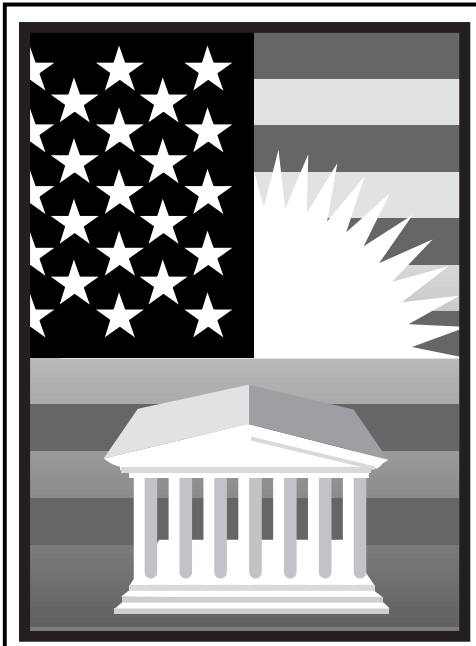




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# Introduction to Estate and Gift Taxes



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## Introduction

If you give someone money or property during your life, you may be subject to federal gift tax. The money and property you own when you die (your estate) may be subject to federal estate tax. The purpose of this publication is to give you a general understanding of when these taxes apply and when they do not. It explains how much money or property you can give away during your lifetime or leave to your heirs at your death before any tax will be owed.

**No tax owed.** Most gifts are not subject to the gift tax and most estates are not subject to the estate tax. For example, there is usually no tax if you make a gift to your spouse or if your estate goes to your spouse at your death. If you make a gift to someone else, the gift tax does not apply to the first \$10,000 you give that person each year.

Even if tax applies to your gifts or your estate, it may be eliminated by the unified credit, discussed later.

**No return needed.** Generally, you do not need to file a gift tax return unless you give someone, other than your spouse, money or property worth more than \$10,000 during a year. An estate tax return generally will not be needed unless the estate is worth more than the applicable exclusion amount for the year of death. This amount is shown in the table under *Unified Credit*.

**No tax on the person receiving your gift or estate.** The person who receives your gift or your estate will not have to pay any gift tax or estate tax because of it. Also, that person will not have to pay income tax on the value of the gift or inheritance received.

**No income tax deduction.** Making a gift or leaving your estate to your heirs does not ordinarily affect your federal income tax. You cannot deduct the value of gifts you make (other than gifts that are deductible charitable contributions).

**What this publication contains.** If you are not sure whether the gift tax or the estate tax applies to your situation, the rest of this publication may help you. It explains in general terms:

- When tax is not owed because of the unified credit,
- When the gift tax does and does not apply,
- When the estate tax does and does not apply, and
- When to file a return for the gift tax or the estate tax.

This publication does not contain any information about state or local taxes. That information should be available from your local taxing authority.

**Where to find out more.** This publication does not contain all the rules and exceptions for federal estate and gift taxes. It does not contain the rules that apply to nonresident aliens. If you need more information, see the following forms and their instructions:

- **Form 706**, United States Estate (and Generation-Skipping Transfer) Tax Return,
- **Form 709**, United States Gift (and Generation-Skipping Transfer) Tax Return, and
- **Form 709-A**, United States Short Form Gift Tax Return.

To order these forms, call 1-800-TAX-FORM (1-800-829-3676). If you have access to TTY/TDD equipment, you can call 1-800-829-4059. To get these forms with your personal computer or by fax, see the first page of this publication.

## Unified Credit

A credit is an amount that eliminates or reduces tax. A unified credit applies to both the gift tax and the estate tax. You must subtract the unified credit from any gift tax that you owe. Any unified credit you use against your gift tax in one year reduces the amount of credit that you can use against your gift tax in a later year. The total amount used against your gift tax reduces the credit available to use against your estate tax.

Previously, the unified credit was \$192,800, which eliminated taxes on a total of \$600,000 of taxable gifts and taxable estate. These amounts were increased for gifts made, and for estates of decedents dying, after 1997. The following table shows the unified credit and the applicable exclusion amount for the calendar year in which a gift is made or a decedent dies.

<b>Year</b>	<b>Unified Credit</b>	<b>Applicable Exclusion Amount</b>
1998	\$202,050	\$ 625,000
1999	211,300	650,000
2000 and 2001	220,550	675,000
2002 and 2003	229,800	700,000
2004	287,300	850,000
2005	326,300	950,000
After 2005	345,800	1,000,000

For examples of how the credit works, see *Applying the Unified Credit to Gift Tax* and *Applying the Unified Credit to Estate Tax*, later.

## Gift Tax

The gift tax applies to the transfer by gift of any property. You make a gift if you give property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. If you sell something at less than its full value or if you make an interest-free or reduced interest loan, you may be making a gift.

The general rule is that any gift is a taxable gift. However, there are many exceptions to this rule.

Generally, the following gifts are **not taxable** gifts:

- 1) The first \$10,000 you give someone during a calendar year (the annual exclusion),
- 2) Tuition or medical expenses you pay for someone (the educational and medical exclusions),
- 3) Gifts to your spouse,
- 4) Gifts to a political organization for its use, and
- 5) Gifts to charities.

**Annual exclusion.** A separate \$10,000 annual exclusion applies to each person to whom you make a gift. Therefore, you generally can give up to \$10,000 each to any number of people each year and none of the gifts will be taxable.

If you are married, both you and your spouse can separately give up to \$10,000 to the same person each year without making a taxable gift. If one of you gives more than \$10,000 to a person during a year, see *Gift Splitting*, later.

**Inflation adjustment.** After 1998, the \$10,000 annual exclusion may be increased due to a cost-of-living adjustment. See the instructions for Form 709 for the amount of the annual exclusion for the year you make the gift.

**Example 1.** You give your niece a cash gift of \$8,000. It is your only gift to her this year. The gift is not a taxable gift because it is not more than the \$10,000 annual exclusion.

**Example 2.** You pay the \$11,000 college tuition of your friend. Because the payment qualifies for the educational exclusion, the gift is not a taxable gift.

**Example 3.** In 1998, you give \$25,000 to your 25-year-old daughter. The first \$10,000 of your gift is not subject to the gift tax because of the \$10,000 annual exclusion. The remaining \$15,000 is a taxable gift. As explained later under *Applying the Unified Credit to Gift Tax*, you may not have to pay the gift tax on the remaining \$15,000. However, you do have to file a gift tax return.

**More information.** Get Form 709 and its instructions for more information about taxable gifts.

## Gift Splitting

If you or your spouse make a gift to a third party, the gift can be considered as made one-half by you and one-half by your spouse. This is known as gift splitting. Both of you must consent (agree) to split the gift. If you do, you each can take the \$10,000 annual exclusion for your part of the gift.

Gift splitting allows married couples to give up to \$20,000 to a person annually without making a taxable gift.

If you split a gift you made, you must file a gift tax return to show that you both agree to use gift splitting. You must file a return even if half of the split gift is less than \$10,000. If the only reason you must file a gift tax return is because you and your spouse are splitting a gift, you may use Form 709-A. See the form instructions for who can use that form. This form is shorter and simpler than Form 709.

**Example.** Harold and his wife, Helen, agree to split the gifts that they made during 1998. Harold gives his nephew, George, \$17,000, and Helen gives her niece, Gina, \$12,000. Although each gift is more than \$10,000, by gift splitting they can make these gifts without making a taxable gift.

Harold's gift to George is treated as one-half (\$8,500) from Harold and one-half (\$8,500) from Helen. Helen's gift to Gina is also treated as one-half (\$6,000) from Helen and one-half (\$6,000) from Harold. In each case, because one-half of the split gift is not more than the \$10,000 annual exclusion, it is not a taxable gift. However, each of them must file a gift tax return.

## Applying the Unified Credit to Gift Tax

After you determine which of your gifts are taxable, you figure the amount of gift tax on the total taxable gifts and apply your unified credit for the year.

**Example.** In 1998, you give your niece, Mary, a cash gift of \$8,000. It is your only gift to her this year. You pay the \$11,000 college tuition of your friend, David. You give your 25-year-old daughter, Lisa, \$25,000. You also give your 27-year-old son, Ken, \$25,000. Before 1998, you had never given a taxable gift. You apply the exceptions to the gift tax and the unified credit as follows:

- 1) Apply the educational exclusion. Payment of tuition expenses is not subject to the gift tax. Therefore, the gift to David is not a taxable gift.
- 2) Apply the \$10,000 annual exclusion. The first \$10,000 you give someone during a year is not a taxable gift. Therefore, your \$8,000 gift to Mary, the first \$10,000 of your gift to Lisa, and the first \$10,000 of your gift to Ken are not taxable gifts.
- 3) Apply the unified credit. The gift tax on \$30,000 (\$15,000 remaining from your gift to Lisa plus \$15,000 remaining from your gift to Ken) is \$6,000. You subtract the \$6,000 from your unified credit

of \$202,050 for 1998. The amount of unified credit that you can use against the gift tax in a later year is reduced by \$6,000.

You do not have to pay any gift tax this year. However, you do have to file Form 709.

## Filing a Gift Tax Return

Generally, you must file a gift tax return on Form 709 if:

- 1) You gave more than \$10,000 (annual exclusion) during the year to someone (other than your spouse),
- 2) You and your spouse are splitting a gift (you may be able to use Form 709-A),
- 3) You gave someone (other than your spouse) a gift that he or she cannot actually possess, enjoy, or receive income from until sometime in the future, or
- 4) You gave your spouse an interest in property that will be ended by some future event.

You do not have to file a gift tax return to report gifts to (or for the use of) political organizations and gifts made by paying someone's tuition or medical expenses.

You also do not need to report deductible gifts made to charities of:

- 1) Your entire interest in property, if no other interest has been transferred for less than adequate consideration or for other than a charitable use, or
- 2) A qualified conservation contribution that is a restriction (granted forever) on the use of real property.

**More information.** If you need to file a gift tax return, you should get Form 709 and its instructions or Form 709-A.

## Estate Tax

Estate tax may apply to your taxable estate at your death. Your taxable estate is your gross estate less allowable deductions.

Any unified credit not used against your gift tax is available for use against your estate tax.

## Gross Estate

Your gross estate includes the value of all property in which you had an interest at the time of death. Your gross estate will also include:

- 1) Life insurance proceeds payable to your estate or, if you owned the policy, to your heirs,
- 2) The value of certain annuities payable to your estate or your heirs, and

- 3) The value of certain property you transferred within 3 years before your death.

## Taxable Estate

The allowable deductions used in determining your taxable estate include:

- 1) Funeral expenses paid out of your estate,
- 2) Debts you owed at the time of death, and
- 3) The marital deduction (generally, the value of the property that passes from your estate to your surviving spouse).

**More information.** For more information on what is included in your gross estate and the allowable deductions, get Form 706 and its instructions.

## Applying the Unified Credit to Estate Tax

As explained earlier, any of the unified credit not used to eliminate gift tax can be used to eliminate or reduce estate tax.

**Example.** Ed Beech gave his son John \$100,000 in 1998. This was Ed's first taxable gift. Ed filed a gift tax return. He subtracted the \$10,000 annual exclusion and figured the gift tax on his taxable gift of \$90,000. The gift tax was \$21,000. Ed used \$21,000 of the unified credit to eliminate the tax on the gift.

If Ed made no other taxable gifts and died in 1999, the available unified credit that can be used against his estate tax is \$190,300. This is the unified credit for 1999 (\$211,300) less the unified credit used against the gift tax (\$21,000).

## Filing an Estate Tax Return

An estate tax return, Form 706, must be filed if the gross estate, plus any adjusted taxable gifts and specific gift tax exemption, is more than the filing requirement for the year of death.

Adjusted taxable gifts is the total of the taxable gifts you made after 1976 that are not included in your gross estate. The specific gift tax exemption applies only to gifts made after September 8, 1976, and before 1977.

**Filing requirement.** The following table lists the filing requirement for the estate of a decedent dying after 1997. Previously, the amount was \$600,000.

Year of Death	Filing Requirement
1998 .....	\$ 625,000
1999 .....	650,000
2000 and 2001 .....	675,000
2002 and 2003 .....	700,000
2004 .....	850,000
2005 .....	950,000
After 2005 .....	1,000,000

**Example.** Donna died in 1998. Her gross estate was worth \$1,325,000. She left a total of \$625,000 to her children and the remainder, \$700,000, to her husband, Bill. The amount that passed to her husband qualified for the marital deduction and, therefore, was not included in the taxable estate. The taxable estate was \$625,000. Neither Bill nor Donna had ever made a taxable gift.

An estate tax return had to be filed because the **gross estate** was more than \$625,000. However, because Donna's **taxable estate** was not more than \$625,000, Donna's unified credit eliminated all of the estate tax.

**More information.** If you think you will have an estate on which the tax must be paid, or if your estate will have to file an estate tax return even if no tax will be due, get Form 706 and its instructions for more information. You (or your estate) may want to get a qualified estate tax professional to help with estate tax questions.