

Wealth Transfers, 2005 Gifts

by Darien Jacobson and Melissa Laine

The Federal transfer tax system, a mechanism for taxing the transfer of assets from one person to another, includes three major components: the estate tax, the generation-skipping transfer tax, and the gift tax. The gift tax, reported on IRS Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*, is incurred for property transfers during the donor's life, *inter vivos* transfers, whereas the estate tax is assessed or incurred on property transferred after death. The purpose of this article is to explore data derived from gift tax returns filed in 2006, demonstrative of gifts given in 2005.¹

Gift tax data provide valuable information on donors, who are primarily wealthy Americans. These data, the result of statistical studies completed by the Statistics of Income (SOI) Division of the Internal Revenue Service (IRS), are tabulated for each filing year and come directly from Form 709.²

The total population of 2005 donors was 261,104, who transferred \$38.5 billion in total gifts to selected donees, or gift recipients. Donors transferred a broad range of assets, including cash, publicly traded stock, real estate, and others. Of the gift tax returns filed, only 2.9 percent reported a tax liability.

Different types of gift-giving vehicles were used to transfer assets from donor to donee. Direct, or outright, transfers comprised 76.3 percent of total assets given. Simple trusts, defined by the Internal Revenue Code as a trust that must distribute all income annually, comprised 7.3 percent of total assets given. Female donors gave a total of \$21.7 billion in gifts, while males gave \$16.8 billion.³

Background

The Federal gift tax, part of the U.S. transfer tax system that also includes estate and generation-skipping transfer taxes, was enacted in the Revenue Act

of 1924.⁴ Federal transfer taxes are incurred or assessed when property is transferred during life or after death.

The Revenue Act of 1924 provided a foundation for the initial structure of gift taxation by establishing giving-ceilings for both annual and lifetime gifts. The annual exemption rule, or the amount a donor may transfer during a year without incurring tax liability, was set at \$500, while the lifetime exemption, the total amount that a donor may give away during his or her lifetime without tax liability, was set at \$50,000.

The gift tax was repealed in 1926, but this hiatus would prove to be short-lived. Wide-spread depression in the 1930s led the U.S. Government to find alternate sources of funding, and the gift tax was reinstated with the passage of the Revenue Act of 1932.⁵ The tax rates were set at three-fourths of the estate tax rates, which continued until 1976 when the transfer tax system underwent a broad revision.⁶

The Tax Reform Act of 1976 created a unified gift and estate tax framework "consisting of a single, graduated rate of tax imposed on both lifetime gifts and testamentary dispositions."⁷ Gift tax rates increased as donors made successive taxable gifts throughout their lives, ending with the highest rates imposed on transfers made at the time of death.⁸ The Tax Reform Act of 1976 also merged the estate and gift tax exclusions into a single gift and estate tax lifetime credit. While this credit may be used to reduce tax liability for *inter vivos* wealth transfers, any remaining credit may be used to offset estate taxes incurred at the time of death.⁹

A gift is taxed based on the year in which the gift is transferred or completed. While the Taxpayer Protection Act of 1997 indexed the annual exemption for gift taxes, initially set at \$10,000 in 1998, broader changes were made to the transfer tax system in the new millennium.¹⁰ The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 gradually increased the lifetime exemption amounts for

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¹ Approximately 95 percent of gifts reported on Filing Year 2006 returns were given in 2005.

² For more information, see the SOI Gift Tax page at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96464,00.html>

³ The remainder of gifts were given by donors of undetermined sex.

⁴ Luckey, John R., "A History of Federal Estate, Gift, and Generation-Skipping Taxes," April 9, 2003, Congressional Research Service, Library of Congress, p. 8.

⁵ *Ibid.*, p. 9.

⁶ *Ibid.*, p. 11.

⁷ *Ibid.*, p. 11-12.

⁸ *Ibid.*, p. 12.

⁹ P.L. 94-455.

¹⁰ P.L. 105-34.

gift taxes to \$1,000,000, with a maximum tax rate of 35 percent.¹¹ While the other two components of the transfer tax system, the estate tax and generation-skipping transfer tax, will be repealed at the end of 2009 without further legislation, the gift tax will remain intact. The EGTRRA provisions will expire in 2011, and the gift tax exemption amounts and maximum tax rates will revert to 2001 tax law levels.

Throughout the era of gift taxation, many components have been introduced that altered the calculation of tax. In 1948, the marital deduction was enacted, allowing interspousal gifts without tax liability. Along with the marital deduction, the split-gift rule was established, allowing the nondonor spouse to elect to be treated as having made half of the total transfer.¹²

Three types of transfers are not defined as “gifts” and, therefore, are not subject to the gift tax under the Internal Revenue Code (IRC). First, gifts to political organizations are not taxed when they meet the criteria of IRC section 527(e) (1). Second, gifts of tuition made to a qualifying educational institution on behalf of an individual are not taxable, as long as the payment is made directly to the educational institution. Finally, the gift tax does not apply to the amount of medical expenses on behalf of an individual, paid directly to the individual or to the medical institution that provided care.

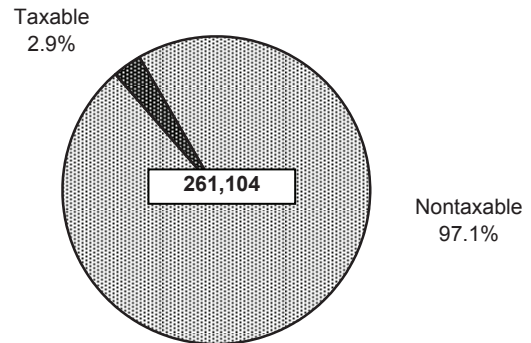
2005 Gifts

The Statistics of Income Division collects data directly from IRS Form 709, which requires a donor to specify all assets transferred during a given calendar year. These include a broad range of assets, such as cash, real estate, trusts, and artwork. Also collected are data on the specific gift-giving mechanism through which assets were given. These mechanisms could include (but are not limited to) direct, or outright, gifts and gifts through trust.

The population of 2005 donors filed 261,104 gift tax returns, which documented the transfer of more than \$38.5 billion in total gifts. Of these gift returns filed, 253,440, or 97.1 percent, were nontaxable (Figure A). A total of \$1.7 billion in gift tax liability was incurred on the other 7,664 returns filed for gifts given in 2005.

Figure A

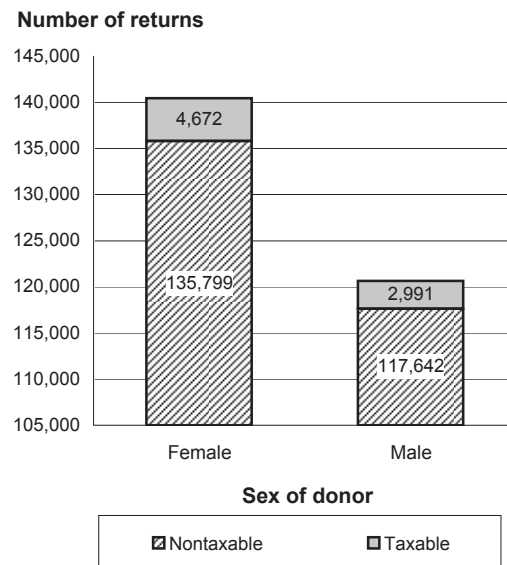
Percentage of Taxable and Nontaxable Gift Tax Returns, 2005 Gifts



When the donor population is examined by sex, females comprised the majority, filing 53.8 percent of gift tax returns, and males comprised the remainder, filing 46.2 percent in 2005. For the filing year, females and males filed nearly equal percentages of nontaxable returns; 96.7 percent of returns filed by females and 97.5 of returns filed by males incurred no tax liability (Figure B).

Figure B

Taxable and Nontaxable Gift Tax Returns, 2005 Donors



¹¹ P.L. 107-16.

¹² Luckey, John R., “A History of Federal Estate, Gift, and Generation-Skipping Taxes,” April 9, 2003, Congressional Research Service, Library of Congress, p. 11.

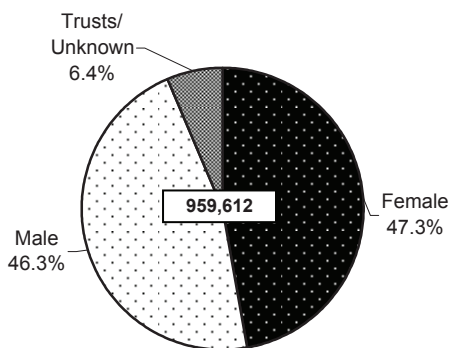
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The 2005 donee population included 959,612 individuals, organizations, and trusts that received gifts in 2005. Females received 47.3 percent of total gifts, while males received slightly fewer, 46.3 percent (Figure C). The remainder of gifts were given to trusts, organizations, or unknown donees.

Figure C

Composition of Donee Population, 2005



The gift tax return requires that donors specify the gift mechanism that they used to transfer assets to their selected recipients. While many of these 2005 gifts were given directly, donors also used simple trusts, insurance trusts, split-interest trusts, and 529-trusts. While direct gifts become the donee's property immediately, gifts through trust may be contingent on a specified future event.

Simple trusts comprise a majority of trusts used for gifted assets. Simple trusts are predominantly trusts, insurance trusts, split-interest trusts, and 529-trusts. While direct gifts become the donee's property immediately, gifts through trust may be contingent on a specified future event.

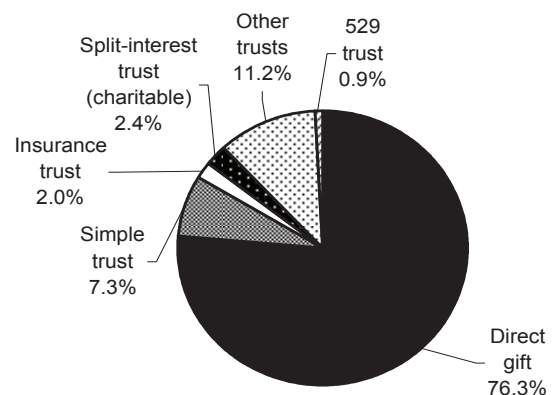
Simple trusts comprise a majority of trusts used for gifted assets. Simple trusts are predominantly established for the benefit of a single individual. Another widely used gift mechanism is an insurance trust. The purpose of a life insurance trust is for a policyholder to transfer ownership of the insurance policy to the trust in order to remove the policy from his or her estate, thereby avoiding possible estate taxation. A third type of gift mechanism is the split-in-

terest trust, which has dual recipients: a private beneficiary and a charity.¹³ Finally, a 529-trust allows a donor to save specifically for the educational costs of a named beneficiary. Along with direct gifts, these trust instruments make up the majority of vehicles by which gifted assets are transferred.

For gifts given in 2005, most assets were transferred by direct gift. Direct gifts comprised 76.3 percent of total gifts, for a total of \$29.4 billion in asset transfers. Second were simple trusts, which transferred \$2.8 billion in assets, or 7.3 percent of total assets (Figure D). Other trusts, which comprised 11.2 percent of asset transfers, included family, personal, marital, personal residence, generation-skipping, and other unspecified trusts.

Figure D

Transfer Method of Gifts, 2005



NOTE: Percentages may not add to total due to rounding.

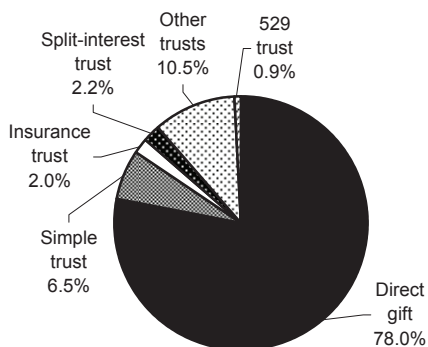
Although the gift method used by females and males were similar, females used direct gifts more than males, for 78.0 percent and 74.0 percent of asset transfers, respectively. Females and males used 529-trusts at the same rate, 0.9 percent of total asset transfers. More men than women used simple trusts, at 8.3 percent and 6.5 percent of total asset transfers, respectively (Figure E).

A broad range of assets were transferred from donor to donee, including (but not limited to) cash, publicly traded or closely held stock, real estate, part-

¹³ For more information on split-interest trust data, please see: <http://www.irs.gov/taxstats/charitablestats/article/0,,id=97066,00.html>

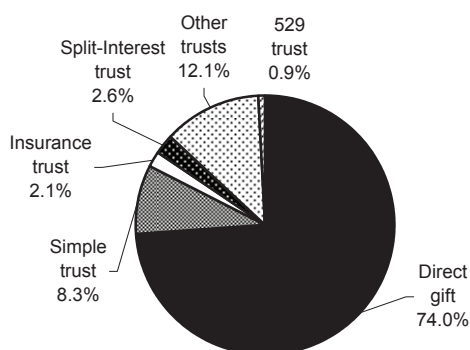
Figure E

Transfer Method of Gifts, Female Donors, 2005



NOTE: Percentages may not add to total due to rounding.

Transfer Method of Gifts, Male Donors, 2005



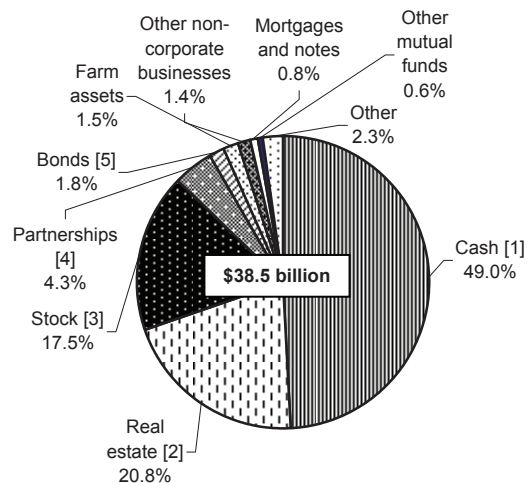
NOTE: Percentages may not add to total due to rounding.

nerships, bonds, mutual funds, art, and insurance. A total of \$38.5 billion in gifts was given in 2005. The most common gift was cash, which comprised \$18.9 billion, or 49.0 percent of total gifts given. Gifts of cash included both cash and cash management accounts. The second largest asset transferred was real estate, which includes personal residences, improved real estate, and vacant land; real estate partnerships; farmland; and real estate mutual funds. Gifts of real estate totaled \$8.0 billion, or 20.8 percent of total gifts reported for 2005. The third most gifted asset was stock, including both publicly traded and closely held stock, comprising 17.5 percent of assets, for a total gift amount of \$6.7 billion (Figure F).

Similar analysis may be completed by donor sex. Men and women show different preferences in gift giving. Figure G shows that cash was the largest

Figure F

Asset Composition of Gifts, 2005



[1] Cash includes both cash and cash management accounts.

[2] Real estate includes improved real estate, personal residence, vacant land, real estate partnerships, farm land, and real estate mutual funds.

[3] Stock includes publicly traded and closely held stock.

[4] Partnerships include limited partnerships and family limited partnerships.

[5] Bonds include State and local bonds, bond funds, Federal savings bonds, other Federal bonds, corporate bonds, and foreign bonds.

asset given overall, with female donors giving more cash than their male counterparts. Females gave a total of \$10.9 billion in cash, while male donors gave \$8.0 billion. Females transferred more cash as a percentage of their total assets than males, or 50.4 percent and 47.3 percent, respectively. When comparing real estate gifts by sex, females gave greater amounts of real estate assets, or \$4.6 billion, which was 20.0 percent of total assets given. Males gave \$3.2 billion in real estate, or 19.6 percent of total assets given. Finally, stock was the third largest asset given by both males and females, although males gave a larger portion of their total gifts, 19.5 percent, in stock. Figure G shows comparisons between the dollar amounts and percentages of assets given by men and women.

Use of Valuation Discounts

For gift tax purposes, transferred property is valued at fair market value on the date of the gift. Fair market value is the value at which property would pass from a willing seller to a willing buyer. However, the value of the property interest may be reduced, or discounted, from fair market value due to certain characteristics or qualities of the ownership interest, such as lack of control or marketability. This reduc-

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Figure G

Asset Composition of Gifts by Sex, 2005

[Money amounts are in thousands of dollars]

Female		Assets gifted	Male	
Percent of total	Amount		Percent of total	Amount
50.4	10,922,605	Cash [1]	47.3	7,950,426
21.4	4,629,750	Real estate [2]	20.0	3,368,554
16.0	3,458,007	Stock [3]	19.5	3,275,397
3.8	820,785	Partnerships [4]	5.0	832,670
2.0	435,595	Bonds [5]	1.3	215,714
1.3	278,579	Farm assets	1.9	313,399
1.3	274,331	Other non-corporate businesses	1.5	255,138
1.0	219,291	Mortgages and notes	0.6	93,471
0.7	149,691	Other mutual funds	0.4	74,174
2.2	485,997	Other	2.5	426,872
100.0	21,674,631	Total	100.0	16,805,815

[1] Cash includes both cash and cash management accounts.

[2] Real estate includes improved real estate, personal residence, vacant land, real estate partnerships, farm land, and real estate mutual funds.

[3] Stock includes publicly traded and closely held stock.

[4] Partnerships include limited partnerships and family limited partnerships.

[5] Bonds include State and local bonds, bond funds, Federal savings bonds, other Federal bonds, corporate bonds, and foreign bonds.

tion in value for tax purposes is known as “valuation discounting” and reduced the amount of taxes owed on the transfer of property.¹⁴

In 2005, valuation discounts were applied to 16.5 percent of gifts for a total of \$3.1 billion in discounts. Most rates of discount were between 20 percent and 40 percent (Figure H).

Figure H

Size of Valuation Discounts as a Percentage of Full Value of Assets

Percentage of valuation discount	Number of discounted gifts	Amount of discount
All discounted gifts	130,695	3,138,723,801
Less than 20 percent	18,247	132,683,160
20 percent under 40 percent	84,336	1,774,089,573
40 percent or higher	28,112	1,231,951,068

Donors took discounts of varying sizes, ranging from less than \$1,000 to greater than \$650,000. Donors who used discounts of \$650,000 or more took \$725.0 million in total discounts, or 23.1 percent of all discounts taken (Figure I).

Crummey Asset Donors

Under 2005 tax law, a donor may give up to \$11,000 to a single entity, person, or trust in a year without tax implications. For example, a donor may transfer \$11,000 in cash to a simple trust and not incur tax on that transfer. Two court cases, however, further expanded nontaxable gifts with the use of trust powers.

The first case, *Crummey v. Commissioner* (1968), legitimized the use of Crummey powers by exercising the idea of a “present interest.”¹⁵ Present interest means that donees have the ability to exercise rights to use gifts at the same time the gifts are transferred to them from the donor. Normally, a donor may give up to the annual exclusion to a single entity, such as a person or a trust, without tax liability. Giving more than \$11,000 to a single entity would generate a tax liability. For example, a donor may set up a simple trust for a named beneficiary in 2005 and place \$11,000 in cash assets into the trust without being taxed on that asset transfer, but a \$12,000 gift would be taxable. Using Crummey powers, however, that same donor could give more than the annual exclusion to the trust, as long as the total value given to each beneficiary was under \$11,000. Here, beneficiaries must have a present interest in the trust, shown

¹⁴ Britton Eller, Martha, “Inter Vivos Wealth Transfers, 1997 Gifts,” *Statistics of Income Bulletin*, Publication 1136, Winter 2003-2004.

¹⁵ Bittker, Boris I; Elias Clark; and Grayson McCouch (2005), *Federal Estate and Gift Taxation*. 9th edition, Thompson West, Minneapolis.

Figure I

Donors with Discounts: Full Value of Assets and Valuation Discounts, by Size of Valuation Discount

Size of valuation discount	Number of returns	Total assets, full value	Valuation discount
	(1)	(2)	(3)
Total	261,104	41,612,965,844	3,138,723,800
Less than \$1,000	226,709	30,929,289,020	421,770
\$1,000 under \$2,000	570	11,454,353	1,012,944
\$2,000 under \$3,000	794	15,420,314	1,935,883
\$3,000 under \$4,000	934	38,825,842	3,466,426
\$4,000 under \$5,000	451	10,025,827	2,045,749
\$5,000 under \$6,000	679	29,949,205	3,468,902
\$6,000 under \$7,000	1,034	50,644,991	6,734,051
\$7,000 under \$8,000	1,143	64,375,341	8,444,875
\$8,000 under \$9,000	914	53,498,448	7,770,305
\$9,000 under \$10,000	405	26,059,767	3,744,794
\$10,000 under \$20,000	6,494	535,975,306	92,412,414
\$20,000 under \$30,000	4,170	426,045,810	101,650,395
\$30,000 under \$40,000	2,511	347,048,510	85,577,702
\$40,000 under \$50,000	2,251	383,057,395	100,287,751
\$50,000 under \$100,000	4,765	1,274,167,206	333,767,813
\$100,000 under \$150,000	2,280	961,347,675	279,782,908
\$150,000 under \$200,000	1,243	928,270,105	215,077,891
\$200,000 under \$250,000	773	558,336,856	173,448,900
\$250,000 under \$300,000	539	485,427,893	149,434,871
\$300,000 under \$350,000	536	516,200,476	173,560,068
\$350,000 under \$400,000	495	556,694,080	184,171,883
\$400,000 under \$450,000	434	520,251,536	185,269,654
\$450,000 under \$500,000	123	161,393,143	57,875,669
\$500,000 under \$550,000	182	257,922,210	95,266,885
\$550,000 under \$600,000	109	160,693,822	62,212,308
\$600,000 under \$650,000	136	201,316,106	84,919,222
\$650,000 and above	430	2,109,274,606	724,961,764

by having reasonable time to exercise the power to remove assets. Thus, the same donor who gave \$11,000 to a single entity could now give \$33,000 to the same trust as long as there were three beneficiaries who exhibit present interests, which is shown by donees having the option of removing and using gifted assets at the time of transfer.

The second case went further by expanding the scope of beneficiaries who may exercise Crummey powers. In *Cristofani's Estate v. Commissioner (1991)*, the court ruled that contingent remainder beneficiaries, usually a grandchild or second-generation beneficiary named by the trust, could also be treated as having present interests, maintaining that they were also given adequate time to exercise their right to remove their portions of assets from the trust.¹⁶

SOI tabulates data on returns that report Crummey powers. In 2005, a total of \$1.6 billion of assets was given to trusts that claimed Crummey powers, or single entity trusts that received gifts of greater than the annual exclusion. Cash, at \$1.0 billion, was the most utilized asset for these trusts. The second largest asset type for which these powers were used was stock, for a total of \$268.8 million in stock gifts. Finally, real estate transfers to trusts with Crummey powers had the third highest use (Figure J).

Figure J

Asset Composition of Gifts for Crummey Powers Donors, 2005

[Money amounts are in thousands of dollars]

Asset type	Amount
Cash	1,042,574
Stock	268,810
Real estate	114,080
Partnerships	81,930
Other noncorporate assets	33,089
Other	32,020
Other mutual funds	8,646
Farm assets	1,566
Mortgages and notes	1,450
Bonds	684

Data demonstrating the types of trusts using Crummey powers are shown in Figure K. Not surprisingly, simple trusts comprise the majority of trusts using Crummey powers, for a total of 36 percent. Second are family trusts, which comprise 23 percent of trusts using Crummey powers.

Summary

A total of 261,104 gift returns were filed in 2006 for gifts given in 2005. A total of \$38.5 billion in assets were transferred from donors to donees. As a result, \$1.7 billion in gift tax liability were reported. Only 2.9 percent of returns were taxable.

Females represented 47.3 percent of the donee population, while males represented 46.3 percent. The remaining 6.4 percent represented trusts and donees with unknown identities. Gifts of cash were the preferred choice for both female and male donors; cash assets comprised 49.0 percent of total gifts.

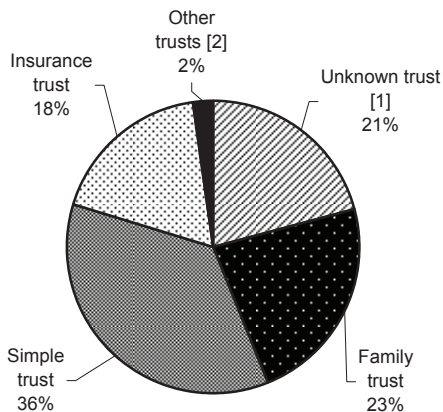
¹⁶ Ibid.

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Figure K

Trusts Utilizing Crummey Powers, 2005



[1] Unknown trust types include trusts in which the taxpayer does not specify the type of trust on Form 709.

[2] Other trust types include: generation-skipping trusts, marital trusts, personal residence trusts, charitable remainder unitrusts, grantor retained annuity trusts, and 529 educational trusts.

Following cash, real estate was the second most frequently gifted asset, in 20.8 percent of asset transfers.

In 2005, donors used a variety of mechanisms to complete their transfers of assets. Direct gifts comprised the bulk of transfers, as 76.3 percent of gifts were given outright.

Data Sources and Limitations

The data used for this article are based on a sample of 9,037 gift tax returns that were filed in 2006. The majority of the returns filed in 2006, approximately 95 percent, recorded gifts given in 2005. Therefore, these returns can be used to represent the behaviors of gift-givers in 2005.

The sample design for the study is a stratified probability sample with two stratifying variables: taxability status and size of total gifts (prior to the subtraction of annual exclusions and deductions in the calculation of total taxable gifts). Taxability status is divided into two categories: nontaxable (i.e., no gift tax liability reported) and taxable (i.e., gift tax liability reported). The second stratifier, size of total gifts, is divided into four or five categories, depending on taxability status. Each stratum is labeled with a sample code.

Each return in the sample is weighted to reflect its share of the population of returns filed in 2006. Because of the variation of the sample sizes, post-stratification is used. The post-stratified weight is computed by dividing the realized population count of filed returns in a given stratum by the realized number of sample returns in that stratum. These weights are adjusted for missing returns, rejected returns, and outliers. These weights are applied to the sample data to produce aggregate estimates for items of interest, such as total gifts and total taxes.

Explanation of Selected Terms

Brief definitions of some terms used in text and figures are provided below:

Beneficiary—The recipient of income or assets from a trust, will, or life insurance policy.

Cash management accounts—Also known as financial or asset management accounts, these are accounts offered by brokerages. Money in the account can be invested in various assets, and check-writing privileges are normally part of the account.

Charitable deduction—An unlimited charitable deduction is available for all outright transfers to qualified charities. The deduction is available for gifts to trust only if the trust meets certain requirements.

Contingent beneficiary—A contingent beneficiary is one whose bequest is reliant on some occurrence outside the control of the transferor. It often refers to an eventual beneficiary of property in which someone else has a life interest. The bequest in such a case is contingent on: (1) the contingent beneficiary living longer than the person with the life interest, and (2) there being some property left for the contingent beneficiary to inherit.

Crummey power—Under current gift tax law, the gift tax exclusion is only available on gifts of present, not future, interests. Therefore, when a trust is created as a life and a remainder interest, the remainder interest is not eligible for the gift tax exclusion. The Crummey Power allows a person with a future interest in the trust to withdraw up to the annual exclusion amount from the trust for a short period every year. This converts the future interest into a present interest, making the exclusion available.

Direct trust—A direct trust is an express trust, as distinguished from a constructive or implied trust.

An express trust is created or declared in express terms, usually in writing, as distinguished from one inferred by law from the conduct or dealings of the parties. It is directly created for specific purposes in contrast to a constructive or resulting trust, which is created by direct and positive acts of the parties, by some writing or deed, or will, or by words expressly or implicitly evincing an intention to create a trust.

Generation-Skipping (transfer) taxes—The 1976 Tax Reform Act imposes a generation-skipping transfer tax on: (1) transfers under trusts (or similar arrangements) having beneficiaries in more than one generation below that of the transferor, and (2) direct transfers to beneficiaries more than one generation below that of the transferor. The tax is imposed (with certain exemptions) on the occurrence of any one of three taxable events: a taxable termination, a taxable distribution (including distributions of income), and a direct skip (an outright transfer to or for the benefit of a person at least two generations below that of the transferor).

Insurance trust—A trust set up with the proceeds of a life insurance policy.

Net gift tax—This is the reported value of gift tax on current period gifts.

Nontaxable returns—Gift tax returns on which taxpayers reported no net gift tax liability.

Partnership—A type of business entity in which two or more people pool their funds and talents and share in the profits and losses of an enterprise.

Taxable gifts, current period—These are the amount of taxable gifts—total gifts less exclusions and deductions—for the current tax year.

Taxable gifts, prior period—These are the amount of taxable gifts—total gifts less exclusions and deductions—for all prior tax years in which the donor transferred property.

Taxable returns—Gift tax returns on which taxpayers reported a net gift tax liability.

Total gifts—These are the value of total gifts reported by the donor after gifts have been split between the donor and the consenting spouse.

Total gifts of donor—These are the dollar value of gifts given by the donor during the current tax year and reported on Schedule A of Form 709. Gifts include those subject to gift tax only and those subject to both gift and generation-skipping transfer taxes.

Total taxable gifts, all periods—These are the amount of taxable gifts—total gifts less exclusions and deductions—for all periods, both prior and current.

Trust—A trust is an arrangement whereby the right to property is held by one party, the “trustee” (or manager), for the benefit of another (the “beneficiary”). The person who sets up the trust (and provides its assets) is called the “grantor.”