

GRRR (Gift Return Reporting Requirements)

Taming the Wild 709 Tiger

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The authors welcome any corrections and suggestions for improvement to this outline.



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- “Portability – Planning and Compliance Issues,” Midland Odessa Business and Estate Council, Midland, Texas, May 14, 2013
- “Portability – Planning and Compliance Issues,” State Bar of Texas 23rd Annual Estate Planning & Probate Drafting Course, Dallas, Texas, October 19, 2012
- “Beneficiary Defective Trusts: Drafting the Dream Trust,” State Bar of Texas 36th Annual Advanced Estate Planning & Probate Course, San Antonio, Texas, June 28, 2012
- “Caveat Grantor: Selecting a ‘Defect’ to Obtain Grantor Trust Status,” State Bar of Texas 35th Annual Advanced Estate Planning & Probate Course, Fort Worth, Texas, June 9, 2011
- “Income Taxation of Simple and Complex Trusts,” American Bar Association Section of Taxation Meeting, Washington, D.C., May 9, 2009
- “Powers of Attorney (POAs): Fiduciary and Other Issues Regarding a Financial Power of Attorney,” Texas Bankers Association, Texas Graduate Trust School, Dallas, Texas, July 25, 2008
- Uniform Principal and Income Act – A Multistate Survey of Enforcement, publication presented to the American Bar Association Section of Taxation, Washington, D.C., May 9, 2008
- “Grantor Trusts - The Basics,” State Bar of Texas, Tax Law Section Webcast, March 6, 2008
- “Basics of Grantor Trusts,” American Bar Association Section of Taxation and Section of Real Property, Trust and Estate Law Joint Meeting, Vancouver, British Columbia, September 28, 2007
- “Powers of Attorney and Fiduciary Duties,” Texas Bankers Association, Texas Graduate Trust School, Dallas, Texas, July 20, 2007
- “Judicial Construction and Modification of Trusts: Practical Advice for the Client,” Dallas Estate Planning Council, Dallas, Texas, May 17, 2007
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Coping with the Threat of a Retroactive Estate Tax, JOURNAL OF TAX PRACTICE & PROCEDURE (CCH), April-May 2010, at 35.

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I. Introduction

The filing of gift tax returns at first blush might seem like a fairly perfunctory task, one that anyone can accomplish in a fairly short amount of time. Indeed, the IRS estimates that it will take less than five hours to learn about the form, prepare the return, and file it with the IRS. However, as most professionals know, gift tax return preparation is often more of an art than a science – and creating a work of art takes time. With that in mind, the goal of this outline is to discuss the basics of gift tax return preparation, along with the various quandaries that arise along the way with more challenging situations.

II. Filing Requirements

A. Basic Overview

The gift tax is a tax on the privilege of transferring property during one's lifetime. Current law coordinates the gift tax with the estate tax, so that each individual has \$5,000,000 (sometimes referred to as the "Basic Exclusion Amount" or the "Unified Credit") in exclusion that can be applied to that individual's lifetime transfers, post-mortem transfers, or some combination of lifetime and post-mortem transfers to shield gift tax and estate tax.¹ For the first time beginning in 2012 and every year after, the Basic Exclusion Amount is indexed for inflation.² The Basic Exclusion Amount increased to \$5,120,000 in 2012. It increased to \$5,250,000 in 2013, and in 2014 the Basic Exclusion Amount is \$5,340,000. For gift transfers in excess of the unified credit amount in 2013 and beyond, the top gift tax rate is 40%.

1. What is a gift?

The short answer is that more transfers than one might think qualify as a "gift" for the purposes of federal gift tax rules. "Any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift."³ The gratuitous transfer is subject to the gift tax rules whether the transfer is in trust or not in trust, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.⁴ Donative intent on the part of the transferor is NOT an essential element in order for the gift tax rules to be applicable.⁵ It has been accepted as a near universal truth that Congress intended a very broad definition of "gift" for the purposes of the federal gift tax.

¹ See IRC § 2010(c)(3)(A). All references to "IRC" or the "Code" are to the Internal Revenue Code of 1986, as amended, unless otherwise specified.

² IRC § 2010(c)(3)(B).

³ Treas. Reg. § 25.2511-1(c)(1). All references to "Treas. Reg." or the "regulations" are to the regulations promulgated under the Code unless otherwise specified.

⁴ IRC § 2511(a); Treas. Reg. § 25.2511-1(a). Also see Instructions for Form 709, "Transfers Subject to the Gift Tax." Note that all references to Form 709 Instructions will be to the title of the relevant section of the instructions rather than to page numbers, as pagination varies from year to year, while basic headings tend to remain consistent.

⁵ Treas. Reg. § 25.2511-1(g)(1).

2. What does not seem like a gift but may be a gift (in whole or in part)?

- a) Forgiving a debt;
- b) Making an interest-free or below market rate loan;⁶
- c) Transferring the benefits of an insurance policy;
- d) Making certain property settlements in divorce cases;
- e) Giving up some amount of annuity in exchange for the creation of a survivor annuity; and
- f) Making certain disclaimers that are not qualified disclaimers.

As noted above, donative intent is NOT an essential element of making a gift for purposes of the federal gift tax. Transfers reached by the gift tax include sales, exchanges, and other dispositions of property for consideration to the extent that the fair market value of the property transferred by the donor exceeds the value of money or property received.⁷ Your clients may therefore have a gift tax return filing requirement even if, in their minds, no money or property has changed hands. It may not be enough to ask your clients if they made any gifts during the calendar year, because your clients may not have a working understanding of the types of transactions that do not seem like gifts, but may actually be gift transactions under federal law.

Example: Your client buys his thirty year old son a car that cost \$50,000 and they agree that Son will pay Dad back with interest. On Christmas Day that same year, Dad tells Son that as his Christmas gift he will not have to pay him back for the car. This forgiveness of debt is a gift that would trigger a gift tax return filing requirement under federal law.

Purported disclaimers are another example of a transaction that may not seem like a gift. A disclaimer is a voluntary refusal to accept a lifetime gift or a bequest under a will or trust. If a person refuses the property given to them, he or she can disclaim the gift by making a qualified disclaimer. If the disclaimer is a qualified disclaimer under federal law, then the property will be treated as if it was never transferred to the original intended recipient because the law would deem the original intended recipient as if he or she had predeceased the donor for purposes of the gift or bequest. The requirements for a qualified disclaimer for gift tax purposes are as follows:

- a) *The refusal to accept the property must be in writing; and*
- b) *The refusal must be received by the donor (or the legal representative of the donor) within nine months after the later of (i) the day the property was transferred or (ii) the day the disclaimant reaches 21; and*

⁶ The concern here is keeping a loan from being characterized as below market under IRC § 7872 based on the applicable federal rate and the term of the note, which may either be based on a specified date or on demand. This subject can be much more complicated than it seems at first blush. For an excellent discussion of the considerations necessary to avoid below-market gift loan status under IRC § 7872 and income tax issues associated with forgiveness of debt see Steve Akers, Estate Planning Issues with Intra-Family Loans, Texas Tax Lawyer, Winter 2013, available at <http://www.texassection.org/LinkClick.aspx?fileticket=xY12KCXkyyY%3D&tabid=80>.

⁷ Treas. Reg. § 25.2511-1(g)(1). Also see Instructions for Form 709, “Transfers Subject to the Gift Tax.”

- c) *The disclaimant must not have accepted the interest or any of its benefits* (e.g., if it is an interest in a bank account the recipient could not have taken \$1 of the account for his or her own personal use, or if the property was an antique credenza the recipient could not have displayed such furniture in his or her home); and
- d) *As a result of the refusal to accept the disclaimed property, the disclaimant cannot direct how the property will pass* (e.g., the disclaimant cannot say, “I don’t want this bank account but I would like it to go to my favorite child instead of all my children in equal shares.”); and
- e) *The refusal must be irrevocable and unqualified* (e.g., the disclaimant cannot refuse to accept a beach house left to her pursuant to her mother’s will, “...save and except that I reserve the right occupy the home during the month of July free of rent.”).

Example: Your client Julie cares for her elderly father Jack. As a matter of convenience, Jack retitles his bank account in his name and Julie’s name as joint tenants with right of survivorship so that if he becomes sick, Julie can pay the bills as a joint account holder. Jack has a will that provides that the bulk of his assets pass to his four grandchildren. When Jack passes away, the law treats Julie as the owner of the account. At his death, the account has a value of approximately \$330,000. After consulting with an attorney, Julie decides Jack did not intend for this account pass to her at his death; rather, he simply added her name to the account so that she could help pay his bills when his health declined. Julie did not strictly adhere to the qualified disclaimer rules, because she did not refuse the rights to the account in writing within nine months of Jack’s date of death, but she nonetheless transfers the entire balance to Jack’s grandkids. Julie has made a gift for federal gift tax purposes that is required to be reported on a timely filed Form 709 under federal gift tax rules.

Practice Pointer: Most disclaimers are made primarily for tax purposes or to defeat creditors’ claims. Note that there is a *different* standard for a qualified disclaimer for federal gift tax purposes than there is for an effective disclaimer under Texas law.⁸ An effective disclaimer for the purposes of the Texas Estates Code must meet a higher bar, as the written disclaimer must be notarized,⁹ must be filed in the probate court in which the decedent’s will has been probated not later than nine months after the date of the decedent’s death,¹⁰ and (effective as of January 1, 2014) must contain a statement as to whether the disclaimant is a child support obligor.¹¹ Therefore, it is possible for a disclaimer to be ineffective for state law purposes (it will be treated as an assignment of

⁸ Compare Texas Estates Code § 122.002 and IRC § 2518.

⁹ Texas Estates Code § 122.051(a).

¹⁰ Texas Estates Code §§ 122.0552, 122.055.

¹¹ Texas Estates Code § 122.051(b).

an interest that could be deemed fraudulent as to preexisting creditors),¹² but effective for federal gift tax purposes.

3. What seems like a gift but is not a gift? ¹³

- a) Transfers to certain political organizations;¹⁴
- b) Payments that qualify for the educational exclusion; and¹⁵
- c) Payments that qualify for the medical exclusion.¹⁶

There are three types of transfers that may seem like gifts under the general rule, but are specifically exempted from the gift tax system by statute. A taxpayer need not file a Form 709 to report these types of transfers and should NOT report these transfers even if the taxpayer is otherwise required to file Form 709 to report gifts.

First, transfers to Section 527 political organizations (organizations designed to influence the selection, nomination, election, appointment or defeat of candidates to federal, state, or local public office) are not considered gifts.¹⁷ PACs and similar organizations are Section 527 organizations. Note, however, that this exception only applies to Section 527 organizations. There is no statutory exception to the applicability of the gift tax rules for transfers to Section 501(c)(3) organizations (public charities) and 501(c)(4) organizations (e.g., civic leagues and other corporations operated for the promotion of “social welfare”). However, as discussed below, a charitable deduction is available for transfers to Section 501(c)(3) organizations.¹⁸ There is no deduction available for transfers to Section 501(c)(4) organizations.

Second, the gift tax does not apply to an amount a taxpayer paid on behalf of another individual directly to a qualifying domestic or foreign educational organization as tuition for the education or training of the individual. A qualifying educational organization is one that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.¹⁹ This term includes institutions such as primary, secondary, preparatory and high schools, colleges, and universities. The definition includes organizations engaged in both educational and noneducational activities, but only if the noneducational activities are merely incidental to the educational activities. For example, a university that incidentally operates a museum or offers concerts to the public is a qualifying educational organization. However, a museum that operates a school would most likely not be a qualifying educational organization.²⁰ Payments to specialized teachers, such as a violin teacher, generally do not qualify. However, tuition payments to the Hockaday School that brings in a violin teacher for private lessons for its students would generally be deemed a payment to a qualifying education organization if the school builds the cost into tuition. The gift tax exclusion for qualifying educational organization

¹² See Texas Estates Code § 122.102.

¹³ See Instructions for Form 709, “Transfers Not Subject to the Gift Tax.”

¹⁴ IRC § 2501(a)(4).

¹⁵ IRC § 2503(e).

¹⁶ *Id.*

¹⁷ IRC § 2501(a).

¹⁸ IRC § 2522(a).

¹⁹ IRC § 170(b)(1)(A)(ii).

²⁰ Treas. Reg. § 1.170A-9(c)(1).

expenses only applies to tuition payments and explicitly does not apply to payments for room and board, books, fraternities, sororities, transportation to school, computers, and similar expenses.²¹ Furthermore, the taxpayer must have made a direct payment to the qualified educational organization. The donor cannot pay the student, who in turn pays tuition, nor can the donor pay off student loans in order to qualify for this exclusion from federal gift tax. Generally, payments to trusts to be used for educational expenses and payments to Qualified Tuition Programs (such as Section 529 plans) do NOT qualify for this exclusion. However, the IRS has ruled that a grandmother's prepaid tuition payments on behalf of her grandchildren were qualified transfers for purposes of 2503(e).²² Also, it is worth noting that tuition payments to a qualified education institution on behalf of another individual are not gifts, regardless of the individual's relationship (or lack of relationship) to the donor.

Third, payments made by a donor exclusively for qualifying medical expenses of another person are not considered gifts for the purposes of the federal gift tax. Such expenses include medical care expenses (e.g., expenses incurred in connection with diagnosis, cure, mitigation, or prevention of disease), transportation, certain lodging expenses necessary for such care, and health insurance.²³ However, the non-applicability of the gift tax rules does not extend to items covered by the beneficiary's health insurance²⁴ or elective cosmetic surgery.²⁵ Similar to the requirements for qualified educational expenses, qualified medical expenses must be paid directly to the health care provider (instead of to the patient who in turn pays the medical provider).

4. Who is the deemed recipient of a gift?

- a) Trusts. For the purposes of the federal gift tax, a gift to a trust is regarded as a gift to the beneficiary or beneficiaries of the trust instead of the trustee of the trust.²⁶
- b) Corporations. A gratuitous transfer to a corporation is treated as a gift to the corporation's shareholders in proportion to their ownership interest in the company.²⁷
- c) Nonprofit Corporations. A gift to a charitable, public, or political organization may fall under an exception.²⁸ For example, the IRS has taken the position that a gift to a nonprofit social club was considered a gift to the entity (instead of a gift to the members of the entity) because the

²¹ Treas. Reg. § 25.2503-6(b)(2).

²² Tech. Adv. Memo. 199941013 (July 9, 1999). Pertinent facts are that the grandchildren attended the school during the periods the payments were made, grandmother's prepaid tuition was subject to forfeiture if the grandchildren stopped attending, and the amounts paid to the school were in payment of specified tuition costs with respect to designated individuals.

²³ Treas. Reg. § 25.2053-6(b)(3).

²⁴ *Id.*

²⁵ See *id.* and IRC § 213(d)(9) (specifying that the term "medical care" does not include cosmetic surgery unless the procedure is necessary to correct a deformity arising from a birth defect or personal injury or disfiguring disease).

²⁶ *Helvering v. Hutchings*, 312 U.S. 393, 396 (1941); Treas. Reg. § 25.2503-2.

²⁷ *Heringer v. Comm'r*, 235 F.3d 149, 152 (9th Cir. 1956), cert. denied, 352 U.S. 927 (1956).

²⁸ Treas. Reg. § 25.2511-1(h)(1). Examples include funds donated to 501(c)(7) social organizations. See PLR 9818042 and PLR 9104024.

nonprofit corporation was not operated for the members' economic benefit.²⁹

- d) Partnerships. A gift to a partnership is deemed a gift to its partners. In at least one case, a gift to a partnership qualified for annual exclusion gifts to the partners.³⁰

B. What qualifies as a reportable gift?³¹

1. Scenarios in Which a Gift Must be Reported

A gift tax return must be filed by a donor when any one or more of the following scenarios applies.

- a) There is a gift of a future interest in any amount.

We know what you are thinking. What the heck is a gift of a future interest? The best way to begin to understand a "future interest" is to define its antonym: a "present interest." A present interest is an unrestricted right to the immediate use, possession, or enjoyment of property or the income from the property.³² A future interest is anything other than an unrestricted right to the immediate use and possession of property, and includes reversions, remainders, and all other property interests that delay use, possession, or enjoyment of a property interest to some future date or time.³³ Gifts to trusts are frequently gifts of future interests to the trust's beneficiaries *unless* the trust agreement provides for a specific withdrawal right granted to one or more beneficiaries. In that case, the amount subject to withdrawal would be a present interest. However, these withdrawal rights are often limited for tax reasons, which results in a gift of both a present and a future interest.

Example: Client creates Client Family Trust with a gift of \$20,000 cash. Client has two children. The terms of the trust agreement provide that each of Client's children may each withdraw the greater of \$5,000 or 5% of the assets of the Trust annually. While the Client's two children have a present interest in \$10,000 worth of this gift (\$5,000 each), the remaining \$10,000 is treated as a gift of a future interest and Client is required to file a Form 709 to report all of his gifts in the calendar year.

A gift of any amount to a trust for the benefit of a person under the age of 21 is considered a gift of a present interest if (i) the property and income earned thereon may be expended by or for the benefit of the minor before age 21, (ii) all property not so expended will pass to the donee on his or her 21st birthday, and (iii) any property remaining at the death of the donee prior to reaching age 21 is includible in his or her estate.³⁴ This type of trust is often referred to as a "minor's trust" or a "2502(c) trust." No withdrawal rights are needed to make

²⁹ *Id.*

³⁰ *Wooley v. United States*, 736 F. Supp. 1506 (S.D. Ind. 1990).

³¹ See Instructions for Form 709, "Who Must File?"

³² Treas. Reg. § 25.2503-3(b).

³³ Treas. Reg. § 25.2503-3(a).

³⁴ IRC § 2503(c).

this type of trust a gift of a present interest based on this statutory exception. As this exception highlights, it is not a certainty that a gift to a trust will be a gift of a future interest. It is always important to read the trust agreement to determine if the gifts to the trust qualify for the annual exclusion or are otherwise considered a gift of a present interest.

- b) The donor made a total gift to or for the benefit of any one person in excess of \$14,000 (for calendar years 2013 and 2014).³⁵

Even a dream client who only makes cash gifts may still have a Form 709 filing requirement. If he or she writes a check to his or her adult child for \$14,000 and then buys the child holiday gifts or takes the child on a trip, he or she has exceeded the annual exclusion threshold and is required to File 709 to report all gratuitous transfers during the calendar year. Note that the annual exclusion amount is indexed for inflation each year; it is rounded down to the next lowest multiple of \$1,000 (e.g., if the cost of living adjustment resulted in number equal to \$14,999, then the annual exclusion amount for the following year would be \$14,000).³⁶

- c) The donor made a gift to a non-U.S. citizen spouse in excess of the annual exclusion amount for non-U.S. citizen spouses.³⁷

Generally, there is an unlimited marital deduction allowed for gifts to a spouse.³⁸ If the donor only makes gifts to his or her spouse, there is usually no requirement to file a gift tax return to report those gifts. However, if the donor's spouse is not a U.S. citizen, the unlimited marital deduction does not apply.³⁹ Instead, there is an annual exclusion applicable to gifts to foreign spouses that works like an annual exclusion amount for gifts to other individuals. A spouse may transfer to his or her non-citizen spouse an amount up to \$143,000 in 2013 and \$145,000 in 2014 before triggering a filing requirement. The exemption for transfers to non-citizen spouses is indexed for inflation in the same manner as the annual exclusion for gifts.⁴⁰

- d) The donor made a gift to a qualified terminable interest property (QTIP) trust.

A QTIP trust is a trust for the benefit of the donor's spouse. During the donee spouse's lifetime it benefits the donee spouse. There can be no other beneficiary with a right to receive distributions from or other benefits of the trust during the donee spouse's lifetime. However, the donee spouse can have the ability to direct where the remaining property passes at the time of his or her death. Why might your client choose a lifetime QTIP trust? It is a popular choice among high net worth individuals because it provides flexibility, protection, and control features. Using a QTIP trust can also defer transfer taxes until after the surviving spouse's death, because gifts to a QTIP trust qualify for the marital deduction for transfer tax purposes. There are also features of the QTIP rules that allow opportunities to maximize both

³⁵ See IRC §§ 2503(b), 6019(1).

³⁶ IRC § 2503(b)(2).

³⁷ IRC § 2523(i).

³⁸ IRC § 2523(a).

³⁹ IRC § 2523.

⁴⁰ IRC § 2523(i)(2).

spouses' generation-skipping transfer ("GST") tax exemptions in certain circumstances. There are several requirements for a trust to qualify as a proper QTIP vehicle, including:

(i) *All trust income must be distributed to the donor's spouse at least annually.*⁴¹ It is important to note that the word "income" as used in this requirement refers to income for the purposes of the trust agreement, if defined therein, or if not defined in the trust agreement, as defined in state law for fiduciary accounting purposes. "Income" does *not* refer to taxable income for federal income tax purposes.⁴²

(ii) *The donor's spouse must be the sole beneficiary during his or her lifetime.*⁴³ No one, including the beneficiary spouse, can be given the power to appoint any part of the property to any person other than the beneficiary spouse during the lifetime of the beneficiary spouse.

(iii) *The donor spouse makes a QTIP election on a timely filed return.*⁴⁴ A QTIP trust set up during the donor's lifetime qualifies for the marital deduction for gift tax purposes *only if* a timely election is made on Form 709. In short, if your client wants to take advantage of the unlimited marital deduction for a transfer to a QTIP trust, he or she not only has to file Form 709, he or she must file Form 709 on time.

e) In certain circumstances in which the client's spouse made a gift of community property, both spouses may be required to file Form 709.

For purposes of the federal gift tax, if one spouse makes a gift of community property to a third party, each spouse is treated as though he or she made one-half of such gift for federal gift tax purposes. The example included on page 1 of the instructions for Form 709 provides: "A gift of \$100,000 of community property is considered a gift of \$50,000 made by each spouse, and each spouse must file a gift tax return."⁴⁵ This rule has particular importance in a community property state such as Texas. Many clients may know that Texas is a community property state, but they might not have any idea what that means. You can certainly see how a client may not be aware he or she had a gift tax return filing requirement in this situation.

Example: Your married clients are both doctors. They met and married in medical school. They have no premarital agreement, but generally keep their finances in separate accounts. They are both successful and have large salaries from their respective practices in Dallas. Husband decides to give his brother a \$50,000 gift (using his salary) to use as a down payment on a home. Your clients may think that the gift was made just from Husband. After all, Husband wrote the check from a checking account in his name using his salary. But according to the

⁴¹ IRC § 2056(b)(7)(B)(ii)(I).

⁴² See Texas Property Code, Chapter 116, the Uniform Principal and Income Act.

⁴³ IRC § 2056(b)(7)(B)(ii)(II).

⁴⁴ IRC §§ 2056(b)(7)(B)(ii)(III); 2523(f)(4).

⁴⁵ Instructions for Form 709, "Who Must File?"

community property rules, Husband's salary is community property without regard to whose name is on the account at the bank. Both Husband and Wife are required to file Form 709 reporting a one-half interest in a \$50,000 community property gift (i.e., a \$25,000 gift) to Husband's brother. The same rule is also applied where there has been a gift of property held by spouses as joint tenants or tenants by the entirety—both spouses must file a return.

- f) If a gift split with a spouse has occurred, both spouses must generally file Form 709.⁴⁶

If one spouse makes a gift of separate property to someone other than his or her spouse, then the spouses can elect to split gifts so that one-half of the transfers made to third parties by either spouse are deemed as made one-half by each spouse for purposes of the federal gift tax.⁴⁷ Because Texas is a community property state, gift splitting may be less common here in light of the fact that community property gifts are already treated as though made one-half by each spouse. However, if you have a situation in which one spouse has significant separate property assets (e.g., he or she had significant assets prior to marriage or inherited assets), gift splitting may be relevant. This concept is discussed in more detail in Section II.C below. Regardless, if your clients elect to gift split, BOTH spouses must generally file Form 709. There is a narrow exception in the event that (1) only one spouse actually makes gifts during the calendar year and (2) all gifts are gifts of a present interest covered by the annual exclusion.⁴⁸ For example, if Husband makes only one gift, a separate property gift of \$20,000 cash to his brother in 2014, and Wife consents to split the gift with Husband, then it would be sufficient for only Husband to file Form 709 with Wife indicating her consent on line 18 of Husband's return.

Practice Pointer: The instructions for Form 709 provide that if a married couple elects to gift split, both spouses' returns should be filed in the same envelope. Otherwise returns should be sent in different envelopes.⁴⁹

- g) When there has been a partial gift to a charity, Form 709 must be filed.⁵⁰

Split interest gifts are transfers that benefit a charitable beneficiary in part and benefit a non-charitable beneficiary in part. Examples include gifts to a charitable lead trust (CLT), charitable remainder trust (CRT), or a pooled income fund. Some commentators have questioned whether an incomplete gift involving a charitable beneficiary, such as a gift to a CRT where the donor has the right to alter the identity of the charitable beneficiary, must be reported. In the face of uncertainty, it is considered a best practice to file a return reporting this type of a gift. Of course, the qualifying charitable portion of the gift will be offset by the gift tax charitable deduction.

⁴⁶ See Instructions for Form 709, "Who Must File?"

⁴⁷ IRC § 2513.

⁴⁸ See Treas. Reg. § 25.2513-2.

⁴⁹ See Instructions for Form 709, "Specific Instructions, Part 1—General Information, Lines 12-18 Split Gift."

⁵⁰ See IRC § 6019(3).

- h) Gifts to which the taxpayer wishes to allocate his or her GST exemption in a manner other than as provided in the automatic GST allocation rules.⁵¹

Form 709 is not just a gift tax return; it is a “United States Gift (and Generation-Skipping Transfer) Tax Return.” There are default rules for automatic allocation of a donor’s GST tax exemption to transfers that are currently subject to the GST tax or may be subject to it in the future. The good news is that a donor can opt out of the automatic allocation rules or opt into automatic allocation rules that would not otherwise apply.⁵² However, the only way a taxpayer can do so is by filing a gift tax return that affirmatively opts in or out of automatic GST tax exemption allocation rules.⁵³ This may trigger an independent filing requirement when no return would otherwise be required.

Example: Your client makes annual exclusion gifts to a trust that qualify as gifts of present interests by virtue of withdrawal rights granted to trust beneficiaries. The trust holds term life insurance on Client’s life. The trust has dynastic provisions that will enable it to continue for as long as state law allows. The trust is considered a GST trust for the purposes of IRC § 2632(c)(3)(B). However, your client is unsure if he will maintain the policy for more than a few years, and in any case, he believes that his children will spend the money during their lifetimes. For these reasons, he does not want to use any of his GST tax exemption on the trust. Even though the donor would not otherwise be required to file Form 709 to report his annual exclusion gifts to the trust for gift tax purposes, in order to opt out of the automatic allocation of GST tax exemption to the trust, the donor must *timely* file Form 709.

The automatic allocation rules associated with the GST tax are discussed in more detail in Section V.C below.

2. If you have to report one, you don’t necessarily have to report them all...but maybe you should!

If your client made no gifts that fall into one of the categories above, then no return is required to be filed. If your client made even one type of gift described in the list above, then your client must file Form 709. If your client is required to file a return to report any noncharitable gifts, then the instructions to Form 709 require you to report *all* charitable gifts made during the year.⁵⁴ If the total gifts of present interests to any donee are more than \$14,000 in the calendar year, then you must enter all such gifts that your client made during the calendar year to that particular donee including those gifts that are excludable under the annual exclusion.⁵⁵ However, if the total amount of gifts of a present interest to any particular donee is less than \$14,000, then you are not required to report any of the gifts to that donee on Schedule A to Form 709.⁵⁶ Note, however, that you may still be required to report allocation of GST

⁵¹ IRC § 2632(a).

⁵² IRC § 2632(c)(5).

⁵³ IRC § 2632(c)(5)(B).

⁵⁴ See Instructions for Form 709, “Who Must File: Gifts to Charities.” Presumably “all” gifts means all gifts to a single charity in excess of the annual exclusion amount.

⁵⁵ See Instructions for Form 709, “Gifts to Donees Other Than Your Spouse.”

⁵⁶ *Id.*

exemption on Part 2 and Part 3 of Form 709 with respect to transfers that you were not required to report on Schedule A. So if your client is already required to file Form 709 or your client is choosing to file Form 709 to make an optional election, we recommend you report all gifts—even if the instructions do not require you to report those gifts.

Example: Dad gives Son \$1 million outright. Dad also gives \$7,000 to a life insurance trust benefiting Daughter. Per Form 709 instructions, Dad is required to file Form 709 to report the gift to Son. The gift to the life insurance trust for the benefit of Daughter is not required to be reported on Schedule A. However, Dad will need to report any GST exemption that was automatically or manually applied to the insurance trust on Part 2 and Part 3 of Form 709. You should recommend that Dad report the gift to the insurance trust on Schedule A, even if he is not technically required to do so.

Practice Pointer: Although taxpayers are required to report gifts to charity, even if those gifts fully qualify for the charitable exemption, these types of gifts are often omitted from the return. The IRS has not seemed concerned about this omission. However, failing to report charitable gifts or gifts to politically affiliated organizations that do not qualify as Section 527 political organizations could potentially lead to the application of the six year statute of limitations if the unreported charitable gifts amount to more than 25% of the total amount of the gifts made by the taxpayer.⁵⁷ Recall that the instructions for Form 709 require you to report all gifts if your client has a Form 709 filing requirement *including* charitable gifts *regardless* of whether such gifts are subject to gift tax. Failing to report charitable gifts—even gifts that are fully deductible—could inadvertently extend the statute of limitations to six years. This pitfall may be even more of a concern in a year in which your clients are reporting small gifts (such as a nominal gift to a GRAT), because gifts to charity may make up a greater percentage of the total “gifts” in such a year.

C. Gift Splitting vs. Community Property Gift

1. Gift Splitting

As discussed above, a married individual may elect to split gifts made to any beneficiary (other than his or her spouse) during the calendar year so that one-half of the transfers in the calendar year are deemed as made by each spouse for purposes of federal gift tax.⁵⁸ This can be a great way to take advantage of both spouses’ exemptions and annual exclusion amounts. Of course, the parties must be married at the time of the gift in order to split the gift. In the first year of the marriage, only those gifts made after the wedding date can be split. Similarly, in any year that the parties divorce or one spouse dies, those gifts made prior to the divorce or death may be split. Note, however, that if a party remarries during a year in which he or she made gifts with the former spouse, gift splitting cannot be elected even if no gifts were made with the new spouse.

⁵⁷ Treas. Reg. § 301.6501(e)-1(b)(1),(2).

⁵⁸ IRC § 2513.

There are a few tricky aspects of gift splitting. First, gift splitting can only be done with spousal consent on a Form 709 filed no later than the earliest of (1) April 15th (or October 15th if properly extended) following the calendar year in question unless neither spouse files Form 709 by that date, (2) the date on which a return is filed by either spouse if this occurs after this deadline, or (3) when a notice of deficiency is sent to either spouse.⁵⁹ Practically speaking, this means you need to remember to make the election on the initial Form 709 filed or else the option to gift split will be lost absent some sort of extraordinary relief. Gift splitting on an amended return is not permitted. Consent to gift splitting is given by checking “Yes” on line 12 of Part 1 - General Information on Form 709 and filling in lines 13-18 where applicable, including having the taxpayer’s spouse sign line 18. In limited circumstances, only one spouse is required to file a return. If the spouse making the gifts to be split does not make gifts that exceed twice the annual exclusion amount to any donee, the consenting spouse does not make gifts that exceed the annual exclusion amount or gifts to any of the donees of the filing spouse, and all gifts made are present interest gifts, then only the spouse who made the gifts to be split will be required to file a return. However, as discussed below, two returns may be required in order to properly report any GST tax consequences with respect to the gifts or to opt out of the automatic allocation rules. Due to the very limited application of this exception, it may be prudent to always file both gift tax returns to ensure the GST issues are not overlooked.

Second, it is important to keep in mind that spouses cannot cherry pick which gifts to third parties they split during the calendar year. If they want to split one gift, they have to split all of the gifts made during the part of the year that they were married. Furthermore, gifts to third parties must be split one-half to each spouse. Spouses could not agree to divide gifts in some other proportion, such as 75%-25%.

Third, spouses can only split gifts to third parties. Gifts by one spouse to the other spouse may qualify for the marital deduction or the annual exclusion, but they do not qualify for the gift splitting election. A gift to a trust for the benefit of the donor’s spouse and third parties will not be able to be split if the portion of the gift to the donor’s spouse is not ascertainable (e.g., the donor’s spouse can receive distributions for her happiness). However, a portion of a gift to a trust established for the benefit of the donor’s spouse and third parties may qualify as a gift permitted to be split, but only if the amount of the gift allocable to the donor’s spouse is ascertainable so that it can be severed from the gift that is intended to be split.⁶⁰ The distribution standard of health, education, maintenance, and support is considered to be an ascertainable standard.⁶¹

Example A: On December 1st Husband makes a gift of \$89,000 to a new insurance trust for the benefit of Wife and their three Kids. The terms of the trust provide that Wife may withdraw up to \$5,000 of the gift, and each of the Kids may withdraw a portion of the gift up to twice the annual exclusion amount (2 x \$14,000 or \$28,000 each). This right will lapse at the end of the year and the trustee may not make any distributions while the withdrawal rights are outstanding. The trust allows for distributions for the health, education, maintenance, and support of Wife and Kids. Wife agrees to split gifts with

⁵⁹ IRC § 2513(b).

⁶⁰ Treas. Reg. § 25.2513-1(b)(4).

⁶¹ Treas. Reg. § 20.2041-1(c)(2); *see also* Treas. Reg. § 25.2512-5 for determining the value.

Husband for the year. Of the \$89,000 gift to the insurance trust, \$84,000 is gift split and is covered by Husband and Wife's annual exclusion amounts (\$14,000 x 2 spouses x 3 kids) and \$5,000 is subject to the marital deduction. Husband will file a Form 709 making the election to split gifts and reporting \$47,000 (\$14,000 to each of the three kids and \$5,000 to Wife) worth of gifts, and Wife will file a Form 709 making the election to split gifts and reporting \$42,000 (\$14,000 to each of the Kids) worth of gifts. Warning -- as this example demonstrates, just because Husband and Wife have elected to gift split, does not mean that the gifts reported will always be identical on their respective returns.

Example B: Husband makes a gift of \$200,000 to a new trust for the benefit of Wife and their three Kids. There are no withdrawal rights provided under the trust agreement. The trust allows for distributions for the health, education, maintenance, and support of Wife and Kids. Wife agrees to split gifts with Husband for the year. The value of Wife's interest in the trust will need to be determined in order to know the amount of the gift that can be gift split. Assume that the Wife's interest in the trust is valued at \$50,000. The remaining \$150,000 (\$200,000 gift - \$50,000 interest attributable to the spouse) gift to the trust is gift split by Husband and Wife. Husband will file a Form 709 making the election to split gifts and reporting \$125,000 worth of gifts (\$50,000 gift to Wife and \$75,000 gift to Kids), and Wife will file a Form 709 making the election to split gifts and reporting \$75,000 worth of gifts (representing Wife's half of gift to Kids).

Example C: Assume the same facts as Example B above, except that the trust allows for distributions for the health, education, maintenance, support, comfort and happiness of Wife and Kids. Wife agrees to split gifts with Husband for the year. However, the value of Wife's interest in the trust is not ascertainable, so she will not be able to split this gift with Husband. Husband will report the entire gift on his Form 709.

Fourth, if spouses make the gift splitting election on Form 709, your analysis does not end there. The GST exemption amount that is allocated by each spouse may be (and most likely *will be*) different than that allocated for gift tax purposes if the gift is to a trust. For purposes of GST exemption allocation, one-half of the entire value of the gift made by the donor spouse is treated as transferred by the non-donor spouse for GST tax purposes. This is true even if the full amount of the gift was not ultimately eligible for gift splitting for gift tax purposes.⁶²

Example A-1: Assume the same facts as Example A above. Even though Husband is deemed the transferor of \$47,000 and Wife is deemed the transferor of \$42,000 for gift tax purposes, for GST tax purposes, Husband and Wife are each deemed the transferor of \$44,500.

Example B-1: Assume the same facts as Example B above. Even though Husband is deemed the transferor of \$125,000 and Wife is deemed the transferor of \$75,000 for gift tax purposes, for GST tax purposes, Husband and Wife are each deemed the transferor of \$100,000.

⁶² Treas. Reg. § 26.2652-1(a)(4).

Example C-1: Assume the same facts as Example C above. Because the gift to the trust was not allowed to be split for gift tax purposes, the Husband is the transferor of the entire \$200,000 for GST tax purposes.

2. Community Property Gifts

As discussed above, the instructions for Form 709 state that a gift of community property is considered as made one-half by each spouse. If all gifts spouses make in a calendar year are gifts of community property, then do NOT make a gift splitting election on your clients' gift tax returns. This is a major pet-peeve of IRS estate and gift tax attorneys who audit gift tax returns, and we have been told that such a rookie mistake immediately signals to the estate tax attorney reviewing the return that the preparer failed to read or comprehend the instructions for Form 709. We try to avoid irritating those who will be reviewing our returns at all costs! In the description of gift it is a best practice to convey exactly what happened.

Example: The description might read "A community property gift of \$30,000 cash was made to Kimberly Kardashian, friend of donor (address 11790 Southampton Ct., Bel Air, CA 90077). The Donor's one-half community property interest in this gift is \$15,000." The gift would be reported in column F as \$15,000 and column G for gift splitting will be blank.

D. Reporting Non-Gift Transactions - "Optional" Filing

The first question that might come to mind is "Why on earth would anyone want to do more work than is necessary on Form 709 by reporting a transaction that you are not required to report?" Reporting a non-gift transaction is a way to "play it safe" for your client. We particularly recommend disclosing a non-gift transaction on Form 709 when there is a sale of a closely held entity to a grantor trust or any other trust, even if you (or your client) believes there was no gift element to the transaction. If adequately disclosed, reporting the sale transaction (with a \$0.00 gift value) will allow the period of time during which the IRS can review the transaction to begin to run. After the statute of limitations has run without a successful challenge by the IRS, they cannot dispute that the transaction was a non-gift transaction. Despite this terrific opportunity, some clients might still raise an eyebrow when you suggest they disclose a sale that they are not required to disclose—or even worse—suggest they file a gift tax return to disclose a non-gift transaction when they would not otherwise be required to file a gift tax return. After all, why would the client want to waive a flag to the IRS drawing attention to the transaction? The result of doing so may be that the client will be subjected to an audit of the return and a challenge to the valuation used in the transaction. The benefit of dealing with any challenge right away is that all of the parties to the transaction will likely be available to help support the valuation claimed. Without disclosure, there will likely be no certainty with respect to the transaction until after the death of the client. Presuming the client will be required to file an estate tax return, the transaction will be disclosed at that time. Currently, question 13(e) on Part 4 of Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return) reads as follows: "Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in lines 13a [trusts created by the decedent] or 13b [trusts created for the benefit or decedent or which decedent was trustee]?" Thus, upon your client's death the IRS will be asking if any sale

occurred. Whether the client decides to disclose a non-gift transaction will depend on the risk tolerance of the client and his or her desire for certainty for future planning purposes. Most clients, if given the choice, would rather the IRS be time-barred by the statute of limitations from challenging the sale. If the client selects this option, then DISCLOSE! DISCLOSE! DISCLOSE!

Taxpayers may report completed transactions on a gift tax return as non-gifts. The transfer is treated as adequately disclosed if the taxpayer: (1) establishes all of the elements of the safe harbor rules under Treas. Reg. § 301.6501(c)-1(f)(2) (except that the valuation portion of Treas. Reg. § 301.6501(c)-1(f)(2)(iv)—the detailed description of the method used to determine the fair market value of the property transferred—is not required) and (2) includes an explanation as to why the transfer does not constitute a gift.⁶³ The fact that a detailed description of the financial information (or an appraisal) used to determine the fair market value of property exchanged in a completed non-gift transaction is not required in order to achieve adequate disclosure at first blush may seem like quite a boon. That means your client is not required to obtain an appraisal to value a non-gift transaction involving trusts for the benefit of family members for tax reporting purposes. However, despite the fact that the taxpayer is not *required* to meet the specific requirements of Treas. Reg. § 301.6501(c)-1(f)(2)(iv) in order to provide adequate disclosure of a non-gift transaction, most practitioners consider it a best practice to disclose such information nonetheless.

What other types of transactions can you get a reprieve on by filing Form 709? Treasury Regulation § 301.6501(c)-1(f)(5) provides that if a taxpayer furnishes adequate disclosure of a transfer that is reported as a completed gift on the gift tax return, the statute of limitations will begin to run from the time the transaction was reported (or when the Form 709 was due if later), even if the IRS ultimately determines the transaction was an incomplete gift. When might this rule be helpful? Consider the following example.

Example: In connection with your preparation of his Form 709 to report other taxable gifts, Grandpa tells you he made annual exclusion gifts to multiple grandchildren on December 25, 2013, by writing each of the grandkids a personal check in the amount of \$14,000. What Grandpa failed to tell you is that none of the grandchildren cashed those checks until after the New Year. Grandpa also wrote a \$14,000 annual exclusion check to each of his grandkids in January 2014. Each of the January 2014 checks which were cashed by the grandchildren that same month. You report gifts of \$14,000 cash with a date of December 25, 2013, on Grandpa's 2013 Form 709 as completed transactions. You did not know the checks were not cashed until 2014, which would cause the December 25, 2013 gifts to grandkids to fail to satisfy the rules for a completed 2013 gifts involving checks as set forth in Revenue Ruling 96-56.⁶⁴ In this type of scenario, Treasury

⁶³ Treas. Reg. § 301.6501(c)-1(f)(4).

⁶⁴ Rev. Rul. 96-56 sets forth the Service's position that a gift by check is complete upon the earlier of (1) the date on which the donor has parted with dominion and control to the degree under local law as to leave the donor with no power to change its disposition, or (2) the date on which the donee deposits the check (or cashes the check against available funds of the donee) or presents the check for payment, if it is established that: (a) the check was paid by the drawee bank when first presented to the drawee bank for payment, (b) the donor was alive when the check was paid by the drawee bank, (c) the donor intended to make a gift, (d) delivery of the check by the donor was

Regulation § 301.6501(c)-1(f)(5) would be advantageous to you. If you have disclosed all information to meet the standard for adequate disclosure, then the statute of limitations will begin to run from the date you reported the 2013 annual exclusion gifts as complete. Even if the Service were to determine in 2020 when Grandpa dies that the checks written in 2013 were not cashed and therefore not completed gifts until 2014, the IRS would be time barred from challenging Grandpa's 2013 Form 709 because the gifts to grandkids were reported as completed transactions. This could be your saving grace in the aforementioned hypothetical as Grandpa definitely did not intend to use up some of his gift tax exemption by making \$28,000 in gifts to the same individual in 2014.

What non-gift transactions should you not worry about reporting on a gift tax return in order to achieve adequate disclosure? A completed transfer to a family member (as defined in IRC § 2032A(e)(2)) in the ordinary course of operating a business is deemed adequately disclosed if it is properly reported by the parties for income tax purposes.⁶⁵

Example: Daughter works in Dad's family business. Dad does not need to worry about disclosing salary paid to Daughter on his Form 709 for her work in the family business. As long as salary paid to daughter is properly reported for income tax purposes on Daughter's and the company's tax returns, it is deemed to be adequately disclosed for gift tax purposes.

E. Adequate Disclosure

1. Adequate Disclosure and Statute of Limitations

The general rule is that the IRS has three years from the date Form 709 is filed (or due, if later) to assess gift tax.⁶⁶ The statute of limitations is six years after the return is filed (or due, if later) if the value of the gifts omitted from the filed gift tax return exceeds 25% of the total value of gifts reported on the filed return in the year in question. If the statute of limitations has run on a gift, then the value of the gift for all federal estate, gift, and GST tax purposes will be its value as reported on the filed Form 709. However, the statute of limitations will not begin to run on a particular gift *unless* the gift has been adequately disclosed on Form 709. Translation: if you want to close the book on a particular gift for federal gift and estate tax purposes, adequate disclosure is everything!

2. How to Achieve Adequate Disclosure

A transfer is adequately disclosed on a gift tax return only if it is reported in a manner adequate to apprise the IRS of the nature of the gift and the basis for the value so

unconditional, and (e) the check was deposited, cashed, or presented in the calendar year for which completed gift treatment is sought and within a reasonable time of issuance.

⁶⁵ Treas. Reg. § 301.6501(c)-1(f)(4).

⁶⁶ IRC § 6501(a).

reported.⁶⁷ Transfers reported on Form 709 are considered adequately disclosed if the return or a statement attached to the return provides the following information:

- A description of the transaction:
 - A description of the property transferred and any consideration received by the transferor (if applicable);
 - The identity of, and relationship between, the transferor and each transferee;
 - The value of the property transferred;
 - A detailed description of the method used in determining the fair market value of the property transferred, noting any financial data used (e.g., balance sheets and income statements with explanations of any adjustments) in valuing the property transferred and specific details regarding the use of any valuation discounts or adjustments. If an interest is actively traded on an established exchange (e.g., the New York Stock Exchange or NASDAQ), recitation of the exchange where the interest is listed, the CUSIP number of the security, and valuing that asset as the mean value between the highest and lowest quoted selling prices on the applicable valuation date is required.⁶⁸ If the property transferred is an interest in an entity (e.g., a corporation or partnership) that is not actively traded the taxpayer must provide the net asset value of a 100% interest in the entity, the pro rata interest of the taxpayer, and a description of any discounts applied. If the taxpayer does not disclose the net asset value of 100% of the entity value, the taxpayer bears a significant burden in proving that the fair market value of the transferred property should be determined in a different matter; and
 - A statement describing any position taken that is contrary to any proposed, temporary, or final Treasury Regulation or revenue ruling (if applicable).⁶⁹
- Additional information needed if the gift is made to a trust:
 - The taxpayer must provide a brief description of the terms of the trust or a complete copy of the trust instrument (*but note* that the instructions for Form 709 provide that if a gift is made to a trust you **MUST** attach a certified or verified copy of the trust instrument to the return on which you report your first transfer to the trust—a summary of the trust will not suffice in the first year).⁷⁰

⁶⁷ Treas. Reg. §§ 301.6501(c)-1(f), 25.2504-2.

⁶⁸ Treas. Reg. § 25.2512-2. Note that there are special rules under this regulation for valuation of assets transferred on the weekend or another day on which the markets are closed.

⁶⁹ Treas. Reg. §§ 301.6501(c)-1(f)(2)(i)-(iv).

⁷⁰ Instructions for Form 709, “Supplemental Documents.”

- The taxpayer must also provide the trust's tax identification number.⁷¹ If the trust is treated as a grantor trust and no trust tax identification number has been obtained, then the grantor's social security number should be reported instead.

3. Including a "Qualified Appraisal" with Respect to Gift Reported on Form 709

In lieu of the taxpayer providing the detailed description of the method of calculating the fair market value of property transferred, the taxpayer may submit an appraisal prepared by an individual who meets the following requirements:

- He or she holds himself or herself out to the public as an appraiser who performs appraisals with regularity;
- Because of the appraiser's qualifications that are detailed in the report (including background, experience, education, and membership in any professional appraisal associations), the appraiser is qualified to make appraisals of the type of property being valued; and
- The appraiser is not the donor, the beneficiary of the transfer, or a member of the family of either donor or the beneficiary or any person employed by the donor, the beneficiary, or a member of the family of either.⁷²

The appraisal report submitted by the qualified appraiser must meet the following requirements:

- Information on the appraisal must include the following information:
 - The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal;
 - A description of the property;
 - A description of the appraisal process employed;
 - A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the analyses, opinions, and conclusions; and
 - The information considered in determining the appraised value, including financial data that was used in determining the value of the interest so that another person could replicate the appraisal process (in the case of business interests);
- The appraisal must follow the procedures outlined in the report and the reasoning must support the valuation given; and
- The report must include the valuation method used (e.g., comparable sales or transactions or sales of similar interests) and the rationale for using such method.⁷³

⁷¹ Treas. Reg. § 301.6501(c)-1(f)(2)(iii).

⁷² Treas. Reg. § 301.6501-1(f)(3)(i).

⁷³ Treas. Reg. § 301.6501(c)-1.

Prior to 1997 if you filed a non-fraudulent Form 709 you were almost guaranteed to start the running of statute of limitations. Now, the hoops you must jump through in order to start the running of the statute of limitations are more significant. When gifts involve an interest in a non-actively traded business, typically the best practice is to obtain a qualified appraisal that meets the criteria listed above. We strongly recommend that you read the Treasury Regulations regarding adequate disclosure each time you are reporting a gift or sale of an interest in a closely held business on Form 709. Furthermore, we recommend you use a comprehensive checklist (developed in conjunction with a reading of Treasury Regulations) to make sure you are complying with the adequate disclosure rules in reporting all such transfers.

F. How to Report

There is more than one way to report a gift, so feel free to let your creative writing skills shine through on Form 709. However, there is some information that is required to be disclosed on every return. Therefore, it is incredibly important that you read the Instructions for Form 709 so that you can identify when you have some leeway and when you are required to supply certain information with respect to a gift. Below is a discussion of and selected examples from some of the most common types of reportable gifts.

1. Gifts to Trusts

There are several things to include when reporting a gift to a trust including the following:

- The trustee's name;
- The trust's name;
- The trust's address (usually the same as the trustee's address);
- The trust's EIN (which is sometimes the grantor's social security number in the case of a grantor trust);
- A copy of the trust as an attachment or an exhibit (note that in the first year in which the donor makes a gift to that trust such trust must be either "certified or verified" per Form 709 Instructions, but in subsequent years a mere copy or a summary of the terms of the trust is sufficient when referencing a gift to a trust for which a verified or certified copy has already been provided on a previously filed Form 709; here's the catch, we have been unable to identify anyone who knows what makes a trust "verified" or "certified" nor have we found anyone who has had the IRS ask for such a copy, so our best advice if you are concerned about this requirement is to prepare a short certification cover sheet for the trustee to sign that "certifies" that the attached copy is correct and complete);
- A short description of the relationship of the beneficiaries of the trust to the donor; and
- Whether there are any withdrawal beneficiaries who have withdrawal rights over the contribution to the trust (we also consider it a best practice to include the full name and address of any withdrawal right beneficiary).

Below is an example of a typical gift description:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Audrey L. Home 2012 Irrevocable Trust 2516 Meadow Valley Ln Dallas, Texas 75202 Benjamin Home, Trustee EIN: 11-1111111 Donor gifted \$15,000 cash to the Audrey L. Home 2012 Irrevocable Trust created on June 17, 2012 (see Trust Agreement attached as Exhibit A). The trust is for the benefit of donor's daughter Audrey L. Home (3024 Flanagan Dr, Dallas, TX 75202) and her issue. Donor's daughter had the right to withdraw \$15,000 (see gift notice letter attached as Exhibit B).	x	15,000	7/17/2012	15,000		15,000

2. Gifts of Real Estate

a) Accurately describe the interest being given

You must include the legal description of each parcel involved, the street name and number of the property (if the property is located in a city), and a general description of the property (e.g., raw land or a city lot with a single family dwelling). Include all documents that help substantiate the transfer or the value to the return as exhibits. Examples of possible attachments for real estate include appraisals, deeds, information regarding comparable sales, and recent closing documents (if applicable). Sometimes a gift is of a partial interest in property instead of a gift of an entire interest in property. Partial interests in property seem to come up frequently with respect to gifts of interests in real property. If a gift is of a partial interest in real estate it will be extremely important to identify that partial interest on Form 709.

Example: Dad owns a 50 acre tract of land in West Texas, and he wants to gift a 25% undivided interest in the tract to Daughter. It is important to report on Form 709 that Dad transferred a 25% undivided interest in the tract of land. To say Dad gifted 12.5 acres of the land would be incorrect and could result in differences in valuation.

In Texas the default type of co-ownership of real property is a tenancy in common, but the deed transferring an interest in real estate could create some type of ownership arrangement such as joint tenants with rights of survivorship. It is a best practice to state the manner in which title is transferred on Form 709.

b) Substantiate Value

Explain how you arrive at the value you report on Form 709. Do not hide the ball. The best case scenario would be for the client to provide you with a qualified appraisal of the real estate interest for you to attach to Form 709. Luckily, real estate appraisals tend to be less expensive to procure than appraisals for closely held businesses and may be well worth their value. If your client does not want to obtain a qualified appraisal, run through the requirements for adequate disclosure of value with the client. If your client insists on using ad valorem tax values (which is not a value that fits squarely within the meaning of fair market value for gift tax purposes, but is a proxy that clients frequently like to use because it can be procured at no cost) disclose to the IRS that the taxpayer valued the property based on ad valorem values. If the client recently purchased the property prior to the gift in an arm's length transaction and wants to use the acquisition price, disclose to your client that the fair market value could have changed since the date of purchase. If the client insists upon using the purchase price as a proxy for the fair market value of the property interest transferred, then report the acquisition price and the date of acquisition in your description of the gift.

Below is an example of a typical description of a gift of real property:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	<p>Laura D. Palmer 9455 Glen Avenue Dallas, TX 75201 SSN: 999-99-9999 Daughter Donor gifted a 55% undivided interest in 339.750 acres of land in Rockwall County Texas to his daughter Laura R. Palmer. At the date of the transfer the sole improvement on the property was a partially constructed residence, which was 30% completed. (see appraisal attached as Exhibit A). All that certain lot, tract or parcel of land, situated in Rockwall County, Texas, being out of the Antonio Rodriguez Survey and a part of the 560 acre tract fully described in Vol 335, page 75 of the Deed Records, Rockwall County, Texas; Beginning at the North corner of said 560 acre tract in the center of a branch and in center of a public road; Thence South 45 deg East 304 feet; South 67-3/4 deg West 96 feet; North 66 deg West 110 feet; North 12 1/2 deg East 170 feet; North 60-3/4 deg West 110 feet; South 45 deg West 125 feet; North 443 1/2 deg West 160 feet; North 15-1/4 deg West 153 feet to the place of beginning, containing 339.750 acres of land, more or less. The land is located at 2255 W Moreland Street, Rockwall, Texas, 75266.</p>		560,000	12/30/2012	1,400,000		1,400,000

Gifts of an Interest in a Closely Held Business

Adequate disclosure is of chief concern with a gift of an interest in a closely held business. It is important that you disclose all information required in order to meet the threshold for adequate disclosure under Treasury Regulations (see Section II.E above). In addition, you must also disclose the taxpayer identification number of the entity transferred. Finally, it is important that you correctly describe the interest that was transferred, whether it is a percentage interest in an entity, limited partnership units, membership units, or an amount pursuant to a formula clause (see Section V.C.2.c below for further discussion). If an assignment has been drafted in connection with the transfer of an interest in a closely held business, we consider it a best practice to attach the assignment as an exhibit/attachment to Form 709.

Below is an example of a typical description of a gift of an interest in a closely held business:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Audrey L. Home 2516 Meadow Valley Ln Dallas, Texas 75202 Daughter SSN: 222-22-2222 Audrey L. Home is the daughter of the Donor. Donor gifted 100,000 common shares out of 1 million total common shares of HDS, Inc., a Texas Corporation. (see appraisal attached as Exhibit B and see gift assignment attached as Exhibit C), to Audrey L. Home.		100,000	9/1/2012	750,000		750,000

3. Gifts of an Interest Where IRC Section 2701 May be an Issue

There are certain situations in which a donor's retained interests are valued at zero for federal transfer tax purposes.⁷⁴ The Internal Revenue Code provides special gift tax valuation rules that are designed to deter abusive transfers by imposing an increased gift tax on the transfer. The focus of these rules is to prevent under-valuations of gifts of interests in closely held businesses to family members. This is accomplished by valuing the interests retained, which purport to be of a higher value at zero, which in turn increases the value of the interests transferred by a like amount. Consider the following example.

Example: Dad owns all of the shares of stock in the family owned business that is a C corporation. He recapitalizes the corporation and creates two classes of stock: preferred stock and common stock. Dad gifts all the common stock to his Daughter. The preferred stock, which carries various rights that Dad may or may

⁷⁴ See IRC § 2701.

not ever take advantage of, are retained by Dad. However, because Dad's shares carry additional rights that Daughter's shares do not have, it follows that the shares transferred to Daughter would be less valuable than units retained by Dad. Under IRC § 2701 Dad's retained shares may be valued at \$0, meaning the common stock price would be the full fair market value of common and preferred stock for the purposes of federal gift tax rules.

The rules described above are contained in Chapter 14 of the Internal Revenue Code and are often referred to as simply as Chapter 14.⁷⁵ However, there is nothing simple about these rules and they have far reaching effects in today's complicated transactional structures. As broadly sweeping as the rules may appear, there are also numerous exceptions. If the situation ever arises that a client indicates that he or she has gifted a portion of a closely held business while retaining an interest, an alarm should go off in your head to remind you to verify with the client's legal counsel that Chapter 14 does not apply to the gift, and you may need to brush up on the rules of IRC § 2701 if there is no legal counsel to turn to.

4. Gift of an Actively Traded Stock or Bond

The instructions for Form 709 require that the following information be provided for a gratuitous transfer of an actively traded stock:

- The name of the company;
- The number of shares transferred;
- A description of the stock as common or preferred (if preferred, you must provide the issue, par value, quotation at which returned, and exact name of corporation);
- For stock not listed on a principal exchange, the location of the principal business office of the corporation, the state in which incorporated, and the date of incorporation;
- For stock actively traded on an exchange, the name of the principal exchange;
- The CUSIP number (a nine-digit number assigned by the American Banking Association to traded securities); and
- The fair market value of stock, which is the mean between the highest and lowest selling prices quoted on the valuation date. If only the closing selling price is available for a stock, then the fair market value is the mean between the quoted closing selling price on the valuation date and on the trading day before the valuation date. If that information is not available, the instructions to Form 709 and Treas. Reg. § 25.2512-2 provide an alternate valuation procedure.

⁷⁵ A discussion of Chapter 14 is beyond the scope of this outline. For an excellent discussion of Chapter 14 taxes, see Lou Mezzullo, Special Valuation Rules: Section 2701, presented at the ABA Joint Meeting of the Tax Section and the Real Property, Probate and Trust Section on May 10, 2013, found at http://meetings.abanet.org/meeting/tax/MAY13/media/egt_freeze_mezzullo_paper.pdf

The instructions for Form 709 require that you must provide the following information for a gratuitous transfer of an actively traded bond:

- The name of the obligor of the bond;
- The number of bonds transferred;
- The principal amount of each bond;
- The date of maturity;
- The rate of interest;
- The date or dates when interest is payable;
- The series number, if there is more than one issue;
- The exchange on which the bond is listed or if unlisted, the location of the principal business office of the corporation; and
- The CUSIP number.

Software programs are available that will generate reports that provide much of the information that you are required to disclose on Form 709. The providers of these services generally charge a set fee for each stock and bond valued and provide a detailed report that shows the calculation of the fair market value.⁷⁶ It can sometimes be a challenge to find the CUSIP number of a stock without paying a fee. We have had success by searching on the free website QuantumOnline.com and entering the ticker symbol of the traded security.

Below is an example of a typical description of a gift of publicly traded stock:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Laura D. Palmer 9455 Glen Avenue Dallas, Texas 75201 Daughter Donor gifted 12,000 shares of Ford common stock (CUSIP: 345370860). Stock is actively traded on the New York Stock Exchange. On the date of the transfer, the high/ask was \$12.20 per share and the low/bid was \$11.80 per share. The mean was \$12.00 per share.		86,270	12/1/2012	144,000		144,000

5. Gift of Interest in Promissory Note or Forgiveness of Interest in a Promissory Note

A gift of an interest in a promissory note and forgiveness of an interest in a promissory note are additional types of gifts. When your client forgives an interest in a promissory note owed to him or her, it will be important to ensure that the note was fully documented and treated as a valid note. In certain circumstances, the IRS has taken the position

⁷⁶ Estate Valuations and Pricing Systems is just one of many providers of this service, although it is rumored that the IRS uses their services as well. They can be located at <http://www.evpsys.com/>.

that there was a prearranged plan to forgive or decline to collect on the note from the beginning, which results in the client being treated as having made a gift of the full amount of the loan upon its creation.⁷⁷ For this reason, it may be risky for a client to forgive a note if no payments have been made on the note and claim it as a gift at that time. Even if the loan is not treated as a gift from inception, forgiven interest may be treated the same as forgone interest in a below-market loan, resulting in a gift to the borrower and imputed interest income to the lender. However, if the forgiveness of an interest in a promissory note includes principal in substantial part as well as income, it may be possible for the donor to avoid having to recognize accrued interest as taxable income.⁷⁸ It is especially important to properly document any forgiveness of indebtedness in the best light possible to reflect that validity of the note upon its creation.

When the gift involves an interest in a promissory note or forgiving an interest in a promissory note, we consider it a best practice to include the following information on Form 709:

- The names of the lender and the obligor;
- The date of the note;
- The original principal balance of the note;
- A description of the term of the note, whether a specified term or a demand note;
- The interest rate of the note;
- A copy of the note;
- If the gift is a forgiveness of obligation, the amount of interest and principal forgiven;
- Details about any prior payment of interest and principal; and
- A copy of any documentation memorializing forgiveness (if available).

Below is an example of a typical description of a forgiveness of debt gift:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	James T. Hurley 2541 Bent Tree Lane Dallas, Texas 75262 Son Forgiveness of \$169,200 in accrued interest and \$3,830,800 of outstanding principal of that certain Promissory Note, effective as of 11/15/2005, by and between James T. Hurley, as obligor, and Edward J. Hurley, as payee (see Promissory Note attached as Exhibit A and memorandum of Note Forgiveness attached as Exhibit B). The Promissory Note is a 9 year term note, with interest accruing annually at 4.23%. It had an original outstanding principal amount owed of \$8,000,000.		8,000,000	11/15/2012	4,000,000		4,000,000

⁷⁷ See Rev. Rul. 77-299, 1977-2 C.B. 343.

⁷⁸ Prop. Reg. § 1.7872-11(a). See footnote 6 herein. Also, if the obligor of the promissory note is the trustee of a grantor trust as to the donor wishing to forgive a portion of the note, there should not be a concern about imputed income interest to the donor.

6. Split Gifts

As noted in Section II.C above, when spouses have agreed to split gifts, all gifts to third parties made during the year are treated as made one-half by each spouse. In addition to making the election by checking the yes box on line 12 and completing lines 13 through 18 (including the consenting spouse's signature on line 18), enter the full description of the gift on Schedule A. In column F, enter the full value of the gift made. In column G, enter ½ of the value of the gift entered in Column F. Use the section labeled "Gifts made by spouse" in Part 1, 2, and 3 of Schedule A only to report gifts made by your spouse that are subject to the gift split.

Below is an example of the reporting of a split gift:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Catherine P. Martell 2012 Insurance Trust 7454 Saw Mill Lane Dallas, Texas 75201 Jocelyn C. Packard, Trustee EIN: 44-4444444 Donor made a cash gift of \$15,000 to the Catherine P. Martell 2012 Insurance Trust (see Trust Agreement attached at Exhibit A). Over which Donor's son Andrew Martell had a \$15,000 withdrawal right (see gift notice letter attached as Exhibit B).	x	15,000	10/31/2012	15,000	7,500	7,500
2	Catherine P. Martell 2012 Insurance Trust 7454 Saw Mill Lane Dallas, Texas 75201 Jocelyn C. Packard, Trustee EIN: 44-4444444 Donor made a cash gift of \$5,000 to the Catherine P. Martell 2012 Insurance Trust (see Trust Agreement attached as Exhibit A). Over which Donor's spouse, Pete Martell had a \$5,000 withdrawal right (see gift notice letter attached as Exhibit C) Per IRC § 2513 gifts to the donor's spouse are not subject to the gift split election.	x	5,000	10/31/2012	5,000		5,000

7. Gift of Life Insurance Policy

For gifts of interests in life insurance policies, Form 709 instructions require you to provide the name of the insurer, the policy number, and a Form 712 for the policy completed as of the date of the transfer.

A gift of an insurance policy to one or more natural persons or trusts is one of the murkiest types of 709 reportable transfers. Why is that? Well, first and foremost, the instructions for Form 709 state that you must attach Form 712 for each insurance policy transferred by the donor in the calendar year.⁷⁹ The only way you can get Form 712 is by contacting the policy carrier and requesting it. You should not try to fill out Form 712 on your own. If you are the advisor requesting the Form 712 on behalf of the client, you will need to give the carrier specific instructions about the date of the valuation (which should be the date the policy was transferred and not the date of your request). We frequently ask the insurance agent to be the designated communicator to the insurance company, as the agent may have better communications with the carrier which may be of assistance, as discussed more fully below. Another important thing to know is that you need to build in sufficient lead time to obtain a Form 712 if your client does not already have one available for you. It can often take a minimum of 10 days for the insurance carrier to get around to your request for Form 712. Furthermore, you need to scour the Form 712 produced by the insurance carrier to make sure it is accurate with respect to the transfer date, owner, etc. In our experience, it is rare to receive a complete and accurate Form 712 from your initial request. Also, on multiple occasions we have requested a Form 712 and the insurance company has provided a letter of value instead of a Form 712. While we appreciated the gesture from the policy carrier, their letter of value is not sufficient where the instructions for Form 709 require a Form 712 to be attached.

You may think you are at the finish line once you receive a completed Form 712 (with the right date and the correct owner) from the insurance carrier—after all, lines 58f and 59e on Form 712 are labeled “Net total value of policy (for gift or estate tax purposes).” Fantastic! This value is handed to you on a silver platter, right? Not so fast.

First, the fair market value of a policy depends on the type of policy that has been transferred.

a) Newly Issued Policy

If an insurance policy is gifted to another person or trust immediately upon creation, then the value of the gift is the cost of the contract.⁸⁰

b) Paid-Up Policy / Single Premium Policy

If the policy is a paid-up or single premium policy, the value of gift is the amount that the carrier would charge for a single premium contract of the same amount, on the life of a person of the same age of the insured, carrying identical rights (including the same cash

⁷⁹ Instructions for Form 709, “Supplemental Documents.”

⁸⁰ Treas. Reg. § 25.2512-6(a), Ex. 1.

surrender value).⁸¹ This should be reported on line 59e. However, the instructions for Form 709 warn “In certain situations, for example, where the surrender value of the policy exceeds its replacement cost, the true economic value of the policy will be greater than the amount shown on line 59 of Form 712. In these situations, report the full economic value of the policy on Schedule A. See Revenue Ruling 78-137.” In Revenue Ruling 78-137, at the time the policy was transferred, its cash surrender value was greater than the replacement cost of a single premium policy with the face value in the same amount issued by the same carrier on a person of the same age. The IRS took the position that, because the cash surrender value of the replacement policy was less than the cash surrender value of the transferor’s policy, the replacement policy did not reflect all of the economic benefits of the policy that the transferor owned and thus was not a “comparable policy.” The ruling stated that if it is not possible to find a comparable policy, then the interpolated terminal reserve (“ITR,” which is approximately equal to the cash surrender value of the policy) should be used to determine the fair market value of the policy. In short, if the replacement cost that the insurance carrier provides you with is less than the cash surrender value of the actual policy in question, you should expect the IRS to take the position that the fair market value equals the cash surrender value of the policy.

c) Policy Neither Newly Issued Nor Paid Up

Perhaps the most likely scenario that you might encounter is a situation in which your client makes a gift of a policy that has been in force for a while but still requires premium payments. In that case, the value for gift tax purposes will be the interpolated terminal reserve plus the amount of any unearned premium for the policy. When the insurance carrier prepares the Form 712 that you have requested, the carrier has no discretion to use any method to determine the policy’s value other than the ITR. Great! The insurance carrier does all the calculation work, so you don’t have to calculate anything. You are done, right? Nope, not so fast.

Ask yourself, what the heck is the ITR? In layman’s terms, the ITR is the amount that the insurance carrier lists on its books of account as the replacement cost of a policy not paid up at the time of your client’s transfer. There are several complicating factors in play with respect to ITRs.

First, the ITR calculation works okay for certain policies such as whole life and annual renewable term. For a whole life policy, the reserve value as of the next anniversary date of the policy is known in advance, so the terminal reserve can be “interpolated” to reflect a valuation between the two policy anniversary dates. For an annual renewable term, the policy matures before the one year anniversary date, so there is no reserve value and the unearned premium for coverage until the next anniversary date is the fair market value. But the terminal reserve value for other types of policies, such as variable universal life, universal life, no-lapse guarantee policies, and multi-year level term policies, is not known until you actually reach the next anniversary date of the policy, because the future value of such types of policies is tied to the fluctuations of the stock and bond markets. This leaves room for variance in how different insurance companies calculate the ITR for variable universal life, universal life, no-lapse guarantee policies, and multi-year level term policies.

⁸¹ Treas. Reg. § 25.2512-6(a), Ex. 3.

What is more, carriers will use different types of reserve value methodology for a policy. Some carriers use the “tax reserve,” which is the reserve value reported on their corporate income tax returns. Still other carriers use the “statutory reserve” method based on the amount required to be reported on financial statements filed with state regulators. Carriers may also use the “AG 38 reserve” method for policies with a secondary no-lapse guarantee such as a no-lapse guarantee or universal life policy. This method generally results in a higher ITR value than if the tax reserve method or statutory reserve method is used because of the long-term death benefit guarantees involved. When you receive a Form 712 from a carrier, you will have no indication as to which reserve method the carrier used to calculate the ITR. In many cases the ITR could have been calculated differently and perhaps in a way that is more beneficial to your client.

Because of the uncertainty in the calculation of an ITR, when faced with the need to request a Form 712 for the transfer of an older policy that still has premiums yet to be paid, it may be a best practice to ensure that either the client or one of the client’s advisors (whether it is you, their insurance advisor, or their attorney) discuss with the carrier (in particular an advanced sales attorney or someone in the actuary department) the manner in which the policy value is determined and reported on Form 712 before formally requesting a Form 712. Some carriers may be willing to provide you with multiple ITR values for the same policy, while others might have a standard operating procedure, such as to exclusively provide a tax reserve value on their Form 712s. If you are faced with a multiple value scenario, you may be able to convince the carrier to go with the lowest ITR value for Form 712 reporting purposes. You do not know for sure until you have the conversation. For more detailed information on the valuation of life insurance policies, see the article by Melvin A. Warshaw, “Life Insurance Policy Valuation: As discussed at the May 2011 AALU annual meeting, the antiquated gift tax regulations create valuation ambiguities,” May 25, 2011.⁸²

Below is an example of reporting for the gift of an insurance policy and a sample Form 712:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Sylvia Home 2012 Insurance Trust 2516 Meadow Valley Ln Dallas, Texas 75202 Benjamin Home, Trustee EIN: 44-4444444 Gift of USAA life insurance policy #B000011111 with a fair market value equal to \$10,000 (see Form 712 attached as Exhibit A) to Benjamin Home, as trustee of the Sylvia Home 2012 Insurance Trust created by Trust Agreement dated 10/31/2012 (see Trust Agreement attached as Exhibit B). The Trust is for the benefit of the donor's children.	x	8,900	10/31/2012	10,000		10,000

⁸² Available at: <http://wealthmanagement.com/financial-planning/life-insurance-policy-valuation>.

Part II Living Insured

(File with Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. May also be filed with Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, or Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States, where decedent owned insurance on life of another.)

SECTION A—General Information

36 First name and middle initial of donor (or decedent) Sylvia	37 Last name Horne	38 Social security number 777 77 7777
39 Date of gift for which valuation data submitted	10/31/2012	
40 Date of decedent's death for which valuation data submitted		

SECTION B—Policy Information

41 Name of insured Sylvia Horne	42 Sex Female	43 Date of birth 7/12/1957
44 Name and address of insurance company USAA Life Insurance Company, 9800 Fredericksburg Rd., San Antonio TX 78288		
45 Type of policy LEVEL TERM V	46 Policy number B000011111	47 Face amount 2,500,000.00
48 Issue date 2006	50 Frequency of payment Monthly	
49 Gross premium 152.07	51 Assignee's name Sylvia Horne 2012 Insurance Trust	
52 Date assigned 10/31/2012	53 If irrevocable designation of beneficiary made, name of beneficiary	54 Sex
55 Date of birth, if known	56 Date designated	
57 If other than simple designation, quote in full. Attach additional sheets if necessary.		

58 If policy is not paid up:			
a Interpolated terminal reserve on date of death, assignment, or irrevocable designation of beneficiary	58a	9869.08	
b Add proportion of gross premium paid beyond date of death, assignment, or irrevocable designation of beneficiary	58b	130.92	
c Add adjustment on account of dividends to credit of policy	58c		
d Total. Add lines 58a, b, and c.	58d	10,000	
e Outstanding indebtedness against policy	58e	10,000	
f Net total value of the policy (for gift or estate tax purposes). Subtract line 58e from line 58d	58f		
59 If policy is either paid up or a single premium:			
a Total cost, on date of death, assignment, or irrevocable designation of beneficiary, of a single-premium policy on life of insured at attained age, for original face amount plus any additional paid-up insurance (additional face amount \$ _____)	59a		
(If a single-premium policy for the total face amount would not have been issued on the life of the insured as of the date specified, nevertheless, assume that such a policy could then have been purchased by the insured and state the cost thereof, using for such purpose the same formula and basis employed, on the date specified, by the company in calculating single premiums.)	59b		
b Adjustment on account of dividends to credit of policy	59c		
c Total. Add lines 59a and 59b	59d		
d Outstanding indebtedness against policy	59e		
e Net total value of policy (for gift or estate tax purposes). Subtract line 59d from line 59c.	59e		

The undersigned officer of the above-named insurance company (or appropriate federal agency or retirement system official) hereby certifies that this statement sets forth true and correct information.

Signature ►

Title ►

Date of
Certification ►

8. Joint and Survivor Private Annuities

With respect to a joint and survivor annuity in which only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die, the donor spouse is treated as electing QTIP treatment of the annuity.⁸³ However, the donor can make an election out of QTIP treatment by checking the box on line 12 and entering the item number(s) from Schedule A of the annuities for which the donor wishes to elect out of QTIP treatment. If you don't elect out of the QTIP treatment of joint and survivor annuities using the election procedure above, you **MUST** enter any joint and survivor annuities subject to the automatic QTIP election on Schedule A, Part 4, line 4 (for gifts of interests for which a marital deduction will be claimed).

9. Gifts Subject to an Estate Tax Inclusion Period (ETIP)

Certain transfers are not completed transfers for GST tax purposes until the expiration of a stated period of time. If the transferred property would have been includible in the donor's estate if the donor had died immediately after the transfer for any reason (other than the donor having died within the 3 year rule of IRC § 2035), the transfer is deemed to be subject to an ETIP.⁸⁴ When you have a transfer subject to an ETIP, the allocation of GST exemption does not occur until after the expiration of the ETIP (i.e., period of includability in the donor's estate) rather than at the time of the actual transfer.⁸⁵ Common examples of transfers subject to an ETIP include transfers to a grantor retained annuity trust ("GRAT") or a qualified personal residence trust ("QPRT"). They also include transfers in which a donor retains a life estate for himself or herself or retains a right that would make the transferred property includible in the donor's estate under IRC § 2036 (such as retaining voting rights over transferred stock).

a) What does this mean for your gift tax reporting?

If you have a transfer subject to an ETIP, in the year of the transfer, report the gift portion of the transfer on Schedule A, Part 1 using the date of transfer value. If the donor survives the ETIP period, report the GST portion of the transfer on Schedule A, Part 2 or Schedule A, Part 3 (depending on whether such transfer is a direct skip or an indirect skip) using the value of the property as of the close of the ETIP. IRS rules prohibit you from allocating GST exemption prior to the close of the ETIP on a gift tax return while the donor is still living. If the donor dies prior to the close of the ETIP, then the transfer should be reported on his or her Form 706 (if such a return is required to be filed).

In the event your client is filing Form 709 solely to report the GST portion of transfers subject to an ETIP, then in the return filed at the close of the ETIP a normal Form 709 should be prepared with the following exceptions:

1. Write "ETIP" at the top of page 1 of Form 709;
2. Complete only lines 1-6, 8, and 9 of Part 1 - General Information;

⁸³ IRC § 2523(f)(6).

⁸⁴ IRC § 2632(c)(4).

⁸⁵ IRC § 2642(b)(1)(B); Treas. Reg. § 26.2632-1(c)(1).

3. Complete Schedule A (either part 2 or part 3) as explained in the instructions for generation-skipping transfers;
4. Complete Schedule D as instructed;
5. Complete only lines 10 and 11 of Schedule A, Part 4; and
6. Complete Part 2 - Tax Computation (with respect to the GST tax portion).

10. Gifts Involving a Defined Value Clause

In 2012 a Tax Court Memorandum Opinion was issued in Wandry v. Commissioner⁸⁶ that lead to an undeniable trend in the way many taxpayers made gifts of closely held business interests and other non-publicly traded property interests. Wandry involved a gift using a defined value clause (or formula based gift), so that the taxpayer gifted an interest in entity X with a fair market value as finally determined for estate and gift tax purposes equal to \$Y. Obviously, this sort of approach has its advantages for taxpayers. If a defined value clause works, a donor can effectively avoid paying gift tax by making a gift of an interest in an entity in an amount that does not exceed his or her applicable exclusion amount. This may be the preference of those who want to take full advantage of their gift tax exclusion amount. In contrast, if the donor transfers a fixed percentage interest in nonmarketable assets, there is always a risk that, upon audit, the IRS could argue that the fair market value of the assets transferred is higher than reported by the donor. To the extent that the increase in the value for tax purposes exceeds the donor's gift tax exclusion amount, gift tax (and possibly GST tax) will be due on the transfer (potentially with interest and penalties).

The IRS has not acquiesced to taxpayers' positions on defined value clauses. The Service argues that it should not be bound by defined value clauses, because such clauses violate public policy by removing all incentive to audit a gift reported in this manner. There have been several taxpayer victories in court cases testing various forms of defined value clauses.⁸⁷ But notably, all the reported cases have involved a charity that received excess value over the stated dollar amount passing to or for the benefit of family members, and some (but not all) of the reasons given in those cases for rejecting the IRS's public policy arguments apply specifically where a charity is involved (i.e., public policy encourages charitable gifts).

While the jury is still out on whether a defined value clause is binding on the IRS, you should be aware that use of defined value clauses has been on the rise in recent years. Before reporting any gift of this type, you need to determine if a formula clause was used to define the amount of your clients' gifts. Although Wandry was a taxpayer victory, one point of ammunition for the IRS in the case was that, despite using a formula clause in the gift assignment document, the taxpayer described gifts on Form 709 as fixed percentage interests in the entity transferred instead of gifts of an interest in an entity subject to a formula. The IRS

⁸⁶ T.C. Memo 2012-88 (March 26, 2012).

⁸⁷ See *McCord v. Comm'r*, 461 F.3d 614 (5th Cir. 2006); *Christiansen v. Comm'r*, 130 T.C. 1 (2008), aff'd, 586 F.3d 1061 (8th Cir. 2009), *Petter v. Comm'r*, T.C. Memo. 2009-280 aff'd, 653 F.3d 1012 (9th Cir. 2011), and *Hendrix v. Comm'r*, T.C., Memo. 2011-133.

argued that the taxpayer should be required to use the reported fixed percentage gift as the amount actually transferred. Although the court ultimately decided that the transfer was the amount actually defined in the formula clause, you can be that the tax return preparer was quite worried about this apparent error on the gift tax return. None of us want to be the person who makes this mistake! Instead, the description of a gift where a Wandry-type clause is used should read something like this:

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 number	C 2632 (c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Donna M. Hayward 2012 Irrevocable Trust 2915 Maple Place Dallas, Texas 75222 Donna M. Hayward, Trustee EIN: 55-5555555 Donor gifted an interest in the stock of Hayward House, Inc., a Texas Corporation, with a fair market value equal to two million five hundred thousand dollars (\$2,500,000) to Donna M. Hayward, as Trustee of the Donna M. Hayward 2012 Irrevocable Trust created on May 1, 2012 (see Trust Agreement attached as Exhibit A). The trust is for the benefit of the donor's daughter, Donna M. Hayward, and her issue. The assignment agreement effecting the transfer of the Gifted Interest is attached as Exhibit B. Pursuant to the appraisal attached as Exhibit C, the donor believes the interest transferred was 225,000 shares of common stock in Hayward House, Inc.	x	649,000	5/30/2012	2,500,000		2,500,000

The description should not limit the gift to a fixed percentage. Rather, the description should make it clear that the gift is formula-based. The interest transferred may differ if there is an adjustment based on audit. It may be prudent to notate this possibility of adjustment on the books of the entity that was transferred and possibly on related tax filings as well, for purposes of consistency.

12. Front-Loaded 529 Plans

If your client so chooses, he or she may make a gift of cash to a qualified state tuition plan under Section 529 (a "529 plan"). As discussed above, cash gifts to 529 plans do not qualify for the non-gift exception for tuition transfers to a qualified education organization. However, cash gifts to a 529 plan do generally qualify for the gift tax and GST tax annual exclusion, and your client can choose to treat up to five times the annual exclusion amount in effect in a given year as if it were made ratably over a five year period beginning in the year of

the contribution.⁸⁸ In order to obtain this treatment, you must check the box for Question B located on Schedule A just above Part 1, (currently near the top of page 2 on Form 709). According to the instructions for Form 709, you must also attach a statement explaining your election that includes:

- The total amount contributed to each donee of a 529 plan (applying gift splitting and community property rules first);
- The amount for which the election is being made (applying gift splitting and community property rules first); and
- The name of the individual for whom the contribution was made.

The instructions also clarify the way you are to report this type of gift. In the year of the front loaded gift, you report one-fifth of the election amount plus any amount contributed to the 529 in excess of the amount permitted under the five-year election. If your client files form 709 in any subsequent year during the five-year period, then you should report on Part 1, Schedule A one-fifth of the amount contributed in the year in which the election was made, plus any amount contributed in that subsequent calendar year. If your client does not otherwise have a filing requirement in subsequent years, then he or she does not have to file a return just to report these remaining gifts.

Example: Your client, Grandma, made a gift in 2013 to a 529 plan for Granddaughter and contributed \$100,000. On Grandma's 2013 Form 709, you check the box for Question B on Schedule A. You attach a statement detailing that \$100,000 was contributed, that Grandma is electing to treat \$70,000 (\$14,000 x 5) as being ratably gifted over 5 years, and that Granddaughter is the beneficiary. On Part 1, Schedule A, you list a gift of \$44,000 (the \$14,000 annual exclusion amount for the current year plus the \$30,000 excess gift [\$100,000 gifted less the \$70,000 in annual exclusions]). If Grandma files a Form 709 for calendar year 2014, but makes no additional gift to Granddaughter or Granddaughter's 529 in 2014, then Grandma will report \$14,000 (one-fifth of the ratable portion of the 2013 gift) on Part 1, Schedule A. In column E you will list *2014* as the date of the gift according to the instructions for Form 709, even though the gift was actually made in 2013. We consider it a best practice to attach a statement clarifying the origin of this gift in subsequent years as well.

If your client dies during the five-year period following a front-loaded gift to a 529 plan, the portion deemed to be made in a year after your client's death will be included in your client's estate for estate tax purposes.⁸⁹

Example: Assume the facts from the previous example apply. If Grandma died in 2015, \$28,000 would be includible in her estate because she was deemed to have made the ratable portion of the gift for calendar years 2013, 2014, and 2015, but she did not survive for years 4 and 5 (2 years x \$14,000 per year ratable portion= \$28,000).

⁸⁸ IRC § 529(c)(2)(B).

⁸⁹ IRC § 529(c)(4)(C).

13. Split Interest Gifts to Charitable Organizations

Gifts to charitable remainder trusts (CRTs), charitable lead trusts (CLTs), and other similar charitable split-interest gifts. This is true even though there may be an offsetting charitable deduction for the portion of the gift to the charity, as the amount passing to the non-charitable beneficiary may be subject to gift tax. The taxability of the gift to the non-charitable beneficiary follows the general rules for reporting a gift as described above. As there are special rules and elections that can be made that affect the valuation of the gift for tax purposes, it will be important to report these types of gifts in order to make the appropriate elections. For example, a gift to a charitable split-interest trust can be valued based on the applicable interest rate (the Section 7520 rate) for the month of the transfer or any of the two preceding months. To make this election, the client will need to attach a special election to do so on his or her gift tax return.

Example: Harry (age 72) and Sally (age 70), who are married to each other, make a \$1,000,000 gift of community property to a CRT in April 2014. The trust will make annuity payments to both of them for their lifetimes, with the remainder to pass to the designated charitable beneficiary. The AFR in April was 2.2%, but it was 2.4% in February. By using the higher rate, the value of the charitable remainder (and the corresponding charitable income tax deduction) will be more. Harry and Sally can use the higher rate in calculating the gift, but only if an election to do so is made on both their income tax return and their gift tax return filed for the year in which the gift was made. Once the value of the charitable interest is calculated,⁹⁰ this amount will be reported as a charitable gift. In addition, Harry will be deemed to have made a gift to Sally due to the actuarial difference in the values of their interests (i.e., Sally's interest worth is more than Harry's, as she is younger), however, this gift should qualify for the gift tax marital deduction.

G. Appraisal Issues

It is our job to work with our clients to make sure all the gifts reported on Form 709 are adequately disclosed. Adequate disclosure is nothing to take lightly. Although your client may obtain an appraisal of the asset transferred for other reasons, a key reason for obtaining an appraisal for federal transfer tax purposes is to ensure that you comply with an otherwise nebulous set of Treasury Regulations regarding adequate disclosure. As return preparers, we should absolutely make sure that any appraisal attached to a Form 709 we prepare meets the standard for a qualified appraisal that is deemed to adequately disclose a transfer and start the statute of limitations. We recommend you use an adequate disclosure checklist and review the appraisal to make sure it passes muster as a qualified appraisal under Treas. Reg. § 301.6501I-1(f)(2)(iv).

Above and beyond making sure that an appraisal meets the standard for adequate disclosure under Treasury Regulations, you should recognize that you may be the only person who lays eyes (in a meaningful way) on an appraisal before it reaches the eager hands of an IRS estate tax attorney flagging gift tax returns for audit. With that in mind, we can best serve our

⁹⁰ Treas. Reg. §§ 1.664-2(c), 1.664-4, 1.7520-1(a).

clients if we go beyond asking if the report meets the adequate disclosure standard and ask ourselves if the report is any good. One of the most important things you can do is check to see if the interest transferred matches the interest that was appraised. Careful scrutiny should be paid to any discounts applied. Do the discounts seem reasonable? Is there any other discount that the appraiser should have considered (e.g., lack of control discount, lack of marketability discount, investment attractiveness discounts, discounts for undivided interest in real estate, built-in-gain discounts, blockage discounts, key person discounts, market absorption discounts)?

Yet another item tax preparers should consider is whether or not you are able to reach the same conclusion of value that the appraiser reached in determining the fair market value of the subject interest. You might be surprised how often errors occur on the most important chart in the entire appraisal. Lastly, you should spot check the report for glaring errors and do a final evaluation. Does the report pass the smell test? This is always the final question on our checklist. Sometimes, the elements are there, but something doesn't seem right. If the report does not pass your smell test, there are increased odds that it will not pass the reviewing IRS estate and gift tax attorney's smell test.

Appendix B attached to this outline is a sample checklist for review of appraisals. The checklist is broken down into questions geared towards adequate disclosure and questions geared towards other aspects of an appraisal.

For an incredibly comprehensive discussion of the appraisal process in connection with filing Form 709, see Scott A. Bowman, Timothy K. Bronza, Stephanie Loomis-Price, and David Pratt's outline, *Wrapping Up Your Gift Tax Return with a Tidy Bow; Reporting Gifts with an Eye Toward Audit*, presented at 48th Annual Heckerling Institute on Estate Planning, January 15, 2014.

H. Technical Issues

1. Who Files?

The donor is obligated to file Form 709.⁹¹ In certain circumstances discussed at length above regarding split gifts and gifts of community property, a donor's spouse may also be required to file Form 709. A court-appointed guardian may file Form 709 on behalf of an incompetent donor.⁹² While an agent may not file Form 709 on behalf of a donor purely for convenience, an agent of a donor may file Form 709 on behalf of a donor if the donor is unable to file for himself or herself because of illness, absence, or non-residence, as long as (1) the agent attaches a statement explaining the reason the donor is unable to file and (2) the donor ratifies the return if and when he or she is able to do so.⁹³

⁹¹ IRC § 6019.

⁹² Treas. Reg. § 25.6019-1(g).

⁹³ Treas. Reg. § 25.6019-1(h).

If the donor dies before filing a gift tax return that is required to be filed, the executor or administrator of the donor's estate must file the gift tax return on behalf of the donor.⁹⁴

2. When to File?

The first day that Form 709 may be filed is on January 1st of the year following the calendar year in which the donor made gifts (just in case you do not have New Year's Day plans) and the due date for Form 709 is April 15th of the year following the calendar year in which gifts were made.⁹⁵ If April 15th falls on a Saturday, Sunday, or a legal holiday, then Form 709 is due on the next succeeding weekday that is not a legal holiday.⁹⁶

There is no penalty for filing a late gift tax return if no tax is due with the return. The only consequence is that the statute of limitations on a gift that is required to be reported will not begin to run until the gift is reported. However, if a return is expected to be filed, we recommend that the taxpayer request an extension of time to file. If your client expects to owe gift or GST tax and is unable to file timely, then in addition to the request for an extension of time to file the gift tax return, he or she must pay the estimated tax owed by the original due date, because an extension of time does not extend the due date for a gift tax (or GST tax) payment.⁹⁷ This payment is made by using the payment voucher in Part III of Form 8892 (Form 8892-V). According to the instructions for Form 709, an extension to file Form 709 can be obtained by one of two methods:

- a) *By extending the time to file income tax return.* If your client seeks an extension of time to file his or her income tax return by filing Form 4868 by the original income tax return due date, he or she will receive an automatic extension to file Form 709 for the same calendar year to October 15th of the same calendar year (or the next weekday if the October 15th falls on a Saturday, Sunday, or legal holiday). This is the only action that needs to be taken if no gift or GST tax is due. If there is gift or GST tax due, that amount should be paid with the extension by using form 8892-V.
- b) *By filing Form 8892.* A taxpayer who does not seek an income tax extension can obtain an automatic six-month extension to file form 709 by filing Form 8892. Remember, if you are filing multiple gift tax returns for spouses, a Form 8892 must be filed for EACH spouse in separate envelopes. If there is gift or GST tax due, that amount should be paid with the extension by using form 8892-V.

An executor who files Form 709 on behalf of a deceased donor must file the donor's form 709 no later than the earlier of:

⁹⁴ Treas. Reg. § 25.6019-1(g).

⁹⁵ IRC § 6075(b)(1); Treas. Reg. § 25.6075-1.

⁹⁶ Treas. Reg. § 25.6075-1(d).

⁹⁷ Treas. Reg. § 25.6081-1.

- a) The due date (including extensions) for filing the donor's Form 706 (if required), which is normally nine months from the donor's date of death (prior to application of any extension); or
- b) April 15th of the year following the calendar year in which the gift(s) were made (unless an extension is granted as to the return).⁹⁸

3. Where to File?

If using United States Postal Service send Form 709 to the following address:

Department of Treasury
Internal Revenue Service
Cincinnati, OH 45999

You may also use a private delivery service to file Form 709. However, only certain private delivery services selected by the IRS meet the "timely mailing as timely filing/paying rule of IRC § 7502. Currently, these include:

- DHL Express: DHL Same Day Service;
- FedEx: FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2Day, FedEx International Priority, FedEx International First; and
- UPS: UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

You should retain written proof of the mailing date, especially if you use a private service. We recommend that returns sent by USPS be sent certified mail, return receipt requested. If you use a private delivery service to File Form 709 send the return to:

Internal Revenue Service
201 West Rivercenter Boulevard
Covington, KY 41011

4. What, no e-filing?

Inevitably, every year we have a client who is new to Form 709. Clients are accustomed to e-filing their annual Form 1040. When we tell them that e-filing is not available for Form 709 they seem frustrated by the complications of filing a paper return. If you are working with a client who is new to gift tax returns, it may be a good idea to tell them that e-filing is not an option at this time; they will be required to physically sign the return before you send it in.

⁹⁸ IRC § 6075(b)(3).

III. Annual Exclusion Gifts

A. What Qualifies?

Any individual may make a gift to or on behalf of any other individual of up to a cumulative amount of \$14,000 in the calendar year without incurring any gift tax liability for calendar years 2013 and 2014, and without using up any of his or her lifetime gift tax exclusion amount; provided however that these “annual exclusion gifts” are gifts of a “present interest.”⁹⁹ As discussed in more detail in Section II.B.1 above, the basic premise behind the present interest requirement is that the beneficiary of such a gift must have an unrestricted, present, and immediate right to use, enjoy, and benefit from the gift. If enjoyment or use of the property is delayed, then the present interest requirement is not met.¹⁰⁰ Your client can make annual exclusion gifts to an unlimited number of beneficiaries annually. There is no requirement that the donees bear any particular relationship to the donor in order to qualify for the annual exclusion. What’s the catch? Well, there are several.

First, the annual exclusion is a “use it or lose it” provision of legislative grace. If you do not use up your entire annual exclusion amount for your child in 2014, you do not get to carry forward unused amounts into future years. Second, the gift tax annual exclusion was designed to provide a way for most ordinary transactions that family members have with one another during the year (such as holiday gifts, birthday gifts, etc.) to be excluded from gift tax system. You may give \$14,000 to or on behalf of an individual per year, and that’s it. You cannot write your daughter a \$14,000 annual exclusion gift check AND buy her a Rolex for her birthday AND take her on a trip during the summer in the same year, without dipping into your \$5.34 million (indexed for inflation in future years) unified gift/estate tax exclusion amount.

Third, the present interest requirement means that many gifts to trusts do not qualify for the annual exclusion. The whole concept of a trust is generally to hold property for the benefit of another person for later use. That doesn’t sound like a gift of a present interest does it? In order to make gifts to trusts qualify as gifts of a present interest many trusts contain special “Crummey” provisions.¹⁰¹ Here is how a Crummey provision works: when a gift is made to a trust, the withdrawal beneficiary is granted a right to withdraw all or a portion of the amount contributed to the trust within some specified time period, generally thirty days or longer.¹⁰² It is common for a trust to have multiple withdrawal beneficiaries so that the donor can take advantage of annual exclusion amounts for multiple beneficiaries. How do you know if the trust has Crummey provisions? Well, if you haven’t done so before, you will need to dust off the trust agreement and read it. This is particularly important if the client is new to you and you are relying on returns prepared by their former preparer. Just because a prior gift tax return reported gifts to a trust as qualifying for the annual exclusion amount doesn’t mean that the trust contains Crummey provisions. When you read through the trust agreement, the Crummey provisions may be labeled as “rights to withdraw” or something similar. Absent the inclusion of those words or

⁹⁹ IRC § 2503(b)(2).

¹⁰⁰ See Treas. Reg. § 25.2503-3(b).

¹⁰¹ *Crummey v. Comm’r*, 397 F.2d 82 (9th Cir. 1968) is the case in which the court blessed provisions in a trust that allowed gifts to the trust to qualify as gifts of present interest to those given withdrawal rights.

¹⁰² A thirty day withdrawal period is the shortest that has been approved by the IRS to date in private letter rulings. See PLR 8813019.

words of similar meaning in the trust agreement, you probably do not have a trust to which annual exclusion gifts can be made. If you are unsure if the trust contains Crummey withdrawal rights or the actual amount of any rights described in the agreement, then it may be best to discuss this topic with the client's attorney.

Also, there is a frequent misconception among clients that \$14,000 is somehow per trust beneficiary, and therefore, the client can simply create multiple trusts for the benefit of the same individual to double or even triple his or her annual exclusion gifting to that individual. Frequently, Grandma thinks that she can give \$14,000 to the Insurance Trust of which Jimmy is a beneficiary and \$14,000 to the education trust of which Jimmy is a beneficiary in the same year and fall within the annual exclusion amount rules because these were gifts to two different trusts. Wrong! The fact that there are multiple trusts for the benefit of the same individual does not change the annual exclusion amount. Grandma may still only claim \$14,000 in annual exclusion for gifts to or on behalf of Jimmy for the year.

Finally, it will be important to determine any other limitations on withdrawal rights that may be applicable in the trust language. Some Crummey provisions limit withdrawal rights to the greater of \$5,000 or 5% of the trust asset per beneficiary annually. This limitation appears because of an IRS rule that treats a withdrawal right beneficiary who is given the right to withdraw funds from the trust, and declines to do so by allowing his or her withdrawal right to lapse, as making a gift to the trust to the extent he or she declines to withdraw funds to which he or she may be entitled that exceed the greater of \$5,000 or 5% of the value of the trust assets.¹⁰³ The result of this deemed contribution would be that part of the trust be includible in that beneficiary's estate for estate tax purposes, which is generally not what is intended. One way to avoid that result is to limit the withdrawal right to the lesser of the annual exclusion amount or the so-called "Five-or-Five" limitation under IRC § 2514. In that scenario, you may have a beneficiary who is limited to a \$5,000 withdrawal right despite the annual exclusion amount being \$14,000 if the value of the assets of the trust is relatively low.

An alternative to the "Five-or-Five" power is the "hanging power." A hanging power limits the lapse of a power to withdraw to the "Five-or-Five" amount each year, and leaves any excess amount still subject to the withdrawal power "hanging" for future years. Therefore, the hanging power is a gradually lapsing power, designed to keep the withdrawal beneficiary from ever making a gift to the trust in accordance with § 2514. The idea is that, in years in which the withdrawal right beneficiary does not receive a right to withdraw any new funds, the withdrawal right beneficiary can catch up on lapsing, and hopefully in the end, the withdrawal right beneficiary lives until the right of withdrawal lapses completely. A hanging power lapses each year only to the extent of the Five-or-Five limitation, and will gradually disappear over the years, once gifts to the trust are no longer being made.

Example: Derrick establishes an insurance trust with Crummey withdrawal rights for the benefit of his son Sam. Sam has the power to withdraw contributions to the trust in an amount not to exceed the annual exclusion amount. The power to withdraw is a hanging power, which lapses in the Five-or-Five amount each December 31. Annual gifts to the trust to pay premiums are \$7,000, and Derrick makes \$7,000 payments for three years only and then makes no

¹⁰³ IRC § 2514(e).

additional payments. Sam's withdrawal rights and the lapsed amount of those rights are as follows.

- Year 1: Sam can withdraw the entire \$7,000 and this is the amount reported on the gift tax return as a gift to Sam. \$5,000 is permissible present year lapse amount and \$2,000 "hangs" for lapsing in future years.
- Year 2: Sam can withdraw the entire \$7,000 and this is the amount reported on the gift tax return as a gift to Sam. \$5,000 is permissible present year lapse amount and \$4,000 "hangs" for lapsing in future years (\$7,000 present year gift - \$5,000 lapse + \$2,000 hanging amount from prior year).
- Year 3: Sam can withdraw the entire \$7,000 and this is the amount reported on the gift tax return as a gift to Sam. \$5,000 is permissible present year lapse amount and \$6,000 "hangs" for lapsing in future years (\$7,000 present year gift - \$5,000 lapse + \$4,000 hanging amount from prior year).
- Year 4: No present year gift, so nothing is reported on the gift tax return. \$6,000 is the hanging amount from previous years. \$5,000 is permissible present year lapse amount and \$1,000 "hangs" for lapsing in future years.
- Year 5: No present year gift, so nothing is reported on the gift tax return. \$1,000 is the hanging amount from previous years. \$1,000 lapses, and there is no remaining amount to lapse in future years.

If the beneficiary dies before his or her withdrawal rights lapse completely, the value of the hanging rights will be included in the beneficiary's estate for federal estate tax purposes.

B. "Crummey" Notices

It is certainly a good practice for the trustee or donor to provide reasonable notice to a withdrawal beneficiary of his or her right to withdraw a contribution made to a trust. It is a best practice to provide written notice to the beneficiary of his or her withdrawal right-- a so-called "Crummey notice" -- and have the beneficiary sign and return the notice to the trustee of the trust for safekeeping in the trust's records. Providing *Crummey* notices may even be a mandatory requirement under the terms of some trust agreements. If a beneficiary is a minor, the minor's legal guardian should sign the *Crummey* notice on the minor's behalf. The IRS has taken the position that gifts will not qualify for the annual exclusion if the beneficiary does not receive specific notice of the gift in question.¹⁰⁴ However, this position is questionable because in the seminal *Crummey* case, the withdrawal beneficiaries did not have actual notice of the gifts. Rather, the court relied on the existence of the withdrawal right (not notice of the withdrawal right) in determining that gifts to the trust were gifts of a present interest.¹⁰⁵ The Service's requirement of withdrawal right notice has also been recently called into question after the issuance of the Tax Court Memorandum Opinion 2011-209 in which the grantor's direct payments of insurance premiums to an insurance carrier for a policy owned by a trust were

¹⁰⁴ Tech. Adv. Memo. 9532001.

¹⁰⁵ See *Crummey v. Comm'r*, 397 F.3d 82 (9th Cir. 1968).

deemed to be gifts of a present interests that qualified for the annual exclusion with respect to the trust's withdrawal right beneficiaries even though the premium payments were never directly held by the trustee of the trust and no notice was given to the withdrawal beneficiaries regarding their withdrawal rights.¹⁰⁶ In spite of these indications to the contrary, the IRS has been asking for copies of Crummey notices as a routine matter in recent gift tax return audits. Accordingly, it may be prudent to request copies of these letters annually when you are gathering the information necessary to prepare the gift tax return.

When reporting a gift to a trust with Crummey provisions, we generally recommend the description reflect a gift to a trustee of the Trust, the EIN of the trust, and the trustee's address. We typically describe who the beneficiaries of the trust are and include a parenthetical that addresses who may withdraw funds and in what amount.

Example: Cash gift to Larry Brown, as Trustee of the Brown Trust (see trust agreement attached as Exhibit A), EIN 00-00000, 300 Crescent Court, Suite 1350, Dallas, TX 75201. The trust is for the benefit of the Donor's issue. Donor's son, Scott Brown and Donor's grandson, Scooter Brown, who both reside at 1234 Hillcrest Avenue, Dallas, Texas 75230, have the right to withdraw \$14,000 each pursuant to Section IV.B.1 of the trust agreement.

IV. Portability – Using a Deceased Spouse's DSUE Amount

A. Background

Portability was introduced beginning in January of 2011 thanks to legislation enacted as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 ("TRA 2010"). Portability was only implemented for 2 years initially under TRA 2010, but the concept was made permanent (and by permanent we mean, it's the law until Congressional whims change) by the American Taxpayer Relief Act of 2012.

The portability law represents a major paradigm shift in the way a taxpayer's exclusion amount (also known informally as the "estate tax exemption amount" or "unified credit amount") is calculated. Prior law employed a "use it or lose it" approach to each individual's exclusion amount. But portability allows a deceased spouse's unused exclusion amount ("DSUE Amount") (i.e., that portion of the deceased spouse's unused \$5.34 million [for 2014] exemption) to be transferred to the deceased spouse's surviving spouse.¹⁰⁷ Now taxpayers don't just have an exclusion amount, they have an "Applicable Exclusion Amount" which is calculated as follows:

Applicable Exclusion Amount = Basic Exclusion Amount (in 2014 this is the remaining amount of donor's personal \$5.34 million exclusion amount) + DSUE Amount

You probably are not surprised to learn that there are several requirements in order to take advantage of portability. The DSUE election may only be made by the executor of the deceased spouse's estate timely filing Form 706—that is a Form 706 that would not otherwise be

¹⁰⁶ *Est. of Clyde W. Turner v. Comm'r*, T.C. Memo. 2011-209 (Aug. 30, 2011).

¹⁰⁷ IRC § 2010(c)(4).

required to be filed except to take advantage of portability.¹⁰⁸ The IRS reserves the right to examine the deceased spouse's Form 706 until the end of the statute of limitations for the surviving spouse's estate.¹⁰⁹

Another important caveat with respect to the DSUE Amount is that a surviving spouse can only use the DSUE Amount of his or her "*last deceased spouse*."¹¹⁰ This means that it is technically possible for a surviving spouse's DSUE Amount to change throughout his or her life depending on whether he or she marries a successive spouse who also predeceases the surviving spouse, whether the surviving spouse uses DSUE Amounts of previously deceased spouse before a successive spouse dies, and how many predeceased spouses the surviving spouse has during his or her lifetime.

Note that portability only applies to a spouse's remaining exclusion amount for gift tax/estate tax purposes. Portability of deceased spouse's unused GST tax exclusion amount is not permitted.

Example: Bob dies January 1, 2014. His wife Sally survives him. She is executor of Bob's estate and timely files Form 706 making the portability election to preserve Bob's unused exemption. Bob had a \$2 million estate, and thus \$3.34 million in portability exemption is transferred to Sally as her DSUE Amount. Sally meets the mysterious and very wealthy Nelson shortly thereafter. They marry, but unfortunately Nelson chokes on a piece of coconut shrimp on the first night of their honeymoon and dies. Nelson left property equal to his entire \$5.34 million [for 2014] Exclusion Amount to a trust for his children from a prior relationship. Sally never got around to using her DSUE Amount ported from Bob's estate before marrying Nelson. Upon Nelson's death, the DSUE Amount Sally received from Bob's estate vanishes into thin air, because Bob is no longer Sally's last deceased spouse.¹¹¹

The surviving spouse may use the DSUE Amount during life or upon death.¹¹² If a taxpayer has acquired a DSUE Amount from one or more predeceased spouses then Temporary Treasury Regulations clarify that the taxpayer's DSUE Amount is applied prior to his or her Basic Exclusion Amount with respect to lifetime gifts.¹¹³

¹⁰⁸ IRC § 2010(c)(5).

¹⁰⁹ IRC §§ 20.2010-2T(d), 20.2010-3T(d), 25.2505-2T(e).

¹¹⁰ IRC § 2010(c)(4).

¹¹¹ But *see* Treas. Reg. § 25.2505-2T(c). Temporary Treasury Regulations from June 2012 correct a potential flaw with the concept of the "last deceased spouse," which was not comprehensively defined in the statute, where a surviving spouse has multiple predeceased spouses and previously applied DSUE Amount(s). The Regulations provide that if a spouse obtains a DSUE Amount ported from a prior spouse which he or she uses during his or her lifetime, and that surviving spouse remarries someone who also predeceases them, the surviving spouse will receive credit for the DSUE Amount already used, even if a subsequent spouse predeceases that surviving spouse and leaves a reduced (or no) DSUE Amount. In fact, most practitioners believe in the so-called "black widow" scenario described above, a surviving spouse could take advantage of multiple pre-deceased spouses' DSUE Amounts as long as he or she spends the DSUE Amounts before his or her subsequent spouse dies. It's a wonder we don't have these wealthy "black widows" cruising nursing homes looking for poor sickly future spouses.

¹¹² Treas. Reg. § 25.2505-2T.

¹¹³ Treasury Decision 9593 (June 18, 2012).

B. When Does the DSUE Amount Come into Play on Form 709?

The good news is that you will probably not be dealing with DSUE Amounts on the vast majority of the gift tax returns you prepare, because in order for the portability rules to be relevant:

- i. Your client has to have a predeceased spouse who died after December 31, 2010; and
- ii. The executor of your client's predeceased spouse's estate had to timely file (what is essentially an optional) Form 706 making the DSUE election.¹¹⁴

C. If Portability is Relevant, What's Next?

1. Schedule C, Part 1

Enter the DSUE Amount from your client's most recent deceased spouse (whose date of death is after December 31, 2010 and whose executor made the election on Form 706 to preserve unused exclusion amount) on Schedule C of Form 709. You will also need the name of the most recently deceased spouse with a DSUE Amount, that individual's date of death, confirmation that the portability election was made, the DSUE Amount previously used by your client on prior gift transfers, and the date(s) of those prior transfers.

2. Schedule C, Part 2

Schedule C, Part 2 is only used if your client is the proverbial unicorn of estate planning; that is, if the client has multiple predeceased spouses (who died after December 31, 2010) with DSUE Amounts (think of the "black widow" who marries destitute sickly individuals for the purpose of collecting multiple DSUE Amounts). It is interesting to note that the IRS has provided six lines for this purpose! In Schedule C, Part 2 enter the same type of information you entered for the client's most recently deceased spouse for all other previously deceased spouses with DSUE Amounts.

Then, you will calculate the Client's Applicable Exclusion Amount (called the Applicable credit amount on Schedule C, Part 2) by adding the available DSUE Amounts from previously deceased spouses and adding it to the client's Basic Exclusion Amount (that is the personal exclusion amount irrespective of DSUE Amounts or what remains of his or her \$5.34 million [for 2014]). Remember, even though you are asked to add together DSUE Amounts from your client's most recently deceased spouse and all other previously deceased spouses, your client may only apply the DSUE Amount of his or her most recently deceased spouse on the current Form 709 you are preparing.

¹¹⁴ Note that the IRS has issued relief to taxpayers who failed to file a timely estate tax return solely for the purpose of electing portability. See Revenue Procedure 2014-18, 2014-7 IRB. Delinquent filers will have until December 31, 2014 to file a return. After that date, relief will only be granted through the 9100 relief process (i.e., a private letter ruling request).

V. GST Tax Issues

A. Annual GST Tax Exclusion, Lifetime GST Tax Exemption Amount, GST Tax Rate

Certain direct skip transfers that qualify for the gift tax exclusion under § 2503(b) or (e) are also excluded from GST tax through the GST tax annual exclusion. However, the GST annual exclusion is much more limited than the gift tax annual exclusion.

An outright transfer to a skip person is not subject to GST tax if it qualifies for the gift tax exclusion under § 2503(b) or (e).

Example: In 2013, Grandma gives her granddaughter Greta \$14,000 and also pays tuition on Greta's behalf directly to SMU. The cash gift and payment of tuition would not be taxable for GST purposes because of the GST annual exclusion.

Gifts to trusts that are direct skips only qualify for the annual GST exclusion if the trust meets the following requirements:

- (i) The trust is for the exclusive benefit of one beneficiary (a skip person) during the beneficiary's lifetime; and
- (ii) The trust contains terms requiring that the remaining trust assets are includible in the sole beneficiary's gross estate if the sole beneficiary dies before the trust terminates.

Note that most trusts that contain Crummey withdrawal rights that qualify for the annual for the gift tax annual exclusion do not meet the criteria for a § 2642(c) trust.

However, it is also important to note that a payment from a non-exempt GST trust is not a generation-skipping transfer if it would qualify for the exclusion under IRC § 2503(e) as a direct payment for certain medical and educational expenses paid directly to a service provider on behalf of a skip person.

Example: Grandma creates a trust that is not GST exempt for the benefit of her children and grandchildren. The trustee has the discretion to pay income and principal to any one or more of the beneficiaries. Distributions by the trustee directly from the trust to a medical care provider who treated Grandchild would not be taxable distributions subject to the GST tax.¹¹⁵

¹¹⁵ See PLR 9823006. However, please be aware that the President's 2014 and 2015 budget proposals each include a provision intended to clarify that the exclusion from the definition of a GST under Section 2611(b)(1) applies only to payments of medical expenses and tuition made directly by a living donor and not to trust distributions, even if made for the same purposes. Department of Treasury, "General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals," at 148 (Apr. 10, 2013) and "General Explanations of Administration's Fiscal Year 2015 Revenue Proposals," at 169 (March 2014).

To the extent a transfer is not covered by the GST annual exclusion or the medical or educational exception, the taxpayer may allocate his or her GST exemption amount by means of affirmative allocation or automatic allocation to any of the donor's transfers of property.¹¹⁶ The GST exemption amount for any calendar year is the amount of the Basic Exclusion Amount (\$5,250,000 for 2013 and \$5,340,000 for 2014).¹¹⁷ Once GST exemption has been allocated, the allocation is irrevocable (absent special relief granted by the IRS).¹¹⁸

Every trust has an inclusion ratio that determines which portion of each future distribution or termination will be subjected to the GST tax. A GST inclusion ratio of zero means that the trust (and distributions from the trust) is totally exempt from the GST tax. A trust with an inclusion ratio of one means that all generation-skipping transfers with respect to the trust will be fully subject to the GST tax (with a current top tax rate of 40%).¹¹⁹ A trust with an inclusion ratio greater than zero but less than one results in complication. For that reason, most clients' advisors try to avoid having a trust with such an inclusion ratio at all costs.

For a direct skip (as defined below), the statute of limitations on the calculation of a particular inclusion ratio does not run until no additional GST tax may be assessed with respect to the direct skip.¹²⁰ With respect to transfers from an indirect skip (as defined below) the inclusion ratio for the trust becomes final upon the later of (1) the expiration of the period for assessment with respect to the first GST tax return filed using that inclusion ratio; or (2) the expiration of the period for assessment of federal estate tax (if no estate tax return was filed, the period for assessment is determined as if the return were actually timely filed).¹²¹ If the transferor dies after the first taxable distribution or termination occurs with respect to the trust in question, then the inclusion ratio will generally become final three years and nine months from the transferor's death.¹²²

B. Determining if a Gift is a "Skip"

1. Background Definitions

Skip person. A skip person may be a natural person or, in certain circumstances, a trust. A natural person is a "skip person" if he or she occupies a generation that is two or more generations below the transferor's generation.¹²³ Spouses and ex-spouses are assigned to the transferor's generation assignment.¹²⁴ If that natural person is unrelated to the transferor, then "generations" are not an appropriate measurement. In that case, a natural person is a skip person as to the donor if he or she is more than 37 ½ years younger than the donor.¹²⁵

¹¹⁶ IRC § 2631(a).

¹¹⁷ IRC § 2631(c).

¹¹⁸ IRC § 2631(b).

¹¹⁹ IRC § 2641.

¹²⁰ Treas. Reg. § 26.2642-5(a).

¹²¹ Treas. Reg. § 26.2642-5(b).

¹²² *Id.*

¹²³ IRC § 2613(a)(1).

¹²⁴ IRC § 2651(c)(1).

¹²⁵ IRC § 2651(d). A person who is no more than 12 ½ years younger than the transferor is deemed to be in the transferor's generation for GST purposes. A person who is more than 12 ½ years younger than the transferor but is no more than 37 ½ years younger than the transferor is deemed to be one generation below the transferor. A person

A trust is considered a “skip person” if:

- a) All the interests in the trust are held by skip persons; or
- b) At the time of a particular transfer to the trust, there is no person holding an interest in the trust, and, at no time after such transfer, may a distribution (including distributions upon termination) be made from such trust to a non-skip person.¹²⁶

Non-skip person. A “non-skip person” means any person who is not a skip person (creative, huh?).¹²⁷

GST Trust. The determination of whether a trust is a “GST Trust” or not will be important for purposes of understanding how the automatic allocation rules for GST tax purposes apply. The designation of a trust as a GST Trust does not mean that no transfers from it can ever be subject to the GST tax. It is simply a designation used for the automatic allocation rules. A “GST Trust” is any trust that could have a transfer to a skip person with respect to the transferor *unless* one of the following exceptions applies:¹²⁸

(i) Age 46 Test

Even if a trust’s terms provide that there may be a distribution to a skip person as to the transferor, the trust is not considered a GST Trust if the trust terms provide that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons (1) before the date that the individual attains the age of 46; (2) on or before one or more dates specified in the trust that will occur before the date that such individual attains the age of 46; or (3) upon the occurrence of an event that, in accordance with regulations prescribed by the Treasury Secretary, may reasonably be expected to occur before the date such individual attains age 46.¹²⁹

(ii) Ten Year Age Difference

Furthermore, a trust is not a “GST Trust” if the terms of the trust provide that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the trust who is more than 10 years older than such individual(s).¹³⁰

who is more than 37 ½ years younger than the transferor but no more than 62 ½ years younger is deemed to be two generations below the transferor, and so on in 25 year increments for each successive generation. In certain circumstances, where a death occurs out of natural order (e.g., a child predeceases a parent), that individual’s issue may be deemed to move up a generation (e.g., Grandpa has a daughter Julie, and a Grandson Jackson. Julie predeceases Grandpa. Jackson may be deemed to move up a generation and would no longer be a skip person as to Grandpa because of Julie’s death).

¹²⁶ IRC § 2613(a).

¹²⁷ IRC § 2613(b).

¹²⁸ IRC § 2632(c)(3)(B).

¹²⁹ IRC § 2632(c)(3)(B)(i).

¹³⁰ IRC § 2632(c)(3)(B)(ii).

(iii) Partial Estate Tax Inclusion Ratio

In addition, if the trust terms provide that if one or more individuals who are non-skip persons die on or before a date or event described in the first two exceptions, more than 25% of the trust corpus either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals, then the trust is not a GST Trust.¹³¹

(iv) Full Estate Tax Inclusion

A trust is not a GST trust if any portion of the trust would be included in the gross estate of a non-skip person (other than the transferor), if such person died immediately after the transfer.¹³²

When might this exception to the GST Trust definition creep up on you? It may apply in the so-called “Hanging Powers Trap.” In this type of situation, a non-skip person holds a hanging power and the amount subject to the hanging power (that is, the amount that exceeded the Five-or-Five power) would be includible in such beneficiary’s estate if he or she died immediately after the donor’s transfer. The flush language at the end of IRC § 2632(c)(3)(B) provides an exception to the exception that would cause the trust to be considered a GST Trust in the initial year of contribution (because the withdrawal right does not exceed the annual exclusion amount provided for in IRC § 2503(b)), but in years in which the beneficiary’s current withdrawal right amount plus any hanging amount exceeds \$14,000, the exception to the exception would not apply. This could leave your client in a lurch, if he or she assumed the trust was subject to the automatic allocation rules.

Example: In 2013, Mike transfers \$14,000 to an irrevocable life insurance trust for the benefit of his daughter Megan, with the remainder to Megan’s issue (not yet born). Megan is granted a 30 day *Crummey* withdrawal right with respect to the \$14,000 contribution that will lapse subject to the Five-or-Five amount. Megan allows her *Crummey* power to lapse unexercised. Because Megan was granted a *Crummey* withdrawal right, the entire \$14,000 contribution is covered by the annual gift exclusion. Mike doesn’t file Form 709 for 2013 since he did not make any other gifts that year and has no filing requirement. Consequently, no affirmative allocation of GST exemption was made. But because the amount subject to Megan’s withdrawal right is within the annual exclusion amount, automatic allocation of GST exemption applies to the trust, resulting in a zero inclusion ratio for the trust at the end of 2013. At the end of the 30 day period, Megan’s \$5,000 withdrawal right lapses and the remaining \$9,000 hangs. In 2014, Mike makes another \$14,000 transfer to the trust. Again this transfer is covered by Megan’s annual gift exclusion, and so Mike does not file Form 709 as he is not required to do so. Because Megan now has a withdrawal right as to the \$14,000 contribution made in 2014 and the \$9,000 hanging amount carried forward from 2013, her total right of withdrawal is \$23,000, which is greater than the annual exclusion amount. Consequently, the exception to the exception does

¹³¹ IRC § 2632(c)(3)(B)(iii).

¹³² IRC § 2632(c)(3)(B)(iv).

not apply, and the trust is no longer a GST Trust. Therefore, automatic allocation rules will not apply to the gifts made to the trust in 2014 and the trust now has a partial inclusion ratio for GST tax purposes.

(v) Charitable Lead Annuity Trust And Charitable Remainder Annuity Trust Exception.

As the name of the exception implies, a trust is not a GST trust if it is a charitable lead annuity trust (see IRC § 2642(e)(3)(A)), a charitable remainder annuity trust, or a charitable remainder unitrust (see IRC § 664(d)).¹³³ As the instructions to Form 709 indicate, transfers to CRUTs, CRATs, and pooled income funds are not transfers to skip persons, and therefore, no direct skips occur. You should always list these gifts in Schedule A, Part 1, even if all of the lifetime beneficiaries are skip persons.

(vi) Charitable Lead Unitrust Exception.

Finally, a trust is not a GST trust if it is a charitable lead unitrust with a non-skip person as a remainder beneficiary, provided that such remainder beneficiary is living at the end of the lead period.¹³⁴

2. Direct Skip

A “direct skip” is any transfer subject to estate or gift tax (even if no tax is payable) of an interest in property to a “skip person.”¹³⁵ Direct skips are reported on Schedule A, Part 2 of Form 709. Remember this can be a transfer to either a natural person who is a “skip person,” or to a trust that qualifies as a “skip person” (e.g., a gift to a pot trust for grandchildren).

Generally, the taxpayer’s GST tax exemption is automatically allocated to a direct skip (see automatic allocation rules below), so that the inclusion ratio of such property is zero, exempting the transferred property from current or future GST tax.¹³⁶ If the taxpayer wishes to opt out of automatic exemption of his or her GST tax exemption, the box in column C must be selected. In addition, you should attach a statement affirmatively opting out of automatic allocation of your client’s GST tax exemption. Once this election is made, the client needs to be prepared to pay GST tax.

3. Indirect Skip

An “indirect skip” is any transfer of property to a “GST Trust” from which a generation skipping transfer could occur in the future.

Example: Mom and Dad set up a trust for the benefit of their children, with remainder to their grandchildren. Such a transfer is an indirect skip, because one day the assets could be distributed to grandchildren. The same result would occur

¹³³ IRC § 2632(c)(3)(B)(v).

¹³⁴ IRC § 2632(c)(3)(B)(vi).

¹³⁵ IRC § 2612(c)(1).

¹³⁶ See IRC § 2632(b).

even if the trust provided that distributions would be made to children and grandchildren during the term of the trust—because children (as non-skip persons) are entitled to distributions. Because the trust does not consist entirely of skip person beneficiaries, such a transfer would be considered an indirect skip. Transfers that are indirect skips are reported on Schedule A, Part 3.

4. Outright Gifts

Remember, generation skipping transfers can be made to natural persons and also with respect to gifts in trust. An outright gift to a grandchild is considered a direct skip to the grandchild unless the GST annual exclusion applies.

5. What seems to be a skip trust but is not?

A trust may seem to qualify as a skip person but actually does not if a charitable beneficiary named therein has an interest in the trust. A charity has an interest in a trust if the charity (i) has a present right to distributions (as opposed to being a mere permissible distributee or discretionary distributee), or (ii) the trust is a charitable remainder trust.¹³⁷

C. Automatic Allocation Rules

Congratulations! Hopefully you have been able to determine whether a particular gift is a gift subject only to gift tax (e.g., grandkids are not in the picture with respect to the gifts), a direct skip (i.e., gift to person or trust made up entirely of skip persons, tax is due absent GST exemption allocation), or an indirect skip (i.e., no tax is automatically due upon a transfer to a trust with skip and non-skip person(s) named as beneficiaries, but there could be a distribution from the trust or a termination of the trust one day in favor of skip persons).

1. How do the default automatic allocation rules work?

When a donor makes a GST, whether it is a direct or an indirect skip, outright or in trust, certain rules may apply that will automatically allocate the donor's GST exemption to the transfer.

If a taxpayer makes a direct skip during his lifetime, any unused portion of the taxpayer's GST exemption is automatically deemed to be allocated to the property transferred to the extent necessary to make the "inclusion ratio" for such property zero, or if the amount of the direct skip exceeds such unused portion, the entire unused GST exemption is allocated to the property transferred, creating a partial inclusion ratio.¹³⁸ To the extent the taxpayer has any remaining GST exemption and he or she makes an indirect skip during his or lifetime, then any unused portion of a taxpayer's GST exemption is automatically allocated to the property transferred to the indirect skip trust to the extent necessary to make the inclusion ratio of such trust zero. If the amount of the indirect skip exceeds the taxpayer's available GST exemption, the entire unused portion shall be allocated to the property transferred, creating a partial

¹³⁷ IRC § 2652(c)(1).

¹³⁸ IRC § 2632(b).

inclusion ratio.¹³⁹ If the trust in question does not qualify as a GST Trust, then there is no automatic allocation of GST exemption to the trust.

2. Elections

a) Direct Skip Election Out Option

A taxpayer may opt out of automatic allocation to Direct Skips.¹⁴⁰ This election can be made by checking the box in column C on Schedule A, Part 2 and paying the GST tax. You must attach a statement to Form 709 clearly describing the transaction and the extent to which the automatic allocation does not apply. As an alternative, reporting a direct skip on a timely filed Form 709 and paying the GST tax on the transfer will qualify as such a statement. Take note, tax will be due on any Direct Skip transfers for which your client opts out of automatic allocation.

b) Indirect Skip Election Options

A taxpayer has more election options with respect to transfers to trusts that could one day be subject to the GST tax. Such transfers are reported on Schedule A, Part 3. A check in column C could connote one of three options.

(i) Election 1: Opt Out, One Time

This election allows the taxpayer to opt not to have the automatic allocation rules apply to the current transfer made to the particular trust.¹⁴¹

(ii) Election 2: Opt Out, Forever (unless you change your mind)

You may elect not to have the automatic allocation rules apply to both the current transfer and any and all future transfers made to that particular trust.¹⁴² However, if a taxpayer wants to terminate an election to not have the automatic allocation rules apply to transfers made in the future, the taxpayer may “undo” his opt out.

(iii) Election 3: Opt in

You may elect to treat any trust as a GST Trust for the purposes of the automatic allocation rules.¹⁴³ This means that if at any time the trust does not qualify as a GST Trust within the meaning of IRC § 2632(c)(3), GST exemption will be automatically allocated to transfers to the trust nonetheless. The taxpayer must attach a “GST trust election

¹³⁹ IRC § 2632(c).

¹⁴⁰ IRC § 2632(b)(3).

¹⁴¹ See IRC § 2632(c)(5)(A)(i)(I).

¹⁴² See IRC § 2632(c)(5)(A)(i)(II).

¹⁴³ IRC § 2632(c)(5)(A)(ii).

statement” to a timely filed return for the year of the transfer identifying the trust, describing the transfer, and specifically providing that the taxpayer is opting in to GST Trust treatment.¹⁴⁴

In addition, Treasury Regulations provide that a taxpayer may opt out of other types of transfers, including (1) automatic allocation of GST exemption to one or more prior year transfers to property at the close of an ETIP,¹⁴⁵ (2) automatic allocation of GST Exemption to specified trusts (even if there is no current year transfer),¹⁴⁶ (3) automatic allocation to all future transfers made by the transferor to any and all trusts,¹⁴⁷ or (4) any combination of the options described above.¹⁴⁸

In addition to the steps above, in order to opt out of the applicability of the automatic allocation rules, the taxpayer must attach an “Election Out Statement” to a timely filed return. The Election Out Statement must (i) identify the trust in question, (ii) identify the transfers to which the election out applies, and (iii) state that the taxpayer is affirmatively electing out of the automatic allocation rules.

The taxpayer can terminate an election to not have the automatic allocation rules apply to current year and future transfers on a timely filed return for the year in which the taxpayer wants the election to terminate (whether or not a return is otherwise required to be filed.)¹⁴⁹ In such event the taxpayer must attach a “Termination Statement” to the timely filed Form 709 describing the prior year election made and the extent to which a prior year election is being terminated or describing any current-year transfers to which the prior election should not apply.¹⁵⁰

c) Formula Allocations

Treasury Regulations specifically permit formula allocations of GST exemption to be used for transfers during life as well as at death. Those formula statements usually include language such as “an amount necessary to produce an inclusion ratio of zero.”¹⁵¹ We consider it a best practice to include a Notice of Allocation that describes every GST transfer for the year in question, whether the client is affirmatively opting in or opting out of automatic GST allocation to the trust, and to apply a formula allocation so that adjustments attributable to minimize the risk of a GST nightmare if values are adjusted on the return. Furthermore, such a formula allocation guards against mathematical error on the part of the return preparer.

d) Late Allocations

IRC § 2632(a)(1) provides that GST exemption may be allocated any time on or before the estate tax return due date. Furthermore, § 2632(e) provides for deemed allocation of unused GST exemption post-mortem. But while a timely filed allocation (that is, an

¹⁴⁴ Treas. Reg. § 26.2632-1(b)(3)(i)(A-D).

¹⁴⁵ Treas. Reg. § 2632-1(b)(2)(iii)(A)(1).

¹⁴⁶ Treas. Reg. § 2632-1(b)(2)(iii)(A)(3).

¹⁴⁷ Treas. Reg. § 2632-1(b)(2)(iii)(A)(4).

¹⁴⁸ Treas. Reg. § 2632-1(b)(2)(iii)(A)(5).

¹⁴⁹ Treas. Reg. § 26.2632-1(b)(2)(iii)(B).

¹⁵⁰ Treas. Reg. § 26.2632-1(b)(2)(iii)(E).

¹⁵¹ Treas. Reg. § 26.2632-1(b)(2)(i), (d)(1).

allocation filed by the Form 709 due date, including extensions) is made effective as of the date of the transfer giving rise to the generation-skipping transfer,¹⁵² a late allocation (that is, an allocation made after the Form 709 due date for the transfer(s) in question), is effective as of the date the allocation is made.¹⁵³ The late allocation of GST exemption does not relate back to the date of the gift.

Obviously, the late allocation of GST exemption can have its advantages and it can have its disadvantages. Late allocation could allow you to wait and see whether a trust is a good candidate for your client's GST exemption. However, if the assets of the trusts appreciate greatly in value, your client may regret not allocating GST exemption at the beginning and "spending" less of his or her GST exemption.

To make a late allocation of GST exemption, the taxpayer can file a Form 709 at any time using the most current form with a notation such as, "SUPPLEMENTAL RETURN--ALLOCATION OF GST EXEMPTION ONLY" placed at the top of the return. The value of the assets for purposes of the amount of the allocation is the fair market value on the date of the election. However, because of the timing conundrum that this creates, the taxpayer can elect to treat the late allocation as if it was made on the first day of the month during which the late allocation is filed. This election can be made by including a statement that the election is being made, the applicable valuation date, and the fair market value of the trust assets on that date.¹⁵⁴

e) Allocation of Addition Indexed Amount (Received in Year Following the Gift)

Because the GST exemption is now indexed for inflation, we are encountering a new issue in preparing Form 709: how does a taxpayer allocate the additional GST Exemption amount received pursuant to the inflationary bump, and what values should be used? The IRS has not issued any guidance on this issue. What should you do to allocate the additional GST Exemption? This issue was discussed in an article published by Beth Shapiro Kaufman.¹⁵⁵ The suggestion in the article is that taxpayers should be able to apply the increase in the GST exemption in the year following the gift to the gifts reported on the prior year's Form 709 (e.g., the 2013 increase in exemption amount to the 2012 gifts). Ms. Kaufman reasons that, by the time Form 709 is due, the inflationary bump is known and can be included as part of the current year's Form 709. Because such an allocation would be made on or before the return's due date, it should not be considered a late allocation under Treasury Regulations. Rather, she believes it should be effective as of the date of the transfer, meaning the date of gift value should be applicable. Ms. Kaufman recommends attaching a second, separate Notice of Allocation to a timely filed gift tax return on which the gift is reported solely to allocate any use of the inflationary bump that the taxpayer received on January 1 of the year following the transfer. She admits there is no guidance on how to do this, but she believes it is a reasonable approach. She

¹⁵² Treas. Reg. § 2632-1(b)(4)(ii)(A)(1).

¹⁵³ *Id.*

¹⁵⁴ Treas. Reg. § 26.2642-2(a)(2) provides that in most circumstances a late allocation can use the value of the property to which GST exemption is allocated as of the first day of the month in which the allocation is filed. The election is still "effective" as of the date of filing.

¹⁵⁵ See LISI Estate Planning Newsletter #2140 (September 11, 2013) at <http://www.LeimbergServices.com>.

recommends the following formula allocation language: “Taxpayer allocates to the trust listed above the smallest amount of the Taxpayer’s GST Exemption necessary to produce an inclusion ratio (as defined in Internal Revenue Code Section 2642(a) for the trust that is closest to or, if possible, equal to zero, *as of the earliest date on which this allocation is effective, believed by the Taxpayer to be [insert the date of gift or if you wish to be more conservative, January 1, of the year following the transfer]*. This is a formula election that will change if values are changed on audit. Based on values as shown on this return, the amount of GST exemption allocated to this transfer is the amount shown above.” Only time will tell if this type of allocation will be effective as of the original date of the gift. If you find yourself in need of a little extra GST exemption amount for a client, this might be a solution to consider.

f) Allocation at the End of an ETIP

When an indirect skip that triggers the automatic allocation of GST exemption under Section 2632(c) is subject to the ETIP rules, it is deemed to have been made at the close of the estate tax inclusion period when the indirect skip is deemed to have occurred.¹⁵⁶ That means if you have a five-year GRAT, GST exemption is automatically allocated to the portion of assets remaining in trust at the end of the five-year term, in an amount equal to the fair market value of the assets on the date of the end of the GRAT term unless the taxpayer elects otherwise.

An allocation of GST exemption is made after the termination of the ETIP.¹⁵⁷ The value used for purposes of allocating GST exemption is the fair market value at the close of the ETIP period.¹⁵⁸ See Section II.F.10 above for more discussion on how to report allocation of GST exemption at the end of an ETIP.

D. Partially Exempt Trusts

1. Calculating the Inclusion Ratio

The inclusion ratio for a trust is initially determined by calculating the portion of the transfer that is not covered by the GST Exemption (or an exception to the GST rules such as the GST annual exclusion or medical or education exceptions), and dividing this amount by the value of the entire transfer.¹⁵⁹

Example: If the client transfers \$3,000,000 into a generation skipping trust and allocates \$2,000,000 of GST Exemption, the inclusion ratio would be:

$$\$1,000,000 / \$3,000,000 = 1/3$$

Subsequent transfers to an existing trust with a zero GST inclusion ratio may affect the trust’s inclusion ratio. If sufficient GST Exemption is allocated to the subsequent transfer, the trust will retain its zero inclusion ratio. It is not advisable to make additions to an

¹⁵⁶ IRC § 2632(c)(4).

¹⁵⁷ IRC § 2642(f)(1).

¹⁵⁸ IRC § 2642(f)(2).

¹⁵⁹ IRC § 2642(a)(2).

existing GST exempt trust in amounts that exceed the available GST Exemption. However, if there is not sufficient GST Exemption remaining, the inclusion ratio is redetermined as follows:

- First, the nonexempt portion of the trust (prior to the new transfer) is determined by multiplying the pre-transfer value of the trust assets by the existing inclusion ratio.
- Second, the value of this nonexempt portion is added to the portion of the new transfer that is not covered by a GST Exemption or exclusion.
- Third, the prior amount of non-exempt assets plus the additional amount of non-exempt assets is divided by the total value of the trust estate immediately following the new transfer.¹⁶⁰

Example: An existing trust with an inclusion ratio of 2/3 has trust assets valued at \$750,000 (meaning that \$500,000 is currently not covered by GST Exemption). If an additional \$500,000 is transferred to the trust, but only \$250,000 of GST Exemption is allocated to the new transfer, then the new inclusion ratio for the trust will be determined as follows:

$$(\$500,000 + \$250,000) / \$1,250,000 = 3/5$$

2. Qualified Severances

A qualified severance is a GST fix. Essentially, it is the process of dividing a single trust with an inclusion ratio greater than zero but less than one into two separate trusts with the same succession of interests and beneficiaries, except that one trust has a GST inclusion ratio of one and the other has a GST inclusion ratio of zero.¹⁶¹ A qualified severance may be made at any time,¹⁶² but the return and Notice of Qualified Severance should be filed by April 15th of the year immediately following the year in which the severance occurred or by the last day of the period covered by an extension.¹⁶³ A qualified severance should be reported by filing a Form 706-GS(T), or any subsequent form specified by the IRS. The filer should write “Qualified Severance” at the top of the return and attach a Notice of Qualified Severance to the return that clearly identifies the trust that is being severed and the new trusts created as a result of the severance. The Notice is required to include the inclusion ratio of the trust that was severed, the inclusion ratios of the new trusts resulting from the severance, and certain other information such as the name of the transferor, the name and date of creation of the original trust, the tax identification number of the original trust and the new trust, the date of severance, the fraction of assets received by the new trust, and the details related to the basis for funding the new trust.¹⁶⁴

¹⁶⁰ IRC § 2542(d).

¹⁶¹ IRC § 2642(a)(3).

¹⁶² IRC § 2642(a)(3)(C).

¹⁶³ IRC § 2642(e).

¹⁶⁴ Treas. Reg. § 26.2642-6(e).

VI. Identifying and Correcting Errors in Prior Returns

A. Amended Return

There is scant authority on what exactly can be accomplished by filing an amended Form 709. Here is what is known. There is no special return that needs to be used. Rather use the Form 709 for the year in question and mark the return as “AMENDED FORM 709 FOR GIFT(S) MADE IN [YEAR]” on the top of page 1. You should include attachments that explain the changes made. Filing an amended return extends the statute of limitations with respect to the gifts appearing on the amended return.

One important use of an amended return is to correct a taxpayer’s failure to adequately disclose the gift because the donor (1) did not report the gift on the return; or (2) the donor failed to submit information concerning the gift necessary under Treas. Reg. § 301.6501(c)-1(f)(2).

Some return preparers rely on rectifying past mistakes on the present year Form 709. For example, if the preparer believes that the GST exemption was incorrectly allocated in a prior year, he or she would simply put in the corrected amount on the current year’s Form 709, attach a statement pointing out the error, and correctly report the entry in future years. The IRS has not specifically approved this procedure.

B. Section 9100 Relief

1. If Certain Mistakes are Discovered Quickly

Treasury Regulations provide for an automatic six month extension where the taxpayer would like to change his or her mind with respect regulatory or statutory elections whose due dates are the due date of the return (excluding extensions) if the return was timely filed by the due date (including extensions).¹⁶⁵ Therefore, if a taxpayer filed a gift tax return by April 15, and realized he or she failed to opt of the automatic allocation rules, the taxpayer can file an amended return with “FILED PURSUANT TO § 301.9100-2” by October 15 to correct the mistake.¹⁶⁶ However, note that this procedure cannot be used to make a QTIP gift tax election under Treas. Reg. § 301.9100-2, because the lifetime QTIP election is prescribed in § 2523(f)(4) and the IRS is authorized only to grant extensions for elections whose due dates are prescribed by regulation or other published guidance.

2. Section 9100 Relief

Another option for fixing certain mistakes on Form 709 is informally referred to as Section 9100 Relief. This type of relief can result in the IRS granting an extension of time to make an allocation of GST exemption for lifetime gifts, an election under IRC § 2632(b)(3) (an election out of automatic allocation to deemed skips), or an election under IRC § 2632(c)(5)(A)(i)-(ii) (an election in and out of the automatic allocation of GST exemption to indirect skips). In determining whether or not to grant relief, the IRS will consider all relevant

¹⁶⁵ Treas. Reg. § 301.9100-2(b).

¹⁶⁶ Treas. Reg. § 301.9100-2(d).

circumstances including evidence of intent to attain GST exempt status in the trust agreement and such other factors as the IRS deems relevant.¹⁶⁷

There are some limitations to 9100 relief. It will not undo an affirmative election in or out of the GST automatic allocation rules that was made on a timely filed return with respect to prior periods nor does it allow a taxpayer to undo an affirmative allocation of GST exemption to a prior transfer.

In order to grant 9100 relief, the IRS will have to find that the taxpayer acted reasonably and in good faith and that the relief will not prejudice the interests of the government.¹⁶⁸ Furthermore, the taxpayer will be required to follow the procedures for requesting a private letter ruling under Treas. Reg. § 301.9100 contained in the applicable Revenue Procedure for the year in which relief is sought. Private letter rulings can be costly in terms of time and money, but a private letter ruling may be worthwhile in certain circumstances.

VII. Conclusion

After reading through this outline, which admittedly has not addressed every possible reporting scenario, it is likely that you are saying, “Grrr!” Even what appear to be relatively straight forward gifts can result in unanticipated complications with regard to reporting them. “Nothing is as simple as we hope it will be”¹⁶⁹ seems to sum up our thoughts on preparing Form 709. Our best advice is to gather the most information possible, disclose as much as possible, and if you are not sure about how to report a transaction, ask another professional for assistance. After all, we all need a little help taming the tiger from time to time.

¹⁶⁷ IRC § 2642(g)(1)(B).

¹⁶⁸ IRC § 301.9100-3(a).

¹⁶⁹ A quote attributed to the late Jim Horning.

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Your Client Wants You to Prepare Form 706: What Information and Items Do You Need?*

1. Has the client previously filed a Form 709? If so, you need a copy of AT LEAST the most recently filed Form 709 but all prior returns if possible. Were there transfers in prior years that should have been on a gift tax return but were not reported?
2. What is the client's social security number?
3. What is the client's mailing address and legal domicile (residence in which he or she currently lives with no present intention to leave)?
4. Date, amount, description and basis of property transferred, beneficiary name, beneficiary date of birth (for GST purposes), beneficiary address, and beneficiary relationship to client for EACH gift.
5. If gift is to trust:
 - Copy of trust agreement;
 - Current trustee name;
 - Trust address (usually the same as the trustee's address);
 - EIN of trust (or if a grantor trust does the trustee use the trust EIN and file an informational Form 1041 or the grantor's social security number?);
 - List of any withdrawal rights that trust beneficiaries may have, along with information regarding EACH withdrawal beneficiary (i.e., name, address, relationship to client), section of trust agreement providing withdrawal right, and copies of signed withdrawal right notice letters (if available); and
 - CHECK TO SEE IF TRUST AGREEMENT ACTUALLY CREATES MULTIPLE SEPARATE SHARE TRUSTS OR IF IT IS ONE TRUST FOR THE BENEFIT OF MULTIPLE BENEFICIARIES.
6. Were there any charitable gifts to report for the client? Political contributions that do not qualify as non-gift transfers?
7. Do any transfers during the year have part gift / part sale components?
8. Have appraisals been obtained for any transfers? Should there be appraisals obtained? If no appraisal is obtained for a gift of an interest in a closely held entity, has the client provided detailed financial information (including financial statements) to substantiate the calculation of value for the gift and the EIN of the entity? Have you reviewed the adequate disclosure checklist and can you meet the standard for adequate disclosure?
9. Was there a discount taken in determining the value of any gift made during the year?
10. For gifts of real estate, has the client provided the legal description of the property as well as the physical address (if applicable), the type of interest in real estate transferred, and a brief description of the improvements on the property?

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11. Were the client's gifts community property gifts, separate property gifts, or both? Is his or her spouse also filing a return? If there are separate property gifts, do the spouses want to elect to gift split those gifts? Do you have the spouse's social security number?

12. Do you have the information you might need for special types of gifts (e.g., Form 712 for gift of life insurance policy, 529 plan information and whether the client is making a large upfront gift that will use his or her annual exclusion amounts for up to 5 years, CUSIP information if gift of actively traded stock or bond, entity EIN if gift of an interest in an entity, etc.)?

13. Have there been any generation-skipping transfers during the year? Does automatic allocation apply or has the client made any opt in or opt out decisions with respect to the automatic allocation rules?

14. Were there transfers in prior years that qualified for the gift tax annual exclusion (eliminating reporting requirement) that did not qualify for the GST tax exclusion and thus GST exemption was automatically allocated (CAUTION: important question when the client has an ILIT).

15. Does the client have a DSUE Amount from a prior deceased spouse (who died after December 31, 2010 and whose executor timely filed Form 706)?

16. Are there any completed non-gift transactions that it would benefit the client to report? If so, do you have transaction details to substantiate that it is a non-gift transaction? Are there any items that you should attach to substantiate the claim that the transaction was a bona fide sale (e.g., assignment, promissory note, security agreement, guaranty, guaranty fee agreement, appraisal, real estate closing documents).

*NOTICE: This page is a sample list of questions. It is by no means comprehensive and does not cover all questions that should be asked, information that should be obtained, and documents that should be obtained in order to accurately and completely prepare Form 709 in all situations. It is designed to be a short form that will cover several important circumstances in a limited number of questions. For a more comprehensive sample checklist (spanning seven pages!), please see the AICPA Gift Tax Return Checklist 2013 available at <http://www.aicpa.org/InterestAreas/Tax/Resources/TaxPracticeImprovement/2013tax-guides-checklists/Pages/USGiftTaxReturnChecklist-2013.aspx> (you may be required to provide AICPA login information to access the checklist).

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Appraisal Checklist for:

Client:

By: _____

Date: _____

Adequate Disclosure Geared Questions (See Treas. Reg. § 301.6501(c)-1(f)(2)(iv))

_____ Has the appraiser attached a CV or resume that indicates he or she holds himself/herself out to the public as an appraiser OR he or she regularly performs appraisals?

_____ Has the appraiser attached a CV or resume that indicates he or she is qualified to make appraisals based on experience, professional affiliation, education, etc.?

_____ Has the appraiser stated in the report that he or she is not the donor, the beneficiary of the transfer, or a member of the family of either donor or the beneficiary or any person employed by the donor, the beneficiary, or a member of the family of either?

_____ Does the report state that the valuation is effective as of the date of the transfer?

_____ Does the report state the correct transfer date?

_____ Does the report state the date the report was issued?

_____ Does the report state that the purpose of the report is valuation for federal transfer tax purposes - see Treas. Reg. §§ 20.2031-1(b) and 25.2512-1?

_____ Does the report describe the interest transferred (both in property description and ownership) correctly?

_____ Does the report describe the standard for fair market value for transfer tax purposes?

_____ Does the report specify the assumptions, limiting conditions, and restrictions made that may affect the conclusion in that report?

_____ Does the report contain the information reviewed and considered in determining the appraisal value?

_____ Does the report describe the valuation method used (e.g., income approach, market approach)?

_____ Does the report describe the appraiser's rationale for selecting the particular appraisal method selected, including why other possible valuation methods would be less appropriate?

_____ Has the appraiser signed the report?

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Other Items to Look For:

_____ Does the report correctly name the client name, trust name, or entity name (as applicable)?

_____ Does the report correctly communicate the rights, benefits, restrictions, limitations, and caveats associated with an ownership interest of the subject property (e.g., business purpose; election, removal of partners/members, managers, officers; approval rights for major and non-major decisions; capital calls; allocation of income and loss; distribution provisions; presence or absence of first right of refusal; § 754 election provisions; withdrawal rights and restrictions on withdrawal; term of entity (if any); liquidation provisions; transfer restrictions, requirements for consent necessary for an assignee to be admitted as member/partner; restrictions on ownership; buy-sell or other restrictive agreements)?

_____ Does the report include an assessment of the general economic conditions of the time and is that assessment for the correct period of time (e.g., a Q2 economic outlook for a May transfer)

_____ Have you checked the report for errors and typos?

_____ If discounts applied, are the reasons for the discounts set forth?

_____ Do you think all relevant discounts have been considered (e.g., lack of control discount, lack of marketability discount, investment attractiveness discounts, discounts for undivided interest in real estate, built-in-gain discounts, blockage discounts, key person discounts, market absorption discounts)?

_____ Do the discounts seem applicable and reasonable?

_____ Have you checked the cross references both to provisions in governing documents and references within the report (including those to exhibits and charts)

_____ Have you double checked the calculation of the subject interest subject to discounts?

_____ Does the report pass the smell test?

Value Calculation Double Check

Net Value of 100% of Entity	
Pro Rata Net Asset Value of a _____% interest	
Discount Type 1: _____ (e.g., lack of control)	
Interim value after Discount Type 1 applied:	
Discount Type 2: _____ (e.g., lack of marketability)	
Value after Discount Type 2 applied:	
Rounded Value of Transferred Interest (if applicable)	
Total discount applied	