

**GIFT AND ESTATE TAX RETURNS:
NUTS, BOLTS, & SOME MONKEY WRENCHES, TOO**

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CHAPTER 1

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TABLE OF CONTENTS

I. INTRODUCTION	1
II. SCOPE OF OUTLINE.....	1
III. GENERAL OVERVIEW OF THE GIFT TAX SYSTEM	1
A. Major Tax Legislation.....	1
B. Lifetime Giving.....	2
C. Tax Planning Considerations for <i>Inter Vivos</i> Gifts	2
1. Tax Advantages of <i>Inter Vivos</i> Gifting	2
a. Use of the Present Interest Annual Exclusion.....	2
b. Removal of Post-Gift Appreciation.....	3
c. Gift Tax is Tax Exclusive—not Tax Inclusive.....	3
d. Removal of the Gift Tax Amount from the Transfer Tax Base	3
e. Income Shifting.....	3
f. Gifts in Contemplation of the Donee-Spouse’s Death	3
g. Income Tax Savings from Charitable Gifts.....	3
2. Disadvantages of <i>Inter Vivos</i> Gifting	4
a. Loss of Step-up in Basis.....	4
b. Prepayment of Estate Tax	4
D. Gift Tax Under the 2010 Tax Relief Act.....	4
E. The Tax Return	5
F. Who Must File	5
G. When a Gift Tax Return Must Be Filed (“Reportable Gifts”)	5
1. Gifts over the Present Interest Annual Exclusion Amount	5
2. Gifts of Future Interest	5
3. Gifts Split Between Spouses	5
4. Gifts of Community Property.....	5
5. Below-Market Sales	5
6. General Powers of Appointment	6
7. Miscellaneous Gifts.....	6
H. Gifts Which Do Not Require a Gift Tax Return	6
1. Marital Deduction Gift Exclusion.....	6
2. Present Interest Annual Exclusion Gifts	6
3. Educational and Medical Gift Exclusions	6
4. Qualified Charitable Gift Exclusion.....	6
5. Political Organization Gifts.....	6
I. Gift-Splitting Election	7
J. Qualified Tuition Programs.....	7

K. Calculation of the Gift Tax	7
L. Due Date of the Return	7
M. Extension Request	7
1. Method One: Extend the Time to File the Donor's Income Tax Return.....	7
2. Method Two: File Form 8892	8
N. Where to File the Return	8
O. Liability for Tax	8
P. Statute of Limitations	8
Q. Sample Form 709	8
IV. GENERAL OVERVIEW OF THE ESTATE TAX SYSTEM	9
A. The Return to Be Filed	9
B. Who Must File Form 706	9
C. When Form 706 Must Be Filed.....	9
1. Post-1976 Taxable Gifts.....	9
2. Exemption for Certain 1976 Gifts.....	9
3. Finality of Gift Tax Values	9
D. The 2010 Tax Relief Act's Impact on the Estate Tax	9
1. Applicable Exclusion Amount	9
2. Rate of the Estate Tax	10
3. 2010 Election out of Estate Tax into Carryover Basis	10
4. Portability.....	10
a. Portability Election.....	10
b. Utilizing the Decedent's Unused Exemption	10
c. Making the Portability Election	10
d. Relaxed Valuation Reporting Requirements.....	11
e. Special Extension for Portability Election	11
f. Extends Statute of Limitations	11
E. Calculation of the Estate Tax	11
1. The Gross Estate	11
a. Property in Which the Decedent Had an Interest	12
b. Certain Gifts Within Three Years of Death	12
c. Transfers with a Retained Life Estate	12
d. Transfers Taking Effect at Death	12
e. Revocable Trusts	12
f. Annuities	12
g. Joint Interests	12
h. Powers of Appointment.....	12
i. Proceeds of Life Insurance.....	13
j. Property for Which the Marital Deduction was Previously Allowed.....	13

2.	Gross Estate: Common Misconceptions	13
3.	Valuation of Assets Included in Gross Estate	13
4.	Deductions	14
a.	Expenses, Indebtedness, and Taxes.....	14
b.	Losses.....	14
c.	Transfers for Public, Charitable, and Religious Uses	14
d.	Bequests to Surviving Spouse.....	14
5.	The Tentative Taxable Estate.....	15
6.	The State Death Tax Deduction	15
7.	The Taxable Estate	15
8.	Tentative Tax	15
9.	Gross Estate Tax	15
10.	Allowable Unified Credit.....	15
11.	Additional Credits	15
12.	Net Estate Tax	15
F.	Due Date of the Return	16
G.	Extension Requests	16
H.	Documents to Be Included with Form 706	16
I.	Requirements for Execution.....	16
J.	Where to File the Return	16
K.	Sample Form 706.....	16
V.	TAX RETURN PREPARER PENALTIES	16
VI.	CONCLUSION	17
	APPENDIX A	18
	APPENDIX B	19
	APPENDIX C	20
	APPENDIX D	21
	APPENDIX E	22
	APPENDIX F.....	23
	APPENDIX G	28

GIFT AND ESTATE TAX RETURNS: NUTS, BOLTS, & SOME MONKEY WRENCHES, TOO

I. INTRODUCTION

The federal gift and estate tax system has been in a continuous state of flux since the enactment of the 2001 Economic Growth and Tax Relief Reconciliation Act (frequently referred to as part of the “Bush Tax Cuts” or “EGTRRA”). With 2012 being a presidential election year and the political landscape being what it is, it is unlikely that we will see the adoption of legislation that settles the estate and gift tax exemptions with certainty for any length of time before 2013 when the exemptions revert to 2001 levels. Therefore, the purpose of this outline is to provide a basic overview of the federal gift and estate tax system as it now stands, as well a brief discussion of laws that have had a major impact on the gift and estate tax system. It provides details on who must file either a gift or estate tax return, when these returns must be filed, where they are filed, and how these taxes are calculated. The purpose of this outline is to discuss basic transfer tax concepts; it is not intended to be a comprehensive discussion of the gift and estate tax system.

II. SCOPE OF OUTLINE

The federal transfer tax is an excise tax on the privilege of transferring property. The federal wealth transfer tax system includes gift taxes, estate taxes, and generation skipping transfer (“GST”) taxes. The gift tax is assessed on transfers made during life, the estate tax applies to transfers made at death, and the GST tax is imposed on transfers made during life or at death where the transfer skips one or more generations and no exception to the tax applies. This outline is intended to give a general overview of federal gift taxes and estate taxes including computation of the taxes for United States citizens. GST taxes are not addressed in this outline.

For a basic review and numerous examples applying the principles of the gift and estate tax laws beyond that provided in this outline, see *Prentice Hall’s Federal Taxation 2012: Corporations, Partnerships, Estates and Trusts*, from which an older version served as a resource for a large portion of this outline. The majority of the information provided herein relating to the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 was

taken from a background paper on the transfer tax provisions of this act presented by the Estate and Gift Tax Committee of the Real Property Trust and Estate Law Section of the American Bar Association. The members of the committee who were responsible for the background paper were Gale Allison, William Burke, Staci Criswell, Richard Franklin, Erica Hickey, Gregg Killoren, Sharon Klein, Lester Law, James Roberts, Martin Shenkman, Javier Tapia, Lenny Thebarger, Brain Tsu, and Timothy Vitollo.

While a more advanced analysis of the applicable federal gift and estate tax rules and regulations is also beyond the scope of this outline, there is an excellent paper which was presented a number of years ago at a State Bar of Texas course which gives a detailed analysis of the preparation and filing of the estate tax return. This paper was prepared by Glen A. Yale, *titled Preparing and Filing the Form 706: Who, What, How, When and Where*, which was presented at the 29th Annual Advanced Estate Planning and Probate Course in 2005.

In this outline, unless otherwise indicated, references to “Sections” are to the Internal Revenue Code (“Code”) of 1986, as amended. References to “Regulations” are to United States Treasury Regulations issued by the Treasury Department that expound upon the Code.

III. GENERAL OVERVIEW OF THE GIFT TAX SYSTEM

A. Major Tax Legislation

Four major tax acts made substantial changes to the estate and gift tax system. The 1976 Tax Reform Act introduced the unification of the estate and gift tax rates and credit which reduced the tax law’s bias in favor of lifetime transfers. The 1981 Economic Recovery Tax Act increased the Section 2503(b) annual gift tax exclusion from \$3,000 to \$10,000, added Section 2503(e) to allow donors to make payment of certain qualified educational and medical expenses which fall outside the reportable gift category, and also removed certain transfers between spouses as reportable gifts. The 2001 Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”) is more favorable toward transfers at death than lifetime gifts. EGTRRA gradually reduces the estate, gift, and generation-skipping transfer tax rates (sometimes collectively referred to herein as “transfer taxes”); gradually increases the exemption amounts; partially decouples the gift tax and estate tax exemptions; and makes a significant number of other technical changes.

The most recent act, the Tax Relief, Unemployment Insurance Reauthorization, and Job

Creation Act of 2010 (“2010 Tax Relief Act”), was signed into law by President Barack Obama on December 17, 2010. This Act:

- Implements an estate tax regime for decedents who died after December 31, 2009, but still allows decedents who die between December 31, 2009, and January 1, 2011, to apply the rules under the EGTRRA;
- Establishes a top rate of 35% for the estate tax and an exclusion amount of \$5 million (indexed for inflation) which sunsets on December 31, 2012;
- Allows for portability of the unused exemption between spouses of the maximum exclusion after December 31, 2010;
- Extends EGTRRA’s state death tax deduction through 2012;
- Provides that the gift tax for 2010 is calculated using a rate schedule with the top tax rate of 35% and a maximum exclusion of \$1 million (after 2010 the maximum gift tax rate will be 35% with an exclusion of \$5 million indexed for inflation); and
- Provides a generation-skipping tax exemption of \$5 million for transfers made during 2010 with a GST tax rate of 0% (after 2010 the GST tax rate will be 35%).

There was intense pressure on Congress to act before the end of 2010, and a number of bills were proposed. If Congress had failed to act before the end of 2010, the estate tax and GST tax would have been reinstated in 2011 at their 2001 rate levels. The federal transfer tax system would have applied to gratuitous conveyances made after 2010, as though EGTRRA had never been enacted. Therefore, the following would have occurred in 2011 without the enactment of the 2010 Tax Relief Act:

- the estate tax applicable exemption amount would have been \$1 million;
- the GST tax exemption amount would have been an indexed amount (at least \$1,340,000, which would have been the indexed amount in 2010);
- the maximum estate and gift tax rate would have been 55% with an additional 5% rate

applied to transfers by gift or at death between \$10 million and \$17,184,000; and

- heirs would inherit assets at the adjusted basis under I.R.C. § 1014.

B. Lifetime Giving

There are a number of reasons why people give gifts during their lifetime. Some of these motives may include helping a person or entity in need, minimizing tax liability, or simply disposing of an unwanted asset. Before the tax reasons are discussed in greater detail below, two basic terms must be defined. The “Donor” is the person making the gratuitous transfer, and the “Donee” is the person receiving the gift.

C. Tax Planning Considerations for *Inter Vivos* Gifts

From a tax-planning standpoint, many factors must be considered in deciding whether to make lifetime gifts. Some of these factors include the anticipated appreciation rate of the asset to be gifted, the Donor’s expectations about future changes to the gift and estate tax laws, and any non-tax reasons the Donor might have for gifting. However, for clients with wealth in excess of the expected estate tax exemption in 2013 (\$1,000,000 for a single person and \$2,000,000 for a married couple), 2012 presents a unique opportunity to take advantage of the \$5,120,000 gift exemption before January 1, 2013, when the Bush Tax Cuts expire and the gift and estate tax exemptions revert to 2001 levels. One of the most important steps that estate planners can recommend to clients is to consider the use of the \$5,120,000 exemption before the end of 2012. Clients should consider using the Unified Credit before it is lost (assuming Congress makes no change before 2013). For a further discussion on scenarios where tax savings may or may not be achieved through making lifetime gifts, see Woodard, *et. al.*, *Inter Vivos Gifts*, 18 Tex. Prac., Prob. & Decedents’ Estates § 1134.

1. Tax Advantages of *Inter Vivos* Gifting

a. Use of the Present Interest Annual Exclusion

Section 2503(b) allows Donors the opportunity to make an annual tax-free gift to one or more Donees per calendar year in an amount not to exceed \$13,000 each. This annual exclusion is allowed without regard to the relationship between the Donor and the Donee(s). This gives the Donor the chance to keep a substantial amount of property off the transfer tax rolls at the Donor’s death. The tax-free amount doubles if a husband and wife use the gift-splitting election, offering the opportunity for a husband and wife to gift up to \$26,000 per Donee annually. There is no estate tax counterpart to the annual gift tax exclusion.

Substantial estate tax savings may be realized with the use of the annual gift tax exclusion. For example, a terminally-ill single person whose taxable estate is \$5,211,000 could completely eliminate his estate tax liability by making at least seven lifetime gifts in the amount of the annual exclusion to different individuals in 2012, as opposed to transferring assets of the same value upon his death.

b. Removal of Post-Gift Appreciation

Once the Donor makes a gift to the Donee, the post-gift appreciation escapes inclusion in the transfer tax base. This value-freezing factor is one reason Donors often favor lifetime transfers of property likely to appreciate. Transfer tax savings are maximized if the Donor gives away assets with the greatest potential for future appreciation. (Caveat: it is generally not a good idea to gift property that has depreciated in value—better to sell the property, recognize the loss, and transfer the proceeds via gift or devise.)

Although lifetime gifts do not benefit from the step-up in basis that transfers at death receive, in many situations it is desirable to reduce the Donor's transfer tax liability by making a lifetime transfer of an appreciated asset, even at the risk of increasing the Donee's future income tax liability on the asset's appreciation. In addition, the gifted asset's basis is stepped-up by the amount of any gift tax paid—to a maximum of the asset's fair market value. [See I.R.C. § 1015(d).]

c. Gift Tax is Tax Exclusive—not Tax Inclusive

The gift tax is “tax exclusive” but the estate tax is “tax inclusive.” The gift tax is assessed only on the value of the asset transferred—any gift tax liability triggered by the transfer is not included in the valuation of the gift. In other words, the gift tax is tax exclusive in that the gift tax base does not include the amount of the gift tax. It is based only on the value of the gift received by the Donee, and then the Donor pays the gift tax using funds that are independent from the gift.

Compare this to the estate tax. The estate tax is assessed on the value of the entire estate, which includes the funds which will be used to pay the estate tax. Since the funds used to pay the estate tax necessarily come from the estate, the computation of the estate tax is said to be tax inclusive because it includes the funds that will be used to pay the tax.

d. Removal of the Gift Tax Amount from the Transfer Tax Base

Generally, gift taxes paid by the Donor are removed from the transfer tax base. However, there is one exception to this rule. Under the “Gross-up Rule” discussed in section IV.E.1.b, *infra*, a Donor's gross estate includes gift taxes paid on gifts made within

three years of the Donor's death. [See I.R.C. § 2035(b).]

e. Income Shifting

Once the Donor gifts property to the Donee, the income produced by the gifted property is taxed to the Donee, whose marginal income tax rate may be lower than the Donor's. This presents the opportunity for annual income tax savings for the Donor, which can be quite sizeable over a span of several years. In addition to income tax savings for the Donor, this strategy prevents accumulated post-gift income from the gifted property from being included in the Donor's estate.

f. Gifts in Contemplation of the Donee-Spouse's Death

In the past, when a husband and wife had a combined gross estate in excess of the exemption amount (currently \$5,120,000 for 2012), it was important to have enough taxable assets in each spouse's estate in order to fully utilize the unified credit. In other words, if Spouse A owned assets in excess of \$5,120,000 and Spouse B owned assets valued at less than \$5,120,000, it would be necessary for Spouse A to transfer a certain amount of assets to Spouse B prior to Spouse B's death in order for the couple to fully take advantage of the unified exclusion. Otherwise, Spouse B's unused exemption amount would be lost forever. (See Appendix A for the Unified Credit and Applicable Exclusion Amounts.)

The portability provision of the 2010 Tax Relief Act eliminates the need for this estate planning tactic, at least for decedents who die in 2011 and 2012. (Portability is discussed in detail in section IV.D.4, *infra*). While the 2010 Tax Relief Act allows portability so that the transfer described above may no longer be necessary, there is no certainty as to whether the portability of the deceased spouse's unused exemption amount will be allowed after December 31, 2012. Therefore, the above planning may still be a viable option for clients to consider.

There is an additional benefit gained from a Donor-spouse gifting appreciated property in contemplation of the Donee-spouse's death. At the Donee-spouse's death, the basis of the property is stepped-up to fair market value. Caveat: if the gifted property passes back to the Donor-spouse upon the death of the Donee-spouse, there is no step-up in basis if the Donee-spouse dies within one year of the date of the gift.

g. Income Tax Savings from Charitable Gifts

Some taxpayers wish to donate a portion of their property to charitable organizations. If the donation is to a qualified charity and thus eligible for a charitable contribution deduction, the transfer tax implications for

transferring *inter vivos* or at death are the same – no taxable transfer. However, from an income tax standpoint, a lifetime transfer is preferable because only lifetime transfers produce an income tax deduction for charitable contributions.

Another point to consider is that not all charities eligible for the income tax deduction are also eligible for the estate tax deduction. For example, a gift to a cemetery association qualifies for an income tax charitable deduction but does not qualify for an estate tax charitable deduction. [Compare I.R.C. § 170(c)(5) and § 642(c) with § 2055(a).]

2. Disadvantages of *Inter Vivos* Gifting

a. Loss of Step-up in Basis

It is important to keep in mind the loss of the step-up in basis when a lifetime gift is made. When the Donor transfers a gift to the Donee, the Donor's basis in the asset transfers over to the Donee; i.e., the Donee receives no step-up in basis for the property acquired by gift. However, the loss of step-up in basis may have little practical significance if the Donee does not plan to sell the property. Even if the Donee does sell the gift, keep in mind that the gain on the sale is likely to be taxed at a 15 percent capital gains rate—while property in the estate may be taxed at a rate of anywhere between 35 and 55 percent, depending upon the year of death.

b. Prepayment of Estate Tax

When a Donor makes a taxable gift that exceeds the exemption equivalent for gifts (currently \$5,120,000 in 2012), the Donor must pay a gift tax. Upon the Donor's death, the taxable gift is included in his or her estate tax base as an adjusted taxable gift. The gift tax paid during the Donor's lifetime reduces the Donor's estate tax liability which is, in a sense, a prepayment of that portion of the estate tax when the Donor pays the gift tax.



Monkey Wrenches: Lifetime Transfers

- Three-year & Gross-up rules
- Loss of control over gifted property
- No basis step-up

D. Gift Tax Under the 2010 Tax Relief Act

In 2010, the gift tax was the only transfer tax that remained in effect under the repeal of EGTRRA. Its

exemption amount was \$1 million with a 35% tax rate on gifts in excess of the \$1 million lifetime exemption.

Under the 2010 Tax Relief Act, the gift tax exemption amount remained \$1 million through the end of 2010. However, beginning in 2011, the gift tax exemption amount was raised to \$5 million, which again unified the gift and estate tax exemption amounts. (Prior to the repeal of EGTRRA, the gift and estate tax were unified—giving taxpayers a “unified credit” for transfers made during a taxpayer's life and after death.) For 2011, the unified applicable exemption amount was \$5 million per person, and in 2012, this amount is indexed for inflation. The Internal Revenue Service recently announced that the exemption for 2012 is \$5,120,000. [See I.R.B. 2011-45.]

New language was added to the end of Section 2502(a) setting forth the method by which the applicable credit amount with respect to prior years' gifts will be determined. Section 2502(a) provides that the gift tax is determined by computing a tentative tax on the sum of the current year's taxable gifts and the prior years' taxable gifts, and subtracting from this amount the tentative tax on the prior years' taxable gifts. As changed by the 2010 Tax Relief Act, the rates of tax in effect for the year of new gift (i.e., the one being reported) are used in lieu of the rates of tax in effect at the time of the prior years' taxable gifts to determine the amounts of the applicable credit amount used by such prior years' taxable gifts. This new method is favorable to the taxpayer and preserves more applicable credit amount for future use.

As a result of the unification of the gift and estate tax applicable credit amounts, taxpayers again have the option to exhaust their entire exemption through lifetime giving without incurring a gift tax liability. Under the laws in effect for 2012, all taxpayers may give at least \$5,120,000 without incurring either gift or estate tax liability, and some taxpayers may give up to \$10,240,000 (with the new portability provision). Using the new method of accounting for the use of the applicable credit amounts for prior years' taxable gift, a taxpayer who made gifts prior to 2010 using the entire applicable credit amount for the prior \$1 million applicable exclusion amount will still be able to transfer at least \$4,120,000 in 2012—with no gift tax liability!

Because the 2010 Tax Relief Act extends EGTRRA's sunset provisions only until December 31, 2012, practitioners find themselves facing the same dilemma that has been lurking for most of the last ten years—an inability to predict what Congress will do in 2013. Assuming Congress does nothing (which based on recent deadlocks appears definitely possible) beginning in 2013, the gift tax exemption returns to \$1 million adjusted for inflation (approximately

\$1,400,000) and the rates return to being graduated with the top rate of 55%.



Monkey Wrenches: Planning

- Estate planning is a challenge, given ever-changing laws and fluid exemptions
- Tax consequences vary year to year
- Multiple revisions to client's plans

E. The Tax Return

If a Donor makes one or more gifts which require the filing of a gift tax return, the Donor must file Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return.

F. Who Must File

An individual who is a citizen or resident of the United States must file a gift tax return—whether or not any tax may ultimately be due—when the Donor makes “reportable gifts” as defined below. Only individuals are required to file gift tax returns, and unlike an income tax return, a husband and wife may not file a joint gift tax return. If a trust, estate, partnership, or corporation makes a gift, the individual beneficiaries, partners, or stockholders are considered Donors and may be liable for the gift and generation-skipping transfer taxes.

G. When a Gift Tax Return Must Be Filed (“Reportable Gifts”)

I.R.C. § 6019 sets forth the specific circumstances under which a Donor should file a gift tax return. The Donor must file a gift tax return in the following situations:

1. Gifts over the Present Interest Annual Exclusion Amount

If the Donor transfers assets totaling more than \$13,000 to a Donee (other than the Donor’s spouse) in 2012, the Donor generally must file a gift tax return. However, the Donor is not required to file a gift tax return if the transfer falls under one of the exclusions discussed in section III.H, *infra*. [See I.R.C. § 2503(b).] While a gift tax return is required whenever a Donor’s gifts to a Donee in the same year exceed the annual gift tax exclusion amount (currently \$13,000 in 2012), the Donor will not pay any gift tax until the Donor’s total lifetime taxable gifts exceed the

lifetime exemption amount (currently \$5,120,000 in 2012).

2. Gifts of Future Interest

A gift is considered a future interest if the Donee’s right to use, possess or enjoy the property or income from the property will not begin until a future date. Examples of gifts of future interest include reversions, remainder interests, and gifts in trust for a beneficiary who does not have Crummey rights of withdrawal. [See Treas. Reg. § 25.2503-3.] When a Donor gives a gift of future interest, a gift tax return must be filed—even if the gift of the future interest is less than the annual gift tax exclusion amount, which is \$13,000 for gifts made in 2012. [See Page 1, Instructions for Form 709.]

As a general rule, a transfer to a trust is classified as a future interest, and therefore does not qualify for the annual exclusion. Some exceptions to this rule are transfers to Section 2503(c) trusts, transfers to Section 2503(b) trusts, and transfers to Crummey trusts. A Crummey provision in a trust agreement essentially converts certain gifts of future interest into gifts of present interest. This is so because a Crummey trust gives the donee a general power of appointment (or withdrawal right) up to the exclusion amount.

3. Gifts Split Between Spouses

If a Donor chooses to split a gift with his or her spouse, then a gift tax return generally must be filed to elect gift-splitting. [Instructions for Form 709, Page 1.] In addition, each spouse must file a gift tax return if a gift has been made of property held by them as joint tenants or tenants by the entirety which exceeds their combined annual gift exclusion. However, certain transfers involving community property do not require a gift tax return. See the discussion on gift-splitting at III.I, *infra*.

4. Gifts of Community Property

If a gift of community property is made, it is considered made one-half by each spouse. Therefore, each spouse must file a gift tax return if the value of the gift exceeds the spouses’ combined present interest annual exclusion amount. For example, spouses gifting community property valued in excess of \$26,000 in 2012 ($2 \times \$13,000 = \$26,000$) would be required to file a gift tax return.

5. Below-Market Sales

A gift tax return must also be filed for sales or exchanges for less than fair market value, unless made in the ordinary course of business.

6. General Powers of Appointment

The exercise or release of a general power of appointment may also be a transfer requiring the filing of a gift tax return.

7. Miscellaneous Gifts

A gift tax return may be required for forgiveness of debt, interest-free or below-market interest rate loans, the assignment of benefits of an insurance policy, certain property settlements in divorce cases, and for the exchange of some amount of annuity for the creation of a survivor annuity. For a comprehensive discussion of situations that are considered transfers for purposes of the federal gift tax, see Bogert, *et al.*, *Federal gift tax—Transfers subject to gift tax*, The Law Of Trusts And Trustees § 278.

H. Gifts Which Do Not Require a Gift Tax Return

While the Donor must generally file gift tax returns for the gifts referenced above, the following gifts do not require the filing of a gift tax return:

1. Marital Deduction Gift Exclusion

Gifts to the spouse which qualify for the marital deduction (see section IV.E.4.d, *infra*) do not require the filing of a gift tax return. [See I.R.C. § 2523.] However, if the gift to the spouse is qualified terminal interest property (“QTIP”), the Donor must report the gift on a gift tax return. The marital deduction is not automatically available for QTIP transfers; the Donor must make this irrevocable election on the gift tax return. [I.R.C. § 2523(f)(4).] Note that a QTIP gift tax marital deduction election cannot be made on an untimely gift tax return (Form 709). [See I.R.C. § 2523(f)(4)(A).]

2. Present Interest Annual Exclusion Gifts

Gifts of a present interest that fall under the gift tax annual exclusion threshold (currently \$13,000 in the year 2012) do not require the filing of a gift tax return. For a gift in trust, each beneficiary of the trust is treated as a separate Donee for purposes of the annual exclusion. A gift is considered a present interest if the Donee has all immediate rights to the use, possession and enjoyment of the property or income from the property. A gift is considered a future interest if the Donee’s right to use, possess or enjoy the property or income from the property will not begin until a future date. These interests include reversions, remainders, and other similar interests or estates.

A gift to a minor is considered a present interest gift if: (a) both the property and its income may be expended by or for the benefit of the minor before the minor reaches age 21; (b) all remaining property and its income must pass to the minor on the minor’s twenty-first birthday; and (c) if the minor dies before the age of 21, the property and its income will be

payable either to the minor’s estate or to whomever the minor may appoint under a general power of appointment. [See I.R.C. § 2503(c).]

3. Educational and Medical Gift Exclusions

Gifts made pursuant to I.R.C. § 2503(e) for certain qualified educational and medical expenses fall outside the reportable gift tax category and do not require the filing of a gift tax return. For payments to qualify under the qualifying educational exception, the payment must be made directly to the qualifying educational organization, and it must be for tuition. [See I.R.C. § 2503(e)(2)(A).] No educational exclusion is allowed for amounts paid for books, supplies, room and board, or other similar expenses that do not constitute direct tuition costs. It is important to note that contributions to a Qualified Tuition Program (“529 Plan”) on behalf of a beneficiary do not qualify for the educational exclusion. (See section III.J, *infra* for a discussion on how 529 Plans fit into the gift tax scheme.)

With regard to the medical exclusion, the gift tax is not imposed on an amount paid on behalf of an individual to a person or institution that provided medical care for the individual. [See I.R.C. § 2503(e)(2)(B).] However, similar to the educational exclusion, the payment must be made directly to the care provider. Medical care includes expenses incurred for diagnosis, cure, mitigation, treatment, or prevention of disease; expenses for the purpose of affecting any structure or function of the body; or costs of transportation primarily for and essential to medical care. Medical care also includes amounts paid for medical insurance on behalf of any individual.

As is true for the present interest annual exclusion, the educational and medical gift exclusions are allowed without regard to the relationship between the Donor and the Donee.

4. Qualified Charitable Gift Exclusion

Gifts to charitable organizations do not require the filing of a gift tax return if the gift is deductible and the organization receives the Donor’s entire interest in the property. [See I.R.C. § 2522(a).] Note, however, that if the Donor is required to file a gift tax return for reportable gifts made to other Donees during the same year, then the Donor must also include all of the Donor’s charitable gifts on the gift tax return—even though they qualify for the charitable gift tax exclusion. [See Instructions for Form 709, page 2.]

5. Political Organization Gifts

Transfers to political organizations (which are defined in I.R.C. § 527(e)(1)) for the use of the organization do not require the filing of a gift tax return. [I.R.C. § 2501(a)(4).]

I. Gift-Splitting Election

A married Donor may elect to split gifts with his or her spouse for gift tax purposes, as long as neither spouse is a nonresident alien at the time of the gift. [I.R.C. § 2513(a).] If the election to gift-split is made, then all spousal gifts to third parties are treated as if they were made one-half by each spouse. Note that gift-splitting is not necessary when making gifts consisting solely of community property because each spouse is deemed to own an undivided one-half of the property—thereby negating the necessity for the split. However, spouses must affirmatively gift-split when the transfer involves separate property.

The benefit of gift-splitting is that it allows the Donor-spouse to use both spouses' annual exclusion amounts for each gift that he makes, which could possibly result in preserving the Donor-spouse's available lifetime credit for future gifts.

When spouses elect to gift-split, both spouses must indicate their consent in one of the following ways:

- Each spouse signifies his or her consent on the other spouse's gift tax return.
- Each spouse signifies his or her consent on his or her own gift tax return.
- Both spouses signify their consent on one of the gift tax returns.

The preferred method is for each spouse to signify his or her consent on the other spouse's gift tax return. It is important to note that when both the Donor and spouse consent to gift-splitting, the entire gift tax liability is a joint and several liability of the spouses. [See I.R.C. § 2513.]

J. Qualified Tuition Programs

Qualified Tuition Programs ("529 Plans") have gained popularity in recent years because of the favorable income tax treatment provided to these plans. (As previously mentioned, these plans do not qualify for the Section 2503(e) educational exclusion discussed in section III.H.3, *supra*.) One gift tax benefit available to 529 Plans is the ability of a Donor to gift up to five (5) times the present interest annual exclusion amount (or \$65,000 in 2012) in one calendar year and have the value of this gift taken into account ratably over five years. [See I.R.C. § 529(c)(2)(B).] This election to ratably account for the gift over five years is made by checking the appropriate box on Form 709. In addition, the Donor is required to attach an explanation of the gift with the following information: (1) the total amount contributed per individual beneficiary; (2) the amount for which the election is

being made; and (3) the name of the individual for whom the contribution was made. If the Donor does not make reportable gifts in the four years subsequent to the gift to the 529 Plan, then the Donor is not required to file a Form 709 to report that year's ratable portion of the prior year's gift to the 529 Plan.

K. Calculation of the Gift Tax

See Appendix B setting forth the formula for calculating the gift tax owed for the current period. The calculation reflects that the gift tax computation involves a cumulative process whereby all the Donor's previous taxable gifts (those made in 1932 or later) plus the Donor's taxable gifts for the current year affect the marginal tax rate for the current taxable gift. This computation results in gifts being taxed on a progressive basis over the Donor's lifetime.

L. Due Date of the Return

All gift tax returns are filed on a calendar-year basis. For gifts made in 2012, the gift tax returns are generally due no later than April 15, 2013. If the Donor dies during the tax year, then the executor must file the Donor's 2012 gift tax return by the earlier of: (a) the due date (with extensions) for filing the Donor's estate tax return; or (b) April 15, 2013, or the extended due date granted for filing the Donor's gift tax return. It is possible that if the Donor dies early in the year in which a gift is made, the due date for the Donor's final gift tax return may be earlier than April 15th of the following year. For example, if the Donor dies on March 1, 2012, his or her estate tax return would be due on December 1, 2012, therefore, the gift tax return would be due on December 1, 2012, as well. Since the information from the gift tax return is needed to complete the estate tax return, it is only logical that the gift tax return for the year of death is due no later than the due date (including extensions) for the Donor's estate tax return.

M. Extension Request

There are two methods by which a Donor may request an extension of time to file the gift tax return. It is important to recognize, however, that neither of these two methods extends the time to pay any gift taxes owed.

1. Method One: Extend the Time to File the Donor's Income Tax Return

Any extension of time granted to file the Donor's calendar year 2012 federal income tax return will also automatically extend the time to file the 2012 gift tax return. Income tax extensions are made by using Form 4868 (Application for Automatic Extension of Time to File U.S. Individual Income Tax Return) or Form 2350 (Application for Extension of Time to File U.S. Income Tax Return For U.S. Citizens and Resident

Aliens Abroad). These forms must be filed by the original return due date of the income tax return. The Donor may use these forms to extend the time for filing his or her gift tax return only if he or she is also requesting an extension of time to file his or her income tax return. If the Donor expects to owe any gift tax, then he or must also file the payment voucher from Part III of Form 8892 and pay the appropriate tax with the extension request.


2. Method Two: File Form 8892

If the Donor does not request an extension of time to file his or her income tax return, he or she may use Form 8892 (Application for Automatic Extension of Time to File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax) to request an automatic six-month extension of time to file the Donor's federal gift tax return. This form must be filed by the later of (1) the original return due date or (2) the expiration of any extension of time to file granted under Treas. Reg. § 1.6081-5. Again, if the Donor expects to owe any gift tax, then he must also pay the appropriate tax payment with the extension request. Generally, the IRS will not grant an extension beyond the initial automatic six-month extension.

N. Where to File the Return

All Forms 709 are filed at the Cincinnati Service Center, regardless of whether the Donor lives in the fifty states, the District of Columbia, a foreign country, or has any other address. The address for filing the Form 709 is as follows:

Department of the Treasury
Internal Revenue Service Center
Cincinnati, Ohio 45999



Nuts & Bolts: Form 709

- 2012 Exclusion \$13,000
- Marital and Charitable Exclusions
- Medical and Education Exclusions
- Due Date: April 15

O. Liability for Tax

The Donor is responsible for paying any gift tax owed. [I.R.C. § 6019.] In the event the Donor does not pay the gift tax, then the Donee becomes personally liable for the gift tax. [See I.R.C.

§ 6324(b).] However, the Donee's liability is limited to the value of the gift. [See *Poinier v. Comm'r*, 858 F.2d 917 (3d. Cir. 1988).] As previously mentioned in section III.I, *supra*, if both the Donor and his or her spouse consent to gift-splitting, the entire gift tax liability is a joint and several liability of the spouses.

P. Statute of Limitations

Generally, the statute of limitations for gift tax purposes is three years after the later of the date the return was filed or the return's due date. [I.R.C. § 6501.] However, if the Donor omits gifts of which the total value exceeds 25% of the gifts reported on the return, then the statute of limitations increases from three to six years. [I.R.C. § 6501(e)(2).] An important benefit to filing gift tax returns is that once the statute of limitations has passed, the IRS cannot revalue prior gifts for purposes of determining the available applicable credit amount and appropriate transfer tax bracket. This is true only if the Donor adequately discloses the gift on a gift tax return and the time for assessing the gift tax has expired. [See I.R.C. § 2504(c).] According to Treas. Reg. §§ 301.6501(c)–1(f)(2), a complete and accurate description of the gift transaction must include each of the following:

- a description of the transferred property
- any consideration received by the Donor
- the identity of the Donor and Donee and their relationship to each other
- if the gift was transferred in trust, then information must be provided identifying the trust (trust tax identification number and brief description of the terms of the trust)
- detailed description of the method utilized to determine the fair market value of the gift
- a statement describing any position taken on the return that is contrary to any proposed, temporary, or final regulation or revenue rulings published at the time of the gift.

This regulation applies to gifts made after December 31, 1996, for which the gift tax return is filed after December 3, 1999.

Q. Sample Form 709

Attached as Appendix F is a sample gift tax return for reference purposes.

IV. GENERAL OVERVIEW OF THE ESTATE TAX SYSTEM

As previously stated, the term “estate tax” applies to the tax imposed on dispositions of property resulting from the transferor’s death. This section of the outline discusses the federal estate tax and examines the types of interests and transactions that cause inclusion in the decedent’s gross estate. It also sets forth the various deductions and credits affecting federal estate tax liability and the rules concerning the taxable gifts that affect the estate tax base, an important issue because of the unified nature of the gift and estate tax system.

A. The Return to Be Filed

If an estate tax return is required to be filed, the return to be filed is Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return). The Form 706 is a “snapshot” of the decedent’s financial situation at a specific date in time – generally, the date of death. The IRS looks not only at what the decedent “owned” but also to what he was “entitled to” at death.

It is important to realize that the information reported by the estate’s representative on Form 706 regarding the value of the decedent’s assets at death and the calculation of the estate tax due is merely a statement of the estate’s position with respect to these items. The estate’s position with respect to the inclusion and valuation of assets is subject to challenge by the IRS upon review.

B. Who Must File Form 706

The decedent’s personal representative is charged with the duty of filing the Form 706. If there is more than one person serving as the executor or administrator, the return must be filed jointly by all. [See Treas. Reg. § 20.6018-2.] If there is no personal representative of the decedent’s estate, then tax law treats persons in possession of the decedent’s property as executors to the extent of the duty to file the Form 706. [See Treas. Reg. § 20.2203-1.]

C. When Form 706 Must Be Filed

I.R.C. § 6018 indicates the circumstances in which an estate tax return is required to be filed. In general, no return is necessary unless the value of the gross estate plus adjusted taxable gifts exceeds the exemption equivalent. The exemption equivalent is also known as the “applicable exclusion amount.” If the date-of-death value of the decedent’s gross estate exceeds the applicable exclusion amount, a Form 706 is required. (See Appendix A for a schedule of applicable exclusion amounts.) This filing threshold is equal to the exclusion amount available in the year that the decedent died, not the year that the return is due if those are two different years. The applicable exclusion amount is \$5,120,000 for a decedent dying in the year

2012. There are, however, three possible adjustments that lower the Section 6018(a) filing threshold. These are:

1. Post-1976 Taxable Gifts

If the decedent made taxable lifetime gifts and used some of his or her applicable exclusion amount, the Form 706 filing threshold is reduced. [I.R.C. § 6018(a)(3)(A).]

2. Exemption for Certain 1976 Gifts

The amount of any pre-1976 Tax Reform Act \$30,000 lifetime gift tax exemption allowed with respect to gifts made after September 8, 1976, but before January 1, 1977, is also subtracted from the Form 706 threshold. [See I.R.C. § 6018(a)(3)(B).] These gifts were made after the 1976 Tax Reform Act was passed but before its effective date.

3. Finality of Gift Tax Values

As stated above, prior taxable gifts will decrease the filing threshold. The value of prior gifts used in determining the decedent’s applicable estate tax bracket and his or her available exemption is the value of the gifts as “finally determined” for gift tax purposes. [I.R.C. § 2001(f).] Effective for gifts made after August 5, 1997, the IRS may not revalue prior gifts if the gift item was adequately disclosed on a gift tax return and the time for assessing gift tax has expired. Before Section 2001(f) was enacted by the 1997 Taxpayer Relief Act, the IRS could revalue a previously-reported gift, even if the limitations period on assessment of gift tax had expired. Now, a gift tax value will be treated as final if: (i) the value shown on the gift tax return was not contested by the IRS before the expiration of the limitations period; (ii) the IRS assigned a value to the gift and the taxpayer did not timely contest that valuation; or (iii) the value was determined by a court or pursuant to a settlement agreement between the IRS and the taxpayer.

D. The 2010 Tax Relief Act’s Impact on the Estate Tax

On December 17, 2010, when President Obama signed the 2010 Tax Relief Act, the estate tax was retroactively reinstated for persons dying after December 31, 2009, with certain modifications. These modifications include:

1. Applicable Exclusion Amount

The applicable credit amount is the amount of tax with respect to the Basic Exclusion Amount of \$5,120,000, plus any Deceased Spousal Unused Exemption Amount (if the portability election applies, as discussed below in section IV.D.4). Beginning in 2012, the applicable exclusion amount is subject to being indexed for inflation with adjustments rounded

to the nearest \$10,000. As previously stated in section III.D, the IRS recently announced the 2012 applicable exclusion amount to be \$5,120,000.

2. Rate of the Estate Tax

The maximum estate tax rate is currently 35 percent in 2012. [See Instructions for Form 706, page 4.]

3. 2010 Election out of Estate Tax into Carryover Basis

The 2010 Tax Relief Act made the estate tax retroactive to January 1, 2010, but gave executors of 2010 decedents the option to choose carryover basis over the estate tax regime. Generally, the estate tax enacted by the 2010 Tax Relief Act applies retroactively to estates of decedents dying after December 31, 2009. However, the act authorizes executors of 2010 decedents the option to elect out of the retroactive estate tax system and to instead use the carryover basis system previously in effect for 2010 ("2010 Carryover Basis Election"). Under the 2010 Carryover Basis Election, executors of 2010 estates can allocate \$1.3 million of basis increase to estate assets, as well as an additional \$3 million of basis increase to assets transferred in a qualifying manner to a surviving spouse.

The 2010 Carryover Basis Election is irrevocable and is made by filing Form 8939. The due date of the Form 8939 was January 17, 2012, with a six-month extension allowed in certain circumstances.

As explained previously in section III.D, the 2010 Tax Relief Act requires the tax rates in effect for the year of death to be used in lieu of the rates in effect at the times of the prior taxable gifts to determine the amounts of the applicable credit amount used by such prior taxable gifts. This new method is favorable to the taxpayer and preserves more applicable credit amount for use against the estate tax.

4. Portability

a. Portability Election

One of the most interesting aspects of the 2010 Tax Relief Act is the concept of portability. [See Section 303(a) of the Act; *see also* I.R.C. § 2010(c)(5)(A).] Portability allows the surviving spouse to use the decedent's unused exclusion amount in addition to the surviving spouse's own basic exclusion amount. Under the new provision, the portability election passes along the decedent's unused estate and gift tax exclusion amount to the surviving spouse for decedents dying after December 31, 2010. The purpose of this new provision is to prevent families from incurring gift and estate tax liability that could have been avoided through planning prior to the death of the predeceased spouse. Use of the new

provision could eliminate the need for spouses to retitle property and create trusts solely to take full advantage of each spouse's basic exclusion amount, a strategy discussed in section III.C.1.f, *supra*. However, the portability provision does not apply to a decedent's unused GSTT exemption.

b. Utilizing the Decedent's Unused Exemption

Portability introduces two definitions starting in 2011: the Basic Exclusion Amount ("BEA") and the Deceased Spousal Unused Exemption Amount ("DSUEA"). [See Temp. Treas. Reg. § 20.2010-1T.] The BEA was \$5 million in 2011 and will be indexed for inflation each year thereafter, rounded to the nearest multiple of \$10,000. [See I.R.B. 2011-45, which sets the BEA for 2012 at \$5,120,000.] When computing the applicable exclusion amount for a donor's or decedent's estate, the DSUEA is added to the donor's or the decedent's BEA. The DSUEA is the lesser of (i) the BEA in effect in the year of the death of the deceased spouse, or (ii) the BEA of the deceased spouse, less the amount with respect to which the tentative tax is determined under Section 2001(b)(1) on the estate of such deceased spouse. [See I.R.C. § 2010(c)(4).] Note that this provision is only applicable to gifts made or decedents dying after December 31, 2010, and only with respect to previously deceased spouses who die after December 31, 2010. These provisions are scheduled to expire after December 31, 2012. [See Section 303(a) of the Act; *see also* I.R.C. § 2010(c)(5)(A).]

c. Making the Portability Election

In order for the DSUEA to be available, the executor of the deceased spouse must make the election by filing Form 706 within nine months from date of death, or within fifteen months from date of death if an extension for filing was granted. When the executor of a deceased spouse makes a timely portability election, the election is effective as of the date of death. However, a portability election is not valid if made by means of an untimely Form 706.

The estate is deemed to have made the portability election by the mere filing of a timely Form 706 without the need to make an affirmative statement, check a box, or otherwise. Should an executor wish to avoid making the election when the estate is otherwise required to file Form 706, the executor must either attach a statement to Form 706 indicating that the estate is not making the election under Section 2010(c)(5) or write "No Election Under Section 2010(c)(5)" across the top of the first page of Form 706. [See IRS Notice 2011-82, *Guidance on Electing Portability of Deceased Spousal Unused Exclusion Amount*.]

The surviving spouse's estate is limited to using the DSUEA of the "last such deceased spouse." Therefore, if the surviving spouse had more than one previously deceased spouse, the survivor's estate may only use the last deceased spouse's DSUEA.

When a portability election is properly and timely made, it is effective as of the date of death and the DSUEA is applicable to transfers made by the surviving spouse after the date of death—including lifetime gifts made by the surviving spouse. If a donor who is a surviving spouse makes a taxable gift and a DSUEA is included in determining the surviving spouse's applicable exclusion amount, the DSUEA is first applied to the taxable gift before the surviving spouse's own BEA. [See Temp. Treas. Reg. § 25.2505-2T(b).]

d. Relaxed Valuation Reporting Requirements

A particularly interesting rule concerning the portability election provides that executors of estates having a gross value that is less than the basic exclusion amount and that are not otherwise required to file an estate tax return do not have to report the value of certain property that qualifies for the marital or charitable deduction. However, the executor must identify such property on the return, as well as attach documentation verifying that title to such property passed to the surviving spouse or charity in a qualifying manner. If an executor chooses to make use of this special rule in filing an estate tax return, the Instructions for Form 706 will provide ranges of dollar values, and the executor must identify on the estate tax return the particular range within which falls the executor's best estimate of the total gross estate. In doing so, the executor must estimate the total value of the gross estate (including the values of the marital- and charitable-deduction property that does not have to be reported on the estate tax return) based on a determination made in good faith and with due diligence regarding the value of all of the assets includible in the gross estate. [See Temp. Treas. Reg. § 20.2010-2T(a)(7)(ii).]

e. Special Extension for Portability Election

In February 2012, the IRS announced a special extension which allows certain estates of married individuals who died during the first six months of 2011 an extension of the deadline to make the portability election. The special extension is available to estates of married individuals with assets of \$5 million or less, but only if the decedent died in the first six months of 2011 and the executor files Form 4768 requesting an extension no later than fifteen months after the decedent's date of death. Affected estates are required to submit both a properly-prepared Form 4768 and Form 706 to the IRS no later than 15

months after the decedent's date of death. [See IRS Notice 2012-21.]

f. Extends Statute of Limitations

When the portability election is made, the election allows the IRS to examine a return of the predeceased spouse for the restricted purpose of making determinations with respect to the DSUEA, even after the relevant limitation periods have expired. [See IRS Notice 2011-82.]



Monkey Wrenches: Portability

- Does not apply to unused GSTT exemption
- Applies only to decedents dying on or after January 1, 2011
- Expires after December 31, 2012 (?)

E. Calculation of the Estate Tax

The calculation of the estate tax begins with identifying and valuing the decedent's gross estate. Then, multiple items are added and subtracted from the value of the gross estate to determine the decedent's taxable estate. Finally, several more adjustments, deductions, and credits may be made before arriving at the final estate tax figure. See Appendix C for a summarized view of the estate tax calculation. The various sub calculations are discussed below.

1. The Gross Estate

Calculating the decedent's estate tax liability starts with the decedent's "Gross Estate." The Code states that the value of a decedent's Gross Estate includes the value of all property to the extent of the interest therein of the decedent at the time of his or her death. [I.R.C. § 2031.] Consequently, the Gross Estate is comprised of virtually all of the property in whatever form owned by the decedent. (See Appendix D for a table listing the types of property included in the decedent's gross estate, as well as the related Code sections.) Generally, items included in the gross estate are valued as of either the decedent's date of death or the alternate valuation date, discussed later in section IV.E.3. It is important to note that assets included in the gross estate consist of more than properties in which the decedent holds formal title at the time of his or her death. Assets included in the decedent's gross estate are as follows:

a. Property in Which the Decedent Had an Interest

According to I.R.C. § 2033, the gross estate includes the value of all property in which the decedent had an interest as of the date of death. This consists of the personal residence, automobiles, stocks, and any other assets titled in the decedent's name. Because Section 2033 refers to property in which the decedent had an "interest," it extends beyond assets held strictly in the decedent's name. For example, remainder interests are also included in the gross estate.

b. Certain Gifts Within Three Years of Death

There are two circumstances when a gift made by the decedent within three years of death triggers an inclusion in the gross estates: (1) transfer of a life insurance policy on the decedent's life that would have been taxed at death under I.R.C. § 2042 (life insurance proceeds received by the executor or for the benefit of the estate) had the policy not been transferred; or (2) an interest in property that would have been taxed at death under I.R.C. § 2036 (transfers with a retained life estate), § 2037 (transfers taking effect at death), or § 2038 (revocable transfers) had it not been transferred. [See I.R.C. § 2035.] Gifts included in the estate under these circumstances are reported at their fair market value as of the date of death. [I.R.C. § 2035(a).]

The "Gross-Up Rule," previously referenced in section III.C.1.d, provides that the Donor-decedent's gross estate is increased by any gift tax that the decedent or his estate pays on any gift made by the decedent (or his spouse in the case of gift-splitting) during the three-year period prior to death. [See I.R.C. § 2035(b).] This provision applies to the gift tax triggered by a gift of *any type* of property during the three-year look-back period.

c. Transfers with a Retained Life Estate

I.R.C. § 2036 includes in the gross estate assets which were transferred during the decedent's life but in which the decedent retained a life estate. Two types of transfers that are taxed under Section 2036 are: (1) those assets with respect to which the decedent kept possession or enjoyment of the property or the right to its income; and (2) assets in which the decedent retained the power to designate the person who is to possess or enjoy the property or to receive its income. The retention of voting rights in stock of a controlled corporation that the decedent transferred can cause the gift of stock to be included in the transferor's gross estate. [See I.R.C. § 2036(b)(1).]

d. Transfers Taking Effect at Death

A decedent's gross estate includes earlier-transferred property if (1) the decedent stipulates that another person must survive the decedent in order to take ownership the property, and (2) the value of the

decedent's reversionary interest exceeds five percent of the value of the transferred property. [See I.R.C. § 2037.]

e. Revocable Trusts

Assets held by the decedent in a revocable trust will be included in the decedent's gross estate. [I.R.C. § 2038.] Also included in the decedent's gross estate is any asset with respect to which the decedent has the power to change its beneficial enjoyment by altering, amending, revoking, or terminating an interest. The asset is included in the decedent's gross estate only if the decedent retained the powers at the time of death—regardless of whether the decedent possessed such powers originally.

f. Annuities

I.R.C. § 2039 addresses the estate tax treatment of annuities. For an annuity to be included in the gross estate, it must involve payments made under a contract or an agreement. In addition, the decedent must be receiving such payments at the time of his or her death or must have the right to collect such payments alone or with another person. For the payments to be included in the decedent's gross estate, they must be paid for the decedent's life, a period that may not be determined without referring to the decedent's date of death, or for a period that does not actually end before the decedent's death. Annuities are valued at the cost of a comparable contract. [See Treas. Reg. § 20.2031-8(a).] To determine the figure to be included in the gross estate, this cost is multiplied by a fraction that represents the portion of the purchase price the decedent has contributed.

g. Joint Interests

Typically, joint ownership provides that upon the death of one joint owner, the decedent's interest passes automatically to the surviving joint owner, (i.e., by right of survivorship). The amount included in the estate is determined by the relationship between the joint owners. If the joint owners are spouses, the property is deemed to be owned 50/50 between the spouses. [See I.R.C. § 2040(b)(1).] When persons other than spouses or persons in addition to spouses own property as joint owners, the amount includable is determined by the consideration-furnished test. [See I.R.C. § 2040(a).] Under this test, property is included in a joint owner's gross estate in accordance with the portion of the consideration he or she furnished to acquire the property.

h. Powers of Appointment

I.R.C. § 2041 requires inclusion of the value of property in the decedent's estate when the decedent has a general power of appointment over property to designate who will eventually own the property. This

applies even if the decedent never actually owns an interest in the property. Only a general power of appointment (as opposed to a limited power) results in inclusion of value of the subject property. A general power of appointment exists if the holder of the power can exercise the power in favor of the holder, in favor of the holder's estate, or in favor of the creditors of the holder's estate. It is important to note that powers of appointment which are governed by an ascertainable standard are free of estate tax consequences if they can be exercised solely for purposes of the decedent's health, education, maintenance and support (frequently referred to as the "HEMS" standard). [See I.R.C. § 2041(b)(1)(A).]

i. Proceeds of Life Insurance

The value of policies on the decedent's life are included in the decedent's gross estate if the proceeds are receivable by the executor or for the benefit of the estate, or if the decedent had any "incidents of ownership" in the policy at the time of death. [I.R.C. § 2042]. "Incidents of ownership" include the following powers: to change the beneficiary; to surrender or cancel the policy; to borrow against the policy; to pledge the policy for a loan; or to revoke an assignment of the policy. [See Treas. Reg. § 20.2042-1(c)(2).]

j. Property for Which the Marital Deduction was Previously Allowed

All of the remaining QTIP property for which a marital deduction was claimed by the estate of the decedent-spouse must be included in the surviving spouse's gross estate. [I.R.C. § 2044.] Of course, no inclusion in the gross estate is required for a QTIP interest which has been disposed of by the surviving spouse during his or her life.

2. Gross Estate: Common Misconceptions

Some common misconceptions exist regarding property included in a decedent's gross estate. One misconception is that the decedent always removes property from his or her gross estate by giving it away prior to the decedent's death. This is not always true. As the discussion in section IV.E.1.c, *supra*, illustrates, the decedent's gross estate must include the gifted property if the decedent retains either the right to receive the income generated by the transferred property or control over the property for the decedent's lifetime. Also, as explained in section IV.E.1.i, life insurance policies gifted within three years of the date of death are included in the decedent's gross estate.

Another misconception is that if the decedent never owned the property, it cannot be included in the decedent's gross estate. Again, as mentioned earlier in section IV.E.1.h, this is incorrect because a decedent

who has a general power of appointment over property belonging to a third party must include the value of that property in the decedent's gross estate.

3. Valuation of Assets Included in Gross Estate

Assets are included in the gross estate at their fair market value, either on the date of death or on the alternate valuation date. I.R.C. § 2032 provides that the alternate valuation date is the earlier of six months after the date of death or the date on which the property is disposed. The valuation date election is an all-or-nothing proposition. The executor is not allowed to select certain items to be valued as of the date of death and others to be valued at the alternate valuation date. Fair market value is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." [See Treas. Reg. § 20.2031-1(b).] One exception to this rule is the valuation of life insurance on the life of a transferor. Upon the death of the insured, the policy is valued at its face value (death payout amount).

In general, the alternate valuation date is six months after the date of death. However, if the property is distributed, sold, exchanged, or otherwise disposed of within six months of the date of death, the alternate valuation date for that asset is the date of sale or other disposition. If the alternate valuation date is elected, generally any changes in value that occur solely because of a "mere lapse of time" must be ignored in determining the property's value. [Treas. Reg. § 20.2032-1(f).] The alternate valuation date election can be made only if it decreases the value of both the gross estate and the estate tax liability. [Treas. Reg. § 2032(c).] This rule prevents an executor from electing the alternate valuation date merely to produce a higher step-up in basis.

One of the most difficult tasks in preparing an estate tax return is valuing the assets included in the gross estate. This is also one of the most highly-litigated areas between the IRS and the decedents' estates. If the value of any property reported on the estate tax return is sixty-five percent or less of the amount determined to be the proper value during an audit or court case, a 20% undervaluation penalty is imposed. [See I.R.C. § 6662(g).] However, this penalty will not be imposed if there is proof that reasonable cause exists for the valuation claimed and that claim was made in good faith. The penalty increases to 40% for a "gross valuation misstatement." [See I.R.C. § 6662(h), which defines a "gross valuation misstatement" as a reported value that is forty percent or less than the amount determined to be the proper value.]

4. Deductions

Once the gross estate has been determined, deductions are subtracted to arrive at the taxable estate. Excluding the state death tax deduction discussed later in section IV.E.5, deductions from the gross estate fall into four categories which are as follows:

- Funeral expenses, administration costs, and debts
- Casualty and theft losses
- Marital deduction
- Charitable contributions

Two of these categories (funeral/administration/debts and casualty/theft losses) allow the tax base to reflect the net wealth passed to the decedent's heirs, legatees and devisees. The other two categories reduce the estate tax base for transfers to the surviving spouse (marital deduction) or charitable organizations (charitable deduction).

a. Expenses, Indebtedness, and Taxes

I.R.C. § 2053 authorizes deductions for mortgages and other debts owed by the decedent, as well as for the decedent's funeral and administration expenses.

Examples of administration expenses include executor's commissions, attorney's fees, court costs, accountant's fees, appraiser's fees, and expenses of preserving and distributing the estate. The executor must decide whether to deduct administration expenses on the estate tax return (Form 706) or on the estate's income tax return (Form 1041). These expenses cannot be deducted twice, although some may be deducted on the estate tax return and others on the estate's income tax return. In the event that an estate owes no estate tax because of an unlimited marital deduction, a charitable deduction, or the use of the applicable exclusion amount, it is usually prudent for the executor to deduct administration expenses on the estate's income tax return rather than on the estate tax return.

In contrast to administration expenses, which may be deducted on the estate's income tax return (Form 1041), funeral expenses are deductible only on the estate tax return (Form 706). Funeral expenses include a reasonable expenditure for a grave stone, monument, or mausoleum, the cost of a burial lot, and a reasonable expenditure for the site's future care. [See Treas. Reg. § 20.2053-2.]

Only those debts and expenses which are properly payable out of the estate's assets under state law are deductible under the Code. [See I.R.C. § 2053(a); Tex. Prob. Code § 322A(c)-(d).]

b. Losses

I.R.C. § 2054 authorizes a deduction for losses incurred from theft or casualty while the estate is being

settled. As with administration expenses, the executor may choose to deduct losses on the estate's income tax return rather than the estate tax return.

c. Transfers for Public, Charitable, and Religious Uses

I.R.C. § 2055 authorizes an unlimited deduction for transfers to charitable organizations. Therefore, it is possible for a decedent to eliminate the potential for any estate tax liability by devising to charity all of his or her property that exceeds the applicable exclusion threshold. However, a person who wishes to leave property to charity at his or her death should generally be encouraged to consider gifting the property *before* death so that he or she can benefit from the income tax deduction triggered by the gift—while at the same time still reducing his or her gross estate by the amount of the gift.

d. Bequests to Surviving Spouse

I.R.C. § 2056 provides for an unlimited marital deduction for decedents dying after 1981. However, not all transfers to the surviving spouse may qualify for the marital deduction. The estate does not receive a marital deduction unless the interest conveyed to the surviving spouse will be subject to either the estate tax in the recipient spouse's estate or to the gift tax if transferred while the surviving spouse is alive. Each of the following three tests must be met before an interest qualifies for the marital deduction:

- The property must be included in the decedent's gross estate. Obviously, assets excluded from the gross estate cannot generate a deduction.
- The property must pass to the recipient spouse in a qualifying manner. The property is deemed to pass from one spouse to the other if the surviving spouse receives the property because of: (i) a bequest or devise under the decedent's will; (ii) an inheritance resulting from the decedent dying intestate; (iii) dower or curtesy rights; (iv) an earlier transfer from the decedent; (v) a right of survivorship; (vi) an appointment by the decedent under a general power of appointment or in default of appointment; or (vii) designation as a beneficiary of a life insurance policy on the decedent's life. [I.R.C. § 2056(c).]
- The interest conveyed must not be a nondeductible terminal interest. A terminal interest is one that ceases with the passage of time or the occurrence of some event. As a general rule, no marital deduction is allowed

for transfers of terminal interest property. However, the Code specifically authorizes a marital deduction for transfers of *qualified* terminal interest property (“QTIP”). [I.R.C. § 2056(b)(7).] The election must be made on Form 706 by the decedent’s executor, and the election is irrevocable. QTIP trusts must (1) provide mandatory income to the surviving spouse for life, payable at least annually; (2) be only for the benefit of the surviving spouse during his or her life; and (3) give no other person power of appointment during the life of the surviving spouse, unless the power cannot be exercised during the spouse’s lifetime.

5. The Tentative Taxable Estate

Deductions for funeral and administration expenses, debts, casualty and theft losses, and marital and charitable bequests are subtracted from the decedent’s gross estate to arrive at the “Tentative Taxable Estate.” State death taxes paid by the estate are then deducted from the “Tentative Taxable Estate,” as discussed below.

6. The State Death Tax Deduction

Prior to January 1, 2005, estates were allowed a credit against the estate tax for amounts paid for estate, inheritance, legacy, or succession taxes paid to any state or the District of Columbia. [See I.R.C. § 2011.] Now, I.R.C. § 2058 allows a *deduction*, rather than a credit, for state death taxes paid by the estates of decedents dying after December 31, 2004. When completing the estate return, the state death tax deduction is not combined with the other deductions. Instead, as shown on Appendix C of this outline, it is reported separately and subtracted directly from the “Tentative Taxable Estate” on page one of Form 706.

7. The Taxable Estate

The deductions discussed above (funeral and administration expenses, debts, casualty and theft losses, marital and charitable transfers, and death taxes) are subtracted from the gross estate, resulting in the “Taxable Estate.” Then, adjusted taxable gifts are added to the taxable estate to arrive at the estate tax base.

Adjusted taxable gifts are defined as all taxable gifts made after 1976, other than gifts included in the gross estate. Adjusted taxable gifts are reported on the estate tax return using date-of-gift values; therefore, any post-gift appreciation is exempt from transfer taxes, as discussed in section III.C.1.b, *supra*.

8. Tentative Tax

After the estate tax base has been calculated, the “Tentative Tax” is computed using the Unified Rate Schedule, which is reproduced in Appendix E of this

outline. [See I.R.C. § 2001(c); page 4 of Instructions for Form 706.]

9. Gross Estate Tax

The estate’s “Tentative Tax” is then reduced by the decedent’s post-1976 gift taxes paid or payable to arrive at the “Gross Estate Tax”. [See I.R.C. § 2001(b).]

10. Allowable Unified Credit

Once the “Gross Estate Tax” is calculated, it is necessary to determine the estate’s “Allowable Unified Credit.” To do so, certain gifts made after September 8, 1976, and before January 1, 1977 (see section IV.C.2, *supra*) are subtracted from the “Maximum Unified Credit.”

The “Maximum Unified Credit” (described in I.R.C. § 2010(c) using the term “Applicable Credit Amount”) is the tentative tax on the estate’s applicable exclusion amount. For example, for estates of decedents dying in 2012, the “Maximum Unified Credit” equals the tentative tax on the sum of the BEA (basic exclusion amount) of \$5,120,000 plus any DSUEA (deceased spousal unused exclusion amount.) (See section IV.D.4, *supra* for an explanation of BEA and DSUEA.)

11. Additional Credits

In addition to the “Allowable Unified Credit,” the following two additional credits are allowed under the Code:

- Credit for Foreign Death Taxes. The estate is entitled to a credit for some or all of the death taxes paid to a foreign country for property located in that foreign country and included in the gross estate. [See I.R.C. § 2014.]
- Credit for Tax on Prior Transfers. This credit minimizes the negative tax consequences that result when the same property is taxed in more than one estate in quick succession. The credit applies if the person who transfers the property to the decedent in question dies no more than ten years before, or within two years after, the date of the transferee/decedent’s death. [See I.R.C. § 2013.]

12. Net Estate Tax

As demonstrated in Appendix C of this outline, the “Allowable Unified Credit” and any credits for foreign death taxes or taxes paid on prior transfers are subtracted from the “Gross Estate Tax” to reach the final “Net Estate Tax.” (The scope of this paper does not include the Generation-Skipping Transfer Tax. Depending on whether or not an estate is subject to GSST, the calculation in Appendix C may or may not

reflect the actual amount of total transfer taxes owed by the estate.). Even if the use of the unified credit completely eliminates the estate's tax liability, the unified credit will never generate a refund.

F. Due Date of the Return

The estate tax return generally must be filed within nine months after the decedent's death. [I.R.C. § 6075(a).] The due date is the numerically-corresponding date on the ninth calendar month after death. Where there is no corresponding day in the ninth month, the due date is the last day of the month. For example, if the date of death is February 2nd, the estate tax return is due the following November 2nd. However, if the date of death is May 30th, the estate tax return is due the next February 28th, (or February 29th in a leap year). If the due date falls on a Saturday, Sunday, or legal holiday, the due date for the estate tax return is the next day which is not a Saturday, Sunday or legal holiday.

G. Extension Requests

The Secretary of the Treasury is authorized to grant a reasonable extension of time for filing. The maximum extension period is six months. This means that the return is due, at the latest, within fifteen months after the decedent's death. [Treas. Reg. § 20.6081-1(b).] Again, it is important to note that obtaining an extension does not extend the time for paying the estate tax due. Under I.R.C. § 6601, interest will be imposed on any portion of the tax not paid by the due date of the return, which is determined without regard to any extension requested and granted. Therefore, it is important to estimate the estate tax liability, include payment with the extension request, and make the extension request no later than the original due date of the estate tax return.

While there are others ways to request an extension, the executor may obtain an automatic six-month extension to file the estate tax return by filing Form 4768 (Application for Extension of Time to File A Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes) on or before the due date for the Form 706. See section 0, *supra*, for information pertaining to the special extension allowed to certain married taxpayers wishing to make the portability election.

H. Documents to Be Included with Form 706

Many documents are required to be filed with the estate tax return. Some of the more important items include, but are not limited to, the following:

- death certificate;
- certified copy of the Last Will and Testament (if any);

- list of any qualified terminal interest property and its value if the executor wishes to make the QTIP election;
- copies of all gift tax returns previously filed by the decedent;
- copies of real estate appraisals;
- copies of valuation reports for businesses owned by the decedent;
- Forms 712 for each life insurance policy on the decedent's life;
- copies of written trusts and other instruments for lifetime transfers the decedent made;
- certified or verified copies of instruments granting the decedent a power of appointment, even if the power held is not a general one; and
- certified copy of the order admitting the Will to probate if the Will makes bequests for which a marital deduction or charitable contribution deduction is claimed.

I. Requirements for Execution

Form 706 must be signed by all executors, under penalty of perjury. [Treas. Reg. § 20.6018-2.] Only one original copy of the estate tax return must be filed. [Rev. Rul. 56-471.]

J. Where to File the Return

File Form 706 at the following address:

Department of the Treasury
Internal Revenue Service Center
Cincinnati, OH 45999

K. Sample Form 706

Attached as Appendix G is a completed sample estate tax return for reference purposes. Also, notice Part 4 on page 3 of the sample Form 706 (revised July 2011). Question 10a now specifically asks if the Decedent owned an interest in a family limited partnership, a limited liability company, or an inactive or closely-held corporation. Question 10b is a follow-up question to 10a and asks if the value of any interest owned in 10a was discounted on the estate tax return. (Should the preparer just put an "AUDIT PLEASE" notice on the return?) Finally, Question 14 asks if the Decedent had an interest or signature authority over a financial account in a foreign country. These revisions to the estate tax return make it clear what areas the Service has paid special attention to in the recent past with estate tax returns and will be paying close attention to when reviewing the return.

V. TAX RETURN PREPARER PENALTIES

No discussion on gift and estate tax returns would be complete without including the recent changes affecting tax return preparer penalties.

Section 6694 of the Code was implemented with the passage of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520. It authorized the imposition of penalties on those who prepare income tax returns for compensation regardless of their educational background or profession (lawyers or accountants) under certain circumstances. In the event the amount of income tax on a tax return or claim for refund (collectively referred to herein as “a return”) was understated, the preparer may be subject to penalty under Section 6694 if the preparer failed to comply with the applicable standards of conduct. Former Section 7701(a)(36) defined a person to be an “income tax return preparer” if he or she prepares (or employs one or more persons to prepare) all or a substantial portion of a return under Subtitle A (income taxes) for compensation.

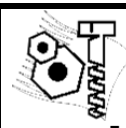
The passage of the Small Business and Work Opportunity Tax Act of 2007 (the “Act”), Pub. L. No. 110-28, 121 Stat. 190, enacted into law on May 25, 2007, substantially broadened the applicability of Section 6694. Section 8246 of the Act amends several provisions of the Code relating to tax return preparers. Specifically, the Act (1) extends the income tax return preparer penalties to all tax return preparers, (2) alters the standards of conduct that must be met to avoid imposition of the penalties for preparing a return which reflects an understatement of liability, and (3) increases the penalties. The amendments to Section 6694 are effective for tax returns prepared after the date of enactment (May 25, 2007).

The Act amended Section 6694(a) to provide that the unreasonable position penalty (formerly referred to as the “negligent penalty”) would apply if (1) the tax return preparer knew (or reasonably should have known) of the position; (2) there was not a reasonable belief that the position would more likely than not be sustained on its merits; and (3) the position was not disclosed as provided in Section 6662(d)(2)(B)(ii) or there was not a reasonable basis for the position. The Act amends the standards of conduct under § 6694(a) in two ways. First, for undisclosed positions, the Act replaces the “realistic possibility” standard with a requirement that there be a “reasonable belief” that the tax treatment of the position would more likely than not be sustained on its merits. Second, for disclosed positions, the Act replaces the “not-frivolous” standard with the requirement that there be a “reasonable basis” for the tax treatment of the position.

With regard to penalties, the Act increased the former unreasonable position penalty for understatements from \$250 to the greater of (1) \$1,000, or (2) fifty percent of the income derived (or to be derived) by the tax return preparer from the preparation of a return with respect to which the penalty was imposed. The Act increased the former penalty for

willful or reckless conduct from \$1,000 to the greater of (1) \$5,000, or (2) fifty percent of the income derived (or to be derived) by the tax return preparer.

Under both the prior and current law, disclosure under Section 6694(a) is adequate if made on Form 8275 or Form 8275-R, as appropriate, and attached to the return or amended return or pursuant to the annual revenue procedure authorized in Treas. Reg. §§ 1.6694-2(c)(3) and 1.6662-4(f)(2).



Nuts & Bolts: Form 706

- 2012 Exemption \$5,120,000
- Deduct Expenses, Debts, & Losses
- Marital & Charitable Deductions
- Portability Election
- Due 9 months after date of death, plus automatic 6-month extension available

VI. CONCLUSION

As becomes evident from reading this outline, there are many opportunities for gift and estate tax planning. However, once past the planning stages, the information needed to prepare the gift and estate tax returns comes from a variety of sources and can take a great deal of time to gather. It is not all black or white as issues involving inclusion in the gross estate and asset valuation frequently arise. The practitioner must carefully organize, analyze, and prepare the returns in accordance with the IRC and regulations. Hopefully, this outline will serve as a starting point for new tax practitioners or a refresher course for those practitioners who do not devote a substantial amount of time to practicing in this area.

APPENDIX A

<u>Year of Gift/Year of Death</u>	<u>Amount of Unified Credit</u>		<u>Applicable Exclusion Amount</u>	
	<u>Estate</u>	<u>Gift</u>	<u>Estate</u>	<u>Gift</u>
January through June, 1977	\$ 30,000	\$ 6,000	\$ 120,666	\$ 30,000
July through December, 1977	30,000	30,000	120,666	120,666
1978	34,000	34,000	134,000	134,000
1979	38,000	38,000	147,333	147,333
1980	42,500	42,500	161,563	161,563
1981	47,000	47,000	175,625	175,625
1982	62,800	62,800	225,000	225,000
1983	79,300	79,300	275,000	275,000
1984	96,300	96,300	325,000	325,000
1985	121,800	121,800	400,000	400,000
1986	155,800	155,800	500,000	500,000
1987 through 1997	192,800	192,800	600,000	600,000
1998	202,050	202,050	625,000	625,000
1999	211,300	211,300	650,000	650,000
2000	220,550	220,550	675,000	675,000
2001	220,550	220,550	675,000	675,000
2002 and 2003	345,800	345,800	1,000,000	1,000,000
2004 and 2005	555,800	345,800	1,500,000	1,000,000
2006, 2007, and 2008	780,800	345,800	2,000,000	1,000,000
2009	1,455,800	345,800	3,500,000	1,000,000
2010	*	330,800	*	1,000,000
2011**	1,730,800	1,730,800	5,000,000	5,000,000
2012	1,772,800	1,772,800	5,120,000	5,120,000
2013***			1,000,000	1,000,000

* The estate tax was originally repealed in 2010. However, the 2010 tax relief act granted an estate a \$5,000,000 exemption or the ability to elect out of the estate tax regime and back under the carryover basis regime that was in place at the time the 2010 tax relief act was enacted.

** The gift tax continued after the repeal of the estate tax in 2010; however, the top tax rate was 35%.





*** Unless Congress acts otherwise, in 2013, the estate and gift tax rules will revert to what they would have been had the 2001 never been enacted.

APPENDIX B

2012 Gift Tax Calculation

	Total gifts made in 2012 by Donor
	- 1/2 value of Donor's 2012 gifts attributable to Spouse (via gift splitting)
	+ 1/2 value of Spouse's 2012 gifts attributable to Donor (via gift splitting)
	- Annual exclusions for gifts made in 2012 (gifts of present interest--\$13,000 per Donee)
	- Marital Deduction for gifts made in 2012 (value of gifts made to Spouse, less annual exclusion)
	- Charitable Deduction for gifts made in 2012 (value of charitable gifts, less annual exclusion)
	= 2012 Taxable Gifts
Calculate Cumulative Taxable Gifts	+ Value of Taxable Gifts from All Prior Years
	= Cumulative Taxable Gifts
Calculate Tentative Tax on Cumulative Taxable Gifts	Use Tax Tables to Calculate:
	Tentative Tax on Cumulative Taxable Gifts
Calculate Tax on 2012 Gifts (Before Unified Credit)	Tentative Tax on Cumulative Taxable Gifts
	- Tentative Tax on Gifts from All Prior Years (using current rate schedule)
	= Tax on 2012 Gifts Before Unified Credit
Calculate Allowable Unified Credit	Total Lifetime Unified Credit
	- Unified Credit Allowed for Prior Periods
	= Allowable Unified Credit
Gift Tax Payable for 2012	Tax on 2012 Gifts Before Unified Credit
	- Allowable Unified Credit
	= TAX PAYABLE FOR 2012

APPENDIX C

<u>Estate Tax Calculation for Decedent Dying in 2012</u>	
<div>Calculate "Taxable Estate"</div> 	Gross Estate
	- Deductions
	= Tentative Taxable Estate
	- State Death Tax Deduction
<div>Calculate "Estate Tax Base"</div> 	= Taxable Estate
	+ Adjust Taxable Gifts (made after 1976)
	= Estate Tax Base
<div>Calculate Gross Estate Tax</div> 	
	x Applicable Estate Tax Rate
	= Tentative Estate Tax
	- Gift Taxes Payable (on post-1976 gifts)
<div>Calculate Allowable Unified Credit</div> 	= Gross Estate Tax
	Maximum Unified Credit
	- Adjustments for Gifts (made 9/8/76 - 1/1/77)
<div>Net Estate Tax</div>	= Allowable Unified Credit
	Gross Estate Tax
	- Allowable Unified Credit
	- Credit for Foreign Death Tax
	- Credit for Tax on Prior Transfers
	= NET ESTATE TAX

APPENDIX D

<u>Type of Property or Transaction Included in Gross Estate</u>	<u>Internal Revenue Code</u>
Property in which decedent had an interest	§ 2033
Gift taxes paid on property given away within three years of death plus certain property given away within three years of death (i.e., life insurance)	§ 2035
Property that decedent transferred during life but in which decedent retained benefits or the power to control enjoyment	§ 2036
Property that decedent transferred during life but for which decedent has too large a reversionary interest (greater than 5%)	§ 2037
Property that decedent transferred during life but over which decedent held the power to alter, amend, revoke or terminate an interest	§2038
Annuities	§2039
Jointly-owned property	§ 2040
Property over which decedent possessed a general power of appointment	§ 2041
Life insurance on decedent's life	§ 2042
QTIP Trust for which a marital deduction was claimed by decedent's spouse	§ 2044

APPENDIX E

UNIFIED RATE SCHEDULE FOR 2011			
Column A	Column B	Column C	Column D
Taxable amount over	Taxable amount not over	Tax on amount in Column A	Rate of tax on excess over amount in Column A
\$0	\$10,000	\$0	18%
\$10,000	20,000	\$1,800	20%
20,000	40,000	3,800	22%
40,000	60,000	8,200	24%
60,000	80,000	13,000	26%
80,000	100,000	18,200	28%
100,000	150,000	23,800	30%
150,000	250,000	38,800	32%
250,000	500,000	70,800	34%
500,000	- - - -	155,800	35%
Example: Taxable Estate valued at \$5 million results in Gross Estate Tax of \$1,730,800			
		Taxable Estate	Gross Estate Tax
	Tax on first \$500,000 in Column A:	500,000	155,800
	Tax on excess amount over amount in Column A (\$4,500,000 x .35)	4,500,000	1,575,000
		5,000,000	1,730,800

APPENDIX F

Form 709 Department of the Treasury Internal Revenue Service	United States Gift (and Generation-Skipping Transfer) Tax Return <small>(For gifts made during calendar year 2011)</small> See instructions.	OMB No. 1545-0020 <div style="font-size: 24pt; font-weight: bold;">2011</div>
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P A R T 1 G E N E R A L I N F O R M A T I O N	1 Donor's first name and middle initial E.F.	2 Donor's last name Rochester	3 Donor's social security number 123-45-6789
	4 Address (number, street, and apartment number) #1 Thornfield Drive		5 Legal residence (domicile) Texas
	6 City, state, and ZIP code City, TX 77777		7 Citizenship (see instructions) United States
	8 If the donor died during the year, check here. <input type="checkbox"/> and enter date of death. _____		
	9 If you extended the time to file this Form 709, check here <input type="checkbox"/>		
	10 Enter the total number of donees listed on Schedule A. Count each person only once. 1		
	11a Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If 'No,' skip line 11b. X		
P A R T 2 T A X C O M P U T A T I O N	b If the answer to line 11a is 'Yes,' has your address changed since you last filed Form 709 (or 709-A)?		N/A
	12 Gifts by husband or wife to third parties. Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (See instructions.) (If the answer is 'Yes,' the following information must be furnished and your spouse must sign the consent shown below. If the answer is 'No,' skip lines 13-18 and go to Schedule A.)		
	13 Name of consenting spouse	14 SSN	
	15 Were you married to one another during the entire calendar year? (see instructions)		
	16 If 15 is 'No,' check whether <input type="checkbox"/> married <input type="checkbox"/> divorced or <input type="checkbox"/> widowed/deceased, and give date (see instructions).		
	17 Will a gift tax return for this year be filed by your spouse? (If 'Yes,' mail both returns in the same envelope.)		
	18 Consent of Spouse. I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.		
	Consenting spouse's signature _____ Date _____		
	1 Enter the amount from Schedule A, Part 4, line 11.		1 4,987,000.
	2 Enter the amount from Schedule B, line 3.		2
3 Total taxable gifts. Add lines 1 and 2.		3 4,987,000.	
4 Tax computed on amount on line 3 (see <i>Table for Computing Gift Tax</i> in instructions)		4 1,726,250.	
5 Tax computed on amount on line 2 (see <i>Table for Computing Gift Tax</i> in instructions)		5	
6 Balance. Subtract line 5 from line 4.		6 1,726,250.	
7 Maximum unified credit (see instructions)		7 1,730,800.	
8 Enter the unified credit against tax allowable for all prior periods (from Schedule B, line 1, column C)		8	
9 Balance. Subtract line 8 from line 7. Do not enter less than zero.		9 1,730,800.	
10 Enter 20% (.20) of the amount allowed as a specific exemption for gifts made after September 8, 1976, and before January 1, 1977 (see instructions)		10	
11 Balance. Subtract line 10 from line 9. Do not enter less than zero.		11 1,730,800.	
12 Unified credit. Enter the smaller of line 6 or line 11.		12 1,726,250.	
13 Credit for foreign gift taxes (see instructions)		13	
14 Total credits. Add lines 12 and 13.		14 1,726,250.	
15 Balance. Subtract line 14 from line 6. Do not enter less than zero.		15 0.	
16 Generation-skipping transfer taxes (from Schedule C, Part 3, column H, Total).		16	
17 Total tax. Add lines 15 and 16.		17 0.	
18 Gift and generation-skipping transfer taxes prepaid with extension of time to file		18	
19 If line 18 is less than line 17, enter balance due (see instructions).		19	
20 If line 18 is greater than line 17, enter amount to be refunded .		20	

A T T A C H C H E C K O R M O N E Y O R D E R H E R E	Sign Here	Under penalties of perjury, I declare that I have examined this return, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than donor) is based on all information of which preparer has any knowledge.		
		May the IRS discuss this return with the preparer shown below (see instructions)? <input type="checkbox"/> Yes <input type="checkbox"/> No		
		Signature of donor _____	Date _____	
		Print/Type preparer's name _____	Preparer's signature _____	Date _____
Paid Preparer Use Only	Check <input type="checkbox"/> if self-employed PTIN _____			
	Firm's name _____		Firm's EIN _____	
	Firm's address _____		Phone no. _____	

BAA For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see the instructions for this form. FDGA0101L 12/23/11 Form 709 (2011)

Form 709 (2011) E.F. Rochester 123-45-6789 Page 2

Schedule A Computation of Taxable Gifts (Including transfers in trust) (see instrs)**A** Does the value of any item listed on Schedule A reflect any valuation discount? If "Yes," attach explanation. Yes ☐ No ☒**B** ☐ Check here if you elect under section 529(c)(2)(B) to treat any transfers made this year to a qualified tuition program as made ratably over a 5-year period beginning this year. See instructions. Attach explanation.**Part 1 — Gifts Subject Only to Gift Tax.** Gifts less political organization, medical, and educational exclusions. (see instructions)

A Item no.	B Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number • If closely held entity, give EIN	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
	See Attachment		650,000.		5,000,000.		5,000,000.

Gifts made by spouse — complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

--	--	--	--	--	--	--	--

Total of Part 1. Add amounts from Part 1, column H. 5,000,000.

Part 2 — Direct Skips. Gifts that are direct skips and are subject to both gift tax and generation-skipping transfer tax. You must list the gifts in chronological order.

A Item no.	B Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number • If closely held entity, give EIN	C 2632(b) election out	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)

Gifts made by spouse — complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

--	--	--	--	--	--	--	--

Total of Part 2. Add amounts from Part 2, column H.

Part 3 — Indirect Skips. Gifts to trusts that are currently subject to gift tax and may later be subject to generation-skipping transfer tax. You must list these gifts in chronological order.

A Item no.	B Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number • If closely held entity, give EIN	C 2632(c) election	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)

Gifts made by spouse — complete **only** if you are splitting gifts with your spouse and he/she also made gifts.

--	--	--	--	--	--	--	--

Total of Part 3. Add amounts from Part 3, column H.

BAA (If more space is needed, attach additional sheets of same size.)

FDGA0102L 12/23/11

Form 709 (2011)

Page 3

1	Total value of gifts of donor. Add totals from column H of Parts 1, 2, and 3	1	5,000,000.
2	Total annual exclusions for gifts listed on line 1 (see instructions).....	2	13,000.
3	Total included amount of gifts. Subtract line 2 from line 1.....	3	4,987,000.
Deductions (see instructions)			
4	Gifts of interests to spouse for which a marital deduction will be claimed, based on item numbers _____ of Schedule A ...	4	
5	Exclusions attributable to gifts on line 4	5	
6	Marital deduction. Subtract line 5 from line 4	6	
7	Charitable deduction, based on item nos. _____ less exclusions.	7	
8	Total deductions. Add lines 6 and 7	8	
9	Subtract line 8 from line 3	9	4,987,000.
10	Generation-skipping transfer taxes payable with this Form 709 (from Schedule C, Part 3, column H, Total)....	10	0.
11	Taxable gifts. Add lines 9 and 10. Enter here and on page 1, Part 2 – Tax Computation, line 1.....	11	4,987,000.

A Calendar year or calendar quarter (see instructions)	B Internal Revenue office where prior return was filed	C Amount of unified credit against gift tax for periods after December 31, 1976	D Amount of specific exemption for prior periods ending before January 1, 1977	E Amount of taxable gifts
1 Totals for prior periods.....	1	0.	0.	0.
2 Amount, if any, by which total specific exemption, line 1, column D, is more than \$30,000.....			2	
3 Total amount of taxable gifts for prior periods. Add amount on line 1, column E, and amount, if any, on line 2. Enter here and on page 1, Part 2 - Tax Computation, line 2.....			3	0.

Form 709 (2011)

123-45-6789

Page 4

Note: Inter vivos direct skips that are completely excluded by the GST exemption must still be fully reported (including value and exemptions claimed) on Schedule C.

[illegible]

Check here <input type="checkbox"/> if you are making a section 2652(a)(3) (special QTIP) election (see instructions) Enter the item numbers from Schedule A of the gifts for which you are making this election		
1	Maximum allowable exemption (see instructions)	1
2	Total exemption used for periods before filing this return	2
3	Exemption available for this return. Subtract line 2 from line 1	3
4	Exemption claimed on this return from Part 3, column C total, below	4
5	Automatic allocation of exemption to transfers reported on Schedule A, Part 3 (see instructions)	5
6	Exemption allocated to transfers not shown on line 4 or 5, above. You must attach a 'Notice of Allocation.' (see instructions)	6
7	Add lines 4, 5, and 6	7
8	Exemption available for future transfers. Subtract line 7 from line 3	8

A Item Number (from Schedule C, Part 1)	B Net transfer (from Schedule C, Part 1, column D)	C GST Exemption Allocated	D Divide column C by column B	E Inclusion Ratio (Subtract column D from 1.000)	F Maximum Estate Tax Rate	G Applicable Rate (multiply column E by column F)	H Generation-Skipping Transfer Tax (multiply column B by column G)
					35% (.35)		
					35% (.35)		
					35% (.35)		
					35% (.35)		
					35% (.35)		
					35% (.35)		
Gifts made by spouse (for gift splitting only)							
					35% (.35)		
					35% (.35)		
					35% (.35)		
					35% (.35)		
					35% (.35)		
					35% (.35)		
Total exemption claimed. Enter here and on Part 2, line 4, above. May not exceed Part 2, line 3, above.			Total generation-skipping transfer tax. Enter here; on page 3, Schedule A, Part 4, line 10; and on page 1, Part 2 – Tax Computation, line 16.				

Form 709 (2011)

Form 709

Donor's name

E.F. Rochester

Social security number

123-45-6789

SCHEDULE A Computation of Taxable Gifts

FDGL0112L 05/03/11

Part 1 - Gifts Subject Only to Gift Tax. Gifts less political organization, medical, and educational exclusions - see instructions

A Item number	B • Donee's name and address • Relationship to donor (if any) • Description of gift • If the gift was of securities, give CUSIP number	C	D Donor's adjusted basis of gift	E Date of gift	F Value at date of gift	G For split gifts, enter 1/2 of column F	H Net transfer (subtract column G from column F)
1	Jane Eyre #123 St. John's Way Morton, TX 77777 Relationship to Donor: Friend Property Transferred: 750 shares Rochester Enterprises, Inc.		650,000.	6/01/11	5,000,000.	0.	5,000,000.
	Total Schedule A, Part 1		\$ 650,000.		\$ 5,000,000.	\$ 0.	\$ 5,000,000.

Demo

APPENDIX G

Form **706**

(Rev. August 2011)

Department of the Treasury
Internal Revenue Service**United States Estate (and Generation-Skipping
Transfer) Tax Return**

OMB No. 1545-0015

Estate of a citizen or resident of the United States (see instructions).
To be filed for decedents dying after December 31, 2010 and before January 1, 2012.

DECEDENT	1a Decedent's first name and middle initial (and maiden name, if any)	1b Decedent's last name		2 Decedent's SSN
	Fitzwilliam	Darcy		999-99-9999
	3a County, state, and ZIP, or foreign country, of legal residence (domicile) at time of death	3b Year domicile estd	4 Date of birth	5 Date of death
	County, Texas	1936	1/02/1936	11/30/2011
	6a Name of executor (see the instructions)	6b Executor's address (number and street including apartment or suite no.; city, town, or post office; state, and ZIP code) and phone number.		
PA	Elizabeth Bennet Darcy	#1 Pemberley Lane		
	6c Executor's social security number (see instructions)	City, TX 77777		
EXECUTOR	1 123-45-6789	Phone number		
	7a Name and location of court where will was probated or estate administered	7b Case number		
	County Court of County, Texas	40, 123		
	8 If decedent died testate, check here <input checked="" type="checkbox"/> and attach a certified copy of the will.	9 If you extended the time to file this Form 706, check here <input checked="" type="checkbox"/>		
	10 If Schedule R-1 is attached, check here <input type="checkbox"/>			
PART 2 TAX COMPUTATION	1 Total gross estate less exclusion (from Part 5 - Recapitulation, item 12)	1	4,347,714.	
	2 Tentative total allowable deductions (from Part 5 - Recapitulation, item 22)	2	1,832,570.	
	3a Tentative taxable estate (before state death tax deduction) (subtract line 2 from line 1)	3a	2,515,144.	
	b State death tax deduction	3b		
	c Taxable estate (subtract line 3b from line 3a)	3c	2,515,144.	
	4 Adjusted taxable gifts (total taxable gifts (within the meaning of section 2503) made by the decedent after December 31, 1976, other than gifts that are includible in decedent's gross estate (section 2001(b)))	4	0.	
	5 Add lines 3c and 4	5	2,515,144.	
	6 Tentative tax on the amount on line 5 from Table A in the instructions	6	861,100.	
	7 Total gift tax paid or payable with respect to gifts made by the decedent after December 31, 1976. Include gift taxes by the decedent's spouse for such spouse's share of split gifts (section 2513) only if the decedent was the donor of these gifts and they are includible in the decedent's gross estate (see instructions)	7	0.	
	8 Gross estate tax (subtract line 7 from line 6)	8	861,100.	
	9 Maximum unified credit (applicable credit amount) against estate tax (see instructions)	9	1,730,800.	
	10 Adjustment to unified credit (applicable credit amount). (This adjustment may not exceed \$6,000. See instructions.)	10		
	11 Allowable unified credit (applicable credit amount) (subtract line 10 from line 9)	11	1,730,800.	
	12 Subtract line 11 from line 8 (but do not enter less than zero)	12	0.	
	13 Credit for foreign death taxes (from Schedule P). (Attach Form(s) 706-CE.)	13		
14 Credit for tax on prior transfers (from Schedule Q)	14			
15 Total credits (add lines 13 and 14)	15	0.		
16 Net estate tax (subtract line 15 from line 12)	16	0.		
17 Generation-skipping transfer (GST) taxes payable (from Schedule R, Part 2, line 10)	17	0.		
18 Total transfer taxes (add lines 16 and 17)	18			
19 Prior payments. Explain in an attached statement.	19			
20 Balance due (or overpayment) (subtract line 19 from line 18)	20	0.		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer other than the executor is based on all information of which preparer has any knowledge.

Sign Here

Signature of executor	Date
Signature of executor	Date

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
Firm's name				Firm's EIN
Firm's address				Phone no.

BAA For Privacy Act and Paperwork Reduction Act Notice, see instructions.

FDRA0201L 10/26/11

Form 706 (Rev 8-2011)

Form 706 (Rev. 8-2011)

Estate of: **Fitzwilliam Darcy**Decedent's SSN
999-99-9999**Part 3 – Elections by the Executor****Please check the 'Yes' or 'No' box for each question (see instructions).**

Note. Some of these elections may require the posting of bonds or liens.

	Yes	No
1 Do you elect alternate valuation?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
2 Do you elect special-use valuation?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
If 'Yes,' you must complete and attach Schedule A-1.		
3 Do you elect to pay the taxes in installments as described in section 6166?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
If 'Yes,' you must attach the additional information described in the instructions.		
Note. By electing section 6166, you may be required to provide security for estate tax deferred under section 6166 and interest in the form of a surety bond or a section 6324A lien.		
4 Do you elect to postpone the part of the taxes attributable to a reversionary or remainder interest as described in section 6163?	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Part 4 – General Information (Note: Please attach the necessary supplemental documents. You must attach the death certificate.)
(See instructions)

Authorization to receive confidential tax information under Regulations section 601.504(b)(2)(i); to act as the estate's representative before the IRS; and to make written or oral presentations on behalf of the estate if return prepared by an attorney, accountant, or enrolled agent for the executor:

Name of representative (print or type)	State	Address (number, street, and room or suite number, city, state, and ZIP code)

I declare that I am the ☐ attorney/ ☐ certified public accountant/ ☐ enrolled agent (you must check the applicable box) for the executor and prepared this return for the executor. I am not under suspension or disbarment from practice before the Internal Revenue Service and am qualified to practice in the state shown above.

Signature	CAF number	Date	Telephone number

1 Death certificate number and issuing authority (attach a copy of the death certificate to this return).

Texas 123452 Decedent's business or occupation. If retired, check here ☐ and state decedent's former business or occupation.**Real Estate**

3 Marital status of the decedent at time of death (see instructions if more than one marriage):

☒ Married☐ Widow or widower – Name, SSN, and date of death of deceased spouse ▶☐ Single☐ Legally separated☐ Divorced – Date divorce decree became final ▶

Explanation:

4a Surviving spouse's name	4b Social security number	4c Amount received (see instrs)
Elizabeth Bennet Darcy	123-45-6789	1,786,899.

5 Individuals (other than the surviving spouse), trusts, or other estates who receive benefits from the estate (do not include charitable beneficiaries shown in Schedule Q) (see instructions).

Name of individual, trust, or estate receiving \$5,000 or more	Identifying number	Relationship to decedent	Amount (see instructions)
Fitzwilliam Darcy Family Trust	451-23-4567	Testamentary Tr	2,515,144.

All unascertainable beneficiaries and those who receive less than \$5,000

Total **2,515,144.****Please check the 'Yes' or 'No' box for each question.**

	Yes	No
6 Does the gross estate contain any section 2044 property (qualified terminable interest property (QTIP) from a prior gift or estate) (see instructions)?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
7a Have federal gift tax returns ever been filed?	<input type="checkbox"/>	<input checked="" type="checkbox"/>
If 'Yes,' please attach copies of the returns, if available, and furnish the following information:		
7b Period(s) covered		
7c Internal Revenue office(s) where filed		
8a Was there any insurance on the decedent's life that is not included on the return as part of the gross estate?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b Did the decedent own any insurance on the life of another that is not included in the gross estate?	<input type="checkbox"/>	<input checked="" type="checkbox"/>

BAA (continued on next page)

FDRA0202L 08/30/11

Page 2

Form 706 (Rev. 8-2011) **Fitzwilliam Darcy**

999-99-9999

Part 4 – General Information (continued)

If you answer 'Yes' to any of questions 9-16, you must attach additional information as described in the instructions.		Yes	No
9	Did the decedent at the time of death own any property as a joint tenant with right of survivorship in which (a) one or more of the other joint tenants was someone other than the decedent's spouse, and (b) less than the full value of the property is included on the return as part of the gross estate? If 'Yes,' you must complete and attach Schedule E.		X
10 a	Did the decedent, at the time of death, own any interest in a partnership (for example, a family limited partnership), an unincorporated business, or a limited liability company; or own any stock in an inactive or closely held corporation?	X	
b	If 'Yes,' was the value of any interest owned (from above) discounted on this estate tax return? If 'Yes,' see the instructions on reporting the total accumulated or effective discounts taken on Schedule F or G.	X	
11	Did the decedent make any transfer described in section 2035, 2036, 2037, or 2038? (see the instructions) If 'Yes,' you must complete and attach Schedule G.		X
12 a	Were there in existence at the time of the decedent's death any trusts created by the decedent during his or her lifetime?	X	
b	Were there in existence at the time of the decedent's death any trusts not created by the decedent under which the decedent possessed any power, beneficial interest, or trusteeship?		X
c	Was the decedent receiving income from a trust created after October 22, 1986 by a parent or grandparent?		X
	If 'Yes,' was there a GST taxable termination (under section 2612) on the death of the decedent?		X
d	If there was a GST taxable termination (under section 2612), attach a statement to explain. Provide a copy of the trust or will creating the trust, and give the name, address, and phone number of the current trustee(s).		
e	Did the decedent at any time during his or her lifetime transfer or sell an interest in a partnership, limited liability company, or closely held corporation to a trust described in question 12a or 12b?		X
	If 'Yes,' provide the EIN number for this transferred/sold item.		
13	Did the decedent ever possess, exercise, or release any general power of appointment? If 'Yes,' you must complete and attach Schedule H.		X
14	Did the decedent have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?		X
15	Was the decedent, immediately before death, receiving an annuity described in the 'General' paragraph of the instructions for Schedule I or a private annuity? If 'Yes,' you must complete and attach Schedule I.	X	
16	Was the decedent ever the beneficiary of a trust for which a deduction was claimed by the estate of a pre-deceased spouse under section 2056(b)(7) and which is not reported on this return? If 'Yes,' attach an explanation.		X

Part 5 – Recapitulation

Item number	Gross estate	Alternate value	Value at date of death
1	Schedule A – Real Estate	1	195,242.
2	Schedule B – Stocks and Bonds	2	6,391.
3	Schedule C – Mortgages, Notes, and Cash	3	0.
4	Schedule D – Insurance on the Decedent's Life (attach Form(s) 712)	4	782,352.
5	Schedule E – Jointly Owned Property (attach Form(s) 712 for life insurance)	5	882,559.
6	Schedule F – Other Miscellaneous Property (attach Form(s) 712 for life insurance)	6	2,441,147.
7	Schedule G – Transfers During Decedent's Life (attach Form(s) 712 for life insurance)	7	0.
8	Schedule H – Powers of Appointment	8	0.
9	Schedule I – Annuities	9	40,023.
10	Total gross estate (add items 1 through 9)	10	4,347,714.
11	Schedule U – Qualified Conservation Easement Exclusion	11	0.
12	Total gross estate less exclusion (subtract item 11 from item 10). Enter here and on line 1 of Part 2 – Tax Computation.	12	4,347,714.
Item number	Deductions	Amount	
13	Schedule J – Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims	13	44,830.
14	Schedule K – Debts of the Decedent	14	0.
15	Schedule K – Mortgages and Liens	15	841.
16	Total of items 13 through 15	16	45,671.
17	Allowable amount of deductions from item 16 (see the instructions for item 17 of the Recapitulation)	17	45,671.
18	Schedule L – Net Losses During Administration	18	0.
19	Schedule L – Expenses Incurred in Administering Property Not Subject to Claims	19	0.
20	Schedule M – Bequests, etc., to Surviving Spouse	20	1,786,899.
21	Schedule O – Charitable, Public, and Similar Gifts and Bequests	21	0.
22	Tentative total allowable deductions (add items 17 through 21). Enter here and on line 2 of the Tax Computation.	22	1,832,570.

BAA Page 3

FDRA0203L 08/30/11

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

SCHEDULE A – Real Estate

- For jointly owned property that must be disclosed on Schedule E, see instructions.
- Real estate that is part of a sole proprietorship should be shown on Schedule F.
- Real estate that is included in the gross estate under section 2035, 2036, 2037, or 2038 should be shown on Schedule G.
- Real estate that is included in the gross estate under section 2041 should be shown on Schedule H.
- If you elect section 2032A valuation, you must complete Schedule A and Schedule A-1.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	<p>One-half interest in residence at # Pemberley Lane, City, Texas, 77777.</p> <p>Value based on County Tax Assessor records. See Exhibit C-1.</p> <p>Value of residence on date of death \$390,485</p> <p>Less 50% Community Property: Interest of surviving spouse</p>			<p>390,485.</p> <p>-195,243.</p>
Total from continuation schedules or additional sheets attached to this schedule.....				
TOTAL. (Also enter on Part 5 – Recapitulation, page 3, at item 1.).....				195,242.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA0301L 08/29/11

Schedule A – Page 4

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN
999-99-9999**SCHEDULE B – Stocks and Bonds**

(For jointly owned property that must be disclosed on Schedule E, see instructions.)

Item number	Description including face amount of bonds or number of shares and par value for identification. Give CUSIP number. If trust, partnership, or closely held entity, give EIN.	CUSIP number or EIN, where applicable	Unit value	Alternate valuation date	Alternate value	Value at date of death
1	Undivided one-half interest in 452 Acme Shares Pre-market: NaN Value at date of death \$12,783.00 See Exhibit C-2. Less 50% Community Property: Interest of surviving spouse		28.28			12,783. -6,392.
Total from continuation schedules (or additional sheets) attached to this schedule.						
TOTAL. (Also enter on Part 5 – Recapitulation, page 3, at item 2.)						6,391.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA0501L 09/22/11

Schedule B – Page 9

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

SCHEDULE D – Insurance on the Decedent's Life

You must list all policies on the life of the decedent and attach a Form 712 for each policy.

Item number	Description	Alternate valuation date	Alternate value	Value at date of death
1	<p>Genworth Life Insurance Company Policy No. 0012345678</p> <p>Insured: Fitzwilliam Darcy Beneficiary: Elizabeth B Darcy</p> <p>See Exhibit C-3 for Form 712.</p> <p>Less 50% Community Property: Interest of surviving spouse</p>			<p>500,000.</p> <p>-250,000.</p>
2	<p>State Life Insurance Company Policy No. 512345678</p> <p>Insured: Fitzwilliam Darcy Beneficiary: Elizabeth B Darcy</p> <p>See Exhibit C-4 for Form 712.</p> <p>Less 50% Community Property: Interest of surviving spouse</p>			<p>505,300.</p> <p>-252,650.</p>
3	<p>The Northwestern Mutual Life Insurance Company Policy #12345678</p> <p>Insured: Fitzwilliam Darcy Beneficiary: Elizabeth B Darcy</p> <p>See Exhibit C-5 for Form 712.</p> <p>Less 50% Community Property: Interest of surviving spouse</p>			<p>559,404.</p> <p>-279,702.</p>
Total from continuation schedules (or additional sheets) attached to this schedule.				
TOTAL. (Also enter on Part 5 – Recapitulation, page 3, at item 4.)				782,352.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA0701L 09/22/11

Schedule D – Page 11

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

SCHEDULE E – Jointly Owned Property

(If you elect section 2032A valuation, you must complete Schedule E and Schedule A-1.)

PART 1. Qualified Joint Interests – Interests Held by the Decedent and His or Her Spouse as the Only Joint Tenants (Section 2040(b)(2))

Item number	Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN	Alternate valuation date	Alternate value	Value at date of death
1	First Bank P.O. Box 200 City, TX 77777 Account #0000001234567 Balance at date of death \$75,049.47 Accrued unpaid interest through date of death \$254.70	CUSIP number or EIN, where applicable		
Total from continuation schedules (or additional sheets) attached to this schedule				1,765,117.
1 a Totals			1 a	1,765,117.
1 b Amounts included in gross estate (one-half of line 1 a)			1 b	882,559.

PART 2. All Other Joint Interests

2 a State the name and address of each surviving co-tenant. If there are more than three surviving co-tenants, list the additional co-tenants on an attached sheet.

Name	Address (number and street, city, state, and ZIP code)
A	
B	
C	

Item number	Enter letter for co-tenant	Description (including alternate valuation date if any). For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN	Percentage includible	Includible alternate value	Includible value at date of death
		CUSIP number or EIN, where applicable			
Total from continuation schedules (or additional sheets) attached to this schedule					
2 b Total other joint interests			2 b		0.
3 Total includible joint interests (add lines 1b and 2b). Also enter on Part 5 – Recapitulation, page 3, at item 5			3		882,559.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA0801L 09/22/11

Schedule E – Page 12

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

Continuation of SCHEDULE E - Jointly Owned Property

PART 1. - Qualified Joint Interests - Interests Held by the Decedent and His or Her Spouse as the Only Joint Tenants (Section 2040(b)(2))

Item no.	Description For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
	See Exhibit C-6.				75,304.
2	Second Bank 4256 Oak Road City, TX 77777 Certificate of Deposit #1301 Value at date of death \$582,421.99 Accrued unpaid interest through date of death \$1,801.62 See Exhibit C-7.				584,224.
3	Third Bank PO Box 205 City, TX 77777 Certificate of Deposit #3103 Value at date of death \$508,196.20 Accrued unpaid interest through date of death \$1,572.00 See Exhibit C-8.				509,768.
4	Commercial State Bank PO BOX 560 City, TX 77777 Checking Account #91546789 Balance at date of death \$11,589.42 See Exhibit C-9.				11,589.
5	Fourth Bank PO BOX 1090 City, TX 77777 DDA Account #16738648 Balance at date of death \$263.51 See Exhibit C-10.				264.
6	5th Bank 890 Hampton Way City, TX 77777 Certificate of Deposit #9204				
FDRL2312L 05/03/11 Totals (Carryforward to main schedule)					1,181,149.

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

Continuation of SCHEDULE E - Jointly Owned Property

PART 1. - Qualified Joint Interests - Interests Held by the Decedent and His or Her Spouse as the Only Joint Tenants (Section 2040(b)(2))

Item no.	Description For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
	Balance at date of death \$254,098.10 Accrued unpaid interest from date of last interest payment to date of death \$784.78 See Exhibit C-11.				254,883.
7	National Bank PO Box 600 City, TX 77777 Account #00000079501234 Balance as of date of death \$3,215.07 Accrued unpaid interest through date of death \$8.20 See Exhibit C-12.				3,223.
8	Peoples Bank 591 Main St. City, TX 77777 Account #00000088888 Balance at date of death \$129,682.91 Accrued unpaid interest through date of death \$508.97 See Exhibit C-13.				130,192.
9	North Bank PO BOX 444 City, TX 77777 Account #56789 Balance at date of death \$127,331.75 Accrued unpaid interest through date of death \$15.81 See Exhibit C-14.				127,348.
10	Last Bank P.O. Box 222 City, TX 77777 Account #84046777				
FDRL2312L 05/03/11 Totals (Carryforward to main schedule)					515,646.

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

Continuation of SCHEDULE E - Jointly Owned Property

PART 1. - Qualified Joint Interests - Interests Held by the Decedent and His or Her Spouse as the Only Joint Tenants (Section 2040(b)(2))

Item no.	Description For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
	Balance at date of death \$68,312.73 Accrued unpaid interest through date of death \$9.42 See Exhibit C-15.				68,322.
FDRL2312L 05/03/11					68,322.
Totals (Carryforward to main schedule)					68,322.

Form 706 (Rev. 8-2011)

Estate of: **Fitzwilliam Darcy**

Decedent's SSN

999-99-9999**SCHEDULE F – Other Miscellaneous Property Not Reportable Under Any Other Schedule**(For jointly owned property that must be disclosed on Schedule E, see instructions.)
(If you elect section 2032A valuation, you must complete Schedule F and Schedule A-1.)

1	Did the decedent own any works of art, items, or any collections whose artistic or collectible value at date of death exceeded \$3,000?	Yes	No
	If "Yes," submit full details on this schedule and attach appraisals.		X
2	Has the decedent's estate, spouse, or any other person received (or will receive) any bonus or award as a result of the decedent's employment or death?		X
	If "Yes," submit full details on this schedule.		
3	Did the decedent at the time of death have, or have access to, a safe deposit box?	X	
	If "Yes," state location, and if held in joint names of decedent and another, state name and relationship of joint depositor.		
South Bank, City, Texas, held jointly by Fitzwilliam and Elizabeth Darcy.			
If any of the contents of the safe deposit box are omitted from the schedules in this return, explain fully why omitted. See Statement 1			

Item number	Description. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.	Alternate valuation date	Alternate value	Value at date of death
1	Undivided one-half interest in Royalty Interest Waverly Royalty Co., LTD. P.O. Box 22222 City, TX 77777 Value of royalty interest on date of death \$3,364 See Exhibit C-16. Less 50% Community Property: Interest of surviving spouse	CUSIP number or EIN, where applicable.		3,364. -1,682.
2	Undivided one-half interest in automobile 2010 Lexus Value of automobile on date of death \$138,930 See Exhibit C-17. Less 50% Community Property: Interest of surviving spouse			138,930. -69,465.
3	Undivided one-half interest in 50% ownership interest in Five Sisters, LLP.			
Total from continuation schedules (or additional sheets) attached to this schedule.				2,370,000.
TOTAL. (Also enter on Part 5, Recapitulation, page 3, at item 6.)				2,441,147.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA0901L 08/30/11

Schedule F – Page 13

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

Continuation of SCHEDULE F - Other Miscellaneous Property Not Reportable Under Any Other Schedule

Item no.	Description For securities, give CUSIP number, if available.	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
	EIN 75-2046465 Value of 50% ownership interest in Five Sisters, LLP on date of death \$55,000 Valuation based on County Tax Assessor records, a copy of which is attached as Exhibit C-18. Less 50% Community Property: Interest of surviving spouse				55,000. -27,500.
4	Undivided one-half interest in Spouse's 50% ownership interest in Darcy Enterprises, Inc. EIN 75-2222222 Discounted value of 50% ownership interest in Darcy Enterprises, Inc. as of date of death \$1,650,000 Fair Market Value Report attached as Exhibit C-19. Less 50% Community Property: Interest of surviving spouse				1,650,000. -825,000.
5	Undivided one-half interest in 50% ownership interest in Darcy Enterprises, Inc. EIN 75-2222222 Discounted value of 50% ownership interest in Darcy Enterprises, Inc. as of date of death \$1,650,000 Fair Market Value Report attached as Exhibit C-19. Less 50% Community Property: Interest of surviving spouse				1,650,000. -825,000.
6	Undivided one-half interest in Spouse's 50% ownership interest in DB Enterprises, Inc. EIN 62-3333333 Discounted value of 50% ownership interest in DB				
FDRL2401L 05/03/11					
TOTAL. (Carryforward to main schedule)					1,677,500.

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

Continuation of SCHEDULE F - Other Miscellaneous Property Not Reportable Under Any Other Schedule

Item no.	Description For securities, give CUSIP number, if available.	CUSIP number or EIN, where applicable	Alternate valuation date	Alternate value	Value at date of death
	Enterprises, Inc. as of date of death \$680,000. Fair Market Value Report attached as Exhibit C-20. Less 50% Community Property: Interest of surviving spouse				680,000. -340,000.
7	Undivided one-half interest in 50% ownership interest in DB Enterprises, Inc. EIN 62-3333333 Discounted value of 50% ownership interest in DB Enterprises, Inc. as of date of death \$680,000. Fair Market Value Report attached as Exhibit C-20. Less 50% Community Property: Interest of surviving spouse				680,000. -340,000.
8	Undivided one-half interest in household furnishings in 3-bedroom, 3-bathroom residence. Value of household furnishings on date of death \$25,000 Less 50% Community Property: Interest of surviving spouse				25,000. -12,500.
FDRL2401L 05/03/11					
TOTAL. (Carryforward to main schedule)					692,500.

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN
999-99-9999**SCHEDULE I – Annuities****Note.** Generally, no exclusion is allowed for the estates of decedents dying after December 31, 1984 (see instructions).

- A** Are you excluding from the decedent's gross estate the value of a lump-sum distribution described in section 2039(f)(2) (as in effect before its repeal by the Deficit Reduction Act of 1984)?.....
- If 'Yes,' you must attach the information required by the instructions.

Yes	No
	<input checked="" type="checkbox"/>

Item number	Description. Show the entire value of the annuity before any exclusions	Alternate valuation date	Includible alternate value	Includible value at date of death
1	American Annuity Company, 300 West Ave, City, TX 77777 Contract #1234567 Total distribution \$80,047.37 See Exhibit C-21. Less 50% Community Property: Interest of surviving spouse			80,047. -40,024.
Total from continuation schedules (or additional sheets) attached to this schedule.				
TOTAL. (Also enter on Part 5 – Recapitulation, page 3, at item 9.).....				40,023.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA1101L 08/29/11

Schedule I – Page 15

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

SCHEDULE J – Funeral Expenses and Expenses Incurred in Administering Property Subject to Claims**Note.** Do not list expenses of administering property not subject to claims on this schedule. To report those expenses, see instructions.

If executors' commissions, attorney fees, etc., are claimed and allowed as a deduction for estate tax purposes, they are not allowable as a deduction in computing the taxable income of the estate for federal income tax purposes. They are allowable as an income tax deduction on Form 1041, U.S. Income Tax Return for Estates and Trusts, if a waiver is filed to waive the deduction on Form 706 (see instructions for Form 1041).

Item number	Description	Expense amount	Total amount
A Funeral expenses:			
1	Casket and grave stone	5,692.	
2	Funeral Service	9,021.	
3	Funeral expenses	1,900.	
Total funeral expenses			16,613.
B Administration expenses:			
1	Executors' commissions — amount estimated /agreed upon /paid. (Strike out the words that do not apply.)		
2	Attorney fees — amount estimated / agreed upon / paid (Strike out the words that do not apply.)		13,117.
3	Accountant fees — amount estimated agreed upon /paid. (Strike out the words that do not apply.)		15,100.
4	Miscellaneous expenses:	Expense amount	
Total miscellaneous expenses from continuation schedules (or additional sheets) attached to this schedule			
Total miscellaneous expenses			
TOTAL. (Also enter on Part 5 — Recapitulation, page 3, at item 13.)			44,830.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA1201L 09/22/11

Schedule J — Page 16

Form 706 (Rev. 8-2011)

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

SCHEDULE K— Debts of the Decedent, and Mortgages and Liens

Item number	Debts of the Decedent — Creditor and nature of claim, and allowable death taxes	Amount unpaid to date	Amount in contest	Amount claimed as a deduction

Total from continuation schedules (or additional sheets) attached to this schedule.....

TOTAL. (Also enter on Part 5 — Recapitulation, page 3, at item 14.).....**0.**

Item number	Mortgages and Liens — Description	Amount
1	<p>Property taxes accrued from Jan. 1 through Nov. 30, 2011 on residence at #1 Pemberley Lane, City, TX.</p> <p>One-half value of residence included in gross estate.</p> <p>\$1,681.98 [(11 months /12) x \$1,835.00]</p> <p>Less 50% Community Property: Interest of surviving spouse</p>	<p>1,682.</p> <p>-841.</p>

Total from continuation schedules (or additional sheets) attached to this schedule.....

TOTAL. (Also enter on Part 5 — Recapitulation, page 3, at item 15.).....**841.**

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA1301L 08/29/11

Schedule K — Page 17

Form 706 (Rev. 8-2011)

Estate of: **Fitzwilliam Darcy**

Decedent's SSN

999-99-9999

SCHEDULE M – Bequests, etc., to Surviving Spouse

		Yes	No
1	Did any property pass to the surviving spouse as a result of a qualified disclaimer? If "Yes," attach a copy of the written disclaimer required by section 2518(b).	<input type="checkbox"/>	<input checked="" type="checkbox"/>
2a	In what country was the surviving spouse born?		
b	What is the surviving spouse's date of birth?		
c	Is the surviving spouse a U.S. citizen?	<input checked="" type="checkbox"/>	
d	If the surviving spouse is a naturalized citizen, when did the surviving spouse acquire citizenship?		
e	If the surviving spouse is not a U.S. citizen, of what country is the surviving spouse a citizen?		
3	Election Out of QTIP Treatment of Annuities. Do you elect under section 2056(b)(7)(C)(ii) not to treat as qualified terminable interest property any joint and survivor annuities that are included in the gross estate and would otherwise be treated as qualified terminable interest property under section 2056(b)(7)(C)? (see instructions)	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Item number	Description of property interests passing to surviving spouse. For securities, give CUSIP number. If trust, partnership, or closely held entity, give EIN.	Amount
A	QTIP property:	
B	All other property:	
1	Genworth Life Insurance Company Policy No. 0012345678 Insured: Fitzwilliam Darcy Beneficiary: Elizabeth B Darcy See Exhibit C-3 for Form 712. (Sch D, Item 1)	250,000.
2	State Life Insurance Company Policy No. 512345678 Insured: Fitzwilliam Darcy Beneficiary: Elizabeth B Darcy See Exhibit C-4 for Form 712. (Sch D, Item 2)	252,650.
Total from continuation schedules (or additional sheets) attached to this schedule		1,284,249.
4	Total amount of property interests listed on Schedule M	1,786,899.
5a	Federal estate taxes payable out of property interests listed on Schedule M	
b	Other death taxes payable out of property interests listed on Schedule M	
c	Federal and state GST taxes payable out of property interests listed on Schedule M	
d	Add items 5a, 5b, and 5c	
6	Net amount of property interests listed on Schedule M (subtract 5d from 4). Also enter on Part 5 – Recapitulation, page 3, at item 20	1,786,899.

(If more space is needed, attach the continuation schedule from the end of this package or additional sheets of the same size.)

BAA

FDRA1502L 09/23/11

Schedule M – Page 19

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN

999-99-9999

Continuation of SCHEDULE M - Bequests, etc., to Surviving Spouse

Item no.	Description of property interests passing to surviving spouse	Amount
B	All other property:	
3	The Northwestern Mutual Life Insurance Company Policy #12345678 Insured: Fitzwilliam Darcy Beneficiary: Elizabeth B Darcy See Exhibit C-5 for Form 712. (Sch D, Item 3)	279,702.
4	First Bank P.O. Box 200 City, TX 77777 Account #0000001234567 Balance at date of death \$75,049.47 Accrued unpaid interest through date of death \$254.70 See Exhibit C-6. (Sch E, Part 1, Item 1)	37,652.
5	Second Bank 4256 Oak Road City, TX 77777 Certificate of Deposit #1301 Value at date of death \$582,421.99 Accrued unpaid interest through date of death \$1,801.62 See Exhibit C-7. (Sch E, Part 1, Item 2)	292,112.
6	Third Bank PO Box 205 City, TX 77777 Certificate of Deposit #3103 Value at date of death \$508,196.20 Accrued unpaid interest through date of death \$1,572.00 See Exhibit C-8. (Sch E, Part 1, Item 3)	254,884.
7	Commercial State Bank PO BOX 560 City, TX 77777 Checking Account #91546789 Balance at date of death \$11,589.42 See Exhibit C-9. (Sch E, Part 1, Item 4)	5,795.
8	Fourth Bank PO BOX 1090 City, TX 77777 DDA Account #16738648 Balance at date of death \$263.51 See Exhibit C-10. (Sch E, Part 1, Item 5)	132.
9	5th Bank 890 Hampton Way City, TX 77777 Certificate of Deposit #9204 Balance at date of death \$254,098.10 Accrued unpaid interest from date of last interest payment to date of death \$784.78 See Exhibit C-11. (Sch E, Part 1, Item 6)	127,441.
FDRL0502L 05/03/11 Total. (Carryforward to main schedule)		997,718.

Form 706

Estate of: Fitzwilliam Darcy

Decedent's SSN


999-99-9999

Continuation of SCHEDULE M - Bequests, etc., to Surviving Spouse

Item no.	Description of property interests passing to surviving spouse	Amount
B	All other property:	
10	National Bank PO Box 600 City, TX 77777 Account #00000079501234 Balance as of date of death \$3,215.07 Accrued unpaid interest through date of death \$8.20 See Exhibit C-12. (Sch E, Part 1, Item 7)	1,612.
11	Peoples Bank 591 Main St. City, TX 77777 Account #00000088888 Balance at date of death \$129,682.91 Accrued unpaid interest through date of death \$508.97 See Exhibit C-13. (Sch E, Part 1, Item 8)	65,096.
12	North Bank PO BOX 444 City, TX 77777 Account #56789 Balance at date of death \$127,331.75 Accrued unpaid interest through date of death \$15.81 See Exhibit C-14. (Sch E, Part 1, Item 9)	63,674.
13	Last Bank P.O. Box 222 City, TX 77777 Account #84046777 Balance at date of death \$68,312.73 Accrued unpaid interest through date of death \$9.42 See Exhibit C-15. (Sch E, Part 1, Item 10)	34,161.
14	Undivided one-half interest in automobile 2010 Lexus Value of automobile on date of death \$138,930 See Exhibit C-17. (Sch F, Item 2)	69,465.
15	Undivided one-half interest in household furnishings in 3-bedroom, 3-bathroom residence. Value of household furnishings on date of death \$25,000 (Sch F, Item 8)	12,500.
16	American Annuity Company, 300 West Ave, City, TX 77777 Contract #1234567 Total distribution \$80,047.37 See Exhibit C-21. (Sch I, Item 1)	40,023.
FDRL0502L 05/03/11 Total. (Carryforward to main schedule)		286,531.


Gift and Estate Tax Returns: Nuts, Bolts, & Some Monkey Wrenches, Too

Tina R. Green
Nikki L. Laing
Capshaw Green, PLLC



Introduction

- Scope of Outline
- Federal Wealth Transfer Taxes:
 - Gift Tax
 - Estate Tax
 - Generation-Skipping Transfer Tax
- Other resources available

(Page 1 of Outline)




Gift Tax Overview

Major Tax Legislation

- 1976 Tax Reform Act
 - Unification
- 1981 Economic Recovery Tax Act
 - ↑ annual gift tax exclusion
 - Qualified education and medical expenses exemption
 - Certain transfers between spouses

[Pages 1-2 of Outline]

4

Tax Legislation Cont.

- 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA)
 - ↓ the estate/gift/GST tax rates
 - ↑ the exemption amounts
 - Decouples the gift/estate tax exemptions

[Pages 1-2 of Outline]

5

Tax Legislation Cont.

- Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010
 - Estate tax regime implemented
 - Top rate of 35%
 - Exemptions
 - Extends state death tax deduction
 - Portability of unused exemption

[Pages 1-2 of Outline]

6

Lifetime Giving

- **Outright Gift:**
Donor transfers asset directly to Donee
- **Inter Vivos Trust:**
Donor transfers asset to Trust
for the benefit of Donee



[Page 2 of Outline]

7

Advantages of Lifetime Giving

Present interest annual exclusion:

- \$13,000 per Donee
- Husband + Wife = \$26,000 per Donee
- No similar exclusion for estate tax



[Page 2 of Outline]

8

Advantages of Lifetime Giving

Present interest annual exclusion: Example

- Mr. and Mrs. Bennet
- Gift \$26,000 to each of 5 daughters
- Not a reportable gift
- No gift tax



9

Advantages of Lifetime Giving

Present interest annual exclusion: Example

- Mr. Bennet—\$5,185,000 estate
- Gift \$13,000 to each of 5 daughters (\$65K)
- Not a reportable gift
- No gift tax
- Eliminates estate tax by reducing estate to \$5,120,000



10

Advantages of Lifetime Giving

Remove post-gift appreciation

- Appreciation not included in tax base
- Freeze value at date of gift
- Assets with appreciation potential—gift now
- Loss property—sell
- Transfer vs. Income Tax



(Page 3 of Outline)

11

Advantages of Lifetime Giving

Remove post-gift appreciation: Example

- Maximilian intends to gift Manderley
 - FMV \$4 million today
 - FMV \$6 million in 5 years
- Lifetime Gift vs. Devise
 - Removes \$2 million from estate tax base



12

Advantages of Lifetime Giving

Exclusive rather than inclusive

- Gift tax is not included in transfer tax base
- Estate tax is included in transfer tax base
- Lifetime: donee receives full value of gift
- Death transfer: donee receives net value



[Page 3 of Outline]

13

Advantages of Lifetime Giving

Exclusive rather than inclusive: Example

- Rochester gifts \$10 million estate to Jane
- Gift tax assessed on value of \$10 million
- Rochester pays gift tax of \$3.5 million
- Jane receives \$10 million gift



14

Advantages of Lifetime Giving

Exclusive rather than inclusive: Example

- Rochester dies owning \$10 million estate
- Estate tax assessed \$10 million estate
- Estate pays estate tax of \$3.5 million
- Jane receives \$6.5 million gift



15

Advantages of Lifetime Giving

Remove gift tax from estate tax base

- Gift tax excluded from gross estate
- Exception: Gross-up Rule
 - Inclusion of gift tax paid on gift made within 3 years of death



[Page 3 of Outline]

16

Advantages of Lifetime Giving

Shift income

- Gift to Donee with lower tax bracket
- Income tax savings for Donor
- Accumulated post-gift income excluded from Donor's estate



[Page 3 of Outline]

17

Advantages of Lifetime Giving

Shift income: Example

- Heathcliff wishes to transfer asset to Cathy
- Transfer now: income taxed at Cathy's rate
- Transfer now: all post-gift income excluded from Heathcliff's estate
- Transfer at death: all post-gift income taxed at Heathcliff's rate and included in his estate



18

Advantages of Lifetime Giving

Equalize estates between spouses

- Utilize full unified credit
- Step-up in Donee's basis upon death
 - Exception: one-year rule
- Portability – Is this still needed?



[Page 3 of Outline]

19

Advantages of Lifetime Giving

Charitable income tax deduction

- Lifetime vs. Death transfer to charity
 - Transfer tax—no difference
 - Income tax—different result
- Lifetime Gift to Charity:
 - income tax deduction
- Devise to Charity:
 - no income tax deduction



[Page 3 of Outline]

20

Disadvantages of Lifetime Gifts

Loss of step-up in basis

- Lifetime: Donor's basis transfers to Donee
- Devise: Donee's basis stepped up to FMV
- Tax rates: 15% vs. 35%+



[Page 4 of Outline]

21

Disadvantages of Lifetime Gifts

Pre-payment of estate tax

- Pay now or later?



[Page 4 of Outline]

22

Monkey Wrenches: Lifetime Gifts

- 3-year Gross-up Rule
- Loss of control over property
- No step-up in basis



[Page 4 of Outline]

23

2010 Tax Relief Act

- 2010 – Gift Tax only
- Change December 17, 2010
- 2011 Gift Tax Exemption
- Prior years' gifts determined
- Gifting ability in 2011 – 2012
- 2013?

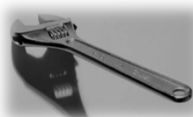


[Page 4 of Outline]

24

Monkey Wrenches: Planning

- Ever-changing laws
- Fluid exemptions
- Tax consequences vary from year to year
- Multiple revisions to client's estate plans
- Unpredictability



[Page 5 of Outline]

25

Form 709: Who?

- Individual
- U.S. Citizen or Resident
- Reportable gift
- Does not file Form 709:
 - Trust
 - Estate
 - Partnership
 - Corporation



[Page 5 of Outline]

26

Form 709: When?

- Gift over annual exclusion (\$13,000)
- Gift of future interest
- Gift split between spouses
- Gift of community property exceeding two times Annual Exclusion (2 x \$13,000)
- Below-market sale



[Page 5 of Outline]

27

Form 709: When?

- General Power of Appointment:
 - Exercise/Release
- Miscellaneous Gifts:
 - Forgiveness of debt
 - Interest-free or below-market loan
 - Assignment of life insurance proceeds
 - Certain divorce property settlements



[Page 5-6 of Outline]

28

Form 709: When?

Do not file for:

- Gift to spouse which qualifies for marital deduction
- Gift of present interest below annual exclusion threshold (\$13,000)
- Gift which qualifies for medical or educational exclusion
- Qualified charitable gifts
- Political contributions



[Page 6 of Outline]

29

Marital Deduction

Marital Deduction Gift Exclusion:

- Must be included in the spouse's gross estate for gift/estate tax purposes
- Must pass in a qualifying manner
- Must not be a nondeductible terminal interest



[Page 6 of Outline]

30

Annual Exclusion

Present Interest Annual Exclusion Gift:

- Currently \$13,000 per person/per calendar year
- Right to immediately use, possess, and enjoy
- Gift to a minor
 - Benefit of minor before 21
 - Distribute at age 21
 - Payable to minor's estate/GPOA



[Page 6 of Outline]

31

Educational Exclusion

Educational Gift Exclusion:

- Directly to qualifying education organization
- Used for tuition
- Does not qualify if used to pay:
 - Books
 - Supplies
 - Room and board
 - Fund a 529 plan



[Page 6 of Outline]

32

Medical Exclusion

Medical Gift Exclusion:

- Paid to person/institution that provided medical care
- Must be paid directly to provider
- Includes expenses for:
 - Diagnoses, cure, mitigation, treatment or prevention of disease
 - Costs of transportation
 - Medical Insurance payment



[Page 6 of Outline]

33

Charitable Exclusion

Qualified Charitable Gift Exclusion:

- Must be deductible
- Charity receives entire interest
- Donor required to report if a Form 709 is required for other gifts



[Page 6 of Outline]

34

Form 709: Gift-Splitting Election

Gift-Splitting Election:

- Married Donors
- Gift to third party
- Each spouse treated as making $\frac{1}{2}$ of gift
- Benefit: allows use of two annual exclusions for one recipient
- Donors make election on Form 709



[Page 7 of Outline]

35

Qualified Tuition Program— “529” Plan

- Do not qualify under educational exclusion
- Gift up to 5 x annual gift exclusion
- Report gift in year 1
- Account for gift ratably over 5 years
- No additional gift tax returns required



[Page 7 of Outline]

36

Form 709: How?

Calculation of Gift Tax:

See Appendix B



[Page 19 of Outline]

37

Form 709: Due Date

- Calendar-year basis
- Generally due April 15 following year of gift
- Exception: if donor dies early in tax year
 - DOD – 3/1/2012
 - Estate Tax Return – due 12/1/2012
 - Gift Tax Return – due 12/1/2012



[Page 7 of Outline]

38

Form 709: Extension

- Donor files request to extend time to file income tax return (Form 4868)

or

- Donor files request to extend time to file gift tax return (Form 8892)



[Page 7 of Outline]

39

Form 709: Where?

Internal Revenue Service Center
Cincinnati, Ohio 45999



[Page 8 of Outline]

40

Gift Tax: Who is Liable?

- Donor is responsible for paying gift tax
- Donee becomes liable if Donor fails to pay
 - Limit: FMV of gift
- Gift-split:
 - J&S liability of spouses



[Page 8 of Outline]

41

Gift Tax: Statute of Limitations

- Generally, 3 years
- Increased to 6 years for omission of gifts valued in excess of 25% of reported value
- No gift tax return—SOL doesn't begin to run!



[Page 8 of Outline]

42

Gift Tax: Statute of Limitations

- No re-valuing of prior gifts if adequate disclosure
- Adequate Disclosure:
 - Description
 - Consideration received by Donor
 - Donor/Donee's identity & relationship
 - Information on trust
 - Valuation method
 - Statement of contrary position (if any)



[Page 8 of Outline]

43

Gift Tax Return

- Sample Gift Tax Return

See Appendix F



[Page 23 of Outline]

44

Estate Tax Overview



45

Form 706: What?

- Snapshot of financial situation
- Does not:
 - Establish value of Decedent's assets at death
 - Establish amount of estate tax due



[Pages 8-9 of Outline]

46

Form 706: Who?

- Decedent's executor is charged with duty of filing
- If no executor, persons in possession of Decedent's property are treated as executors



[Page 9 of Outline]

47

Form 706: When?

- Must file if estate tax base is over the exemption amount (\$5,120,000 for 2012)
- See Appendix A
- Adjustments:
 - Post – 1976 Taxable Gifts
 - Exemption for Certain 1976 Gifts
 - Finality of gift tax value



[Page 9 of Outline]

48

2010 Tax Relief Act

- Applicable Exclusion Amount
- Rate of Estate Tax
- Election out of the Estate Tax
- Portability

[Pages 9-10 of Outline]



49

Portability Election

- Allows Surviving Spouse to use deceased spouse's unused exclusion amount
- Deceased Spouse's Executor makes election by filing timely Form 706
- For estates under basic exclusion amount, no need for formal valuation of property that qualifies for Marital/Charitable Deduction

[Pages 10-11 of Outline]



50

Portability Election

- Election effective as of date of death
- Basic Exclusion Amount ("BEA")
- DSUE amount ("DSUEA")
- Gifts by Surviving Spouse:
 - Apply DSUEA before Surviving Spouse's BEA
- Transfers at death by Surviving Spouse:
 - Apply DSUEA + BEA

[Pages 10-11 of Outline]



51

Portability Election

- Decedents dying after December 31, 2010
- Set to expire December 31, 2012
- Does NOT apply to unused GSTT exemption

[Pages 10-11 of Outline]



52

Portability Election

- Extends IRS period of review for limited purpose of reviewing DSUEA valuations
- Effectively extends statute of limitations
- Applies to valuation of DSUEA applied to any transfers by Surviving Spouse

[Page 11 of Outline]



53

Portability Election

- Special Extension
- Decedent who died Jan – Jun 2011
- Estate FMV does not exceed \$5 million
- File Extension + Form 706 within 15 months from date of death

[Page 11 of Outline]



54

Monkey Wrenches: Portability

- Does not apply to unused GSTT exemption
- Applies only to decedents dying on or after January 1, 2011
- What happens after 2012?



[Page 11 of Outline]

55

Gross Estate

- Deductions
-
- = Tentative Taxable Estate
-
- State Death Tax Deduction
-
- = Taxable Estate

[Page 20 of Outline]

56

The Gross Estate

Everything—including the Kitchen sink!

- All property in which Decedent had an interest:
 - Residences
 - Real estate
 - Vehicles
 - Intangible assets
 - Stocks
 - Remainder interests
 - Life insurance policies



[Page 11 of Outline]

57

The Gross Estate

Gifts within 3 years of death

- Transfer of:
 - Life insurance policy
 - Interest covered under § 2036, § 2037, or § 2038
- Gross-up Rule:
 - Gift tax paid
 - W/in 3 years of death
 - On any property



[Page 12 of Outline]

58

The Gross Estate

Transfers with retained life estate

- Decedent retained:
 - Possession/Enjoyment of property
 - Right to receive income from property
 - Right to designate recipient of possession/enjoyment/income
 - Voting rights in stock of controlled corporation



[Page 12 of Outline]

59

The Gross Estate

Transfers taking effect at death

- Earlier transferred property where Decedent requires donee to survive Decedent in order to take ownership of property
- Value of Decedent's reversionary interest exceeds 5% of property



[Page 12 of Outline]

60

The Gross Estate

Revocable Trust

- Assets in a revocable trust
- All transfers over which Decedent (at death) had power to change the enjoyment of a property interest:
 - Alter
 - Amend
 - Revoke
 - Terminate



[Page 12 of Outline]

61

The Gross Estate

Annuities

- Payments made under contract/agreement
- Decedent was receiving or had a right to collect payments at time of death
- Payment term:
 - Length of Decedent's life
 - Based on Decedent's life
 - Does not end before Decedent's death



[Page 12 of Outline]

62

The Gross Estate

Joint Interests

- Property jointly owned with another
- Query—relationship between owners
- Spouses—50/50
- Non-spouses—consideration-furnished test



[Page 12 of Outline]

63

The Gross Estate

Powers of Appointment

- Include property over which Decedent possessed general power of appointment
- GPOA: decedent/estate/creditors of estate
- Applies even if Decedent never owned interest in property
- Excludes ascertainable standard (HEMS)



[Page 12 of Outline]

64

The Gross Estate

Life Insurance Proceeds

- Included if Decedent's estate is beneficiary
- Included if Decedent had incidents of ownership
- Remember Three-year Rule!



[Page 13 of Outline]

65

The Gross Estate

Life Insurance Proceeds

- "Incidents of Ownership" includes power to:
 - Change beneficiary
 - Surrender or cancel policy
 - Revoke an assignment of the policy
 - Borrow against policy
 - Pledge policy



[Page 13 of Outline]

66

The Gross Estate

Marital Deduction Property

- QTIP trust property from spouse who predeceased Decedent
- Not included if Decedent disposes of all QTIP property before death



[Page 13 of Outline]

67

The Gross Estate

Gathering Information

- Sources:
 - Client, CPA, banker, financial advisor
- Documents:
 - Insurance policies
 - Bank statements
 - Tax returns
 - Credit reports
 - Public records



68

The Gross Estate

Valuation of Assets

- Fair Market Value on date of death
- Alternate Valuation Date
 - 6 months after date of death
 - or
 - Date of disposal, if earlier



[Page 13 of Outline]

69

The Gross Estate

Valuation of Assets

- Fair Market Value on date of death
- Alternate Valuation Date
 - 6 months from date of death or date of disposal, if earlier than 6-month mark
 - ONLY if decreases both:
 - Value of gross estate
 - and
 - Estate tax liability



[Page 13 of Outline]

70

Gross Estate

- Deductions

= Tentative Taxable Estate

- State Death Tax Deduction

= Taxable Estate

[Page 20 of Outline]

71

Deductions from Gross Estate

- Funeral expenses, costs of administration, and Decedent's debts
- Casualty and theft losses
- Marital deduction
- Charitable deduction



[Page 14 of Outline]

72

Deductions from Gross Estate

Expenses, Indebtedness, and Taxes

- Mortgages and other debts
- Funeral expenses
- Costs of administering the estate
 - Executor's commissions
 - Attorneys' fees
 - Court costs
 - Accountants' fees
 - Appraisers' fees
- Form 706 or Form 1041



[Page 14 of Outline]

73

Deductions from Gross Estate

Losses

- Theft
- Casualty loss
- Incurred while estate is being administered
- 706 or 1041



[Page 14 of Outline]

74

Deductions from Gross Estate

Charitable Transfers

- Public, charitable, or religious use
- Unlimited deduction
- Potential to eliminate estate tax completely by devising all property in excess of applicable exclusion amount to charity
- Consider lifetime transfer
 - Income tax deduction



[Page 14 of Outline]

75

Deductions from Gross Estate

Marital Deduction

- Unlimited marital deduction for qualifying transfers to surviving spouse
- Must pass in qualifying manner
- Must be subject to gift/estate tax when transferred by surviving spouse



[Page 14 of Outline]

76

Deductions from Gross Estate

Marital Deduction

- Must not be non-deductible terminal interest property
- QTIP:
 - Mandatory income to SS
 - For sole benefit of SS
 - No POA except to SS



[Page 14 of Outline]

77

Gross Estate

- Deductions

= **Tentative Taxable Estate**

- State Death Tax Deduction

= Taxable Estate

[Page 20 of Outline]

78

State Death Tax Deduction

- Credit prior to 2005
- Deduction for estates of decedents dying after December 31, 2004
- Subtracted as separate line item



[Page 15 of Outline]

79

Gross Estate

- Deductions
-
- = Tentative Taxable Estate
-
- State Death Tax Deduction
-
- = **Taxable Estate**

[Page 20 of Outline]

80

Adjusted Taxable Gifts

- All taxable gifts made after 1976
- Report at date-of-gift value



[Page 15 of Outline]


81

Taxable Estate
+ Adjusted Taxable Gifts
= **Estate Tax Base**

[Page 20 of Outline]
82

Tentative Tax

- Calculate using Unified Rate Schedule
- See Appendix E



[Page 15 of Outline]
83

Estate Tax Base
x Applicable Estate Tax Rate
= **Tentative Estate Tax**
- Gift Taxes Payable
= Gross Estate Tax

[Page 20 of Outline]
84

Gift Taxes Paid & Payable

- Gift taxes paid on post-1976 gifts
- Calculate gift taxes “payable” on post-1976 gifts, using current tax rates



[Page 15 of Outline]

85

$$\begin{array}{rcl}
 & \text{Estate Tax Base} & \\
 \times & \text{Applicable Estate Tax Rate} & \\
 \hline
 = & \text{Tentative Estate Tax} & \\
 - & \text{Gift Taxes Payable} & \\
 \hline
 = & \text{Gross Estate Tax} &
 \end{array}$$

[Page 20 of Outline]

86

Allowable Unified Credit

- Maximum Unified Credit
 - Tentative tax on estate’s applicable exclusion amount
 - Less: certain 1976 gifts



[Page 15 of Outline]

87

Gross Estate Tax

- **Allowable Unified Credit**
- Credit for Foreign Death Tax
- Credit for Tax on Prior Transfers


= Net Estate Tax

[Page 20 of Outline]

88

Additional Credits

- Credit for foreign death taxes
- Credit for tax on prior transfers
 - Tentative tax on estate's applicable exclusion amount
 - Less: certain 1976 gifts



[Page 15 of Outline]

89

Gross Estate Tax

- Allowable Unified Credit
- Credit for Foreign Death Tax
- Credit for Tax on Prior Transfers

= **Net Estate Tax**

[Page 20 of Outline]

90

Form 706: Due Date

- Due within 9 months after death
- Example:
 - January 2 – October 2
 - May 30 – February 28 (or 29 if leap year)
- Weekend or legal holiday?
 - Due next day which is not a weekend or legal holiday



[Page 16 of Outline]

91

Form 706: Extension

- Maximum extension is 6 months
- Due within 15 months after death
- No extension of payment of tax
- Form 4768
- Must request extension before due date of the Form 706



[Page 16 of Outline]

92

Form 706: Documents

- Death Certificate
- Certified copy of the Will
- Listing and valuation of QTIP
- Copies of all gift tax returns
- Copies of appraisals
- Forms 712
- Copies of trust agreements



[Page 16 of Outline]

93

Form 706: Documents

- Copies of instruments for lifetime transfers
- Certified/verified copies of documents granting Decedent any type of POA
- Certified copy of Order admitting Will to probate



[Page 16 of Outline]

94

Form 706: Execution

- Must be signed by all executors
- File one original with IRS



[Page 16 of Outline]

95

Form 706: Where?

Internal Revenue Service Center
Cincinnati, Ohio 45999



[Page 16 of Outline]

96

Sample Form 706

- Sample Form 706

See Exhibit G



[Page 28 of Outline]

97

Tax Return Preparer Penalties

- Preparer is subject to penalties
- 2007 Act broadened definition of a preparer to all tax return preparers
- Penalties for understatements:
 - From \$250 to \$1,000 or 50% of income derived by preparer

Adequate Disclosure – KEY!



[Page 16 of Outline]

98

Conclusion



