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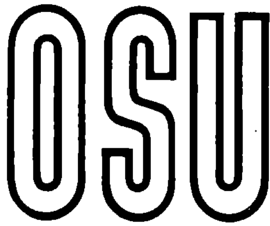

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ESTATE AND GIFT TAX CHANGES UNDER THE 1978 REVENUE ACT

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Below are some of the major changes in the Revenue Act of 1978, pertaining to estate and gift taxes. For a more complete discussion of estate planning, see Circular E-726, Estate Planning, which was revised in late 1978.

Carryover Basis Postponed

The carryover basis of inherited property has been delayed until January 1, 1980. This means for heirs who inherit property from decedents who died between December 31, 1976, and January 1, 1980, the basis of the property in most cases will be the value at which it was appraised for estate tax purposes. In most cases, this means the basis will be higher and therefore, less income taxes to be paid when the property is sold. Those who sold carryover basis property should file amended returns.

Credit for Spouse Services

Surviving spouses of jointly owned property used in a farm or other business may be given some credit for the value, to the extent they participated in the management and operation of the business. For purposes of material participation, the code refers to Section 1402A, relating to net earnings from self-employment. According to this code section, the surviving spouse would actually have had to have participated in the management of the business in a similar manner that qualifies a person for self-employment tax for Social Security.

A special rule for excluding a portion of the value of the gross estate is included in the law. The exclusion is based on the number of years the surviving joint tenant materially participated in the business. The amount is computed as follows: The original consideration is appreciated at the rate of six (6) percent per year. This figure is subtracted from the date-of-death value of the property. The remaining figure is then multiplied by two (2) percent per year that the wife materially participated in the business. The resulting figure is the excludable amount.

An example follows: John Doe and his wife purchased a farm in 1969 for $50,000. They both materially participate until John's death in 1979, when the farm is valued at $100,000. The amount excluded is $4,000, computed as follows:

$50,000 x .06 x 10 = $30,000 appreciation
$50,000 + 30,000 = $80,000 (original contribution plus appreciation)
$100,000 - 80,000 = $20,000
$20,000 x .02 x 10 = $4,000

The rule cannot result in the inclusion of less than fifty (50) percent of the value of the joint interest, or decrease the gross estate by more than $500,000. This new provision is effective for decedents' estates who die after 12/31/78.

Joint Tenancy Change

Under the 1976 Act, only one-half the value of joint tenancy property held by the husband and wife is included in the estate of the first to die, if the donor elected to treat the creation as a taxable gift and filed a gift return. This applied only to joint tenancies created after 12/31/76. Under the new law, the rule also applies to joint tenancies created before 1977, between husband and wife if the taxpayer elects to report the creation of the joint interests as a gift in a return filed in any calendar quarter in 1977, 1978, or 1979. The gift will be treated as having been made at the close of the quarter for which the return is filed. The amount of the gift generally will be equal to the appreciation attributable to the gift portion of the consideration furnished by the donor spouse at the time the joint interest was created.

As a general rule, many estate planning authorities frown on making gifts in joint tenancy. Generally, the goal is to avoid excessive tax at the death of the last surviving spouse since no marital deduction is available. Joint tenancy usually results in the total value of the property being taxed in the estate of the last spouse to die.

Estate Tax Lien Change

Liens by the Treasury may be subordinate to bank loans or other lenders. According to the 1978 Revenue Act, this may apply to those who elect the current use value of appraising farm or small business property. When the current use election is made, the savings in estate taxes will be recaptured if the heirs failed to meet requirements for a 15 year period, such as an early disposition or if its' qualifying use ceases. Therefore, the government takes a lien on such property for a 15 year period. This would allow owners of such property to mortgage their property giving lenders priority over the government lien.

Current Use Valuation of Farm Property

The basis of farm property is which the current use valuation is elected will be the current use value and not the market value for the period 1977 through 1979. Thus, if the land is sold within 15 years, considerable more income tax will likely have to be paid as well as additional estate taxes having to be recaptured.

Holding Period

Carryover basis property received from a decedent will be deemed to have been held sufficient to qualify for long term capital gains.

Gift Changes

Under the 1976 Act, if a donor died within three years of the date of the gift, the gift included in the decedent's estate was reduced by the $3,000 annual exclusion. Under the new law, the full value will be included.

Under the 1973 Act, if a gift is $3,000 or less and no gift return was due, it will not be included in the estate of the donor decedent under the automatic three year rule.

An exception is made for a gift of life insurance within three years of death. So, if an insured transferor of a life insurance policy with a cash value of $3,000 or less dies within three years of the transfer of the policy, the entire policy proceeds will be included in the insured's gross estate.

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