person related to the trust) in exchange for an obligation, or (2) holds a qualified obligation from the trust that is currently outstanding; or **(c)** the executor of the estate of a U.S. decedent and (1) the decedent made a transfer to a foreign trust by reason of death, (2) the decedent was treated as the owner of any portion of a foreign trust immediately prior to death, or (3) the decedent's estate included any portion of the assets of a foreign trust. **Complete all applicable identifying information requested below and Part I of the form.**

☐ You are a U.S. owner of all or any portion of a foreign trust at any time during the tax year. **Complete all applicable identifying information requested below and Part II of the form.**

☐ You are **(a)** a U.S. person (including a U.S. owner) or an executor of the estate of a U.S. person who, during the current tax year, received, directly or indirectly, a distribution from a foreign trust; **(b)** a U.S. person who is a U.S. owner or beneficiary of a foreign trust and in the current tax year, you or a U.S. person related to you received (1) a loan of cash or marketable securities, directly or indirectly, from such foreign trust, or (2) the uncompensated use of trust property; or **(c)** a U.S. person who is a U.S. owner or beneficiary of a foreign trust and in the current tax year such foreign trust holds an outstanding qualified obligation of yours or a U.S. person related to you. **Complete all applicable identifying information requested below and Part III of the form.**

☐ You are a U.S. person who, during the current tax year, received certain gifts or bequests from a foreign person. **Complete all applicable identifying information requested below and Part IV of the form.**

1a Name of U.S. person(s) with respect to whom this Form 3520 is being filed (see instructions)			**b** Taxpayer identification number (TIN)
c Number, street, and room or suite no. If a P.O. box, see instructions.			**d** Spouse's TIN
e City or town	**f** State or province	**g** ZIP or foreign postal code	**h** Country

i If you are filing with your spouse a current-year joint income tax return and a joint Form 3520, check this box . . . . ☐

j If an automatic 2-month extension applies for the U.S. person's tax return, check this box and attach statement. See instructions . . . ☐

k If an extension was requested for the tax return, check this box ☐ and enter the form number of the tax return to be filed:

2a Name of foreign trust (if applicable)			**b** Employer identification number (EIN), if any
c Number, street, and room or suite no. If a P.O. box, see instructions.			**d** Date foreign trust was created
e City or town	**f** State or province	**g** ZIP or foreign postal code	**h** Country

3 Did the foreign trust appoint a U.S. agent (defined in the instructions) who can provide the IRS with all relevant trust information? ☐ **Yes** ☐ **No**
If "Yes," complete lines 3a through 3g. If "No," and you are required to complete Part I, complete lines 15 through 18.

3a Name of U.S. agent			**b** TIN, if any
c Number, street, and room or suite no. If a P.O. box, see instructions.			
d City or town	**e** State or province	**f** ZIP or postal code	**g** Country

4a Name of U.S. decedent (see instructions)	**b** Address	**c** TIN of decedent
d Date of death		**e** EIN of estate

f Check applicable box.
☐ U.S. decedent made transfer to a foreign trust by reason of death.
☐ U.S. decedent treated as owner of foreign trust immediately prior to death.
☐ Assets of foreign trust were included in estate of U.S. decedent.

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 56398R Form **3520** (Rev. 12-2023)

Part IV **U.S. Recipients of Gifts or Bequests Received During the Current Tax Year From Foreign Persons** (see instructions)

54 During your current tax year, did you receive more than $100,000 that you treated as gifts or bequests from a nonresident alien (including a distribution received from a domestic trust treated as owned by a foreign person) or a foreign estate? See instructions for special rules regarding related donors . . . . ☐ **Yes** ☐ **No**

If "Yes," complete columns (a) through (c) with respect to each such gift or bequest in excess of $5,000. If more space is needed, attach a statement.

(a) Date of gift or bequest	**(b)** Description of property received	**(c)** FMV of property received
Total		$

55 During your current tax year, did you receive amounts from a foreign corporation or a foreign partnership that you treated as gifts in excess of the amount provided in the instructions? See instructions regarding related donors . . . . ☐ **Yes** ☐ **No**

If "Yes," complete columns (a) through (g) with respect to each such gift. If more space is needed, attach a statement.

(a) Date of gift	**(b)** Name of foreign donor	**(c)** Address of foreign donor	**(d)** TIN, if any

(e) Check the box that applies to the foreign donor		**(f)** Description of property received	**(g)** FMV of property received
Corporation	**Partnership**		

56 Do you have any reason to believe that the foreign donor, in making any gift or bequest described in lines 54 and 55, was acting as a nominee or intermediary for any other person? If "Yes," see instructions . . . . ☐ **Yes** ☐ **No**

Sign Here	Under penalties of perjury, I declare that I have examined this return, including any accompanying reports, schedules, or statements, and to the best of my knowledge and belief, it is true, correct, and complete.		
	Signature	Title	Date

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
	Firm's name			Firm's EIN	
	Firm's address			Phone no.	

Form **3520** (Rev. 12-2023)

APPLYING FOR AN INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER

An individual taxpayer identification number (ITIN) enables individuals to file tax returns if they are ineligible to obtain SSNs. This section identifies what an ITIN is, which individuals or situations necessitate applying for an ITIN, and the procedures for obtaining an ITIN.

PURPOSE OF AN ITIN

First introduced in 1996,[119] ITINs are 9-digit numbers used for federal tax reporting purposes only. The IRS issues them to individuals who are required to have a U.S. taxpayer identification number but are ineligible to obtain an SSN. Those who must apply for an ITIN include individuals who are required to furnish a federal tax identification number or file a federal tax return and are in one of the following categories.[120]

- An NRA who is required to file a U.S. tax return or is filing a U.S. tax return to claim a refund
- A U.S. resident alien who files a U.S. tax return based on the number of days they were present in the United States
- A dependent or spouse of a U.S. citizen, resident alien, or visa-holding NRA
- An NRA student, professor, or researcher who files a U.S. tax return or claims an exception to the U.S. tax return filing requirement
- An NRA who claims a tax treaty benefit requiring an ITIN

> **Note.** For more information on who is required to file an individual federal income tax return, see IRS Pub. 17, *Your Federal Income Tax*.

Certain parties, such as banks or financial institutions, may request an ITIN from an individual for those parties to comply with information reporting requirements, even if those individuals are not filing or are not required to file an income tax return. Such individuals may apply for an ITIN if they qualify for one of the following exceptions to the return filing requirement.[121]

1. The individual receives passive income subject to third-party withholding or covered by tax treaty benefits.
2. The individual does not claim benefits of an income tax treaty and receives taxable scholarship, fellowship, or grant income or claims the benefits of a U.S. tax treaty with a foreign country and receives any of the following.
    a. Wages, salary, compensation, and honoraria payments
    b. Scholarships, fellowships, and grants
    c. Gambling income
3. The individual has a home mortgage loan on real property in the United States that is subject to third-party reporting of mortgage interest.
4. The individual is a party to the disposition of a U.S. real property interest by a foreign person, which is generally subject to withholding by the transferee or buyer.
5. The individual has an IRS reporting requirement under TD 9363[122] and is submitting Form W-7, *Application for IRS Individual Taxpayer Identification Number*, with Form 13350, *Registration for e-services*.

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119. *The Facts About the Individual Taxpayer Identification Number (ITIN)*. Mar. 14, 2022. The American Immigration Council. [www.americanimmigrationcouncil.org/research/facts-about-individual-taxpayer-identification-number-itin] Accessed on Dec. 6, 2023.

120. *Individual Taxpayer Identification Number*. Nov. 7, 2023. IRS. [www.irs.gov/individuals/individual-taxpayer-identification-number] Accessed on Dec. 6, 2023.

121. Instructions for Form W-7.

122. TD 9363, 2007-49 IRB 1084.

A benefit of obtaining an ITIN includes the ability for taxpayers to e-file income tax returns, such as Form 1040-NR, *U.S. Nonresident Alien Income Tax Return.* However, taxpayers may only e-file the returns beginning with the calendar year following the year in which they applied for the ITIN.[123]

> **Note.** TD 9363 concerns the requirements for filing corporate income tax returns and returns for certain exempt organizations on magnetic media.

APPLICATION PROCESS

Applicants use Form W-7 to apply for and obtain an ITIN. The form, along with supporting documentation, may be submitted with the original tax return for which the filer is attempting to obtain the ITIN, provided they reside in the United States.[124] Alternatively, filers may furnish Form W-7 and supporting documentation to the IRS by mail, in person to an IRS employee, or to a certified acceptance agent (CAA).[125] For filers who reside outside of the United States, they must furnish Form W-7 and supporting documentation by mail or in person to an IRS employee, a Secretary-approved community-based CAA, or a designee of the Secretary at a United States diplomatic mission or consular post.[126]

> **Note.** In order to determine whether a particular tax center reviews and accepts ITIN applications, see **uofi.tax/24x2x1** [www.irs.gov/help/irs-taxpayer-assistance-centers-providing-in-person-itin-document-review].

Form W-7

Form W-7 is an informational form identifying the applicant's name, mailing address, birth information, and the type of identification documents accompanying the application. The form, along with the supporting documentation, may be mailed to the following address.[127]

Internal Revenue Service
ITIN Operation
P.O. Box 149342
Austin, TX 78714-9342

The IRS suggests allowing up to seven weeks for the agency to notify filers of their ITIN application status, although this process may take an additional two to four weeks if applicants filed their applications during the peak processing period of January 15 through April 30.[128]

Example 21. Elsa is a Norwegian student studying atmospheric sciences at the University of Illinois. She is an NRA and earns income from part-time work. Elsa applied for an ITIN in February 2023 when she prepared her 2022 Form 1040-NR. Elsa submitted the following Form W-7, along with her Form 1040-NR and supporting documents on paper. In 2024, Elsa can e-file her 2023 Form 1040-NR with the ITIN the IRS issued her in 2023.

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123. IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number ITIN.*
124. IRC §6109(i)(1).
125. IRC §6109(i)(1)(A).
126. IRC §6109(i)(1)(B).
127. Instructions for Form W-7.
128. Ibid.

For Example 21

Form **W-7** (Rev. August 2019) Department of the Treasury Internal Revenue Service

Application for IRS Individual Taxpayer Identification Number

► For use by individuals who are not U.S. citizens or permanent residents.
► See separate instructions.

OMB No. 1545-0074

An IRS individual taxpayer identification number (ITIN) is for U.S. federal tax purposes only.

Before you begin:
• ***Don't submit*** *this form if you have, or are eligible to get, a U.S. social security number (SSN).*

Application type (check one box):
☒ Apply for a new ITIN
☐ Renew an existing ITIN

Reason you're submitting Form W-7. Read the instructions for the box you check. **Caution:** If you check box **b, c, d, e, f,** or **g, you must file a U.S. federal tax return with Form W-7 unless you meet one of the exceptions** (see instructions).

- **a** ☐ Nonresident alien required to get an ITIN to claim tax treaty benefit
- **b** ☐ Nonresident alien filing a U.S. federal tax return
- **c** ☐ U.S. resident alien **(based on days present in the United States)** filing a U.S. federal tax return
- **d** ☐ Dependent of U.S. citizen/resident alien — If **d,** enter relationship to U.S. citizen/resident alien (see instructions) ►
- **e** ☐ Spouse of U.S. citizen/resident alien — If **d** or **e,** enter name and SSN/ITIN of U.S. citizen/resident alien (see instructions) ►
- **f** ☒ Nonresident alien student, professor, or researcher filing a U.S. federal tax return or claiming an exception
- **g** ☐ Dependent/spouse of a nonresident alien holding a U.S. visa
- **h** ☐ Other (see instructions) ►

Additional information for **a** and **f**: Enter treaty country ► and treaty article number ►

Name (see instructions)	**1a** First name: **Elsa**	Middle name	Last name: **Frost**
Name at birth if different . . ►	**1b** First name	Middle name	Last name
Applicant's Mailing Address	**2** Street address, apartment number, or rural route number. **If you have a P.O. box, see separate instructions.** **1301 W Green St**		
	City or town, state or province, and country. Include ZIP code or postal code where appropriate. **Urbana, IL 61801**		
Foreign (non-U.S.) Address (see instructions)	**3** Street address, apartment number, or rural route number. **Don't use a P.O. box number.** **2013 Olaf Ln**		
	City or town, state or province, and country. Include postal code where appropriate. **Oslo, Norway 0160**		
Birth Information	**4** Date of birth (month / day / year): **11/22/2003**	Country of birth: **Norway**	City and state or province (optional) — **5** ☐ Male ☒ Female
Other Information	**6a** Country(ies) of citizenship: **Norway**	**6b** Foreign tax I.D. number (if any)	**6c** Type of U.S. visa (if any), number, and expiration date

6d Identification document(s) submitted (see instructions) ☒ Passport ☐ Driver's license/State I.D. ☐ USCIS documentation ☐ Other

Issued by: **Norway** No.: **456789** Exp. date: **12/31/26** Date of entry into the United States (MM/DD/YYYY): **08/15/2022**

6e Have you previously received an ITIN or an Internal Revenue Service Number (IRSN)?
☒ **No/Don't know.** Skip line 6f.
☐ **Yes.** Complete line 6f. If more than one, list on a sheet and attach to this form (see instructions).

6f Enter ITIN and/or IRSN ► **ITIN** ☐☐☐–☐☐–☐☐☐☐ **IRSN** ☐☐☐–☐☐–☐☐☐☐ and name under which it was issued ► First name Middle name Last name

6g Name of college/university or company (see instructions) ► **University of Illinois**
City and state ► **Urbana, IL** Length of stay ► **4 years**

Sign Here

Keep a copy for your records.

Under penalties of perjury, I (applicant/delegate/acceptance agent) declare that I have examined this application, including accompanying documentation and statements, and to the best of my knowledge and belief, it is true, correct, and complete. I authorize the IRS to share information with my acceptance agent in order to perfect this Form W-7, Application for IRS Individual Taxpayer Identification Number.

Signature of applicant (if delegate, see instructions)	Date (month / day / year) / /	Phone number
Name of delegate, if applicable (type or print)	Delegate's relationship to applicant ►	☐ Parent ☐ Court-appointed guardian ☐ Power of attorney

Acceptance Agent's Use ONLY

Signature	Date (month / day / year) / /	Phone	Fax
Name and title (type or print)	Name of company	EIN	PTIN
		Office code	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 10229L Form **W-7** (Rev. 8-2019)

Supporting Documentation

Applicants must provide supporting documentation accompanying Form W-7 that meets all the following requirements.[129]

1. The documentation establishes the applicant's identity and connection to a foreign country (foreign status).
2. The documents supporting the information disclosed on Form W-7 must be original documents or copies provided and certified by the issuing agency.
3. The documents must be current and unexpired.

Note. Applicants who are dependents of U.S. military personnel are allowed to submit notarized copies of identification documents, which a public notary bears witness to the signing of an official document and affixes a seal asserting the document is legitimate.[130] All other applicants are not able to use this form of documentation to satisfy the document requirements for the ITIN application.

Unless an individual provides an original valid passport or a **certified copy from the issuing agency,** an applicant must submit at least two documents from the following list to verify their identity (i.e., the document contains the applicant's name) and support their claim of foreign status. At least one of the documents must contain the applicant's photo unless the application is submitted for a dependent who is under age 14 (under age 18 if a student).[131]

Documentation	Establishes Foreign Status	Establishes Identity
Passport	X	X
U.S. Citizenship and Immigration Services (USCIS) photo identification	X	X
Visa issued by the U.S. Department of State	X	X
U.S. driver's license		X
U.S. military identification card		X
Foreign driver's license		X
Foreign military identification card	X	X
National identification card (containing name, photograph, address, date of birth, and expiration date)	X	X
U.S. state identification card		X
Foreign voter's registration card	X	X
Civil birth certificate (required if an applicant is under age 18 and did not provide a valid passport)	X (if foreign)	X
Medical records (valid only for dependents under age 6)	X (if foreign)	X
School records (valid only for a dependent under age 18, if a student; period must be for a term ending no more than 12 months from date of application)	X (if foreign)	X

129. Ibid.

130. *ITIN Documentation Frequently Asked Questions (FAQs)*. Oct. 20, 2023. IRS. [www.irs.gov/individuals/international-taxpayers/itin-documentation-frequently-asked-questions-faqs] Accessed on Dec. 8, 2023.

131. Instructions for Form W-7.

CAA Program

An alternative to mailing supporting documentation with Form W-7 available to applicants is working with a CAA to assist in the application for an ITIN. A CAA is a person or entity authorized by the IRS to review the necessary documents, authenticate the applicant's identity when able, and forward the completed forms to the IRS.[132]

A CAA may use Form W-7 (COA), *Certificate of Accuracy for IRS Individual Taxpayer Identification Number*, to certify that they reviewed and verified original documentation or certified copies from issuing agencies of documents.[133] The IRS requires the CAA to retain copies of the supporting documentation used to fulfill the verification requirements, along with copies of the signed Forms W-7 they submitted to the IRS on behalf of the applicant.[134]

Acceptance Agents (AAs) are another resource that applicants may use for assistance. AAs assist applicants with the preparation and filing of Form W-7, but they do not certify the validity of the supporting documentation accompanying the application. Consequently, original documents or certified copies are submitted with the Form W-7 and later returned to the applicant after processing.[135]

Note. A directory of CAAs and AAs may be found online at **uofi.tax/24x2x2** [www.irs.gov/individuals/international-taxpayers/acceptance-agent-program]. The IRS updates the directory quarterly.[136]

Taxpayer Assistance Centers[137]

Applicants may also apply for an ITIN in person at designated IRS Taxpayer Assistance Centers (TACs). Agents may assist applicants with the preparation and filing of Form W-7 and verification of supporting documentation. Consequently, the IRS agent immediately returns supporting documentation to the applicant. Applicants may utilize this resource only by scheduling an appointment.

RENEWING AN ITIN

An ITIN generally remains valid until the taxpayer does not file an income tax return or is claimed as a dependent on the return of another taxpayer for three consecutive taxable years after the ITIN's issuance.[138] For ITINs that were issued before January 1, 2013, they are valid until the earlier of the applicable date or until the taxpayer does not file an income tax return or is **not** claimed as a dependent on the return of another taxpayer for three consecutive taxable years after the ITIN's issuance.[139] The applicable date for such ITINs is as follows.[140]

- January 1, 2017, for ITINs issued before January 1, 2008
- January 1, 2018, for ITINs issued during 2008
- January 1, 2019, for ITINs issued in 2009 or 2010
- January 1, 2020, for ITINs issued in 2011 or 2012

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132. Ibid.
133. Instructions for Form W-7 (COA).
134. Form W-7 (COA).
135. Instructions for Form W-7.
136. *Acceptance Agent Program*. Dec. 7, 2023. IRS. [www.irs.gov/individuals/international-taxpayers/acceptance-agent-program] Accessed on Dec. 12, 2023.
137. Instructions for Form W-7.
138. IRC §6109(i)(3)(A).
139. IRC §6109(i)(3)(B).
140. IRC §6109(i)(3)(C).

When an ITIN expires, the taxpayer must renew their ITIN unless they will not be filing a tax return or claiming a refund.[141] If individuals only use an ITIN for information returns, such as Forms 1099, they do not need to renew their ITIN and may use it for those reporting purposes.[142] Taxpayers renew existing ITINs by completing Form W-7, checking the "Renew an existing ITIN" box at the top of the form, including the original tax return filing with the ITIN listed, and providing supporting documentation confirming the taxpayer's identity and foreign status.[143] Upon renewal, the taxpayer should receive a CP565 Notice, *Confirmation of your Individual Taxpayer Identification Number*, from the IRS.[144]

ACCESS TO ONLINE IRS ACCOUNT[145]

Taxpayers with ITINs can register for an IRS online account to check balances due, view their payment history, and access their tax records. The registration utilizes a video chat process through ID.me,[146] where applicants must provide a valid email address, proof of having an ITIN, one primary document, and one secondary document. Either the primary or secondary document must provide proof of address. Primary documents include passports, U.S. state- or territory-issued driver's licenses and state IDs, and U.S. permanent resident cards.[147] Secondary documents may include U.S. health insurance cards, Forms W-2, *Wage and Tax Statement,* pay stubs, electric bills, and bank, loan, or financial institution statements.[148]

141. *ITIN Expiration Frequently Asked Questions*. Oct. 20, 2023. IRS. [www.irs.gov/individuals/itin-expiration-faqs] Accessed on Dec. 15, 2023.

142. Ibid.

143. Instructions for Form W-7.

144. *Understanding Your CP565 Notice*. Jan. 30, 2023. IRS. [www.irs.gov/individuals/understanding-your-cp565-notice] Accessed on Dec. 19, 2023.

145. *Individual Taxpayer Identification Number.* Nov. 7, 2023. IRS. [www.irs.gov/individuals/individual-taxpayer-identification-number] Accessed on Dec. 19, 2023.

146. *A digital passport to streamline your life.* ID.me. [www.id.me] Accessed on Mar. 14, 2023.

147. *Primary and secondary identification documents*. 2022. ID.me. [help.id.me/hc/en-us/articles/360017833054-Primary-and-secondary-identification-documents] Accessed on Dec. 19, 2023.

148. Ibid.