ANALYSIS OF THE 1998 GIFT TAX PANEL STUDY

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The Federal gift tax is one of three taxes included in the U.S. transfer tax system, which, simply stated, is a unified system that taxes transfers of property completed both during life and at death. The two other components of the U.S. transfer tax system are the estate tax, applied to the value of property transferred at death, and the generation-skipping transfer tax, applied to the value of property transferred to trust for the benefit of an individual or individuals two or more generations below that of the grantor, or donor.

The first Federal gift tax was introduced in the Revenue Act of 1924. Congress imposed the 1924 tax after it realized that wealthy Americans could avoid the estate tax, introduced in 1916, by transferring wealth during their lifetimes, called *inter vivos* giving. Tax-free *inter vivos* gifts effectively negated the estate tax's capacity to redistribute wealth accumulated by large estates and removed a source of revenue from the Federal Government's reach (Johnson and Eller, 1998).

The first gift tax was short-lived. Due to strong opposition against estate and gift taxes during the 1920's, Congress repealed the gift tax with the Revenue Act of 1926 (Zaritsky and Ripy, 1984). Reintroduced in the Revenue Act of 1932, when the need to finance Federal spending during the Great Depression outweighed opposition to gift taxation, the 1932 gift tax allowed a grantor to transfer $50,000 during his or her life and allowed a $5,000 annual exclusion per gift recipient, or donee. The 1932 Act set gift tax rates at three-quarters of the estate tax rates, a level maintained until 1976, when Congress passed the Tax Reform Act (TRA) of 1976 and created the unified estate and gift tax framework that consisted of a "single, graduated rate of tax imposed on both lifetime gift and testamentary dispositions" (Zaritsky and Ripy, 1984). The generation-skipping transfer tax was also introduced in TRA of 1976.

During the years since 1932, features such as the marital deduction and rules on split gifts were introduced to gift tax law, but the predominant changes to the law were adjustments to the amount of lifetime exemption and annual exclusion. A gift is taxed under the law that is in effect during the year in which the gift is completed, or given. According to transfer tax law in effect for gifts completed in 1997, the focus of this paper, a grantor was required to file a Federal gift tax return (Form 709) for transfers of property in excess of $10,000 per donee, and the lifetime unified credit--equal to the tax on the lifetime-giving threshold for 1997, $600,000--was $192,800. Under Internal Revenue Code (IRC) section 2511(a), the gift tax applies to a broad spectrum of gifts, "whether the gift is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." Regulation 25.2511-1(c)(1) provides that a completed gift, one that is subject to tax, is "any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed."

Gift tax data extracted from Federal gift tax returns provide a glimpse into the economic behavior of predominantly wealthy Americans. Such behavior includes donors' transfers of money and other assets to gift recipients and the creation and continued funding of trusts, both of which are reported on gift tax returns. Since individuals are required to file annual returns for gifts completed during a prior calendar year, it is possible to construct a panel of gift tax returns filed during life for a subset of U.S. taxpayers, thereby capturing the lifetime giving patterns exhibited by the group.

The Statistics of Income Division (SOI) of the Internal Revenue Service (IRS), an organization that extracts and publishes data from Federal tax and information returns, initiated the 1998 Gift Tax Panel Study in order to examine gift tax revenue, as well as the lifetime giving patterns of wealthy Americans. At the close of the study, SOI will have obtained and extracted data from post-1976 returns filed by donors included in the study, creating a retrospective panel of returns for selected donors. Resultant data will facilitate the research of lifetime giving patterns and patterns of trust creation and maintenance, among other goals.

The 1998 Gift Tax Panel Study is an exception to the usual design of SOI studies in which statistical samples are based on estimates of given populations of returns. Because SOI sampling of returns normally occurs immediately after IRS processing of returns for tax revenue purposes, the final population of returns is not known at the time of sample design and weekly selections. But the population of gift tax filers was known before the inception of the study because the sample frame for the study was the 1998 IRS Returns Transaction File (RTF), a data file that contains all Tax Year 1997 gift tax returns that posted to the IRS Master File during revenue processing in 1998.

This paper will present the results of the 1998 Gift Tax Panel Study. Total gifts, net gift tax, and other variables will be examined by sex and taxability status. The sample design, weighting, and, of course, future plans will also be addressed.

Sampling Design and Estimation

The sampling frame for the 1998 Gift Tax Panel Study included 219,414 Federal gift tax returns filed for gifts completed in 1997. Based on budget and other constraints, a sample of 10,000 returns, or donors, was targeted. The sample design for the study is a random sample stratified by two 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.

Neyman allocation is used to assign the designated sample to the stratum. A Bernoulli sample is selected independently from each stratum. In Bernoulli sampling, the sample size is a random number. For nontaxable returns, sampling rates vary from 0.9 percent, for returns with total gifts under $100,000, to 100 percent, for returns with $1 million or more in total gifts. For taxable returns, sampling rates vary from 12.6 percent, for returns with total gifts under $100,000, to 100 percent, for returns with totals gifts of $1 million or more.

The sampling selection scheme for each noncertainty stratum is based on the Taxpayer Identification Number (TIN), which is the donor's Social Security number (SSN), as found on the return and the RTF. An integer function of the SSN, called the Transformed Taxpayer Identification Number (TTIN), is computed. The last four digits of the TTIN is a pseudorandom number. A return for which the pseudorandom number is less than the sampling rate multiplied by 10,000 is selected into the sample. Any returns with total gifts of $1 million or more were automatically selected. Because all post-1976 gift tax returns for each donor in the sample are included in the study, the total number of Federal gift tax returns in the panel is 46,300.

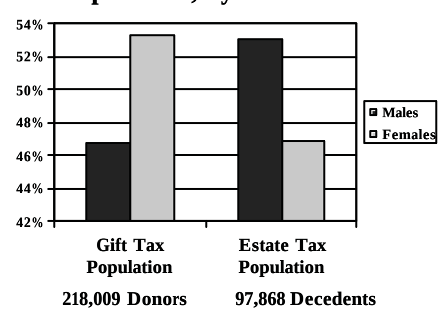
Each return in the sample is weighted to reflect its share of the population of 1998 filers who gave gifts in 1997. Because of the variation of the sample sizes, the post-stratification technique is used. The post-stratified weight is computed by dividing the population count of filed returns in a given stratum by the realized number of the sample return in that stratum. These weights are adjusted for missing returns. The weights range from 1.08 for the largest strata of nontaxable gifts to 120.05 for the smallest strata of taxable gifts. These weights are applied to the sample data to produce aggregate estimates for items of interest, such as total gifts, total deductions, and total taxes.

Results

Characteristics of the Donor Population

There were 218,009 donors required to file Federal gift tax returns in 1998 for gifts completed in 1997. These donors gave more than $31.1 billion in total gifts to gift recipients, or donees, and they reported $3.2 billion in net gift tax liability. The majority of the donor population was female, as 53.3 percent of the population was female, and only 46.7 percent was male (see Figure 1). The sex composition of the gift tax filing population is dissimilar to that of the estate tax filing population, which was comprised of 53.1 percent males and 46.9 percent females in Filing Year 1998. Since women, on average, outlive their male counterparts, they may attempt to reduce their potential taxable estates, for estate tax purposes, by giving gifts during life, according to astute estate tax planning practices. This may explain women's overriding presence in the donor population.

Figure 1: Comparison of Gift and Estate Tax Populations, By Sex

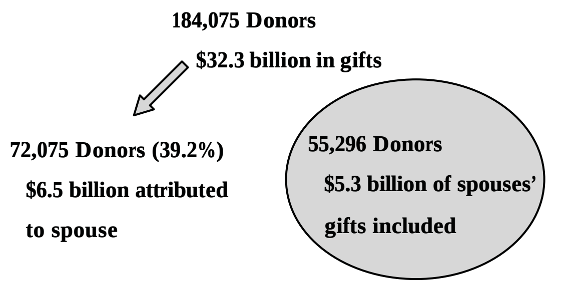


Married Donors

Federal gift tax law allows married couples to split gifts to third parties if certain requirements are met. For instance, both spouses must be citizens or residents of the United States, and they must be married to one another at the time of the gift. If a couple's marital status changes during the year of the gift, due to divorce or death, then no spouse may remarry and still elect to split gifts. In addition, agreeing to split gifts requires that all gifts to third parties, both taxable and nontaxable, must be split. When taxable gifts are given, the annual exclusion is doubled to $20,000, but, in turn, both spouses' available unified credits are depleted, according to Federal gift tax law in effect for 1997 gifts. Both the donor spouse and the consenting spouse must file gift tax returns unless certain requirements are met.

In the 1997 donor population, 184,075 individuals gave gifts that totaled $32.3 billion, and 72,075 of those donors attributed half of their gifts to their spouses (see Figure 2). The total value of gifts attributed to spouses was $6.5 billion. In addition, 55,296 donors included $5.3 billion in spouses' gifts on their own gift tax returns.

Figure 2: Gift-Splitting in the 1997 Donor Population



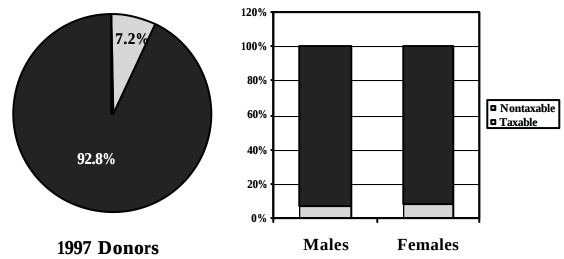
A donor is not obligated to report any outright gifts of present interest to his or her spouse under Federal gift tax law. However, a donor is required to report gifts to a spouse if the spouse is not a U.S. citizen at the time of the gift; if the gift was a terminable interest, such as a life or income interest in a trust; or if the gift was a future interest. A donor is not required to report gifts of life interests with power of appointment, since those gifts essentially become the property of the receiving spouse, in that the receiving spouse may, for example, specify the distribution of income from a trust.

Gift tax law also provides for an unlimited marital deduction for all outright gifts to a spouse. Terminable gifts, however, do not typically qualify for the marital deduction. For Gift Year 1997, 2,352 donors, or 1.1 percent of the donor population, deducted the value of gifts to their spouses. The amount of the deduction exceeded $816.5 million, or 2.6 percent of total gifts.

Taxability of Gift Tax Returns

The overwhelming majority of 1997 donors reported no gift tax liability in 1998. Of the 218,009 returns filed in 1998, 202,295, or 92.8 percent, were nontaxable, while only 15,714, or 7.2 percent, were taxable, i.e., reported a gift tax liability. Male and female donor populations were almost equally likely to report a tax liability. Males reported a tax liability on 6.4 percent of returns, while females reported a tax liability on 7.9 percent of returns (see Figure 3).

Figure 3: Percentage of Taxable & Nontaxable Returns



As age data become available, the gift tax population will be examined by age of donor.

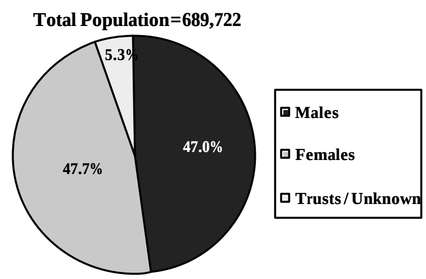
Analysis of Gifts and the Donee Population

The Federal gift tax return is a rich source of data on the transfer of wealth during life. Schedule A of Form 709, the gift tax return, is a listing of all gifts from a donor to his or her donees. In most cases, Schedule A's gift description includes the name of the donee and, therefore, the sex of the donee; the type of asset that was gifted; the amount of the gift (before the annual exclusion is subtracted); the method by which the gift was given, i.e., direct or through trust; and, in some cases, the relationship of the donee to the donor. If the donee was a trust, for example, a charitable trust, some trust detail, such as the type of trust, may also be available.

SOI-edited data are the only sources of donee and gift information from Federal gift tax returns. IRS Master File or Returns Transaction File (RTF) data do not contain this valuable information. In the course of the 1998 Gift Tax Panel Study, SOI extracted detailed donee and asset data from each Federal gift tax return included in the study. Assets, the building blocks of total gifts, were assigned to one of several asset categories.

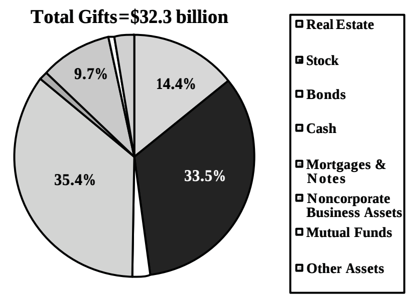
Donors who gave gifts in 1997 transferred assets to almost 690,000 recipients, including both individuals and trusts. Males and females were equally likely to receive gifts. Males were the recipients of direct gifts or gifts through trust in 47.0 percent of cases, while females received gifts, direct and through trust, in 47.7 percent of cases (see Figure 4). Gifts given in the creation or maintenance of trusts for the benefit of organizations or gifts to recipients of unknown sex occurred in 5.3 percent of cases.

Figure 4: Donee Population, By Sex of Donee



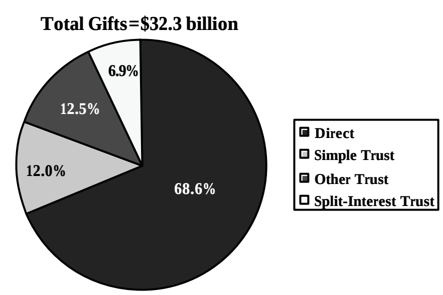
The 1997 donor population gave $11.4 billion in cash assets, including cash management accounts, to donees. This category of assets represented the largest percentage, 35.4 percent, of total gifts completed in 1997 (see Figure 5). The second largest category, narrowly following cash, was stock. Gifts of stock comprised 33.5 percent of total gifts. Donors gave $7.0 billion in corporate stock and $3.7 billion in the stock of closely held corporations. The third largest category of gifts was real estate, which includes the value of personal residences, commercial real estate, real estate partnerships, and other real estate. Real estate assets comprised 14.4 percent of total gifts, as donors gave $4.6 billion in real estate to donees. The fourth largest category, noncorporate business assets, which includes limited and family limited partnerships and other noncorporate assets, comprised 9.7 percent of total gifts.

Figure 5: Asset Composition of Gifts to Donees



Because SOI extracted data on the method by which gifts were given, it is possible to examine gift tax data for 1997 donors by type of gift instrument. The majority of gifts were direct or outright, 68.6 percent (see Figure 6). The remaining gifts, 31.4 percent, were given through trust instruments. About 12.0 percent of gifts were given through simple trusts, trusts that are typically established for the benefit of one individual. Other trusts, excluding split-interest trusts, represented 12.5 percent of total gifts. The remaining gifts, 6.9 percent, were given through a variety of split-interest trusts, which are established by donors for the benefit of both charities and private individuals. Split-interest trusts include charitable lead trusts (annuity or unitrust), charitable remainder trusts (annuity or unitrust), and pooled income funds.

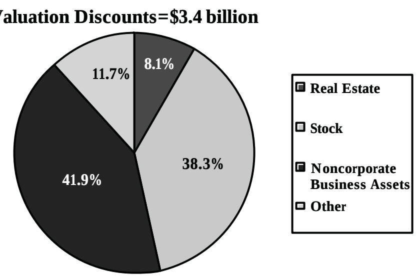
Figure 6: Percentage of Gifts, By Type of Instrument



Minority and marketability discounting techniques are used in estate tax planning to reduce the value of transferred wealth and, thereby, reduce the amount of transfer taxes owed by grantors. While much discounting occurs for business assets, discounting techniques, in many cases, are also applied to other, non-business assets. The total value of minority and marketability discounts applied to

1997 gifts was $3.4 billion, or 10.7 percent of total gifts (see Figure 7). The largest percentage of discounts, 41.9 percent, was applied to the value of noncorporate business assets, including limited and family limited partnerships and noncorporate business assets. The value of minority and marketability discounts for these assets reached $1.4 billion. Stock holdings were discounted at $1.3 billion, or 38.3 percent of total discounts. The third largest category of discounts was the other category, which includes various assets, such as mutual funds, bonds, farm assets, and depletable and intangible assets. Discounts taken on other assets totaled $401.5 million and represented 11.7 percent of all discounts. The value of real estate minority discounts reached $280.4 million, making that category the fourth largest, 8.2 percent of total discounts.

Figure 7: Composition of Valuation Discounts, By Gift Type

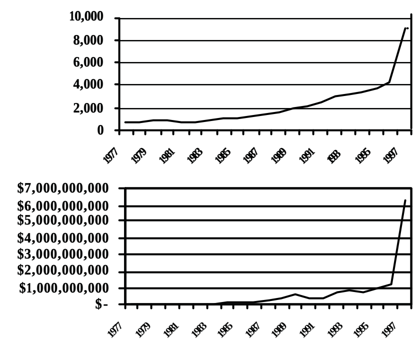


Future Plans

In the spring of 2003, SOI will initiate a study of Federal gift tax returns that will examine Gift Year 2002 and Filing Year 2003. The new study will also include a subsample of returns selected in the 1998 study. This design will allow us to follow a panel of 1998 gift donors into the future. For the small sub-sample of 1998 donors, we will be able to extract data from returns filed between 1998 and 2003.

This paper has presented results for Gift Year 2002. However, in the course of the 1998 Gift Tax Panel Study, data for all gifts given by 1997 donors between 1977 and 1997 were collected. Figure 8 presents an unweighted number of returns for 1997 donors in each year, 1977 through 1997, as well as an unweighted total for current period gifts. The number of returns filed and the amount of gifts began to increase in the middle of the 20-year period. However, in each year, there were returns that were unavailable to SOI for processing. For each 1997 donor, the number and specific years of missing returns were recorded. This information, along with RTF available from 1988 to present, will be used to impute for missing values.

Figure 8: Number and Amount of Current Period Gifts, 1977-1997



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