

# Trust & Estates

## Taxes and Planning

### TM Financial Services

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### Distributions of Property from a Trust or Estate

#### Statute of Limitations and Adequate Disclosures for Gifts

Even though the majority of gifts do not require the filing of a gift tax return because of the annual exclusion, it is often desirable to file one in order to start the three year statute of limitations period, after which the value of the gift cannot be challenged by the IRS either as it pertains to that particular gift filing or for estate tax purposes upon the death of the donor.

If no gift tax return is filed, the statute does not apply. Thus, if a taxpayer fails to file a gift tax return, the IRS can pursue him indefinitely. Additionally, if the taxpayer files a gift tax return with inadequate information, the statute of limitations does not apply.

Prior to 1997 the IRS was successful in a number of cases in being able to revalue for estate taxes, the value of a gift for which the three year statute of limitations had passed. Under the Taxpayer Relief Act of 1997 the IRS is now precluded from such action provided that a properly prepared return was filed and the statute period had expired.

When distributions which satisfy the terms of a will or trust document, are made in property rather than cash there are complicated rules governing such issues as:

- Will the trust or estate realize a gain or loss on such distributions
- Will the beneficiaries be required to pick up income via a Form K-1 with a corresponding distribution deduction to the trust or estate.
- What will the beneficiary's basis be in the property he or she receives.

To answer these questions we need to know such things as the type of distribution being made (one satisfying a specific bequest or as part of the residue), the number of distributions that were made, the language in the will or trust governing formula bequests and any special elections available and chosen by the fiduciary, specifically the §643 election to have the trust or estate recognize a gain on the distribution of property other than specific bequests.

Page 3 includes a chart which attempts to summarize the various possibilities.

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**Gift Tax Q&A**

**Gifts** (continued from page 1)

This rule applies whether or not an individual actually paid a gift tax or merely used annual exclusions or a portion of the unified credit.

The conditions for an adequately disclosed gift include a description of the property and consideration received, the identity and relationship of the transferor & transferee, if transferred in trust - the trust's TIN and a copy of the trust instrument, a detailed description of the methodology used to determine the value, and a statement describing any position taken, contrary to IRS regulations or revenue rulings.

The submission of an appraisal will satisfy the requirement of a description of the the method of valuation as long as the appraiser is an individual who performs appraisals on a regular basis, has the necessary background, experience and education to make appraisals of the type of property being valued and the appraiser is not the donor or the donee or a member of the family of the doner or donee.

The appraisal itself must contain the date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal. Additionally it needs to contain a description of the property and of the appraisal process employed, a description of the assumptions, and any restrictions on the property that affect the analyses, opinions, and conclusions. The information in the appraisal must be sufficiently detailed so that another person could replicate the process and arrive at the appraised value. Finally it needs to include the appraisal procedures followed, the valuation method utilized and the basis for the valuation such as specific comparable sales, asset-based approaches, etc.

If a reported gift contains a discount for lack of marketability or a minority interest, this must be disclosed by checking the box at the top of schedule A and attaching an explanation for the discount and the amount taken.

**Is a return required for a gift to a spouse?**

No, unless -

The gift is of a terminal interest or  
The spouse is not a citizen and the gift exceeds \$139,000.

**In addition to a gift exceeding the annual exclusion when else must a return be filed?**

If the gift is of a future interest or the spouses choose to split gifts.

**If spouses elect gift splitting, must both file a return?**

In general yes, but only one return is needed if one of these two exceptions are met:

- |    |  |     |  |
|----|--|-----|--|
|    | <u>1<sup>st</sup> Spouse</u>                           |     | <u>2<sup>nd</sup> Spouse</u>   |
| 1. | Gifts to each donee are ≤ \$36,000                     | and | No gifts made  |
|    |  |     | or   |
| 2. | Gifts to each donee are between \$13,000 and \$26,0000 | and | Gifts to donees are ≤ \$13,000 and are not to any of 1 <sup>st</sup> spouse's donees |

**Is a gift tax return needed for payments to a Qualifying Educational Organization or a Qualified Tuition Program?**

Yes and No. Payments on behalf of another to a qualifying educational organization (most colleges and universities) are not subject to the gift tax if made directly to the organization and the payment is solely for tuition.

Payments to a qualified tuition plan (529 plans) are generally subject to gift tax if the yearly payment exceeds \$13,000. However, one may elect to treat up to \$65,000 of contributions as if it had been made ratably over a 5 year period. Only 20% of the payment is reported in the year of the gift. If in the next four years, no other gifts are made, no return need be filed to report that year's share of the year one transfer.

(Continued on page 4)

## Property Distributions Tax Effects to Trusts & Estates

page 3

	<u>Gain To Fiduciary</u>	<u>Loss</u>	<u>Beneficiary's Basis</u>	<u>Carries out income to beneficiaries &amp; deduction to estate</u>
<b><u>Specific Bequest of Property</u></b>				
<b>In 3 or fewer distributions</b>	No	No	Carryover	No
<b>In more than 3 distributions</b>	Yes	Yes	FMV at Date of Dist.	Yes (FMV of Assets)
<b>Different Property substituted For Property specified in will</b>	Yes	No	FMV at Date of Dist. Carryover	No No
<b>Pecuniary Distribution in Kind - 3 or fewer distributions</b>	Yes	Yes	FMV at Date of Dist.	No
<b>Pecuniary Distribution in Kind - more than 3 distributions</b>	Yes	Yes	FMV at Date of Dist.	Yes (FMV of Assets)
<b>Formula Pecuniary Bequests:</b>				
<b>True Worth Pecuniary Bequest</b>				
(Property distributed is valued at date of distribution for purposes of funding)	Yes	Yes	FMV at Date of Dist.	No
<b>Fairly Representative Pecuniary Bequest</b>				
(Property distributed is valued at adjusted Basis for income taxes in satisfying bequest)	No	No	Carryover	No
<b>Minimum Worth Pecuniary Bequest</b>				
(Property distributed is valued at lesser of Date of distribution value or adjusted basis)	No	Yes	Carryover Carryover *	No No
* minus loss recognized by fiduciary				
<b><u>Residuary Property Distributions</u></b>				
<b>Without §643(e)(3) election</b>	No	No	Carryover	Yes (lesser of FMV or basis)
<b>With §643(e)(3) election</b>	Yes	No	FMV at Date of Dist. Carryover	Yes (FMV of Assets) Yes (FMV of Assets)

Note – As used in this chart, **carryover** basis means the basis of the estate or trust; not the original basis of the decedent or grantor.



## Trusts & Estates

### Taxes and Planning

<b>IRS</b>	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
<b>NJ</b>	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
<b>NY</b>	General Information	518-457-5181
	Estate Tax	518-457-5387
<b>CT</b>	General Information	860-297-5962
<b>PA</b>	General Information	717-787-8201

### Gift Q&A (continued from page 2)

#### What are the penalties related to Form 709?

Late filing – 5% per month up to maximum of 25%

Late payment – 0.5% per month up to maximum of 25%

Fraudulent failure to file – 15% per month up to maximum of 75%

Substantial valuation understatement (reported value is 65% or less of actual value) – 20%

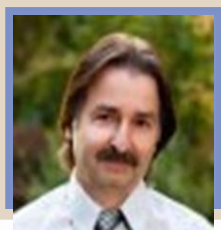
Gross valuation understatement (reported value is 40% or less of actual value) – 40%

#### What are the extension procedures for Form 709?

By filing an income tax extension on Form 4868, the time to file a gift tax return is also extended. If an extension for income taxes is not required, Form 8892, Application for Automatic Extension of Time to file Form 709 and/or Payment of Gift/Generation-Skipping Transfer tax should be filed.

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