Some Things to Consider about Gifts to Children

If you have property that would produce a loss if sold, you should consider selling the property, claiming the loss, and transferring the proceeds to the child, rather than transferring the property to the child who would not be able to claim the loss.

If you make significant gifts to your children or someone else's children, or if someone else makes gifts to your children, there are a number of things for you to consider.

Transfers that are not taxable gifts

There are a variety of ways for you to make transfers to children that are not treated as taxable gifts for gift tax purposes. Filing a gift tax return is generally required if you make gifts (other than qualified transfers) totaling more than $14,000 to an individual during the year.

- **Providing support.** When you provide support to a child, it should not be treated as a taxable gift if you have an obligation to provide support under state law. This may provide a large umbrella for parents of minor children, college-age children, boomerang children, and special needs children.
- **Annual exclusion gifts.** You can generally make gifts of up to $14,000 per child gift tax free each year. If you split gifts with your spouse, the amount is effectively increased to $28,000. In the case of a gift to a qualified tuition program (529 plan) for a child, the annual exclusion can be effectively increased to five times the above amounts (i.e., to $70,000, or $140,000 if you split gifts with your spouse).
- **Qualified transfers for medical expenses.** You can make unlimited gifts for medical care gift tax free, provided the gift is made directly to the medical care provider.
- **Qualified transfers for educational expenses.** You can make unlimited gifts for tuition gift tax free, provided the gift is made directly to the educational provider.

The same exceptions for transfers that are not taxable gifts generally apply for purposes of the generation-skipping transfer (GST) tax. The GST tax is a separate tax that generally applies when you transfer property to someone who is two or more generations younger than you, such as a grandchild.

Income tax issues

A gift is not taxable income to the person receiving the gift. However, when you make a gift to a child, there may be several income tax issues regarding income produced by the property or from sale of the property.

- **Income for support.** Income from property owned by your children will be taxed to you if used to fulfill your obligation to provide support.
- **Kiddie tax.** Children subject to the kiddie tax are generally taxed at their parents' tax rate on any unearned income over a certain amount. For 2014, this amount is $2,000 (the first $1,000 is tax free and the next $1,000 is taxed at the child's rate). The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support. If the child's income would be taxed at the parents' high tax rates, it may make sense to invest in ways that can produce nontaxable income (e.g., tax-exempt bonds) or defer taxation (e.g., Series EE bonds) until after the kiddie tax period.
- **Basis.** When you make a gift, the person receiving the gift generally takes an income tax basis equal to your basis in the gift. (This is often referred to as a "carryover" or "transferred" basis.) The carried-over basis is increased--but not above fair market value (FMV)--by any gift tax paid that is attributable to appreciation in value of the gift (appreciation is equal to the excess of FMV over your basis in the gift immediately before the gift). The income tax basis is generally used to determine the amount of taxable gain if the child then sells the property. However, for purpose of determining loss on a subsequent sale, the carried-over basis cannot exceed the FMV of the property at the time of the gift.

Gifts to minors

Outright gifts should generally be avoided for any significant gifts to minors. In that case, you may wish to consider a custodial gift or a trust for a minor.

- **Custodial gifts.** Gifts can be made to a custodial account for the minor under your state's version of the Uniform Gifts/Transfers to Minors Acts. The custodian holds the property for the benefit of the minor, generally until an age (often 21) specified by state statute. Generally, any adult or trust company can be the custodian, but check state law.
- **Trust for minor.** A Section 2503(c) trust is a trust specifically designed to obtain the gift tax annual exclusion for gifts to a minor. Principal and income can be distributed to the minor before age 21, but there is no requirement of any distribution to the minor before age 21. The minor does generally gain access to undistributed income and principal at age 21.

Consult a tax professional for more information about your specific situation.

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