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NEWSLETTER

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What Is a Gift

Generally

We sometimes receive questions about gifting and gift reporting. Although no tax is normally due, annual gifts of more than $14,000 are required to be reported on a properly filed gift tax return Form 709. A gift is normally created when a beneficial interest in property is transferred for less than full and adequate consideration in money or money's worth. Thus, a taxable gift can occur by creating a trust, forgiving a debt, making interest-free or below-market interest rate loans, assigning the benefits of a life insurance policy, sales for less than fair market value, or as a result of certain property settlements in divorce cases, as well as by direct transfer of cash or other property. The transfer may be direct or indirect and is measured by the property's value passing from the donor. The property may be real or personal, tangible or intangible.

Donative Intent

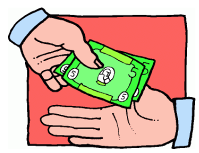
Donative intent on the part of the transferor is not required for the gift tax to apply. The application of the gift tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than the subjective motives of the donor. Therefore, the IRS can assess gift tax without having to prove donative intent. However, the lack of donative intent may be a determining factor when business transfers are involved. For example, a sale of property, even to a family member, will be deemed made for full and adequate consideration if the transaction is bona fide, at arm's-length, and free from donative intent.

Failing to take an estate or trust distribution may result in unintended gifts, if the distributions are deemed transferred to secondary beneficiaries or remaindermen. The Tax Court has ruled that an estate beneficiary had made indirect gifts of the estate's income to her children, since the income she was entitled to was not distributed to her. While the beneficiary had no intent to make gifts to her children, her failure to actually receive the income would cause its transfer to her children, which was a gift.

Full and Adequate Consideration

Generally, a transfer is not subject to the gift tax if the transferor receives adequate consideration in exchange for the property transferred. Consideration includes amounts received in money or money's worth and includes both tangible and intangible property. Consideration that is not reducible to a monetary value, such as love and affection or a promise to marry, is disregarded.

Payments for Personal Services



Adequate consideration can include the transfer of property in exchange for personal services. Payments made to a care giver can be treated as compensation and not gifts. Determining whether payments are compensation or gifts depends entirely on the facts. The amount of the payments must reflect the value of the services provided. If the payments exceed the value of the services rendered, gifts might exist.

If the employer files the appropriate payroll tax forms and makes payroll tax payments, the payments should not be considered gifts. Problems are created when no payroll tax forms or payments are filed.

Support Payments

Transfers made to discharge the transferor's legal obligation of support are deemed to be made in exchange for full and adequate consideration. Thus, a parent's payment of a child's food and shelter is not a gift. Whether a transfer is a gift or a discharge of legal obligation to support is a matter of state law. Various state laws define a legal support obligation and determine whether a minor's or dependent's own resources affect a parent's obligation to support. The duty to support must be a legally enforceable obligation under state or local law, not purely moral obligation.

A person's domicile impacts what is deemed support instead of a gift, because state law determines if a payment is for support or a gift. State law can either be defined by statute or case law. One major question that often arises is whether paying for a child's college education is a gift. If a child's parents are legally required to provide a college education, then education payments are not gifts. There are no exceptions found in the Code or regulations exempting a parent's payment of college expenses from gift taxes, except in the context of a legal support obligation. However, these are exceptions that provide for excluding direct tuition payments to colleges.

Traditionally, parents are not obligated to provide for their children once the child had reached majority. Until that time, parents are to provide the necessities of life. In the past, college was not deemed a necessity of life, so parents were not obligated to provide a college education; therefore, any payments for college would be gifts. Over the years, the importance of college has increased. Within the divorce context, courts have been willing to obligate one parent to make support payments until the child graduated from college or reached a stated age. If a parent is legally obligated under a divorce decree to make child support payments for a child's college, these payments would be a legal support obligation and not gifts. It is unclear whether the reasoning in divorce cases would apply to other situations.

The factors used to determine if a parent is legally obligated to provide a college education vary dramatically by state, so no clear guideline can be given. Also, if a parent is legally obligated to pay for a child's college and someone else makes the payment, it may result in taxable income to the parent. The education tuition exclusion for direct payments to an institution (referred to above), the annual exclusion (currently $14,000 per person), and split gifts can also be used to minimize any gift tax effect, if no support obligation exists. Of note, we have never encountered a situation where the IRS has attempted to apply gift tax rules to college expense payments made by parents for children.

Sales for less than fair market value are gifts.

Small Gifts Are Gifts

Most taxpayers know that direct transfers of cash or property may be subject to gift tax. However, birthday, wedding, and holiday gifts can be gifts. That said, most authorities believe that the payment of expenses associated with events such as a child's wedding or bar mitzvah are likely not considered gifts. However, if funds are directly paid to the child with the intention of being used for an event, most authorities believe there has been a transfer subject to gift tax. Therefore, rather than reimbursing the son or daughter for certain expenses, the parent should consider paying the vendors directly.

The annual exclusion of $14,000 per person allows taxpayers relief from reporting numerous small gifts. The annual exclusion amount was intended to be large enough to cover wedding, bar mitzvah, holiday, birthday, and other occasional gifts. These occasional gifts should be taken into consideration when making gifts intended to take advantage of the annual exclusion.

Watch Out for IRD Issues with Inheritances

Once a relatively obscure concept, income in respect of a decedent (IRD) can create a surprisingly high tax bill for those who inherit certain types of property, such as IRAs or other retirement plans. Fortunately, there are ways to minimize the IRD tax bite.

How It Works

Most inherited property is free from income taxes, but IRD assets are an exception. IRD represents income a person was entitled to, but had not yet received at the time of his or her death. It includes:

- Distributions from tax-deferred retirement accounts, such as 401(k)s and IRAs,
- Deferred compensation benefits and stock option plans,
- Unpaid bonuses, fees and commissions, and
- Uncollected salaries, wages, and vacation and sick pay.

IRD isn't reported on the deceased's final income tax return, but it is included in his or her taxable estate, which may generate an estate tax liability, if the deceased's estate exceeds the $5.49 million (for 2017) estate tax exemption, less any gift tax exemptions used during life.

IRD is then taxed — potentially a second time — as income to the beneficiaries who receive it. This income retains the character it would have had in the deceased's hands. So, for example, income the deceased would have reported as ordinary income is taxed to the beneficiary as ordinary income.

What Can Be Done

When IRD generates estate tax liability, the combination of estate and income taxes can significantly reduce the inheritance. The tax code helps to alleviate this double taxation by allowing beneficiaries to claim an itemized deduction for estate taxes attributable to amounts reported as IRD.

The estate tax attributable to IRD is equal to the difference between the actual estate tax paid by the estate and the estate tax that would have been paid without the IRD asset.

Suppose, for instance, that you're the beneficiary of an estate that includes a taxable IRA. If the estate tax is $150,000 with the retirement account included as an asset and $100,000 without, the estate tax attributable to the IRD income is $50,000. This amount will be allowed as an itemized deduction of the beneficiary as the IRD payments are received (either lump-sum or over a period of years).

We Can Help

If you stand to inherit property that could be considered IRD, please give us a call for assistance in helping to manage the tax consequences. With proper planning, you can keep the tax cost to a minimum.

Viatical Settlements: A Funding Mechanism for Medical Costs

Someone who's terminally or chronically ill may lack the funds to cover significant medical costs. Although insurance policies have historically been held for the death benefits, it may be possible to sell a policy to a viatical settlement provider. This way, the individual can secure much-needed and generally tax-free cash while still alive.

Buyers and Sellers

Viatication allows a terminally ill person to sell an existing life insurance policy to an investor for more than its cash surrender value, but less than its net death benefit. The buyer continues to pay the premiums and receives the life insurance proceeds upon the death of the insured. Many companies currently either buy the policies themselves or serve as brokers to match buyers and sellers for a fee.

In identifying a potential seller, many viatical companies limit their selection to terminally ill individuals with a certain remaining life expectancy (for example, 24 months or less). This is because the company wants to minimize its risk that the individual will outlive his or her life expectancy, resulting in a lower return from the purchase of the life insurance policy for the company.

Factors to Consider

To determine whether it would be advantageous to sell a policy, the insured should consider factors such as:

- His or her cash needs,
- The discount in the value of the death benefit,
- The possibility that payments will disqualify him or her for Medicaid benefits, and
- Access to the payments by his or her creditors.

Tax Consequences

Amounts received under a life insurance contract on the life of terminally ill (or within limits, chronically ill) individuals are excluded from gross income for federal income tax purposes. A similar exclusion applies to the sale or assignment of any portion of a death benefit to a viatical settlement provider, if the insured is chronically or terminally ill and the payments in question are funded by and diminish the life insurance policy's death benefit.

The exclusion doesn't apply if the accelerated death benefits are paid to someone other than the insured individual and the recipient has a business or financial relationship with the insured.

TAX CALENDAR

MAY & JUNE 2017

MAY

May 10
Employees who work for tips - if you received $20 or more in tips during April, report them to your employer. You can use Form 4070.

May 15
Employers - for Social Security, Medicare, withheld income tax and nonpayroll withholding, deposit the tax for payments in April, if the monthly rule applies.

JUNE

June 12
Employees who work for tips - if you received $20 or more in tips during May, report them to your employer. You can use Form 4070.

June 15

Individuals - make a payment of your 2017 estimated tax if you are not paying your income tax for the year through withholding (or will not pay in enough tax that way). You need to use Form 1040-ES. This is the second installment date for estimated tax in 2017.

Employers - for Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

Corporations - Deposit the second installment of estimated income tax for 2017. A worksheet, Form 1120-W, is available to help you estimate your tax for the year.

Other helpful on-line services

www.IRS.gov
www.MyFlorida.com
&
www.Volusia.org