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An important Tax law update from the law firm of Jackson Walker.

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IRS Cracks Down on Undisclosed Real Estate Gifts

By Shawn O'Brien

The recent changes in estate and gift tax laws have incentivized taxpayers to give large gifts of real estate as a form of estate planning. As a result of many taxpayers failing to file a Form 709 United States Gift (and Generation Skipping Transfer) Tax Return, the IRS has quietly launched a gift tax enforcement initiative to find taxpayers making real estate gifts.

Legislative Change in Gift Tax Exemption

Last year, Congress enacted the "Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010." This Act increased the gift tax exemption from $1 million to $5 million, enabling a person to gift more during his or her lifetime without being taxed. As a result of this Act, large transfers of real estate have become an increasingly popular method of estate planning.

IRS Filing Requirements For Gifts

Despite the change in estate and gift tax laws, every U.S. citizen and resident must still file a Form 709 for any gifts with a fair market value of $13,000 or more in one calendar year, including gratuitous transfers of real estate.

The Form 709 must be filed with the IRS prior to April 15th of the year succeeding the year in which the gift was made. Failure to file a Form 709 or undervaluation of gifts on a Form 709 can result in penalties to the taxpayers making gifts.

IRS Gift Tax Enforcement Initiative

The IRS is cracking down on taxpayers who make gifts of real estate and fail to file a Form 709. To enforce the Form 709 filing requirement, the IRS has started reviewing local real property records to find taxpayers who have made gratuitous real estate transfers.

The IRS has been relatively quiet about this initiative, but a recent California federal court decision (*In re Tax Liabilities of John Does*, No. 2:10–mc–00130–MCE–EFB (E.D. Cal. 2011)), made this initiative public. The decision, which was in response to an IRS John Doe summons, refused to force the California taxing authority to release its land-transfer records to the IRS. The California court denied the summons because the IRS did not prove that it could not obtain the records from another readily available source. While the California court's denial of the John Doe summons is interesting in its own right, the decision is significant because it publicly announced the IRS initiative to pursue and penalize taxpayers who made gifts of real estate, but did not file a Form 709.

While California has refused to release its real property records to the IRS, many states have voluntarily disclosed their real property records to the IRS for investigation. Texas is among the 16 states that have released land-transfer records to the IRS.[1] Other states include: Connecticut, Florida, Hawaii, Nebraska, New Hampshire,

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The extent of noncompliance with Form 709 filing requirements is extremely high. According to a sworn declaration by Josephine Bonaffini, Federal/State Coordinator for the IRS Estate and Gift Tax Program, more than 323 taxpayers have been examined for failing to report possible real estate gifts, 217 taxpayers are currently being examined and 250 more taxpayers are being considered for review. A sampling of local real property records reviewed by the IRS showed noncompliance rates of 60% in Connecticut and Nebraska, 80% in Washington, 90% in Florida and Virginia and 100% in Ohio. The IRS has not yet released the rate of noncompliance with Form 709 filing requirements for the State of Texas.

Suggested Action

Taxpayers who have made real estate gifts should consult their tax advisor to determine whether they are in compliance with gift tax filing requirements. The IRS is analyzing local real property records, including real property records in the State of Texas. For more information regarding how you may be affected by this IRS compliance initiative and what you can do to protect yourself from liability, please contact **Shawn O'Brien** at 713-752-4544 or **sobrien@jw.com** or any member of Jackson Walker's **Tax** or **Wealth Planning** groups.

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[1] Declaration of Josephine Bonaffini, Dec. 21, 2010, as part of *In re Tax Liabilities of John Does*.

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