College Tax Strategy

Gift of Appreciated Assets

STRATEGY
7

Basic Tax Strategy # 7 – Gift Of Appreciated Assets

Gifting appreciated assets (and the income generated from those assets) from parents to children (or parents to grandparents) can be effective means of minimizing taxes. In most cases, this particular strategy is used to maximize the funds available for a child's college tuition because the income tax due is typically less when the income generated by those appreciated assets are taxed to the child rather than the parents.

Note: when a child is under the age of 24, these strategies must be done correctly to avoid the "kiddie tax" rules. The Small Business and Work Opportunity Tax Act of 2007 (IRC Sec. 1(g)(2)(A)) changed the kiddie tax rules. Children are subject to the "kiddie tax" if:

- *The child has not attained age 18 before the close of the tax year,*
- *The child is age 18-23 and a full time student and the child's earned income for the tax year doesn't exceed one-half of his or her support;*
- *Either parent of the child is alive at the end of the tax year; and*
- *The child does not file a joint return for the tax year.*

A child who is subject to the kiddie tax rule will pay taxes at his or her parents' highest marginal tax rate on the child's unearned income over $2,000 (for 2013), if that tax is higher than the tax the child would otherwise pay on it.

How To Qualify For The Gift Of Appreciated Assets Strategy

If you can find ways to move income that would be taxable to you (at your higher tax bracket) to your children, the entire family will benefit. This technique also works if you have parents that you support in one way or another who are in a lower tax bracket than yours.

Gift Tax Qualifications

Provisions of the Internal Revenue Code relating to gift tax are favorable for annual gifts up to $14,000 per donee. By taking advantage of the gift-splitting provisions, a married couple can give each donee up to $28,000 per year without incurring any gift tax liability. For the exclusion to apply, the gift must be of a present, rather than future, interest in the property. The IRS has ruled that a gift to children using a UGMA or UTMA is a gift of a present interest, thus qualifying for the annual gift tax exclusion

Income Tax Qualifications

For income tax purposes, income on gifts of appreciated assets is taxable to the donee. However, Kiddie tax" rules apply to unearned income on gifts, if the child (beneficiary) is under age 24 and is a full-time student, and the child's "earned" income for the tax year doesn't exceed one-half of his or her support. This is important when determining how much to gift to a child or how to invest the funds. Once a child reaches age 24, the kiddie tax rules do not apply, so more income is taxed at the child's lower tax rates.

Benefits Of The Gift Of Appreciated Assets Strategy

By gifting those appreciated assets to a family member in a lower tax bracket, you are "shifting" the taxable appreciation of that asset from a higher bracket to a lower bracket in order to reduce taxes. Is it legal? Yes it is, when done correctly. As long as you follow the IRS guidelines, shifting income is allowable.

Gifting appreciated assets to a child in a lower tax bracket is also a great way to fund a college savings account as long as those appreciated assets do not generate unearned income of more than $2,000 each year. If the child (beneficiary) is under age 24 and is a full-time student), then any unearned income of more than $2,000 / year is subject to "Kiddie tax" and is taxed at the parents' higher tax rate. Once a child reaches age 24 the kiddie tax rules do not apply, so unearned income of more than $2,000 per year is taxed at the child's lower tax rates.

Tax Savings Involving The Gift Of Appreciated Assets Strategy

The Gift of Appreciated Assets strategy offers real and significant tax savings for business owners who would normally use after-tax monies to purchase items (such as a car, a college education, etc.) for a family member in a lower tax bracket. It allows the business owner to shift the unearned income from these appreciated assets to family member in a lower tax bracket, and thus pay lower income taxes on that unearned income, as well as pay lower capital gains tax when the appreciated assets are sold. In addition, gift taxes can be avoided for annual gifts up to $14,000 per donee, or annual gifts made by a married couple of $28,000 per year, per each donee.

> *Note: Gifting "fully depreciated assets" may offer an even greater tax savings if the parents are in a high tax bracket because the depreciated assets are taxed as ordinary income and not capital gains when sold (See Example 3 below).*

Example Of The Gift Of Appreciated Assets Strategy

Example 1:

Tom and Mary are in the 35% federal tax bracket. During 2013 they transferred $28,000 in publicly traded stocks to Dave, their 16 year old son, who will use the money for his college education. Dividends earned on the stocks were $1,600 for 2013. Dave's tax is $0 ($1,600 income - $1,000 standard deduction) x 0% dividend tax rate) because the kiddie tax does not apply to unearned income less than $2,000. Tom and Mary would have paid tax of $240 (15% on dividends x $1,600) on the $1,600 dividend income had they not transferred stocks to Dave. Thus, the stock transfer resulted in $240 ($240 - $0) of tax savings in 2013.

Example 2:

Tom and Mary are in the 35% federal tax bracket. During 2013 they transferred $28,000 in publicly traded stocks to Janie, their 24 year old daughter, to help pay off her student loans. Janie's federal tax bracket in 2013 is 15% and the cost basis of these gifted stocks is $14,000. Janie sells these stocks in 2013 and uses the $28,000 to pay off her student loans. Janie's capital gains tax on the sale of these stocks is $0 because the capital gains tax in 2013 is 0% for those in the 15% tax bracket ($28,000 - $14,000 x 0% capital gains tax = $0). In addition, Tom and Mary will not incur a gift tax on the transfer of these stocks to Janie because of the gift tax exemption made by a married couple of $28,000 per year, per each donee.

Example 3:

Tom and Mary are in the 35% federal tax bracket. During 2013 they transferred $28,000 in fully depreciated property to Janie, their 24 year old daughter, to help pay off her student loans. Janie's federal tax bracket in 2013 is 15%. Janie then sells the property in 2013 for $28,000 and uses the money to pay off her student loans. Janie's ordinary income tax on the sale of the property is $4,200 ($28,000 x 15%); whereas if Tom and Mary had sold the property the taxes would have been $9,800 ($28,000 x 35%), thus creating a tax savings of $5,700 ($9,800 - $4,100). In addition, Tom and Mary will not incur a gift tax on the transfer of the property to Janie because of the gift tax exemption made by a married couple of $28,000 per year, per each donee.

Implementing The Gift Of Appreciated Assets Strategy

❑ Step 1: Identify the assets or property to contribute (gift).

❑ Step 2: If donee/leasor is your child under the age of majority, you will need to have your attorney draft a trust to hold title (if the property has a title).

❑ Step 3: Appraise or determine the value of the gifted assets or property to get a fair market value.

❑ Step 4: Execute the "Assignment of Interest".

❑ Step 5: Re-title the property (if the property has a title, such as real estate, autos, etc.).

❑ Step 6: File an IRS form 709 to report your yearly taxable gifts over $14,000 ($28,000 for joint gifts).

Documents Used To Implement The Gift Of Appreciated Assets Strategy

These are the documents you will need to implement the Gift or Sale and Leaseback strategy:

- Assignment of Interest
- Asset/Property Appraisal
- Form 709 to report taxable gifts over $14,000

IRS Publications & Forms References

IRS Publications

Frequently Asked Questions On Gift Taxes
http://www.irs.gov/businesses/small/article/0,,id=108139,00.html

IRS Forms 709, 1099 MISC
http://www.irs.gov/app/picklist/list/formsInstructions.html

Sample Document
Gift Of Appreciated Assets

The following document is needed in order to implement the "Gift of Appreciated Assets" strategy and follow the IRS procedures and guidelines.

Assignment of Interest (Gift of Appreciated Asset)

THIS IS AN AGREEMENT TO ASSIGN PROPERTY, which is effective on the following date ______/ ______/ ______ by and between:

_________________________________ AND ___________________________________
_________________________________ ___________________________________
_________________________________ ___________________________________
_________________________________ ___________________________________
Assignee Assignor

The above Assignor is the owner of the property listed in the Property Schedule, below:

Property Schedule:

Description	**Value**
____	$ _________________
____	$ _________________

And the Assignor wishes to transfer said property to the Assignee;

THEREFORE IT IS AGREED that the Assignor hereby transfers and assigns all rights, titles, and interests in said Property to the Assignee:

____________________________ ____________________________
Assignee Assignor

Signed and sealed in the presence of:

____

____
Notary Public

