Chicago Daily Law Bulletin®

Volume 162, No. 250 Serving Chicago's legal community for 161 years

In season of giving, parental gifts carry tax, legal concerns with them

This is the gifting season. During this time of year, it's common for parents to make gifts to their minor or adult children. When such gifts become more financially significant than the average holiday-wrapped present, however, special consideration should be given to both the immediate tax implications of making such gifts as well as to the long-term view of how those gifts may be treated in the future, especially if a child is involved in a divorce.

With respect to tax implications, a financial gift may be planned so that it qualifies as an exclusion from the gift tax rules and is therefore tax-free. Generally, when such a gift is made, the donor is responsible for paying the gift tax. However, our present tax code allows a $14,000 annual exclusion from gift tax liability.

Thus, each person may give $14,000 tax-free per year to each beneficiary. If a married couple gives the gift, the annual exclusion increases to $28,000 a year to each beneficiary.

For a gift to qualify for the $14,000 annual exclusion, the recipient must have a "present interest" in the gifted property: He or she must have the immediate right to use and benefit from the gift. It is important to note, however, that to qualify for the exclusion, the gift need not be cash — it can also be an interest in other investments, such as stocks and real property.

In addition, parents may find great benefit in utilizing the unlimited gift tax exclusion for education and medical payments. To qualify, these payments must be paid directly to the educational or medical institution or service provider and must meet certain criteria defining appropriate education or medical expenses.

Along these lines, parents may also contribute to qualified tuition programs (also called "529 plans") to meet a child's future higher education expenses. These contributions are also eligible for the annual gift tax exclusion.

Therefore, by making gifts to each of their children — and also grandchildren — a couple can reduce their estate by a significant amount each year without tax consequence.

If a child recipient of such a gift is getting divorced, however, it is also important to consider how such gifts may be treated in a divorce. Gifts made to a child while that child is married may be characterized as his or her nonmarital property — and therefore not subject to equitable distribution during dissolution proceedings — where the recipient proves that the transfer meets the legal definition of "gift."

Specifically, under the Illinois Marriage and Dissolution of Marriage Act, all property acquired during a marriage is presumed to be marital, unless the party can show by the heightened clear and convincing evidence standard that it is not.

One category of nonmarital property is "property acquired by gift." Where the transfer of property is between a parent and child, a competing presumption arises that it is a gift. Thus, if a child receives a transfer of property from a parent during the marriage, these two presumptions are in conflict and they cancel each other out.

Accordingly, no presumptions apply, and the court employs a preponderance of the evidence standard to decide whether a gift has been made.

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Generally, the elements of a valid gift are the donor's intent and delivery. The critical inquiry usually pivots on whether the transfer of property was absolute and made without any proverbial strings attached that could permit the donor to reclaim it at some future time.

If such strings exist, the transfer will likely be considered a loan rather than a gift, and the property will be considered marital, and, therefore, divisible.

One sound way to establish intent is to prepare and file gift tax returns. In addition, it is useful to request that accountants and/or attorneys prepare letters to both the parent and the child to document that a gift has been made. In determining the existence of a gift, a court will analyze all the facts surrounding the transfer, including any testimony provided by the donor, the recipient and any witnesses.

In addition, gifts made by parents to children who are married may affect child support obligations if the couple were to divorce. In determining the amount of child support, our courts begin the calculation by looking to the payor's "total income from all sources." In doing so, courts have held that annual gifts received from parents may be considered "income" for purposes of calculating child support.

Because most people receive gifts on special occasions and the value is not especially high, such gifts will likely not count as income for purposes of child support. However, if significant monetary gifts to a married child are made on a regular basis, it is likely that those gifts will be counted as part of his or her income for child support purposes.

In sum, the gifting of significant amounts between a parent and a child can have important tax and family law implications. Especially during this season of giving, it is essential to keep these considerations in mind.

MODERN FAMILY

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