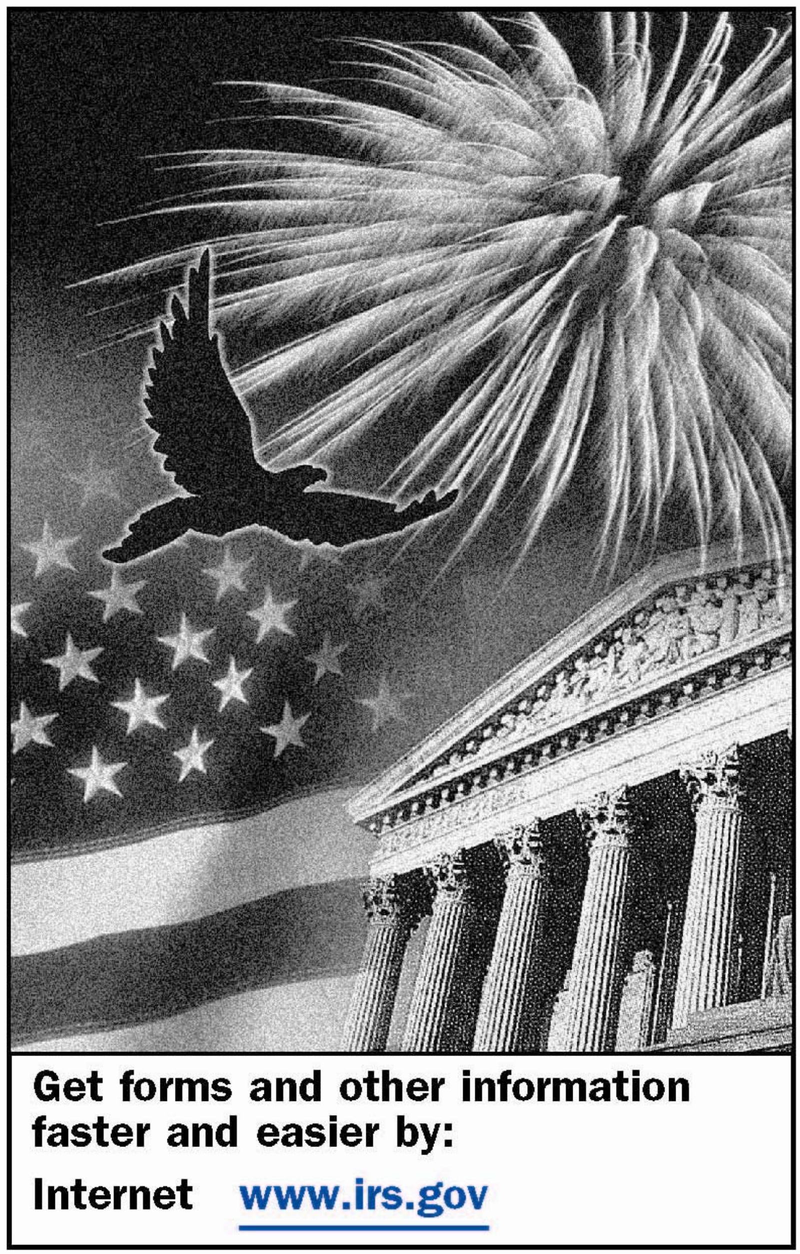
Publication 950

Introduction to Estate and Gift Taxes



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Contents

What's New

- The annual gift exclusion remains $13,000 in 2011 and 2012. See *Annual exclusion*, later, for more information.
- The basic exclusion amount for gifts made and estates of decedents who died in calendar year 2011 is $5,000,000, and $5,120,000 for gifts made and estates of decedents who die in 2012.
- Beginning in 2011, the Deceased Spousal Unused Exclusion (DSUE) amount may be added to the basic exclusion amount to determine the applicable exclusion amount. The DSUE is only available if an election is made on the Form 706 filed by the deceased spouse's estate.
- The IRS has a created a page on IRS.gov for information about Publication 950, at *www.irs.gov/ pub950*. Information about any future developments affecting Publication 950 (such as legislation enacted after we release it) will be posted on that page.

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 and the gross income of your estate may be subject to federal income 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. Gifts you make during your life or bequests from your estate can also be subject to the generation-skipping transfer (GST) tax, if the gifts or bequests are to a person, such as a grandchild, who is more than one generation younger than you.

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 to a charity or if your estate goes to your spouse or to a charity at your death. If you make a gift to someone else, the gift tax usually does not apply until the value of the gifts you give that person exceeds the annual exclusion for the year. See *Annual exclusion* under *Gift Tax,* below.

Even if tax applies to your gifts or your estate, it may be eliminated by the unified credit, also known as the applicable credit amount, discussed below. However, many estates are subject to federal income tax. See *Income Tax on an Estate*.

No return needed. Gift tax returns are filed annually. However, you generally do not need to file a gift tax return unless you give someone, other than your spouse, money or property worth more than the annual exclusion for that year, or a gift not subject to the annual exclusion. An estate tax return generally will not be needed unless the estate is worth more than the basic exclusion amount for the year of death. However, you may wish to file a return if a deceased spouse's estate has any unused exclusion amount that the surviving spouse could use. If an estate tax return must be filed, it is generally due 9 months after the date of death.

No tax payable by the person receiving your gift or bequest. Generally, the person who receives your gift or your bequest will not have to pay any federal 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. However, covered gifts or bequests received from expatriates after June 16, 2008, may be subject to tax which must be paid by the recipient. Consult a qualified tax professional for more information.

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) or any federal gift resulting from making those gifts. You also cannot deduct the value of any bequests made or estate tax resulting from making bequests.

What this publication contains. If you are not sure whether the gift tax, the estate tax, the income tax, or the GST 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,
- When to file a return for the gift tax or the estate tax,
- When the GST tax may apply, and
- When the income tax may apply to an estate.

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, gift, income, or GST taxes. Nor does it contain all the rules that apply to nonresident aliens. If you need more information, see the following publication, forms, and instructions.

- Publication 559, Survivors, Executors, and Administrators;
- Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return;
- Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return;
- Form 706-NA, U.S. Estate (and Generation-Skipping Transfer) Tax Return for Nonresidents, not a Citizen of the U.S.; and
- Form 1041, U.S. Income Tax Return for Estates and Trusts.

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. You can also get forms, instructions, and publications or research answers to tax questions by visiting the IRS website at *IRS.gov*.

Unified Credit (Applicable Credit Amount)

A credit is an amount that reduces or eliminates tax. The *unified credit* applies to both the gift tax and the estate tax and it equals the tax on the applicable exclusion amount. You must subtract the unified credit from any gift or estate tax that you owe. Any unified credit you use against gift tax in one year reduces the amount of credit that you can use against gift or estate taxes in a later year.

Beginning in 2011, the amount of unified credit available to a person will equal the tax on the basic exclusion amount plus the tax on any deceased spousal unused exclusion (DSUE) amount. The DSUE is only available if an election was made on the deceased spouse's Form 706.

The unified credit on the basic exclusion amount for 2011 is $1,730,800 (exempting $5 million from tax) and is $1,772,800 for 2012 (exempting $5,120,000 from tax). The following table shows the unified credit (recalculated at current rates) for the calendar years in which a gift is made or a decedent dies after 2001.

Table of Unified Credits (Recalculated at Current Rates)

Period	Recalculated Unified Credit
1977 (Quarters 1 and 2)	$6,000
1977 (Quarters 3 and 4)	$30,000
1978	$34,000
1979	$38,000
1980	$42,500
1981	$47,000
1982	$62,800
1983	$79,300
1984	$96,300
1985	$121,800
1986	$155,800
1987 through 1997	$190,800
1998	$199,500
1999	$208,300
2000 and 2001	$217,050
2002 through 2010	$330,800
2011	$1,730,800
2012	$1,772,800

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 transfers by gift of property. You make a gift if you give property (including money), the use of property, or the right to receive income from property without expecting to receive something of at least equal value in return. If you sell something for 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:

- Gifts, excluding gifts of future interests, that are not more than the annual exclusion for the calendar year,
- Tuition or medical expenses paid directly to an educational or medical institution for someone else,
- Gifts to your spouse,
- Gifts to a political organization for its use, and
- Gifts to charities.

Annual exclusion. A separate annual exclusion applies to each person to whom you make a gift. The gift tax annual exclusion is subject to cost-of-living increases.

Gift Tax Annual Exclusion	
Year(s)	**Annual Exclusion**
1998– 2001	$10,000
2002– 2005	$11,000
2006– 2008	$12,000
2009– 2012	$13,000

Currently, you generally can give gifts valued up to $13,000 per person, to any number of people, and none of the gifts will be taxable.

However, gifts of future interests cannot be excluded under the annual exclusion. A gift of a future interest is a gift that is limited so that its use, possession, or enjoyment will begin at some point in the future.

If you are married, both you and your spouse can separately give gifts valued up to $13,000 to the same person without making a taxable gift. If one of you gives more than the $13,000 exclusion, see *Gift Splitting,* later.

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 $13,000 annual exclusion.

Example 2. You pay the $15,000 college tuition of your friend directly to his college. Because the payment qualifies for the educational exclusion, the gift is not a taxable gift.

Example 3. You give $25,000 to your 25-year-old daughter. The first $13,000 of your gift is not subject to the gift tax because of the annual exclusion. The remaining $12,000 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 $12,000. However, you do have to file a gift tax return.

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

Gift Splitting

If you or your spouse makes 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 agree to split the gift. If you do, you each can take the annual exclusion for your part of the gift.

Currently, gift splitting allows married couples to give up to $26,000 to a person without making a taxable gift.

If you split a gift you made, you must file a gift tax return to show that you and your spouse agree to use gift splitting. You must file a Form 709 even if half of the split gift is less than the annual exclusion.

Example. Harold and his wife, Helen, agree to split the gifts that they made during 2011. Harold gives his nephew, George, $21,000, and Helen gives her niece, Gina, $18,000. Although each gift is more than the annual exclusion ($13,000), by gift splitting they can make these gifts without making a taxable gift.

Harold’s gift to George is treated as one-half ($10,500) from Harold and one-half ($10,500) from Helen. Helen’s gift to Gina is also treated as one-half ($9,000) from Helen and one-half ($9,000) from Harold. In each case, because one-half of the split gift is not more than the 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 2011, you give your niece, Mary, a cash gift of $8,000. It is your only gift to her this year. You pay the $15,000 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. You have never given a taxable gift before. 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 annual exclusion. The first $13,000 you give someone is not a taxable gift. Therefore, your $8,000 gift to Mary, the first $13,000 of your gift to Lisa, and the first $13,000 of your gift to Ken are not taxable gifts.

3. Apply the unified credit. The gift tax on $24,000 ($12,000 remaining from your gift to Lisa plus $12,000 remaining from your gift to Ken) is $4,680. Subtract the $4,680 from your unified credit of $1,730,800 for 2011. The unified credit that you can use against the gift or estate tax in a later year is $1,726,120.

You do not have to pay any gift tax for 2011. However, you do have to file Form 709.

For more information, see the Table for Computing Gift Tax in the Instructions for Form 709.

Filing a Gift Tax Return

Generally, you must file a gift tax return if any of the following apply:

- You gave gifts to at least one person (other than your spouse) that are more than the annual exclusion for the year.

- You and your spouse are splitting a gift.

- You gave someone (other than your spouse) a gift of a future interest that he or she cannot actually possess, enjoy, or receive income from until some time in the future.
- 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 the following deductible gifts made to charities:

- 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
- A qualified conservation contribution that is a perpetual restriction on the use of real property.

More information. If you think you need to file a gift tax return, see Form 709 and its instructions for more information. You can get publications and forms from the IRS website, *www.irs.gov*. You may want to speak with a qualified tax professional to receive help with gift tax questions.

Estate Tax

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

Gross Estate

Your *gross estate* includes the value of all property you own partially or outright at the time of death. Your gross estate also includes the following:

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

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

- The charitable deduction (generally, the value of the property that passes from your estate to the United States, any state, a political subdivision of a state, the District of Columbia, or to a qualifying charity for exclusively charitable purposes), and
- The state death tax deduction (generally any estate, inheritance, legacy, or succession taxes paid as the result of the decedent's death to any state or the District of Columbia.

More information. For more information on what is included in your gross estate and the allowable deductions, see Form 706 and Form 706-NA and their instructions.

Applying the Unified Credit to Estate Tax

Basically, any unified credit not used to eliminate gift tax can be used to eliminate or reduce estate tax. However, to determine the unified credit available for use against the estate tax, you must complete Form 706.

Filing an Estate Tax Return

An estate tax return must be filed if the gross estate, plus any adjusted taxable gifts and specific gift tax exemption, is more than the basic exclusion amount. Beginning in 2010, the *basic exclusion amount* is $5,000,000; it will be indexed for inflation starting in

2012. The basic exclusion amount is generally equal to the filing requirement.

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 January 1, 1977.

The *applicable exclusion amount* is the total amount exempted from gift and/or estate tax. For estates of decedents dying after December 31, 2010, the applicable exclusion amount equals the basic exclusion amount plus any deceased spousal unused exclusion (DSUE) amount. The DSUE is the remaining applicable exclusion amount from the estate of a predeceased spouse who died after December 31, 2010. The DSUE is only available where an election was made on the Form 706 filed by the deceased spouse's estate.

Filing requirement. The following table lists the filing requirements for estates of decedents dying after 2001.

Year of Death:	File return if estate's value is more than:
2002 and 2003	1,000,000
2004 and 2005	1,500,000
2006, 2007, and 2008	2,000,000
2009	3,500,000
2010 and 2011	5,000,000
2012	5,120,000

More information. If you think you will have an estate on which tax must be paid, or if your estate will have to file an estate tax return even if no tax will be due, see Publication 559, Form 706, Form 706-NA, and the forms' instructions for more information. You can get publications and forms from the IRS website at *www.irs.gov*. You (or your estate) may want to speak with a qualified tax professional to receive help with estate tax questions.

Generation-Skipping Transfer Tax

The GST tax may apply to gifts during your life or transfers occurring at your death, called *bequests*, made to skip persons. A *skip person* is a person who belongs to a generation that is two or more generations below the generation of the donor. For instance, your grandchild will generally be a skip person to you or your spouse.

The GST tax is figured on the amount of the gift or bequest transferred to a skip person, after subtracting any GST exemption allocated to the gift or bequest at the maximum gift and estate tax rates. Each individual has a GST exemption equal to the basic exclusion amount, as indexed for inflation, for the year involved.

GSTs have three forms: direct skip, taxable distribution, and taxable termination.

- A *direct skip* is a transfer made during your life or occurring at your death that is:

1. Subject to the gift or estate tax,
2. Of an interest in property, and
3. Made to a skip person.

- A *taxable distribution* is any distribution from a trust to a skip person which is not a direct skip or a taxable termination.
- A *taxable termination* is the end of a trust's interest in property where the property interest will be transferred to a skip person.

More information. If you think you will have a gift or bequest on which GST tax must be paid, see Form 709, Form 706, Form 706-NA, and the forms' instructions for more information. You can get publications and forms from the IRS website, www.irs.gov. You (or your estate) may want to speak with a qualified tax professional to receive help with GST questions.

Income Tax on an Estate

Your estate may have an income tax filing requirement for each year that it has $600 or more of gross income or a beneficiary who is a nonresident alien. The tax is figured on the estate's income in a manner similar to that for individuals.

Filing an income tax return. Every estate with an income tax filing requirement must file a Form 1041.

Schedule K-1. Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., reports a beneficiary's portion of income, deductions, and credits from the estate. Also, for the final year of the estate, a beneficiary may receive the following tax benefits from the estate:

- Excess deductions on termination, which are treated as itemized deductions;
- Unused capital loss carryovers;
- Unused net operating loss carryovers; and
- Payment of estimated taxes.

More information. If you think your estate may have income tax filing requirements, see Form 1041 and its instructions, and Publication 559. You (or your estate) may want to speak with a qualified tax professional to receive help with questions about income tax filing requirements of an estate.