Section 5: Specialized Returns for Individuals

5.2 Gift Tax

1. Gift- Splitting

Gift- Splitting

TRANSFER TAXES—IN GENERAL

Excise taxes are imposed upon the transfer of goods and services and based on the value of the property rather than the income derived.

Federal tax law imposes excise taxes on the gratuitous transfer of property either by gift or through an estate.

Nature of the Taxes

Federal gift tax is imposed on the right to transfer property by one person (donor) to another (donee) during life for less than full and adequate consideration.

a. Tax is payable by the donor.

b. If the donor fails to pay the tax when due, the donee may be held liable for the tax to the extent of the value of the property received.

c. Gift tax is to be determined by using the fair market value of the property as of the date of the gift.

d. A gift by a corporation is considered made by the individual shareholders.

Gift- Splitting

Formula for the Federal gift tax:

a. Gift tax applies the taxable base, which is the fair value of the gift less the annual exclusion ($15,000 2018-2019).

b. Gift tax is cumulative in nature, thus, prior taxable gifts are taken into account in arriving at the tax base for current taxable gifts (Example 1).

c. Credit is allowed against current gift tax for taxes paid on prior gifts included in the tax base.

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.

Gifts that are not more than the annual exclusion for the calendar year.

Tuition or medical expenses you pay for someone (the educational and medical exclusions).

Gifts to your spouse.

Annual Per Donee Exclusion

a. An annual exclusion applies to gifts of a present interest (the unrestricted right to the immediate use, possession, or enjoyment of the property or the income currently) and not to gifts of a future interest (the right that comes into existence at some future date).

b. Accumulating the income in a trust rather than paying it out currently makes the transfer a gift of a future interest.

c. Code provides an exception to the future interest rule when transfers are to a minor (under age 21) and certain conditions are met.

Both property and its income may be expended for the benefit of the minor. Any portion of the property or income not expended by time the beneficiary reaches 21 passes to the beneficiary at that time.

If the beneficiary dies before reaching 21, the property and income is part of the minor's estate.

Unified Credit

Unified tax credit (also called exemption equivalent or bypass amount).

a. It provides an exclusion amount upon which the taxpayer is exempt from the transfer taxes. It allows most individuals to avoid transfer taxes based on certain amounts.

b. A credit is an amount that reduces or eliminates tax. The applicable credit applies to both the gift tax and the estate tax and it equals the tax on the applicable exclusion amount. The applicable credit must be subtracted from any gift or estate tax owed. Any applicable credit used against gift tax in one year reduces the amount of credit that can be used against gift or estate taxes in a later year.

Unified Credit

In 2019, the credit on the basic exclusion amount is $4,505,800. The total amount of applicable credit available to a person will equal the tax on the basic exclusion amount plus the tax on any de-ceased spousal unused exclusion (DSUE) amount.

c. The American Taxpayer relief Act (ATRA) of 2012 made the following Changes:

(1) Rescinded a sunset provision that would have reinstated the $1 million exclusion amount and the top rate of 55% for years after 2012.

(2) Made the $5 million exclusion permanent and kept it subject to annual indexation. Thus, the $2,045,800 (exemption equivalent or exclusion amount of $5.25. million).

(3) Raised the *top* unified transfer tax rate from 35% to 40%.

Unified Credit

Valuation for Estate and Gift Tax Purposes

Property valuation for transfer taxes is generally on the date of the gift or date of death. Under certain conditions, however, an executor can elect to value *all* estate assets on the alternate valuation date.

a. Alternative valuation date to relieve hardship when assets decline after the date of death. It is the earlier of 6 months after date of death or the distribution date.

b. Election for alternative valuation is available only if a Form 706 is required and the valuation decreases both the value of the gross estate and the estate tax liability.

c. Income earned by the property after death is not considered in the alternate valuation date determination

Unified Credit

Key Property Concepts

Form of ownership is important when property is transferred by gift or death.

a. Joint tenants and tenants by the entirety provide the right of survivorship.

b. Tenants in common or community property ownership is not defeated by death.

c. Interests in assets can be divided into rights to income and rights to principal

4. Effect on estate tax (e.g., Generation skipping transfer tax)

Congress enacted the generation-skipping transfer tax (GSTT) to preclude avoidance of either the estate or gift tax on each generation by making transfers that bypass the next younger generation

Effect on estate tax (e.g., Generation skipping transfer tax)

GSTT is triggered when any of these events occur: a taxable termination occurs, a taxable distribution takes place, or there is a direct skip.

Example. GF (grandfather) creates a trust, with a life estate to S (son), and the remainder to GD (granddaughter). Upon S's death, a termination event occurs that is subject to the GSTT.

Example. GF (grandfather) creates a trust, income and corpus payable to GS (grandson). Upon trust distributions to GS, a distribution event takes place that is subject to the GSTT.

Example. GM (grandmother) gives property to GS (grandson). This is a direct skip and is subject to the GSTT.

Effect on estate tax (e.g., Generation skipping transfer tax)

Example. GF (grandfather) dies and leaves property to GD (granddaughter). This is a testamentary direct skip and is subject to the GSTT.

b. In determining when a generation is skipped.

(1) Spouses, regardless of age disparity, are of the same generation.

(2) A generation is not skipped if the skip-person’s parent (direct or collateral descendent) is dead.

Filing Requirements

General Considerations

Requirements for a Gift include the following:

- Donor competent to make a gift.
- Donee capable of receiving and possessing the property.
- Donative intent on behalf of the donor.
- Actual and constructive delivery of the property to donee or donee's representative.
- Acceptance of the gift by donee.
- Incomplete transfers (where the transferor retains rights to the property) are not gifts. An incomplete transfer, however, becomes a gift upon the later occurrence of some event that makes the transfer complete.

Please Refer to the Addendum to this Section