

Filing Form 709 — Beyond the Basics of Gift Tax Returns

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This article was first published
in the April 2016 edition of
Estate Planning magazine.

Since 2013, the gift tax filing threshold has been \$14,000, making it relatively apparent that if your client made a gift in excess of \$14,000 to any one person (other than a spouse) in 2013 or any year thereafter, the client probably had to file a federal gift tax return (Form 709). Less obvious are the various elections, allocations, and disclosures reported on Form 709 that provide additional reasons to file gift tax returns, some of which are mandatory and some of which are elective. This article explores some of those less obvious issues that may arise when preparing a Form 709.

Gift Splitting—Not As Easy As It Looks

Code Section 2513 allows a married couple to split a gift made by one of them for federal gift tax purposes if, at the time of the gift, each spouse is a citizen or resident of the United States. An individual is considered the “spouse” of another individual only if they were married to each other at the time of the gift and he or she does not remarry during the calendar year. The consent must be made on a gift tax return filed for the year in which the gift is made. If a return is filed for that year that does not indicate consent by the spouse, it cannot later be changed in an amended return unless the amended return is filed by April 15 of the year after the year of the gift. If no timely return is filed, the consent may be indicated on the first late return filed for that gift unless a notice of deficiency with respect to the gift in question has been sent by the IRS. Note that if the spouse of the donor is not a U.S. citizen but the couple is living in the U.S. at the time of the gift, the gift can be split, but if the couple is living outside of the U.S. at the time of the gift, the gift cannot be split.

¹ The authors would also like to thank Georgia Loukas Demeros for her contributions to this article.

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Gift splitting is an all or nothing proposition. The consent must apply to “all...gifts made during the calendar year by either while married to each other.”² This is an important point that many couples and professionals do not realize. It is especially important in second marriages if gifts in excess of the annual exclusion are being made. A spouse readily may agree to split annual exclusion gifts to their respective children and families, but doing so also means that any taxable gifts during the year are split and both spouses’ lifetime gift tax exclusions are used. This can result in one spouse inadvertently using his or her lifetime gift tax exemption for gifts made to the children of a prior marriage. The only exception to this rule is that the gift cannot be split to the extent it is to or for the benefit of the spouse. If a donor makes a gift to an irrevocable trust of which the spouse is one of the beneficiaries, the gift cannot be split unless, at the time of the gift, the interests of the other beneficiaries are ascertainable and identifiable separate from the spouse’s interest.³ This rule does not directly impact annual exclusion gifts, but it can have an impact in a trust over which the spouse and children (or descendants) have Crummey powers, such as a typical irrevocable insurance trust. Most practitioners view the Crummey withdrawal rights as separately identifiable and ascertainable interests. Therefore, they report gift splitting for the children’s Crummey powers but not, of course, for the spouse’s Crummey power.

EXAMPLE: John gives \$61,000 to a Crummey trust over which his wife, Jane, has a \$5,000 Crummey power and each of their two children have \$28,000 Crummey powers. John and Jane elect to split gifts. John’s transfer to Jane qualifies for the annual exclusion and is not split. The gifts to the children are treated as one-half from John and one-half from Jane. Thus, for gift tax purposes, John is treated as having made \$33,000 of gifts and Jane is treated as having made \$28,000 in gifts. It should be noted that on occasion, the IRS has disagreed with this treatment. If the trust is a spray trust with the spouse and children all as beneficiaries, the IRS has concluded that none of the gifts can be split because the children’s underlying interests in the trust are not ascertainable in value.⁴

With certain trusts, such as QPRTs and non-zero-out GRATs, gift splitting can have a negative effect if the actual grantor of the trust dies before the end of the income or annuity term. In that case, the portion of the gift deemed made by the deceased grantor will have no effect for transfer tax purposes since adjusted taxable gifts do not include gifts that are included in the donor’s estate for federal estate tax purposes, but the gift deemed to be made by the nongrantor spouse will continue to be an adjusted taxable gift in that spouse’s estate at his or her death.

Although for gift tax purposes, the portion of a gift to a trust of which a spouse is the beneficiary cannot be split, for GST purposes, it is, in effect, split when determining the amount of GST exemption to allocate. Each spouse is treated as the transferor of one-half of the gift even if a portion of the gift was to the spouse.⁵ Thus, in the example above, even though John is treated as making a gift of \$33,000 and Jane is treated as making a gift of \$28,000, each must allocate \$30,500 of GST exemption to the trust to keep it exempt from

² Section 2513(a)(2).

³ Reg. 25.2513-1(b)(4).

⁴ See Letter Rulings 200616022 & 200422051 (withdrawal rights of children ignored in determining availability of gift splitting). But see Letter Ruling 200130030 (gift splitting allowed for amounts subject to children’s Crummey powers); Letter Ruling 200218001 (wife’s interest subject to ascertainable standard and therefore susceptible of valuation).

⁵ Reg. 26.2652-1(a)(4).

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GST tax. What if the spouse's interest in the trust is not susceptible to valuation? Assuming all other gifts are split for gift tax purposes in the year in question, does the GST exemption for this gift still get allocated one-half by each spouse? Although the regulations are not clear on this, it seems that the better position is that the donor spouse must allocate all of the GST exemption to this trust.

Adequate Disclosure to Start Statute of Limitations

The IRS generally has three years from the filing of a gift tax return to assess a deficiency.⁶ However, this will only apply to gifts that are adequately disclosed on the gift tax return.⁷ If the statute of limitations expires with respect to a gift, then the IRS cannot later revalue the gift for any purpose. Since the calculation of whether any gift tax is due is dependent on the value of prior gifts, this prevents the IRS from revaluing the gift in a later year solely for the purpose of determining the gift tax due as a result of a subsequent gift. Similarly, the IRS cannot contest the value of a gift for which the statute has run in the estate of the donor for purposes of determining the amount of estate tax that is owed. Prior to changes in the law in 1997 and 1998, the IRS had successfully asserted this position in a number of cases.

The IRS has issued regulations regarding what constitutes "adequate disclosure."⁸ Adequate disclosure must include: (1) a description of the property transferred and any consideration received for it; (2) the identities of the transferor and transferee and how they are related; (3) if the transferee is a trust, the trust's FEIN and a brief description of the trust terms (or a copy of the trust); (4) a detailed description of the method used to determine the fair market value of the transferred property; and (5) a statement describing any position that is contrary to IRS regulations or Revenue Rulings.

For gifts of nonmarketable assets, the key requirement for adequate disclosure is the description of how the fair market value was determined. Section 301.6501-1(f)(2)(iv) states that the return must include a detailed description of the method used to determine fair market value, including financial data used in making the determination. Any restrictions that were considered in valuing the property and any valuation discounts also must be disclosed. If the value of the entity or interest in an entity being transferred is determined based on the net asset value of the entity, the gift tax return must include a statement providing the fair market value of 100% of the entity before any discounts. When the value of an asset is not based on particular financial data, the regulations do not address what disclosure is required. For example, if recent sales are the basis for the valuation, is it sufficient to disclose that fact and the dates and prices for the sales? It would appear that the additional information relating to financial information should not be necessary in that case. If the entity that is the subject of the transfer owns an interest in another nonmarketable entity, then the information required by the regulations showing how the gift was valued also must be provided for the indirectly owned entity if the information is relevant and material in determining the value of the gift.⁹

⁶ See Section 6501(a).

⁷ See Section 6501(c)(9).

⁸ Reg. 301-6501(c)-1(f).

⁹ Reg. 301-6501(c)-1(f)(4).

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Appraisals may also satisfy the disclosure requirement if the appraisal submitted is prepared by a qualified appraiser who is independent of the donor and the appraisal contains a description of the property appraised, the appraisal process, the assumptions used, and the financial data used “that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value.”¹⁰

In some cases, a taxpayer will want to report a transaction not intended to be a gift in order to start the statute of limitations running. A common example is a sale to an irrevocable grantor trust. The disclosure requirements are not quite as burdensome in these situations. The taxpayer must provide basic factual background and explain why the transfer is not a gift. The taxpayer does not have to describe the method used to value the property or provide supporting financial data.¹¹ Many advisors and taxpayers prefer not to report such transactions, viewing them as red flags to the IRS; however, the estate tax return requires disclosure of certain non-gift transactions, such as sales to grantor trusts, increasing the likelihood that such a transaction might be reviewed years later, possibly tipping the scales in favor of disclosure at the time of the transaction.

Not All Annual Exclusion Gifts Are Alike for GST Tax Purposes

As a result of changes enacted in 1988, annual exclusion gifts that benefit multiple generations are not automatically exempt from GST tax. For transfers on or before March 31, 1988, a gift that qualified for the annual exclusion for gift tax purposes also was GST exempt. The 1988 changes limited this exempt treatment for transfers after March 31, 1988 to (1) outright direct skip gifts (including custodial gifts) that qualify for the gift tax annual exclusion, and (2) certain direct skip annual exclusion gifts in trust.¹²

What is a “direct skip?” A direct skip is a transfer subject to gift or estate tax to a skip person. A “skip person” is a natural person assigned two or more generations below the transferor or a trust if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time may any distribution from the trust be made to a non-skip person.¹³ An “interest” is defined for these purposes as a present right to receive income or principal from the trust.¹⁴

Gifts made to a trust are considered as made to the trust, not to the beneficiaries of the trust. So, a gift to a Crummey trust held for children and grandchildren will be treated as a gift to a nonskip person, since the trust has children as beneficiaries, and not separate gifts to skip and nonskip individuals. If a gift is made to a non-family member, the generation assignment is based on the relative ages of the donor and donee. The donee will be in the first generation below the donor if he or she is between 12 ½ and 37 ½ years younger than the donor and in the second generation below the donor if he or she is between 37 ½ and 62 ½ years younger than the donor. Gifts to a custodial account for a minor will qualify for the GST annual exclusion if

¹⁰ Reg. 301-6501(c)-1(f)(3).

¹¹ Reg. 301-6501(c)-1(f)(4).

¹² Section 2642(c).

¹³ Section 2613(a).

¹⁴ Section 2652(c).

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they also qualify for the gift tax annual exclusion. Gifts to 529 Plans are treated the same way even though the beneficiary of a 529 Plan is subject to change.

Even if a direct skip gift is made to a trust, assuming the gift does not exceed the gift tax annual exclusion, it will be a nontaxable gift only if the trust is for a single beneficiary and the trust property will be included in that beneficiary's gross estate for federal estate tax purposes if the trust is still in existence at the beneficiary's death.¹⁵ Annual exclusion gifts to so-called "2503(c) trusts" for minors will qualify for this GST "annual exclusion." Annual exclusion gifts to irrevocable trusts with Crummey powers that benefit multiple generations do not avoid GST tax unless GST exemption is allocated. If the trust is drafted so that it has only one beneficiary and vests ultimately in that beneficiary, it can be qualify for both a gift tax annual exclusion and as a nontaxable GST transfer.

The use of the annual exclusion is done on a chronological basis during the year. Thus, the timing of gifts to different trusts or beneficiaries can be important.

EXAMPLE: An individual creates a Section 2503(c) trust in January 2016 for his minor grandchild and makes a taxable gift of \$14,000 to the trust. In August 2016, the individual makes an additional \$100,000 gift to an irrevocable insurance trust of which the grandchild and three other descendants are Crummey beneficiaries. The gift in January will qualify as a nontaxable transfer for GST purposes. However, if the gift to the insurance trust was made in January and the gift to the 2503(c) trust was made in August, the gift to the 2503(c) trust would not qualify as a nontaxable transfer for GST purposes because the gift in January will have used up the donor's annual exclusion. As a result, the gift in August will not qualify for the gift tax annual exclusion, which is a requirement to qualify as a nontaxable gift for GST purposes.

Lapses of Crummey Powers and Allocation of GST Exemption

There are a number of potential complications that can arise in reporting gifts to irrevocable trusts with Crummey powers. If a Crummey power held by a beneficiary lapses in a way that is taxable to that beneficiary, then the beneficiary becomes the transferor. This may negate an allocation of GST exemption by the creator of the trust.

EXAMPLE: Father gives \$20,000 to an irrevocable trust for the benefit of his child for life, with the remainder passing to his grandchild. Father allocates \$20,000 of GST exemption to the trust. His child is permitted to withdraw the contribution for 30 days after the transfer. If the child fails to exercise his Crummey power and the 5-and-5 exception protects \$5,000 of the lapse, then Father will be treated as the transferor with respect to \$5,000 and the child will be treated as transferor with respect to the remaining \$15,000. With respect to future distributions, Father is transferor over one-fourth of the trust ($\$5,000/\$20,000$) and child is transferor over three-fourths of the trust. This means that \$15,000 of Father's allocation of GST exemption is ineffective.

¹⁵ Section 2642(c)(2)

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The regulations also indicate that the lapse of the Crummey power shifts the transferor only to the extent that the lapse constitutes a completed gift.¹⁶

EXAMPLE: Same facts as in the previous example, except that the child had a testamentary special power of appointment over the trust. This renders any gift upon lapse of the Crummey power incomplete. For GST tax purposes, Father remains transferor with respect to the entire trust. Fifteen years later, after Father's death, the trustee makes a \$10,000 discretionary distribution to a grandchild. The distribution in effect completes the gift made by a child at the time of the lapse as to three-fourths of the amount distributed. Only one-fourth of the \$10,000 distributed to the grandchild is considered to be property as to which Father is transferor, and therefore potentially subject to GST tax.

The lapse of a Crummey power can have adverse GST tax consequences in a multi-generational trust designed to benefit the great-grandchildren, as well as the grandchildren, of the original-transferor. In the above examples, Father may allocate GST exemption only to the portion of the trust with respect to which he is treated as transferor. If a child is treated as transferor with respect to a portion of the trust property as a result of the lapse of a Crummey power, then a portion of any distribution to, or termination in favor of, a great-grandchild of the original transferor will be subject to GST tax, unless the child also allocates GST exemption to the trust. This problem cannot be solved by giving the holder of a Crummey power a testamentary power of appointment, which would make the lapse of the Crummey power an incomplete gift. In that case, the shift of the transferor would merely be delayed until the holder's death, at which time, the consequences of the shift could be even worse if the property had appreciated.

EXAMPLE: Father transfers \$10,000 to a dynasty trust for the benefit of his daughter and her descendants, and allocates \$10,000 of his GST exemption to the trust. The daughter may withdraw the entire \$10,000 for 30 days, after which time the power lapses. She also has a testamentary special power of appointment and income interests in the trust. The testamentary power of appointment renders any gift upon the lapse of the Crummey power incomplete. For GST tax purposes, Father remains the transferor with respect to the entire trust. However, the lapse of the daughter's power and her other interests in the trust will cause one-half of the trust (\$5,000/\$10,000) to be included in her estate at death. If the trust is worth \$100,000 at her death, \$50,000 will be taxed in the daughter's estate and she will become transferor of this amount. Assume that the trust will continue for the life of a grandchild and ultimately distribute to great-grandchildren. In order to keep the trust GST exempt, the daughter's executor must allocate \$50,000 of her GST exemption at her death. If daughter did not possess the testamentary power of appointment, she would have been treated as transferor of only \$5,000 upon the lapse of the Crummey power (assuming the value of the trust assets neither appreciated nor depreciated during the withdrawal period). In that case, she would have needed to allocate only \$5,000 of GST exemption at the time of the lapse of the Crummey power to keep the trust GST exempt.

¹⁶ See Reg. 26.2652-1(a)(6), Ex. 5.

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Watch Out for Automatic Allocations

Since enactment of the GST tax, the Code has provided that a transferor of property will be deemed to have allocated GST exemption to certain transfers, unless the transferor specifically elects otherwise on a gift tax or estate tax return. The automatic allocation rules initially applied only to direct skips – transfers directly to a grandchild or more remote descendant or to a trust only for the benefit of such persons.¹⁷ The rule made a great deal of sense, because GST tax immediately would be due on a direct skip not exempted from the tax.

In 2001, Congress expanded the automatic allocation rules beyond direct skips. Section 2632(c) now provides for an automatic allocation of an individual's GST exemption to a lifetime "indirect skip." An "indirect skip" is defined as any transfer of property (other than a direct skip) made to a "GST trust." The characterization of a gift as a direct skip, indirect skip or neither is critical to determining where the gift should be reported on the federal gift tax return. Gifts that are neither direct skips nor indirect skips are reported on Part 1 of Schedule A. Gifts that are direct skips are reported on Part 2 of Schedule A. Gifts that are indirect skips are reported on Part 3 of Schedule A.

A "GST trust" is defined to include any trust in which there is a significant likelihood that a GST tax ultimately will be owed as a result of a taxable termination or taxable distribution. It is defined in such a way as to apply to any trust that could have a generation-skipping transfer with respect to the transferor unless certain conditions are present. Those conditions are:

1. if the trust provides that more than 25% of the principal must be distributed or may be withdrawn by one or more non-skip persons:
 - a. before the date that the non-skip person attains age 46;
 - b. on or before one or more dates specified in the trust that will occur before the non-skip person attains age 46; or
 - c. upon the occurrence of an event that, in accordance with regulations to be issued, may reasonably be expected to occur before the non-skip person attains age 46, the trust is not a GST trust; and
2. if the trust provides that more than 25% of the principal must be distributed or may be withdrawn by one or more non-skip persons who are living on the date of death of another person identified in the trust who is more than 10 years older than such non-skip person, the trust is not a GST trust;
3. if the trust provides that if one or more non-skip persons die on or before a date or event described in the prior two sentences, more than 25% of the trust principal will be distributed to their estates or be subject to a general power of appointment, the trust is not a GST trust;
4. if any portion of the trust would be included in the estate of a non-skip person (other than the

¹⁷ Section 2632(b).

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transferor) if he or she died immediately after the transfer, a trust is not a GST trust. This exception to the GST trust rule would seem to overlap with the prior exception in many cases¹⁸;

5. charitable lead annuity trusts and all charitable remainder trusts are also not considered; and
6. a charitable lead unitrust that has a non-skip person as the remainder beneficiary is also not a GST trust.

Note that in each of cases numbered 1-4 above, a right to withdraw no more than the annual exclusion amount (such as a Crummey power of withdrawal) will not cause property to be considered to be includable in the estate of, or subject to withdrawal by, a non-skip person, and non-general powers of appointment granted under the trust instrument to non-skip persons will be assumed to go unexercised.

The above-listed conditions are not going to be satisfied in many irrevocable trusts that are not intended to be generation-skipping trusts. For example, if a grantor creates an irrevocable insurance trust that has a trust for spouse and descendants following his death, and then at the spouse's death creates separate trusts for the children with withdrawal rights at ages 30, 35, and 40, the trust will be a GST trust, unless the children already are over age 30 at the time of the transfer to the trust. Why is this the case? This trust does not fit into exception number one listed above since the withdrawal rights do not apply until after the spouse's death, so there is no assurance that 25% of the property will be subject to withdrawal by the time the children are 46 years old. This trust also does not fit into the second exception listed above if the children are not already 30 years old since the withdrawal rights will not be effective if the spouse (their mother) were to die right after the gift is made. The trust also does not fit into any of the other exceptions. Thus, if the grantor takes no action, GST exemption automatically will be allocated to transfers to the trust pursuant to the indirect skip rules.

As with the automatic allocation rules for direct skips, an individual can elect out of the indirect skip treatment. Pursuant to Section 2632(c)(5), this is to be done on a timely filed gift tax return or at such later time as permitted by regulations. It also is possible to "opt in" — to elect to treat a trust as a GST trust. Given the expansive definition of GST trust in the statute, the election out of the automatic allocation rules is quite important. By electing out, the grantor can eliminate the possibility of inadvertent allocations of GST exemption to the trust. The IRS has issued regulations that explain how to make the election. The regulations provide that a gift tax return should be filed to make a contemplated election, even if a gift tax return is not otherwise required for that year.¹⁹ For example, the only gifts the grantor may make during the year may be annual exclusion gifts to an irrevocable insurance trust. A gift tax return would not otherwise be required. Nevertheless, the grantor should file one to elect out of the indirect skip rules. The regulations provide that an election out of automatic allocations does not preclude an explicit allocation of GST exemption on a gift tax return in the usual way.²⁰

¹⁸ Section 2632(c)(3).

¹⁹ Reg. 26.2632-1(b)(2)(iii).

²⁰ Reg. 26.2632-1(b)(2)(iii).

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An opt out or opt in election can be made just for the year of the gift tax return, or the taxpayer can make the election for that year and all future years. An election that also applies to future years can be terminated on a subsequent gift tax return.²¹ The election in every case is made by attaching a statement to the gift tax return that identifies the trust and the election being made. Because of the confusing definition of a GST Trust, a preparer should consider always including an opt in or opt out notice the first time a gift is reported to a trust. That way, even if the nature of the trust has been incorrectly analyzed, the proper result will occur.

Section 2642(g)(1) of the Code directs the IRS to grant extensions of time to individuals for the allocation of GST exemption, and the making of elections with respect to allocations, such as the elections under Section 2632 not to have deemed allocations of GST exemption to indirect skip transfers or the election to treat a trust as a GST trust. In Notice 2001-50, 2001-2 C.B. 189, the IRS announced that relief under Section 2642 will be granted under Section 301.9100-3 if the taxpayer follows those procedures and establishes that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. The IRS has issued hundreds of rulings under Section 301.9100-3 granting relief. It generally has been liberal in granting the relief requested.²²

Every GST Allocation Should Be a Formula Allocation

A formula allocation always should be made when allocating GST exemption to a gift of anything but cash. Otherwise, if assets are revalued on audit, the trust might wind up with an inclusion ratio greater than zero. A late allocation might be possible at that time, but date of allocation values would have to be used, which could be considerably higher than the values as of the date of the gift.

EXAMPLE: In 2016, T makes a gift of closely-held stock that he values at \$4,000,000 to an irrevocable trust for his descendants and files a timely gift tax return. On that return, he allocates \$4,000,000 of his GST exemption to the transfer. Two years later, in 2018 the IRS audits the return and increases the value of the initial transfer to \$5,000,000. In 2018, the value of the stock in the trust is \$8,000,000. The most T can do is allocate his remaining GST exemption to the trust. However, since this will constitute a late allocation, the trust would not have an inclusion ratio of zero. Rather, the inclusion ratio would be determined as follows. When the initial gift tax return was filed, the trust would have had an applicable fraction of $\frac{4}{5}$ ($\frac{\$4,000,000}{\$5,000,000}$), so the inclusion ratio of the trust would have been .200. When the late allocation is made, the trust was worth \$8,000,000, and the nontaxable portion would be \$6,400,000 ($\frac{4}{5}$ of \$8,000,000). Assume T has \$1,500,000 of GST exemption available in 2018. The additional allocation of \$1,500,000 of GST exemption would increase the nontaxable portion to \$7,900,000. The applicable fraction would have a numerator of \$7,900,000, and the trust would have an inclusion ratio of .013 ($\frac{1}{7,900,000/8,000,000}$).

²¹ Reg. 26.2632-1(b)(2)(iii)(E).

²² In 2008, the IRS issued proposed regulations regarding this subject. Prop. Reg. 26.2642-7(d). They have yet to be finalized. The proposed regulations would replace the 9100 relief with another method of seeking relief for making GST allocations.

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Had a formula been used on the initial return indicating that T was allocating the least amount necessary to give the trust an inclusion ratio of zero, the initial allocation would have been deemed to have been \$5,000,000, and the trust would have an inclusion ratio of zero.

Understand the Predeceased Child Rule

Under Section 2651(e), a grandchild or more remote descendant of the transferor is moved up a generation if, at the time of the transfer, the descendant's parent, who also is a descendant of the transferor, is deceased.

EXAMPLE: T makes a gift in trust to her grandson. T's child, who is the grandson's parent, is deceased at the time of the transfer. The grandson is moved up one generation and treated as a child of T. Therefore, the gift is not a direct skip.

The rule applies only to lineal descendants. However, if the transferor has no living lineal descendants, then it also applies to transfers to collateral relatives, which are defined as lineal descendants of the transferor's parents.

Prior to 1998, the predeceased child rule applied only to direct skip transfers. Beginning in 1998, this exception was expanded to cover taxable terminations and taxable distributions as well if the parent is deceased at the time of the transfer.²³ A living descendant who dies no later than 90 days after a transfer is treated as having predeceased the transferor if the governing instrument or local law so provides.²⁴

EXAMPLE: Grandfather's will provides that one-half of his estate be distributed outright to Grandson, and the other one-half to a trust for the benefit of all of his descendants. Grandson's mother, who was the daughter of Grandfather, predeceased Grandfather. Under the current bump-up rules, both the outright distribution to Grandson (which has always been exempt) and any distribution from the trust that might later be made to Grandson will be exempt from GST tax. However, any distribution from the trust to any other grandchild whose parents were not deceased at Grandfather's death would be a taxable distribution.

If the transfer is to a QTIP trust, and no reverse QTIP election is made, the determination of generation assignment is made at the time the spouse dies (or causes the QTIP trust to be subject to tax during life).²⁵ Thus, if a child survives the father, but dies during the mother's life, then the child's children move up a generation at the mother's death with respect to the QTIP trust. If a reverse QTIP election is made, the bump-up rule would not apply in the facts assumed above because the child still was alive at the father's death. But it would not matter because the father would have allocated GST exemption to the reverse QTIP trust.

Making Late Allocations of GST Exemption

If an allocation of GST exemption is made on a timely-filed gift tax return, the amount of exemption that must

²³ Section 2651(e)(1).

²⁴ Reg. 26.2612-1(a)(2).

²⁵ Reg. 26.2651-1(a)(3).

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be allocated equals the value of the gift, determined as of the date of the gift. However, with one exception noted below, if a taxpayer wishes to allocate GST exemption at a later date, the amount of GST exemption that must be allocated is the value of the gift at the time of the late allocation, not at the time of the transfer. As assets usually appreciate over time, this means that more GST exemption generally will be needed if a late allocation is made.

Recognizing the practical difficulties involved with making a late allocation based on values on the date of filing the return, the Regulations offer an alternative. The transferor may elect to make a late allocation of GST exemption based on the value of the transferred property as of the first day of the month in which the allocation occurs. An allocation based on this election is only effective upon the filing of a gift tax return stating that the election was made, the date of the election, and the value of the trust as of the valuation date.²⁶ This option is not available for a life insurance policy or a trust that owns a life insurance policy after the death of the insured. Insurance was excluded in such a circumstance in order to prevent an allocation of GST exemption in the month in which the transferor dies at the lower value of the policy on the first day of that month.

PLANNING NOTE: While an individual can make a late allocation, most individuals give property away with the expectation that it will appreciate in value, so they will want to allocate the exemption as early as possible. However, if the asset depreciates between the date of the gift and the date that the gift tax return is due (normally April 15 of the following year), the individual will not want to make the allocation on a timely filed return based on the date of gift value. The individual, without any risk, can gain an extra four months for making the decision of when to allocate the exemption by obtaining an automatic extension for filing the return. If the property has increased in value by the extension due date, the allocation can be made on the gift tax return based on the date of gift value. If the property has depreciated, the allocation can be made separately based on the current value.

Determining the amount of GST exemption needed for a late allocation can become complicated if other transfers were made to the trust after the original transfer was made. If an allocation is made for a current transfer on a timely basis and for a past transfer on a late basis, the allocation is first used for the timely transfer, with any additional amount allocated to the earlier transfer. If any excess amount remains, it is applied to any unreported transfers that may have been made.²⁷ The regulations also set forth a priority system for allocating exemption between reported and unreported gifts.

There is one exception to the rule that date-of-allocation values must be used when a late allocation is made. Under Section 2632(d), a donor can make a retroactive allocation of GST exemption using date-of-gift values if there is a premature death of a child who is a beneficiary of the trust. In order to take advantage of this, the donor must file a gift tax return no later than April 15 of the year following the year of death of the child (subject to any extensions actually granted) that makes the requisite allocation.

²⁶ Reg. 26.2642-2(a)(2).

²⁷ Reg. 26.2632-1(b)(2)(ii).

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Reporting Frontloaded Gifts to 529 Plans

A Section 529 plan, or Qualified State Tuition Program plan, is a program established by a State and subject to special tax treatment under Code Section 529. The plan allows a person to make contributions to an investment account that will be used to pay for the higher education expenses of a designated beneficiary. The person creating the account can retain a great deal of control over it. If the program meets the requirements specified in Section 529, the earnings in an account under the program will not be subject to income tax before they are withdrawn. In addition, under current law, if the funds are withdrawn to pay higher education expenses, they also will not be subject to income tax when so used.

For gift tax purposes, a contribution to a college savings plan is treated as a completed gift that qualifies for the annual exclusion. A contribution cannot be treated as a Section 2503(e) payment of education expenses. The donor may treat contributions as split gifts with his or her spouse. It is not necessary to grant the designated beneficiary of the account a Crummey power or otherwise create a present interest in the beneficiary. The annual exclusion gift treatment applies for both gift tax and generation-skipping tax purposes.²⁸ This acceleration can give a person a significant head start in accumulating assets outside his or her estate.

Section 529(c)(2) allows the donor to elect to treat all or any portion of a contribution as if it were made over a period of up to five years for purposes of annual exclusion treatment. This allows a married individual to contribute up to \$140,000 to a Section 529 plan account for a child or grandchild in one year and treat it as five years worth of annual exclusion gifts to that beneficiary. The gift is not reported all in one year, though. In the year of the gift and each subsequent year, the donor reports 1/5 of the amount of the gift on Schedule A. The date of the gift is deemed to be the year for which the return is being filed, not the year of the actual contribution to the account. If no gift tax return would otherwise be required during any of the last 4 years of the deemed gift, it is not necessary to file a return solely to report the 1/5 gift to the 529 account. If a gift to a 529 Plan is split with the donor's spouse, each spouse can individually decide whether to make this 5-year election.

Filing a Donor's Final 709 On Time

In general, the Form 709 must be filed by April 15 of the calendar year following the year of the gift, subject to extensions. A different rule applies for a gift made in the donor's year of death. In that case, the return must be filed by the earlier of April 15 of the following calendar year (subject to extensions) and the date the federal estate tax return must be filed (subject to extensions).²⁹ In some cases, this may mean having to file a gift tax return in the same calendar year in which the gift is made.

Reporting Lifetime Transfers to a QTIP Trust

For estate planning purposes, an individual may make a lifetime transfer of property into a QTIP trust for the benefit of his or her spouse instead of an outright gift to the spouse. In order to qualify a gift to a lifetime

²⁸ See Prop. Reg. 1.529-5(b).

²⁹ See Section 6075(b)(3).

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QTIP trust, the gift must be reported on a timely filed gift tax return. The election cannot be made on a late return, and the IRS cannot grant retroactive relief. If the election is not made on a timely return, it will be considered a taxable gift by the donor.

Deceased Spousal Unused Exclusion Amount

For individuals whose spouses died after December 31, 2010, their available gift tax exemption may be subject to increase if the deceased spouse did not use fully his or her estate tax exemption and the appropriate election was made on the deceased spouse's federal estate tax return. This is referred to as the "deceased spousal unused exclusion amount," or "DSUE amount." The DSUE amount is available from the *last* deceased spouse. Thus remarriage in and of itself does not cause a surviving spouse to lose use of the deceased spouse's DSUE unless the new spouse also predeceases the surviving spouse. The DSUE amount is deemed to be used first when a surviving spouse makes a taxable gift. Given the last deceased spouse rule, this is an advantage because if the surviving spouse has used the DSUE of his or her first spouse, it is not lost if the subsequent spouse also dies. However, if the DSUE is not used, it is then lost. The DSUE only applies to gift and estate tax exemption, not to GST exemption. It also is tied to the estate tax exemption at the death of the deceased spouse, so future inflation increases in the estate tax exemption do not increase the DSUE.

Conclusion

The filing of Form 709 is critical to implementing and safeguarding the benefits of careful estate planning, especially the benefits of GST tax planning. Practitioners are therefore well advised to timely file and properly prepare Form 709, which is not merely required for annual gifts in excess of \$14,000, but for various elections, allocations, and disclosures as well.

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