MAKELA, TOUTANT, HILL, NARDI & KATONA, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

201 West Bluff Street
Marquette, Michigan 49855
(906) 228-3600

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YEAR-END GIFTS AND THE GIFT TAX ANNUAL EXCLUSION

With the holidays and year-end approaching, you might be considering making gifts of stock or cash to family members and loved ones. By using your annual exclusion, those gifts — within generous limits — can reduce the size of your taxable estate. For 2022, the annual gift exclusion is $16,000.

This covers gifts you make *to each recipient each year*. Therefore, a taxpayer with three children can transfer a total of $48,000 to them every year free of federal gift taxes. If these are the only gifts made in a year, there's no need to file a federal gift tax return. If an annual gift exceeds $16,000 per person, only the amount that exceeds $16,000 is a taxable gift. In addition, even taxable gifts may result in no gift tax liability thanks to the unified credit. (See "'Unified' credit for taxable gifts" on page 2.)

Because more than $16,000 is being transferred by a spouse, a gift tax return (or returns) will have to be filed, even if the $32,000 exclusion covers total gifts.

Note: Gifts made to a spouse aren't covered here, because these gifts are free of gift tax under separate marital deduction rules.

MARRIED TAXPAYERS AND GIFT SPLITTING

If you're married, a gift made during a year can be treated as split between you and your spouse, even if only one of you gives the gift. That means, by gift splitting, a married couple can use their two exclusions to give a recipient up to $32,000 a year. For example, a married couple with three married children can transfer a total of $192,000 each year to their children and the children's spouses ($32,000 for each of six recipients).

Because more than $16,000 is being transferred by a spouse, a gift tax return (or returns) will have to be filed, even if the $32,000 exclusion covers total gifts. If gift splitting is involved, both spouses must

"UNIFIED" CREDIT FOR TAXABLE GIFTS

Gifts that are taxable because they aren't covered by the annual exclusion may still not result in a tax liability. This is because a tax credit wipes out the federal gift tax liability on the first taxable gifts that you make in your lifetime, up to $12.06 million for 2022. The amount of the credit you use against a tax liability reduces or eliminates the credit available for use against the federal estate tax upon your death.

Gifts made directly to an educational institution to pay tuition or to a health care provider to pay for medical expenses on behalf of someone else do *not* count towards the exclusion. For example, you can pay $20,000 directly to your grandson's college for his tuition this year, plus still give him a direct cash gift of up to $16,000.

Annual gifts reduce the taxable value of your estate. While the estate and gift exemption amount is historically high right now, it's scheduled to fall in 2026 to around $8 million, depending on inflation. Congress could act to extend it or could make other changes to estate tax laws. Making large tax-free gifts could help insulate you against any later reduction in the unified federal estate and gift tax exemption.

consent to it and that consent should be indicated on each gift tax return (or returns) that each spouse files.

Have you made gifts to one individual that exceed $16,000 within a year? If so, we can prepare a gift tax return (or returns) for you. ■

SELLING TRADE OR BUSINESS PROPERTY? KNOW THE TAX EFFECTS

Many rules can potentially apply to the sale of business property, but what are the tax consequences? For simplicity, let's assume that the property you want to sell is depreciable property used in your business and you've held it for more than a year. (Different rules apply based on property type, such as property held for sale to customers, intellectual property, low-income housing, and farming or livestock property.)

GENERAL RULES

Under the Internal Revenue Code, your gains and losses from sales of business property are netted against each other. The net gain or loss qualifies for tax treatment as follows:

1. If the netting process results in a net gain, then long-term capital gain treatment results, subject to "recapture" rules discussed below. This treatment is generally more favorable than ordinary income treatment.

2. If the netting of gains and losses results in a net loss, that loss is fully deductible against ordinary income (so, none of the rules that limit the deductibility of capital losses apply).

RECAPTURE RULES

The availability of long-term capital gain treatment for business property net gain is limited by recapture rules. Recapture rules specify that amounts are treated as ordinary income rather than capital gain because of previous ordinary loss or deduction treatment for these amounts (such as depreciation, for example).

There's a special recapture rule that applies only to business property. Under this rule, to the extent you've had a business property net loss within the previous five years, any business property net gain is treated as ordinary income, not as long-term capital gain.

MORE TAX CODE DETAILS

Here are some more details about two types of property:

Section 1245 property. This is all depreciable personal property, tangible or intangible, and certain depreciable real property (usually, real property with specific functions). If you sell this property, you must recapture your gain as

ordinary income to the extent of your earlier depreciation deductions on the asset.

Section 1250 property. This type of property generally includes buildings and their structural components. If you sell such property that was placed in service after 1986, none of the long-term capital gain attributable to depreciation deductions will be subject to depreciation recapture. (Additional rules apply for Section 1250 property placed in service before 1987.)

However, for most noncorporate taxpayers, the gain attributable to depreciation deductions up to the amount of the business property net gain will be taxed at no higher than 28.8% (as reduced by the business property recapture rule above). That's 25% adjusted for the 3.8% net investment income tax, rather than the maximum 23.8% rate (20% adjusted for the 3.8% net investment income tax) that generally applies to long-term capital gains of noncorporate taxpayers.

PROCEED WITH CAUTION

As you can see, the tax treatment of the sale of business assets can be complex. Contact us for help with specific transactions or additional questions. ■

AS TRAVEL RETURNS, SO DO TRAVEL SCAMS

Even though COVID-19 remains a concern, many people have started traveling again — and are planning to take trips during the holiday season. Unfortunately, as travel demand has increased, so has travel-related fraud.

For example, some fraud perpetrators posing as airline employees call would-be victims to try to elicit credit card numbers. Other scam artists send phishing emails that appear to offer cheap seats or rooms. And there are plenty of fake websites masquerading as legitimate travel companies.

BE ALERT FOR FRAUD

As you plan your next trip, take these steps:

Ignore unsolicited communications. If you receive an email, text, flyer or telemarketing call with a travel bargain, it's probably smart to ignore it. Afraid of missing out on a deal? Directly contact the airline, hotel or rental car company featured in the promotion.

Book with established companies. Whether traveling for business or pleasure, make reservations with companies whose names you know. If you're booking with a new service provider, read online reviews by fellow travelers. Some review platforms allow you to search using keywords, others identify keywords frequently used by reviewers and allow you to filter for those reviews. Also, perform an online search with the name of the company and words such as "fraud" or "scam."

Watch out for lodging scams. Many travelers use online property marketplaces to find lodging. But you need to scrutinize listings. Some fraud perpetrators post ads for nonexistent properties with enticing, below-market rates. If a "property owner" asks you to move the conversation off the site to avoid fees, refuse the request. Reputable platforms provide some protections, such as insurance in the event the transaction results in fraud. They also include credit card protection.

Work with trusted services. If you travel frequently or don't have time to research trips, consider engaging a travel advisor or travel agent. These professionals maintain close working relationships with legitimate companies, know about the latest deals, may be able to provide insider tips about your destination and can make reservations for you.

FOLLOW YOUR INSTINCTS

Before booking your vacation or business trip, scrutinize it for signs of fraud. If you doubt the legitimacy of a service provider or are suspicious of individuals involved in a transaction, go with your instincts and look elsewhere. Safe travel requires diligence before your journey begins. ■

DISCOVER THE "HIDDEN" ADVANTAGE OF HSAs

A Health Savings Account (HSA) coupled with a high-deductible health plan can be a powerful tool for funding medical expenses on a tax-advantaged basis. For 2022, individuals with self-only coverage can make tax-deductible contributions to an HSA of up to $3,650 ($7,300 for family coverage). These limits are increased by $1,000 for individuals aged 55 or older.

When an employer establishes an HSA and contributes on an employee's behalf, the employer gets the tax deduction. And the employer's contribution isn't considered taxable compensation for the employee.

Accountholders can withdraw funds tax-free to pay qualified medical expenses. Once you reach age 65, you can withdraw funds penalty-free for any purpose (though if the funds aren't used for qualified medical expenses, they'll be subject to tax).

But there's also a "hidden" advantage of HSAs that many people overlook: These accounts can play a helpful role in your estate plan. HSAs have an advantage over traditional IRAs and 401(k) plans in that they're not subject to required minimum distributions at age 72.

This means, to the extent you don't use the account for medical expenses, the account can continue growing on a tax-deferred basis indefinitely — providing valuable future benefits for your loved ones.

If your spouse inherits the account, it will be treated as his or her own HSA. If someone else inherits it, the HSA will terminate and the recipient will be taxed on its value, less any qualified medical expenses of the decedent paid by the transferee within one year after the date of death. ■

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