The NSA Complete EA Exam Review Course consists of three volumes devoted to each of the three parts of the Enrolled Agents Examination.

Each Part is divided into 50 topics, and each topic is divided into subtopics.

The enclosed sample is for Topic 29C, Adjusted Basis – Gift Property.

The “header box” for each subtopic discloses the priority of the topic (“Red” indicates that the topic is asked frequently on the exam and involves relatively straight-forward concepts).

The “header box” also discloses the number of questions on that topic that appeared on the last ten publically available EA exams (frequency analysis discloses that this topic was the most tested of all topics on old exams).

The header box is followed a concise and focused discussion of the basic tax law for the topic, supplemented with examples and occasional diagrams that summarize the basic law.

The discussion is followed by a selection of questions from prior EA exams during the open-era exam (see sample); this provides insights as to the level of detail to be expected on the exam.

Note that a few of the questions are shown in bold; These are part of the “Top 150 Questions” for Part 1 of the exam. All 150 questions are repeated at the end of the module, and several blank answer sheets are provided to reinforce the concepts for quick study right before taking the exam.

Answers and explanations for all questions are provided in the back matter of each study volume (see sample).

Each part of the exam includes a set of Final Review Cards, which provide very concise summaries for memory jogging right before taking the exam.

The final package also includes 18 weekly study guides, 6 for each part of the exam, that discuss the tricks of the trade in studying for certain topics; more review questions are also included.

The following pages reproduce the discussion of Topic 29C, Adjusted Basis – Gift Property, the 10 prior exam questions related to this topic, the portion of the Answers & Explanations section for this topic, and a portion of the Final Review Card.
C. Adjusted Basis – Gift Property

Gift Assets – The Basic Rules – Property acquired by a gift can create a “dual basis” problem in that the basis for loss may differ from the basis for gain. The basic rules are: (1) the basis for gain is always the donor’s adjusted basis; (2) the basis for loss is the lesser of the donor’s basis or the fair market value (FMV) of the gift on the date of the gift; and (3) if the amount realized (sales price) is between the two possible bases, then no gain or loss is recognized (the basis is assumed to equal the amount realized).

Gift Tax Add-on to Basis – In some cases, a donor may be required to pay a federal gift tax on gifted property. To mitigate multiple layers of taxation, the Code provides a special addition to the donor’s basis in determining a donee’s basis. The addition to the donor’s basis is determined as follows:

- Pre-1977 Gifts – 100% of the gift tax paid (as long as the basis doesn’t exceed FMV of the gift on the date of the gift).
- Post-1976 Gifts – A portion of the gift tax related to appreciation in value of the gift:
  \[ \text{Addition} = \text{Gift Tax Paid} \times \left( \frac{\text{Appreciation in Value}}{\text{FMV of Gift @ Date of Gift}} \right) \]

Figure 1-8 – Examples – Gain/Loss on Sales of Gift Property by Donee

<table>
<thead>
<tr>
<th>Facts:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Taxpayer receives 100 shares of stock as a gift on 4/1/2014</td>
<td>• Assumptions $15,000 FMV of Gift on 4/1/2014:</td>
<td>• Assumptions $8,000 FMV of Gift on 4/1/2014:</td>
</tr>
<tr>
<td>• Cost of stock to donor on 1/1/2010 was $10,000</td>
<td><strong>If sold on 9/1/2014 for $18,000:</strong></td>
<td><strong>If sold on 9/1/2014 for $18,000:</strong></td>
</tr>
<tr>
<td>• Donor paid a gift tax of $1,200 on the transfer</td>
<td>Gain = $18,000 – $10,000 + [\frac{($5,000/15,000) \times $1,200]}{]</td>
<td>Gain = $18,000 – $10,000</td>
</tr>
<tr>
<td></td>
<td>Gain = $18,000 – $10,400</td>
<td>Gain = $8,000 long-term gain*</td>
</tr>
<tr>
<td></td>
<td>Gain = $7,600 long-term gain*</td>
<td></td>
</tr>
<tr>
<td><strong>If sold on 9/1/2014 for $6,000:</strong></td>
<td>Loss = $6,000 – $10,400</td>
<td>[Loss = $6,000 - $8,000]</td>
</tr>
<tr>
<td></td>
<td>Loss = $4,400 long-term loss*</td>
<td>Loss = $2,000 short-term loss**</td>
</tr>
<tr>
<td><strong>If sold on 9/1/2014 for $12,000:</strong></td>
<td>Gain = $12,000 – $10,400</td>
<td>[Gain (or Loss) = $0***]</td>
</tr>
<tr>
<td></td>
<td>Gain = $1,600 long-term gain*</td>
<td></td>
</tr>
</tbody>
</table>

* Holding period begins on 1/1/2010 (since donor’s basis is used)
** Holding period begins on 4/1/2014 (since fair market value is used as basis)
*** Selling price is between the two possible bases; no gain or loss is recognized, since the adjusted basis is assumed to equal the amount realized on the sale
Example: Mitch Ryder received 100 shares of stock as a gift from his mother this year. His mother had paid $20,000 for the shares in 2009, and they were worth $25,000 on the date of the gift. Mitch’s mother paid $4,000 gift taxes on the transfer. Mitch may increase the donor’s basis of $20,000 by $800, the portion of the gift tax related to the appreciation in value of the shares (i.e., $5,000 appreciation/$25,000 FMV x $4,000). Thus, Mitch’s basis for both gain and loss is $20,800 ($20,000 + $800). Note that the add-on occurs only when the gift has appreciated in value; if the property has depreciated in value, this calculation may be ignored.

**Holding Period of Gifts** – If the donor’s basis is used to determine gain or loss, then the holding period of the donor is tacked on to the seller’s holding period. If the FMV of the gift is used to determine gain or loss, then the holding period begins on the date of the gift. In the example given above, Mitch’s holding period is presumed to start in 2009.

**Comprehensive Study Aid** – Figure 1-8 (presented on the previous page) provides a comprehensive demonstration problem illustrating the various rules. *Be sure to review this (more than once!) prior to the exam. This has proven to be one of the most heavily tested topics on the EA exam (21 questions in 9 years!).*

**Review Questions – Topic 29C – Adjusted Basis – Gift Property**

1. Jerry received two acres of land valued at $10,000 as a gift. The donor’s adjusted basis was $12,000. Jerry subsequently sold the land for $20,000. For purposes of computing his gain, what is Jerry’s basis in the land?
   a. $12,000  
   b. $10,000  
   c. $8,000  
   d. $2,000

2. Charles gave his daughter, Jane, a residential house. He had purchased the house for $250,000 in 2002. The fair market value on the date of the gift was $300,000. Charles had added a $25,000 roof the year before he gave it to Jane. Jane converts the house to a residential rental property within one year of the gift. Jane’s basis in the property is:
   a. $300,000  
   b. $250,000  
   c. $225,000  
   d. $275,000

3. In February, Billy’s father deeded him 400 acres of land. The fair market value on the date of the transfer was $350,000. His father had paid $40,000 for the land. No gift tax was paid on the transfer. When Billy’s father died six months later, the fair market value of the land was $400,000. What is Billy’s basis in the 400 acres?
   a. $400,000  
   b. $350,000  
   c. $40,000  
   d. $260,000
4. In 2007, Paul received a boat as a gift from his father. At the time of the gift, the boat had a fair market value of $60,000 and an adjusted basis of $80,000 to Paul's father. After Paul received the boat, nothing occurred affecting Paul's basis in the boat. In 2014, Paul sold the boat for $75,000. What is the amount and character of Paul’s gain?
   a. ordinary income of $15,000
   b. long-term capital gain of $15,000
   c. long-term capital loss of $5,000
   d. neither a gain nor a loss

5. Juan received a gift of property from his uncle. At the time of the gift, the property had a fair market value of $100,000 and an adjusted basis to his uncle of $40,000. Juan’s uncle paid a gift tax on this transfer of $18,000. What is Juan’s basis in the property?
   a. $40,000
   b. $50,800
   c. $60,000
   d. $128,000

6. Bob’s aunt Barbara gave him a house. At the time of the gift, the house had a fair market value of $36,000 and his aunt’s adjusted basis was $12,000. His aunt paid a gift tax on $6,000 on the house. What is Bob’s basis in the house for purposes of determining gain?
   a. $16,000
   b. $18,000
   c. $36,000
   d. $42,000

7. Your father gave you a gift of property with a fair market value of $75,000. His adjusted basis was $50,000. The gift tax paid was $15,000. What is your basis in the property?
   a. $55,000
   b. $75,000
   c. $50,000
   d. $53,333

8. Bill gave his daughter, Jane, his personal residence with an adjusted basis to him of $52,000 and a fair market value of $50,000. Jane lived in the house for two years and then sold it for $48,000. Jane will
   a. report no gain or loss
   b. report a $2,000 loss
   c. report a $4,000 loss
   d. have her father report a $4,000 loss

9. Tran received a vacant parcel of land from her uncle as a gift. Tran’s uncle purchased the land in 1990 for $15,000, and at the time of the gift to his niece, he paid $500 in gift tax based on the land’s fair market value of $13,000. Tran did not have any other events that increased or decreased her basis in the gift after she received it. What is her gain if she sold her property for $17,000?
   a. $4,000 gain
   b. $3,500 gain
   c. $2,000 gain
   d. $1,500 gain
10. Wanda purchased a manuscript in 1943 for $10. In 2012, the year before her death, Wanda gave the manuscript to her granddaughter Ruth. At the time of the gift the manuscript had an appraised value of $510. In 2013, Ruth sells the manuscript for $1,010. What is the amount and character of Ruth’s gain from the sale of the manuscript?

a. $1,000 long-term capital gain
b. $1,000 ordinary gain
c. $500 long-term capital gain
d. $500 ordinary gain

Sample Answer Sheet for Part 1

| 29-C-1 | a | Donor’s basis always used for purposes of determining gain |
| 29-C-2 | d | Basis for property is donor’s cost plus the cost of the improvement |
| 29-C-3 | c | This is a gift property, so the basis is a carryover of the donor’s basis |
| 29-C-4 | d | Selling price is between the two possible bases (and FMV < basis) |
| 29-C-5 | b | Donor’s basis is increased by (60,000/100,000 x $18,000 gift tax) |
| 29-C-6 | a | Donor’s basis is increased by (24,000/36,000 x $6,000 gift tax) |
| 29-C-7 | a | Donor’s basis is increased by (25,000/75,000 x $15,000 gift tax) |
| 29-C-8 | a | Careful - since the residence is a purely personal asset, the $2,000 loss is not allowed |
| 29-C-9 | c | No gift tax add-on is permitted, since donor’s cost exceeds FMV |
| 29-C-10 | a | Donor’s basis of $10 is used, holding periods tack to produce long-term capital gain |

Sample Portion of Final Review Card for Part 1

29 Determining Adj. Basis of Property – Purchased – total cost incl. sales, tax, freight-in & install., bargain purchase allocate by relative FMVs, above FMV paid allocate by FMVs & excess to goodwill; stock – stock div. or rights nontaxable if proportionate, allocate cost to all shares (by blocks of stock); gifts – donor’s basis for gain, lesser of donor’s basis or FMV as basis for loss, $0 gain if between two bases, partial gift tax add-on, tack donor’s holding period; inherited (FMV at date of death or Alternate Val. Date 6 mos. later, automatic LT, use state value if no estate tax); converted personal (basis for loss/depr lesser of cost or FMV @ conversion); S Corporation Stock (basis like partnership, increase for income and contributions, decrease for losses and withdrawals).