Don't Let the IRS Sour the Sweetness of Your Financial Favors

Bestowing Gifts and Avoiding Taxes

by Alexandra Armstrong, CFP, CRPC, and Christopher Rivers, CFP, CRPC

The month of January is often thought to be named after the Roman god Janus, who was said to have two faces, one looking to the past and one to the future. In modern times January often finds us reflecting on the afterglow of the holiday season, while planning for the future through New Year's resolutions.

One of the joys of the holiday season is giving to others. When gifts grow beyond the simple toys of childhood and become more substantial gifts, it's important to plan for them within the framework of the United States tax system.

The federal gift tax is one of the most widely misunderstood pieces of our tax structure. The federal gift tax applies to transfers of property where the donor does not receive value in return. Like the estate tax, this is a transfer tax and is completely independent of income tax. If gifts are made above certain limits, you're required to file a gift tax return (Internal Revenue Form 709) along with your income tax return.

Wait — If I Give Away Something, I May Have to Pay a Tax?

In some instances, a gift is subject to gift tax. The donor — the person giving the gift — is responsible for filing a gift tax return and paying gift tax if necessary. Gifts you receive aren't considered income, so there's no income tax due.

In 2019, the annual gift tax exclusion is $15,000 per recipient. Total gifts up to this amount are tax-free to the recipient. The limit applies per person, so a married couple can give $30,000 to their daughter with no gift tax implications.

As an example, if a mother and father write separate checks to their daughter for $11,000 each, no gift tax return would be necessary and no gift tax due. If Mom writes one check (or makes one gift of stock) for $22,000, there will still be no gift tax due, but the couple will be required to file a gift tax return to indicate that they have made a gift that should be considered split between the two of them, thus staying below the annual $30,000 exclusion.

If the daughter is married, a total of up to $60,000 could be given tax-free, with $15,000 each going to both the daughter and her spouse, from both Mom and Dad.

When Must I File a Gift Tax Return?

Generally, a gift tax return is required in each of the following instances:

- **The total value of all gifts** made to the same person within the 2019 calendar year exceeds $15,000. (Note that this annual gift-tax exclusion may increase in the future with inflation.)
- **Your spouse gives property to the same person** that exceeds $15,000 in value in the 2019 calendar year. Although your spouse is the only one who really made the gifts, you and your spouse may elect to say the gifts came from both spouses, as noted in the example above.
- **The total value of gifts made from a spouse** who is a U.S. citizen made to a spouse who is not a U.S. citizen exceeds $152,000 in 2019. Gifts made to a spouse who is not a U.S. citizen are limited to a specific dollar amount, indexed for inflation each year. Gifts between two U.S. married citizens don't have this restriction.
- **You make a gift of a future interest** to anyone during the course of the year. A gift of a future interest is one in which the recipient will not be allowed free and immediate use of the gift.
- **A below-market transaction** can be considered a gift and could require a gift tax return to be filed. For instance, if you give your child a family heirloom worth $30,000 and ask the child to pay $10,000 for it, you have made a $20,000 gift. As this is over the $15,000 annual exclusion threshold, a gift tax return would be required. It's recommended that you get a professional appraisal when gifting valuable property.

When Is the Gift Tax Return Due?

The gift tax Form 709 is due on or before April 15 of the year following the year that you made the gift. If you aren't sure whether gifts you have made during the course of the year should be reported on Form 709, consult with your estate-planning attorney and accountant well before April 15 to be sure. If you extend your income tax filing to Oct. 15, this automatically extends the due date for a gift tax return.

Will I Owe Gift Tax?

Filing a gift tax return doesn't necessarily mean the donor must pay a gift tax. In fact, it's increasingly rare for there to be gift tax due, in large part due to the recent tax changes that went into effect in 2018.

In addition to the $15,000 annual exclusion, U.S. taxpayers also have a lifetime federal estate, gift and generation-skipping transfer tax exemption of $11.2 million for individuals and $22.4 million per couple. This is often referred to as the "unified credit." This means that if you use a portion of this exemption for gifts now, it will reduce the amount exempt from estate tax when you die.

To illustrate how this works, let's return to the couple above. In this instance, they want to give $130,000 to their daughter to help with a down payment on a house. Of that amount, $30,000 would be applied to the annual gift exclusion ($15,000 from Mom and $15,000 from Dad), leaving $100,000 that would be potentially exposed to gift tax.

Mom and Dad, however, could then elect to use $100,000 of their unified lifetime credit and avoid paying gift tax in 2019. That amount would be deducted from their lifetime credit, meaning that their estates would now be taxable above $22.3 million, instead of $22.4 million.

Given that very few households have more than $22.4 million in assets, it's clear that in most cases gifts over the $15,000 annual exclusion will simply be deducted from the lifetime credit.

Here again, you must file gift tax Form 709 to indicate to the IRS that you're using a portion of your lifetime credit, in order to avoid paying gift tax.

Exceptions to the Rule

There's always an exception to the rule, and the gift tax is no different.

Gifts may qualify for the medical exclusion if the payment is made directly to an institution that provides medical care or that provides medical insurance. This means you can pay for your grandchild's doctor bills in the amount of $10,000 and also give your grandchild an additional $15,000 without incurring any federal gift tax or having to file.

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Gifts made directly to a qualifying institution as tuition for a recipient's education are exempt from gift tax, regardless of the amount. You can pay your grandchild's college tuition of $45,000 and also give your grandchild an additional $15,000 in the same year without incurring any federal gift tax or having to file a gift tax return. In both cases it's crucial that the payment be made directly to the institution.

A popular use of the annual exclusion is to put money in Section 529 college savings plans. The law also permits tax-free gifts of as much as five years' worth of gifts per recipient at once — $75,000 per spouse in 2019. In this case, you must file a gift tax return electing to treat the gift as if it had been spread over five years. During this five-year period, you can't make additional annual exclusion gifts to the beneficiary of the 529 plan.

Filing Even When Not Required to Do So

In certain circumstances it may be wise to file a gift tax return even if the rules don't require it. Consider filing whenever you sell hard-to-value assets to a family member, such as real estate or a family business. If not filing, the IRS can claim transactions between family members were actually gifts in disguise.

Filing the gift tax return not only clarifies whether any consideration was offered, but also means that the IRS has only three years to challenge the legitimacy of the sale.

Keep Good Records

The exclusion amounts from estate and gift taxes are cumulative, so gift tax returns should be kept indefinitely. Keep copies of these returns forever. Yes, really — forever.

Although current tax laws mean that the vast majority of us will never pay gift tax, this is only true if gifts are properly documented and gift tax returns are filed in a timely fashion. As we move into 2019, consider a resolution to plan for future giving now in order to alleviate stress around the holidays.

Alexandra Armstrong is a CERTIFIED FINANCIAL PLANNER professional and Chartered Retirement Planning Counselor as well as chairman and founder of Armstrong, Fleming & Moore, Inc., a registered investment advisory firm located at 1800 M St. N.W., Suite 1010-S, Washington, D.C. 20036-5813, 202/887-8135.

Christopher Rivers, a CERTIFIED FINANCIAL PLANNER professional and Chartered Retirement Planning Counselor and co-author of this article is a principal of Armstrong, Fleming & Moore, Inc. Securities are offered through Commonwealth Financial Network, member FINRA/SIPC.