HASHEM and SIMMS, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

George K. Hashem, CPA *Tyler W. Simms, CPA*

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Dear Client,

You may have concerns about the federal income tax consequences regarding the value of property acquired by gift, bequest, devise or inheritance, this letter is intended to you to provide you with a very brief overview of this subject matter. Once you have had a chance to review this letter, you may have a needto get together in order to discuss your particular circumstances.

In general, gross income does not include for federal income tax purposes the value of property acquired by gift, bequest, devise, or inheritance. It does, however, include the income from any property acquired by gift, bequest, devise, or inheritance and where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.

In addition, where, under the terms of the gift, bequest, devise, or inheritance, the payment, crediting, or distribution thereof is to be made at intervals, then, to the extent that it is paid or credited or to be distributed out of income from property, it will be treated for purposes of federal income tax law as a gift, bequest, devise or inheritance of income from property, and is thus includible in the recipient's gross income. Similarly, any amount included in the gross income of a beneficiary under subchapter J is also treated for purposes of federal income tax law as a gift, bequest, devise, or inheritance of income from property and is thus includible in the recipient's gross income.

Finally, any amount transferred by or for an employer to, or for the benefit of, an employee, is includible in the gross income of the recipient under federal income tax law, excluding, however certain employee achievement awards and certain de minimis fringes.

The exclusion from gross income does not apply to prizes and awards nor does it apply to scholarships and fellowship grants. In addition, it is not intended to tax a donee upon the same income which is taxed to the grantor of a trust or assignor of income.

Critical to the determination as to whether any gratuitous transfer of money or property may be excludible from the recipient's gross income under these statutory rules is that the transfer qualifies as a gift, whether it is a lifetime gift (sometimes referred to as an "inter vivos gift" or a gift transfer at death (sometimes referred to as a "gift causa mortis"). The term "gift," though a common expression, has significantly differing meanings in legal parlance. For example, when used in reference to federal estate and gift taxes, it generally means a transfer of property for less than its fair market value. When used in reference to contract law, it generally means a transfer made for no legal consideration.

276 Newport Road, The Gallery Suite 218, New London, NH 03257 (603) 526-6809 FAX (603)526-6908

Neither the Internal Revenue Code nor the regulations define a gift for purposes of the exclusionary rule. The meaning of the term "gift" for such purposes has experienced a long and varied history of interpretation in the courts. In a leading 1960 decision, the Supreme Court in Comr. v. Duberstein, 363 U.S. 278, 288 (1960), summarized the relevant case law and established that a gift will be excluded from the recipient's gross income under federal income tax law if it is primarily motivated by a "detached and disinterested generosity" made on the donor's part "out of affection, respect, admiration, charity or like impulses" and not by moral or legal obligations or anticipation of economic benefit, and not in return for services. This standard for determining whether a gift, bequest, devise or inheritance will be excludible from a recipient's gross income is sometimes referred to today as the "Duberstein standard."

A determination of whether a transfer proceeds from detached and disinterested generosity requires an inquiry into the transferor's intention in making the payment. Insight into a transferor's intention can be gained by examining the factors that the transferor considered in deciding whether to make the transfer and the form of the assistance. A donor's characterization of his action is not determinative — there must be an objective inquiry as to whether what is called a gift amounts to it in reality. Note that the "external features" of a transaction may be examined to determine if a transfer was made with the expectation of a quid pro quo.

Accordingly, in determining whether a gift is made for these purposes, the primary factor is the transferor's dominant motive or intention in making the transfer. Identification of the dominant motive for the transfer must be made on the basis of all of the facts. Thus, a voluntary transfer of property from one person to another without compensation or consideration is not necessarily a gift for federal income tax purposes. Note that the subjective motives of a donor are not relevant for federal gift tax purposes.

In addition to the necessary "intent" or "motive" necessary to qualify for the exclusion, a gift must also be complete under federal income tax law. A gift is generally deemed complete for these purposes if three requisite elements are present: First, an intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion and control of the subject at the very time he undertakes to make the gift. Second, the irrevocable transfer of the present title, dominion and control of the thing given by the donor. Third, the delivery, by the donor to the donee, of the subject of the gift or of the most effectual means of commanding the dominion of it. Whether the delivery and acceptance requirements (i.e., the "formalities") have been met is usually determined under state law. Thus, in order to ensure the desired tax results, it is critical to ascertain that the formalities required under state law have been met.

With respect to will contests or other litigation conducted against the estate or between heirs, state law determination of the parties' rights is not controlling for purposes of these rules; rather, the underlying nature of the claim which was adjudicated forms the basis for determining the federal income tax consequences. Hence, the taxability of an amount a taxpayer receives in settlement of a lawsuit is determined by reference to the origin and character of the claim which gave rise to the lawsuit.

Since the determination of whether a transfer of property is a gift depends primarily upon an assessment of the factual situation, including the donor's intent and compliance with the local law concerning delivery and acceptance, planning for gift transfers is necessary to avoid causing the transferee to include the value in gross income. Similarly, a devise, bequest, or inheritance should be structured so that the property itself rather than the income from the property is passed on to the intended beneficiary if it is not desirable to increase that recipient's gross income. Many of the cases and rulings are quite complex in this area and in some cases, the results vary depending upon the jurisdiction in which you reside. In addition, the inquiry for these purposes is fact intensive. Moreover, the federal gift and estate tax consequences of any such transfer, which are not addressed in this letter, must also be considered. For this reason, the facts of your situation should be carefully reviewed.

Sincerely,

George K Hashem, CPA

Tyler W Simms, CPA

Member American Institute of Certified Public Accountants

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