Gifts and Inheritances

[1] In General

Income cannot be assigned to another taxpayer to avoid taxation. The owner of the asset generating income is the taxpayer responsible for the tax associated with the income.

If an asset is gifted to another taxpayer, the tax associated with income generated by the asset after the gift occurs is the responsibility of the person who received the gift. Example: If A gifts stock of XYZ Company to B, A is responsible for the tax on XYZ stock dividends until the stock is transferred into the name of B.

There is never an income tax associated with the transfer of an asset via a gift or inheritance. A transfer is a gift if it is made while a person is living and an inheritance refers to the transfer of assets because of the transferor's death. A gift or estate tax (a tax on the transfer of wealth) is assessed on the transferor however; gifts and inheritances have no affect on the income tax liability of the transferor or transferee.

Income generated by jointly owned property is allocated to the owners of the property based on their percentage of ownership. The percentage of ownership does not have to be divided equally among the owners.

Income generated by assets owned by a husband and a wife in a community property state is allocated equally to the husband and the wife. The New England states are not community property states.

Local or state law determines the ownership of property and the rights to income generated by the property (an example is the allocation of income in community property states mentioned above). Federal law (the Internal Revenue Code) determines the tax consequences of the income associated with the ownership of property.

[2] Basis

The basis of inherited property is the fair market value of the property at the decedent's date of death or the fair market value of the property 6 months after the decedent's date of death. The decedent's estate chooses the valuation date.

The basis of property acquired by gift is generally a carryover basis. For purposes of computing a loss on the disposition of property acquired by gift, the basis is the lesser of the carryover basis or the fair market value of the property on the date the property was acquired by gift. The purpose of this rule is to prevent the transfer of property with a built-in loss to another taxpayer.

Example: Property acquired by gift had a fair market value of $30 on the date of the gift. The basis in hands of donor was $50 (the original purchase price). If the property was sold for $40, no gain or loss is recognized on the sale. The basis for computing gain is

$50. If the property is sold for $40, there is no gain. The basis for computing a loss is $30. If the property is sold for $40, there is no loss.