# Form 709
# The Gift Tax Return

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## Summary

Oft ignored by the unwitting taxpayer and overlooked by the practitioner, gift tax returns can be left unfiled. Find out when these returns are due and how to prepare them. An in-depth review of reporting requirements and preparation tactics will be provided. Strategies that can be used to mitigate and, in some instances, even eliminate a tax that currently can take as much as a 40% bite from gratuitous transfers will be examined, along with looming legislative changes that threaten to upend planning for wealth transfers.

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***The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed.***

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## I. Introduction

At Christmas time, it sits beneath the decorated tree wrapped in shiny paper that will soon be torn to shreds by an eager child who spent a year begging Santa for the Lego Master Builder Academy, gold Buckycubes, or Rock Star Mickey. At a wedding, it is tastefully and professionally wrapped in gold or silver and will be returned to the store from whence it came to be exchanged for something the bride and groom really wanted.

Whether large or small, packaged in a box or buried beneath tissue paper in a gift bag, discretely hidden in a birthday card or simply given as a card, gifts one and all are fun to give and fun to get! They are offered as tokens of appreciation, to say thanks to a valued employee, as expressions of love and kindness, to assuage guilt or buy gratitude, to say "I care," "I love you."

Whatever the size or motivation, gifts are given, not taken. The giver may hope for reciprocity – he may hope to get something back in exchange, a quid pro quo. He may hope that his gift will be matched with kindness and generosity but, in truth, a gift may go unacknowledged without even a "thank you."

That's the thing about gifts. They are one-way transfers made with nothing more than hope and expectation but without guarantee that anything – tangible or intangible – will be returned. No money, no bigger or better Lego set, no hard work, no obligation or indebtedness, no recognition. Nothing! A gift is *given* but not *taken.*

## II. Definition

For tax purposes, gifts are defined as "any transaction in which interest in property is gratuitously passed or conferred upon another."[1]

| Oscar winners must include the value of luxury goodie bags received from the Motion Picture Academy as taxable income since the items *are given to curry favor*. They are, therefore, not gifts but rather a form of compensation.[2] |
|---|

| In contrast, title to the family home transferred from father to son *in exchange for care provided* was deemed to be a gift since, under applicable state law, "parents are not required to pay a child, regardless of age and services performed, when they live with them."[3] In this case, not only was Dad held liable for unpaid gift taxes but Son – under the theory of transferee liability – assumed Dad's previously unpaid income tax debts which had been secured by the IRS when it filed a lien against the home long before title was transferred. |
|---|

| Casey Charf was diagnosed with cancer. To help with mounting medical costs, family members set up a GoFundMe account and collected about $50,000 from hundreds of donors. Two years later, the IRS sent a $20,000 tax bill, claiming that the funds collected represented taxable income (not gifts).[4] |
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[1] Reg. § 25.2511-1(c).

[2] *2006 Oscars and Goodie Bags*, The Prophet Newsletter, March 2006.

[3] *Rubenstein v. Commissioner*, 134 TC No. 13 as cited in *Father Sells Condo to Son for $10*, NATP TAXPRO Monthly, May 2011.

[4] Indeed, GoFundMe and other crowd-funding facilitators post warnings on their websites that they will issue 1099-Ks to the payment recipients who collect "at least $20,000 **and** over 200 donations in the calendar year." [available at http://support.gofundme.com/hc/en-us/articles/204295498-Am-I-responsible-for-taxes-US-Only-, last accessed May 7, 2021].


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A gift is considered complete once the donor parts with dominion or control over the transferred property and no longer has the power to change the disposition of the property for his own benefit or that of others.[5]

> You've pushed your plate of food with uneaten morsels across the table and said, "Here, honey, I'm full; you can have the rest of my dinner." With that, you get up from the table to wash the dishes while your honey remains seated and enjoys his extra portion. Just as he savors that extra serving of steaming lasagna, you return to the table to collect dirty dishes. Watching your husband dig into the still-steaming dish of pasta afloat in its creamy béchamel sauce, you suddenly have a craving to have just one more bite and reach over to snatch that mouthful delicacy. Disappointed, your spouse exclaims, No fair!"

So, when is a gift a "gift"?

In the case of parents making an interest-free loan to their son, the Court determined that they conveyed an economic benefit (the use of money) without consideration (interest payments). They made a gift equal to the value of the interest income they could (should) have earned.[6]

On the other hand, despite donative intent, a gift is not made if the donor does not part with anything of value. In the case where the wife substituted her note for that of her husband's obligation, but the bank continued to rely upon the husband's creditworthiness, the Court held that an agreement to guarantee another's debt did not constitute a completed gift because there was no certainty that payment on the guarantee would be required.[7]

In another case of marital accord, the husband offered to give his fiancé $150,000 if she accepted his marriage proposal but because marriage is not deemed consideration, the Court held that the husband had made a (taxable) gift.[8] Conversely, the transfer of property pursuant to a divorce decree is not a gift since the surrender of marital rights does not occur voluntarily.[9]

### A. Elements

The essential elements of a valid gift include:

- Delivery
- Intent
- Acceptance

**Delivery** may be actual (e.g., Dad parks a new car in the driveway for his teenage son) or implied (e.g., Dad hands his car key to his son), requiring some affirmative act to take place.[10] Delivery

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[5] Reg. § 25.2511-2(b).

[6] *Dickman v. Commissioner*, 465 US 330 (1984).

[7] *Bradford v. Commissioner*, 34 T.C. 1059 (1960).

[8] *Commissioner v. Wemyss*, 324 US 303 (1945).

[9] *Harris v. Commissioner*, 340 US 106 (1950).

[10] Essential Elements of a Gift, USLegal Inc., [available at http://gifts.uslegal.com/essential-elements-of-gift/, last accessed May 7, 2021].


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may be made directly or indirectly through a third party (e.g., Dad asks Mom to give the car keys to their son) and is considered complete only when the third party has transferred the property.

Donative **intent** may be expressed clearly and unmistakably or inferred from circumstances, such as the relationship between and the behavior of the parties. The intent must be present at the time of the gift and cannot vaguely indicate the transfer of property at some indeterminate time in the future.

> Police Officer Peebles discovered that his wife was having an affair with her physician Dr. Hestir. Peebles confronted Hestir and threatened to sue him for $150,000. Two days later, Hestir met Peebles and delivered $25,000 (the most he claimed he could raise). Peebles taped their conversation during the exchange: "Now, Doc, this isn't blackmail money." Hestir replied, "No, I didn't say it was blackmail money; I said I hope it helps you [and your wife]."
>
> The following year, Hestir's accountant issued a **1099-MISC** form to Peebles reporting the $25,000 payment. Peebles, however, did not report this income since he considered it to have been a "gift" from Hestir. The Tax Court disagreed, stating that the doctor's payment "was not the result of detached and disinterested generosity or paid out of affection, respect, admiration, or charity. Instead, it was paid to avoid a lawsuit, mitigate public and professional embarrassment, and assuage his own feelings of guilt or moral obligation."[11]

While it may seem that intent is a subjective measure, the Supreme Court opined that intent is inherently a question of fact that can be objectively discerned by examining the facts and circumstances surrounding the transaction. In other words, the donor's subjective expression of intent ["This is a gift"] must be supported by actions and context, which, in turn, must be evaluated by the trier of fact. Thus, the highest court in the land has ruled that it is ultimately up to a judge or jury to review each case to determine whether intent has been satisfied in each case. The proverbial adage "actions speak louder than words" holds true.[12]

Lastly, the recipient must unconditionally **accept** the gift at the time that it is made although he does have the right to reject the gift before the transfer is complete.[13] Once accepted, the donor forfeits all rights to the property and no longer has the power to alter, amend or revoke the gift.

### B. Examples of Gifts

While hardly an exhaustive or all-inclusive list, some common examples of gifts include:

- **Below-market loan**: The gift is equal to the interest that should have been charged if the applicable federal rate had been used.[14]
- **Debt forgiveness**: The gift is equal to the unpaid principal balance.
- **Below-market sale**: The gift is equal to the difference between the current fair market value (FMV) and the discounted sales price.

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[11] *Peebles v. Commissioner,* TC Summary Opinion 2006-61 as reported in California Enrolled Agent, August 2007.

[12] Commissioner v. Duberstein, 363 U.S. 278 (1960).

[13] If a donee makes a qualified disclaimer by irrevocably refusing to accept the proffered gift in writing, the transfer is treated as though it had never been made [IRC § 2518].

[14] As per IRC § 7872, the gift is treated as though made on the last day of the calendar year (if demand loan) or on the date the loan was made (if term loan). Gift loans that do not exceed $10,000 are exempt from gift tax.


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- **Transfer to an irrevocable trust**: The gift is equal to the value of all assets transferred into the trust.
- **Joint and survivor annuity**: The gift is equal to the difference between the premium paid for the joint annuity and the premium paid for a similar single-life annuity.
- **Year-end check**: Although the donor's check may not yet have cleared the donee's bank until the following year, the gift is considered complete if (1) the donor intended to make a gift, (2) the delivery was unconditional, (3) the deposit was made in the year for which completed gift treatment is sought and within a reasonable time of issuance, (4) the donor's bank did not reject the check and (5) the donor was alive when the donor's bank paid it.[15]
- **Corporate dissolution**: The gift is equal to the value of the distribution which exceeds the shareholder's interest in the corporate entity.

In some cases, placing assets into **joint ownership** may be deemed to be a gift when the joint tenancy is created. In other instances – depending on state law – the gift becomes complete only when the assets are withdrawn from the joint account. Generally, transfers of real property, mutual funds, stocks and bonds are considered complete upon re-titling of the assets, but transfers of bank and brokerage accounts are complete only when the donee makes a withdrawal from the joint account for his own benefit.[16]

| Divorced mom titles her condo in joint tenancy with her son to avoid probate [Gift # 1] but later re-marries and asks her son to quit claim the property back to her [Gift # 2]. |
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| Father owns an apartment building worth $1 million and adds his daughter as joint tenant. Because the daughter may at any time sever the joint tenancy and hold title to her 50% share as a tenant-in-common, Father is deemed to have made a gift.[17] |
|---|

If the property continues to be held in joint tenancy until the donor's death, the full value of the property is included in the donor's taxable estate. Thereafter, the donee – once a joint tenant – becomes the owner of the asset which he inherits with a stepped-up basis.[18]

**Life estate and remainder interests**, often used by donors wishing to transfer title to real property while reserving the right to use the property until death, are also governed by state law. Typically, a completed gift is made when the deed is recorded, although the value of the gift may be discounted since the donee does not receive all beneficial rights at the time of transfer.[19]

In some instances, **derivative or partial gifts** may arise due to a sale or other transaction which included insufficient consideration for the property transferred or the parties agreed that the donee (rather than the donor) would pay the attendant gift tax. In the instance where the donee pays

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[15] Rev. Rul. 96-56.

[16] Reg. § 25.2511-1(h)(4).

[17] *The Tax Prophet* (Issue # 104, January 2012) recommends that transferors protect themselves against potential gift tax consequences by drafting a written agreement that states that (i), neither party has the right to sever the joint tenancy without mutual consent, (ii) the joint tenancy is for estate transfer purposes only, and (iii) the original owner will continue as sole owner until he dies, or the parties agree to sever the joint tenancy.

[18] IRC § 1014.

[19] Refer to IRC § 7520 for valuation of annuities, life estates, remainders, and reversions.


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the donor's tax, the donor may deduct the gift tax from the value of the transferred property (now considered a "net gift")[20] but must then also include the difference between the gift tax and the property's basis in his taxable income.[21]

| Taxpayer gifted stock to his children on the condition that they pay the resulting gift tax of $60,000 which exceeded the donor's basis of the stock ($50,000). Since the taxpayer recognized a capital gain of $10,000, he is liable for income tax on this gain. |
|---|

Generally, a transfer of property to a **Limited Liability Company (LLC)** is treated as a contribution of capital to the contributing member's capital account. Therefore, the transfer does not qualify as a completed gift until such time that the contributing member transfers his ownership units in the LLC to other members.

## III. Taxation

In an attempt to tax the transfer of property whether during or after life, the Gift Tax as we know it today was enacted in 1932, about sixteen years after the Estate Tax was put on the books. It is a tax imposed on the donor based on the cumulative value of all gifts made during lifetime, even those which may have been previously taxed.

Like the Estate Tax, the Gift Tax is assessed at graduated rates, but because all of the donor's gifts – past and present – are aggregated, a gift may be taxed at a higher marginal bracket than a comparable asset would be taxed if transferred at death. While it is often advantageous to spread the receipt of taxable income over several years to gain the benefit of lower marginal tax brackets, it generally matters not whether one large gift is made in one year or multiple smaller gifts are made over several years since each successive gift is added to those previously made and the total is then subjected to the applicable gift tax rate.

### A. Not Gifts

Most gratuitous transfers of property ("gifts") are subject to gift tax with certain exceptions:

- Gifts made to IRS-approved charitable organizations are exempt from gift tax. Although there is no limit to this exemption for gift tax purposes, income tax deductions for cash contributions are generally limited to 60% of the taxpayer's Adjusted Gross Income (AGI) each year. Unused deductions may be carried forward for five years.[22]

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[20] Rev. Rul. 75-72.

[21] *Diedrich v. Commissioner*, 82-1 USTC 9419.

[22] The 50% AGI limitation as per IRC § 170(b)(1)(A) has been temporarily increased to 60% (from 50%) for tax years 2018 – 25 [Tax Cut and Jobs Act (TCJA), Public Law 115-97].


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Boxer Oscar De La Hoya made a side bet with his opponent's manager, rapper Jay Z, who had agreed to pay $100,000 to Oscar's charity of choice should he win the match. However, when Oscar won, Jay Z was not entitled to a charitable deduction since he lacked the requisite donative intent and was, instead, settling a gambling debt.[23]

- Direct payments to providers for another individual's **medical expenses** are not considered gifts. These payments may cover any type of expense deductible for income tax purposes, including payment of insurance premiums.[24]
- Similarly, direct payments of **tuition** for another person, if paid directly to a qualifying education organization, are not considered gifts.[25] Tuition for full- and part-time students qualifies, but payments for books, school supplies, room and board do not.

Grandpa sent $40,000 directly to Brown University to pay for his grandson's tuition and also sent $13,000 to the teenager to pay for books, supplies and other expenses. Neither payment is reportable for gift tax purposes since the first was a direct payment for tuition and the second was eligible for the annual exclusion.

If Grandpa had instead sent a check for $53,000 to his grandson and directed the teen to pay the tuition bill, Grandpa would have made a gift that while reportable, may still not have been taxable if Grandpa availed himself of his lifetime exemption [see below].

**NOTE:** Payments to **Qualified Tuition Programs** (QTPs)[26] are not covered by the tuition exemption and are instead treated as taxable gifts. However, QTP contributions are eligible for the annual gift tax exclusion [see below]. In fact, taxpayers may contribute as much as the aggregate of five years' worth of annual exclusions in a lump sum without incurring gift tax consequences. In other words, a donor may elect to exclude up to $75,000 (in 2021), if no other gifts are made to the same donee in this or the next four years.[27] A QTP donor is not subject to gift tax on distributions from these plans unless the designated plan beneficiary is changed or the plan is rolled over to a beneficiary who is a generation below (younger than) the original beneficiary.[28]

A parent's **support payments** for the benefit of a minor child are not considered to be gifts if legally required to be made.

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[23] Erbs, Kelly Phillips, "Jay Z Loses On Alvarez-Cotto Boxing Bet As Charity Gets Big Win", *Forbes* (November 22, 2015) [available at https://www.forbes.com/sites/kellyphillipserb/2015/11/22/jay-z-loses-on-alvarez-cotto-boxing-bet-as-charity-gets-big-win/?sh=2947e1e1332d, last accessed May 8, 2021].

[24] Reg. 25.2503-6(b)(3).

[25] IRC § 2503(e).

[26] IRC § 529.

[27] The election is made by checking the box on Line B of **Form 709**, Schedule A and attaching a statement listing the amounts contributed for each beneficiary and the amounts for which the election is made. Twenty percent of the gift is reported each year for five years; however, if in any of the four years following the election, the taxpayer is not required to file **Form 709** other than to report that year's portion of the election, the taxpayer does not need to file or otherwise report that year's portion. Any amount in excess of $75,000 must be reported in the year the gift is made [IRC §529(c)(2)].

[28] IRC § 529(c)(5).


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> Dad contributes to the living expenses of his son (age 25) who lives away from home. Amounts in excess of the annual exclusion are deemed to be taxable gifts. On the other hand, if his son were only 17, his payments would be considered to be a part of his legal obligation to support his minor child and, therefore, not deemed to be taxable gifts.

## B. Annual Exclusion

Each year, a donor may exclude the first $15,000 (in 2021) given to each donee. Husband and wife may join together and gift up to $30,000.[29]

Married Donors

Gift-splitting allows a married couple to treat gifts made by only one spouse as though one-half had been made by each spouse. As a result, spouses are able to maximize their annual exclusions, sheltering gifts made from the assets of only one spouse and which would otherwise not be fully excluded by that individual's annual exclusion. To qualify, spouses must (1) be US citizens or residents at the time of the gift, (2) be married at the time of the gift, and (3) remain unmarried at the end of the calendar year if they have separated during the year of the gift.[30]

> Husband (H) and Wife (W) agreed to split the following gifts: H gave his nephew $21,000; W gave her niece $18,000. H's gift to nephew is treated as one-half ($10,500) from H and one-half ($10,500) from W. W's gift to niece is also treated as one-half ($9,000) from W and one-half ($9,000) from H.
>
> Each donee is then viewed separately to determine if the allocated amounts gifted exceed the annual exclusion. In this case, no taxable gifts were made, but each donor must file a gift tax return to report the gift-splitting.

Present Interest

To qualify for the annual exclusion, the donor must gift a present interest and grant the donee an immediate right to use and possess the property.[31] Generally, gifts to trusts do not constitute present interest unless the donee has a right to the income from the property and has the right to sell his interest in the property. However, gifts to a minor's trust[32] – such as those made under the Uniform Transfer to Minors Act (UTMA) – qualify as present interests if (1) the funds can be used immediately for the minor's benefit, (2) the minor will receive the property by age 21 and (3) the property will pass to the minor's estate if the minor dies before reaching the age of majority.[33]

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[29] These limits are those currently in effect for 2021. The exclusion has been indexed for inflation since 1998 but will not be increased until the inflation-adjusted amount reaches the next multiple of $1,000 [IRC § 2503(b)(2)]. Applicable amounts were: 1998 – 2001 ($10,000), 2002 – 05 ($11,000), 2006 – 08 ($12,000), 2009 – 12 ($13,000), 2013 – 17 ($14,000), 2018 – present ($15,000).

[30] The election is made on lines 12 through 17 of Part 1 on **Form 709**. Each spouse must consent by signing Line 18 of the other spouse's **Form 709**. The returns should be mailed to the IRS in the same envelope.

[31] The gift of publicly traded stock is considered a gift of present interest, but gifts of restricted stock, family limited partnerships, and shares of a limited liability company are deemed to be gifts of future interest since the donee cannot freely transfer his interest. [*Hackl v. Commissioner*, 335 F.3d 664 (2003)].

[32] Beware of the Kiddie Tax that may apply the parents' tax rate to the investment income of children under age 19.

[33] IRC § 2503(c).


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Gifts of future interest given to a trust may be "converted" to present interest with the insertion of a Crummey power[34] granting trust beneficiaries the right to withdraw principal from the trust for a limited period of time.

| Dad establishes an irrevocable life insurance trust (ILIT) to ensure that the eventual estate taxes due upon his death can be paid without compounding the tax liability by including the insurance policy in his taxable estate. He funds the ILIT annually with just enough to cover the insurance premiums. His children, the beneficiaries of the trust, are notified each year of their right to withdraw the annual contribution. Wisely, they choose to leave the ILIT funds untouched and allow the trustee to make the scheduled premium payment but because they have the right – even only temporarily – to possess the gifted amount, Dad's contribution becomes a present interest eligible for the annual gift tax exclusion. |
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A gift to a corporation is a gift to its shareholders but because title of the transferred property is held in the corporation's name, shareholders do not receive an immediate right to use, possess, or enjoy the donated property or the income from the property.[35] Of course, the gifted property increases the value of the underlying shares of the corporation but the shareholders cannot benefit from this increase until the company is liquidated or the shareholders are able to dispose of their stock holdings. Thus, gifts to a corporate entity have been deemed to be gifts of future interest and are not eligible for the annual gift tax exclusion.[36]

However, a gift to a corporation with a single shareholder could potentially be deemed to be a gift of a present interest since the sole shareholder could liquidate the corporation at will. Similarly, a gift to a partnership, LLC or other pass-through entity is considered to be a gift allocated to the individual partners or members proportionate to the partners' or members' respective capital accounts[37] as long as the donee partners or members have the unrestricted right to withdraw their capital.[38]

### C. Lifetime Exemption (Applicable Credit)[39]

In addition to the annual exclusion, each donor is entitled to a lifetime exemption of $11,700,000 (2021)[40], indexed annually for inflation. This exemption translates to a gift tax credit of $4,625,800 (based on current applicable tax rates). If an individual makes taxable gifts in excess of the annual exclusion amount, he must report them on **Form 709** when made, but need not pay any tax until

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[34] *Crummey*, 397 F.2d 82 (9th Cir. 1968).

[35] *Hollingsworth v. Comm.*, 86 T.C. 91 (1986) and Rev. Ruling 71-443.

[36] *Chanin v. US*, 393 F. 2d 972.

[37] *Shepherd v. Comm.,* 115 T.C. 376 (2000).

[38] *Wooley v. US*, 736 F. Supp. 1506 (1990)].

[39] IRC § 2010(c).

[40] Rev. Proc. 2020-45. Beginning in 2010, the lifetime exemption amount was raised to $5 million and then indexed annually for inflation. In 2018, TCJA doubled the then-applicable exclusion amount to $11.18 million, adjusted annually for inflation to $11.4 million (2019), $11.58 million (2020), and $11.7 million (2021). The lifetime exemption is scheduled to revert to the pre-2018 threshold of $5 million in 2026. **NOTE:** The Treasury has issued final regulations that individuals, who take advantage of the higher exclusion amounts currently in effect, will not be adversely affected when the exclusion later drops. As per Notice 2019-189, a decedent's estate will be allowed to compute its estate tax credit based on the higher of the exclusion amount applicable to lifetime gifts made or the exclusion amount on the date of death.

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his current or subsequent taxable gifts cumulatively exceed the lifetime exemption. Accumulated gifts excluded by the lifetime gift exemption serve to reduce the applicable exemption available to the decedent on his estate tax return (**Form 706**).

| Taxpayer gives $25,000 to her daughter in 2021. The first $15,000 of the gift is not subject to gift tax because of the annual exclusion. The remaining $10,000 is a taxable gift but may be exempt from taxation under the lifetime exemption. Nevertheless, a gift tax return must be filed for the year of the gift. |
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In 2021,[41] Taxpayer (who has not previously made any gifts) gifted the following:

- $8,000 car to Son (no other gift was given to Son during the year).
- $26,000 cash to Daughter for down-payment on a house.
- $19,000 paid to college for Nephew's tuition.

Taxpayer must apply the exclusions and exemptions in the following order:

1. Apply the educational (medical or charitable) exemption: Gift to Nephew is exempt.
2. Apply the annual exclusion: Entire gift to Son; first $15,000 of gift to Daughter are excluded.
3. Apply the lifetime exemption: Remaining $11,000 of gift to Daughter is taxable. The tax thereon totals $4,400 which will reduce Taxpayer's available Unified Credit to $4,621,400.

Taxpayer does not owe gift tax in the current year but must file **Form 709**.

**Form 709** must be filed whenever a donor makes a reportable gift, whether or not he anticipates that his cumulative gifts will be exempt under the lifetime exemption or that his estate will ultimately be too small and not subject to the estate tax.

The lifetime exemption is applicable to both gift and estate taxes[42] and, in fact, has been unified under the Tax Reform Act of 1976 and renamed the "Applicable Credit Amount". While the effect is the same, the exemption is used to reduce the amount of taxable gifts, whereas the credit is used to reduce the amount of tax due. Therefore, when properly computing the gift tax liability on **Form 709**, the taxpayer begins by reporting all taxable gifts and calculating the tax on the *full* amount of these gifts. Only after the tax is calculated, may the taxpayer then subtract the applicable credit to determine the actual tax due.

## D. Applicable Individuals

The gift tax applies to donors who are US citizens and residents, regardless of where the gifted property is situated.[43] On the other hand, non-resident aliens (NRAs) are subject to gift tax only if the gifted property is US-sited real or tangible personal property.

| A Mexican citizen owns real property in Arizona which she gifts to her son (also a Mexican citizen). She is liable for US gift tax since the gifted property is in the US. |
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[41] **REMINDER:** For 2021, applicable exclusion is $15,000; gift tax credit is $4,625,800; and the gift tax rate is 40%.

[42] Exemption amounts are portable between spouses. As a result, a surviving spouse may apply the unused portion of the pre-deceased spouse's estate tax exemption against any future estate *or gift* tax liability of the survivor as long as the deceased spouse was the most recent spouse of the survivor [IRC §§ 2010, 2501 and 2502].

[43] IRC § 2501(a).


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A US citizen owns real property in Mexico which he gifts to his daughter. Because he is a US citizen, he is liable for gift tax, whether or not his daughter is a US citizen.

An unlimited marital deduction is allowed for gifts passing between citizen spouses; not including Qualified Terminable Interest Property (QTIP).[44] Gifts to non-citizen spouses are limited to an inflation-adjusted amount of $159,000 (in 2021) on transfers of present interests.

## E. Special Rules for Non-resident Aliens[45]

Non-resident aliens are eligible for the annual gift exclusion but *not* the lifetime exemption. Instead, the estate of an NRA receives a credit of only $13,000 against the federal estate tax (the equivalent of a $60,000 exemption), an exemption level that has remained unchanged since 1988.

**BEWARE:** An individual who is otherwise non-resident may be considered to be a "resident" for gift and estate tax purposes. The determination will hinge not on residency but rather on the taxpayer's domicile. Thus, if an alien enters the US even only briefly but has no definitive intent to depart, he will be considered to be a US resident subject to US gift and estate regimes. If US tax authorities are unable to collect gift or estate tax liabilities accrued to the alien, the liability will likely be transferred to and collected from the US beneficiary of the gift or inheritance.

While non-resident aliens are subject to federal estate tax on all US-sited tangible and intangible property, they are subject to gift tax only on lifetime transfers of US-sited tangible (not intangible) property.[46] In general, aliens may not claim a credit for death taxes paid to a foreign government even if the tax results in double taxation of the same property here and abroad. (Certain countries have entered into estate tax treaties that may modify the general rules applicable to estate and gift taxes.[47])

Aliens seeking to avoid US gift tax, may consider gifting intangible assets (such as investments held at a brokerage account) or transferring US-sited real property to a business entity, thereby converting a tangible asset into an intangible which can then be transferred gift-tax free to a beneficiary.[48] To minimize or avoid estate taxation, aliens should not hold any US-sited assets at death.

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[44] A QTIP is a trust in which the surviving spouse receives lifetime income from the trust's assets, but the trust's corpus is left to an alternate beneficiary, such as the couple's child. A QTIP qualifies for the annual gift tax exclusion if the donee spouse receives income payments for life and no one retains a power of appointment to substitute the donee spouse as beneficiary. If the gift tax exclusion is claimed on the QTIP, the property must be included in the donee spouse's estate [IRC § 2523]. Gift taxes paid by donee spouse on transfers made by the donee spouse within three years prior to the donee spouse's death, are includible in the donee spouse's estate [*Estate of Morgens*, 109 AFTR 2d 2012-736].

[45] US citizens who reside in US possessions (i.e., Puerto Rico, Guam, American Samoa, the Northern Mariana Islands and the US Virgin Islands) are *not* NRAs but may be treated as NRAs for gift and estate tax purposes if they acquired US citizenship solely because (1) they are a resident of the possession or (2) because they were born in the possession [IRC § 2209].

[46] In a strange twist of logic, cash – in the form of bills and coins – is considered tangible property (subject to gift tax) but transfers by check are considered intangible and exempt from gift tax (PLR 8210055).

[47] For a list of international estate and gift tax treaties, see https://www.irs.gov/businesses/small-businesses-self-employed/estate-gift-tax-treaties-international (last accessed May 8, 2021).

[48] **TIP:** It is suggested that at least a year pass between the dates of property transfer to the corporation or partnership and the eventual transfer to an individual recipient.


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Surprisingly, aliens are entitled to claim up to $11.7 million Generation-skipping Tax (GST) exemption (in 2021), just like US citizens and residents.[49]

It is the donor, of course, who is liable for filing **Form 709,** but it should be noted that US recipients of "foreign" gifts may be subject to reporting requirements as well. If the aggregate value of gifts received from a non-resident alien individual or foreign estate exceeds $100,000 per year,[50] the US beneficiary must attach **Form 3520** Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts to a timely filed individual income tax return (or estate tax return if the recipient has died).[51]

### F. Expatriates

US citizens and residents who receive gifts or bequests on or after June 17, 2008 from covered expatriates[52] may be subject to a transfer tax (imposed on the recipient rather than the donor).[53] The tax is assessed at the then applicable top estate and gift tax rate (40% in 2021).

## IV. Tax Return Specifics

All gifts in excess of the annual exclusion are reportable on **Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return**. Gift tax returns cannot be filed jointly since each spouse has a separate annual exclusion attributable only to him, even when gift-splitting is elected.

### A. Filing Requirement

Gift tax returns must be filed for all taxable transfers of property for which inadequate consideration was received and must be filed in the following situations, even if no tax is due with the return:

- A taxpayer gave gifts in excess of the annual exclusion amount to someone other than his spouse.
- A taxpayer made a gift in excess of the annual limit to a non-citizen spouse.
- A taxpayer made a gift of a future interest of any amount since it is not exempted by the annual exclusion amount.
- A married couple elects to split gifts (regardless of amount) or one spouse makes a gift of jointly held or community property.
- An individual is a beneficiary, partner, or shareholder of a trust, estate, partnership, or corporation that has made a gift.
- An executor on behalf of a donor who has died prior to filing a required gift tax return.
- A donor who has not paid his gift tax liability, which must be transferred to the donee.

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[49] Treas. Reg. § 26.2663.-2.

[50] For gifts from foreign corporations and partnerships, the reporting threshold is $16,815 (in 2021).

[51] Penalties for failure to file **Form 3520** equal the greater of $10,000 or 35% of the value of property transferred to or distributions received from a foreign trust.

[52] "Covered" expatriates are US citizens or long-term residents who meet certain income and net worth threshold amounts and who have (in)voluntarily relinquished their citizenship or green card status [IRC § 877A].

[53] IRC § 2801.


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No return is due for gifts that do not exceed the allowable annual exclusion to each donee, donations of the donor's full interest in the donated property, transfers to political organizations,[54] or payments that qualify for educational and medical exclusions.

Even when **Form 709** is required, not all gifts need to be reported since each donee is considered separately. If all gifts to one donee can be excluded by the annual exclusion, no gifts to that donee are reported; however, if gifts to a second donee exceed the exclusion, then those gifts must be reported.

### B. Filing Deadline

Gift tax returns must be filed by April 15th of the year following the calendar year in which the gratuitous transfer was made, unless an extension for filing the taxpayer's income tax return has been requested using **Form 4868 Application for Automatic Extension of Time to File US Individual Income Tax Return.** If **Form 4868** has not been filed, **Form 8892 Application for Automatic Extension of Time to File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax** may be used instead to obtain an automatic six-month extension.

To report gifts made by an individual who has died since making the gift, the filing deadline is the earlier of April 15th or the deadline (with extensions) for the estate tax return. While extensions extend the time for filing, they do not extend the time for payment which, if late, is subject to penalties and interest.[55]

### C. Tax Rates (in 2021)

The applicable gift tax rates are the same as those applied to the estate tax.

| Taxable Amt ($) | Tax Rate (%) |
|---|---|
| 0 – 10,000 | 18 |
| 10,001 – 20,000 | 20 |
| 20,001 – 40,000 | 22 |
| 40,001 – 60,000 | 24 |
| 60,001 – 80,000 | 26 |
| 80,001 – 100,000 | 28 |

| Taxable Amt ($) | Tax Rate (%) |
|---|---|
| 100,001 – 150,000 | 30 |
| 150,001 – 250,000 | 32 |
| 250,001 – 500,000 | 34 |
| 500,001 – 750,000 | 37 |
| 750,001 – 1,000,000 | 39 |
| 1,000,001 and over | 40 |

**NOTE:** Since marginal rates rapidly progress and reach the maximum rate with taxable gifts (and estates) of only $1 million, practitioners often apply the highest rate to all gifts when making rough estimates for planning purposes.

### D. The Gift Tax Calculation

(Taxable Gifts during lifetime * Applicable Tax Rate)
– (Taxable Gifts in prior years * Applicable Tax Rate)
= Tentative Tax
– Applicable Credit Amount
= Tax Due

Calculated at *cumulative* graduated rate

[54] IRC § 527(e)(1).

[55] IRC § 6651(a)(1).



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In 2017, taxpayer made taxable gifts (after the annual exclusion) totaling $5 million. In 2020, taxpayer made additional taxable gifts totaling $13 million. The value of taxpayer's estate was $30 million when he died in 2021.

Gift Tax Calculation:

$ 5 M in '17 → Tax = $1,945,800 (BUT $0 paid since $2,141,800 lifetime credit available)
13 M in '20
$18 M cumulative gifts → Tax = $7,145,800 tentative tax on total gifts made in both years

| | |
|---|---|
| $ 7,145,800 | Tentative tax |
| – 1,945,800 | Tax liability on '17 gift |
| $ 5,200,000 | Tax attributable to '20 gift |
| – 2,632,000 | Credit available in TY'20 (= $4,577,800 – 1,945,800 used in 2017) |
| $ 2,568,000 | Gift tax due in '20 |

Estate Tax Calculation:

| | |
|---|---|
| $ 30 M | Value of estate on DoD |
| + 18 M | Prior taxable gifts added back to estate |
| $ 48 M | Tax base used to compute estate tax |

| | |
|---|---|
| $ 19,145,800 | Tentative tax on $48 million tax base |
| – 2,568,000 | Tax previously paid on gifts |
| $ 16,577,800 | Estate tax liability |
| – 4,625,800 | Credit available in TY'21 |
| $ 11,952,000 | Estate tax due in '21 |

## E. Responsibility for the Tax

Transferee Liability

While the donor is principally liable for the gift tax, liability may shift to the donee if the donor fails to meet his obligation. Assessment against the donee may be made up to one year after the expiration of the assessment statute against the donor expires.[56] The IRS may file a lien against the transferred property for a period of ten years from the date of the gift.

Net Gift

In some instances, a donee may wish to voluntarily assume the liability for the donor's tax. While this assumption of liability does not offer any tax savings, it does alleviate the donor's burden of making the tax payment. The gift tax liability will be the same whether the donor transfers a gross amount to the donee on the condition that the donee pays the gift tax due, or the donor pays the gift tax and only transfers a gift net of tax to the donee. To compute the net gift to be transferred, the taxpayer must first compute the tentative gift tax liability that would be due if transfer did not involve a net gift. The tentative tax is then divided by the sum of one plus the rate of tax. The result is the actual tax due.[57]

[56] IRC § 6901(c)(1).

[57] Rev Rul 75-72.

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Mom, who has made no prior gifts, transfers $15 million to Son in 2020. Son agrees to pay the gift tax.

| | |
|---|---|
| Tax on Gross Transfer of $15 M | $ 5,945,800 |
| Applicable Credit (TY'20) | (4,577,800) |
| Tentative Gift Tax | $ 1,368,000 |
| Divide by 1.40 (= 1 + 40% tax rate) | ÷ 1.40 |
| Actual Tax Due | $ 977,143[58] |
| Net Gift to Donee (= $15 M – Actual Tax) | $14,022,857 |

Mom could transfer $14,022,857 after she pays gift tax *or* Mom could transfer $15 M and demand that Son pays the gift tax; either way, Son will net the same after-tax dollars from Mom's gift.

However, the gift tax paid by Son must be added back to Mom's gross estate if she dies within three years of making the gift.[59]

Net, Net Gift

This arrangement goes one step further by requiring the donee to assume the gift tax liability as well as the continent estate tax liability that might arise if the donor dies within the 3-year lookback period. Since the estate tax liability is conditioned on the donor's death within the mandated timeframe, it can be discounted based on a present value computation. As a result, a net, net gift can offer gift and estate tax savings, enabling the donee/beneficiary to net more in-pocket dollars.[60]

Deceased Donor

The personal representative of a donor's estate may become personally liable for unpaid gift taxes, although he may request release from personal liability by submitting a written application.[61]

### F. Penalties

Taxpayers may be subject to penalties ranging from late filing and late payment assessments[62] to penalties arising from valuation misstatements for which they will be assessed 20% of any underpayment caused by a substantial over- or understatement of value.[63]

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[58] **REMINDER:** Because the gift tax liability originates with the donor, **Form 709** must be prepared on the donor's behalf. As a result, it is the donor's (not the donee's) lifetime exemption that this is reduced. The donee, on the other hand, may reduce the basis of the gifted property by the amount of git tax liability paid on donor's behalf.

[59] IRC § 2035(b).

[60] Arlein and Frazier, *The Net, Net Gift*, Trusts & Estates, August 2008 [available at https://www.pbwt.com/content/uploads/2015/07/Trust-Estates-Article-August-2008-ePrint.pdf, last accessed May 10, 2021].

[61] IRC § 2204.

[62] IRC §§ 6651(a)(1) and (2).

[63] IRC § 6662 defines "substantial" misstatements as those that are 65% or less of the determined value and cause a tax understatement of more than $5,000. The penalty is increased to 40% for "gross" valuation misstatements which are 40% or less of the determined value.


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Persons – including lawyers, appraisers, and tax practitioners – who knowingly aid and abet the understatement of another's tax liability may also be penalized.[64] In 2007, preparer penalties for understatement of a taxpayer's income tax liability were extended to include preparers of estate and gift tax returns.[65]

## G. Statute of Limitations

For the purpose of giving taxpayers certainty that the government cannot pursue them for unpaid taxes after a given period of time, the statute on gift tax returns is limited to three years (six years if the amount of unreported items exceeds 25% of the amount of the reported items).[66] However, prior to the enactment of The Taxpayer Relief Act (TRA) of 1997, even gift valuations reported on properly filed gift tax returns could be challenged and changed by the IRS after the donor's death![67]

Under TRA 1997, in order to revalue a gift that has been adequately disclosed on a gift tax return, the Service must issue a final notice of redetermination of value within the statute of limitations applicable to the gift for gift tax purposes.[68] As a result, "there is now an added incentive for a taxpayer to file a gift tax return that includes details about the nature of the transfers made. This will ensure the taxpayer has met the adequate disclosure standard and will curtail the IRS's ability to challenge the valuation of gifts."[69]

| Sumner Redstone, former Chairman of Viacom an CBS, was pursued by the IRS more than 4 decades after he transferred company stock to his children but failed to file a gift tax return. Although aware of the transfer, the IRS did not issue its tax bill until Redstone testified in an unrelated case that he had "just made an outright gift." The Tax Court ruled against Redstone who – in the gift tax case – claimed that the long-ago transfer had been made in the ordinary course of business. |
|---|

To meet the adequate disclosure standard, gift tax returns should include a detailed description of the transaction – whether transferred or retained interests – as well as the identity of and relationship between donor and donee, and a detailed explanation of the method used to value the transferred property (less applicable discounts). **TIP:** Taxpayers today may wish to disclose even non-reportable gifts to establish valuation methods and preclude potential revaluation should they later make similar (taxable) transfers.

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[64] IRC § 6701.

[65] IRC § 6694.

[66] The statute of limitations does not apply to unfiled returns or to those returns that, while filed, did not provide adequate information regarding the nature of the gift, its value, the valuation methodology used, or discounts applied.

[67] *Smith v. Commissioner*, 94 T.C. 872 (1990).

[68] Department of the Treasury, Internal Revenue Service, Office of Chief Counsel, Notice N (35) 000-151, February 27, 1998.

[69] Soled, *New Gift Tax Considerations*, Journal of Accountancy, October 1998 [available at TaxProf Blog, http://www.journalofaccountancy.com/Issues/1998/Oct/soled.htm, last accessed May 20, 2014].


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Taxpayer owns all of Company's outstanding 100 shares, valued at $2 million. He gifts one share to his daughter and values that share at $10,000 by applying a 50% minority and marketability discount ($2,000,000/100 × 50%). Based on this value, the taxpayer's gift is less than the annual exclusion and therefore not reportable. However, by filing **Form 709**, the taxpayer can explain how he determined the value and prevent the IRS from challenging his valuation after the statute of limitations expires should he wish to gift additional shares or leave them for his heirs to inherit.

## V. Valuation

Gifted property must be valued at fair market value[70] at the time that the transfer from donor to donee is completed. Certain gifts, such as gifts of partial interest, may be eligible for valuation discounts unavailable to testamentary transfers that can lessen the gift tax bite.[71] On the other hand, transfers by bequest (post-death) but not gift (inter vivos) generally receive a stepped-up basis which may serve to lessen a future capital gains tax.

FMV can be determined for assets, such as publicly traded stocks and bonds that trade on an established market; but the valuation of other assets may become more challenging and may require valuation by a competent and professional appraiser. The IRS requires "qualified" appraisals to be prepared by "qualified" appraisers who must provide reports that contain information regarding the appraiser's background; a description of his fee arrangement with the taxpayer; the method, basis, and justification of the valuation used; in addition to, of course, the established value.[72]

Nevertheless, even valuations of gifts appraised in this manner may be disputed by the IRS which typically favors high rather than low valuations to boost tax collections. Taxpayers, on the other hand, obviously prefer the reverse and often seek to justify valuation discounts based on the lack of marketability, income, or control of the gifted property. Discounted valuations almost inevitably are disputed by the IRS and often must be settled in court where a battle of experts is waged.

<u>Lack of Marketability</u>

Restricted stock (unregistered shares of publicly-traded companies), shares of closely-held or privately owned companies, limited and family partnerships, amongst others share a common trait – the inability to be readily converted to cash. Studies, which have compared the price of publicly traded, unrestricted shares of companies to the price of restricted shares of the same companies sold in the private market, have found pricing differences ranging from 13% to 45%.[73]

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[70] The fair market value of property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or to sell and both having knowledge of all relevant facts [Reg. §25.2512-1].

[71] If discounted values are used, the taxpayer must check the box at the top of **Form 709**, Page 2 and provide an explanation along with the discount amounts claimed.

[72] Reg. § 301.6501(c)-1(f)(3).

[73] Ransome and Satchit, *Valuation Discounts for Estate and Gift Taxes*, Journal of Accountancy, July 2009 [available at http://www.journalofaccountancy.com/Issues/2009/Jul/20091463, last accessed May 10, 2021].


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Lack of Control

When minority shares are gifted, the donee often owns an asset but cannot meaningfully participate in the management of the entity or determine its destiny by voting. In the past, "[t]he IRS contended that a 'unity of ownership' theory espoused under Revenue Ruling 81-253 1981-2 CB 187 prohibited a minority discount for shares that a donor gives to relatives. The revenue ruling concluded that, absent family discord, no minority discount is allowed for transfers of a corporation's shares among a family's members if the family controls the corporation at the time of the transfer. However, courts have consistently rejected the IRS' position and ruled in favor of granting a minority discount to taxpayers who transfer shares of a closely held corporation to family members. *Charles W. Ward,* 87 TC 78 (1986); *Estate of Samuel I. Newhouse,* 94 TC 193 (1990). Finally, the IRS announced recognition of minority discounts for intra-family transfers of closely held stock. Rev. Rul. 93-12, 1993-1 CB 202"[74]

Built-in Gains

In some cases, property is gifted that includes built-in gains on assets held long before the donee acquired his ownership. These gains will eventually be taxed – presumably to the donee – creating a tax liability for gains that never truly belonged to him but for which, by virtue of the gift, he is now responsible. "While the courts and the IRS have agreed that built-in gains tax on a corporation's appreciated assets should be taken into account in valuing its stock using the net asset valuation method, they have not agreed on the proper method for quantifying the discount."[75]

## VI. Basis & Holding Period

The donee's basis and holding period of property transferred by gift generally equals the donor's basis and holding period.[76] The donee's basis may be increased by the amount of gift tax attributable to the accumulated appreciation, if actually paid.

Donee received a gift with a basis of $100,000 and a FMV of $120,000. Donor paid the $5,000 gift tax. Donee later sold the gift item for $150,000.

Donee's basis is calculated as follows:

| | |
|---|---|
| Donor's Basis | 100,000 |
| Allocated Gift Tax Paid {(120,000 – 100,000) ÷ 100,000} * 5,000 | 1,000 |
| Donee's Basis | 101,000 |

However, if the donee sells the gifted property for less than what the FMV was at the time of the gift, his basis is the lesser of the donor's basis or the FMV of the property at the time of the gift. The chart below summarizes the rules governing the donee's basis depending upon whether the donee later sells the gifted property at a price more than, less than, or equal to the FMV at the time of the gift:

---

[74] Trott and Sutton, *Federal Gift Tax (and the Generation-Skipping Transfer Tax)*, page 21.

[75] Ransome and Satchit, *Valuation Discounts for Estate and Gift Taxes*.

[76] IRC §§ 1015 and 1223(2).



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| | Sell < FMV | Sell btw FMV & Donor's Basis | Sell > FMV |
|---|---|---|---|
| **Donor's Basis** | 100 | 100 | 100 |
| **FMV at the time of gift** | 90 | 90 | 90 |
| **Donee's Sales Price** | 80 | 95 | 120 |
| **➔ Donee's Basis** | 90 | 90 or 100 | 100 |
| **Donee's Capital Gain (Loss)** | (10) = 80 - 90 | 0 | 20 = 120 - 100 |
| **RULE: Donee's Basis equals…** | Lesser of FMV or Donor's Basis | NO gain/loss recognized: Basis for gain (100) Basis for loss (90) | Donor's basis [**GENERAL** rule] |

Part Sale / Part Gift

If an owner sells his property for less than its FMV, the transaction is deemed to be part sale/part gift. The buyer's basis is the greater of the amount paid for the property or the seller's basis increased for any gift tax paid attributable to the appreciation. However, the basis for loss cannot exceed FMV at the time of the gift. The seller's capital gain is the difference between the amount realized from the sale and the adjusted basis. (His loss, if realized, is not deductible).[77]

| | Donee sells at gain | Donee sells at loss |
|---|---|---|
| **Donor's Basis** | 12 | 40 |
| **FMV at the time of the gift** | 35 | 35 |
| **Donor sells to Donee for…** | 20 | 20 |
| **Donor's reportable gift** | 35 – 20 = 15 | 35 – 20 = 15 |
| **Donor's Capital Gain (Loss)** | 20 – 12 = 8 | 20 – 40 = (20) BUT Donor can't deduct loss |
| **➔ Donee's Basis** | 20 Greater of amt. Donee pd. or Donor's basis | 35 Greater of amt. Donee pd. or Donor's basis, BUT never more than FMV |
| **Donee sells for…** | 50 | 15 |
| **Donee's Capital Gain (Loss)** | 50 – 20 = 30 | 15 – 35 = (20) |

## VII. Generation-skipping Tax (GST)

The GST is imposed on a direct transfer of property to a grandchild which would otherwise be subject to two levels of estate (or gift) taxation if first taxed as part of the parent's estate, then transferred from parent to child, taxed as part of the child's estate, and finally transferred to the grandchild.[78] Because the GST rate equals the top bracket of the estate tax rate currently in effect, this tax usually exceeds that

[77] Reg. § 1.1001-1(e).

[78] GST is imposed on direct skips, taxable terminations, and taxable distributions made to a skip person defined as a relative who is at least two generations below the transferor. Spouses, former spouses, tax-exempt organizations and charitable trusts are non-skip persons. If the transferor's child is deceased, the grandchildren by that child are not considered skip persons [IRC § 2612]. If the transferor has no lineal descendants and a niece or nephew of the transferor is deceased, the children of the deceased niece or nephew are not skip persons [IRC § 2651].

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which would have otherwise been incurred at graduated rates if the property had been transferred and taxed at each successive generation.

GST is imposed on the following transfers:
- A transfer of property, subject to gift or estate tax, made to a skip person.
- A termination of a trust interest that passes property to a skip person.
- Any other trust distribution to a skip person.

### A. GST Exclusion

Each transferor has a $11.7 million exclusion (in 2021).[79] The tax is not applied to outright gifts that are excluded by the annual gift tax exclusion or qualified transfers for medical and tuition payments. However, a gift to a trust which qualifies for the gift tax annual exclusion must meet additional requirements to qualify for the GST tax exclusion – for example, Crummey Trusts qualify for the annual gift tax but not the GST exclusion.

> A taxpayer, who for years has made annual gifts to his three grandchildren to take advantage of the annual gift tax exclusion, has now created a trust for the benefit of all three children and made one lump-sum gift to the trust equal to three times the annual gift tax exclusion. This gift, while eligible for the gift exclusion does not qualify for the GST exclusion.

Gifts to trusts must first satisfy the annual exclusion for all gifts ($15,000 in 2021) plus two additional requirements: (1) the trust must be for the benefit of a *single* skip person[80] and (2) the trust must be includible in the skip person's gross estate if the trust does not terminate before that person's death.[81]

The GST exemption is not an exemption in the customary sense but serves instead to reduce the applicable rate of tax on the GST transfer.[82] Any portion of an individual's GST exclusion that is not used during a calendar year is automatically allocated to lifetime transfers that are not direct skips but are indirect skips to GST trusts. If the GST tax exemption is not allocated by the due date of **Form 706**, the remaining exemption is automatically allocated, first to direct skips occurring at death, and next to all transfers to GST trusts for which the decedent is the most recent transferor. Transferors can elect not to have the automatic rules apply.[83]

### B. Computation

The GST Tax is calculated using the maximum estate tax rate currently in effect; it is not a graduated tax but simply the total of all GST transfers during the year multiplied by the maximum estate tax rate (40% in 2021) times an inclusion ratio which is used to convert an allocated portion

[79] IRC § 2631. **NOTE:** Unlike the estate tax exclusion, which is portable between husband and wife, the unused portion of the GST exclusion is not transferable.

[80] IRC § 2613(a).

[81] IRC § 2642(c)(2).

[82] **REMINDER:** If the GST inclusion ratio is zero, no GST tax will be due.

[83] IRC § 2632(b) and (c).

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of the GST exemption into a tax rate deduction. **NOTE:** In 2010, when the estate tax rate was temporarily set at zero, there was no GST.

> Taxpayer transfers $2 million to a trust for her son and grandson which permits the trustee to make discretionary distributions to either or both beneficiaries. Taxpayer allocates $500,000 of her GST exemption to the transfer. When the son dies in 2021, there is a taxable termination. With the value of the trust now at $3 million, the tax will be calculated as follows:
>
> $3,000,000 * 40% * [1 – (500,000 ÷ 2,000,000)] = $3,000,000 * 30% = $900,000

### C. Reporting

Direct skip transfers made during lifetime are reported on **Form 709** on Schedule A, Part 2;[84] direct skips made at death are reported on **Form 706** on Schedule R.

Liability for the GST is assigned to the transferor for direct skips, to the trustee for taxable terminations, and to the transferee for tax distributions from trusts.

## VIII. Estate Tax

When the Estate Tax was enacted in 1916, it did not take long for clever taxpayers to circumvent the tax which gave the government the ability to share in the transfer of wealth at death. While some taxpayers mulishly announced, "I just won't die!" others simply chose to transfer their wealth while still alive and avoid what is often called the "Death Tax."

And so, the Gift Tax was first enacted in 1924, repealed in 1926, overhauled and reintroduced in 1932 as a protective measure to minimize estate and income tax avoidance. Later, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 began to phase out the Estate Tax,[85] but maintained the Gift Tax precisely for the same reasons it was originally enacted.[86]

To ensure that all transfers – whether during life or after death – are similarly taxed, estates and gifts are subject to a common rate schedule. Additionally, cumulative taxable gifts made during life are added back to the taxable estate. This has the effect of bumping the taxable estate into a higher tax bracket and increasing the resulting tax due from which taxpayers. [Yes, taxpayers may then subtract the amount of gift tax actually paid in prior years.] This convoluted calculation has the effect of eliminating double taxation but ensures that all gifts are ultimately taxed at the highest applicable tax bracket based on their cumulative value at death.

The Gift Tax is said to be tax-exclusive since the tax is assessed only on moneys that are actually transferred, while the Estate Tax is tax-inclusive since taxpayers are required to pay tax on moneys that will be transferred as well as moneys that will be used to pay the tax due. As a result, the Estate Tax is more onerous than the Gift Tax.

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[84] The tax is computed on Schedule C.

[85] Many of EGTRRA's provisions were scheduled to sunset at the end of 2010 but were extended through December 31, 2012 by TRA 2010.

[86] Joulfaian, *The Federal Gift Tax: History, Law, and Economics*, US Department of Treasury, OTA Paper 100, November 2007.




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For easy math, assume that the tax rate on both estates and gifts is a flat 50% and that all of the unified credit has been used: If Taxpayer gave a $2 million GIFT; he would pay $1 million tax from moneys that he retained and did not transfer to the donee. As a result, Taxpayer will "spend" $3 million, of which the donee pocketed ⅔.

In, instead, Taxpayer has a net worth of $3 million at the time of death, a 50% tax would consume $1.5 million, netting the heirs only ½ of the decedent's ESTATE.

**NOTE:** Any unified credit that is used up to reduce the gift tax, no longer remains available to offset the estate tax.

### A. Deathbed Transfers

Often, proactive taxpayers attempting to prevent the inclusion of assets at death, "quickly" transfer assets before passing away. While the appreciation on these last-minute transfers[87] between the date of transfer and death is never included in the estate, the value (at the time of the gift) of certain gifted property[88] – along with the gift tax previously paid – is added back to the gross estate and subject to estate tax.[89]

Billionaire Parent gifted his personal residence valued at $13 million to his daughter in 2020, retaining the right to live in the home rent-free. After subtracting the annual gift exclusion of $15,000 and Parent's previously unused lifetime exemption of $11.58 million, the gift tax equals $562,000 (which Parent paid).

Parent dies in 2021. Both the value of the gift and the gift tax paid must be added back to Parent's estate which is now taxed on an additional $13,547,000 [= $13,000,000 - 15,000 + 562,000] even though the property transferred before death. After computing the estate tax tentatively due, the tax will be reduced by the amount of gift tax previously paid.

To prevent the deathbed transfer of assets from a healthy spouse to one who is ill, a one-year waiting period is imposed on the basis step-up rule: If during that year a transferred asset is returned to the donor-spouse, the donor will not be entitled to a basis step-up.[90]

The value of life insurance policies gifted within three years of the transferor's death will be included in the decedent's estate.[91]

### B. Capital Gains

Recall that the basis and holding periods of assets transferred by gift differ from those transferred by bequest: Wile gifted assets generally retain the donor's basis and holding period, inherited assets receive a stepped-up basis and always have a long-term holding period. As a result, heirs get a fresh start, whereas donees become liable for any gains accumulated during the transferor's

---

[87] The IRS imposes a three-year look-back period.

[88] Affected gifts include retained life estates (§ 2036), transfers effective at death (§ 2037), revocable transfers (§ 2038), and life insurance proceeds (§ 2042).

[89] IRC § 2035(b) – known as the "Gross-up Rule".

[90] IRC § 1014(e).

[91] IRC § 2035(a).


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tenure. To ensure that these accrued gains are not subjected to both gift and income taxes, the assets bases are increased for gift taxes paid that are allocable to the gains.[92]

## C. Possible Legislative Changes

Something's afoot in Washington! While nothing is yet set in stone, experts prognosticate that changes are coming to fund President Biden's proposed infrastructure expenditures and address large federal deficits generated by recent COVID-19 relief acts. Law changes are expected to affect businesses and individuals, as well as income and estate taxation. The following brief discussion will outline a few of the more likely changes to the estate and gift tax regime.[93]

Annual Exclusion

A proposed change would limit the use of the annual $15,000 per donor per donee exemption for gifts made to irrevocable trusts and family entities, as well as prohibit the use of Crummey powers used to convert gifts of future value into present value.

Lifetime Exemption

Currently set at $11.7 million (in 2021) but scheduled to revert to the pre-TCJA amount at the start of 2026, current proposals hope to lower the exemption amount to differing levels as soon as 2022. Suggested amounts range from a low of $3.5 million (with no inflation adjustments) to $5 million (with inflation adjustments). Another proposal seeks to decouple the unified gift and estate exemption, limiting the gift exemption to as little as $1 million with any amount used during lifetime to be charged against the estate exemption at death.

Tax Rates

President Biden hopes to raise the current maximum marginal tax rate from 40 to 45%, while certain Congressional proposals seek to raise the tax rate even more substantially by applying a 45% rate to estates valued between $3.5 and 10 million, then rising incrementally to as high as 65% for estates valued at over $1 billion beginning in 2022.

Family Transfers and Trusts

Proposed limitations on minority and marketability discounts seek to restrict the use of intra-family transfers. To further discourage multi-generational transfers, proposals have been made to subject dynasty trusts to the GST tax for transfers to great-grandchildren and later generations; to end the use of intentionally defective grantor trusts by repatriating trust assets back into the grantor's estate at death; and to require that grantor retained annuity trusts (GRATs) be maintained for at least ten years. All such changes are intended to close "loopholes" currently exploited by wealthy taxpayers.

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[92] IRC § 1015(d)(2).

[93] Robert A. Briskin, *Proposed New Tax Law Changes*, April 2021 [memo sent by e-mail on April 9, 2021].




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Step-up Basis

Various proposals seek to eliminate or curtail the rule that allows revaluation of assets upon the decedent's death so that heirs and beneficiaries can be taxed on wealth that has accumulated prior to asset transfer during the decedent's lifetime.

## IX. Tax Minimization Strategies

Although the average taxpayer remains (as-yet) unencumbered by the gift and estate tax regime, some individuals may find themselves ensnared should any of the proposed legislative changes be enacted. Meanwhile, high net worth taxpayers have long ago turned to expert consultants in hopes of minimizing – and often eliminating – the wealth transfer tax bite with the implementation of creative and often complex strategies. Many of these tactics will be impacted or made obsolete as soon as January 2022, in some instances, prospectively and in others retroactively. Nevertheless, a brief survey of available strategies (that have not already been discussed elsewhere in this text[94]) is warranted.

### A. Grantor Retained Annuity Trust (GRAT)

Used to freeze the value of an estate and make a tax-free transfer future appreciation,[95] a GRAT is created when a grantor deposits assets into a fixed-term irrevocable trust, while retaining the right to an annuity stream until the assets are distributed to the beneficiaries at the end of the trust's term. The grantor's annuity stream is independent of the trust's income stream; in fact, if trust's income is insufficient, the trustee must invade corpus to make the promised distributions to the grantor.

> Grantor places $5 million into a GRAT when the IRS applicable rate is 3.4% and retains the right to an annual annuity of $500,000 for 10 years. Based on IRS Publication 1457, the present values of the annuity stream are $4,179,350 and $820,650 for the remainder interest. If trust assets appreciate at the applicable rate, the grantor will receive 10 payments of $500,000 each and, at the end of 10 years, the beneficiaries will receive $1,146,484 (= future value of $5 million less the annuity payments that appreciate at 3.4% annually).
>
> If the annual growth rate exceeds 3.4%, the beneficiaries will receive all excess growth. Nevertheless, the grantor would be liable only for the gift tax on the present value of the remainder interest as originally calculated ($820,650).[96]

There are several things to note:

- Since a GRAT is a grantor trust, all income, gains, and losses are taxed to the grantor.
- If the grantor dies during the term of the trust, the value of the remainder interest will be included in his gross estate. However, if the grantor transfers the right to receive any as-yet

[94] Previously discussed tax-minimization strategies include direct payments of medical expenses and tuition, charitable giving, gift-splitting, discounted valuation, Crummey power, net gifting, life estates, use of the GST exemption, gifting of intangibles by NRAs, amongst others.

[95] The IRS presumes that the trust will generate a return at least equal to the IRC § 7250 applicable rate in effect at the time the trust is first funded. Any appreciation in excess of the presumed amount passes tax-free to the beneficiaries. On the other hand, if the trust fails to perform as anticipated, the trust's assets are returned to the grantor.

[96] Burke, *Great Time for a GRAT*, Journal of Accountancy, October 1, 2019 [available at https://www.journalofaccountancy.com/issues/2019/oct/wealth-transfer-grantor-retained-annuity-trusts.html, last accessed May 12, 2021].

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unpaid annuity amounts to the surviving spouse, the unlimited marital deduction could be used to eliminate any estate tax liability attributable to the GRAT's inclusion.
- Since transfers to a GRAT are gifts of future interest, such gifts do not qualify for the annual gift tax exclusion. And because eventual transfers to the GRAT's beneficiaries are not yet complete, the GRAT is not entitled to the GST exemption.

### B. Qualified Personal Residence Trust (QPRT)

As with a GRAT, a grantor can place a primary or secondary residence in trust, retain possession and use of the property, and eventually pass ownership to beneficiaries when the term of the trust expires. In this manner the value of the residence – including all future appreciation – is removed from the grantor's estate. The grantor, of course, must file a gift tax return to report the transfer of the home in the trust, discounting the FMV for lack of marketability since any potential buyer must allow the grantor to live in the residence rent-free until the end of the trust's term. Once again, because the transfer is not of present interest, the QPRT is not entitled to the annual gift tax exclusion.

During the term of the trust, the grantor is responsible for the maintenance and upkeep of the home and is entitled to deductions for mortgage interest and property taxes. The cost of any capital improvements made by the grantor during the term of the trust is treated as an additional gift to the trust and must be reported at FMV. If the grantor dies prior to the expiration of the trust, the value of the QPRT on the date of death must be included in the grantor's gross estate, although the estate will receive a credit for previously paid gift taxes allocable to the original QPRT transfer.

If the grantor survives the term of the trust, the home passes to the beneficiaries. Should the grantor wish to thereafter remain living in the home, the grantor must lease the home from the beneficiaries at fair market rent. Since the trust beneficiaries will receive the grantor's oft-low basis, any future sale of the property may generate large capital gains.[97]

### C. Spousal Lifetime Access Trust (SLAT)

By transferring appreciated assets – often closely-held stock or other assets which can be valued at a discount due to limited marketability and lack of control – into a SLAT, a donor can affect a completed gift, file **Form 709**, and use his lifetime exclusion while it is still set to the high amounts in effect through 2025. If properly structured, the SLAT can shield each spouse's estate from any appreciation in value that may occur after funding. Trust assets eventually pass to remainder beneficiaries but do not receive a stepped-up basis upon the grantor's death since the trust was funded during the donor's lifetime as a gift.

The SLAT is drafted so that the grantor's spouse is the trust beneficiary entitled to lifetime distributions of income and potentially of principal for health, education, maintenance, and support HEMS) at the trustee's discretion. These distributions can, of course, continue to benefit the grantor who can share the income of the marital unit until divorce or the premature death of the beneficiary spouse.

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[97] Additionally, the property will generally be re-assessed when it passes to the trust beneficiaries except in jurisdictions that allow for a parent-child exclusion. In CA, as per the recently enacted Proposition 19, the property value of a residence held in an existing QPRT will be reassessed at the time of transfer unless the property is used by the child as their primary residence. If the home's market value exceeds the assessed value by more than $1 million, the child would only inherit the reduced property tax basis on the first $1 million.




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Because the SLAT is deemed to be a grantor trust,[98] the grantor remains liable for income taxes on the trust's earnings and, in that manner can make an additional tax-free gift to the trust's remainder beneficiaries.[99]

### D. Upstream Planning[100]

This strategy is designed for younger taxpayers who wish to use their lifetime exclusion to shield substantial gifts of appreciated assets by transferring them to a parent with the understanding that the elder will bequeath the asset back to the child. In this manner, the child can use his lifetime exclusion while it is still high, and the parent – who otherwise has few assets of his own – will not add to his taxable estate with his own assets.

Of course, numerous caveats should be heeded: The IRS may choose to unwind the transaction as a deathbed transfer if the parent dies too soon after receiving the child's gift. And the child must beware that the parent may not make good on his promise to transfer the gifted assets back; either spending the monies received or bequeathing them to another beneficiary.

## X. Conclusion

"Supporters of the estate and gift tax argue that it provides progressivity in the federal tax system, provides a backstop to the individual income tax and appropriately targets assets that are bestowed on heirs rather than assets earned through their hard work and effort."[101] Critics on the other hand, claim that the tax stifles and even discourages savings and economic growth, that it unfairly burdens small businesses and family farms, and that it is assessed at an inopportune time when families should devote energies to the grieving process rather than tax compliance. Whatever the pros and cons, gift and estate taxes are generate less than 1% of total federal revenues.[102] This sobering statistic can be used to argue in favor of eliminating these transfer taxes altogether due to their ineffectualness or used to argue in favor of expanding legislation to tap into what might become a lucrative source of revenue.

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[98] IRC § 677(a).

[99] When the grantor of a trust, who is also the owner of the trust, pays the income tax attributable to the inclusion of the trust's income in the grantor's taxable income, the grantor is not treated as making a gift of the amount of the tax to the trust beneficiaries [Rev Rul 2004-64].

[100] Hune, *An Old Tax Dodge for the Wealthy Is Making a Comeback*, Barron's, May 7, 2019 [available at https://taxprof.typepad.com/taxprof_blog/2019/05/an-old-tax-dodge-for-the-wealthy-is-making-a-comeback-upstream-planning.html, last accessed May 11, 2021].

[101] Gravelle, *Economic Issues Surrounding the Estate and Gift Tax: A Brief Summary*, CRS Report for Congress, The Library of Congress, Order Code RS20609, April 24, 2007.

[102] As estimated by the Office of Management and Budget, reported by Andrew Lundeen of Tax Foundation [available at https://taxfoundation.org/estate-tax-provides-less-one-percent-federal-revenue/, last accessed May 11, 2021].




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# APPENDIX A
## Comprehensive Example

<u>Facts:</u>
Single taxpayer made the following cash gifts in 2020:

- $1,000,000 Cash to Son (Bob)
- $12,000,000 Donation to church
- $15,000 ea. Checks to 5 grandchildren

<u>Step 1:</u> Use Schedule A, Part 1 to report gifts to Son and Church – report gifted amounts in full (and provide as much detail as possible).

<u>Step 2:</u> Do not report gifts to grandchildren in Part 2 or 3 since they are exempt under the annual exclusion.

<u>Step 3:</u> Carry totals from Part 1 to Part 4 (on Page 3) – deduct annual exclusion and non-taxable charitable deduction (net of its exclusion) to determine taxable gifts.

<u>Step 4:</u> Carry total of taxable gifts on Line 11 of Schedule A, Part 4 to Line of **Form 709,** Page 1 and complete tax computation using tax rate schedule provided with **Form 709** Instructions; then subtract available Unified Credit to determine tax due.

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 2020)
► See instructions.

OMB No. 1545-0020
**2020**

| 1 Donor's first name and middle initial | 2 Donor's last name | 3 Donor's social security number |
|---|---|---|
| 4 Address (number, street, and apartment number) | | 5 Legal residence (domicile) |
| 6 City or town, state or province, country, and ZIP or foreign postal code | | 7 Citizenship (see instructions) |

**Part 1—General Information**

| Line | | 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.**) — Use if reporting split gifts | | |
| 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 ► | | |
| 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 | | |

**Part 2—Tax Computation**

| Line | | Line | Amount |
|---|---|---|---|
| 1 | Enter the amount from Schedule A, Part 4, line 11 | 1 | 985,000 |
| 2 | Enter the amount from Schedule B, line 3 — NO gifts made in prior years | 2 | |
| 3 | Total taxable gifts. Add lines 1 and 2 | 3 | 985,000 |
| 4 | Tax computed on amount on line 3 (see *Table for Computing Gift Tax* in instructions) | 4 | 339,950 |
| 5 | Tax computed on amount on line 2 (see *Table for Computing Gift Tax* in instructions) | 5 | |
| 6 | Balance. Subtract line 5 from line 4 | 6 | 339,950 |
| 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 — for TY'20 | 7 | 4,577,800 |
| 8 | Enter the applicable credit against tax allowable for all prior periods (from Sch. B, line 1, col. C) | 8 | |
| 9 | Balance. Subtract line 8 from line 7. Do not enter less than zero | 9 | 4,577,800 |
| 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 | |
| 11 | Balance. Subtract line 10 from line 9. Do not enter less than zero | 11 | 4,577,800 |
| 12 | Applicable credit. Enter the smaller of line 6 or line 11 — $4,237,850 Applicable Credit remaining for future years (= 4,577,800 - 339,950) | 12 | 339,950 |
| 13 | Credit for foreign gift taxes (see instructions) | 13 | |
| 14 | Total credits. Add lines 12 and 13 | 14 | 339,950 |
| 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 | |
| 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 | 0 |
| 20 | If line 18 is greater than line 17, enter **amount to be refunded** | 20 | |

Form 709 (2020) 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 transfers 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 | Bob (son) | | 1,000,000 | 6/15/20 | 1,000,000 | | 1,000,000 |
| | 1234 Main Street Anytown, USA 99999 | | | | | | |
| 2 | First Church | | 12,000,000 | 8/3/20 | 12,000,000 | | 12,000,000 |
| | 1111 Pennsylvania Avenue Anytown, USA 99999 | | | | | | |

Gifts made by spouse—complete *only if you are splitting gifts with your spouse and he/she also made gifts.*

Charitable gifts must be included if Form 709 is req'd to report other gifts

**Total of Part 1.** Add amounts from Part 1, column H ► 13,000,000

**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 | $15,000 gifts to skip persons are excluded by annual exclusion and not reportable | | | | | | |

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 ►

**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.

Form 709 (2020) Page **3**

**Part 4—Taxable Gift Reconciliation**

| Line | | Line | Amount | Line | Amount |
|---|---|---|---|---|---|
| 1 | Total value of gifts of donor. Add totals from column H of Parts 1, 2, and 3 | | | 1 | 13,000,000 |
| 2 | Total annual exclusions for gifts listed on line 1 (see instructions) — $15,000 annual exclusion per donee | | | 2 | 30,000 |
| 3 | Total included amount of gifts. Subtract line 2 from line 1 | | | 3 | 12,970,000 |
| | **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 | | | |
| 5 | Exclusions attributable to gifts on line 4 | 5 | | | |
| 6 | Marital deduction. Subtract line 5 from line 4 | 6 | | | |
| 7 | Charitable deduction, based on item numbers 2 less exclusions | 7 | 11,985,000 | | |
| 8 | Total deductions. Add lines 6 and 7 | | | 8 | 11,985,000 |
| 9 | Subtract line 8 from line 3 | | | 9 | 985,000 |
| 10 | Generation-skipping transfer taxes payable with this Form 709 (from Schedule D, Part 3, col. G, total) | | | 10 | |
| 11 | **Taxable gifts.** Add lines 9 and 10. Enter here and on page 1, Part 2—Tax Computation, line 1 | | | 11 | 985,000 |

**Terminable Interest (QTIP) Marital Deduction.** (See instructions for Schedule A, Part 4, line 4.)

If a trust (or other property) meets the requirements of qualified terminable interest property under section 2523(f), and:

**a.** The trust (or other property) is listed on Schedule A; and

**b.** The value of the trust (or other property) is entered in whole or in part as a deduction on Schedule A, Part 4, line 4, then the donor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2523(f).

If less than the entire value of the trust (or other property) that the donor has included in Parts 1 and 3 of Schedule A is entered as a deduction on line 4, the donor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on Schedule A, Part 4, line 6. The denominator is equal to the total value of the trust (or other property) listed in Parts 1 and 3 of Schedule A.

If you make the QTIP election, the terminable interest property involved will be included in your spouse's gross estate upon his or her death (section 2044). See instructions for line 4 of Schedule A. If your spouse disposes (by gift or otherwise) of all or part of the qualifying life income interest, he or she will be considered to have made a transfer of the entire property that is subject to the gift tax. See *Transfer of Certain Life Estates Received From Spouse* in the instructions.

**12 Election Out of QTIP Treatment of Annuities**

☐ ◄ Check here if you elect under section 2523(f)(6) **not** to treat as qualified terminable interest property any joint and survivor annuities that are reported on Schedule A and would otherwise be treated as qualified terminable interest property under section 2523(f). See instructions. Enter the item numbers from Schedule A for the annuities for which you are making this election ►

**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 |
|---|---|---|---|---|
| | None previously made | | | |



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## Tax Preparation Pointers

1. All charitable gifts must be included on **Form 709** (if otherwise required to be filed) even though the Code specifically provides that gifts of any amount may be made tax-free to charitable organizations. To ensure that these gifts remain untaxed, gifts to §501(c)(3) organizations must first be included in the taxpayer's total amount of taxable gifts made during the year and then deducted under §2522 from that total.[103]

   It may seem unnecessary to include and deduct charitable gifts only to net out to zero. But because gifts of partial interests in property are not eligible for the gift tax charitable deduction, all gifts must first be included and then reduced by only those gifts that are deductible.[104] As a result, all charitable gifts must be listed on Schedule A, carried to Part 4 as part of the donor's total value of gifts (Line 1), and then deducted *if* eligible for the §2522 exclusion (Line 7). The net result (Line 11) is, of course, transferred to Page 1 of **Form 709**.

2. As per the IRS' instructions for **Form 709**, the first $15,000 of gifts of present interest to each donee during the calendar year is subtracted from total gifts when calculating taxable gifts. For a gift in trust, each beneficiary of the trust is treated as a separate donee for purposes of the annual exclusion. However, it is critical to determine whether a present interest existed when the trust was funded or only at the time that Crummey powers are invoked annually.[105]

   If a donor makes multiple gifts to the same donee throughout the year which exceed the annual threshold ($15,000 in 2021), the annual exclusion must be allocated to each gift in chronological order.

> Grandfather gifts $40,000 to an Irrevocable Life Insurance Trust (ILIT) with Crummey powers for the benefit of his 5 grandchildren on September 1st and gifts an additional $10,000 in cash to Grandson A on October 1st. **NOTE:** The gift to the ILIT is considered an indirect gift eligible for the annual exclusion but not the GST exclusion since the trust has multiple beneficiaries. The cash gift is considered a direct skip and is eligible for both the annual and the GST exclusions.
>
> The annual exclusion is allocated for each beneficiary of the trust; since the annual exclusion is greater than the allocable trust contribution for 4 of the 5 trust beneficiaries, these gifts are not taxable. But the combined total of gifts for Grandson A exceeds the annual exclusion which must, therefore, be allocated based on the date gifted, first to the ILIT gift which uses up $8,000 of the allowable $15,000 exclusion; then to the cash gift which uses up the remaining $7,000 of the annual exclusion. The $3,000 which is not sheltered by the annual exclusion may be tax-free if Grandfather elects to allocate a portion of his GST exemption to the cash gift.

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[103] Rhomberg, *The Law Remains Unsettled on Gift Taxation of Section 501(c)(4) Contributions*, Taxation of Exempts, September/October 2003, Vol. 15 Number 2.

[104] IRC § 2522(c). A list of non-deductible gifts is available in Treas. Reg. 25-2522(c)-3 "Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969".

[105] As per Rev. Rul. 81-7, a gift in trust qualifies as a present interest only if the beneficiary has actual, albeit not necessarily written notice of his right to withdraw trust assets. Therefore, estate planners advise that trusts should provide that withdrawal powers are created at the time of a grantor's gift, rather than upon the trustee's delivery of a written notice to the beneficiaries; thereby ensuring that even if the trustee fails to deliver an annual notice, the grantor's intent can be inferred as long as the amount subject to the Crummey power is ascertainable at the time that it is exercisable. [Gooen & Clayton, *Avoid Crummey Mistakes: Take Care in Structuring Trust Withdrawal Powers*, New Jersey Law Journal, Vol. CXCVII, No. 7, August 17, 2009].


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## APPENDIX B
## Form 709 Mistakes to Avoid

- ❑ Preparer has not read Form 709 instructions.
- ❑ Return not filed by responsible party or true donor.
- ❑ Filing a return when it is not needed.
- ❑ Not filing an un-needed return to start the clock on the statute of limitations.
- ❑ No spousal signature when gift-splitting has been elected.
- ❑ Inaccurate summary of previously filed gift tax returns and exemptions claimed.
- ❑ Mis-identifying gifts as those that should be reported as direct or indirect skips.
- ❑ Failure to report § 529 gifts ratably over 5 years and checking box atop Page 2.
- ❑ Reportable charitable donations omitted.
- ❑ Incorrectly allocating the annual gift tax exclusion to a GST transfer.
- ❑ Improper GST exemption allocations and tax computations.
- ❑ Deceased Spousal Unused Exclusion (DSUE) overlooked.
- ❑ Insufficient supporting documents and lack of table of contents for ease of reference.
- ❑ Failure to attach governing instruments of trusts referenced on Form 709.
- ❑ Failure to attach Crummey notices.

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