



FORT SAM HOUSTON LEGAL ASSISTANCE OFFICE **GIFT AND ESTATE TAX**

GIFT TAX

The gift tax is a tax on the transfer of property by one individual to another while receiving nothing, or less than full value, in return. The tax applies whether the gift giver intends the transfer to be a gift or not.

The gift tax applies to the transfer by gift of any property. You make a gift if you give property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. If you sell something at less than its full value or if you make an interest-free or reduced-interest loan, you may be making a gift.

The gift giver is generally responsible for paying the gift tax. Under special arrangements the person receiving the gift *may* agree to pay the tax instead. Please visit with your tax professional if you are considering this type of arrangement.

DEFINITION OF GIFT

Any transfer to an individual, either directly or indirectly, where full consideration (measured in money or money's worth) is not received in return.

EXCEPTIONS

The general rule is that any gift is a taxable gift. However, there are many exceptions to this rule. Generally, the following gifts are not taxable gifts.

1. Gifts not amounting to more than the annual exclusion for the calendar year. In 2005 this is \$11,000.00.
 - a. The annual exclusion applies to gifts to each recipient of a gift. In other words, if you give each of your children \$11,000 in 2003, 2004 or 2005, the annual exclusion applies to each gift.
 - b. If you and your spouse want to give away property you own together you are each entitled to the annual exclusion amount on the gift. Together, you can give \$22,000 to each gift recipient.
2. Tuition or medical expenses you pay for someone (the educational and medical exclusions). These gifts must be paid directly to the institution providing the service

3. Gifts to your spouse.¹
4. Gifts to a political organization for its use.

In addition to this, gifts to qualifying charities are deductible from the value of the gift(s) made.

GIFTS AND THE INCOME TAX RETURN

Making a gift or leaving your estate to your heirs does not ordinarily affect your federal income tax. You cannot deduct the value of gifts you make (other than gifts that are deductible charitable contributions). If you are not sure whether the gift tax or the estate tax applies to your situation, refer to Publication 950, Introduction to Estate and Gift Taxes.

SALE OF GIFT PROPERTY

The general rule is that your basis in the property is the same as the basis of the gift giver. For example, if you were given stock that the gift giver had purchased for \$10 per share (and that was his/her basis), and you later sold it for \$100 per share, you would pay income tax on a gain of \$90 per share. (Note: The rules are different for property acquired from an estate).

GIFT TAX RETURN

The gift tax return is due from the gift giver on April 15th following the year in which the gift is made

INFORMATION REQUIRED

Refer to Form 709, 709 Instructions and Publication 950. Among other items listed:

1. Copies of appraisals.
2. Copies of relevant documents regarding the transfer.
3. Documentation of any unusual items shown on the return (partially-gifted assets, other items relevant to the transfer(s)).

REPRESENTATION NEEDED

When deciding whether or not you need representation to file a Gift Tax Return consider the complexity of the transfer. For most simple, small transfers (less than the annual exclusion amount) you may not need the services of a professional.

However, if the transfer is large or complicated or both, it is a good idea to consult with an attorney and Certified Public Accountant (CPA) or Enrolled Agent (EA). Inquire into how much experience they have had and ask for referrals. This process should be similar to locating a good

¹ Gifts made to non-citizen spouses after July 14, 1988 do not qualify for a gift tax marital deduction. The annual exclusion amount for gifts made to spouses in 2005 is 117,000.

physician. Locate other individuals that have had similar experiences and ask for recommendations. Finally, after the individual(s) are employed and begin to work on transfer matters, make sure the lines of communication remain open so that there are no surprises.

ESTATE TAX

The Estate Tax is a tax on your right to transfer property at your death. It consists of an accounting of everything you own or have certain interests in at the date of death (Refer to Form 706). The fair market value² of these items is used, and not necessarily what you paid for them or what their values were when you acquired them.

The total of all of these items is your "Gross Estate." The includible property may consist of Cash and Securities, Real Estate, Insurance, Trusts, Annuities, Business interests and other assets. Keep in mind that the Gross Estate will likely include non-probate as well as probate property.

Once you have accounted for the Gross Estate, certain deductions (and in special circumstances, reductions to value) are allowed in arriving at your "Taxable Estate." These deductions may include Mortgages and other Debts, Estate Administration expenses, property that passes to Surviving Spouses and Qualified Charities.

After the net amount is computed, the value of lifetime taxable gifts which exceed the applicable annual exclusion (beginning with gifts made in 1977), is added to this number and the tax is computed. The tax is then reduced by the available unified credit. Presently, the amount of this credit reduces the computed tax so that only total taxable estates and lifetime gifts that exceed \$1,500,000³ will actually have to pay tax. In its current form, the estate tax only affects the wealthiest 2% of all Americans.

²Fair market value is defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate." Regulation §20.2031-1.

³ An estate tax return for a U.S. citizen or resident needs to be filed only if the gross estate exceeds the applicable exclusion amount, listed below.

Applicable Exclusion Amounts	
Year	Exclusion Amount
2004 and 2005	\$1,500,000
2006, 2007, and 2008	\$2,000,000

EXCLUSIONS AND DEDUCTIONS TO THE GROSS ESTATE

EXCLUSIONS

Generally, the gross estate does not include property owned solely by the decedent's spouse or other individuals. Lifetime gifts that are complete (no powers or other control over the gifts are retained) are not included in the Gross Estate (but taxable gifts are used in the computation of the estate tax). Life estates given to the decedent by others in which the decedent has no further control or power at the date of death are not included.

DEDUCTIONS

1. **Marital Deduction:** One of the primary deductions for married decedents is the Marital Deduction. All property that is included in the gross estate and passes to the surviving spouse is eligible for the marital deduction. The property must pass "outright." In some cases, certain life estates also qualify for the marital deduction.⁴
2. **Charitable Deduction:** If the decedent leaves property to a qualifying charity, it is deductible from the gross estate.
3. **Mortgages and Debt.**
4. **Administration expenses of the estate.**
5. **Losses during estate administration.**

SALE OF INHERITED PROPERTY

The sale of such property is usually considered the sale of a capital asset and may be subject to capital gains (or loss) treatment. However, IRC §1014 provides that the basis of property acquired from a decedent is its *fair market value at the date of death*, so there is usually little or no gain to account for if the sale occurs soon after the date of death. (Remember, the rules are different for determining the basis of property received as a lifetime gift).

Most information for this page came from the Internal Revenue Code: Chapter 11--Estate Tax (generally Internal Revenue Code §2000 and following, related regulations and other sources)

2009	\$3,500,000
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⁴ This unlimited marital deduction is not allowed for estate tax purposes. To avoid estate taxation in this situation consult with an attorney about setting up a qualified domestic trust.

FILING THE RETURN

INFORMATION REQUIRED

See Form 706 and Instructions and Publication 950. Among other items listed:

1. Copies of the death certificate.
2. Copies of the decedent's will and/or relevant trusts.
3. Copies of appraisals.
4. Copies of relevant documents regarding litigation involving the estate.
5. Documentation of any unusual items shown on the return (partially included assets, losses, near date of death transfers, others).

DUE DATE

Generally, the estate tax return is due nine months after the date of death. A six month extension is available if requested prior to the due date and the estimated correct amount of tax is paid before the due date.

DUE DATE EXTENSIONS

The estate's representative may request an extension of time to file for up to six months from the due date of the return. However, the correct amount of tax is still due by the due date and interest is accrued on any amounts still owed by the due date that are not paid at that time.

REPRESENTATION NEEDED

Consider the following when deciding whether to hire representation to file an Estate Tax Return:

1. The complexity of the estate. By the time most estates reach \$1,500,000⁵, there is usually some complexity involved.
2. The condition of the decedent's records.
3. How many beneficiaries are there, and are they cooperative?

In the event you decide to seek aid in sorting out the estate consult with an attorney and a CPA or EA to help you through the filing process. It is important when you are seeking help to ensure that the professionals with whom you are working are experienced in the area of estate taxation. Be sure to interview a few professionals before deciding who to hire.

TIMELINE FOR ACCEPTANCE OF THE ESTATE TAX RETURN

There can be some variation, but for returns that are accepted as filed and contain no other errors or special circumstances, you should expect to wait about 4 to 6 months after the return is filed to

⁵ Note that this amount will change more than once between now and 2010. Be sure to evaluate your estate plan on a yearly basis and update your documents accordingly.

receive your closing letter. Returns that are selected for examination or reviewed for statistical purposes will take longer.

Reminder: Most relatively simple estates (cash, publicly-traded securities, small amounts of other easily-valued assets, and no special deductions or elections, or jointly-held property) with a total value under \$1,500,000 do not require the filing of an estate tax return.