

# Avoiding Common Gift Tax Return Preparation Errors

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**Why is this topic even relevant?**

- Annual revenues from gift taxes were around \$3 billion dollars in 2010 and \$6.5 billion dollars in 2011 (and probably even higher in 2012) [per IRS Data Book, Summary Internal Revenue Collections]
- 0.75% of gift tax returns were audited in 2010 while that number increased to 1.2% for 2011 (and is expected to rise even more substantially for 2012) [per IRS Data Book, Examination Coverage]
- Relative to the number of Forms 706 and 709 filed, estate tax related work results in a disproportionately high rate of malpractice claims and insurance payouts related to those claims are also disproportionately high (both in terms of dollars involved and number of cases resulting in a payout) compared to claims of other types, both in the legal and accounting professions.

**How to avoid common mistakes on gift tax returns:**

1. File the return and file it on time.
  - a. The extension is only an extension of time to file and NOT an extension of time to pay.
  - b. The extension to file the individual return (Form 4868) also extends the time to file the Form 709.
  - c. If the Form 1040 is filed on time, but the gift tax return needs an extension, a Form 8892 MUST be filed in order to avoid late filing.
  - d. Make sure to check the box on Line 9 if extension was filed.
  - e. The CPA should include in the annual organizer and check with the client every year whether or not the client made any gifts. Both the CPA and the attorney should be on the lookout for any unintentional gifts (see item 2 below for more detail on this).
2. Make sure that the proper person reports the proper gift. (This is a complex topic on its own)
  - a. 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 GST taxes.
  - b. Be on the lookout for less obvious and sometimes unintentional gifts, like forgiveness of debt, interest-free or below market interest loans, exercise or release of a general power of appointment, etc. Issues pertaining to Joint Tenancy (property, bank accounts,

investments, etc.) can also result in unintentional gifts (or intentional gifts that are frequently excluded from the Forms 709 by accident).

3. Make sure that a properly trained CPA with experience in this area is involved (or if you are a CPA, then make sure that an attorney is involved)
  - a. Both the CPA and the attorney should review the Form 709 prior to submission.
4. Read the instructions to the Form 709! It has a lot of valuable information and many of them change from year to year. ([www.irs.gov/pubs/irs-pdf/i709.pdf](http://www.irs.gov/pubs/irs-pdf/i709.pdf))
5. Review the applicable trust documents (and any other related legal documents) and confirm with the attorney that your interpretation/understanding of it is the same.
  - a. Contact the drafter of the document, if necessary.
6. Review Forms 709 filed for prior years (at least the ones for the last 2-3 years)
  - a. This is especially true if they were prepared by someone else (be on the lookout for prior errors that could accumulate over time and result in unnecessary gift tax or waste of exclusion amounts).
7. Make sure you have properly prepared and supported valuations (especially where valuation discounts apply)
  - a. Valuation disagreements are a very common part of gift tax audits (and can potentially result in a malpractice claim if the examination outcome is not favorable to the taxpayer).
  - b. Use of an expert valuation company with a good reputation can reduce the chance of IRS disagreements. Hence, I recommend using them even for valuation of gift of publicly traded stock or other easy to value items.
  - c. Valuation discounts are very frequently questioned under examination. Have all necessary support available prior to filing the return. Make sure that all parties involved (client, attorney, CPA, etc.) are aware of the position(s) taken and the potential negative consequences if successfully challenged by IRS (i.e.: additional gift tax due or further reduction of remaining exemption).
8. Attach all required attachments to the Form 709.
  - a. Valuation/appraisal reports.
  - b. If the transfer is in trust, a brief description of the terms of the trust or a copy of the trust document.
  - c. Form 706, if portability was elected and Deceased Spousal Unused Exclusion (DSUE) is being used on the Form 709.
  - d. Many times the space provided is not sufficient to list the necessary information, so attachments are needed to provide all required details. Do not forget to attach those to the final copy.
9. Gift splitting is NOT automatic!
  - a. Gift splitting has to be elected and consented to by each spouse on separate Forms 709. (each spouse must sign the other spouse's Form 709 on line 18)
  - b. There is no such thing as a joint gift tax return, so both husband and wife will have to file a Form 709, if gifts are split.
  - c. Gift of community property or property held as joint tenants or tenants by the entirety also require separate gift tax returns by each spouse.

10. NEW LINE and NEW SCHEDULE for 2012 (Part1, Line 19 and Schedule C)

- a. If portability is elected, a donor may use the unused exclusion amount of a spouse that died after 12/31/2010.
- b. If DSUE is being applied, Line 19 on page 1 has to be checked and Schedule C has to be completed.
- c. Schedule C is easy to complete if all information is available. This will make it even more important to review prior years' gift tax returns as in 10-15 years tracking the received, used, and remaining DSUE amounts will be very complicated, if not impossible, without copies of prior gift tax returns.

11. Effects on GST tax where intervening parent is deceased.

- a. If a donor made a gift to his grandchild and at the time the gift was made, the child's parent (the donor's child) was deceased, then for GST purposes, the grandchild is considered to be the child of the donor.
- b. Same applies to gifts to great-grandchildren in case the grandchild is deceased at the time of the gift (or to any gap in lineal descendants).

12. Potential pitfalls on Schedule A, Parts 1, 2, and 3 (page 2 of Form 709)

- a. Make sure to include all required details, especially in column B. (this will most likely require an attachment)
- b. If you elect to split gifts with your spouse, you must split all gifts made by you and your spouse to third parties (unless you gave the spouse a general power of appointment over a gift).
- c. A gift can only go in the section for gifts made by you or gifts made by the spouse; never both. Similarly, a gift can only go in Part 1, 2, OR 3; never list a gift in more than one part.
- d. Make sure to properly allocate all gifts between Parts 1, 2, and 3. This is where proper cooperation between attorney, CPA, and client is crucial. Also, without having a copy of and reading the trust document that applies to the gift, you will most likely make an incorrect allocation.
- e. Under Part 2 (Direct Skips), you have to elect out of the automatic allocation rules of IRC Section 2632(b), if so desired.
- f. Under Part 3 (Indirect Skips), if so desired, the automatic allocation of the donor's unused GST exemption to indirect skips under IRC Section 2632(c) has to be specifically elected (the allocation is automatic, but the election is not). Furthermore, there are 3 different types of election can be made, so an attachment has to be prepared describing the specific election being made and the trusts and/or transfers to which the election applies.
- g. Make sure that the trustee complies with the annual Crummey notice requirements! This step is usually forgotten about as the years go by, but in case of an exam, it can create some major headaches (and potential malpractice issues) for the attorney, the CPA, and the trustee.
  - i. Failure to provide annual notices to the beneficiaries of their right to withdraw disqualifies for the annual gift tax exclusion the owner's annual additions to the trust. The result is that the gifts fail to qualify as a present interest and all of the

gifts that the owner has made to the trust may be taxable gifts that reduce the owner's lifetime gift tax exemption.

13. Schedule A, Part 4, Taxable Gift Reconciliation

- a. This part can get tricky when splitting gifts with spouse.
- b. Line 2 equals the grand total of the smaller of (1) the annual exclusion or (2) the half of the total split gift for each gift (amount will not be divisible by \$13K if any of the split gifts are under \$26K).
- c. Lines 4 through 7 are only completed for donor spouse. Those lines are left blank for the donee spouse (the one receiving the gift). [Premium payments to an ILIT by one spouse benefiting the other spouse is an example where this will become an issue.]
- d. The QTIP election under IRC Section 2523(f)(6) is automatic. If you want to elect out of it, the box on Line 12 must be checked and you cannot include that amount on Line 4. The election is irrevocable, so this is another instance where the client, the attorney, and the CPA must be in agreement with the position taken.

14. Schedule B, Gifts From Prior Periods

- a. Schedule B is relatively simple to complete. However, it is impossible to do without copies of prior gift tax returns. Hopefully, the most recent one filed will have a complete list of prior gifts. If a gap is noted for people who usually make annual gifts, an inquiry should be made as to the reason for the gap in gift tax returns filed.

15. Schedule D (formerly, Schedule C), Computation of GST Tax

- a. This schedule is generally only applicable when items are listed on Part 2 of Schedule A (Direct Skips).
- b. The only potential major pitfall here is Line 6, which applies in case the taxpayer wants to allocate the GST exemption to transfers not reported on the return being filed, such as a late allocation (which can be intentional and a part of good planning in case the assets fall in value after gifting).

Form **709**Department of the Treasury  
Internal Revenue Service**United States Gift (and Generation-Skipping Transfer) Tax Return**► Information about Form 709 and its separate instructions is at [www.irs.gov/form709](http://www.irs.gov/form709).

(For gifts made during calendar year 2012)

► See instructions.

OMB No. 1545-0020

**2012****Part 1—General Information**

1	Donor's first name and middle initial	2	Donor's last name	3	Donor's social security number	
4	Address (number, street, and apartment number)			5	Legal residence (domicile)	
6	City, state, and ZIP or postal code			7	Citizenship (see instructions)	
8	If the donor died during the year, check here <input type="checkbox"/> and enter date of death				Yes	No
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. ►					
11a	Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b					
b	Has your address changed since you last filed Form 709 (or 709-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.)					
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 ►

19 Have you applied a DSUE amount received from a predeceased spouse to a gift or gifts reported on this or a previous Form 709? If "Yes," complete Schedule C

**Part 2—Tax Computation**

1	Enter the amount from Schedule A, Part 4, line 11	1	
2	Enter the amount from Schedule B, line 3	2	
3	Total taxable gifts. Add lines 1 and 2	3	
4	Tax computed on amount on line 3 (see <i>Table for Computing Gift Tax</i> in instructions)	4	
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	
7	Applicable credit amount. If donor has DSUE amount from predeceased spouse(s), enter amount from Schedule C, line 5; otherwise, see instructions	7	
8	Enter the applicable credit against tax allowable for all prior periods (from Sch. B, line 1, col. C)	8	
9	Balance. Subtract line 8 from line 7. Do not enter less than zero	9	
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	
12	Applicable credit. Enter the smaller of line 6 or line 11	12	
13	Credit for foreign gift taxes (see instructions)	13	
14	Total credits. Add lines 12 and 13	14	
15	Balance. Subtract line 14 from line 6. Do not enter less than zero	15	
16	Generation-skipping transfer taxes (from Schedule D, Part 3, col. H, Total)	16	
17	Total tax. Add lines 15 and 16	17	
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 <b>balance due</b> (see instructions)	19	
20	If line 18 is greater than line 17, enter <b>amount to be refunded</b>	20	

**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.

Signature of donor

Date

May the IRS discuss this return with the preparer shown below (see instructions)? ☐ Yes ☐ No**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.			

Attach check or money order here.

**SCHEDULE A Computation of Taxable Gifts** (Including transfers in trust) (see instructions)**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)

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

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 . . . . . ▶**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.

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

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.

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

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 . . . . . ▶

(If more space is needed, attach additional statements.)

**Part 4—Taxable Gift Reconciliation**

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

**Terminable Interest (QTIP) Marital Deduction.** (see instructions for Schedule A, Part 4, line 4)

If a trust (or other property) meets the requirements of qualified terminable interest property under section 2523(f), and:

- a.** The trust (or other property) is listed on Schedule A, and
- b.** The value of the trust (or other property) is entered in whole or in part as a deduction on Schedule A, Part 4, line 4, then the donor shall be deemed to have made an election to have such trust (or other property) treated as qualified terminable interest property under section 2523(f).

If less than the entire value of the trust (or other property) that the donor has included in Parts 1 and 3 of Schedule A is entered as a deduction on line 4, the donor shall be considered to have made an election only as to a fraction of the trust (or other property). The numerator of this fraction is equal to the amount of the trust (or other property) deducted on Schedule A, Part 4, line 6. The denominator is equal to the total value of the trust (or other property) listed in Parts 1 and 3 of Schedule A.

If you make the QTIP election, the terminable interest property involved will be included in your spouse's gross estate upon his or her death (section 2044). See instructions for line 4 of Schedule A. If your spouse disposes (by gift or otherwise) of all or part of the qualifying life income interest, he or she will be considered to have made a transfer of the entire property that is subject to the gift tax. See *Transfer of Certain Life Estates Received From Spouse* in the instructions.

**12 Election Out of QTIP Treatment of Annuities**

- ☐ Check here if you elect under section 2523(f)(6) **not** to treat as qualified terminable interest property any joint and survivor annuities that are reported on Schedule A and would otherwise be treated as qualified terminable interest property under section 2523(f). See instructions. Enter the item numbers from Schedule A for the annuities for which you are making this election ►

**SCHEDULE B Gifts From Prior Periods**

If you answered "Yes," on line 11a of page 1, Part 1, see the instructions for completing Schedule B. If you answered "No," skip to the Tax Computation on page 1 (or Schedules C or D, if applicable). Complete Schedule A before beginning Schedule B. See instructions for recalculation of the column C amounts. Attach calculations.

<b>A</b> Calendar year or calendar quarter (see instructions)	<b>B</b> Internal Revenue office where prior return was filed	<b>C</b> Amount of applicable credit (unified credit) against gift tax for periods after December 31, 1976	<b>D</b> Amount of specific exemption for prior periods ending before January 1, 1977	<b>E</b> Amount of taxable gifts
<b>1</b>	Totals for prior periods . . . . .	<b>1</b>		
<b>2</b>	Amount, if any, by which total specific exemption, line 1, column D is more than \$30,000 . . . . .	<b>2</b>		
<b>3</b>	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. . . . .	<b>3</b>		

(If more space is needed, attach additional statements.)

**SCHEDULE C Deceased Spousal Unused Exclusion (DSUE) Amount**

Provide the following information to determine the DSUE amount and applicable credit received from prior spouses. Complete Schedule A before beginning Schedule C.

A Name of Deceased Spouse (dates of death after December 31, 2010 only)	B Date of Death	C Portability Election Made?		D If "Yes," DSUE Amount Received from Spouse	E DSUE Amount Applied by Donor to Lifetime Gifts (list current and prior gifts)	F Date of Gift(s) (enter as mm/dd/yy for Part 1 and as yyyy for Part 2)	G RESERVED
		Yes	No				
<b>Part 1—DSUE RECEIVED FROM LAST DECEASED SPOUSE</b>							
<b>Part 2—DSUE RECEIVED FROM PREDECEASED SPOUSE(S)</b>							
<b>TOTAL</b> (for all DSUE amounts applied for Part 1 and Part 2)							

<b>1</b>	Donor's basic exclusion amount (see instructions)	<b>1</b>		
<b>2</b>	Total from column E, Parts 1 and 2	<b>2</b>		
<b>3</b>	Reserved	<b>3</b>		
<b>4</b>	Add lines 1 and 2	<b>4</b>		
<b>5</b>	Applicable credit on amount in line 4 (See <i>Table for Computing Gift Tax</i> in the instructions). Enter here and on line 7, Part 2—Tax Computation	<b>5</b>		
<b>6</b>	Reserved	<b>6</b>		
<b>7</b>	Reserved	<b>7</b>		
<b>8</b>	Reserved	<b>8</b>		
<b>9</b>	Reserved	<b>9</b>		
<b>10</b>	Reserved	<b>10</b>		

**SCHEDULE D Computation of Generation-Skipping Transfer Tax**

**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 D.

**Part 1—Generation-Skipping Transfers**

A Item No. (from Schedule A, Part 2, col. A)	B Value (from Schedule A, Part 2, col. H)	C Nontaxable Portion of Transfer	D Net Transfer (subtract col. C from col. B)
<b>1</b>			
Gifts made by spouse (for gift splitting only)			

(If more space is needed, attach additional statements.)



**Part 2—GST Exemption Reconciliation (Section 2631) and Section 2652(a)(3) Election**Check here ☐ 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 ►

<b>1</b>	Maximum allowable exemption (see instructions) . . . . .	<b>1</b>	
<b>2</b>	Total exemption used for periods before filing this return . . . . .	<b>2</b>	
<b>3</b>	Exemption available for this return. Subtract line 2 from line 1 . . . . .	<b>3</b>	
<b>4</b>	Exemption claimed on this return from Part 3, column C total, below . . . . .	<b>4</b>	
<b>5</b>	Automatic allocation of exemption to transfers reported on Schedule A, Part 3 (see instructions) . . . . .	<b>5</b>	
<b>6</b>	Exemption allocated to transfers not shown on line 4 or 5, above. <b>You must attach a "Notice of Allocation."</b> (see instructions) . . . . .	<b>6</b>	
<b>7</b>	Add lines 4, 5, and 6 . . . . .	<b>7</b>	
<b>8</b>	Exemption available for future transfers. Subtract line 7 from line 3 . . . . .	<b>8</b>	

**Part 3—Tax Computation**

<b>A</b> Item No. (from Schedule D, Part 1)	<b>B</b> Net Transfer (from Schedule D, Part 1, col. D)	<b>C</b> GST Exemption Allocated	<b>D</b> Divide col. C by col. B	<b>E</b> Inclusion Ratio (Subtract col. D from 1.000)	<b>F</b> Maximum Estate Tax Rate	<b>G</b> Applicable Rate (multiply col. E by col. F)	<b>H</b> Generation-Skipping Transfer Tax (multiply col. B by col. G)
<b>1</b>					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 . . . . .			<b>Total generation-skipping transfer tax.</b> Enter here; on page 3, Schedule A, Part 4, line 10; and on page 1, Part 2—Tax Computation, line 16 . . . . .				

(If more space is needed, attach additional statements.)