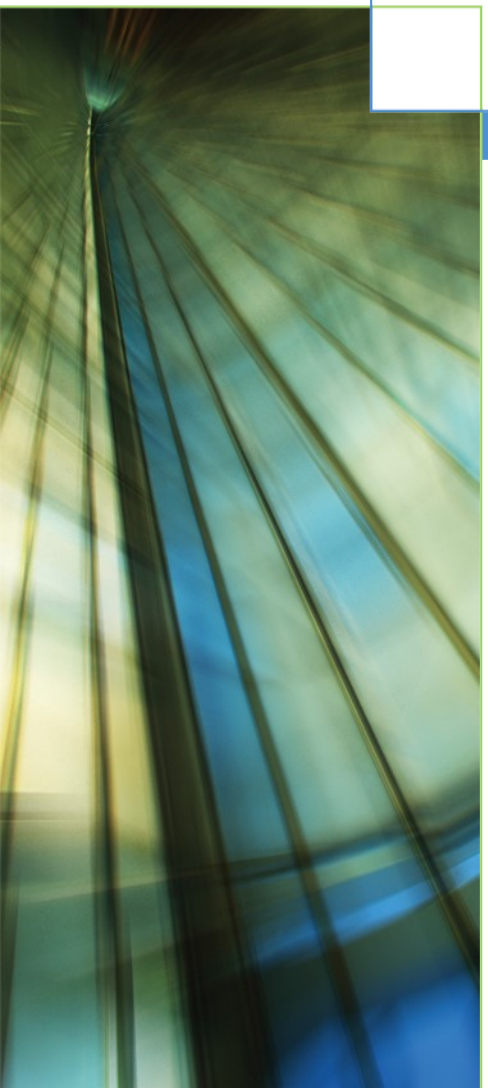

Gift-Splitting – A Boondoggle or a Bad Idea?

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Basic Elements to Qualify Under Section 2513

- Each spouse is a U.S. citizen or resident
- Spouses were married at the time of the gift, and neither spouse has remarried within the same calendar year
- Both spouses consent to gift-splitting
- Gift is not to the consenting spouse
  - Consenting spouse does not have a GPOA
  - Consenting spouse has no interest in the gifted property or has an interest that is severable and can be quantified actuarially

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Basic Elements to Qualify

- No post-mortem gift-splitting
- No post divorce gift-splitting

"All or Nothing"

- The election to split gifts once made applies to all gifts made by either spouse during the calendar year
- No picking and choosing
- Can create issues if gifts exceed the available annual exclusions of the spouses and the spouses have unequal remaining gift tax shelter

"All or Nothing"

- Should conduct due diligence to determine what gifts have in fact been made by the spouses
- Consider the possibility that subsequent events may cause consent to be withheld
- All gifting has the effect of depleting the marital estate of the spouses, the effect of which should be discussed prior to proceeding – consent to gift-splitting will likely imply knowledge and approval of the depletion

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Joint and Several Liability for the Gift Tax Due

- Section 2513(d) provides that consent to gift-splitting causes the gift tax on all gifts made during the calendar year to be joint and several

Signifying Consent

- Treas. Reg. §25.2513-2 sets forth the rules on the manner and timing of signifying consent
- Consent must be signified by both spouses
- Each spouse may signify consent on the spouse's own return, on the other spouse's return or on one of the returns
- Regulations recommend that each spouse signify consent on the other spouse's return

Consent is Irrevocable

- UNLESS revoked on an amended gift tax return filed prior to April 15th of the calendar year following the year of the gift

Validity of Consent

- In *Jones*, the IRS assessed gift tax because W failed to sign H's return in the space provided to signify consent
- The Tax Court agreed, but the 4th Circuit reversed stating there is no rule that consent can be signified only by a signature
- Court considered consent "abundantly evident" by pattern of consent in prior years

Validity of Consent

- However, *Clark* is to the contrary, where the box to elect gift-splitting was checked by the donor but the spouse failed to sign the consent portion because there was a dispute concerning the spouse's intention to consent

When Must Consent Be Signified?

- Does NOT require a timely filed gift tax return
- But consent must be signified on the first return filed by either spouse
- And consent must be filed before a notice of deficiency is issued

When Must Consent Be Signified?

- Posthumous consent is permitted to be made by the decedent's executor
- The guardian of a legally incompetent spouse may also give consent
- A late filed election to split gifts will have retroactive, and irrevocable, gift and GST effect

When Is Consent Needed?

More often than you think.

When Is Consent Needed?

- Consider gifts in excess of one, but not two, annual exclusions made from a joint bank account
  - Under the laws of most states a transfer to a joint bank account is not a completed transfer of half the funds to the joint tenant
  - Therefore, writing a check on a joint bank account is a transfer only by the signator, not by both tenants
  - Gift-splitting is needed to avoid a taxable gift

Additional Rules For Posthumous Gift-Splitting

- The entire amount of gift tax unpaid at a decedent's death and attributable to gifts made by the decedent, including split-gifts, is deductible as a debt for Federal estate tax purposes
- But there is no similar deduction if the decedent's estate pays the tax on gifts split with the surviving spouse unless consent to gift-splitting was made by the decedent prior to death

Additional Rules For Posthumous Gift-Splitting

- Posthumous gift-splitting may increase the decedent's adjusted taxable gifts
- The decedent's estate becomes jointly and severally liable for the gift tax, including on pre-death gifts made by the surviving spouse

Gift-Splitting and Spousal Interests

- In general, gifts in which the consenting spouse may have an interest may not be split
- Rule applies primarily to trusts
- Rev. Rul. 56-439 – Gifts to a wholly discretionary trust in which the consenting spouse has a discretionary interest may not be split

Gift-Splitting and Spousal Interests

- If the interest of the consenting spouse can be actuarially computed, or if the interest is so remote as to be negligible, then gifts may be split, at least in part
- The rule permits gifts to be split if either the interest of the spouse can be quantified or the interests of third parties can be quantified

Gift-Splitting and Spousal Interests

- What if the trust contains Crummey powers of withdrawal
  - Earlier ruling indicates that the gifts are to the powerholders; therefore, the consenting spouse's discretionary interest can be ignored – PLR 200130030
  - More recent ruling casts doubt, however, but the facts are incomplete
  - PLR 200616022 – concluded that the spouse's interest was ascertainable and severable but failed to analyze the consequences of possible Crummey powers of withdrawal

Effect of Improper Gift-Splitting Election

- In PLR 201523003, Husband created a discretionary Family Trust for Wife and descendants
- Husband also created a series of GRATs that poured over to the Family Trust at the end of the annuity term
  - Husband and Wife elected gift-splitting with respect to the GRATs
  - The statute of limitations ran on the returns reporting the GRATs and on the transfers that occurred at the end to the ETIP periods
  - RESULT – Gift-splitting stands, and Husband and Wife's GST exemptions were automatically allocated

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Smaldino v Commissioner, TCM 2021-127

- Taxpayer (a CPA) created an irrevocable trust for his children and grandchildren with his son as trustee
- Taxpayer assigned on a formula basis an interest in an LLC to his wife based upon the amount of her then available estate and gift tax exemption
- Mrs. Smaldino transferred the LLC interest to the irrevocable trust the next day
- Taxpayer, on the same date, assigned from his revocable trust to the irrevocable trust, also on a formula basis, an interest in the LLC

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Smaldino v Commissioner, TCM 2021-127

- Taxpayer was hoping to use both his and his wife's available estate and gift tax shelters
- Citing the "substance over form" doctrine and *Brown v. U.S.,* 329 F.3d 644 (9th Cir. 2003), the Tax Court concluded the transfer to the irrevocable trust by Mrs. Smaldino was an indirect transfer by the taxpayer
- The transactions were part of a prearranged plan. Mrs. Smaldino testified she made "a commitment, promise" to transfer the LLC interest to the irrevocable trust
- The formalities to make Mrs. Smaldino a member, as opposed to a mere assignee, were not followed
- The partnership return for the LLC never reported Mrs. Smaldino as a partner and an amendment to the operating agreement was undated
- Accordingly, the court also concluded no LLC interest was ever effectively transferred to Mrs. Smaldino

Gift-Splitting and Spousal Interests

- Powers of Appointment
  - General power of appointment is not permitted
  - Special power of appointment appears to be permissible
  - Query what the effect might be if the powerholder can appoint in favor of the consenting spouse, but the consenting spouse is not a taker in default
- What about decanting?
  - Should be OK if the consenting spouse's interest cannot be enhanced, but only diminished, and the original interest was quantifiable

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Inclusion of Split-Gift in Donor's Estate

- In general, a split-gift would be an adjusted taxable gift in the consenting spouse's estate
- The consenting spouse may reduce the tentative estate tax by one-half the gift tax payable on the split-gift even if the donor spouse paid 100% of the tax

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Inclusion of Split-Gift in Donor's Estate

- What happens if the donor spouse's estate must include the split-gift under Section 2035
  - Special rule under 2001(e) says the consenting spouse must exclude one-half the gift from decedent's adjusted taxable gifts and receives no credit for the gift tax paid by the donor spouse
  - Problem can occur if consenting spouse dies first
  - Further problem arises if inclusion in the donor spouse's estate occurs by reason of another provision such as 2036(a)(1) – e.g. a QPRT

Inclusion of Split-Gift in Donor's Estate

- Lastly, there is no mechanism to restore the consenting spouse's gift tax shelter during lifetime, which restricts the consenting spouse's potential lifetime estate planning

GST effects of Gift-Splitting

- If the spouses elect split gift treatment, Section 2652(a)(2) will treat each spouse as the transferor of one-half of all gifts that are eligible for gift-splitting
- Deemed allocation rules will automatically apply with respect to each spouse as to one-half the gift
- Each spouse must file a return to make any allocations of GST exemption or elections out of deemed allocation

Other Issues

- Gift completeness
  - The regulations appear to preserve the distinction between donor and consenting spouse so that it would seem gift completeness is tested only with respect to powers or interests of the donor spouse
- Valuation
  - No fractionalization discount will apply merely as the result of gift-splitting
- Estate tax inclusion
  - Consent to gift-splitting will not cause a split gift to be treated as made by the consenting spouse for purposes of testing estate tax inclusion under the string provisions
- Grantor trust status
  - Consent to gift-splitting will not cause the consenting spouse to be treated as the grantor of a trust

Be Careful

Especially When Advising a Consenting Spouse