

THE 700 CLUB (706, 709, 712 ...)

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The 700 Club, as I have titled my discussion, deals primarily with the reporting of gift and estate tax matters to the Internal Revenue Service (the "IRS") and the relevant forms for reporting the same. While these forms (Forms 706, 709, 712, etc.) may remain constant in their general format and purpose, there are technical and procedural changes that take place from time to time, which if not understood and adhered to, can result in improperly filed forms, returned and unaccepted forms by the IRS and even potential penalties or losses of available exemptions if not claimed timely not to mention the overpayment of taxes. Recent substantial changes have occurred with regard to the Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return and particularly, with regard to reporting split gifts between spouses and the regulations regarding the election out of the automatic allocation of the generation-skipping transfer tax exemption. Other issues outlined below deal with the legal side of determining and calculating the reporting requirements for gift and estate tax matters and the proper role of the tax attorney as a compliment to the accountant or other preparer of the tax returns.

I. SOMETHING OLD/SOMETHING NEW

In 2004, the IRS substantially revised Form 709, which is applicable to gifts made in 2003. In 2005, the IRS released another revised Form 709, which is substantially the same as the 2003 Form 709. The most significant change to Form 709 (from the 2002 and prior year's forms) was to Schedule A. Specifically, a new Part 3 and three additional columns were added. Such revisions were implemented to (1) modify the method in which spouses who elect to gift-split report such gifts under Section 2513 of the Internal Revenue Code of 1986, as amended (the "IRC"); (2) add a section to Schedule A to report "indirect skips;" (3) add a mechanism to elect out of the automatic allocation of generation-skipping transfer ("GST") tax exemption for direct and indirect skips; and (4) add a line to Part 2 of Schedule C (GST tax

schedule) to illustrate the automatic allocation of GST tax when an indirect skip is reported. **(Note: Even though the 709 has changed significantly from its prior version, practitioners who file returns to report gifts made prior to 2003 will presumably still need to use the prior Forms 709 for those applicable years).**

A. Initial Considerations

1. Reportable Gifts

Any individual citizen or resident of the United States who makes a transfer by gift must file a 709, unless such transfer is not includible in such individual's total amount of gifts for the year by the application of Sections 2503(b) or 2503(e), or when such individual makes a transfer of an interest with respect to which a marital deduction is allowed for the value of the entire interest under Section 2523. It is necessary to file Form 709 in order to elect to gift-split under Section 2513, regardless of the amount of the gift. Section II of this outline below provides a more detailed analysis of the gift-splitting requirements under Section 2513.

- a. Section 2503(b) provides that in the case of present interest gifts made by a donor during the year, the first \$10,000 of each gift (indexed for inflation and currently at \$11,000 for 2005, anticipated to be \$12,000 for 2006) shall not be included in the total amount of gifts made during the year by the donor. Section 2523(i) substitutes \$100,000 (indexed for inflation and currently \$117,000 for 2005, anticipated to be \$120,000 for 2006) for the \$10,000 figure provided in Section 2503(b) when the donee spouse is a non-US Citizen.

- b. Section 2503(e) provides that a “qualified transfer” shall not be treated as a transfer of property for gift tax purposes. A qualified transfer is a transfer of tuition for the benefit of the donee paid directly to the educational institution, or the payment of medical care for the benefit of the donee paid directly to the medical care provider.

- c. Section 2523
 - i. General. Section 2523 provides that when a donor transfers an interest in property to an individual, who at the time of the gift is the donor’s spouse, a deduction shall be allowed in computing the donor’s taxable gifts for the year in an amount equal to the value of the property transferred.

 - ii. Inter Vivos Qualified Terminable Interest Property (“QTIP”) Trusts. If the donor transfers property to a QTIP trust for the benefit of his or her spouse, and wants to make a QTIP election with respect to such transfer, a 709 must be filed in order to make the election. Such an election can only be made on a timely filed 709 (including extensions). If the donor dies during the same year of the transfer, the election must be made on a Form 709 filed no later than the due date of the Federal estate tax return (including extensions). Because this election is prescribed by statute, as opposed to being a regulatory election, Section 9100 relief is unavailable to make a late QTIP

election under Section 2523. See PLR 9641023 (July 10, 1996).

2. Form 709-A, which previously could be used by taxpayers solely to report gifts in limited circumstances, is now obsolete. All reportable gifts must now be reported on Form 709.
3. Party Responsible for Filing the Form 709.

Although it sounds overly simplistic at first discussion, many individuals and professionals remain confused about the fact that it is the donor of a gift that must report a gift and pay any applicable gift tax, not the donee. And the requirements only get more technical from here.

- a. General. The donor is required to file the Form 709.
- b. Donor is unable to sign. If a donor is legally incompetent, his guardian may file a Form 709 on his behalf. Additionally, an agent of the donor may file the Form 709 on behalf of the donor. However, in order for an agent to file on behalf of a donor, the donor must be unable to file for himself by reason of illness, absence or nonresidence and such return must be ratified by the donor when he becomes able to do so. An agent may not sign on behalf of the donor as a matter of mere convenience.
- c. Donor is deceased. If the donor is deceased, the executor of the deceased donor's estate may file the Form 709 on behalf of the donor for gifts made prior to the donor's death. In addition, the executor may elect to gift-split under Section 2513 on behalf of the donor if the requisite requirements are satisfied.

4. Due Date

- a. General. The Form 709 may not be filed prior to January 1st of the year following the year in which the gift was made and cannot be filed later than April 15th of such year, unless the appropriate extension of time to file is requested.
- b. Extensions. If the taxpayer files Form 4868 to automatically extend the due date of his or her individual income tax return by four months to August 15th, such extension will also automatically extend the time to file his or her Form 709. It is no longer necessary for the taxpayer to check a box in order to extend the due date of his or her Form 709. In addition, if the taxpayer files Form 2688 to request an additional time to file his or her individual income tax return to October 15th, such extension will also extend the time to file his or her 709. It is important to note that a taxpayer may no longer submit payment of gift or GST tax with Forms 4688 or 2688.

B. The Anatomy of the Return

This section of the outline will describe the method of reporting gifts and the allocation of GST tax exemption on a 2002 (and prior years) Form 709 followed by a detailed description of how the reporting should be done on the new Form 709.

1. Page 1

- a. Part 1 (709 prior to 2003). Part 1 is the General Information section in which the taxpayer provides the IRS with basic information such as his or her name,

social security number and address. In addition, the taxpayer answers various questions. For example, the taxpayer will address whether the 709 was put on extension and whether he or she has previously filed a 709. Part 1 also provides an area in which the taxpayer can elect to have the gifts made by him or her to third parties considered as gifted one-half (1/2) by the taxpayer and one-half (1/2) by the taxpayer's spouse.

- b. Part 2 (709 prior to 2003). Part 2 of the 709 is the Tax Computation section, wherein the amount of taxable gifts is carried over from Schedule A and the tax due, taking into account the taxpayer's available gift tax exemption, is calculated.
- c. New 709. Page 1 of the new 709 was not substantially altered. The only change made was to line 1 of Part 2 so that the value carried over from Schedule A is taken from line 11 of Part 4, rather than from line 15 of Part 3, as it was on the 2002 Form 709.

It should also be noted that the spousal consent for gift-splitting under Section 2513 contained in Part 1 of the 709 has remained unchanged, although the method to report split gifts has changed significantly, as described below.

2. Schedule A

On the 2002 Form 709 and prior years Forms, Schedule A consists of Part 1 – Gifts Subject Only to Gift Tax, Part 2 – Gifts that are Direct Skips and Subject to Both Gift Tax and Generation-Skipping Transfer Tax and Part 3 – Taxable Gift

Reconciliation. The new 709 adds a new Part 3 and moves the tax reconciliation section to Part 4. In addition, a new column C was added, which is used in Part 2 and Part 3 to elect out of the automatic allocation of GST tax exemption, as discussed in greater detail below. The method of reporting split gifts was also significantly changed by the addition of columns G and H.

- a. Questions A and B (709 prior to 2003)
 - i. Valuation discounts. The taxpayer must indicate in question A, whether the value of any gift reported on Schedule A reflects a discount of any kind, including, but not limited to, lack of marketability, fractional interest or minority interest discounts. If so, the taxpayer must attach an explanation giving the basis for taking such discounts.
 - a) Section 6501 of the IRC. It should be noted that the proper disclosures should be made when reporting a gift, the value of which was discounted, in order to commence the gift tax statute of limitations.
 - ii. Qualified state tuition programs. If a taxpayer gifted cash to a qualified state tuition plan under Section 529 in excess of the annual exclusion amount (\$11,000 in 2005) on behalf of any individual beneficiary, he or she may elect to treat up to five times such amount (\$55,000 in 2005) of such contribution as made ratably over a 5-year period, beginning in the year of the contribution. If the taxpayer elects to do so, he or she must

check the box in question B, located at the top of Schedule A. A contribution to a qualified state tuition program on behalf of a designated beneficiary is considered to be a present interest gift and, thus, qualifies as an annual exclusion gift under Section 2503(b).

iii. New 709. Questions A and B both remain unchanged.

b. Part 1

i. 709 prior to 2003. All gifts subject to gift tax only, whether or not such gifts could be subject to GST tax at a later date, are reported on Part 1 of Schedule A in chronological order. For example, a transfer to a trust with GST potential in the future (i.e. an indirect skip) is reported on Part 1. of Schedule A.

a) Indirect Skip. An indirect skip is a transfer of property (that is not a direct skip) subject to the gift tax that is made to a “GST Trust.” Section 2632(c)(3).

b) Column B. The taxpayer must identify the donee’s name and address, the relationship of the donee to the donor and a description of the gift. In addition, if the gift was made to a trust, the trustee’s name and address, and such trust’s EIN must be provided, and the taxpayer must attach a copy of the trust to the 709. If a security

was gifted, such as a stock or bond, the taxpayer must provide the CUSIP number for such security.

- c) Column C. The taxpayer must state his or her basis in the gifted property.
 - d) Column D. The taxpayer must disclose the date the gift was made to the donee. As noted above, all gifts are to be listed in chronological order.
 - e) Column E. The taxpayer must disclose the fair market value of the gifted property as of the date of the gift. If a valuation discount was taken, such discount is reflected in column E and the taxpayer must indicate that a valuation discount was taken, as discussed above, by answering yes to question A, located at the top of Schedule A, and disclosing the requisite information and attaching the appropriate documentation, as provided for in Section 6501.
- ii. New 709. In 2003, Form 709 was changed so that only gifts subject to gift tax and having no chance of being subject to GST tax at a later date, are reported in Part 1 of Schedule A. Note that gifts are still reported in chronological order.
- a) Column B. The information reported in column B remained unchanged.

- b) Column C. Column C was changed on the new Form 709; however, such column is not applicable in Part 1 of Schedule A of the new Form 709.
- c) Column D. In column D, the taxpayer now includes his or her basis in the gifted property, as was done in column C in previous years.
- d) Column E. In column E, the taxpayer now discloses the date the gift was made to the donee, as was done in column D in previous years.
- e) Column F. In column F, the taxpayer now discloses the value of the gift as of the date of the gift, as was done in column E in previous years.
- f) Column G. In column G, the taxpayer now discloses one-half of the value reported in column F in cases in which the taxpayer has elected to split gifts with his or her spouse under Section 2513. If the taxpayer is filing a 709 to report gifts of his or her spouse, which he or she elected to gift-split, and such taxpayer did not make any gifts during that year, Column F would contain no values in the top part; Column F in the bottom part would include the taxpayer's spouse's gifts. In addition, one-

half of the value of his or her spouse's gifts would be reported in Column G.

- g) Column H. In column H, the taxpayer indicates the net transfer. If the taxpayer elects to split his or her gifts with his or her spouse under Section 2513, the gift is reduced by one-half of his gifts (this one-half is reported in Column G, as described above).

c. Part 2.

- i. 709 prior to 2003. In 2002 and prior year's returns, all gifts that were subject to both GST tax and gift tax (direct skips) are reported on Part 2 of Schedule A. The information disclosed in columns C through E is the same as the information disclosed in columns C through E in Part 2 of Schedule A of the 2002 Form 709.

- a) Direct Skip. A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person, which may be an individual or certain trusts. An individual is a skip person if he or she is two or more generations below the transferor's generation. A trust is a skip person if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution be made to a person who is not a skip person.

- b) Election out of automatic allocation of GST tax exemption. Section 2632(b) provides that an individual's GST tax exemption shall be automatically allocated to direct skips so that the inclusion ratio of such property is zero. In 2002 and prior years returns, there is no place to indicate that the taxpayer wants to opt-out of such allocation. Instead, the taxpayer is required to attach a statement to the Form 709 describing the election and clearly identifying the transfer to which the election applied.
- ii. New 709. Direct skips are still reported on Part 2 of Schedule A of the Form 709. As noted above, additional columns were added for the purposes of electing out of the GST tax exemption automatic allocation rules and reporting split gifts. The information disclosed in columns B through H is the same information disclosed in Columns B through H in Part 1 of Schedule A of the new Form 709.
 - a) Election out of automatic allocation of GST tax exemption. The new 709 was changed so that an election to opt-out of the automatic allocation of GST tax exemption to direct skips can be made on the Form 709 by indicating such opt-out in column C of Part 2 of Schedule A. It should be noted that it is still necessary to attach an

explanation to the Form 709 clearly describing the transaction and the extent to which the automatic allocation of GST tax exemption should not apply.

d. Part 3.

i. 709 prior to 2003.

- a) Calculation of taxable gifts. On line 1 of Part 3, the taxpayer must provide the total amount of gifts as provided for in column E of Parts 1 and 2 of Schedule A. If the taxpayer elects to split the gifts pursuant to Section 2513 (presuming that the taxpayer's spouse consented to such split) then one-half of the total amounts gifted is indicated on line 2 and subtracted from the amount on line 1. As a result, line 3 contains the total amount of gifts subject to gift tax made by the taxpayer. On line 4, the taxpayer inserts the amount of any gifts made by the taxpayer's spouse that are included on the taxpayer's Form 709 by reason of the taxpayer electing to gift-split; such amount is then added to the balance of gifts subject to gift tax provided for in line 3. Accordingly, line 5 contains the total amount of gifts subject to gift tax, taking into account any gift splitting elected by the taxpayer and the taxpayer's spouse. On line 6, the total amount of gifts which

qualifies for the annual exclusion is subtracted from the total amount of gifts subject to gift tax. Line 7 contains the total amount of includible gifts.

- b) Deductions. The taxpayer accounts for any deductions applicable to the includible gifts on lines 8 through 15 of Part 3. For example, gifts which qualify for the gift tax marital deduction would be subtracted on line 8. An example of such a gift would be a transfer to an inter vivos trust (revocable living trust) for which QTIP treatment is elected.

If the donee spouse does not have a general power of appointment over the interest, the taxpayer may elect QTIP treatment so that the transfer qualifies for the marital deduction. The QTIP election is made by listing such property on line 8 of Part 3 of Schedule A (checking a box to make sure such election is not necessary).

- c) Joint and survivor annuities. Section 2523(f)(6) provides that in the case of 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 unless he or she elects otherwise.

Accordingly, if taxpayer purchased a joint and survivor annuity for a spouse (and only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die) and such gift was reported on Schedule A by the donor spouse, the donor spouse could indicate on Line 17 that he or she wishes to opt out of having such annuity automatically treated as QTIP property.

- ii. New 709. Part 3 of Schedule A was substantially changed so that “indirect skips” are reported therein. An indirect skip is any transfer of property, other than a direct skip, subject to gift tax and made to a GST trust. A GST trust is any trust that could have a generation-skipping transfer with respect to the transferor, subject to certain exceptions. The Taxable Gift Reconciliation, which was contained in Part 3 of Schedule A on Form 709 for 2002 and prior years, was moved to Part 4 of Schedule A. The information disclosed in columns B through H is the same information disclosed in columns B through H in Parts 1 and 2 of Schedule A of the new Form 709.
 - a) Election out of automatic allocation of GST tax exemption. Section 2632(c) provides that an individual’s GST tax exemption shall be automatically allocated to transfers to trusts from which a taxable distribution

or taxable termination may occur. In 2002 and 2001 (the first year in which an “indirect skip” and the automatic rules thereto applied), there was no place to indicate that the taxpayer wanted to opt-out of such allocation. Instead, the taxpayer was required to attach a statement to the Form 709 describing the election and clearly identifying the transfer to which the election applied. The 2003 Form 709 was changed so that an election to opt-out of the automatic allocation of GST tax exemption to trusts with GST tax potential can be made on the Form 709 by indicating such opt-out in column C of Part 3 of Schedule A. A taxpayer may wish to opt-out of such allocation, for example, if he or she was the grantor of an irrevocable life insurance trust and such trust owned a term life insurance policy. If the policy expired while in the trust and GST tax exemption was allocated to such trust, the exemption could be wasted. In 2004, column C was changed so that not only could an election to opt-out be made in such column, but any available election under Section 2632(c) could be made on the Form 709.

- iii. Final Regulations on election out of Automatic Allocation. On June 29, 2005, the IRS issued final regulations (“Final Regulations”) with respect

to electing out of the automatic allocation rules of Section 2632(c) for transfers made to GST trusts (indirect skips) and for making an election to treat a trust as a GST trust. Column C of Part 3 of Schedule A of the new Form 709, as discussed above, provides a mechanism for a taxpayer to make these elections. However, according to the Final Regulations, it is also necessary to attach a statement to the Form 709 stating the taxpayer's intention to elect out of the automatic allocation rules; such statement is referred to as an "election out statement" in the Final Regulations. The Final Regulations contain numerous examples which illustrate the provisions contained therein.

- a) Taxpayers may elect out of the automatic allocation rules for the following transfers:
- One or more prior-year transfers subject to Section 2642(f) (regarding estate tax inclusion periods ["ETIPs"]) made by the transferor to a specified trust or trusts;
 - One or more (or all) current-year transfers made by the transferor to a specified trust or trusts;
 - One or more (or all) future transfers made by the transferor to a specified trust or trusts;
 - All future transfers made by the transferor to all trusts (whether or not in existence at the time of the election out); or

- Any combination of the above. See Treas. Reg. Section 26.2632-1(b)(2)(iii)(A).
- b) Manner of election out. The taxpayer must attach an “election out statement” to a timely filed Form 709 (whether or not a 709 is otherwise required). The election out statement must (1) identify the trust (unless such trust is not in existence at the time of the election out; (2) must identify the transfers to which the election out shall apply; and (3) state that the taxpayer is electing out of the automatic allocation rules with respect to the transfer(s) described therein. Furthermore, any prior year transfer subject to Section 2642(f) must be identified. In addition, unless the election out is made for all transfers made to the trust in the current year and/or in all future years, the current-year transfers and/or future transfers to which the election out is to apply must be specifically described or otherwise identified in the election out statement. The Final Regulations contain examples of election out statements for various scenarios.
- c) Termination of election out. If a taxpayer wants to terminate an election to not have the automatic allocation rules apply to any transfers made to a specific trust, the termination may be done on a timely filed

Form 709 for the year in which the taxpayer wants the election to terminate (whether or not a 709 is otherwise required to be filed for such year). A statement, referred to in the Final Regulations as a “termination statement” must be attached to the Form 709 and must (1) identify the trust; (2) describe the prior election that is being terminated; and (3) specifically provide that such election out is being terminated and either (a) describe the extent to which the prior election out is being terminated or (b) describe any current-year transfers to which the prior election is not to apply. A termination of an election out does not affect any transfer, or any election out, that is not described on the termination statement.

- d) Election out of automatic allocation to an indirect skip subject to an ETIP. A transferor may elect out of the automatic allocation rules with respect to a transfer subject to an ETIP by filing a Form 709 for any year within the ETIP; such return cannot be filed any later than the due date for the year in which the ETIP closes. The election out statement referred to above must identify any prior year transfers that are subject To Section 2642(f) and to which the election out is to apply. It should be noted that a return filed during an ETIP

which purports to elect out of the automatic allocation rules for all future transfers will not apply to an allocation that is to occur at the close of an ETIP, unless such election out is specifically identified as described herein.

- e) Election to treat a trust as a GST trust. A taxpayer may elect to treat a trust, which is not a GST trust, as a GST trust (regardless of whether such trust is subject to an ETIP), so that the automatic allocation rules of Section 2632(c) will apply to a current transfer(s), selected future transfer(s), all future transfers made to such trust, or any combination thereof. The taxpayer must attach a statement, referred to in the Final Regulations as a “GST trust election statement” to a timely filed Form 709 for the year of the transfer (whether or not a 709 is otherwise required to be filed for such year) that (1) identifies the trust; (2) describes the transfer; and (3) specifically provides that the taxpayer is electing to have the trust treated as a GST trust. This election may be terminated by filing a timely filed Form 709 for the year in which the taxpayer wants the election to terminate. The taxpayer must attach a statement to the Form 709 identifying the trust, describing the transfer and providing

that the prior election to treat the trust as a GST trust as provided is terminated.

- f) Effective date. The Final Regulations with respect to the election out of the automatic allocation rules for indirect skips and the election to treat a trust as a GST trust, are effective for elections made on or after July 13, 2004 (the date of the publication of the proposed regulations). The Final Regulations as they relate to transfers subject to ETIPs are effective for elections made after June 29, 2005.
- e. Part 4. The 709 for 2002 and prior years did not contain Part 4 of Schedule A. Due to the fact that Part 3 was added to Schedule A in 2003, the Taxable Gift Reconciliation section of the former Part 3 was moved to Part 4. Changes were made to the section to account for the fact that gifts made by the taxpayer consented to split, are now listed on Schedule A and accounted for in the total of value of gifts of donor, as reported on line 1 of Part 4 of Schedule A. In prior years, such gifts were accounted for in the Taxable Gift Reconciliation section, formerly Part 3 of Schedule A.
- 3. Schedule B. The taxpayer reports gifts from prior periods on Schedule B. In column A, the taxpayer lists the year of the prior gift. In column B, the taxpayer lists the IRS office where the Form 709 was filed. In column C, the taxpayer lists the amount of unified credit used for such gift for gifts made after December 31, 1976. In column D, the taxpayer lists the

amount of exemption used for gifts made before January 1, 1977. In column E, the taxpayer lists the amount of the taxable gifts for the corresponding year. The total amount of taxable gifts from prior periods is then carried over to line 2 of Part 2 on Page 2 of the Form 709. No changes were made to Schedule B of the new Form 709.

4. Schedule C.

a. 709 prior to 2003

- i. Part 1. All direct skips, whether or not such gifts qualify for the GST tax annual exclusion under Section 2642(c) are reported on Part 1 of Schedule C. In column A, the taxpayer lists the corresponding item number from column A of Part 2 of Schedule A. In column B, the taxpayer lists the value of the gift, as provided in column E of Part 2 of Schedule A. In column C, the taxpayer lists an amount equal to one-half of the amount listed in column B, if the taxpayer's spouse consents to split the gifts of the taxpayer under Section 2513. The taxpayer then subtracts the amount in column C from the amount in column B and inserts such difference in column D. In column E, the taxpayer lists the applicable annual exclusion amount and subtracts such amount from the value in column D. Finally, the taxpayer lists the amount in excess of the annual exclusion amount in column F and such amount equals the net transfer subject to GST tax. Gifts made by the taxpayer's spouse, which the taxpayer elects

to split pursuant to Section 2513, are reported on Part 1 of Schedule C. Columns C through F, as described above, have a space in which such gifts can be reflected so that the total net transfer subject to GST tax reflected in column F can include the gifts of the taxpayer's spouse which are attributable to the taxpayer.

- ii. Part 2. On line 1, the total applicable GST tax exemption amount is indicated. On line 2, the total amount of such exemption used in prior periods is listed. Line 2 is subtracted from line 1 and the resulting number (the exemption amount available for the current year's 709) is listed on line 3. On line 4, the taxpayer indicates the amount of GST tax exemption allocated in Part 3 of Schedule C. On line 5, the taxpayer allocates any GST tax exemption such taxpayer wants to allocate to transfers not reported in Part 1 of Schedule C, such as indirect skips. Line 6 provides the total amount of GST tax exemption allocated, including the exemption allocated on the current year's Form 709, and line 7 provides the total amount of available exemption accounting for the exemption allocated on the current year's Form 709.
- iii. Part 3. Every gift listed in Part 1 of Schedule C is also required to be listed in Part 3 of Schedule C. The net transfer of each gift, as calculated in Part 1 of Schedule C, is listed in column B. The amount of GST tax exemption allocated to each

gift in column C. The taxpayer cannot allocate an exemption in excess of the exemption available to such taxpayer at the time the 709 is filed. Columns D through H guide the taxpayer in calculating the amount of GST tax due with the Form 709, if any.

- iv. Notice of allocation. If a taxpayer wants to allocate GST tax exemption to a transfer other than a direct skip, and the transfer does not qualify under the automatic allocation rules, the taxpayer is required to allocate the exemption on line 5 of Schedule C and attach a Notice of Allocation to the 709.

- v. Late allocation of GST tax exemption. If the taxpayer wants to allocate GST tax exemption to a trust so that the trust's inclusion ratio is zero and wants to make such allocation on a Form 709 that is not timely filed, the taxpayer must allocate an amount of GST tax exemption equal to the value of the property either on the date the return is filed or on the first day of the month in which that return is filed. The IRS issued Notice 2001-50, 2001-2 C.B. 189, which provided that taxpayers may seek an extension of time in which to affirmatively allocate GST tax exemption. If relief is granted, the amount of GST tax exemption necessary to reduce the trust's inclusion ratio to zero is based on the value of the property as of the date of the gift. In order to obtain such relief, it was necessary for the

taxpayer to request a private letter ruling. On August 2, 2004, the IRS issued Rev. Proc. 2004-46, 2004-31 I.R.B. 142, in order to provide taxpayers a simplified alternative method for the late allocation of GST tax exemption. Various requirements must be met in order to be eligible for such relief and various procedural requirements must be followed when filing the Form 709, all of which are outlined in detail in that Revenue Procedure. If relief is granted under Rev. Proc. 2004-46, the taxpayer will be able to allocate GST tax exemption based on the value of the assets transferred to the trust, as of the date of transfer. It is not then necessary to apply for a private letter ruling pursuant to the Revenue Procedure.

- b. New 709. Schedule C was changed significantly on the new Form 709.
 - i. Part 1. The values listed in column B of Part 1 of Schedule C include the adjustments for gift-splitting due to the fact that if the taxpayer elects to split gifts made by such taxpayer's spouse or if the taxpayer's spouse elects to split gifts made by the taxpayer, the values of the taxpayer's gifts, as reported on Schedule A have already been adjusted to reflect the gift-splitting. In 2002 and in prior years, the taxpayer was required to make such adjustments for purposes of allocating GST tax exemption directly on Schedule C.

- ii. Part 2. A line was added to the new Form 709 to allow taxpayers to allocate GST tax exemption to transfers reported on Part 3 of Schedule A (i.e. indirect skips). Transfers reported in such section are transfers to trusts which qualify for the automatic allocation rules. The donor is not required to attach a Notice of Allocation with respect to such transfers. Instead, the automatic allocation rules will apply to effectively allocate GST tax exemption and such exemption allocation should be noted on line 5 of Schedule C. If it is unclear whether the automatic allocation rules apply, the taxpayer should attach a Notice of Allocation to the 709 anyway to ensure that the proper GST tax exemption is allocated.
- iii. Part 3. The only change made to Part 3 on the new 709 was that the maximum estate tax rate, as indicated in column F of Part 3 of Schedule C was amended to show the lower 2003 estate tax rate of 49%. This should be updated annually to reflect the current maximum estate tax rate.

II. CARE TO SPLIT A GIFT?

Many practitioners assume that they have a complete understanding of Section 2513 and the Gift Tax Reconciliation thereunder. In fact, the law surrounding gift-splitting are complex and an election to gift-split, or the failure to properly gift-split, could cause unintended adverse tax consequences. When practicing in the field of estate and gift taxation, a practitioner must have a complete understanding of the requirements that must be met in order for a married couple to elect to gift-split, as well as the

effects of such an election. **For example, once an election under Section 2513 has been made, the taxpayers may not choose which gifts they will split. Instead, the election is applicable to all gifts made during the calendar year. Moreover, once made, the election is irrevocable.** For these and other reasons of equal or greater severity, it is strongly advised that the accountant, CPA, tax return preparer and the client agree with the decision for the engagement of legal counsel with regard to the preparation of any Forms 709 that include such gift-split issues, or that at a minimum, that legal counsel be consulted with and given an opportunity to review and comment on the return before the filing deadlines are passed.

- A. Requirements under Section 2513 for all gifts to third parties (gifts to spouses may not be split) made by the donor spouse to be considered as made one-half by donor spouse and one-half by non-donor spouse.
1. U.S. citizenship or residency. At the time of the gift, each spouse must be a U.S. citizen or a U.S. resident.
 2. Married at the time of the gift. At the time of the gift, the spouses must be married. If during the same year that the gift was made, the spouses divorce, they may still elect to split gifts made while they were married, provided neither of them remarry during the same calendar year. The same holds true for spouses who die during the same year that the gift was made, so long as the gift was completed during the part of the year that the deceased spouse was surviving. A gift by the donor spouse or by the surviving spouse during that portion of the year that the spouses were divorced or after the deceased spouse's death are not eligible for gift-splitting treatment.
 3. Consent by both spouses. Both the donor spouse and the non-donor spouse must signify their consent to the election to gift-split.

B. Limitations as to which gifts a couple may elect to gift-split

1. Gifts to spouse. A couple may not elect to split gifts to each other.
2. Spouse with power of appointment. A gift by the donor spouse cannot be split where the donor spouse created in the non-donor spouse a general power of appointment as defined in Section 2515(c).
3. Elections made by executor or agent. An election to gift-split may be made on behalf of a deceased donor by such donor's executor. However, the gift must have been made while the donor spouse was still living. An election to gift-split may also be made by an agent of the spouse pursuant to Section 25.6019-1(d) of the Gift Tax Regulations. Such regulation provides that a return shall not be made by an agent unless by reason of illness, absence or nonresidence, the person liable for the return is unable to make it within the time prescribed. The regulation further provides that if by reason of illness, absence or nonresidence, a return is made by an agent, the return must be ratified by the donor or other person liable for its filing within a reasonable time after such person becomes able to do so.
4. Interest gifted to third party must be ascertainable. If a donor spouse transfers property so that a portion of the property interest is gifted to a third party and a portion of the interest is gifted to his or her spouse, in order for the portion gifted to a third party to be eligible for gift-splitting, such interest must be ascertainable at the time of the gift and hence severable from the interest transferred to the non-donor spouse.

C. Manner and time of signifying consent to gift-split

1. When only one spouse files a 709. If gift-splitting is elected and only one spouse makes gifts during the calendar year, the other spouse is not required to file a 709, provided that the total value of the gifts made to each third party donee is not in excess of two times the annual exclusion amount (currently \$22,000) and no portion of the property transferred constitutes a gift of a future interest. In such a case, the consent of both spouses should be signified on the donor's spouse's 709.
2. When both spouses file 709s. Consent may be signified in one of three ways: (1) the consent of the husband may be signified on the wife's 709 and the consent of the wife may be signified on the husband's 709; (2) consent of each spouse may be signified on his or her own 709; or (3) the consent of both spouses may be signified on one of the returns.
3. Time for consent. Consent may not be signified after April 15th of the year following the year in which the gift was made (due date of the 709). However, if no 709 was filed by either spouse on or before April 15th, consent may be signified on a late 709. If one of the spouses filed on or before April 15th and consent was not signified, consent may not be signified on the second spouse's 709 when it is filed. If either spouse receives a notice of deficiency with respect to gift tax for the year in which the gift was made, consent to split may not be signified for such period.
4. Revocation of consent. If consent was made on or before April 15th of the year following the year in which the gift was made, the consent may be revoked on or before April 15th of such year. The revocation may be made by either spouse filing in duplicate a signed statement of revocation. Such statement

must be filed on or before April 15th of the year following the year in which the gift was made. If consent is signified after April 15th of the year following the year in which the gift was made, it may not be revoked.

- D. Joint and Several Liability. Pursuant to Section 2513(d), when spouses elect to gift-split, the entire gift tax liability of each spouse for that tax year is joint and several and fraud on the part of the donor spouse cannot cause the statute of limitations to remain open with respect to the 709 filed by the non-donor spouse.
- E. No deemed gift for payment of entire gift tax liability by one spouse. Pursuant to Section 25.2511-1(d), if a husband and wife elect to gift-split and gift tax liability with respect to such transfers is paid by one spouse, the payment of the tax is not deemed a transfer subject to gift tax.
- F. Allocation of GST tax exemption. If an election to gift-split is made under Section 2513 to treat the gift as made one-half by each spouse, then such gift shall also be treated as if made one-half by each spouse for purposes of GST tax.
- G. Uniform Transfers to Minors Act.
 - 1. Section 2038. Such section provides that the gross estate of a decedent shall include the value of all property transferred by the decedent, in trust or otherwise, over which he holds at the date of his death, either alone or in conjunction with any other person, the power to alter, amend, revoke or terminate the enjoyment of the beneficial interest.
 - 2. Revenue Ruling 59-357, 1959-2 C.B. 212. Such revenue ruling holds that the value of any transfer of property to a minor under the Uniform Gifts to Minors Act is includible in the gross estate

of the donor for Federal estate tax purposes if the donor appoints himself custodian and dies while serving as such.

3. In order for an asset to be included in the estate of a decedent under Sections 2035 and 2038, the decedent must “transfer” such asset prior to his or her death. Because a spouse who elects to gift-split under Section 2513 does not “transfer” the gifts of the donor spouse, which he or she consents to gift-split, the IRS held that no part of the value of the assets transferred by the donor spouse would be included in the estate of the non-donor spouse upon her death.

H. Transfers to QPRTs/GRATs/GRITs. Gift-splitting should not be elected when one spouse gifts assets to a QPRT, GRAT or GRUT. If the donor spouse dies during the term of the trust, the entire value of the assets gifted will be included in the gross estate of the donor spouse and the non-donor spouse will receive no credit for such inclusion upon his or her death. The result is that the gift tax exemption of the non-donor spouse could be wasted. In the case of a gift to a “zeroed out” GRAT, it shouldn’t make a difference whether gift splitting is elected.

III. NO MATTER WHAT, JUST CALL THE LAWYER!

As discussed above with regard to several of the complicated tax issues that arise with the reporting on taxable gifts and the filing of Forms 709, many of the matters related to estate taxes and Form 706 are considerably more “legal” than “accounting” natured. Dealing with this legal aspect of the return requires that each party involved, including the accountant, CPA, tax return preparer and the client value the advice of legal counsel. Appropriate use of legal counsel in such situations may range from having legal counsel complete the Form 706, counsel the tax preparer in the completion of the return or at a minimum, having counsel review the final prepared Form 706

prior to filing. Issues often requiring legal consultation include issues of determining and applying valuation discounts, interpreting underlying trust documents and formulas therein for distribution/allocation of assets, proper application of QTIP elections, proper valuation and inclusion of life insurance proceeds and the Form 712, as well as many other discretionary decisions regarding the reporting and valuing of estate/trust assets for inclusion on the Form 706, including but not limited to the proper treatment of prior taxable gifts, reported and unreported on prior Forms 709.