More on Gift Giving

Roger McEowen (roger.mceowen@washburn.edu) – Washburn University School of Law
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Overview

Earlier this month I wrote about one aspect of the tax rules surrounding making gifts. In that discussion I pointed out one way in which the IRS determines that a gift has been made – out of a "detached and disinterested generosity." In other words, there is no quid pro quo. There's nothing expected in return. But there are even more rules surrounding gifting. Today, I take a look at some of those additional rules in the context of how they came up in some recent cases and IRS rulings.

More on gift giving – it's the topic of today's post.

Disclosure and Statute of Limitations

A federal gift tax return (Form 709) must be filed when gifts to one person in a year total more than $17,000 this year. That amount goes to $18,000 for gifts made in 2024. That threshold is known as the "present interest annual exclusion" and it covers outright gifts up to that ceiling. Any excess amount gifted to a person in a calendar year then use up the donor's unified credit that is available to offset taxable gifts during life or federal estate tax at death. So, while gifts over the threshold may not be taxable because of the credit, they still must be reported on Form 709. That's an important point because filing Form 709 will toll the statute of limitations. Otherwise, the statute is never tolled, and the IRS can come back years later and assert that gift tax (and penalties) is due.

In *Schlapfer v. Comr., T.C. Memo. 2023-65,* the petitioner owned a life insurance policy that was issued in 2006. It was funded by his solely owned corporation. He assigned ownership of the policy to his mother, aunt and uncle in 2007. In 2012, he got involved with the IRS Offshore Voluntary Disclosure Program (OVDP) because IRS thought he had undisclosed offshore assets that he hadn't disclosed that triggered a tax reporting obligation. As part of the disclosure packet that he submitted to the IRS in 2013, he included a 2006 Form 709 with an attached protective election describing a gift of just over $6 million of corporate stock but asserting that it wasn't taxable because it was a gift of intangible personal property from a non-domiciled foreign citizen. In 2016, he signed Form 872 for his 2006 Form 709, agreeing to extend the time to assess tax until November 30, 2017.

Note: The present interest annual exclusion was only $1 million for years 2006 and 2007.

In August of 2016, the IRS issued the petitioner a report for his gift tax return. The IRS concluded in the report that there was no taxable gift in 2006, but that he had made a taxable gift of the insurance policy in 2007 (the year in which he relinquished dominion and control) for which he didn't file a gift tax return and now owed over $4.5 million of gift tax, plus penalties of approximately $4.3 million. The IRS didn't buy his claim that he was a non-domiciled foreign citizen, noting that he had lived in the U.S. since 1979, possessed a green card, and actually became a citizen in 2008. The IRS claimed that the 2007 wasn't adequately disclosed and that the statute of limitations on assessment never began to run.

The petitioner withdrew from the OVDP, and the IRS prepared a substitute gift tax return for 2007, followed with the provision in late 2019 of a statutory notice of deficiency formally asserting the $4.4 million in gift tax deficiency and $4.3 million in penalties. In turn, he filed a Tax Court petition claiming that the three-year statute of limitations (running from the time the gift tax return is filed) to assess gift tax had expired because he had filed a gift tax return with a protective election.

The Tax Court agreed with the petitioner, noting that it was immaterial when the gifts were completed. This was because the Tax Court determined that he had made adequate disclosure of incomplete gifts upon the filing of his 2006 return. That was enough, the Tax Court reasoned, to trigger the three-year period of limitations (s*ee Treas. Reg. § 301.6501(c)-1(f)(5)*) because he had adequately disclosed the gifts on his 2006 gift tax return by providing the IRS with enough information by virtue of the return and accompanying documents. Taken in total it was enough to satisfy the adequate disclosure requirement, resulting in substantial compliance. This was true even though the petitioner had not strictly satisfied the requirements of Treas. Reg. § 301.6501(c)-1(f)(2). Thus, the period of limitations to assess the gift tax had expired before the deficiency notice was issued.

Charitable Giving - Substantiation

If you are claiming a deduction for a charitable gift, you must substantiate the gift. In *Albrecht v. Commissioner, T.C. Memo. 2022-53*, the petitioner donated approximately 120 pieces of jewelry to a museum in 2014. The museum was a qualified charity. The museum executed a "Deed of Gift" which specified, in part, that "all rights, titles, and interests" in the jewelry were transferred from the donor to the donee upon donation unless otherwise stated in the Gift Agreement. The petitioner claimed a charitable deduction for the donation on her 2014 return and supported the claimed deduction by submitting the "Deed of Gift" documentation.

The IRS denied the deduction on the basis that the "Deed of Gift" documentation did not meet the substantiation requirements of I.R.C. §170(f)(8)(B) that require a description of the donated item(s); whether the donee provided any form of consideration in exchange for the donation; and a good faith estimate of the value of the donation. The IRS pointed out that the "Deed of Gift" documentation from the museum did not state whether the museum provided any goods or services in return for the donation. In addition, the terms of the "Deed of Gift" documentation with the museum referred to a superseding agreement, "the Gift Agreement," which left open the question of whether the donor retained some title or rights to the donation, and also indicated that the petitioner's documentation did not include the entire agreement with the done.

The Tax Court agreed with the IRS and held that the petitioner did not comply with the substantiation requirements of I.R.C. §170(f)(8)(B) and denied the charitable deduction.

Estate Transfers

The decedent in *Estate of Spizzirri v. Comr., T.C. Memo. 2023-25,* had four children from the first of his four marriages and had three stepchildren as the result of his fourth marriage. Before his fourth marriage, the decedent and his next wife-to-be entered into a prenuptial agreement, which was modified several times during their marriage. Among other provisions, the prenuptial agreement, as modified, provided that the decedent's will would include payments to the surviving spouse and a bequest of $1 million to each of the stepchildren.

Although the decedent's fourth marriage was never dissolved, he and his wife were estranged for several years before his death as a result of his various relationships with other women that resulted in two illegitimate children. The decedent made large payments to a number of these women as well as to various other family members, but he never reported them as gifts or issued a Form 1099-MISC to the recipients. The decedent's will had been executed before his fourth marriage and did not contain the provisions he agreed to in the prenuptial agreement regarding payments to his surviving spouse and her children. The will generally provided that the decedent's estate would go to his children from his first marriage. There were three codicils to this will, all of which specified the rights of his two bastard sons and one that provided for the payment of the mortgage on, and transfer of his interest in, a condominium he had purchased with one of his courtesans.

During probate, the decedent's surviving spouse filed claims seeking enforcement of the prenuptial agreement, which were ultimately settled. The surviving spouse's children also filed claims seeking to enforce the prenuptial agreement regarding the $1 million bequest to each of them. The estate ultimately paid these bequests and sent the Forms 1099-MISC reporting these payments. After the claims were settled, the estate filed an estate tax return. Among other reported items, the return reported no adjusted taxable gifts, even though the decedent had made payments to various persons in excess of the gift tax annual exclusion. The return also reported the payments to the surviving spouse's children as claims against the estate that reduced the decedent's taxable estate. Additionally, the estate claimed as administrative expenses the cost of repairs to property of the estate.

The IRS issued a notice of deficiency that increased adjusted taxable gifts from zero to nearly $200,000, disallowed the deductions for the payments to the surviving spouse's children, and disallowed administrative expenses for repairs to one of the estate's properties. The Tax Court determined that the estate had failed to meet its burden of proof that the transfers were not gifts. The estate argued that the transfers were payments for care and companionship services during the last years of the decedent's life. The court noted that the decedent made the transfers by checks that contained no indication that they were meant as compensation. In addition, the decedent failed to issue any Forms 1099 or W-2 related to these payments, nor did he report them on his personal income tax returns. The Tax Court also noted that witness testimony failed to establish that the transfers were anything other than gifts. The Tax Court also noted that the payments to the surviving spouse's children would only provide a deduction for the estate if they were bonafide and contracted for "adequate and full consideration in money or money's worth" and not be predicated solely on the fact that the claim is enforceable under state law. Based on these requirements, the Tax Court determined that the claims were not bonafide but were of a donative character, finding that payments to the surviving spouse's children did not stem from an agreement for the performance of services — they were essentially bequests not contracted for adequate and full consideration in money or money's worth.

Regarding the administrative expenses for repairs to the house, the Tax Court noted that Treas. Reg. §20.2053-3(a) limits deductible administrative expenses to those that are actually and necessarily incurred in the administration of the decedent's estate. The Tax Court noted that the appraisal report for the house, on which the house's claimed FMV was based, stated that the decks on the house that were repaired "may need to be replaced" and that the estate did not provide any corroboration that their replacement was necessary for a sale or to maintain the FMV claimed on its return. Thus, the court determined that the costs paid for the repairs were not deductible expenditures necessary for the house's preservation and care but rather were nondeductible expenditures for improvements to it.

Conclusion

The rules on gifting can be complex. If you are thinking about making substantial gifts and/or doing so in a complicated fashion, make sure to get good professional advice beforehand.