



Steer Clear of These Ten Common Gift Tax Return Mistakes

Errors on gift tax returns can invite IRS audits and prevent the statute of limitations on revaluing gifts from running.

RAJ A. MALVIYA AND BRANDON A.S. ROSS

With the lifetime gift tax exemption amount nearly doubled under the recently enacted Tax Cuts and Jobs Act,¹ clients have a historic and limited opportunity to engage in significant lifetime transfers until the exemption is scheduled to restore to pre-reform figures in 2026, or perhaps earlier if the tax laws change before then. The surge of lifetime gifts and related transfers will necessitate the preparation and filing of gift tax returns.

While some types of transfers are straightforward to report, many involve a deeper understanding of the transfer tax rules and nuances embedded in the gift tax return. This article addresses ten common mistakes that the estate planning practitioner may encounter when preparing or a more common role of reviewing, gift tax returns. The mistakes are outlined in the order that the mistakes would appear on a gift tax return.

Of course, there are many ways to make mistakes, but this article focuses on mistakes that stem from the complexity of the laws for a particular issue or can occur without careful attention to the gift tax return form and its accompanying instructions (the “Instructions”). By ensuring that mistakes are not made, the practitioner will prevent the statute of limitations from failing to run and establish

grounds to support the client’s position in the event of an audit.²

1. Not filing the return

The threshold mistake for preparing gift tax returns is, simply, not filing one when required. A gift tax return, Form 709, is required to report a taxable gift.

When required to file. The donor of a taxable gift who is a citizen or resident of the U.S. must file a gift tax return.³ A “taxable gift” is a gratuitous transfer that is not excluded as an annual exclusion gift,⁴ qualified transfer for educational or medical expense,⁵ charitable donation,⁶ or marital gift.⁷ It is immaterial whether such transfer is in trust or otherwise; whether the gift is direct or indirect; or whether the property is real or personal, or tangible or intangible.⁸

Nonresidents are subject to U.S. gift tax only on transfers of U.S. situs real property and tangible property.⁹ Conversely, nonresidents

RAJ A. MALVIYA, LL.M., is a partner in the Private Client practice group at Miller Johnson, and he practices in the firm’s Grand Rapids, Michigan, office. Mr. Malviya is a fellow of the American College of Trust and Estate Council (ACTEC) and practices in all areas of transfer tax and fiduciary income tax planning. BRANDON A.S. ROSS, LL.M., is special counsel in the Estates, Trusts & Tax Planning practice group of Pillsbury Winthrop Shaw Pittman, and he practices in the firm’s Washington, D.C. area and Florida offices. He is a fellow of the American Bar Association’s Section of Real Property, Trust & Estate Law and practices in all areas of transfer tax and fiduciary income tax planning. A prior version of this article was published by Leimberg Information Services, Inc. (LISI) at www.LeimbergServices.com. Copyright ©2018, Raj A. Malviya and Brandon A.S. Ross.

are *not* subject to U.S. gift tax reporting on transfers of intangible property,¹⁰ which provides a planning opportunity to avoid the U.S. transfer tax system. Gift planning considerations for nonresidents is beyond the scope of this article.

A donor must file a gift tax return to split gifts with the donor's spouse, regardless of the amount of the gift.

Charitable and marital gifts meeting specific requirements do not need to be reported on a gift tax return. A transfer of the entire interest (not a partial interest or a split interest charitable trust) to a political or charitable organization under Section 2522 qualifies as a charitable gift that does not require a gift tax return to be filed.¹¹ Unexpectedly, if a taxpayer must otherwise file a gift tax return, the donor must report charitable gifts on the return to comply with the Instructions for Form 709.

A “marital gift,” as used herein, is a transfer of an interest in prop-

erty to an individual who, at the time of the gift, is the donor's spouse and a U.S. citizen.¹² However, a transfer of an interest in property to an inter vivos qualified terminable interest property (QTIP) trust for the benefit of the donor's spouse requires that a gift tax return be filed to make the QTIP election for qualifying for the marital deduction.¹³ Such election cannot be made on a late-filed federal gift tax return.¹⁴ Failure to make the QTIP election on a timely filed gift tax return will result in a taxable gift in the year of the transfer.¹⁵ What is known in tax parlance as “9100 relief” is not available to obtain an extension of time to make a QTIP election for an inter vivos transfer.¹⁶

Importantly, a donor cannot qualify a lifetime transfer to a noncitizen spouse under the QTIP election. This is because gifts to a noncitizen spouse must be either outright or in a trust that qualifies them as gifts of a present interest and in a form that would qualify for the marital deduction if the spouse were a U.S. citizen.¹⁷

Many individuals know that qualified transfers and annual exclusion gifts are excluded from

gift tax. A “qualified transfer” is a transfer directly to an educational institution for tuition of another or to a medical care provider for medical care for another.¹⁸ An “annual exclusion gift” is a gift of \$15,000 (indexed for inflation) to an individual in any one year that may be given to an unlimited number of individuals.¹⁹ Much larger is the annual exclusion amount for gifts to noncitizen spouses, namely, \$152,000.²⁰

On a related topic, the rules that apply to real estate transfers between a citizen and noncitizen spouses are not intuitive. A U.S. citizen or resident adding a noncitizen spouse to the title of real property as a joint tenant (tenancy by the entirety or joint tenancy with rights of survivorship) is not a gift to the spouse, regardless of any consideration furnished.²¹ At the first spouse's death, however, assets owned jointly with a noncitizen spouse are fully includable in the estate of the first spouse to die, except to the extent that the surviving spouse can prove contribution to the property.²²

Unexpectedly, a donor must file a gift tax return to split gifts with the donor's spouse, regardless of

¹ An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (the “Tax Cuts and Jobs Act”) was signed into law by President Trump on 12/22/2017.

² Unless otherwise specifically stated, the rules and laws described in this article apply to current gifts and not necessarily to prior gifts. The transfer tax rules have been revised and updated multiple times since inception, and a detailed analysis of these rules throughout history is outside the scope of this article. However, select historic transfer tax rules are covered to provide context on certain rules addressing adequate disclosure.

³ Section 6019.

⁴ Section 2503(b).

⁵ Section 2503(e).

⁶ Sections 2522 and 6019(3).

⁷ Sections 2523 and 6019(2).

⁸ Section 2511.

⁹ Sections 2501(a) and 2511(a); Regs. 25.2511-1(b) and 25.2511-3(a). The specific rules that govern U.S. situs and non-U.S. situs property for these purposes is beyond the scope of this article.

¹⁰ Section 2501(a)(2).

¹¹ Sections 2522 and 6019(3).

¹² Section 2523.

¹³ Section 2523(f)(4).

¹⁴ If a lifetime QTIP trust is formed, it is crucial that a *timely* gift tax return is filed to make the QTIP election. A QTIP election for a lifetime transfer cannot be made after the due date for the gift tax return for such transfer. Section 2523(f)(4)(A); Reg. 25.2523(f)-1(b)(4). Moreover, a discretionary extension is not available to make the QTIP gift tax election under Reg. 301.9100-3 because the time for making the election is prescribed by Section 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. See Ltr. Rul. 9641023, denying a discretionary extension under prior, but substantially identical, standard. See also Ltr. Rul. 200314012, where the IRS held that it lacked authority to grant 9100 relief to allow an extension beyond the statutory period for making a QTIP election on a late filed Form 709.

¹⁵ See, e.g., Wells Fargo Bank, 319 F.3d 1222, 91 AFTR2d 2003-857 (CA-10, 2003).

¹⁶ Relief under Reg. 301.9100-3 is not available when the time to make an election is set by statute.

¹⁷ Section 2523(i); Regs. 25.2523(i)-1(c)(1) and (d), Example 3.

¹⁸ Section 2503(e).

¹⁹ Section 2503(b).

²⁰ Rev. Proc. 2017-58, sections 3.37(1) and (2).

²¹ Section 2523(i)(3); Reg. 25.2523(i)-2(b)(1).

²² Reg. 20.2056A-8(a).

²³ Section 2513.

²⁴ Reg. 25.2511-1(h)(1).

²⁵ Section 2504(c).

²⁶ Regs. 301.6501(c)-1(e) and (f).

²⁷ If a gift made after 8/5/1997 is reported on a gift tax return or was disclosed on the gift tax return in a manner adequate to apprise the Secretary of the Treasury of the nature of the gift, the gift may not be revalued for estate tax purposes once the gift tax statute of limitations has run. See P.L. 105-206, section 6007(e)(2)(B), Section 2504(c); Section 2001(f)(1); Section 6501(c)(9); Reg. 301.6501(c)-1(f)(8).

the amount of the gift.²³ Accordingly, it is not always obvious when a gift is required to be disclosed to the IRS through a gift tax return.

Properly identifying the donor. The donor is the individual who makes a transfer of property by gift. If a trust, estate, partnership, or corporation makes a gift, the individual beneficiaries, partners, or shareholders are generally considered the donors.²⁴

Disclosure of sales. Although not required, a taxpayer may want to disclose a sale of property to a grantor trust to start the three-year statute of limitations for the IRS to examine the transaction. However, to commence the running of the statute, the sale must be adequately disclosed (see Exhibit 1). To be cautious, a taxpayer should adequately disclose a sale of an interest in a closely held entity to a grantor trust. Properly disclosing a gift of zero value will allow the statute of limitations to start and, upon running, leave the value of the transfer as finally determined.²⁵ Importantly, as part of satisfying the adequate disclosure rules on reporting, there should be an explanation as to why the transfer is not a gift.²⁶

Taxpayers may desire to avoid potential scrutiny of the transaction by not reporting a sale transaction on a gift tax return. However, if, upon the taxpayer's death, the taxpayer's estate is required to file a federal estate tax return, the sale must be disclosed because line 13e of Part 4 of the return mandates the disclosure of all transfers or sales of an interest in a partnership, limited liability company, or closely held corporation to a grantor trust during the decedent's lifetime.

Prior adequate disclosure on a gift tax return would allow for the statute of limitations to pass

and avoid a challenge by the IRS at the taxpayer's death, which will likely be harder to defend than dealing with the sale closer to when it happened and facts are easier to remember. Accordingly, it is advisable to file a gift tax return to adequately disclose a sale to a grantor trust of an interest in a closely held company if a federal estate tax return will be required. Similar consideration should be given to any transaction that causes a reduction in a client's gross estate. Other examples include intra-family loans and exclusion gifts (especially those of income-producing property).²⁷

Regardless of whether a gift tax return is required, the taxpayer's decision to forgo filing a return may be a mistake, leading to a costly audit during the taxpayer's lifetime or at death. Given that exposure for clients generally creates exposure for advisors, the authors recommend leaving the decision about disclosure of transactions to the client and appropriately including documentation of the intended transaction in the file.

2. Skipping the instructions

After determining that a gift tax return will be filed, the next major mistake for preparing gift tax

returns is skipping the Instructions. Reading the Instructions prior to preparing the first gift tax return each year will help mitigate mistakes and conform to the latest directions in the Instructions.

Like many IRS forms, the gift tax return has evolved over the years. Specifically, the Parts to Schedule A concerning reporting gifts with generation-skipping transfer (GST) aspects have changed significantly, as has the reporting of the allocation of GST exemption. The most recent significant change is the addition of Schedule C for reporting the deceased spouse's unused exemption amount.

The Instructions for the gift tax return highlight these changes. The Instructions attempt to demystify some of the complexities for completing the gift tax return. Importantly, the Instructions have a section on what is new each year, focusing the preparer on the updates in the law and gift tax return form itself. As many tax preparers use tax preparation software for competing gift tax returns, the Instructions can highlight the new aspects of the gift tax return form that the preparer should use to double check the tax preparation soft-

Morse Genealogical Services, LLC
International Probate Research

We LOCATE Missing Heirs

SERVICES INCLUDE:
Missing & Unknown Heirs
Genealogical Charts
Genealogical Research
Affidavits of Due Diligence
Expert Court Testimony
Independent Corroboration
Comprehensive Reports

FOR OVER 75 YEARS
Local • National • International
(386) 760-5000
WWW.FINDANHEIR.COM

EXHIBIT 1

Disclosure of Gifts

Generally, to satisfy adequate disclosure of gifts under current law, the following information must be included on or with the gift tax return:

1. A description of the transferred property and any consideration received by the transferor.
2. The identity of, and relationship between, the transferor and each transferee.
3. If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument.
4. A detailed description of the method used to determine the fair market value of property transferred, including any financial data (e.g., balance sheets, etc. with explanations of any adjustments) that was used in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property.

In the case of a transfer of an interest that is actively traded on an established exchange, such as the New York Stock Exchange, the American Stock Exchange, the NASDAQ National Market, or a regional exchange in which quotations are published daily, including recognized foreign exchanges, recitation of the exchange where the interest is listed, the CUSIP number of the security, and the mean between the highest and lowest quoted selling prices on the applicable valuation date will satisfy all of the adequate disclosure requirements. In the case of the transfer of an interest in an entity that is not actively traded, a description must be provided of any discount claimed in valuing the interests in the entity or any assets owned by such entity.

In addition, if the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity, a statement must be provided regarding the fair market value of the entire entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity), the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred interest as reported on the 709. If the value of the entire entity is not disclosed, the donor bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity. If the entity that is the subject of the transfer owns an interest in another non-actively traded entity (either directly or through ownership of an entity), the information required herein must be provided for each entity if the information is relevant and material in determining the value of the interest.

5. A statement describing any position taken that is contrary to any proposed, temporary, or final Treasury regulations or revenue rulings published at the time of the transfer. (Reg. 301.6501(c)-1(f)(2).)

Many times, as a substitute for (or in satisfaction of) the requirements under item 4, above, the taxpayer will file an appraisal. Note that the appraiser must meet the following criteria:

- The appraiser is an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.
- The appraiser's qualifications, as described in the appraisal that details the appraiser's background, experience, education, and membership, if any, in professional appraisal associations, are such that the appraiser is qualified to make appraisals of the type of property being valued.
- The appraiser is not the donor or the donee of the property or a member of the family of the donor or donee, as defined in Section 2032A(e)(2), or any person employed by the donor, the donee, or a member of the family of either. (Reg. 301.6501(c)-1(f)(3)(i).)

For adequate disclosure, the appraisal itself must contain:

- 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.
- The information considered in determining the appraised value, including in the case of an ownership interest in a business, all financial data that was used in determining the value of the interest that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value.
- The appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions.
- The valuation method used, the rationale for the valuation method, and the procedure used in determining the fair market value of the asset transferred.
- The specific basis for the valuation, such as specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisition transactions, etc. (Reg. 301.6501(c)-1(f)(3)(ii).)

To avoid the mistake of missing one of these requirements, it helps to have the requirements for the appraisal recited in the report.

EXHIBIT 1

Disclosure of Gifts, cont'd

Disclosure for Certain Transactions

Specific to a transfer valued under Section 2701 and 2702, including to qualified personal residence trusts and grantor retained annuity trusts, to provide adequate disclosure, the taxpayer must provide:

1. A description of the transaction, including a description of transferred and retained interests and the method (or methods) used to value each.
2. The identity of, and relationship between, the transferor, transferee, all other persons participating in the transaction, and all parties related to the transferor holding an equity interest in any entity involved in the transaction.
3. A detailed description (including all actuarial factors and discount rate used) of the method used to determine the gift arising from the transfer (or taxable event), including, in the case of an equity interest that is not actively traded, the financial and other data used in determining value. Financial data should generally include balance sheets and statements of net earnings, operating results, and dividends paid for each of the five years immediately before the valuation date. (Reg. 301.6501(c)-1(e)(2).)

Similar to the adequate disclosure requirements for gifts generally, the appraisals prepared by qualified appraisers are often used to provide all of the information to the IRS. The mistakes from lack of adequate disclosure may stem from avoiding certain details but usually arise from not having all the details required above, despite trying to disclose all of those details.

ware to ensure that the software has incorporated any applicable changes and updates.

Although obvious, experience is not a substitute for reading the Instructions.

3. Gift-splitting errors

Many mistakes on the gift tax return relate to splitting gifts because of the intricacies of the gift-splitting rules. Married taxpayers who are U.S. citizens or residents use gift splitting to allow one spouse to make a gift to a third party, but have the gift treated as made one-half by each spouse.²⁸ More specifically, gift splitting is allowed only if, at the time of the gift, each spouse was a U.S. citizen or resident. Therefore, gifts made while one spouse is a nonresident may not be split.²⁹

In summary, the requirements of splitting gifts are:

1. At the time of the gift, each spouse must be a U.S. citizen or a U.S. resident.

2. At the time of the gift, the spouses must be married.
3. If during the same year as that of the gift the spouses divorce, they may still elect to split gifts made while they were married, provided neither of them remarries during the same calendar year.
4. Both of the spouses must signify their consent to the election to split gifts.³⁰

The election to split gifts for a year is irrevocable and applies to all gifts during that calendar year by the married couple, except for gifts to each other.

Manner and timing. Many of the mistakes for gift splitting arise from rules for the manner and timing of gift splitting. There are certain requirements for electing to split gifts on the gift tax return, and there are a few ways to properly signify the consent to splitting gifts.³¹

In general, both spouses must file a gift tax return for the same year if they elect gift splitting. Whenever there is gift splitting, both spouses must sign the return. The consent of each spouse may be

signified on each spouse's own return. The consent of both spouses may be signified on one of the spouse's gift tax returns.

To file a gift tax return for one spouse and split gifts, the spouses need to meet certain criteria.³² When (1) only one spouse makes gifts during a calendar year, (2) the aggregate gifts to any one individual do not exceed twice the annual exclusion amount for that year, and (3) the gifts are all present interest gifts, the donor spouse may file a return on which the spouses would consent to split gifts without the non-donor spouse having to file a separate return. Similarly, even when both spouses made gifts of present interests during the year, but one spouse's gifts meet the same requirements as described in the prior sentence, and the other spouse's gifts are to different beneficiaries than their spouse's gifts and do not exceed the annual exclusion amount, only one spouse needs to file a gift tax return.

Unfortunately, many times a spouse will forget to sign the other spouse's gift tax return in the box for consenting to split gifts for

²⁸ Section 2513(a).

²⁹ Section 2513(a)(1).

³⁰ Section 2513(a).

the year. The mistake has not only adverse gift tax consequences, but also potential GST tax implications because the spouses would miss dividing the use of their GST exemptions in half for the year.

Often taxpayers will look for ways to cut down on the burden of disclosing or paying for a good appraisal, which leads to the mistake of inadequate disclosure.

The rules for the timing of giving consent for the election to split gifts are less complicated than the rules for revoking the election.³³ Consent may generally be provided at any time following the close of the calendar year of the gift. However, spouses may not elect gift splitting if the IRS has sent a notice of deficiency for the gift tax to either spouse, regardless of whether a gift tax return has been filed for that year.³⁴

If one spouse has filed a gift tax return by the April 15 deadline, the other spouse may change the gift-splitting election with a return filed after that initial return and by the April 15 deadline, by (1) consenting to split gifts when the first spouse to file did not make that election or (2) revoking an election to split gifts by the first spouse to file. The election to split gifts may also be revoked by either spouse filing in duplicate with a signed statement of revocation by the April 15 deadline. Consent may not be revoked for an election to split gifts made after the April 15 deadline.³⁵

An agent of the spouse may elect to split gifts if, by reason of illness, absence, or nonresidence, the person liable for the gift tax return is

unable to make consent within the time prescribed.³⁶ However, the return must be ratified by the donor or other person responsible for its filing within a reasonable time after such person becomes able to do so.³⁷

Complexity and liability. Some of the mistakes for gift splitting relate to the complexity of the substantive laws that arise out of certain situations that prohibit the gift-splitting election. Specifically, marital gifts reveal some of this complexity.

As mentioned above, gifts between a married couple may not be split. Included in this prohibition is a gift to a third party over which the non-donor spouse receives a general power of appointment.³⁸ Similarly, interests in gifts to a third party, a portion of which also may pass to the donor's spouse, may be split only if the interest for the third party is ascertainable. There is no clear rule as to whether a third party's interest is "ascertainable" or a spouse's interest is negligible to the extent that the spouse's interest may be ignored.³⁹ There is also limited authority available addressing the availability of gift splitting where the spouse is a permissible beneficiary of a trust. The IRS has ruled that when the value of a spouse's interest in a trust cannot be determined, gift splitting is not available.⁴⁰ On the other hand, cases have held that if a spouse has a distribution right under an ascertainable standard (maintenance and support), the value of the principal interest was ascertainable and gift splitting was allowed.⁴¹

The authors view the law to be unsettled on this issue and recommend avoiding gift splitting unless a spouse's interest is clearly ascertainable.⁴² Even if a spouse's interest in a trust is arguably ascertainable, the complexity in valuing such

an interest may be enough of a deterrent to decide not to gift split.

The law is clear that when a married couple divorces or the marriage ends from the death of a spouse, the gift splitting may apply only to the gifts made while the couple was married.⁴³

The benefit of being able to split gifts also carries the burden of joint and several liability.⁴⁴ The entire gift tax liability of each spouse for the year of splitting gifts is joint and several; however, the IRS has protected the non-donor spouse from tax liability when the donor spouse has committed fraud.⁴⁵ Given this joint and several liability of the spouses, a preparer should be cautious when recommending to gift split for situations when the spouses are represented by separate counsel or one spouse is clearly kept out of the loop concerning the finances.

4. Adequate disclosure of transfers

One major mistake for gift tax returns is not satisfying the adequate disclosure rules.⁴⁶ If a gift is adequately disclosed, the IRS will generally have three years to audit the gift tax return without an agreement to toll the statute of limitations.⁴⁷

³¹ Reg. 25.2513-2(a)(1).

³² *Id.*

³³ Reg. 25.2513-2(b)(1).

³⁴ Section 2513(b).

³⁵ Reg. 25.2513-3.

³⁶ Reg. 25.6019-1(h).

³⁷ *Id.*

³⁸ Section 2513(a)(1).

³⁹ See Wang, TCM 1972-143; Falk, TCM 1965-22; and Ltr. Ruls. 200616022 and 200551009.

⁴⁰ See Rev. Rul. 56-439.

⁴¹ For example, see Robertson, 26 TC 246 (1956). But see Kass, TCM 1957-227, where the Tax Court did not allow gift splitting where the spouse has the ability to invade principle for "general welfare."

⁴² See footnote 38, *supra*; Ltr. Ruls. 200345038, 200422051, and 200616022.

⁴³ Section 2513(a).

⁴⁴ Section 2513(d); Reg. 25.2513-4.

⁴⁵ See CCA 200205027.

⁴⁶ The "adequate disclosure rules" can be found at Reg. 301.6501(c)-1(f).

⁴⁷ Section 6501(a).

However, if a gift is not adequately disclosed, the statute of limitations never begins to run.⁴⁸ Starting the statute of limitations and having finality for a value of the transfer are strong reasons to satisfy the adequate disclosure rules. The general rules for disclosure of gifts are listed in Exhibit 1.

Gifts made after 8/5/1997. Prior to the passage of the Taxpayer Relief Act of 1997 (TRA '97), the law regarding the gift tax statute of limitations was well-settled. The statute of limitations for most purposes was three years from the due date of the gift tax return, or three years from the date that the gift tax return was filed, whichever was later. If the statute of limitations had run, under the pre-TRA '97 version of Section 2504(c), the value of a gift made in a prior year was the value reported on the return, provided that federal gift tax was assessed or paid. Other-

wise, the value of the gift, solely for purposes of computing the prior years' taxable gifts, could be pre-determined.⁴⁹ This generally meant that for gifts made prior to the effective date of the TRA, the only way to secure a binding determination of a gift value for gift tax purposes (on current and future gift tax returns) was to trigger the *payment or assessment* of gift tax. Importantly, using up unified credit⁵⁰ did not equate to the payment or assessment of gift tax.⁵¹

Congress fixed the problem of an open-ended opportunity on gift revaluation for estate tax purposes with the enactment of the TRA '97 and the IRS Restructuring and Reform Act of 1998 (RRA '98). Under the TRA '97 and RRA '98, if a gift made after 8/5/1997 was reported on a gift tax return and satisfied adequate disclosure rules, the gift may not be revalued for estate tax purposes once the gift tax statute of limitations had run.⁵²

A careful reading of the gift tax statute of limitations applies an open statute of limitations to all gifts that are not adequately disclosed on a gift tax return.⁵³ The corresponding adequate disclosure regulations state that the effective date of the open statute of limitations is for all gifts made after 12/31/1996, which would, by definition, include the entire 1997 calendar year.⁵⁴ The problem, however, is that this effective date conflicts with the legislative history of Section 6501(c)(9), which clearly says that the open statute of limitations applies only to gifts not adequately disclosed made after the date of enactment—8/5/1997.⁵⁵

Saving paper. Often taxpayers will look for ways to cut down on the burden of disclosing or paying for a good appraisal, which leads to the mistake of inadequate disclosure. When taxpayers hear what an

appraisal costs, they may search for a low-cost appraiser to help save money. This can be a mistake.

For those companies already having 409A appraisals done for income tax purposes, taxpayers will want to use those appraisals. However, this is cutting corners because those reports are not prepared for transfer tax purposes and may not have all of the requirements for meeting adequate disclosure under the Treasury Regulations provided in Exhibit 1. Instead, if the taxpayer is not willing to have a separate appraisal prepared, the taxpayer should have the appraiser update the 409A appraisal to add the adequate disclosure requirements for transfer tax purposes.

Taxpayers may also want to refrain from reporting the sale of closely held entity interests to a grantor trust for adequate consideration, as discussed above. However, reporting sales is generally recommended because if the sale is adequately disclosed, the statute of limitations for assessment will begin to run. Failing to adequately disclose this type of transfer may lead to a costly mistake.

5. Forgetting to check the box for valuation discounts

A mistake that is both easily made and costly is not checking one of the boxes for the first question on Schedule A, question A, inquiring as to whether valuation discounts were applied to a gift on the return. This question is easily missed because it is only one line at the top of Page 2 of the gift tax return.

Valuation discounts are generally heavily scrutinized by the IRS. If the question is not answered or answered in the negative when discounts have been taken on the return, the IRS will likely exercise additional scrutiny on review of the return. It may look like the taxpayer is trying to hide something,

⁴⁸ Section 6501(c).

⁴⁹ Section 2504(c) was amended in 1998 by the RRA '98, P.L. 105-206, section 6007(e)(2)(B), to be effective for gifts made after 8/5/1997. Prior to the amendment, Section 2504(c) (pre-TRA and -RRA) provided that for gifts made on or before 8/5/1997:

(c) Valuation of certain gifts for preceding calendar periods. If the time has expired within which a tax may be assessed under this chapter or under corresponding provisions of prior laws on the transfer of property by gift made during a preceding calendar period, as defined in Section 2502(b), the value of such gift made in such preceding calendar period shall, for purposes of computing the tax under this chapter for any calendar year, be the value of such gift which was used in computing the tax for the last preceding calendar period for which a tax under this chapter or under corresponding provisions of prior laws was assessed or paid.

⁵⁰ The unified credit for gift and estate taxes between 1987 and 1997 was \$192,800, the credit equivalent of \$600,000 in total taxable transfers.

⁵¹ See Reg. 25.2504-2(a); Rev. Rul. 84-11; TAM 8132011; GCM 38703; TAM 8447005.

⁵² P.L. 105-206, section 6007(e)(2)(B), Section 2504(c); Section 2001(f)(1); Section 6501(c)(9); Reg. 301.6501(c)-1(f)(8).

⁵³ See Section 6501(c)(9).

⁵⁴ See Preamble to TD 8845, 12/2/1999; Reg. 301.6501(c)-1(f)(8).

⁵⁵ In 1997, P.L. 105-34, section 506(b), amended para. section 6501(c)(9), effective for gifts made in calendar years ending after 8/5/1997.

even if the discounts are disclosed elsewhere on the return and the question was really just missed.

Importantly, if the “yes” box has been checked to advise the IRS that a discount was applied in a valuation, an explanation of the discount needs to be attached to the return. The explanation of the discount is often provided in an attached appraisal or valuation report. Although the valuation discount question is an easy one to miss, the cost of not checking a box may mean more scrutiny from the IRS than if the question were answered in the affirmative.

6. Forgetting to check the box for frontloading qualified tuition plans

The next question on the gift tax return that is easy to miss is question B, the check-the-box for applying the current year’s contribution to a qualified tuition plan ratably over a five-year period. The most commonly used qualified tuition plan is a 529 account and “529 account” will be used herein to encompass all qualified tuition plans. Under the Tax Cuts and Jobs Act, clients may fund 529 accounts to cover tuition at primary and secondary school in addition to college. Consequently, missing the check-the-box for gifts to a 529 account may now have greater repercussions.

Although many people know that a contribution to a 529 account qualifies for an annual exclusion from gift tax, many do not know that the account may be frontloaded.⁵⁶ A taxpayer may contribute up to five years’ worth of annual exclusions to a 529 account to qualify a contribution of \$75,000 (i.e., \$15,000 times five years) for the annual exclusion for the tax year of the gift tax return that is being filed, plus the next four calendar years of annual exclusions for the bene-

ficiary of the 529 account. Furthermore, that amount can be doubled through gift splitting.

Failing to check the box for this question will lead to any gift to a 529 account that exceeds the annual exclusion amount using some of the taxpayer’s lifetime exemption amount and not being able to use the annual exclusions for four more years on the current year’s contribution. Although a small box, there is a significant consequence for missing it.

7. Reporting gifts on wrong part of Schedule A

Many times a gift is reported in the wrong part of Schedule A. This may be a consequence of Schedule A of the gift tax return evolving or not understanding the nuances of the GST tax rules. Each of Parts 1, 2, and 3 has a first set of rows for reporting gifts by the taxpayer and a second set of rows for reporting gifts by the taxpayer’s spouse. The second set of rows is used to report gifts made by the taxpayer’s spouse when the taxpayer and the taxpayer’s spouse are electing to split gifts. By having the two sets of rows, each part includes the gifts being split by both the taxpayer and the taxpayer’s spouse. Often the second set of rows for the taxpayer’s spouse’s gifts is overlooked.

Part 1 of Schedule A. Part 1 of Schedule A is for gifts that are subject to the gift tax and not the GST tax. Although Part 1 is straightforward, Part 1 may be erroneously used when the preparer does not understand the use of the other two Parts concerning the GST tax.

Part 2 of Schedule A. Part 2 of Schedule A is for direct skips, subject to both the gift and GST tax. In the gift tax return context, a “direct skip” is a transfer of an interest in property to a skip per-

son subject to gift tax.⁵⁷ A “skip person” may be an individual or trust. An individual who is two or more generations younger than the transferor’s generation is a “skip person.”⁵⁸ A trust is a “skip person” if all interests in the trust are held by skip persons, or no person holds an interest in the trust and no distributions may be made to a person who is not a skip person.⁵⁹ Typically, determining whether an individual is a skip person is a straightforward assessment; however, as outlined below, determining whether a trust is a skip person or a GST trust can be riddled with complexity. GST trusts should be reported on Part 3 and not Part 2 of Schedule A.

Preparers sometimes inadvertently do not check the box in column C of Part 2. When the box in column C is checked, the taxpayer is electing out of the allocation of his or her GST exemption to the gift. A direct skip automatically has GST exemption allocated to the transfer in an amount sufficient to exempt the transfer from GST tax, unless elected out of the automatic allocation under column C.⁶⁰ Furthermore and easily forgotten, an explanation must be attached to the gift tax return describing the transaction and the extent to which the automatic allocation should not apply to the gift. In lieu of such an explanation, reporting a direct skip on a timely-filed Form 709 and paying the GST tax on the transfer qualifies as such a statement.⁶¹

Part 3 of Schedule A. Part 3 of Schedule A is for “indirect skips,” which are transfers subject to gift

⁵⁶ Section 529(c)(2)(B).

⁵⁷ Section 2612(c).

⁵⁸ Section 2613(a)(1).

⁵⁹ Section 2613(a)(2).

⁶⁰ Section 2632(b).

⁶¹ See Instructions to Form 709 (2017), page 10.

⁶² Section 2632(c)(3)(A).

⁶³ Section 2632(c)(3)(B).

tax made to a GST trust.⁶² Properly classifying a trust as a GST trust is often overlooked. A “GST trust” is a trust that could have a GST, except if:

- The trust instrument provides 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 age 46.
 2. On or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46.
 3. Upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46.
- The trust instrument provides 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 instrument (by name or by class) who is more than ten years older than such individuals.
- The trust instrument provides that, if one or more individuals who are non-skip persons die on or before a date or event described in the first two bulleted clauses, above, 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.

- The trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer.
- The trust is a charitable lead annuity trust (within the meaning of Section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of Section 664(d)).
- The trust is a trust with respect to which a deduction was allowed under Section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

For this purpose, the value of transferred property is not considered to be includable in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in Section 2503(b) with respect to any transferor, and it is assumed that powers of appointment held by non-skip persons will not be exercised.⁶³

The IRS tried to help by attempting to define GST trusts as trusts fitting situations when the taxpayer would want automatic allocations of GST exemption; however, the definition with its exceptions is sometimes difficult to apply and may be overbroad or too narrow, depending on the facts. For example, depending on its terms and how

HELP US PROTECT THEM FROM ABUSE



Through Planned Giving,
your clients can provide
Last Chance for Animals
the opportunity to save
thousands of animals from
fear, abuse and pain.

Gifts of stocks and bonds,
life insurance, real estate, and
other bequests helps keep
animals safe from harm, while
helping ease the tax burden
on your clients estate.

Call for more information:
310-271-6096 X28



8033 Sunset Blvd. #835
Los Angeles CA 90046
501(c)(3) non-profit organization
EIN #95-4013155

it is structured, a GRAT could constitute a GST trust for purposes of these rules, but automatic allocation of GST exemption may not be desirable for the GRAT. Consequently, trusts need to be carefully analyzed in conjunction with the GST trust definition to identify the appropriate place for reporting it on the gift tax return and, as described below, the application of the automatic allocation rules.

Part 3, similar to Part 2, has an important check-the-box election under column C. However, this check-the-box in Part 3 operates drastically different than in Part 2. Similar to Part 2, without checking this box in Part 3, the client's GST exemption is automatically allocated to the gift.⁶⁴ Part 3, however, has options for three different elections by checking the box in column C.⁶⁵ The Instructions describe these elections, which must be detailed on an "election statement."

Election 1 prohibits an automatic allocation of GST exemption to that specific, current transfer. Election 2 prohibits not only the automatic allocation of GST exemption to the current transfer, but also any and all future transfers to that trust. Election 3 deems the trust to be a GST trust for purposes of having all transfers to the trust use automatic allocations of the taxpayer's GST exemption.⁶⁶ While the box may be checked, the election statement may be missing from the gift tax return or the election may not clearly describe which election is being made.

Paying careful attention to the reporting on Schedule A should help the preparer to mitigate the complexity of the laws related to Schedule A.

8. Calculating the wrong annual exclusion amount

Part 4 of Schedule A, line 2 asks for the total annual exclusion amount,

which is often miscalculated. The annual exclusion from gift tax allows a taxpayer to exclude from gift tax up to \$15,000, per year, per individual.⁶⁷ Gifts to a trust can also qualify for the annual exclusion if the gift qualifies as a present interest. A beneficiary has a present interest in a trust if the beneficiary has "[a]n unrestricted right to the immediate use, possession, or enjoyment of property or the income from the property."⁶⁸ Often, to qualify for a present interest and the annual exclusion from gift tax, a beneficiary is given the right to withdraw a contribution to a trust for a certain period of time—usually in the form of a *Crummey* power.⁶⁹

A preparer should carefully examine the outright, 529 account, and trust gifts for a beneficiary when calculating the total amount of the annual exclusions from gift tax for a given year.

The preparer should review the trust agreement to determine a beneficiary's qualification for a present interest. Surprisingly, some of the withdrawal rights may be pegged to a certain amount that is not indexed for inflation, unlike the annual exclusion. Assuming the withdrawal from the trust is the annual exclusion amount may lead to a taxpayer unknowingly using his or her lifetime exemption amount or a deficiency of gift tax.

Entity interest not qualifying.

Although preparers may easily identify outright annual exclusion gifts and annual exclusions through *Crummey* powers, sometimes gifts of entity interests will mistakenly be count-

ed as annual exclusion gifts. The beneficiary receiving the entity interest or that has the withdrawal right over the interest must have "[a]n unrestricted right to the immediate use, possession, or enjoyment of property or the income from the property."⁷⁰

Unfortunately, many entity agreements do not allow the recipient-beneficiary immediate access to the enjoyment of the underlying property of the entity. Many times these agreements are drafted with certain restrictions to enjoyment of distributions from the entity to achieve greater discounts on valuing the entity interests than providing unfettered access to entity distributions or property. Without having access to distributions, the beneficiary receiving the entity interest, whether outright or in trust, will not have a present interest and will not qualify for the annual exclusion from gift tax.⁷¹

Often, preparers will assume that a gift of an entity interest will qualify for the annual exclusion from gift tax without examining the entity agreement to determine what restrictions may apply to the beneficiary's enjoyment of the property. Accordingly, reviewing the entity agreement will mitigate mistakes with calculating the annual exclusion amount.

Forgetting about other uses of exclusion. For various reasons, it is easy to inflate the total amount of annual exclusions from gift tax. A taxpayer may not realize that the 529 account will count against the annual exclusion from gift tax. Or a pre-

⁶⁴ Section 2632(c).

⁶⁵ Section 2632(c)(5).

⁶⁶ Reg. 26.2632-1(b)(2)(iii)(A) (election rules).

⁶⁷ Section 2503(b).

⁶⁸ Reg. 25.2503-3(b).

⁶⁹ See *Crummey*, 397 F.2d 82, 22 AFTR2d 6023 (CA-9, 1968).

⁷⁰ Reg. 25.2503-3(b).

⁷¹ See *Hackl*, 118 TC 279 (2002), *aff'd* 335 F.3d 664, 92 AFTR2d 2003-5254 (CA-7, 2003).

⁷² Section 2642(c)(2).

parer may forget that the taxpayer frontloaded his or her 529 account in a prior year and instead erroneously attributes that 529 account beneficiary with an additional annual exclusion gift. Just as easy to forget is a beneficiary who has withdrawal rights over multiple trusts. Accordingly, a preparer should carefully examine the outright, 529 account, and trust gifts for a beneficiary when calculating the total amount of the annual exclusions from gift tax for a given year.

Assuming that an annual exclusion gift also qualifies for exclusion from GST tax—Schedule D, Part 1. A common mistake is assuming that a transfer qualifying for the annual exclusion from gift tax also qualifies for the annual exclusion from GST tax. Different rules apply to qualifying for those annual exclusions, namely, the qualification for the annual exclusion from GST tax for an interest in a trust has added requirements. The trust must benefit only a skip person and the assets must be includable in the skip person's estate if the trust does not terminate prior to the skip person's death.⁷² *Crummey* powers do not meet those requirements and,

thus, do not qualify for the annual exclusion from GST tax.

Assuming that the *Crummey* powers qualify for the GST tax annual exclusion will lead to the wrong calculation of GST tax under Part 1 of Schedule D. Furthermore, if automatic allocations of GST exemption apply to the trust to which the transfer was made that is mistakenly thought to be an annual exclusion from GST tax, then the taxpayer's GST exemption would be unknowingly used. Alternatively, if the automatic allocation of GST exemption is prohibited from an election, then the trust may have a mixed inclusion ratio. Either way, not realizing that the *Crummey* power does not qualify for the annual exclusion from GST tax leads to a mess that will need to be fixed. Realizing that qualifying for the annual exclusion from gift tax will not necessarily qualify the gift for the annual exclusion from GST tax will avoid mistakes related to the taxpayer's allocation of GST exemption.

9. Skipping Schedule B for prior gifts

Schedule B for gifts from prior years is often left blank. The preparer

should use Schedule B to report all taxable gifts by the taxpayer from prior years to determine how much lifetime exemption (or "applicable credit" on the gift tax return form) has been used in prior years and the total amount of the taxable gifts from prior years. These "carryforwards" are then used in the Part 2—Tax Computation on the first page of the gift tax return.

Although Schedule B is straightforward, it is surprising how often the Schedule is left blank when there have been past taxable gifts. Hopefully it is not for laziness, but this Schedule may be blank because the taxpayer switched preparers and the new preparer does not have the information to complete Schedule B yet. As these carryforwards are used to compute the current gift tax due, this Schedule is important, and missing taxable gifts may create a deficiency for the taxpayer.

10. Incorrectly completing the GST exemption reconciliation

Similar to Schedule B, the reconciliation for GST exemption in Part 2 of Schedule D is often skipped. Whether it is for lack of understanding the GST tax or not having the information to complete this

STEP GLOBAL CONGRESS 2018

Embracing Change: Strategies for Practitioners in an Age of Uncertainty

KEYNOTE SPEAKERS:

Prof. Jason Sharman
University of Cambridge, UK

Leanne Kaufman TEP
RBC Estate and Trust Services, Canada

Ivan Sacks TEP
Withersworldwide, USA

Mark McMullen
Stonehage Fleming, Switzerland

Desmond Teo
EY, Singapore

Dr. Liane Davey
Author, Canada

Bill Mitchell
Townsville Community Legal Service,
Australia

13-14 September 2018

The Westin Bayshore, Vancouver

Following the success of the inaugural and second STEP Global Congresses, our third Global Congress will be moving to Canada and take place in Vancouver.

Programme Focus:

- Towards a UN convention on the rights of older persons
- Serving the new global clientele: tools for 21st-century advisors in a fast-changing environment
- The bad and the good of the rise of AI in society
- True family wealth: rethinking money, success and succession
- Countering cross-border financial crime: how well does the system work and how could it work better?

Register now: www.stepglobalcongress.com

#STEPCongress

Gold Sponsors



Silver Sponsors



Part, many times Part 2 is blank. Still, even with strong effort, preparers are prone to mistakes in Part 2 of Schedule D, as allocating GST exemption is very complex.

Allocations of GST exemption.

As mentioned above, it is not always clear when a trust is a GST trust to which automatic allocations of GST exemption will apply. Furthermore, if automatic allocations are applying to transfers to a trust, the preparer may forget to account for the use of the taxpayer's exemption in one or more years. Lastly, whether the trust qualifies as a GST trust or not may change from year to year, unknowingly. Because of these intricacies for determining whether the trust is a GST trust, preparers will often miscalculate the automatic allocation amount to be inserted in line 5 of Part 2 of Schedule D.

Instead of trying to determine whether the trust is a GST trust and relying on whether or not automatic allocations of GST exemption apply, the preparer should use an election statement to affirmatively choose how the taxpayer's current year transfer and future transfers to the particular trust will be treated. For non-automatic allocations of GST exemption, using a Notice of Allocation is recommended to describe the amount of, and to which transfers, exemption is allocated. The paper trail of using election statements and Notices of Allocation provides an explanation of how the taxpayer's GST exemption is being used and avoids any ambiguities that may arise from determining whether the trust is a GST trust.

ETIP. Often preparers do not realize that GST exemption cannot be allocated to be effective during the estate tax inclusion period (ETIP).⁷³ The ETIP is when the transferred assets may be included in the transferor's or transferor's spouse's estate.⁷⁴ If GST exemption is attempted to be allocated to a trust during the ETIP, the exemption will not be allocated until the close of the ETIP, potentially leading to using much more of the taxpayer's GST exemption than realized or having a mixed inclusion ratio trust. Accordingly, it is generally advisable to elect out of any automatic allocation of GST exemption during the ETIP to avoid any unintended allocation of GST exemption at the close of the ETIP.

Gift splitting. If spouses have elected to gift split, the gift is treated as if made one-half by each spouse for purposes of the GST tax.⁷⁵ What can lead to mistakes is the result of a split gift for which a portion is payable to a non-donor spouse. The spouses may not split the gift attributable to the interest for the non-donor spouse, but the non-donor spouse is deemed the transferor of one-half of the entire value of the property transferred by the donor, regardless of the interest that the non-donor spouse is actually deemed to have transferred.⁷⁶

Combining the complication of gift splitting with the ETIP understandably leads to mistakes. For a split gift that is a gift to a spouse subject to an ETIP, no GST exemption would be allocated on the gift tax return reporting the gift. The GST exemption, however, will be allocated at the close of the ETIP.

If the non-donor spouse dies during the ETIP, that spouse's executor may still allocate GST exemption up to the amount of the non-donor spouse's deemed transfer at the end of the ETIP, but not before then.⁷⁷ The gift splitting and ETIP rules have another level of complexity to layer onto allocating GST exemption that leads to improper amounts of GST exemption being allocated on Part 2 of Schedule D. Accordingly, preparers will benefit from double checking the reporting of gifts concerning spouses, ETIP, or splitting.

Conclusion

Minimizing transfer tax exposure and establishing the grounds to support all aspects of the transfer if an audit occurs is one of the many responsibilities for the holistic estate planning practitioner. Properly completing and reviewing the gift tax return is a key component to meeting this responsibility. However, as outlined in this article, gift tax returns often contain common mistakes that increase the chances of an audit or prevent the statute of limitations from beginning to run. By gathering the necessary facts, being aware of the applicable transfer tax rules, and understanding the nuances of the gift tax return form and corresponding schedules, practitioners, whether as the initial preparer or reviewer, will be better equipped to properly handle the gift tax return component. ■

⁷³ Section 2642(f).

⁷⁴ Reg. 26.2632-1(c)(2)(i).

⁷⁵ Section 2513.

⁷⁶ Reg. 26.2652-1(a)(4); Ltr. Rul. 200422051.

⁷⁷ Reg. 26.2632-1(c)(5), Example 3.