FILING GIFT TAX RETURNS WITH 2020 VISION

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I. INTRODUCTION

As a result of the 2017 legislation commonly known as the Tax Cuts and Jobs Act (TCJA), the basic exclusion amount doubled to an inflation-adjusted $10,000,000 per person.[1] After accounting for the inflation adjustment, that amount is a record-high $12,060,000 per person for 2022.[2] This increase is only temporary, as the basic exclusion amount will revert to the pre-2018 amount of an inflation-adjusted $5,000,000 per person as of January 1, 2026, absent further action from Congress.[3]

1. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 11061(a), 131 Stat. 2054, 2091 (2017).
2. Rev. Proc. 2021-45, 2021-48 I.R.B. 764.
3. § 11061(a), 131 Stat. 2054, 2091.

Not long after the enactment of the TCJA, many practitioners found that clients were increasingly interested in making significant gifts to take advantage of the temporary increase in the gift tax exclusion amount.[4] For donors who seek to utilize a specific amount of their remaining gift tax exclusion amount or to successfully freeze the value of an asset through a non-gift sale, making the transfer is merely the first step.[5] Equally important is the proper preparation and filing of a Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return to report that gift or transfer to the Internal Revenue Service (IRS or Service).[6] The primary purpose of this Article is to revisit the fundamentals of gift tax return preparation and the reporting requirements necessary to achieve adequate disclosure.[7] Although this Article was originally written in response to the increased gifting activity seen in 2020 following the election of President Joe Biden, the uncertainty surrounding the longevity of the current gift and estate tax laws remains.[8] As a result, the principles in this Article will continue to be relevant as clients continue to engage in large gift and sale transactions in 2022 and beyond.[9]

II. DETERMINING WHETHER TO FILE

In some cases, a donor who made gifts will not be required to file a gift tax return.[10] In others, an individual who made no gifts at all will choose to file a gift tax return.[11] As a result, determining whether a client is required to file a gift tax return is a distinct inquiry from whether a client should file a gift tax return.[12]

When determining whether a donor should file a gift tax return, it is important to bear in mind that certain transactions that would not be considered a gift in the conventional sense of the word will constitute a gift for federal tax purposes.[13] Any transfer made for less than adequate and full consideration will be a taxable gift, even in the absence of any donative intent on the part of the transferor.[14] To ensure that these less obvious gifts are part of the calculus, it is often helpful to ask clients whether they have recently

4. *See Estate and Gift Tax FAQs*, IRS, https://www.irs.gov/newsroom/estate-and-gift-tax-faqs (Dec. 21, 2021) [https://perma.cc/G7QT-4EEV].

5. *Id.*

6. *See Instructions for Form 709*, IRS, https://www.irs.gov/instructions/i709 (Nov. 17, 2021) [https://perma.cc/ZR5T-QWZN].

7. Author's original thought.

8. Author's original thought.

9. *See* Erin Duffin, *Estate and Gift Tax Revenue and Forecast in the United States from 2000 to 2031*, STATISTA (Nov. 9, 2021), https://www.statista.com/statistics/217518/revenues-from-estate-and-gift-tax-and-forecast-in-the-us/ [https://perma.cc/SCK6-CH34].

10. *See Instructions for Form 709*, *supra* note 6.

11. *See id.*

12. Author's original thought.

13. *See* Dickman v. Comm'r, 465 U.S. 330, 333 (1984).

14. I.R.C. § 2512(b); Treas. Reg. § 25.2511-1(g)(1).

forgiven any debts, sold any assets for less than their fair market value, or exercised any powers of appointment, as well as to ask about the type of support they may provide to adult children or other family members (e.g., rent-free housing or an interest-free loan).[15] Once the full scope of a client's gifts or other relevant transfers is known, the next step is determining whether a return needs to be filed.[16]

A. When a Donor Is Required to File

A donor is required to file a gift tax return under any of the circumstances described in this subsection.[17]

1. Gifts of Present Interests That Exceed the Annual Exclusion Amount

A donor who, in any calendar year, makes a total amount of gifts to a donee (except the donor's spouse) in excess of the annual exclusion amount will generally be required to file a gift tax return.[18] There are several notable exceptions to this general rule, all described in more detail in Section II.B below.[19] The annual exclusion amount is adjusted for inflation on an annual basis.[20] The annual exclusion amount was $15,000 per person in 2021 and increased to $16,000 per person in 2022.[21]

The annual exclusion is only available in connection with gifts of present interests.[22] The Regulations define a present interest as the "unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain)."[23] The annual exclusion is most commonly used to offset outright gifts made to a donee as well as gifts made in trust that are subject to *Crummey* withdrawal rights.[24]

A gift to or for the benefit of an individual who is under age twenty-one will be considered a present interest and thus will be eligible for the annual exclusion if it meets the following criteria:

- The gifted property and income may be expended by or for the benefit of the donee before the donee reaches age twenty-one;

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15. *See Instructions for Form 709*, *supra* note 6.
16. *See id.*
17. *See id.*
18. I.R.C. § 6019(1).
19. *See infra* Section II.B.
20. I.R.C. § 2503(b)(2).
21. Rev. Proc. 2020-45, 2020-46 I.R.B. 1016; Rev. Proc. 2021-45, 2021-48 I.R.B. 764.
22. I.R.C. § 2503(b)(1).
23. Treas. Reg. § 25.2503-3(b) (as amended in 1983) (All references hereinafter to the "Regulations" are to the Treasury Regulations promulgated under the Internal Revenue Code of 1986, as amended.).
24. Crummey v. Comm'r, 397 F.2d 82, 87–88 (9th Cir. 1968).

- To the extent that the gifted property is not so expended, it must pass to the donee on the donee's twenty-first birthday; and
- If the donee dies prior to reaching age twenty-one, the property must be payable to the donee's estate or to whomever the donee may appoint under a general power of appointment.[25]

This exception is often used to establish a so-called "2503(c) trust," but it also covers gifts made to Uniform Transfers to Minors Act (UTMA) and Uniform Gifts to Minors Act (UGMA) accounts.[26]

2. Gifts of Future Interests

Any gift of a future interest, regardless of the amount, must be reported on a gift tax return.[27] Future interests include "reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time."[28] Any gift to a trust that is not subject to *Crummey* withdrawal rights or does not meet the requirements of Code Section 2503(c) is a gift of a future interest.[29]

3. Gifts Involving Spouses

A gift to or by a spouse will necessitate the filing of a gift tax return under the circumstances described in this subsection.[30]

a. Split Gifts

Spouses have the option to treat a gift made by one spouse to a third party as if it were made one-half by each of them by making an election to split gifts.[31] Spouses may split gifts so long as they were married to one another at the time of the gift and provided that neither spouse remarries during the year in which the gift was made.[32] Gifts of community property are already considered as having been made one-half by each spouse and should not be reported as split gifts.[33]

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25. I.R.C. § 2503(c); Treas. Reg. § 25.2503-4(a).
26. *See* UNIF. TRANSFERS TO MINORS ACT § 1 cmt. at 7 (UNIF. LAW COMM'N 1983, amended 1986); TEX. PROP. CODE ANN. § 141.005 (1995).
27. *See Instructions for Form 709*, *supra* note 6.
28. Treas. Reg. § 25.2503-3(a).
29. *See Instructions for Form 709*, *supra* note 6.
30. *See id.*
31. I.R.C. § 2513(a)(1).
32. Treas. Reg. § 25.2513-1(a).
33. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Who Must File").

If a married couple desires to split gifts, then at a minimum, the donor-spouse will be required to file a gift tax return.[34] The consenting, non-donor spouse will also be required to file a gift tax return unless: (i) only the donor-spouse made gifts, (ii) the total value of the gifts to each third-party donee does not exceed the spouses' combined annual exclusion amounts ($30,000 for 2021 and $32,000 for 2022), and (iii) all of the gifts were of present interests.[35] Alternatively, if the consenting spouse also made gifts, such spouse will not be required to file a gift tax return if (i) those gifts were less than the annual exclusion amount ($15,000 for 2021 and $16,000 for 2022) and made to third-party donees who did not also receive gifts from the donor-spouse and (ii) all gifts by both spouses were of present interests.[36] Under either circumstance, a successful election to split gifts may be made by completing Lines 12–17 of Part 1 on the donor-spouse's gift tax return and adding the consenting spouse's signature to Line 18.[37] If both spouses are required to file a gift tax return, the same procedure should be followed with each spouse signing Line 18 of the other spouse's return.[38]

If a married couple makes a gift-splitting election, it will apply to all gifts made by either spouse during the calendar year while married to the other.[39] Put another way, married couples do not have the flexibility to elect gift splitting for some gifts but not others.[40] The preparer must carefully explain this principle to a married couple considering splitting gifts, particularly if only one spouse made gifts of a significant amount.[41] In that event, the consenting spouse must consider whether it is desirable to utilize the consenting spouse's gift tax exclusion and generation-skipping transfer (GST) tax exemption amounts on the donor-spouse's gifts.[42] Furthermore, spouses will be jointly and severally liable for any gift tax associated with a split gift, regardless of which spouse made the gift.[43]

There are certain gifts to which a gift-splitting election will not apply.[44] First, it will not apply to any gift of an interest subject to a general power of appointment exercisable by the non-donor spouse.[45] Second, it will not apply

34. Treas. Reg. § 25.2513-2(a)(1).

35. *Id.* § 25.2513-1(c).

36. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "When the Consenting Spouse Must Also File a Gift Tax Return").

37. *Id.*

38. Treas. Reg. § 25.2513-2(a)(1) (Although the Regulations note that other methods of consenting to gift splitting are acceptable, having each spouse sign the other's return is the preferred approach and is the method prescribed by the Instructions for Form 709.).

39. I.R.C. § 2513(a)(2).

40. *See id.*

41. *See id.*

42. *See id.*

43. *Id.* § 2513(d); Treas. Reg. § 25.2513-4.

44. *See* I.R.C. § 2513(a)(1).

45. *Id.*

to any gifts made by the donor-spouse to the donee-spouse.[46] If a gift is made in part to the donee-spouse and in part to third parties, a gift-splitting election may be made with regard to the interest gifted to the third parties "only insofar as such interest is ascertainable at the time of the gift and hence severable from the interest transferred to [the] spouse."[47] Thus, if the donor-spouse makes a gift to a trust for the benefit of his or her spouse and one or more third parties, only the portion of the gift attributable to the third parties will be eligible for gift splitting, assuming that such portion is ascertainable.[48] This issue is discussed in more depth in Section IV.F.2 herein.[49]

b. Gifts of Community Property

Gifts of community property are "considered made one-half by each spouse."[50] If one or both spouses make a gift of community property assets, then each spouse will be required to file a gift tax return if (i) the total value of the gift exceeds the spouses' combined annual exclusion amounts ($30,000 for 2021 and $32,000 for 2022) or (ii) the gift is of a future interest, regardless of value.[51]

c. Gifts to Non-Citizen Spouses

A donor is generally not required to report any gifts of present interests made to the donor's spouse on a gift tax return because such gifts are subject to an unlimited marital deduction.[52] However, the unlimited marital deduction does not apply to gifts made to a donee-spouse who is not a U.S. citizen.[53] Instead, an annual exclusion amount is available to a donor who makes a gift to a non-citizen spouse equal to $100,000, as adjusted for inflation.[54] That annual exclusion amount was $159,000 for 2021 and is $164,000 for 2022.[55] If a donor makes one or more gifts to his or her non-citizen spouse that exceeds the annual exclusion amount, the donor will be required to report all of those gifts on a gift tax return.[56]

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46. *Id.*
47. Treas. Reg. § 25.2513-1(b)(4).
48. *See id.*
49. *See infra* Section IV.F.2.
50. *See Instructions for Form 709*, *supra* note 6.
51. *Id.*
52. I.R.C. § 2523(a); *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Gifts to Your Spouse").
53. I.R.C. § 2523(i).
54. *Id.* §§ 2523(i)(2), 2503-2(b).
55. Rev. Proc. 2020-45, 2020-46 I.R.B. 1016; Rev. Proc. 2021-45, 2021-48 I.R.B. 764.
56. *See Instructions for Form 709*, *supra* note 6.

d. Gifts of Terminable Interests

The unlimited marital deduction does not apply to a donor's transfer of certain terminable interests to or for his or her spouse's benefit.[57] A terminable interest is defined as any interest in property that "will terminate or fail on the lapse of time or on the occurrence or the failure to occur of some contingency."[58] If the donor gifts his or her spouse a terminable interest in property that will be subject to the possession or enjoyment of any other person (including the donor) upon the failure or termination of that interest, it will generally not qualify for the marital deduction.[59] This general rule is subject to the following exceptions:

- Joint Interests: An interest transferred to the donee-spouse as the sole joint tenant with the donor or as tenant by the entirety will qualify for the marital deduction even though the donor may possess or enjoy the property after the termination of the interest by virtue of being the surviving spouse.[60]

- Life Estate with a Power of Appointment: Code Section 2523(e) provides that an interest that is gifted by the donor-spouse to or for the benefit of the donee-spouse will qualify for the marital deduction if it satisfies two main criteria: (i) the donee-spouse must be entitled to all of the income from the interest for life, payable at least annually, and (ii) the donee-spouse must hold a general power of appointment over the interest, exercisable in favor of the donee-spouse or his or her estate.[61]

- *Inter Vivos* QTIP: An interest in property that is gifted by the donor-spouse to or for the benefit of the donee-spouse will qualify for the marital deduction as a qualified terminable interest if that interest (i) is transferred by the donor-spouse, (ii) provides the donee-spouse with a qualifying income interest for life, and (iii) is subject to the election under Code Section 2523(f)(4).[62] A donee-spouse will be considered to have a qualifying income interest for life if the donee-spouse is entitled to all of the income from the interest on an annual or more frequent basis, and so long as no person has a power to appoint any part of the interest to any person other than the donee-spouse.[63]

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57. I.R.C. § 2523(b).
58. Treas. Reg. § 25.2523(b)-1(a)(3).
59. *Id.* § 25.2523(b)-1(b); I.R.C. § 2523(b).
60. I.R.C. § 2523(d); Treas. Reg. § 25.2523(d)-1.
61. I.R.C. § 2523(e).
62. *Id.* §§ 2523(f)(2), (4).
63. *Id.* § 2056(b)(7)(B)(ii).

- Charitable Remainder Trust: Code Section 2523(g) provides that an interest passing to a qualified charitable remainder trust will qualify for the marital deduction if the donee-spouse is the only non-charitable beneficiary of that trust.[64]

Because a joint interest is not considered a terminable interest for transfer tax purposes, transfers of this nature are not required to be reported on a gift tax return.[65] Similarly, a terminable interest gifted to a spouse that qualifies as a life estate with a power of appointment is not required to be reported.[66] There is also no requirement to report a gift to a donee-spouse of an interest in a qualified charitable remainder trust.[67]

A donor is required to file a gift tax return to report any gifts made to a qualified terminable interest property (QTIP) trust.[68] Assuming that the donor-spouse desires for the gift to be subject to the marital deduction, it is vitally important that the donor-spouse makes the *inter vivos* QTIP election on a timely filed gift tax return, as late elections are not permitted.[69] Partial and reverse QTIP elections may be made in conjunction with a gift to an *inter vivos* QTIP, but there are no gift tax regulations that appear to authorize a Clayton QTIP election for gift tax purposes.[70]

Some commentators are concerned that any changes to the gift and estate tax laws that are enacted in 2022 could apply retroactively to January 1, 2022.[71] In order to mitigate the risk associated with making large taxable gifts, some planners are recommending that their married clients create "QTIPable" trusts for one another.[72] These trusts contain all of the elements necessary to qualify for the marital deduction, namely, providing for the donee-spouse to be the only trust beneficiary and granting such spouse a qualifying income interest for life, but they will only do so if the *inter vivos* QTIP election is actually made.[73]

The *inter vivos* QTIP election for any 2022 gifts will not need to be made until April 17, 2023 (or October 16, 2023, if the donor's gift tax return is extended).[74] This gap in time between the gift and the due date of the

64. *Id.* § 2523(g).

65. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Line 4. Marital Deduction").

66. *See id.* (referring to the text under subheading "Gifts to Your Spouse").

67. *Id.*

68. *Id.*

69. I.R.C. § 2523(f)(4)(A).

70. *Id.* § 2652(a)(3)(B); Treas. Reg. § 25.2523(f)-1(b)(3)(i).

71. *See* Hollis F. Russell, Gail W. Marcus, Barbara A. Sloan & T. Randolph Harris, *Lifetime 'QTIPable' Trusts for Gift, Estate Tax Exemption Planning*, N.Y. L.J., (Mar. 17, 2021), https://www.mclaughlinstern.com/wp-content/uploads/2021/06/NYLJ03172021483509McLaughlin.pdf [https://perma.cc/8ZAD-R2EP].

72. *See id.*

73. I.R.C. § 2523(f)(4)(A).

74. *Id.*

associated return empowers the donor-spouse to decide whether to make the *inter vivos* QTIP election with the benefit of hindsight.[75] If retroactive tax legislation were enacted, the donor-spouse could make a full or partial QTIP election to qualify the gift for the marital deduction to the extent necessary to avoid being subject to gift tax.[76] If no retroactive legislation is enacted, the donor-spouse may decline to make the QTIP election at all, thereby necessitating the use of an amount of the donor-spouse's gift tax exclusion amount equal to the value of the gift.[77] Regardless of the donor-spouse's final decision regarding the QTIP election, the donor-spouse will be required to file a gift tax return.[78]

4. Certain Gifts to Charitable Organizations

For gift tax purposes, there is an unlimited charitable deduction for gifts made to charitable organizations.[79] There is no requirement to file a gift tax return if a donor only made gifts to charity and if all of such gifts were of the donor's entire interest in the gifted property.[80] In contrast, a donor will be required to file a gift tax return if the donor gifted only a partial interest in property to a charitable organization or if a gifted interest was transferred in part to a charitable organization and in part to a third party.[81] Consequently, donors who make gifts to charitable remainder trusts or pooled income funds must file a gift tax return.[82]

If a donor is required to file a gift tax return for any reason, that donor must include all the donor's charitable gifts from the relevant calendar year on the return.[83] There is a common misconception that gifts to charitable organizations as reported on a gift tax return are only subject to the charitable deduction, and preparers often complete Line 7 of Part 4 of the return by noting the full value of all of the donor's charitable gifts for the relevant calendar year.[84] However, one should first offset a gift to a charitable organization by applying the annual exclusion amount, and thus only the balance of that gift in excess of $16,000 (or the annual exclusion amount for the year in question) should be reported as being subject to the charitable deduction.[85]

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75. *Id.*
76. *Id.*
77. *See id.*
78. *See id.*
79. *Id.* § 2522.
80. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Who Must File").
81. *Id.*
82. I.R.C. § 2522(c)(2).
83. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Who Must File").
84. *See id.*
85. *Id.* (referring to "Line 7. Charitable Deduction").

B. When a Donor Is Not Required to File

Not all gifts are required to be reported on a gift tax return.[86] The prior subsection highlighted a number of gifts that will not give rise to a gift tax reporting requirement, including (i) gifts of present interests that are fully covered by the annual exclusion amount; (ii) gifts of non-terminable interests made to or for a U.S. citizen spouse that qualify for the unlimited marital deduction; and (iii) gifts to charitable organizations of the donor's full interest in the gifted property.[87] This subsection describes the other types of gifts that will not, on their own, give rise to a gift tax return filing requirement.[88] The transfers described in this subsection are not considered to be gifts for transfer tax purposes and thus are never required to be reported on a gift tax return, even if the donor is otherwise required to file one.[89]

1. Transfers to Political Organizations

Transfers to certain political organizations (within the meaning of Code Section 527(e)(1)) are not required to be reported on a gift tax return.[90] The Code defines a "political organization" as "a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function."[91] For purposes of this definition, an "exempt function" encompasses efforts to influence "the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization."[92] Common examples of organizations that meet these criteria are political parties, campaign committees, and political action committees (PACs).[93]

2. Payments That Qualify for the Medical or Educational Exclusion

The gift tax does not apply to certain payments made directly to an educational organization or medical care provider on behalf of a third party.[94] Payments made directly to a student or patient, even if those payments are

86. *Id.*

87. *See supra* Section II.A; *id.*

88. *See infra* Section II.B.

89. *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Transfers Not Subject to the Gift Tax").

90. I.R.C. § 2501(a)(4).

91. *Id.* § 527(e)(1).

92. *Id.* § 527(e)(2).

93. *See Political Action Committees (PACs)*, FED. ELECTION COMM'N, https://www.fec.gov/press/resources-journalists/political-action-committees-pacs/ (last visited Jan. 16, 2022) [https://perma.cc/VMN3-LTNM].

94. I.R.C. § 2503(e).

used for educational or medical expenses, do not qualify for the exclusion and are considered taxable gifts.[95] Contributions to a trust administered for the sole purpose of funding the beneficiary's education or paying the beneficiary's medical expenses are also ineligible for the exclusion.[96] In sum, donors who rely on the medical or educational exclusion must take care to make payment directly to the educational organization or medical provider at issue.[97]

The educational exclusion applies to the payment of tuition if it is made to "an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on."[98] This broad definition encompasses nearly all precollegiate private schools and undergraduate and post-graduate studies at colleges and universities.[99] Note that this exception only applies to the payment of tuition and not to the payment of expenses for books, supplies, dormitory fees, board, or other similar expenses that do not constitute tuition costs.[100]

Only payments made directly to an educational organization qualify for the educational exclusion, meaning that contributions to Qualified Tuition Programs (QTP), such as Section 529 Plans, do not qualify.[101] However, the gift tax annual exclusion amount can be applied towards gifts to QTPs, and donors have the option to treat a contribution of up to $80,000 to a QTP for a single individual as if such contribution had been made ratably over a five-year period.[102]

The medical exclusion applies to the payment of medical expenses "incurred for the diagnosis, cure, mitigation, treatment or prevention of disease" and certain transportation and lodging costs that are associated with that care.[103] It also applies to the payment of health insurance costs, but it does not apply to the payment of medical expenses that are reimbursed by the donee's insurance company.[104] The medical exclusion does not apply to the payment of expenses for cosmetic surgery or other related procedures unless the surgery or procedure is necessary to correct issues related to a congenital abnormality, accident, or disease.[105]

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95. *See* Treas. Reg. § 25.2503-6(c) (examples 2 and 4).
96. *See id.*
97. *See id.*
98. I.R.C. §§ 2503(e)(2)(A), 170(b)(1)(A)(ii).
99. *See id.* § 170(b)(1)(A)(ii).
100. Treas. Reg. § 25.2503-6(b)(2).
101. *See Instructions for Form 709*, *supra* note 6.
102. I.R.C. § 529(c)(2)(B). In this case, $80,000 represents five years' worth of annual exclusion amounts, so this amount will adjust upwards if and when the annual exclusion amount is increased as a result of an inflation adjustment. *See id.*
103. I.R.C. § 213(d); *see* Treas. Reg. § 25.2503-6(b)(3).
104. *See* Treas. Reg. § 25.2503-6(b)(3); I.R.C. § 213(d).
105. I.R.C. § 213(d)(9).

3. Qualified Disclaimers

If a donee makes a qualified disclaimer in accordance with Code Section 2518 and the associated Regulations, it will be as if the gifted property had never been transferred to the donee.[106] The Instructions for Form 709 provide that in the event of a qualified disclaimer, "the disclaimant is not regarded as making a gift to the person who receives the property because of the qualified disclaimer."[107]

A Texas donee contemplating a disclaimer should be mindful that it is possible to make a disclaimer that is valid under state law but is not considered a qualified disclaimer for federal tax purposes.[108] In that scenario, the disclaimer will be disregarded, and the disclaimant will be treated as if they transferred the gifted assets to the persons who received them due to the nonqualified disclaimer.[109] Depending on the nature and value of that transfer, the disclaimant may be required to file a gift tax return.[110]

C. When a Donor Should File Regardless

Practitioners are often met with a healthy dose of skepticism when they suggest that a client voluntarily file a gift tax return not otherwise required, but it is often in the client's best interests.[111] This subsection explores a number of scenarios in which it may be appropriate to file a gift tax return that is not otherwise required.[112] Similarly, a donor who has a filing requirement may want to go above and beyond by reporting certain gifts or transactions the donor is not otherwise required to disclose to realize the potential benefits described herein.[113]

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106. *Id.* § 2518(a).

107. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Transfers Not Subject to the Gift Tax").

108. *See* Glenn M. Karisch, Thomas M. Featherston, Jr., & Julia E. Jonas, *Disclaimers Under the New Texas Uniform Disclaimer of Property Interests Act*, ST. BAR TEX. EST. PLAN. & PROB. DRAFTING COURSE, HOUS., TEX., (Aug. 26, 2015) https://www.res-ipsa.com/seminars/TLTA-2019/Day1Materials/N_Disclaimers%20of%20Real%20Property%20Rights.pdf [https://perma.cc/KTA7-H883] (discussing Texas disclaimers are subject to the Texas Uniform Disclaimer of Property Interests Act, which can be found in Chapter 240 of the Texas Property Code)

109. Treas. Reg. § 25.2518-1(b).

110. *See id.* § 25.2518-1(b).

111. Author's original opinion.

112. *See infra* Sections II.C.1–2.

113. *See infra* Sections II.C.1–2.

1. Allocating GST Exemption (Or Not)

The preparation of a gift tax return involves reporting transfers that may be subject to gift tax and GST tax.[114] Gifts solely subject to gift tax, such as outright gifts to a child or sibling, are reported on Part 1 of Schedule A of the return.[115] Gifts currently subject to both gift and GST taxes, such as gifts to a grandchild or a trust for the grandchild's sole benefit, are reported on Part 2 of Schedule A of the return.[116] Gifts that are currently subject solely to gift tax but could be subject to GST tax in the future, such as gifts to a trust for the benefit of the donor's children and grandchildren, are reported on Part 3 of Schedule A of the return.[117] By filing a gift tax return to report a direct skip, an indirect skip, or something in between, the donor will be empowered to make certain elections to dictate whether or not the donor's GST tax exemption amount is allocated to such gifts.[118]

a. Direct Skips

When a donor makes a gift that constitutes a direct skip, an amount of the donor's unused GST tax exemption automatically allocates to the gift to the extent necessary to produce an inclusion ratio of zero.[119] If the gifted amount exceeds the donor's remaining GST tax exemption amount, the entire unused portion of that exemption will be allocated to the gift.[120]

Although a donor may opt out of the automatic allocation of GST exemption to a direct skip, doing so will produce a GST tax liability.[121] As a result, it is rarely beneficial for a donor to opt out of automatic allocation in connection with a direct skip, but there are situations when doing so is advantageous.[122] For example, assume that a donor who has $1,000,000 in remaining GST tax exemption makes a gift of $100,000 to a grandchild and a gift of $1,000,000 to a trust where the beneficiaries are her grandchildren.[123] In that scenario, the donor could opt out of automatic allocation in connection with the outright gift so that the full balance of her remaining GST tax

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114. For purposes of this Article, it is assumed that the reader has a general working knowledge of the GST tax. For a detailed overview of the GST tax, *see* Diana S. C. Zeydel & Parker F. Taylor, *Tricks and Traps of Planning and Reporting Generation-Skipping Transfers*, STRAFFORD (Feb. 7, 2017), http://media.straffordpub.com/products/mastering-gst-elections-and-reporting-minimizing-generation-skipping-transfer-tax-through-indirect-skips-2017-02-07/reference-materials.pdf [https://perma.cc/E2UL-ST59].

115. *See Instructions for Form 709*, *supra* note 6.

116. *See id.*

117. *See id.*

118. *See id.*

119. *See Instructions for Form 709*, *supra* note 6; I.R.C. § 2632(b)(1).

120. *See Instructions for Form 709*, *supra* note 6; I.R.C. § 2632(b)(1).

121. *See Instructions for Form 709*, *supra* note 6; I.R.C. § 2632(b)(3).

122. *See Instructions for Form 709*, *supra* note 6; I.R.C. § 2632(b)(1).

123. *See Instructions for Form 709*, *supra* note 6; I.R.C. § 2632(b)(1).

exemption is allocated to the trust.[124] Even though GST tax will be due on the outright gift, the trust will have an inclusion ratio of zero, and any growth enjoyed by the trust assets will remain shielded from the GST tax.[125] To opt out of automatic allocation for a direct skip, the donor must describe the transfer and the extent to which automatic allocation is not to apply on a timely filed gift tax return and pay the associated GST tax liability.[126]

b. Indirect Skips and Other Transfers in Trust

In connection with a transfer in trust reportable on Part 3 of Schedule A, the donor may elect whether or not that trust will be exempt or nonexempt from the GST tax by filing a gift tax return.[127] In the absence of a filed return, or if no affirmative elections are made on a filed return, the donor will be at the mercy of the more complex provisions of the automatic allocation rules that apply to "indirect skips."[128]

An indirect skip is any transfer of property, other than a direct skip, that is made to a "GST Trust."[129] A GST Trust is any trust that could have a generation-skipping transfer as to the donor unless one of the following exceptions applies:

> [T]he trust . . . provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons[:] (I) before the date that the individual attains age 46, (II) on or before one or more dates specified in the trust that will occur before such individual attains age 46, or (III) upon the occurrence of an event that, in accordance with [the applicable Regulations,] may reasonably be expected to occur before the date that such individual attains age 46[.][130]

> [T]he trust . . . provides that more than 25 percent 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 10 years older than such individuals[.][131]

> [T]he trust 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 exceptions in the preceding bullet points], more than 25 percent of the trust corpus either must be distributed to the estate or estates of one or more of such

124. *See Instructions for Form 709*, *supra* note 6.
125. *See id.*
126. Treas. Reg. § 26.2632-1(b)(1)(i).
127. *See Instructions for Form 709*, *supra* note 6.
128. I.R.C. § 2632(c); Treas. Reg. § 26.2632-1(b)(2).
129. I.R.C. § 2632(c)(3)(A).
130. *Id.* §§ 2632(c)(3)(B)(i)(I)–(III).
131. *Id.* § 2632(c)(3)(B)(ii).

> individuals or is subject to a general power of appointment exercisable by one or more of such individuals[.][132]
>
> [T]he 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[.][133]
>
> [T]he trust is a charitable lead annuity trust (within the meaning of [Code] section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of [Code] section 664(d))[.][134]
>
> [T]he trust is a trust with respect to which a deduction was allowed under [Code] 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.[135]

For the purpose of applying these exceptions, the 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 the non-skip person solely because the non-skip person has a right to withdraw an amount of property that does not exceed the annual exclusion amount.[136]

Any trust that is designed to benefit multiple generations of the donor's family for the maximum amount of time allowable under local law will often qualify as a GST Trust, as such trust is unlikely to include age-terminating provisions, grant any beneficiary a general power of appointment, or provide any beneficiary with a right to withdraw an amount in excess of the annual exclusion amount.[137] When a donor makes a gift to a GST Trust, any unused portion of the donor's GST tax exemption amount will be automatically allocated to the gift to the extent necessary to ensure that the trust will have an inclusion ratio of zero.[138] If the gift amount exceeds the donor's remaining GST tax exemption amount, the full balance of that exemption will be allocated to the gift.[139] If the trust does not qualify as a GST Trust, no amount of the donor's GST tax exemption will be automatically allocated thereto.[140]

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132. *Id.* § 2632(c)(3)(B)(iii).
133. *Id.* § 2632(c)(3)(B)(iv).
134. *Id.* § 2632(c)(3)(B)(v).
135. *Id.* § 2632(c)(3)(B)(vi).
136. *See id.* § 2632(c)(3)(B).
137. *See generally* TEX. PROP. CODE ANN. § 112.036 (assuming such trust is situsedin a state like Texas that is subject to the rule against perpetuities).
138. I.R.C. § 2632(c)(1).
139. *Id.*
140. *See id.*

When it comes to crafting irrevocable, dynastic trusts, there are no one-size-fits-all plans.[141] The terms of these types of trusts may differ dramatically from client to client based on the family tree, core values, perspective on inherited wealth, and the nature and value of the assets that are intended to be contributed to the trust.[142] Along those same lines, relying on the automatic allocation rules will not produce the desired result for every client.[143]

For example, consider a donor who creates an irrevocable trust intended to provide for his children for the remainder of their lifetimes.[144] The trust grants liberal distribution discretion to an independent trustee and specifically provides that the trustee has no duty to preserve corpus for the benefit of future generations.[145] The trust provides for the remaining corpus to pass to a child's descendants upon the child's death, but these provisions were included primarily to provide cover in the event of an unexpected, out-of-order death.[146] If the settlor's GST tax exemption is allocated to this trust by virtue of the automatic allocation rules, but the majority of the trust corpus is ultimately distributed to the settlor's children, those distributions will represent an ineffective and wasteful use of the settlor's GST tax exemption.[147]

Fortunately, donors who want to achieve an outcome that differs from the default under the automatic allocation rules have a variety of options at their disposal, as follows:

- Opt Out for One or More Current Transfers: A donor may opt out of automatic allocation with respect to one of more transfers made to a particular GST Trust as reported on the donor's current gift tax return.[148] While automatic allocation will not apply to the relevant gifts, it will continue to apply to future transfers to the subject trust if the donor does not opt out on future gift tax returns.[149]

- Opt Out for All Current and Future Transfers: A donor may opt out of automatic allocation with respect to all current and future transfers made to a particular GST Trust.[150] If a donor does not intend for any part of a particular trust to be exempt from the GST tax, making this election will ensure that future transfers are not subject to automatic

141. *See infra* notes 144–61 and accompanying text.
142. *See infra* notes 144–61 and accompanying text.
143. *See infra* notes 144–61 and accompanying text.
144. Author's original hypothetical.
145. Author's original hypothetical.
146. Author's original hypothetical.
147. *See* I.R.C. § 2632(c).
148. *Id.* § 2632(c)(5)(A)(i)(I).
149. *Id.*
150. *See id.* § 2632(c)(5)(A)(i)(II).

allocation.[151] If a donor opts out but later has a change of heart, the donor can terminate the election with respect to all current and future transfers by attaching a termination statement to the donor's gift tax return.[152]

- Opt In: A donor may also elect to treat any trust as a GST Trust for purposes of the automatic allocation rules.[153] Making this election will cause all transfers made by the donor to the trust to be deemed made to a GST Trust, and thus automatic allocation will apply.[154] The donor may elect to treat a trust as a GST Trust with respect to one or more current year transfers to such trust, any selected future transfers to such trust, all future transfers to such trust, or any combination of the foregoing.[155] If a donor opts in but later has a change of heart, the donor can terminate the GST Trust election with respect to all current and future transfers by attaching a termination statement to the donor's gift tax return.[156]

In order to make one of the foregoing elections, the preparer must check column C, labeled "2632(c) election," in the same row in which the relevant gift is reported in Part 3 of Schedule A.[157] The preparer must also attach a statement to the return that identifies the trust, specifically describes the transfers covered by the election, and specifically states that the donor is opting in or opting out of GST Trust treatment, as applicable.[158] The Regulations and Instructions for Form 709 expressly permit the use of formula allocations of GST tax exemption, such as "an amount necessary to produce an inclusion ratio of zero."[159] It is generally best practice to use a formula allocation in connection with each transfer in trust to guard against valuation adjustments or even clerical errors on the preparer's part.[160]

A 2632(c) election must be made on a timely filed gift tax return, whether or not a gift tax return would otherwise be required to be filed for that year.[161] The allocation of GST tax exemption through a timely filed gift tax return is effective as of the date of the gift.[162] In other words, if a donor made a gift of stock worth $20,000 on December 31, 2021, then $20,000 of GST tax exemption is all that is needed to ensure that gift has an inclusion

151. *Id.*
152. Treas. Reg. § 26.2632-1(b)(2)(iii)(E).
153. I.R.C. § 2632(c)(5)(A)(ii).
154. *See id.*
155. Treas. Reg. § 26.2632-1(b)(3)(i).
156. *Id.* § 26.2632-1(b)(3)(iv).
157. *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Section 2632(c) Election").
158. Treas. Reg. §§ 26.2632-1(b)(2)(iii)(B), 26.2632-1(b)(3)(ii).
159. *Id.* § 26.2632-1(d)(1); *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Line 6").
160. *See Instructions for Form 709*, *supra* note 6.
161. Treas. Reg. §§ 26.2632-1(b)(2)(iii)(C)(2), (b)(3)(ii).
162. I.R.C. § 2642(b)(1).

ratio of zero, even if the value of the stock has increased to $30,000 by the time the gift tax return is due.[163]

If more than one donor makes gifts to a particular trust, they must each file a gift tax return and make the appropriate election to ensure that the trust will have an inclusion ratio of zero or one.[164] Similarly, spouses who split gifts are treated as separate donors and must each file a return that satisfies the applicable provisions of Section 2632(c) to successfully opt in or opt out of automatic allocation for a GST Trust.[165]

For the year in which the donor makes the initial contribution to an irrevocable trust that could produce a generation-skipping transfer at some point in the future, it is often prudent to file a gift tax return to opt in or out of GST Trust treatment with respect to all current and future transfers to that trust.[166] Doing so will provide the donor with certainty as to the trust's exempt or nonexempt status, particularly with respect to future transfers to the trust that are not required to be reported on a gift tax return (e.g., an annual exclusion gift to a trust that is subject to *Crummey* withdrawal rights and thus qualifies as a present interest).[167]

Making a Code Section 2632(c) election will also relieve the donor and the donor's preparer of the burden of periodically reassessing whether or not a trust qualifies as a GST Trust that is subject to the automatic allocation rules.[168] This is especially true of trusts that include hanging withdrawal rights.[169] Recall that a trust is not considered a GST Trust if any portion thereof would be included in the gross estate of a non-skip person if such person died immediately after the transfer, provided that transferred property is not considered to be includable in the gross estate of a non-skip person solely because the non-skip person has a right to withdraw an amount of property that does not exceed the annual exclusion amount.[170] Following the initial contribution to a trust that provides a non-skip person with a *Crummey* withdrawal right, the trust can still qualify as a GST Trust, as the unlapsed portion of the withdrawal right will not exceed the annual exclusion amount.[171] However, if the donor continues to make contributions to the trust that are subject to that non-skip person's withdrawal right, eventually the unlapsed portion of the withdrawal right (sometimes called a hanging power) may exceed the annual exclusion amount, at which point the trust will

163. *Id.*
164. *See id.* § 2642(b)(1).
165. Treas. Reg. § 26.2632-1(b)(2)(iii)(A).
166. *See* I.R.C. § 2632(c).
167. Crummey v. Comm'r, 397 F.2d 82, 87–88 (9th Cir. 1968).
168. *See* I.R.C. § 2632(c); Treas. Reg. § 26.2632-1(b)(2).
169. *See Crummey*, 397 F.2d at 87–88.
170. I.R.C. § 2632(c)(3)(B).
171. *See id.* § 2041(b)(2) (In any calendar year a beneficiary's withdrawal right may only lapse in an amount equal to the greater of $5,000 or 5% of the trust assets without causing estate inclusion.).

arguably no longer qualify as a GST Trust.[172] In that scenario, a donor solely relying on automatic allocation will end up with a trust with an inclusion ratio between zero and one.[173] These potential complications can be avoided by simply making an election to opt in or out of GST Trust treatment.[174]

Finally, the Instructions for Form 709 provide that if a donor is reporting a gift to a trust for which an election to opt in or out of GST Trust treatment for all future transfers was made on a previous gift tax return that the donor should not make an entry in column C or attach a statement.[175] This approach will work if the donor and the IRS maintain impeccable records that include copies of all previously filed returns, but that is not always the case.[176] To prevent confusion, it is often helpful to bend the rules and attach a statement to the gift tax return confirming a prior election in or out with respect to a particular trust.[177]

c. Late Allocations

A donor who declines to make an election to opt into GST Trust treatment may affirmatively allocate GST tax exemption at any time prior to the due date of the estate tax return for their estate.[178] An allocation after the due date for the gift tax return for the relevant transfer is often referred to as a "late allocation."[179] Unlike an allocation made on a timely filed gift tax return, a late allocation is based on the value of the property as of the date when the allocation is filed.[180] A gift tax return is deemed filed on the date it is postmarked to the IRS.[181] Alternatively, a donor may make a late allocation based on the value of the property as of the first day of the month when the late allocation is made.[182]

Utilizing a "wait and see" approach with GST tax exemption allocation is risky.[183] Most donors who gift non-cash assets in trust purposefully select assets that they believe have great appreciation potential to maximize the efficiency of a transfer that will move assets out of their taxable estate.[184]

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172. *See* 3A JERE D. MCGAFFEY, MCGAFFEY LEGAL FORMS TAX ANALYSIS § 16:71 (1997).

173. *See generally* I.R.C. § 2642 (discussing inclusion ratio).

174. MCGAFFEY, *supra* note 172, § 15A:42.

175. *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Column C. Section 2632(c) Election").

176. *See generally id.* (requiring documentation of transactions to be submitted to IRS).

177. *See id.*

178. I.R.C. § 2632(a).

179. Treas. Reg. § 26.2632-1.

180. *Id.* § 26.2642-2(a)(2); I.R.C. § 2642(b)(3).

181. Treas. Reg. § 26.2632-1(b)(4)(ii)(A)(1).

182. *Id.* § 26.2642-2(a)(2) (This exception does not apply to a life insurance policy, including one held in trust, if the insured has died.).

183. CAROL HARRINGTON, HOWARD M. ZARITSKY, LLOYD PLAINE & JULIE KWON, GENERATION-SKIPPING TRANSFER TAX § 4.06(2) (2022).

184. KATHRYN HENKEL & JUDITH TOBEY, ESTATE PLANNING AND WEALTH PRESERVATION: STRATEGIES AND SOLUTIONS § 8.03 (2022).

Because the increase in the GST tax exemption amount may be temporary, whether due to the sunset provisions of the TCJA or tax law changes, most donors would be well-advised to allocate their GST tax exemption amounts to their 2021 and 2022 gifts as appropriate.[185] If those gifts do not utilize the full amount of a donor's remaining GST tax exemption, it may be worthwhile to consider making a late allocation of that exemption to one or more existing nonexempt trusts for which the person making the late allocation is the transferor.[186]

2. To Start the Statute of Limitations

The statute of limitations for assessing gift tax is generally three years from the later of the date on which the gift tax return is filed or the date on which such return was due.[187] For example, if a 2021 gift tax return was filed on February 1, 2022, the statute of limitations with respect to that return will not begin to run until April 15, 2022.[188] The statute of limitations extends to six years if the gift tax return omits gifts with a value that exceeds 25% of the total amount of gifts reported on the return.[189] As a result, it is vitally important to properly report all of a donor's gifts, including items such as charitable gifts that may seem less consequential.[190] Failing to do so could unnecessarily extend the statute of limitations by three years.[191]

The statute of limitations will not run on a false or fraudulent return, in the case of a willful attempt to evade tax, or if no return is filed at all.[192] Even if a gift is reported on a gift tax return, the statute of limitations for that gift will not begin to run unless it has been adequately disclosed, as discussed in more detail in Section IV.A herein.[193]

Once the statute of limitations has run, the value of a gift or transfer as finally determined for gift tax purposes shall be its value for all gift and estate tax purposes.[194] The value "as finally determined for gift tax purposes" will generally be the value as reported on the gift tax return unless that value was subsequently adjusted in connection with an IRS challenge.[195] In sum, once the statute of limitations on a reported gift or transfer has run, the IRS will be

185. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054, 2056 (2017).
186. *See* Treas. Reg. §§ 26.2632-1(b)(3), (4).
187. I.R.C. §§ 6501(a), (b)(1).
188. *See id.* § 6501(b)(1).
189. *Id.* § 6501(e)(2).
190. *See id.*
191. *Id.*
192. *Id.* §§ 6501(c)(1)–(3).
193. *Infra* Section IV.A; *id.* § 6501(c)(9); Treas. Reg. § 301.6501(c)-1(f)(2).
194. I.R.C. §§ 2001(4), 2504(c).
195. Treas. Reg. §§ 20.2001-1(b), (c).

barred from revaluing that gift or transfer in connection with future gift or estate tax liability or for any other purpose.[196]

If no gift tax return is filed, the IRS will be free to assess gift tax at any time.[197] Interest and penalties may also be assessed in connection with unpaid gift tax.[198] Because the stakes are so high, it is often advisable for a donor to file a gift tax return to start running the statute of limitations, even if that return is not otherwise required.[199] This option often comes up in the context of reporting non-gift sales, as is discussed in more detail in Section IV.C herein.[200]

III. MAKING PREPARATIONS

Once the donor has decided to file a gift tax return, whether out of necessity or otherwise, the donor must select a tax return preparer, determine when the return will be filed, and gather all of the information that the preparer will need to prepare a complete and accurate return.[201] While assisting the donor with this process, the preparer should consider the duties the preparer owes both to the donor and the IRS.[202]

A. Who Will File the Return?

Sometimes donors are conflicted as to whether their CPA or attorney should prepare the gift tax return.[203] Regardless of the donor's choice, it is often helpful for both professionals to communicate with one another regarding the relevant gifts and transfers and the return itself.[204] The attorney and CPA may each know facts about the donor and relevant past transactions that the other does not.[205] In any event, it is often helpful for the professional who does not prepare the return to review it prior to filing, particularly with regard to complex gift and sale transactions and GST tax elections and allocation.[206]

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196. *Id.* § 20.2001-1(c)(1).
197. I.R.C. § 6501(c)(3).
198. *See id.* §§ 6601, 6651.
199. *See id.* § 6501.
200. *See* discussion *infra* Section IV.C.
201. *See Topic No. 254 How to Choose a Tax Return Preparer*, IRS, https://www.irs.gov/taxtopics/tc254 (Jan. 26, 2022) [https://perma.cc/U3JG-LNHY].
202. *Id.*
203. *See* Ilene L. McCauley, *Gift Taxes: What Your CPA Doesn't Know*, AVVO (Apr. 8, 2013), https://www.avvo.com/legal-guides/ugc/gift-taxes-what-your-cpa-doesnt-know [https://perma.cc/US7D-RGPD].
204. *See id.*
205. *See id.*
206. *See id.*

1. Preparer Penalties

A gift tax return preparer may be subject to penalties for preparing a return with an understatement of liabilities attributable to an "unreasonable position," as defined by Section 6694(a)(2), or willful or reckless conduct.[207] A "tax return preparer" is any person who prepares for compensation or employs one or more persons to prepare for compensation, any tax return, or claim for refund of tax as required under the Code, including gift tax returns.[208]

Both signing and nonsigning preparers are potentially subject to liability for preparer penalties.[209] A signing tax return preparer is primarily responsible for the overall substantive accuracy of a return.[210] A nonsigning tax return preparer is anyone who does not sign the return but who prepares all or a substantial portion of the return with respect to events that have occurred at the time the advice is rendered.[211] A nonsigning tax return preparer may include an attorney who provides written or oral advice to a taxpayer or another tax return preparer that leads to a position or entry that constitutes a substantial portion of the return.[212]

A signing tax return preparer is generally considered to be primarily responsible for any position taken on the return giving rise to an understatement unless, based upon credible information, it is concluded that a nonsigning tax return preparer was primarily responsible for such position.[213] In that event, the nonsigning tax return preparer who is determined to be primarily responsible for the position giving rise to the understatement will generally be considered liable for any relevant preparer penalties.[214] If a signing tax return preparer and a nonsigning tax return preparer are with the same firm, the penalty may only be assessed against one of them (i.e., the tax return preparer who is determined to be primarily responsible for the position giving rise to the understatement).[215] The tax return preparer's firm may also be penalized.[216]

As demonstrated by this brief introduction to the provisions of the Code and Regulations that address preparer penalties, an attorney who does not sign a client's gift tax return can still be penalized for certain inaccuracies on that return.[217] If multiple attorneys within one firm are advising a client

207. I.R.C. §§ 6694(a)–(b).
208. *Id.* § 7701(a)(36); Rev. Proc. 2009-11, 2009-3 I.R.B. 313.
209. Treas. Reg. §§ 1.6694-1(b)(2)–(3).
210. *Id.* § 301.7701-15(b)(1).
211. *Id.* § 301.7701-15(b)(2).
212. *Id.*
213. *Id.* § 1.6694-1(b)(2).
214. *Id.* § 1.6694-1(b)(3).
215. *Id.* § 1.6694-1(b)(4).
216. *Id.* § 1.6694-1(b)(5).
217. *Id.* § 1.6694-1(b)(3).

regarding a planning transaction or preparing the associated gift tax return, each attorney should be mindful of the level of the attorney's involvement and should review the return before it is finalized if the attorney's advice or counsel significantly influenced how certain gifts or transactions were reported.[218] An attorney should conduct a similar analysis if a client's CPA is preparing the gift tax return.[219] In that event, the attorney should make a conscious effort to document the attorney's thoughts on the return and associated strategy, particularly if the CPA takes a position on that return with which the attorney disagrees.[220]

B. When Will the Return Be Filed?

Gift tax returns are generally due on April 15th of the year following the calendar year in which the gift was made.[221] In years when April 15th falls on a Saturday, Sunday, or legal holiday, gift tax returns will be due on the next succeeding weekday.[222] The donor may request an automatic six-month extension of time to file the gift tax return by filing a Form 8892.[223] Alternatively, a six-month extension of time to file the donor's income tax return will also extend the time to file the donor's gift tax return.[224] If the donor dies during the year in which the donor made the gift, the gift tax return must be filed on or before the earlier of (i) the due date of the estate tax return (with extensions) or (ii) the date on which the gift tax return would otherwise be due (with extensions).[225]

The IRS has the authority to extend the filing deadline for certain tax returns, including gift tax returns, in the event of a federally declared disaster or a terroristic or military action.[226] For example, due to the severe winter storms that affected much of Texas in February 2021, the IRS issued relief that postponed the deadline to file various returns and make certain tax payments to June 15, 2021.[227] This relief applied to gift tax returns and was available to all Texas residents.[228]

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218. *Id.* § 1.6694-1(b).

219. *Id.* § 1.6694-1(b)(1).

220. *See id.*; James J. Rigos, *Applying the AIPA's Professional Standards to Tax Practice,* CPA J., (Mar. 2017), https://www.cpajournal.com/2017/03/20/applying-aicpas-professional-standards-tax-practice/ [https://perma.cc/V6JY-3783].

221. I.R.C. § 6075(b)(1).

222. Treas. Reg. § 25.6075-1(d); *id.* § 7053.

223. *See Form 8892*, IRS, https://www.irs.gov/pub/irs-pdf/f8892.pdf (Mar. 22, 2022) [https://perma.cc/5QUT-9Q8G].

224. *Id.* § 6075(b)(1).

225. *Id.* § 6075(b)(2).

226. *Id.* § 7508A.

227. *IRS Announces Tax Relief For Texas Severe Winter Storm Victims*, IRS, https://www.irs.gov/newsroom/irs-announces-tax-relief-for-texas-severe-winter-storm-victims (Jan. 25, 2022) [https://perma.cc/V7C9-TS4K].

228. *See id.*

Because an automatic extension of time to file is so readily available to gift tax return filers, it can be tempting to put off filing until October.[229] The advantage of filing a return on the April filing deadline is that it will start the running of the statute of limitations as soon as possible.[230] As is discussed in Section II.C.2, the earliest that the statute of limitations can begin to run on a gift tax return is April 15th (or the next succeeding weekday, in years in which that date falls on a weekend or legal holiday), so there is no advantage to filing in advance of that deadline.[231]

In some cases, it will be preferable to request an extension and wait to file on the October deadline.[232] If a donor made a gift to a QTIP-able trust, the donor may want to wait as long as possible to determine whether or not to make the *inter vivos* QTIP election.[233] If a donor made a gift that could be subject to a disclaimer, the donor may want to wait to file until the nine-month window in which a qualified disclaimer can be made has closed.[234] Finally, a donor may want to wait and see how a gifted asset performs before making a final decision regarding the allocation of a GST tax exemption.[235]

C. Gathering the Necessary Information

One of the first and most crucial steps in preparing a gift tax return is to gather all of the information and documents relevant to the return.[236] Because clients are often unaware of exactly what goes into preparing a gift tax return, it is up to the preparer to ask the right questions.[237] This subsection highlights some of the items and information that preparers need to set themselves up for success.[238]

1. The Basics

A gift tax return must include the donor's full name, social security number, current mailing address, legal residence, and citizenship.[239] If a

229. *See* I.R.C. § 6075(b)(2).

230. *Id.* §§ 6501(a), (b)(1).

231. *See supra* Section II.C.2.

232. *See* I.R.C. § 6075(b)(2).

233. *See* George F. Bearup, *Wait and See Planning: Fine Tune a QTIP Trust*, GREEN LEAF TR., https://greenleaftrust.com/news/wait-and-see-planning-fine-tune-a-qtip-trust/ (last visited Feb. 12, 2022) [https://perma.cc/8NH8-H8JM].

234. *See* I.R.C. § 2518(b)(2).

235. *See* HARRINGTON, ZARITSKY, PLAINE & KWON, *supra* note 183.

236. *See 2021 Gift Tax Return Organizer – Form 709*, AICPA, https://www.aicpa.org/resources/download/gift-tax-return-organizer-form-709 (last visited Mar. 22, 2022) [https://perma.cc/4BNB-SX9G].

237. *See id.*

238. *See id.*

239. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Part 1 – General Information").

donor will be splitting gifts with their spouse, the return must also provide the spouse's name and social security number.[240]

2. Deceased Spouses and the DSUE Amount

If the donor is a widow or widower, the preparer will need to determine whether there is any DSUE amount available for the donor's use.[241] This determination can typically be made by examining the deceased spouse's estate tax return and any subsequent gift tax returns filed by the donor.[242]

Interestingly, the Regulations provide that the DSUE amount is considered available for use by the surviving spouse as of the date of the deceased spouse's death, presuming a valid portability election is eventually made on the deceased spouse's estate tax return.[243] As a result, a donor does not necessarily have to wait for the deceased spouse's estate tax return to be filed to apply the anticipated DSUE amount toward gifts made after the deceased spouse's death.[244] Applying the DSUE amount before an estate tax return is filed is risky if the surviving spouse is not the executor of the deceased spouse's estate and has no legally binding assurances that the executor will, in fact, file an estate tax return to make the portability election.[245] Furthermore, the DSUE amount will not be available in connection with a taxable gift to the extent that it cannot be determined.[246] Finally, the Instructions for Form 709 instruct a donor applying a DSUE amount to attach the first four pages of the deceased spouse's estate tax return (and any attachments thereto that relate to the DSUE amount) to the gift tax return.[247] It is unclear how a donor would substantiate a DSUE amount before the estate tax return has been filed.[248]

If the donor has a DSUE amount available for use, that amount is applied to gifts made by the surviving spouse before the donor's own gift tax exclusion amount.[249] When preparing a return for a donor using a DSUE amount, the preparer must check "yes" on Line 19 of Part 1 of the return and complete Schedule C.[250] On Schedule C, the donor must provide the name of the deceased spouse, his or her date of death, the DSUE amount the donor received, and the date and amount of each gift to which that DSUE amount

240. *See id.* (referring to the text under subheading "Lines 12 – 18. Split Gifts").
241. *See id.*
242. *See id.*
243. Treas. Reg. §§ 20.2010-3(c)(1), 25.2505-2(d)(1).
244. *Id.*
245. *See id.*
246. *Id.* § 25.2505-2(d)(1)(iii).
247. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Line 19. Application of DSUE Amount").
248. *See id*.
249. Treas. Reg. § 25.2505-2(b).
250. *See Instructions for Form 709*, *supra* note 6.

has been applied.[251] In the rare circumstance in which a donor has more than one deceased spouse from whom the donor received a DSUE amount, information about those spouses and the amount and use of any DSUE amount associated with them must be included as well.[252]

3. The Donor's Gifting History

A preparer must clearly understand a donor's gifting history to be properly equipped to prepare a new gift tax return.[253] If a donor has previously filed one or more gift tax returns, the preparer should make every effort to review those returns.[254] Hopefully, the donor will be able to supply copies of all prior returns, but if not, the donor can file a Form 4506, Request for Copy of Tax Return, to obtain copies from the IRS.[255]

The preparer should also inquire about unreported gifts.[256] If the preparer learns of a prior gift that should have been reported but was not, it may be necessary to prepare an amended or late return to report that gift, as discussed in more detail in Section III.D.2 below.[257] Some unreported gifts that did not give rise to a filing requirement will nevertheless affect the reporting on the new return.[258] For example, a donor who only makes annual exclusion gifts to a GST Trust is not strictly required to file a gift tax return, but the donor's GST tax exemption amount is still automatically allocated to each of those gifts.[259] If the use of that exemption is not taken into account, the preparer may mistakenly allocate an exemption that the donor does not have or advise the donor that the donor has a sufficient exemption to make certain tax-free transfers to skip persons when that is not the case.[260]

If the donor has filed gift tax returns in prior years, the preparer must check "yes" on Line 11a of Part 1 and complete Schedule B of the gift tax return.[261] Schedule B is used to determine the amount of applicable credit against gift tax allowable for prior periods and the amount of prior taxable gifts, and those values are then carried over into Part 2 of the return to determine the total tax due (if any).[262]

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251. *See id.* (referring to the text under subheading "Completing Schedule C").

252. *See id.* (referring to the text under subheading "Part 2. DSUE Received from Other Predeceased Spouse(s)").

253. *See id.* (referring to the text under subheading "Schedule B. Gifts From Prior Periods").

254. *See id.*

255. See *Topic No. 156 Copy or Transcript of Your Tax Return – How to Get One*, IRS, https://www.irs.gov/taxtopics/tc156 (Jan. 13, 2022) [https://perma.cc/4SBD-T2KS].

256. *See 2021 Gift Tax Return Organizer – Form 709*, *supra* note 236.

257. *See infra* Section III.D.2.

258. *See 2021 Gift Tax Return Organizer – Form 709*, *supra* note 236.

259. *See* I.R.C. §§ 2632(c)(1), 6019(1).

260. *See id*.

261. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Schedule B. Gifts From Prior Periods").

262. *Id.*

4. Information on Current Gifts

The preparer will also need all relevant information for the prior year's gifts that will be reported on the gift tax return, including:

- Each donee's name, address, and their relationship to the donor;
- If a donee's relationship to the donor does not immediately identify them as a skip or non-skip person, the donee's date of birth should be confirmed;
- A description of the gifted property;
- The donor's adjusted basis in the gifted property;
- The date on which each gift was made; and
- If the donor was married on the date of the gift, whether the gift was of separate or community property.[263]

If the return will include a gift made to a trust, the preparer will need a copy of the trust instrument, the trust's employer identification number (EIN), and the name and address of the current trustee.[264] Even if the trust is a grantor trust, do not assume that it uses the donor's social security number, as some donors may prefer to use a separate EIN.[265]

If the trust provides withdrawal rights to one or more beneficiaries, confirm whether or not those rights were applicable to the current gifts.[266] Some trust instruments authorize the donor to modify or eliminate withdrawal rights in connection with a trust contribution, so do not assume they apply in all events.[267] Each trust beneficiary is treated as a separate donee for applying the annual exclusion amount.[268] As a result, the preparer should also gather the name, address, and relationship to the donor of each beneficiary who has a withdrawal right.[269]

As the preparer is gathering this information, the preparer should take one last opportunity to ask the donor about gifts or transfers that the donor might mistakenly think are irrelevant, such as charitable gifts, non-qualified disclaimers, interest-free loans, power of appointment exercises, and non-gift sale transactions.[270] If this line of questioning uncovers a transfer that may constitute a gift or should otherwise be reported, additional information may be required.[271]

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263. *Id.* (referring to the text under subheading "Schedule A. Computation of Taxable Gifts").
264. *Id.*; Treas. Reg. § 301.6501(c)-1(f)(2)(iii).
265. Treas. Reg. § 1.671-4.
266. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Annual Exclusion").
267. *Id.*
268. *See id.*
269. *Id.*
270. *See id.* (referring to the text under subheading "Transfers Subject to the Gift Tax").
271. *Id.*

D. Understanding the Preparer's Duties

In addition to the duties and ethical standards that attorneys must uphold to their clients and as members of the bar, attorneys who prepare tax returns must also be mindful of the duties and rules imposed upon individuals who represent taxpayers before the IRS.[272] In this respect, every tax return preparer should be familiar with Treasury Department Circular 230, which regulates practice before the IRS.[273]

1. Obtaining and Maintaining a PTIN

As an administrative matter, any individual who prepares or assists with preparing gift tax returns for compensation must have a preparer tax identification number or Paid Preparer Tax Identification Number (PTIN).[274] Every attorney who has a hand in preparing gift tax returns should have a PTIN, even if that attorney will not sign any of those returns.[275] Other staff members such as paralegals and administrative assistants who provide clerical assistance in the preparation of gift tax returns do not need a PTIN.[276]

A PTIN can be obtained through the IRS website or by completing and filing a Form W-12, IRS Paid Preparer Tax Identification Number Application and Renewal.[277] PTINs must be renewed on an annual basis, and the fee for 2022 is $35.95.[278] When applying for a PTIN, a preparer is required to disclose any felony convictions as well as any outstanding obligations for the payment of tax or the filing of a return for the preparer's individual or business federal taxes.[279] The preparer must also certify that the preparer is aware that paid tax return preparers must have a data security plan to protect all taxpayer information.[280] If the preparer does not have such a plan in place, the Instructions for Form W-12 provide some additional resources on the subject.[281]

2. Duties as to Competence, Accuracy, and Taxpayer Compliance

An attorney who practices before the IRS "must possess the necessary competence," meaning "the appropriate level of knowledge, skill,

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272. 31 C.F.R. § 10.8 (2011).
273. *Id.* § 10.0.
274. *Id.* § 10.8.
275. *Id.*
276. *Id.*; Treas. Reg. § 301.7701-15(f)(1)(viii).
277. *IRS Tax Professional PTIN System*, IRS, https://rpr.irs.gov/datamart/mainMenuUSIRS.do (last visited Feb. 12, 2022) [https://perma.cc/7HH9-65AE] (The current PTIN system can be accessed here.).
278. *Id.*
279. *Instructions for Form W-12*, IRS, https://www.irs.gov/pub/irs-pdf/iw12.pdf (May 2021) [https://perma.cc/6FP3-4R3K] (referring to the text under subheading "Specific Instructions").
280. *See id.* (referring to the text under subheading "Line 11").
281. *Id.*

thoroughness, and preparation necessary for the matter for which the practitioner is engaged."[282] Competence may be achieved "through various methods, such as consulting with experts in the relevant area or studying the relevant law."[283] It is worth noting that this standard for competence is a bit different than the one promulgated under the Texas Disciplinary Rules of Professional Conduct, which prohibits an attorney from accepting employment in a legal matter that is beyond the attorney's competence.[284] In that context, competence "denotes possession or the ability to timely acquire the legal knowledge, skill, and training reasonably necessary for the representation of the client."[285]

An attorney must exercise due diligence when preparing or assisting with the preparation of a client's gift tax return, determining the correctness of oral or written representations made to the IRS, and determining the correctness of oral or written representations made to the client regarding that return.[286] Circular 230 does not define "due diligence," but it seems reasonable to infer that this provision imposes a duty on preparers to conduct a reasonable inquiry regarding a client's past gifts (whether reported or not) and any transactions that may be reportable on the current gift tax return.[287]

When advising a client regarding the client's gift tax return, an attorney may generally rely upon the information provided by the client without independently verifying the same.[288] At the same time, the attorney may not "ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete."[289] If an attorney learns of a transaction that seems like it may constitute a taxable gift, whether through a review of a client's estate planning documents, an offhand comment made by the client, or otherwise, the attorney has a duty to conduct further due diligence to determine whether the client may be subject to a gift tax reporting requirement.[290] For example, if a client tells her attorney, "I only made annual exclusion gifts to my kids last year," but later mentions that she made a loan to her daughter pursuant to an oral agreement, the attorney should ask follow-up questions to discern whether that loan may actually constitute a taxable gift.[291]

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282. 31 C.F.R. § 10.35 (2011).
283. *Id.*
284. TEX. DISCIPLINARY RULES OF PROF'L CONDUCT R. 1.01, *reprinted in* TEX. GOV'T CODE ANN., tit 2, subtit. G, app. A (Tex. State Bar R. art. X, § 9).
285. *Id.*
286. 31 C.F.R. § 10.22(a)(1).
287. *See id.*
288. *Id.* § 10.34(d).
289. *Id.*
290. *See id.*
291. *See id.*

An attorney may not willfully, recklessly, or through gross incompetence sign a gift tax return or advise a client to take a position on a gift tax return that (a) lacks a reasonable basis, (b) constitutes an unreasonable position (as defined by Code Section 6694(a)(2)), or (c) is a willful attempt by the attorney to understate the liability for tax or a reckless or intentional disregard of the rules and regulations.[292] An attorney may also be subject to sanctions for "giving false or misleading information, or participating in any way in the giving of false or misleading information" to the IRS.[293] As these rules demonstrate, an attorney will be noncompliant with the rules and duties imposed by Circular 230 if the attorney knowingly omits or underreports a taxable gift on a client's gift tax return.[294]

These duties may also extend to prior reporting errors.[295] More specifically, Circular 230 provides:

> A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.[296]

Consequently, if an attorney discovers that a client failed to file a gift tax return when one was required, the attorney must advise the client of that fact, explain the potential consequences of failing to report the relevant gift, and recommend that the client file a late return to report the gift.[297]

This provision also suggests that upon discovering an error on a previously filed return, the attorney must advise the client of the error, relay the consequences thereof, and recommend filing an amended return.[298] The analysis gets a little more complicated in this situation, given that there is no provision in the Code, Regulations, or any other relevant authority that requires taxpayers to file amended gift tax returns.[299] If the client declines to follow the attorney's recommendation and does not file an amended return, it may be possible for the attorney to continue representing the client without running afoul of any of the attorney's ethical duties.[300] However, even in the

292. *Id.* § 10.34(a).
293. *Id.* § 10.51(a)(4).
294. *Id.*
295. *Id.* § 10.21.
296. *Id.*
297. *See id.*
298. *See id.*
299. *Id.* §§ 10.0–10.93.
300. *See id* § 10.33.

absence of an amended return, the attorney cannot ignore prior taxable gifts of which the attorney has knowledge when it comes time to file a new gift tax return, as doing so would violate the attorney's duties under Circular 230.[301]

IV. REPORTING GIFTS AND OTHER TRANSFERS

The Code, Regulations, and Instructions for Form 709 all provide guidance regarding the information that must be provided on a gift tax return.[302] When in doubt, it is always preferable to provide too much information or documentation rather than too little, regardless of the type or value of the reported transfer.[303] The ultimate goal with any gift tax return is to achieve "adequate disclosure" of each gift so that the statute of limitations will begin to run.[304] This section discusses the meaning of adequate disclosure, meeting the requirements thereunder, and strategies for reporting particular types of gift and non-gift transactions.[305]

A. Achieving Adequate Disclosure

A transfer that is reported on a gift tax return will be considered adequately disclosed if it is reported in a manner adequate to apprise the IRS of the nature of the gift and the basis for its reported value.[306] More specifically, adequate disclosure will be achieved if the return provides the following information:

- A description of the transferred property and any consideration received by the transferor;
- The identity of, and relationship between, the transferor and each transferee;
- 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;
- A detailed description of the method used to determine the fair market value of the transferred property, including a description of any financial data that were utilized, any restrictions on the transferred property that were considered, and any discounts that were applied; and

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301. *See* Celeste C. Lawton, *Gift Tax Returns: Finding and Fixing Problems*, ST. BAR TEX. (June 10-12, 2015), https://pdf4pro.com/cdn/gift-tax-returns-finding-and-fixing-problems-59f00f.pdf [https://perma.cc/V8JM-2T34] (for an excellent discussion of an attorney's duties to find and correct gift tax reporting errors, as well as the types of errors that are most common).

302. *See Instructions for Form 709*, *supra* note 6.

303. *Id.*

304. *Id.*

305. *Id.*

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

- A statement describing any position taken that is contrary to any proposed, temporary, or final Regulation or revenue rulings published at the time of the transfer.[307]

Meeting the requirements for adequate disclosure is often the most challenging when reporting transfers of nonmarketable assets, such as an interest in a closely-held entity.[308] When reporting a transfer of an entity interest, the description of the method used to determine its fair market value must include a description of any discounts claimed on the value of the interest or on any assets owned by the entity.[309] If the value of the interest was determined based on the entity's net asset value, the gift tax return must include the fair market value of 100% of the entity without discounts, the pro rata portion of the entity subject to the transfer, and the fair market value of the interest as reported on the return.[310] If the fair market value of 100% of the entity is not disclosed, then the transferor bears the burden of demonstrating that the fair market value of the interest is properly determined by a method other than one that is based on the entity's net asset value.[311] If the entity that is the subject of the transfer owns interests in other nonmarketable entities, the information described in this paragraph must be provided with respect to all of those entities.[312]

In lieu of providing all of the information described in the preceding paragraph, the transferor may submit an appraisal that contains the following information:

- The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal.[313]
- A description of the property.[314]
- A description of the appraisal process employed.[315]
- A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the analyses, opinions, and conclusions.[316]
- 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

307. *Id.*
308. *See id.*
309. *Id.* § 301.6501(c)-1(f)(2)(iv).
310. *Id.*
311. *Id.*
312. *Id.*
313. *Id.* § 301.6501(c)-1(f)(3)(ii).
314. *Id.*
315. *Id.*
316. *Id.*

sufficiently detailed so that another person can replicate the process and arrive at the appraised value.[317]

- The appraisal procedures followed and the reasoning that supports the analyses, opinions, and conclusions.[318]
- The valuation method utilized, the rationale for the valuation method, and the procedure used in determining the fair market value of the asset transferred.[319]
- The specific basis for the valuation, such as specific, comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisition transactions, etc. [320]

The appraisal cannot be prepared by the donor, donee, a member of the donor or donee's family (i.e., an ancestor, spouse, lineal descendants of the donor, donee, the donor's or donee's spouse, or a parent of the donor or done, or the spouse of any such lineal descendant), or any person employed by the donor, donee, or a family member of the donor or donee.[321] The appraiser must be an individual who holds himself or herself out to the public as an appraiser or performs appraisals regularly.[322] Finally, the appraiser must be qualified to make appraisals of the type of property being valued.[323] The appraiser should demonstrate the appraiser's qualifications by providing information in the appraisal that details the appraiser's background, experience, education, and membership, if any, in professional appraisal associations.[324]

B. Commonly Reported Gifts

With regard to most gifts, the keys to achieving adequate disclosure are (i) to include sufficient detail so that the gifted property is easily identified and (ii) to clearly explain how the reported value of the gift was determined.[325] The reported value of each gift should be its fair market value as of the date of the gift.[326] For gift tax purposes, a property's fair market value is "the price at which the property would change hands, between a willing buyer and willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts."[327] This

317. *Id.*
318. *Id.*
319. *Id.*
320. *Id.*
321. *Id.* § 301.6501(c)-1(f)(3)(i)(C).
322. *Id.* § 301.6501(c)-1(f)(3)(i)(A).
323. *Id.* § 301.6501(c)-1(f)(3)(i)(B).
324. *Id.*
325. *Id.* § 301.6501(c)-1(f)(2).
326. I.R.C. § 2512(a).
327. *Id.* § 25.2512-1.

standard is intuitive in some cases and less so in others.[328] Fortunately, the Regulations and Instructions for Form 709 fill in some of the gaps by providing more specific guidance for reporting a wide variety of gifted assets.[329]

1. Real Estate

To report a gift of real estate, the return must include a legal description of each parcel, including the street number, name, area (if the property is located in a city), and a short statement of any improvements made.[330] Be sure to specify whether the gift was of a full or partial interest in the property.[331] To substantiate the value of the gift, the best practice is to obtain a professional real estate appraisal.[332] It is particularly advisable to obtain an appraisal in connection with a gift of a partial interest in property, as the pro rata value of the interest may be subject to discounts for lack of control and marketability.[333]

If the donor is unwilling to obtain a professional appraisal, find out if the property has recently been the subject of an arm's length sale transaction.[334] If a sale occurred on or around the date of the gift, the sales price may be a good representation of the property's fair market value.[335] In that event, it is helpful to attach the closing statement or some other document that confirms the sales price as an exhibit to the return.[336] Donors and preparers sometimes use the property value as determined by the local property tax assessor, although doing so is only appropriate if that value reflects the property's true fair market value.[337]

2. Publicly Traded Stocks and Bonds

The description for any gift of stock should include:

- The number of shares;
- Whether the shares are common or preferred, and if they are preferred, the description should also include the par value, quotation at which returned, and the exact name of the corporation;

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328. *See id.*
329. *See Instructions for Form 709*, *supra* note 6.
330. *See id.* (referring to the text under subheading "Column B").
331. *Id.*
332. *See id.* (referring to the text under subheading "Columns E and F. Date and Value of Gift"); Treas. Reg. § 301.6501(c)-1(f)(2)(iv).
333. *See Instructions for Form 709*, *supra* note 6.
334. *Id.*
335. *Id.*
336. *Id.*
337. Treas. Reg. § 25.2512-1.

- If the shares are listed, give the principal exchange;
- If the shares are unlisted, give the location of the principal business office of the corporation, the state in which incorporated, and the date of the incorporation;
- If the shares are listed, give the principal exchange; and
- The CUSIP number.[338]

The description for any gift of bonds should include:

- The number of bonds transferred;
- The principal amount of each bond;
- Name of the obligor;
- Date of maturity;
- Rate of interest;
- Date or dates when interest is payable;
- Series number, if there is more than one issue;
- Exchanges where listed or, if unlisted, give the location of the principal business office of the corporation; and
- The CUSIP number.[339]

For gift tax purposes, the fair market value of a publicly-traded stock or bond is the mean between the highest and lowest quoted selling prices on the date of the gift, subject to certain exceptions that apply to gifts made on non-trading days.[340] Many preparers rely on valuation software to determine the fair market value of stocks and bonds for gift tax reporting purposes.[341] In that event, the valuation report should be attached to the return as an exhibit to substantiate the reported value.[342]

3. Life Insurance

When reporting a gift of a life insurance policy, the description of the gift must include the name of the insurer and the policy number.[343] The Instructions for Form 709 also require the donor to attach a Form 712, Life Insurance Statement, in connection with a gift of a life insurance policy.[344] The Form 712 must be completed by the policy carrier and will provide the value of the policy.[345] However, depending on the nature of the gifted policy,

338. *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Column B").
339. *Id.*
340. Treas. Reg. § 25.2512-2(b).
341. *See id.*
342. *Id.*
343. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Column B").
344. *See id.* (referring to the text under subheading "Supplemental Documents").
345. *Id.*

this value may not accurately reflect the policy's fair market value for gift tax purposes.[346] While a robust discussion regarding the valuation of different types of life insurance policies is beyond the scope of this Article, beware that the Form 712 may not tell the whole story and cannot always be relied upon for valuation purposes.[347]

4. Closely-Held Entities

When reporting a gift of an interest in a closely-held entity, the description of the gift should include the legal name of the entity, the specific type of entity (e.g., limited liability company, limited partnership, etc.), and the entity's EIN.[348] It is often helpful to mirror the terminology used in the entity's governing documents to describe the gifted interest, whether that be a percentage interest, membership interest, limited partnership units, or otherwise.[349] The description should also specify the nature of the interest, such as a general or limited partnership interest, or a voting or non-voting membership interest.[350] These characteristics, and any others that may affect the value of the interest, should be noted.[351] In the spirit of offering as much information as possible about the gift in pursuit of adequate disclosure, it is often advisable to attach the relevant transfer documentation to the return.[352]

It is especially important to closely adhere to the regulations that govern adequate disclosure when describing the methodology used to value a gift of a closely-held entity interest.[353] While the regulations authorize the donor to substantiate the value of such an interest by other means, providing an independent, third-party appraisal report is generally seen as the most reliable option.[354]

5. Gifts to Trusts

To achieve adequate disclosure, the description of any gift to a trust must include the trust's tax identification number and a brief description of

346. *See* Donald O. Jansen, *That Life Insurance Policy May be Worth More Than You Think!*, UNIV. TEX. L. CLE (Dec. 2–3, 2015), https://utcle.org/ecourses/OC5996/get-asset-file/asset_id/37239 [https://perma.cc/8DXX-KME8]; *Valuation of Life Insurance Policies*, JOHN HANCOCK INS., https://theasagroup.com/wp-content/uploads/JHancock-Valuation-of-Life-Insurance-Policies.pdf (last visited Jan. 18, 2022) [https://perma.cc/F9H2-6BVZ].

347. *See* Jansen, *supra* note 346; *Valuation of Life Insurance Policies*, *supra* note 346.

348. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Column B").

349. *See id.*

350. *See id.*

351. *See id.*

352. *See* Treas. Reg. § 301.6501(c)-1(f)(2).

353. *See id.* § 301.6501(c)-1(f)(2)(iv).

354. *See id.* §§ 301.6501(c)-1(f)(2)(iv), 301.6501(c)-1(f)(3) (In other words, most practitioners generally rely on Treas. Reg. § 301.6501-1(f)(3) instead of Treas. Reg. § 301.6501-1(f)(2)(iv).).

the terms of the trust.[355] In lieu of a description of the trust terms, the donor may provide a copy of the trust instrument.[356] The Regulations do not specify what level of detail a description of the trust terms must have in order to meet the standards for adequate disclosure.[357] As a result, the soundest option is to attach a copy of the trust instrument.[358]

Although the regulations seemingly provide the donor with two options for disclosing the terms of the trust, the instructions for Form 709 provide that when reporting a gift to a trust, the donor must "attach a certified or verified copy of the trust instrument" to the return on which a gift to that trust is first reported.[359] The instructions provide no additional information on what constitutes a "certified or verified copy" of a trust, but presumably, this requirement can be satisfied by attaching a short statement signed by the preparer, certifying that the attached trust instrument is a true and correct copy thereof.[360] In subsequent years, any reported gifts to the subject trust may include either a brief description of the terms of the trust or a copy of the trust instrument, but no certification or verification is required.[361]

The description of a gift in trust should also identify the trustee, provide the trust's address (typically the address of a co-trustee or sole trustee), and describe the beneficiaries of the trust and their relationship to the donor.[362] If one or more of the beneficiaries have withdrawal rights over the trust, it is a good practice to identify those beneficiaries by name and describe the nature of their withdrawal rights.[363] Including this information will substantiate the application of one or more annual exclusion amounts on Part 4 of Schedule A of the return, if applicable.[364]

C. Reporting Non-Gift Sale Transactions

Although gifting can be an efficient way to transfer wealth to future generations and reduce the donor's taxable estate, it is far from the only viable strategy for meeting those objectives.[365] One of the most common and

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355. *See id.* § 301.6501(c)-1(f)(2)(iii).

356. *See id.*

357. *See id.*

358. *See id.*

359. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Supplemental Documents").

360. *See id.*

361. *See id.*

362. *See Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return*, IRS, https://www.irs.gov/pub/irs-pdf/f709.pdf, (last visited Feb. 12, 2022) [https://perma.cc/T83D-AQ37].

363. *See generally id.* (providing where to identify beneficiaries).

364. *See id.*

365. *See generally* N. Todd Angkatavanich, *Deconstructing Different Flavored Freezes: A Comparison of Popular Estate Freeze Techniques*, ERNST & YOUNG LLP, NYC, https://nysba.org/NYSBA/Meetings%20Department/Section%20Meetings/Trusts%20and%20Estates/TRUSSP18Materials/Panel%203%20-%20Deconstructing.pdf (last visited Mar. 31, 2022) [https://perma.cc/9L2Y-9UGS].

effective alternatives involves the transferor selling assets to an intentionally defective grantor trust.[366] In some cases, it may be more appropriate for the transferor to sell an asset directly to a family member or loved one.[367] The transferor must proceed with caution in either case, as any sale not made in the ordinary course of business for which the consideration received by the transferor is less than the fair market value of the transferred interest will be subject to gift tax (or at a minimum, will result in the use of some or all of the transferor's gift tax exclusion amount).[368]

A transferor who engages in a non-gift sale transaction should strongly consider reporting that sale on a gift tax return.[369] Although reporting a sale transaction is entirely optional, the benefit of doing so is that it will start the running of the statute of limitations.[370] It may seem counterintuitive to voluntarily invite IRS scrutiny, but once the three-year limitations period ends, the IRS will be barred from asserting that any part of the relevant sale transaction was a gift.[371] In contrast, an unreported sales transaction could potentially be subject to challenge at any point in the future.[372] This possibility is of particular concern for transferors who will likely be required to file an estate tax return.[373] This is because a decedent's executor is required to disclose on an estate tax return whether the decedent ever sold an interest in a partnership, limited liability company, or closely-held corporation to a grantor trust at any point during the decedent's lifetime.[374]

When reporting a non-gift sale, the transferor must comply with a slightly modified version of the adequate disclosure rules to start the statute of limitations.[375] Any non-gift transfer will be considered to be adequately disclosed if the gift tax return provides the following: (i) a description of the property subject to the sale and the consideration received by the transferor; (ii) "the identity of, and relationship between, the transferor" and the buyer; (iii) if the property is sold to a 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;" and (iv) an explanation as to why the transfer is not a gift under Chapter 12 of the Code.[376]

Notably, neither a description of the method used to determine the fair market value of the transferred property nor an appraisal is required to

366. *See id.*
367. *See id.*
368. *See* I.R.C. § 2512(b); *Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Transfers Subject to Gift Tax").
369. *See* I.R.C. § 2512(b).
370. *See id.* § 6501(a).
371. *See id.* §§ 2001(4), 2504(c).
372. *See id.* § 6501(c)(3).
373. *See id.*
374. *See Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return*, *supra* note 362 (referring to Part 4, Questions 13e).
375. *See* Treas. Reg. § 301.6501(c)-1(f)(4).
376. *Id.*

achieve adequate disclosure for a non-gift sale transaction.[377] However, the transferor is still required to explain why the transfer does not constitute a gift, which inherently involves asserting that the consideration received by the transferor was equal to the fair market value of the transferred interest.[378] Making that assertion without any substantiation may be more likely to invite a challenge by the IRS, particularly if an interest in a closely held entity is the subject of the sale.[379] Consequently, it is often considered prudent to attach an appraisal or other relevant financial data to support the transferor's position that transferor received full and adequate consideration in exchange for the sale of the transferred interest.[380]

As an exception to the foregoing, certain transfers to members of the transferor's family that are made in the ordinary course of operating a business are deemed to be adequately disclosed so long as they are properly reported by the relevant parties for income tax purposes.[381] For example, if the salary of a family member employed by a family business is reported on the income tax returns of the business and the family member, that transfer will be considered adequately disclosed for gift tax purposes.[382]

D. Formula Gifts

In 2021, and now in 2022, the goal of many donors has been to utilize some or all of the "bonus" exclusion amount that was made available upon the enactment of the TCJA.[383] More specifically, many donors sought to make gifts of interests in property with a fair market value of $11,700,000 in 2021 (or $12,060,000 in 2022) to use that exclusion amount prior to its scheduled reduction under the sunset provisions or a change to the current tax laws.[384]

When gifting any asset other than cash, it can be difficult to quantify the exact value of a particular interest on the date of the gift.[385] Even if the value of the interest is known, there is always a possibility that the IRS will challenge that valuation, resulting in an increased gift tax liability.[386] To remedy this issue, many practitioners and their clients utilize formula clauses to make gifts of a specific dollar value of the transferred interest rather than

377. *See id.*
378. *See id.*
379. *See id.*
380. *See id.*
381. *Id.*
382. *Id.*
383. *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 11061(a), 131 Stat. 2054, 2091 (2017).
384. *See id.*
385. *See* John Porter, *Current Issues in Estate and Gift Tax Audits and Litigation*, ST. BAR TEX. ADVANCED EST. PLAN. STRATEGIES (April 22–23, 2021) (describing when to use defined value for determining the amount of a gift tax).
386. *See id.*

a specific portion of that interest.[387] For example, instead of a donor making a gift of 500 shares of stock in XYZ, Inc., the donor could make a gift of shares of stock in XYZ, Inc. with a value of $5,000,000.[388] With this approach, the donor can control the ultimate value of the gift, even if the donor is unsure of the fair market value of a share of stock in XYZ, Inc. as of the date of the gift and even if that fair market value is adjusted during the course of an IRS audit.[389]

Formula clauses are disfavored by the IRS and have been successfully challenged in court on the grounds that formula clauses are contrary to public policy because any effort on the part of the IRS to enforce the tax will merely defeat the gift.[390] However, in recent years taxpayers have begun to experience more frequent success with the use of defined value clauses.[391] One of the most well-known examples of these successes is *Wandry v. Commissioner*.[392]

The *Wandry* case involved gifts made by Mr. and Mrs. Wandry to their children and grandchildren of a number of units in an LLC with a stated fair market value for gift tax purposes.[393] The assignment document for each gift provided the following:

> Although the number of Units gifted is fixed on the date of the gift, that number is based on the fair market value of the gifted Units, which cannot be known on the date of the gift but must be determined after such date based on all relevant information as of that date. Furthermore, the value determined is subject to challenge by the Internal Revenue Service (IRS). I intend to have a good-faith determination of such value made by an independent third-party professional experienced in such matters and appropriately qualified to make such a determination. Nevertheless, if, after the number of gifted Units is determined based on such valuation, the IRS challenges such valuation and a final determination of a different value is made by the IRS or a court of law, the number of gifted Units shall be adjusted accordingly so that the value of the number of Units gifted to each person equals the amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or a court of law.[394]

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387. *See* John H. Skarbink & Ron West, *Formula Clauses: Adjusting Property Transfers to Eliminate Tax*, TAX ADVISER (Jan. 31, 2013), https://www.thetaxadviser.com/issues/2013/feb/skarbnik-feb2013.html [https://perma.cc/5D73-2N2C].

388. Author's original hypothetical.

389. Author's original hypothetical.

390. Comm'r v. Procter, 142 F.2d 824, 827 (4th Cir. 1944); Ward v. Comm'r, 87 T.C. 78, 113 (1986).

391. *See generally* Porter, *supra* note 385 (explaining recent use of formula provisions).

392. *See* Wandry v. Comm'r, 103 T.C.M. (CCH) 1472, at *9–10 (2012).

393. *Id.* at *1–2.

394. *Id.* at *2.

The Wandrys' CPA prepared their gift tax returns and reported the gifts as specific percentage interests derived from the dollar values identified in the gift assignments and the value of a one percent interest in the LLC as determined by a professional appraiser.[395] During an IRS audit, the parties agreed that the LLC units had a higher value than initially reported, and the IRS asserted that additional gift tax was due.[396] More specifically, the IRS argued that: (1) the gift descriptions in the gift tax return were admissions that the Wandrys transferred fixed percentage interests in the LLC, (2) the LLC's capital accounts had been adjusted to reflect the gifts, which controlled the nature of the gifts, and (3) the gift documents transferred fixed interests in the LLC, and the adjustment clause was invalid because it created a condition subsequent to completed gifts and was void as to public policy.[397] The court ultimately rejected all three arguments and upheld the use of the defined value clause.[398]

1. Lessons Learned from Wandry

In light of its role in this important taxpayer victory, the so-called *Wandry* clause is now widely used by donors to effectuate gifts of hard-to-value assets, such as closely-held entity interests.[399] While the *Wandry* clause is often imitated, the *Wandry* gift tax reporting provides an excellent example of what not to do.[400] Fortunately for the Wandrys, the court ruled that the percentage interests in the LLC reported on their gift tax returns were not determinative and that the formula clause in the gift agreements controlled.[401] Nevertheless, reporting the gifts in that manner unnecessarily provided the IRS with evidence to support its argument that the taxpayers had made gifts of fixed interests.[402]

When reporting a formula gift, the best practice is to be consistent throughout the transfer documents and the gift tax return in describing the gift as a transfer of a specific dollar amount.[403] While the gift agreement will contain the formula clause, it is important to use similar language in any other related documents, such as entity assignments, promissory notes, security agreements, and within the entity's books and records.[404] The description of the gift on the gift tax return should also mirror the formula in the gift

395. *Id.* at *3.
396. *Id.*
397. *Id.*
398. *Id.* at *6, *9–11.
399. *See* Steve R. Akers & Edward F. Koren, Wandry v. Commissioner: *Further Support for Defined Value Clauses*, KOREN EST. TAX & PERS. FIN. PLAN. (June 2012) (on file with the ABA website).
400. Author's original thought.
401. *Wandry*, 103 T.C.M. (CCH) at *10.
402. *Id.* at *9.
403. Author's original thought.
404. *See* Akers & Koren, *supra* note 399; *Wandry*, 103 T.C.M. (CCH) at *10.

agreement.[405] That description should also provide the percentage interest (or units, shares, etc.) that the donor believes was actually transferred while making it clear that such interest is subject to adjustment until there is a final determination of value for transfer tax purposes.[406]

The IRS has not acquiesced to the *Wandry* decision and continues to challenge the use of formula clauses on audit and beyond.[407] Because of the higher level of risk associated with this type of planning, it is especially important to achieve adequate disclosure in connection with formula transfers.[408] Failing to disclose a particular aspect of the transaction may prove fatal in this regard, so over disclosure of the gift is far preferable.[409] Along those lines, it is often best to attach all of the transfer documents to the return to fully disclose the transaction and the implementation of the formula gift.[410]

2. Other Formula Transfers

Taxpayers have also had significant success in cases involving the transfer of a fixed interest in which a specified dollar amount of that interest passes to one or more donees (typically family members or trusts for their benefit), with the remainder passing to charity.[411] A robust discussion of these cases and the planning techniques they describe is beyond the scope of this Article, but when reporting these types of transfers, the same principles discussed in the preceding subsection apply.[412] In addition, it is particularly important to properly report the gift(s) to charity if this type of planning has been used.[413]

E. Powers of Appointment

The exercise or release of a power of appointment can have significant gift tax consequences for the power holder.[414] In some cases, it may be appropriate to report the exercise of a power of appointment on the powerholder's gift tax return.[415]

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405. Porter, *supra* note 385.
406. *See id.*
407. *See Wandry*, 103 T.C.M. (CCH) at *10.
408. *See id.*
409. *See id.*
410. Author's original thought.
411. *See, e.g.*, McCord v. Comm'r, 461 F.3d 614, 632 (5th Cir. 2006); Est. of Christiansen v. Comm'r, 130 T.C. 1, *18 (2008); Est. of Petter v. Comm'r, 98 T.C.M. (CCH) 534, *17 (2009); Hendrix v. Comm'r, 101 T.C.M. (CCH) 1642, *5 (2011).
412. *See supra* Section IV.D.1.
413. *See Instructions for Form 709*, *supra* note 6.
414. Treas. Reg. § 25.2514-1(a)(1).
415. *See Instructions for Form 709*, *supra* note 6.

1. General Powers of Appointment

The exercise or release of a general power of appointment will be deemed a transfer of property by the individual possessing that power.[416] In other words, if a donor exercises or releases a general power of appointment during the donor's lifetime, the donor should report the transfer on a timely filed gift tax return.[417] The Instructions for Form 709 do not offer any guidance on how to report a transfer via a general power of appointment exercise, but presumably it is helpful to clearly identify and describe the trust over which the power was exercised, detail the manner in which the power was exercised, and identify the persons who received the appointed assets.[418] These descriptions can be further substantiated by attaching a copy of the subject trust agreement and the instrument that was used to exercise the power.[419]

2. Limited Powers of Appointment

Because property that is subject to a general power of appointment is includable in the powerholder's taxable estate, it is relatively intuitive that a lifetime exercise of a general power would be subject to gift tax.[420] What may come as a surprise to some powerholders is that the exercise of a limited power of appointment can also produce a gift tax liability.[421] This issue is most likely to arise if the powerholder's exercise of the power of appointment has a material effect on the powerholder's beneficial interest in the trust.[422] Consider the following example from the regulations:

> If A is possessed of a vested remainder interest in property, subject to being divested only in the event he should fail to survive one or more individuals or the happening of some other event, an irrevocable assignment of all or any part of his interest would result in a transfer includable for Federal gift tax purposes.[423]

Although this example refers to an assignment, presumably any exercise of a limited power of appointment that divests the powerholder of a remainder interest in the trust would also be considered a taxable gift.[424]

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416. I.R.C. § 2514(b).
417. *See Instructions for Form 709*, *supra* note 6.
418. *See id.*
419. *See id.*
420. I.R.C. §§ 2041(a), 2514(b).
421. *See* Treas. Reg. § 25.2511-1(a).
422. *See id.* § 25.2511-1(c)(1).
423. *Id.* § 25.2511-1(h)(6).
424. *See id.*

The regulations also expressly provide that a trust beneficiary with an income interest for life who exercises an *inter vivos* limited power of appointment has made a taxable gift under Code Section 2511.[425] Technical Advice Memorandum (TAM) 9419007 provides a helpful summary of the Service's evolving position on this issue and the notable case law on the subject.[426] The TAM addresses the beneficiary of a trust who was entitled to receive all trust income until she reached age thirty, at which point the trust would terminate and the full balance of trust property would be distributed to her.[427] The beneficiary also had an *inter vivos* limited power of appointment over the trust, which she chose to exercise prior to reaching age thirty.[428] The IRS concluded that the beneficiary's exercise of her power of appointment effectively amounted to a transfer of her income interest and contingent remainder interest in the trust, and that such transfer was a taxable gift under Code Section 2511.[429]

But what happens if the powerholder is a beneficiary of a discretionary trust? Does the absence of a vested or quantifiable interest, such as an income interest for life, change the IRS's position? The answer is less clear.[430] The Regulations do not specifically address this scenario, but the IRS has ruled on multiple occasions that the exercise of an *inter vivos* limited power of appointment by a beneficiary of a trust with a discretionary distribution standard is a taxable gift.[431] Of course, a taxpayer cannot rely on a private letter ruling obtained by another individual, but private letter rulings do reflect the Service's current position on an issue and thus should be considered.[432]

There is even less certainty as to how a powerholder should value a taxable gift stemming from the exercise of an *inter vivos* special power of appointment.[433] Some of the letter rulings suggest that the gift should be valued in accordance with Revenue Ruling 75-550.[434] One of the rulings seems to acknowledge that in a situation in which distributions to the

425. *Id.* §§ 25.2514-1(b)(2), 25.2514-3(e) (referring to example 3).

426. *See* I.R.S. Tech. Adv. Mem. 9419007 (Feb. 3, 1994).

427. *Id.*

428. *Id.*

429. *Id.*

430. *See generally* I.R.S. Priv. Ltr. Rul. 85-35-020 (May 30, 1985); I.R.S. Priv. Ltr. Rul. 94-51-049 (Sept. 22, 1994); I.R.S. Priv. Ltr. Rul. 2002-43-026 (Oct. 25, 2002); I.R.S. Priv. Ltr. Rul. 2011-22-007 (June 3, 2011) (private letter rulings which pose this question to the IRS).

431. I.R.S. Priv. Ltr. Rul. 85-35-020; I.R.S. Priv. Ltr. Rul. 94-51-049; I.R.S. Priv. Ltr. Rul. 2002-43-026; I.R.S. Priv. Ltr. Rul. 2011-22-007.

432. *See Private Letter Ruling*, WEST'S TAX L. DICTIONARY (2021 ed.).

433. *See generally* Rev. Rul. 75-550, 1975-2 C.B. 357 (a taxpayer posed the question of valuation of an exercise of an *inter vivos* special appointment power).

434. Rev. Rul. 75-550, 1975-2 C.B. 357; I.R.S. Priv. Ltr. Rul. 94-51-049; I.R.S. Priv. Ltr. Rul. 2002-43-026.

powerholder are highly unlikely to be made, the value of the gift may be nominal.[435]

A number of tentative conclusions regarding gift tax reporting of power of appointment exercises may be drawn based on the various sources of authority described above.[436] First, the IRS seems to take the position that any exercise of an *inter vivos* limited power of appointment by a beneficiary is a taxable gift.[437] Thus, the most conservative approach is for the powerholder to report each exercise of such a power on a timely filed gift tax return to start the statute of limitations.[438] If the powerholder's right to receive trust distributions is subject to a discretionary standard and the powerholder rarely (if ever) receives distributions, it may be worthwhile to construct a detailed narrative addressing the trust's distribution standard, the distribution history (or lack thereof), and the other wealth and resources that are available to the powerholder to include with the return.[439] If these factors make it apparent that it is highly unlikely that the powerholder will receive meaningful distributions from trust at any point during their lifetime, it may be reasonable to assert that any gift produced by the exercise of an *inter vivos* power of appointment had nominal value.[440]

F. Reporting Gifts to SLATs[441]

The creation of spousal lifetime access trusts, otherwise known as "SLATs," is a technique that has enjoyed increased popularity since the enactment of the TCJA.[442] At its most basic level, a SLAT is a trust created by a settlor-spouse for the benefit of his or her spouse that is designed to be excluded from both spouses' taxable estates.[443] SLATs are very appealing in the current estate planning environment because they offer the donor-spouse an opportunity to utilize the full amount of the donor-spouse's gift tax exclusion amount while also maintaining indirect access to the SLAT assets by virtue of the beneficiary-spouse's beneficial interest in the trust.[444] This

435. I.R.S. Priv. Ltr. Rul. 2011-22-007.

436. *See* Rev. Rul. 75-550, 1975-2 C.B. 357; I.R.S. Priv. Ltr. Rul. 94-51-049; I.R.S. Priv. Ltr. Rul. 2002-43-026; I.R.S. Priv. Ltr. Rul. 2011-22-007.

437. Treas. Reg. § 25.2514-1(b)(2); Rev. Rul. 75-550, 1975-2 C.B. 357.

438. *See* Rev. Rul. 75-550, 1975-2 C.B. 357.

439. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 2002-43-026.

440. *See id.* I.R.S. Priv. Ltr. Rul. 2011-22-007.

441. This subsection of the Article uses the term "SLAT" to generally refer to any trust created by a spouse that includes their spouse as a current beneficiary. As a result, many of the concepts discussed herein are equally applicable to ILITs with a beneficiary-spouse or even a "Descendants' Trust" of which the spouse is a permitted beneficiary.

442. *See The Spousal Lifetime Access Trust (SLAT)*, FIDELITY, https://www.fidelity.com/viewpoints/wealth-management/insights/slat-estate-plan#:~:text=The%20Spousal%20Lifetime%20Access%20Trust%20(SLAT),-Most%20estate%20plans&text=As%20the%20name%20suggests%2C%20a,assets%20from%20their%20combined%20estates (last visited Feb. 15, 2022) [https://perma.cc/6U63-62TG].

443. *See id.*

444. *See id.*

subsection addresses several issues that may arise in connection with reporting a gift to a SLAT on a gift tax return.[445]

1. Specifying the Marital Property Character of the Gift

A SLAT funded with community property would be self-settled as to the beneficiary-spouse, so SLATs created by Texas settlors must always be funded with the settlor-spouse's separate property.[446] It is always a best practice to specify the marital property character of gifts reported on a gift tax return for a Texas donor, but this is particularly true in the case of a SLAT, as it is directly relevant to the includability of the SLAT in each spouse's taxable estate.[447]

Married couples in Texas rarely have significant amounts of separate property unless (a) they have a preexisting marital property agreement that eliminates or significantly curtails the creation of a community property estate, (b) one or both spouses were independently wealthy prior to the marriage, or (c) one or both spouses have received a significant amount of separate property assets by gift, devise, or descent.[448] In anticipation of making a gift to a SLAT, a Texas settlor-spouse must often acquire the necessary separate property by partitioning community property into equal shares with the beneficiary-spouse.[449]

2. Is Gift Splitting an Option?

Some clients, particularly those who have made a gift-splitting election in the past or are accustomed to making gifts of community property allocated equally between spouses, may wonder if it is possible to make a gift-splitting election for a contribution to a SLAT.[450] In determining the answer, it is important to first consider whether there is anything to be gained by gift splitting in that situation.[451]

One spouse may understandably be reluctant to create a SLAT for the benefit of the other without receiving something in return.[452] As a result, it is quite common for both spouses to create a SLAT for each other (even if that

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445. *See infra* Sections IV.B.1–3.

446. *See* Jason R. Flaherty, *Drafting Spousal Lifetime Access Trusts*, CORPUS CHRISTI EST. PLAN. COUNCIL (Nov. 19, 2019) (presentation at the Corpus Christi Estate Planning Council).

447. *See* I.R.C. § 2036.

448. *See* TEX. FAM. CODE ANN. § 3.001.

449. *Id.* § 4.102.

450. *See* Treas. Reg. § 25.2513-1(b)(4).

451. *Id.*

452. *See* Hoffman, Havard, & Damm, *Spousal Lifetime Access Trusts (SLATs): Not Just for the Rich and Famous*, KNOX L. INST. (Oct. 16, 2016), https://www.kmgslaw.com/knox-law-institute/publications/spousal-lifetime-access-trusts-slats-not-just-for-the-rich-and-famous?filter= [https://perma.cc/89HP-U5VE].

is done at different times).[453] To avoid the application of the reciprocal trust doctrine, well-conceived SLATs are likely to have different distribution standards, powers of appointment, and beneficiaries.[454] In an effort to further distinguish the SLATs, they may each be funded with a unique mix of assets of unequal value.[455] Even in that case, each spouse will have likely made a significant gift to the other spouse's SLAT.[456] In that circumstance, the net benefit to be gained by gift splitting (if such an option is even available) will be relatively minimal.[457]

Consequently, it is typically only worthwhile to consider gift splitting in a situation in which only one spouse has created a SLAT for the benefit of the other.[458] But even in that scenario, the spouses should also consider whether gift splitting represents the most efficient use of their combined gift tax exclusion amounts.[459] Because the "bonus" gift tax exclusion amount may only be available temporarily, for some couples it may be preferable for the donor-spouse to utilize their full balance of that exclusion.[460] For example, assume that H and W have made no prior gifts and that H makes a gift of $12,060,000 to a SLAT.[461] If H and W split gifts, they will each use $6,030,000 of their gift tax exclusion amount.[462] If the sunset provisions of the TCJA take effect and the exclusion amount is reduced to an inflation-adjusted $5,000,000, H and W will both be left with very little (if any) remaining exclusion amount.[463] If H and W do not split gifts, H will use the full balance of his gift tax exclusion amount, but W will retain the full balance of her gift tax exclusion amount, both before and after the sunset provision under the TCJA.[464] Presumably, this exclusion amount could be used to make gifts to H or to H and W's joint children.[465]

If the spouses determine that gift splitting would be advantageous in their specific situation, there is another obstacle to overcome.[466] As was detailed in Section II.A.3.a above, gift splitting is generally not an option in

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453. *Id.*

454. *See* United States v. Est. of Grace, 395 U.S. 316, 324–25 (1969).

455. *See* Charles Douglas, *Adaptable Wealth Planning Strategies*, WELLS FARGO (July 2012), https://www.naepcjournal.org/journal/issue12m.pdf [https://perma.cc/82BT-5DML].

456. *See* Hoffman, Havard, & Damm, *supra* note 452.

457. *See id.* For example, consider a situation in which H gifts $10,000,000 to the W Trust and W gifts $9,000,000 to the H Trust. By gift splitting, each of H and W will be considered to have made a gift of $9,500,000, saving H $500,000 in gift tax exclusion amount, representing only a 5% reduction. *See id.*

458. *See id.*

459. *Id.*

460. *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 11061(a), 131 Stat. 2054, 2091 (2017).

461. *Id.*

462. I.R.C. § 2513.

463. *See id.* § 20.2010-1(c)(2)(ii) (The IRS has confirmed that the use of the bonus exclusion amount prior to 2026 will result in the use of the so-called base exclusion amount following the sunset.).

464. I.R.C. § 2010.

465. *Id.*

466. *See Planning Strategies for Gift Splitting*, FIDELITY (June 25, 2021), https://www.fidelity.com/learning-center/wealth-management-insights/gift-splitting [https://perma.cc/WH2A-JSFW].

connection with a gift that is to or for the benefit of the donor's spouse.[467] A gift to a SLAT is only eligible for gift splitting if an ascertainable portion of that gift is for the benefit of a third party and thus can be severed from the gift for the spouse.[468]

It is fairly well established that gift splitting is not an option if the trustee has broad discretion as to distributions of income and principal to the spouse, as the value of the spouse's interest is not susceptible to determination in that circumstance.[469] But, if there is an ascertainable standard for distributions (such as the "health, education, maintenance, and support" standard or some variation thereof), it may be possible to assign a value to the spouse's interest and sever it from the interest for the benefit of a third party.[470]

For example, in *Robertson v. Commissioner*, the court found that the husband and wife could gift split a portion of the husband's gift to a trust for the benefit of the wife that provided her with an income interest for life and authorized a corporate trustee to make distributions of principal as "necessary for her maintenance and support" after considering her other sources of funds.[471] Based on the wife's life expectancy, her other available resources, and the amounts necessary to maintain her accustomed standard of living, the court concluded that there was "no likelihood" of the trustee invading the trust principal and that such portion of the gift had an ascertainable value that was subject to gift splitting.[472]

The court reached a similar conclusion in *Falk v. Commissioner* but under a different set of facts.[473] In that case, the husband created a trust for the benefit of the wife and his descendants that granted the trustee the discretion to distribute trust income to the beneficiaries as "appropriate under all the facts and circumstances then existing" and principal for their "care, comfort, support, maintenance, and general welfare."[474] The court concluded there was a distinct possibility the trustee would make income distributions to the wife, but the possibility of the invasion of principal was so remote as to be negligible.[475] As a result, the interest in principal was severable from the income interest and was eligible for gift splitting.[476]

As these cases demonstrate, the spouse's interest in a trust is most likely to be severable from that of a third party if the trust has an ascertainable distribution standard and the donor can clearly establish what portion of the

467. I.R.C. § 2513(a)(1); Treas. Reg. § 25.2513-1(b); *see supra* Section II.A.3.a.
468. *See* Treas. Reg. § 25.2513-1(b)(4).
469. Rev. Rul. 56-439, 156-2 C.B. 605.
470. *Id.*
471. Robertson v. Comm'r, 26 T.C. 246, 246–47 (1956).
472. *Id.* at 252–53.
473. Falk v. Comm'r, 24 T.C.M. (CCH) 86 (1965).
474. *Id.*
475. *Id.*
476. *Id.*

trust (if any) will actually be used to benefit the spouse.[477] Both of these elements are equally important.[478] If the trust's distribution standard is not sufficiently limited, the value of the spouse's interest in the trust will not be ascertainable.[479] On the other hand, if the donor does not produce sufficient evidence of the beneficiary-spouse's financial situation and current and future needs, it is not possible to ascertain the probability that the trustee will (or will not) make distributions for the spouse.[480]

In sum, gift splitting may be available in connection with a gift to a SLAT.[481] If a donor and the donor's spouse decide to split gifts, they will increase their odds of success if the donor-spouse's return provides detailed information regarding the beneficiary-spouse's financial needs, explains the extent to which trust distributions may be made in light of those needs, and how that determination influenced the calculation of the value of the spouse's severable interest in the trust.[482]

3. GST Tax Implications

In connection with a split gift, the electing spouse is treated as the transferor of one-half of the gifted property for GST tax purposes, regardless of the interest that the electing spouse is actually deemed to have transferred for gift tax purposes.[483] In other words, if spouses elect gift splitting for a gift to a SLAT, the value of each spouse's gift for gift tax purposes and GST tax purposes may not be the same.[484]

For example, assume H makes a gift of $100,000 to a trust for W and their children.[485] W's interest in the trust is determined to be severable from that of the children and has a value of $20,000.[486] H and W then elect gift splitting.[487] For gift tax purposes, H has made a gift of $60,000, while W has made a gift of $40,000.[488] For GST tax purposes, H and W have each made a gift of $50,000.[489]

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477. *See supra* notes 471–76 and accompanying text.
478. *See supra* notes 471–76 and accompanying text.
479. *See* Wang v. Comm'r, 31 T.C.M. (CCH) 719, 719 (1972).
480. *See* Kass v. Comm'r, 16 T.C.M. 1035, 1035 (1957).
481. *See id.*; *supra* notes 471–76 and accompanying text; *Planning Strategies for Gift Splitting*, *supra* note 466.
482. *See id*.
483. Treas. Reg. § 26.2652-1(a)(4).
484. *Id.*
485. Author's original hypothetical.
486. Author's original hypothetical.
487. Author's original hypothetical.
488. Author's original hypothetical.
489. Author's original hypothetical.

G. Gifts Subject to an ETIP

Certain transfers are subject to an estate tax inclusion period, also known as an "ETIP."[490] An ETIP is the period during which a transferred interest would be includable in the donor's estate if the donor died (for a reason other than the donor having died within three years of making the gift pursuant to Code Section 2035).[491] Gifts to grantor retained annuity trusts (GRATs), and qualified personal residence trusts (QPRTs) are common examples of transfers that are subject to an ETIP.[492]

A gift that constitutes a direct skip or an indirect skip that is subject to an ETIP is deemed to have been made at the close of the ETIP.[493] As a result, a gift subject to an ETIP is often reported on two separate gift tax returns.[494] First, a gift tax return should be filed for the year of the initial gift that is subject to an ETIP, and such gift should be reported on Part 1 of Schedule A of the return.[495] Upon the close of the ETIP, the allocation of the GST tax exemption (if any) should be reported on Part 1 of Schedule D.[496] If the GST tax exemption is allocated upon the close of the ETIP, note that it will be based on the value of the property at that time rather than the value as of the date of the gift.[497] If a donor is filing a gift tax return for the sole purpose of reporting the allocation of the GST tax exemption to a transfer subject to an ETIP, the return should be completed as usual, subject to the following exceptions:

- Write "ETIP" at the top of page 1;
- Complete only lines 1 through 6, 8, and 9 of Part 1;
- Complete Schedule D;
- Complete only lines 10 and 11 of Schedule A, Part 4; and
- Complete Part 2 – Tax Computation.[498]

It can be difficult to predict the value of an interest upon the close of an ETIP.[499] As a result, it is often advisable to opt out of automatic allocation in connection with an indirect skip to a GST Trust subject to an ETIP.[500] A donor may opt out of automatic allocation at any time prior to the due date of

490. *See* I.R.C. § 2642(f)(3).
491. *See* Treas. Reg. § 26.2632-1(c)(2)(i).
492. *See* Thomas L. Stover, *The Perilous Federal Gift Tax Return–Part II*, 28 COLO. LAW., 39, 41–42 (1999).
493. Treas. Reg. § 26.2632-1(c)(1)(i).
494. *See id.*
495. *See Instructions for Form 709*, *supra* note 6.
496. *See id.* (referring to the text under subheading "Transfers Subject to an Estate Tax Inclusion Period (ETIP)").
497. *See id.*
498. *Id.*
499. *See* Treas. Reg. § 26.2632-1(c)(1)(i).
500. *See id.*

the gift tax return for the calendar year in which the close of the ETIP occurs (regardless of whether the transfer was made in the year for which the gift tax return was filed, and whether or not a gift tax return would otherwise be required for that year).[501]

V. THE FINISHING TOUCHES

Once the return itself has been drafted, all that is left to do is add the finishing touches and file it.[502]

A. Attach the Exhibits

As noted throughout this Article, it is often helpful (and sometimes required) to attach certain documents, statements, or other items to a gift tax return.[503] When assembling the return for filing, be sure to include all of the necessary attachments.[504] While not exhaustive, the following list describes many of the items that are often attached to a gift tax return for filing:

- Any statement that is necessary to opt in, opt out, or terminate a prior election to opt in or out of the automatic allocation of GST tax exemption pursuant to Code Section 2632;
- Transfer documents substantiating a gift or non-gift sale, including assignment documents, purchase agreements, promissory notes, and security agreements;
- Documents that support the reported value of a gift, including appraisals, financial data, and documents evidencing the recent sales price of the subject interest;
- Any narratives that have been prepared to explain a reported transfer, such as an explanation as to why a sale transaction did not constitute a gift, or how the value of a gift associated with the exercise of a power of appointment was determined; and
- In the case of a gift in trust, a copy of the trust instrument (and a certification/verification document for that trust instrument, if it is the first gift ever reported to that trust).[505]

501. *Id.*
502. *See Instructions for Form 709*, *supra* note 6.
503. *See id.*
504. *See id.*
505. *See id.* (referring to the text under subheading "Supplemental Documents").

B. Gather Signatures

A gift tax return often requires multiple signatures, as described below.[506] Handwritten signatures are typically required, but in light of the ongoing COVID-19 pandemic, the IRS has temporarily authorized digital signatures on certain forms that cannot be filed electronically, including gift tax returns.[507] A gift tax return may be filed with digital signatures if it is postmarked from August 28, 2020, through October 31, 2023.[508]

1. Donor

The donor must sign the gift tax return prior to filing.[509] If the donor is deceased, the donor's executor must sign the return.[510] If the donor is incapacitated and has a court-appointed guardian, that guardian must sign the return.[511] Alternatively, a donor's agent under a durable power of attorney may sign the return, but only if the donor's illness, absence, or nonresidence has rendered the donor unable to sign the return in a timely fashion.[512] In that event, a statement fully explaining the donor's inability to sign must be signed by the agent and filed with the return.[513] A gift tax return signed by an agent must be ratified by the donor within a reasonable time after they become able to do so.[514]

2. Donor's Spouse

If the donor's spouse has consented to gift splitting, that spouse should also sign the return on Part 1, Line 18.[515]

3. The Preparer

If the donor pays another person, firm, or corporation to prepare the return, that person must also sign the return as the preparer unless the person is a regular full-time employee of the donor.[516] Recall that the tax return

506. *See id.*

507. *IRS Operations During COVID-19: Mission-Critical Functions Continue*, IRS, https://www.irs.gov/newsroom/irs-operations-during-covid-19-mission-critical-functions-continue#digitalsignature (Jan. 28, 2022) [https://perma.cc/GL3W-TR9N].

508. *Id.*

509. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Signature").

510. Treas. Reg. § 25.6019-1(g).

511. *Id.*

512. *Id.* § 25.6019-1(h).

513. *Id.*

514. *See id.*

515. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Signature"); *id.* § 25.2513-2(a)(1).

516. *See Instructions for Form 709*, *supra* note 6 (referring to the text under subheading "Signature").

preparer who signs the return generally has the primary responsibility for the overall substantive accuracy of a return.[517] If multiple preparers work on a return, they should be thoughtful about who is best suited to sign.[518]

4. Other Signatures

If an appraisal is attached to the gift tax return, be sure that it is signed by the appraiser.[519] If the return is disclosing the initial gift to a trust, remember to include a signed certification or verification for the trust instrument.[520]

C. Filing the Return

Gift tax returns must still be filed the old-fashioned way, meaning that e-filing is not an option.[521] The return may be filed through the U.S. Postal Service or an authorized private delivery service and is considered timely filed so long as it is timely mailed.[522] It is best to consult the Instructions for Form 709 on an annual basis to confirm the correct address for delivery, as it does change from time to time.[523]

D. Making Payment

In the event that gift tax is due in connection with the filing of a return, payment must be made on or before the original due date for the return (i.e., April 15th in most years) without regard to any extension of time for filing.[524] A donor's request for an extension of time to pay may be granted if timely payment would involve undue hardship, as detailed in Regulation Section 25.6161-1.[525] If the donor is extending the time to file the return, whether through Form 4868, 2350, or 8892, any gift or GST tax that is due should be paid with Form 8892-V.[526]

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517. Treas. Reg. § 301.7701-15(b)(1).
518. *See id.*
519. *See Instructions for Form 709*, *supra* note 6.
520. *See id.*
521. *12044: 709 - Cannot Be E-Filed*, DRAKE SOFTWARE, https://kb.drakesoftware.com/Site/Browse/12044/709-Cannot-Be-Efiled#:~:text=You%20cannot%20e%2Dfile%20Form,the%20applicable%20address%20listed%20below (last visited Feb. 15, 2022) [https://perma.cc/YP4F-GUJZ].
522. *See* I.R.C. § 7502.
523. *See Instructions for Form 709*, *supra* note 6.
524. I.R.C. § 6151(a).
525. Treas. Reg. § 25.6161-1.
526. *See Instructions for Form 709*, *supra* note 6.

VI. CONCLUSION

A thorough, well-prepared gift tax return is integral to every successful gift transaction.[527] A gift tax return also offers taxpayers the opportunity to disclose non-gift sales and other estate planning transactions to foreclose the possibility of an unanticipated gift and estate tax liability in the future.[528] While these concepts are not new, they have taken on renewed importance in light of the many clients who are eager to make significant transfers of wealth in advance of potential tax law changes.[529] Practitioners will be better prepared to achieve successful outcomes for their clients by periodically revisiting the fundamentals of gift and GST tax reporting.[530]

527. *See* discussion *supra* Part I.
528. *See* discussion *supra* Section II.C.
529. *See* discussion *supra* Part II.
530. *See* discussion *supra* Part IV.