Planning on Giving a Financial Gift? Consider These Tax Implications

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Preparing to make gifts to family can raise personal questions like "When is the right time to give?" and "How much should we give?"

This can be a major source of personal reflection. However, many families also wonder "How much am I allowed to give?" and "What are the tax implications of these gifts?" This article will highlight some key tax figures to consider when making gifting decisions.

What Is a Gift?

Before discussing the tax implication of gifting, let's talk about what constitutes a gift. The Internal Revenue Service (IRS) defines a gift as any transfer to an individual where the full value of the transfer is not being received in return. Example of gifts are parents giving money to children, the gifting of a car to a sibling, or even an interest-free loan to a grandchild. All gifts are considered taxable and can cause tax implications. For this reason, it is important to understand the tax rules associated with gifting.

There are a few notable exceptions to gifts that are considered taxable listed below. These taxable gift exceptions can be very useful when making gifts to family members.

- Tuition or medical expenses you pay for someone else directly to the establishment
- Gifts to your spouse
- Gifts for a political organization for its use

How Much Am I Allowed to Give?

There is no limit to how much you are allowed to give to any person or charity. However, there are several rules regarding the taxability of gifts. Two key tax figures that can affect taxes associated with gifting are the annual gift exclusion and the lifetime gift tax exemption.

Annual Exclusion

The annual exclusion is the amount that an individual can give another person in a year without incurring gift taxes. This figure is updated each year. For 2020, the annual exclusion is $15,000 per person. So, in 2020 a person can give $15,000 to as many different people as they want without tax implications. This rule is why no one needs to worry about paying gift taxes on small gifts given to others, such as giving a bottle of wine to a neighbor. If you gift a person more than the annual exclusion amount, the gift must be reported to the IRS and may be subject to gift tax. However, you will not need to pay any gift taxes if your lifetime gifting has not exceeded the lifetime gift tax exemption.

The Lifetime Gift Tax Exemption

The lifetime gift tax exemption for 2020 is $11.58 million. The lifetime gift tax exemption is how much a person is allowed to gift in total over a lifetime without incurring gift taxes. For example, if you gift $115,000 to your son in 2020 and you had made no previous gifts, $15,000 would be excluded from gift taxes by the annual gift exclusion and $100,000 would need to be reported to the IRS. The $100,000 of the gift would reduce your lifetime gift exclusion to $11.48 million, but no gift taxes would be due in 2020.

The lifetime gift exclusion is important during the life of a giver as well as at death, because the lifetime gift exclusion is also directly related to the taxes that are required when a person dies and must transfer assets at death. Gifts made that reduce your lifetime gift exclusion also reduce the federal estate tax exemption, which can leave an estate tax bill at the death of giver with more assets than their remaining estate tax exemption.

Bottom Line

There are several tax considerations to think through when making gifting decisions and knowing a little about the current tax rules impacting gifting can provide valuable intel into the right gifting strategy for your family.

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