Tax Smart Gifting

Article Highlights:

- Lifetime exemption
- Annual exemption
- Medical exemption
- Education exemption
- Gifting techniques

Frequently, taxpayers think that gifts of cash, securities or other assets they give to other individuals are tax deductible and, in turn, the gift recipient sometimes thinks income tax must be paid on the gift received. Nothing is further from the truth. To fully understand the ramifications of gifting, one needs to realize that gift tax laws are interrelated with estate tax laws, and Uncle Sam does not want you giving away your wealth before you pass away to avoid inheritance taxes.

As a result, what you give away prior to death will reduce the amount that can pass to your beneficiaries free of inheritance taxes after your death. For 2014, the lifetime exemption from inheritance tax is $5.34 million ($5.43 million for 2015). The following amounts do not reduce the lifetime exemption:

- **$14,000 each to any number of recipients during every tax year.** The amount is periodically adjusted for inflation, but the amount for 2014 and 2015 remains at $14,000.
- **Directly pay medical expenses.** This applies to amounts paid by one individual on behalf of another individual **directly** to a provider of medical care as payment for that medical care. Payments for medical insurance qualify for this exclusion.
- **Directly pay education expenses.** This applies to amounts paid by one individual on behalf of another individual **directly** to a qualifying educational organization as tuition for that other individual. Costs of room and board aren't eligible as direct payments.

If the gift giver is married and both spouses are in agreement, gifts to recipients made during a year can be treated as split between the husband and wife, even if the cash or property gift was made by only one of them. Thus, by using this technique, a married couple can give $28,000 a year to each recipient under the annual limitation discussed previously.

Gifting Techniques:

High-Wealth Individuals – If you are a high-wealth individual who would like to pass as much on to your heirs as possible while living, without reducing the lifetime exemption, you could pay directly your heirs' medical expenses and higher education expenses in addition to annual gifts of cash or property of $14,000. You may want to do this, even if you are not a high-worth individual, to avoid having to file a gift tax return.

Medical Expenses – Except in rare circumstances, you cannot deduct the medical expenses you pay for another person, and they cannot deduct the expenses either since they did not pay them. Thus careful consideration should be given regarding whether you make the gift directly to the individual subject to the $14,000 annual limit, which would allow him or her to pay the medical expenses and claim the medical deduction on his or her tax return, or you pay the medical expenses directly.

If the medical expenses you want to pay are greater than $14,000, then you could always gift $14,000 to the individual and pay the balance directly to the care provider(s), and thereby avoid reducing the lifetime exemption. Under rare circumstances, the recipient who will benefit from your gifts may qualify as your medical dependent, under which circumstance you would be able to deduct the medical expenses if they had been paid directly to the doctor, hospital or other provider.

Education Expenses – When you pay the qualified post-secondary education tuition for another individual, it does not mean, as is the case for medical expenses, that someone cannot benefit taxwise. Tax law says that whoever claims the exemption for the student is entitled to the American opportunity credit or lifetime learning credit for higher education expenses if they otherwise qualify.

Gifts of Appreciated Property – Consider replacing your cash gifts with gifts of appreciated property, such as stock for which you have a "paper gain." When you gift an appreciated asset, the potential gain on the asset transfers to the recipient. This works for individuals, except for children who are subject to the kiddie tax, which requires the child's income to be taxed at the parent's tax rate if it is higher than the child's rate. It also works great for contributions to charitable organizations. Although not subject to the gift tax rules, an appreciated asset gifted to a charity not only gets you out of reporting any gain from the appreciation, but you also get a charitable tax deduction equal to the fair market value (FMV) of the asset. The deduction for these gifts is generally limited to 30% of your adjusted gross income (AGI), but the excess carries over for up to five years of future returns.

Please call this office if you need assistance with planning your gifting strategies.