

the donor for the annual exclusion to be available. A husband and wife could give \$24,000 to each person each year even though the property is owned by only one of them.

To be eligible for the annual exclusion, the gift must be of a present interest. It must not be a gift of something like a remainder interest, which would be a future interest. If the person receiving the gift would have the right to the income from the gift and possession of it now, it would generally be a present interest and would be eligible for the annual exclusion. If the person receiving the gift is to receive the property and income later, such as after expiration of a life estate, then the gift would not be eligible for the annual exclusion.

Gifts to charity

In addition to the annual exclusion, an unlimited deduction is available for gifts to a qualified charity. Other than for gifts to a subdivision of government or a church, a charity should have an exemption letter from the Internal Revenue Service indicating that gifts are eligible for the gift tax charitable deduction if it is planned for the gift to be deductible.

Marital deduction

Under the federal gift tax marital deduction, 100 percent of the value of gifts from one spouse to another is deductible. That permits a couple to arrange property ownership in any desired pattern with no federal gift tax concern.

The federal gift tax marital deduction can also be claimed for a life estate left to the surviving spouse. The executor of the first spouse to die can elect to treat a life estate left to the surviving spouse as “qualified terminable interest property.” In that event, the entire value of the property - and not merely the value of the surviving spouse’s life estate - qualifies for the marital deduction.

Later, if the surviving spouse disposes of his or her interest by gift, the entire value of the property is subject to federal gift tax. Similarly, if retained until death, the entire value of the property is subject to

federal estate tax at the surviving spouse’s death. Any gift tax or estate tax attributable to the remainder interest may be recoverable from those holding the remainder interest.

Gifts to the spouse can be used to help balance the estates of husband and wife, which may be an advantage in some estate plans. With balanced estates, use of the federal estate tax marital deduction may not be as crucial.

As an example of how these deductions and exclusions may be used, a husband and wife with five children could give away \$120,000 each year - \$24,000 to each of the five children. That annual exclusion could be continued each year for as long as desired.

There is no limit to the number of years the annual exclusion can be used nor is there a limit on the amount of property in the aggregate that can pass under the \$12,000 (OR \$24,000 for husband and wife) annual exclusion. In addition, one spouse could give the other an unlimited amount under the gift tax marital deduction without encountering federal gift tax problems.

For gifts beyond those amounts, the unified credit is available. The unified credit is discussed above and in *Information File C4-24, Federal Estate Tax*.

Gift tax return

If a gift of more than \$12,000 is made to any person (other than spouse) in any year, a federal gift tax return must be filed, even if no gift tax would be due. Any size gift of a future interest requires that a federal gift tax return be filed. The gift tax return is to be filed on an annual basis; however a gift tax return is not required unless gifts exceed the annual exclusion for that year. If gifts exceed \$12,000 for at least one person, a return should be filed.

Federal gift tax returns are filed on an annual, calendar year basis. The gift tax return is to be filed on or before April 15, except for the year of death, and that year the gift tax return is due with the federal estate tax return.

Gifts are reported to the Internal Revenue Service on Federal Form 709. Again, gifts of more than \$12,000 to any one person (other than to a spouse) in any year are to be reported if they are gifts of a present interest. A gift of a future interest, such as a remainder, should be reported on a gift tax return regardless of the size of the gift. Form 709A may be used to report gifts by husband and wife wishing to split the gift to take advantage of the combined \$24,000 federal gift tax annual exclusion.

Gifts that exceed the annual exclusion, the marital deduction, and the charitable deduction are taxable gifts. Taxable gifts are brought back into the taxable estate at death for federal estate tax purposes if they were given after 1976. The IRS after death may be able to challenge the date of gift valuation of property given away as a taxable gift unless properly reported as a gift.

Inadvertent gifts

Gifts may occur on transfer of insurance policies or other property - land, stocks, bonds, inventory items, for example - and are valued for gift tax purposes at fair market values as of the date of the gift.

The IRS position is that a gift may also occur if property is sold with payment over a period of years at an interest rate different from a market rate of interest. This may occur, for example, on sales of land to family members where a special interest rate of six percent is allowed up to \$500,000 of sales of land each year.

Example: Parents sell farmland to their two daughters for \$400,000 with payment over 20 years at 6 percent interest. IRS determines that a market rate of interest at the time would be 11 percent. At that interest rate, the contract is valued at \$250,000. The difference, \$150,000, is a gift from parents to the daughters.

The IRS position has been upheld by the Tax Court and by the Eighth and Tenth Circuit Courts of Appeals but not by the Seventh Circuit Court of Appeals. The Seventh Circuit decision generally

prevails in Illinois, Indiana, and Wisconsin.

Taxable gifts may also occur in transfers to or from co-ownership. As a general rule, a transfer of cash or other property from one person to that person and another as co-owner would constitute a gift of an appropriate fraction of the value involved. Hence, purchase of \$100,000 of corporate stock by A from A's funds would involve a gift of \$50,000 to B if title to the stock were taken by A and B as tenants in common or joint tenants. The gift occurs at the time the property is acquired.

But there are two current exceptions to the general rule.

- Deposits of funds in a joint bank or brokerage account by one owner alone do not constitute a gift—until the co-owner not providing the funds withdraws from the account without any responsibility to account to the one who deposited the funds.
- Purchase of U.S. Government savings bonds by an individual with title taken in joint tenancy with another is not a gift—until the one not providing the funds redeems the bonds while both are living without any responsibility to account to the one who provided funds for the bonds.

Acquisition of land, by a husband and wife, in joint tenancy between December 31, 1954, and January 1, 1982, even though only one of them provided the money, was not a gift at the time of acquisition unless expressly declared to be a gift on a timely filed federal gift tax return.

For acquisitions of land by a husband and wife in joint tenancy after 1981, if initial contributions are not equal, a gift is involved (and would be covered by the federal gift tax marital deduction). Thus, such a joint tenancy could be later severed into tenancy in common without a gift.

Gifts from value freezes

Some individuals cap or “freeze” their estates or specific items of property by converting the assets into a form that does not change in value over time.

An installment sale of land is a type of freeze for the seller. The value of the contract in the seller's hands does not change as land values change. All fluctuations in value of the land are felt by the purchaser, not by the seller.

In 1990, federal legislation repealed an attack on such freezes enacted in 1987 that involved federal estate tax rules. The 1990 law imposed detailed rules governing the valuation of interests retained and transferred as a result of a freeze for federal gift tax purposes.

Gifts to minors

Another tool for estate planning is gifts to minors. Because minors are not competent to manage property from a legal standpoint, there is a problem of making transfers of property to those under the age of majority. Until recently it was often necessary to set up a trust if property was to be transferred to minors in Iowa. But the trust may be somewhat cumbersome, particularly for small gifts.

The Iowa General Assembly has authorized the use of a simpler device than the trust for making gifts to minor children - the "Transfers to Minors Act" custodianship.

Under this act, property can be given to a custodian who acts for the minor. The custodian manages the property until the time control over the property is relinquished to the individual. Unlike a trust, property cannot be held beyond that age. The custodian could be one of the parents, another adult, or a bank or trust company.

The Transfers to Minors Act provides a relatively simple and convenient device for making gifts of property to minors without a great deal of complexity. It can be used for gifts of cash, stocks, life insurance policies, or securities, as well as for gifts of tangible property.

Tax reasons suggest the same person should not be the donor of the property and also the custodian under a Transfers to Minors Act arrangement. For

example, if a father makes the gift and is also custodian and the father dies before the child reaches the age for distribution, the property managed could be included in the father's estate for tax purposes. The matter of control of property is again the influencing factor.

Also, it may be preferable that a parent legally obligated to support the child not act as custodian. Another adult or a bank or trust company might be used as custodian.

The custodianship can be activated simply by putting title on the stock, security, or bank account in the name of "Mrs. John Doe as custodian for John Doe, Jr., under the Iowa Uniform Transfers to Minors Act."

Though more complex, the trust also is an option for making gifts to an adult or minor.