

Estate and Gift Tax*

*J C Hobbs, Assistant Extension Specialist
Department of Agriculture Economics, Oklahoma State University*

Introduction

Individuals may be subject to Federal estate and gift taxes when large transfers of property, money, or other assets occur. Estate taxes apply to the transfer of assets (money and/or property) to one or more individuals when the owner dies. Gift taxes are imposed on the transfer of assets to another individual during the owner's lifetime. In addition, many states also have estate and/or gift taxes.

Estate Taxes

Estate taxes are based upon the fair market value of all property owned or controlled by an individual at the time of death. This is called the gross estate. The fair market value is the value of the property if exchanged between a willing buyer and seller. All the property in the estate is valued at the date of death or at the alternate valuation date (six months after death).

The gross estate is then reduced by a variety of allowable deductions to determine the taxable estate. The deductions include debts of the decedent at the time of death, funeral expenses, administrative expenses, the marital deduction for assets that are transferred to the surviving spouse, and the unified estate and gift tax credit (unified credit). The unified credit for deaths occurring during 2012 is \$1,772,800 which allows an estate valued at \$5,120,000 or less to be transferred free of estate tax. The \$5,120,000 is referred to as the estate tax exemption. For the current amount of the unified credit and the annual gift tax exclusion, refer to IRS Publication 950 "Introduction to Estate and Gift Taxes."

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Estate Tax Return

An estate tax return is due within nine months of the date of death. An estate tax return (IRS Form 706) needs to be properly filed for the estate, even if no estate tax is due. A taxable estate is one with a value greater than \$5,120,000 after all the deductions are subtracted from the value of the gross estate. The filing of an estate tax return sets the basis or inherited value of the estate assets for the recipients. It also starts the statute of limitations running for the estate.

Gift Taxes

Gifts of money, services, property and other assets may be subject to gift taxes if the value is greater than the annual exclusion amount. In addition, if property is sold to an individual for significantly less than its fair market value the difference between the fair market value and the sale price will likely be treated as a gift. Several exemptions apply and must be considered in order to determine if a gift is taxable. First, there is an annual exclusion (\$13,000 for 2012) that reduces the taxable amount of a gift or gifts given to an individual in any year. There are also exclusions for medical and educational expenses paid for someone else, gifts made to a spouse, a gift made to charity, or a gift to a political campaign.

The annual exclusion applies to the total value of all gifts from one individual to another made in a year. A husband and wife can each give the annual exclusion amount to an individual in a year by using a provision known as gift splitting. Therefore a married couple could make an annual gift of up to \$26,000 to a third party in 2012 without the gift being subject to gift taxes. The annual exclusion is indexed for inflation and will increase over time.

Taxable Gifts

When an annual gift of more than the annual exclusion is made, the amount of the gift in excess of the annual gift tax exclusion is subject to gift tax. In most cases, the gift will not result in a gift tax being due but rather the unified estate and gift tax credit is used to offset the amount of the gift tax due. In other words, a portion of the \$1,772,800 unified credit is used to offset the gift taxes due. For example, if a gift of property in 2012 results in a taxable gift of \$2,800, the unified credit reduces the gift tax due to zero and the remaining unified credit available at the time of death or for offsetting future taxable gifts is \$1,770,000.

Gifts to a spouse, a political organization, a charity, or gifts used to pay college tuition or medical expenses are not subject to the annual gift tax exclusion. Thus, the only time a gift tax return will be due is when a gift is made that is larger than the annual exclusion and the only time gift tax will be owed is when the total amount of the unified credit has been used over the gift giver's lifetime.

Gift Tax Return

A gift tax return (Form 709) is filed with the annual income tax return and is due on April 15th. The form is required when an annual gift is made to an individual and the value of the gift is greater than \$13,000 or \$26,000 for 2012 using the gift splitting rules. The gift tax return is filed with the individual's income tax return.

Gift Recipients

An individual who receives a gift or an inheritance from an estate does not have to pay either a federal gift tax or an estate tax. Gift taxes are payable by the giver and estate taxes are payable by the estate. Gifts and inheritances are not subject to income taxes for the recipient, as well. State tax laws should be consulted to determine if taxes will be due on a gift or inheritance that has been received.

IRS Publications

For more information on estate and gift taxes, see IRS Publication 950 "Introduction to Estate and Gift Taxes," found on the IRS website at www.irs.gov. Also refer to the instructions for IRS Form 706 "United States Estate (and Generation-Skipping Transfer) Tax Return" and IRS Form 709 "United States Gift (and Generation-Skipping Transfer) Tax Return." To view or download publication or forms, click on "Forms and Publications". Then click on "Publication number" under "Download forms and publications by:". Type the publication number in the find box to search for the publication. Publications may be viewed online or downloaded by double clicking on the publication.

Additional Topics

This fact sheet was written as part of Rural Tax Education a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

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