

The IRS Has Rules on How Much Money You Can Freely Share With Others

# How to Make Tax-Efficient Gifts

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**If you're comfortably retired and/or in a good financial position, it can be extremely rewarding to make a gift to the next generation to help them get started in their adult life or begin passing down a legacy. However as with most financial actions, there are tax rules to consider.**

**W**hen talking to clients we find that the federal gift tax is one of the most 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 monetary limits, you're required to file a gift tax return (Internal Revenue Service 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 a gift tax if necessary. Gifts you receive are not considered income, so there's no income tax due.

In 2022, the annual gift tax exclusion is \$16,000 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 \$32,000 to their daughter with no gift tax implications.

For 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 they 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 \$32,000 exclusion.

If the daughter is married, a total of up to \$64,000 could be given tax-free, with \$16,000 each going to both the daughter and her spouse from both mom and dad.

## Be Careful When Making Non-Cash Gifts

When gifting an asset other than cash, the value of the gift for tax purposes is the value on the date of transfer. The most common version of this is a gift of shares of a stock or mutual fund. For common stocks and exchange-traded funds, the value of gift is the average between the high and low prices on the date the transfer is made. Mutual funds are valued at the closing price on the day of the transfer.

Typically, gifts of shares of stock are made by specifying the number of shares. For example, if you intend to gift \$16,000 of stock XYZ, and the share price is \$100, you would consider gifting 160 shares.

However, if on the day the gift goes through the share price opens the day at \$100 per share but increases 5% to \$105 per share during the day, you will be over the annual gift limit. The average price for the day will be \$102.50 and your gift exceeds the annual exclusion.

## 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 2022 calendar year exceeds \$16,000. (Note that this annual gift tax exclusion may increase in the future with inflation.)
- **Your spouse gives property to the same person** that exceeds \$16,000 in value in the 2022 calendar year. Although your spouse is the only one who 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 to a spouse who is not a U.S. citizen exceeds \$164,000 in 2022. Gifts made to a spouse who is not a U.S. citizen are limited to a specific dollar amount, indexed for inflation each year. Note that gifts between two U.S. married citizens are unlimited.
- **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. An example of this would be a trust or real estate property that could not be used by the gift beneficiary until after your death.
- **A below market transaction can be considered a gift** and could require a gift tax return to be filed. For instance, if you give one of your children a family heirloom worth \$30,000 and ask him to pay \$10,000 for it, you have made a \$20,000 gift. As this is over the \$16,000 annual exclusion threshold, a gift tax return would be required. It is 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 are not 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 does not necessarily mean the donor must pay a gift tax. In fact, it is increasingly rare for there to be gift tax due, in large part due to the tax changes that went into effect in 2018.

In addition to the \$16,000 annual exclusion, in 2022 U.S. taxpayers also have a lifetime federal estate, gift and generation skipping transfer tax exemption of \$12.06 million for individuals, or \$24.12 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 that is exempt from estate tax when you die.

To illustrate how this works, let’s consider a couple who wants to give \$132,000 to their single daughter to help with a down payment on a house. Of that amount, \$32,000 would be applied to the annual gift exclusion (\$16,000 from mom and \$16,000 from dad), leaving \$100,000 that would be potentially exposed to gift tax.

However, mom and dad could then elect to use \$100,000 of their unified lifetime credit and avoid paying gift tax in 2022. That amount would be deducted from their lifetime credit, meaning that their estates would now be taxable above \$24.02 million, instead of \$24.12 million.

Given that very few households have more than \$24.12 million in assets, it’s clear that in most cases gifts over the \$16,000 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 are 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.

## “Filing a gift tax return does not necessarily mean the donor must pay a gift tax.”

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 \$16,000 without incurring any federal gift tax or having to file. There is no limit on the amount you may gift under the medical exclusion.

In addition, 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 \$50,000 and also give your grandchild an additional \$16,000 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 — \$80,000 per spouse in 2022. 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 generally make additional annual exclusion gifts to the beneficiary of the 529 plan. An exception would be if the annual exclusion was increased to \$17,000 next year, then you would be permitted to add an additional \$1,000.

### 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.

While 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. It’s crucial that you coordinate any sizable gifts with your accountant and financial planner, to ensure they are made as tax efficiently as possible. ■



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