Gift Tax

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Gift Tax

There is no dollar limit on the amount that one person is allowed to give to another. Gift tax rules do not prohibit a donor from making gifts in excess of the annual exclusion ($15,000 for 2021). However, if more than the annual exclusion is given to any one recipient, other than a spouse or charity, the amount over the annual exclusion is considered a"taxable gift."

Consequences of making taxable gifts:

- Donor is required to file a gift tax return (Form 709) for the year.
- Taxable gifts reduce the donor's $11,700,000 (2021) lifetime gift and estate tax exclusion. Gift tax is paid once the exclusion is exhausted.
- Taxable gifts are added to the donor's taxable estate at death.

Donors with small estates can make gifts over the annual exclusion and pay no gift or estate tax.

Example: *Kay wants to give her house to her daughter, Mary. The FMV of the house is $250,000. Kay's other assets total $175,000. The only tax consequence to Kay as a result of the gift is the requirement to file a gift tax return. Kay is unlikely to use the full gift tax exclusion and unlikely to pay estate tax at her death.*

Annual Exclusion ($15,000 for 2021)

Gifts must be present interests to qualify for the annual exclusion.

Present and Future Interests

A present interest is an unrestricted right to the immediate use, possession, or enjoyment of property or its income. An annual exclusion is not allowed if these rights will begin at some time in the future. A gift in trust is a present interest if the trust will receive income and an ascertainable portion will flow steadily to the beneficiary.

Example: *Jo transfers securities into an irrevocable trust. Under the terms of the trust, Horace receives all trust income for life, and Sarah receives the securities at Horace's death. Horace has a present interest in the trust. Sarah has a future interest. The annual exclusion will apply to Horace's gift, but not to Sarah's.*

Gifts Subject to Gift Tax

Gift tax applies to any transfer by gift of real or personal property, whether tangible or intangible, that was made directly or indirectly, in trust, or by any other means to a donee. Gifts include transfers of cash, personal property, and payment of debts or expenses for another person. Certain transfers are specifically excluded from gift tax.

Completed Gifts

A gift is not subject to tax until the gift is complete. Gifts are valued on the date completed.

- ***Below-market sale.*** Property transferred in part as a sale and in part as a gift is a gift from the seller of the difference between the FMV and the amount realized. The seller's capital gain is the difference between the amount realized and adjusted basis. A loss is not deductible. The buyer's basis is the greater of the amount paid or gift basis.

  Example: *Nadya owns a cabin with a FMV of $200,000 and an adjusted basis of $50,000. She sells the property to her son, Jeremy, for $55,000. Nadya reports a capital gain of $5,000 on Form 1040 and a gift of $145,000 on Form 709. Jeremy's basis is $55,000 (assuming Nadya paid no gift tax on the gift).*
- ***Checks.*** Gifts by check are generally complete when the check is paid by the donor's bank.

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- ***Municipal bonds.*** Gifts of municipal bonds are subject to gift tax even though income is exempt from income tax.
- ***Stock.*** A gift is complete on the date the stock is transferred on the books of the corporation to the new owner.
- ***Trusts.*** A transfer to an irrevocable trust is a completed gift if the donor retains no power over the property. A transfer to a fully revocable trust is not a completed gift.

Loans

- ***Debt forgiveness.*** If an individual makes a loan, and as part of a prearranged plan intends to forgive the debt, the debt is a gift at the time the loan is made. If there is no prearranged plan, the lender makes a gift when the loan is forgiven.
- ***Below-market gift loans.*** If interest on a loan is less than the applicable federal rate (AFR), the foregone interest is a gift from the lender. In addition, foregone interest is taxable income to the lender.

  Find the AFR at https://apps.irs.gov/app/picklist/list/federalRates.html

  Exceptions: If the borrower and lender are individuals, and the outstanding amount of all loans between them is $10,000 or less, foregone interest is not subject to gift tax and is not included in the lender's income.

Joint Tenancies

The creation of a joint tenancy is a completed gift for some assets. For other assets, the gift is not complete until assets are withdrawn by the donee. Gifts are complete in most states as listed below.

Creation of joint tenancy completes the gift:

- Real property (if deed is recorded or delivered to donee).
- Stocks and mutual funds.
- U.S. Treasury securities other than U.S. Savings Bonds.

Withdrawal of assets from joint tenancy completes the gift:

- Bank and credit union accounts.
- Brokerage accounts in street name.
- U.S. Savings Bonds. If a purchaser registers bonds with a co-owner, a gift is complete when the bonds are reissued in the co-owner's name alone or when the purchaser allows the co-owner to redeem the bonds and keep the proceeds.

Example: *In 2021, Marge changed ownership of her house and bank accounts to joint tenancy with her daughter, Lori. Since Lori is entitled under state law to half the proceeds should the house be sold, Marge has made a completed gift of one-half of the value of the house. The transfer of the bank accounts is not a completed gift because Lori made no withdrawals from the accounts in 2021.*

Not Gifts

The following transfers are specifically excluded from gift tax and are not reported on Form 709.

Qualified Transfers for Tuition or Medical Expenses

Payment must be made directly from the donor to the school or care provider. Payments made to a beneficiary do not qualify even if the payments reimburse the beneficiary for tuition or medical expenses. Payments made to a school or medical provider from a trust do not qualify. The donor and donee do not need to be related. There is no limit on the amount that can be transferred. An annual exclusion gift can be made to the same beneficiary in the same year. Qualified medical expenses include any unreimbursed expenses that would be deductible medical expenses on Form 1040. Tuition can be for primary, secondary, or higher education and for part-time students. Books, room and board, and other expenses do not qualify.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 72.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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