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WEEKEND INVESTOR

Giving the Gift of Money to Loved Ones

Financial Gifts Can Provide Lasting Value to Recipients—and Save You Cash

Some grandparents put money into 529 savings plans to help with students' college costs. Here, students on the Penn State campus. *ASSOCIATED PRESS*

By **LIZ MOYER**

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The red sweater might be a good fit for your nephew. The flat-screen television would probably look great in your daughter's living room.

But here is something to keep in mind as you draw up your holiday list: Sometimes money is the most appropriate present.

Done right, it can also be thoughtful. Financial gifts can launch a child on a lifetime of good habits, help a student graduate without heavy debt, ease the strain of an unexpected medical bill or bolster a loved one's retirement account.

"A sensible gift can teach children about the power of savings and self-discipline as well as philanthropy, with returns that can long outlast toy or gadget fads," says Timothy Speiss, a partner in charge of the wealth-advisory group at EisnerAmper, an accounting firm based in New York.

Giving also can be nearly as good as receiving, thanks to the tax benefits associated with some financial gifts. The givers can often reduce their tax bills by, for example, shifting income-producing investments to family members who pay taxes at lower rates or taking deductions on charitable gifts.

Here is a guide to financial gifts that can provide lasting value to the recipients—and, in some cases, pay off for you as well.


TIM FOLEY

Start Small

Great satisfaction can come from giving a child a coveted present or a life-enhancing experience. But don't discount the possibility that money can be a memorable gift.

Cash is the simplest form. Internal Revenue Service rules currently allow individuals to give up to $14,000 each to an unlimited number of individuals a year without any gift-tax implications.

Cynthia Conway and her husband give cash gifts at the holidays to their son, who is in high school, and their daughter, a college junior. Ms. Conway's daughter is thinking about putting this year's gift and some other savings toward buying a car, while her son is in "strong saving mode" because he wants some spending money when he goes to college.

Over the years, the gifts have helped the children think about how much to spend, save and give to charity, says Ms. Conway, who is 53 years old and lives in Wilmington, Del.

"It's established a fiscal responsibility, and a true, tangible value for money, but also independence to have the autonomy to make the financial decisions they want and to feel comfortable with those decisions," she says.

Other ways of giving money also can impart lessons about the importance of saving and the benefits of long-term financial planning.

Series I Savings Bonds, for example, can be purchased online from the U.S. government through TreasuryDirect.gov in increments as small as $25, up to a limit of $5,000. I Bonds also can be bought with a portion of your federal tax refund.

The bonds come with a fixed interest rate as well as a variable interest that adjusts twice a year based on changes in the consumer-price index. The fixed rate on bonds is currently 0%, but inflation is running at 1.48%, so I Bonds currently earn 1.48%.

I Bonds also can encourage delayed gratification. The bonds have to be held for at least 12 months, and if they are redeemed within less than five years, the holder forfeits three months of interest.

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Moreover, I Bonds are exempt from state and local taxes and no federal income tax is due on the interest until the bond is redeemed. In some cases, interest also may be protected from federal tax if the money is used to pay for educational expenses.

To give an I Bond as a gift, you need to have the recipient's Social Security number and the recipient also needs to have a TreasuryDirect account, so that you can transfer the bond to the recipient's account after you buy it. If the recipient doesn't have a TreasuryDirect account, you can hold an I Bond in your account until the recipient wants to redeem it.

Good candidates for such gifts can include children who are nearing college age, says Lou Stanasolovich, chief executive of Legend Financial Advisors in Pittsburgh. That is because many young recipients cash in such gifts during their college years, and I Bonds provide some inflation protection without the risk of market losses that would come with, for example, stocks.

Invest in the Future

Another way to give money to children is to open a custodial bank or brokerage account on their behalf. A parent doesn't have to be the custodian—any adult can manage the account, and anyone can add money to it.

Custodial accounts, under the Uniform Gifts to Minors Act and the Uniform Transfer to Minors Act, can be funded with cash or securities, says Scott Bishop, director of financial planning at STA Wealth Advisors in Houston. The adult who opens the account can act as custodian until the child takes control, typically at age 18 or 21.

A cautionary note: A custodial account is considered a child's asset for purposes of calculating college financial aid, so it can reduce potential awards.

One option is to liquidate the account before applying for aid and transfer the money to a custodial 529 college-savings plan, which doesn't count to the same extent in financial-aid calculations.

Alternatively, gift-givers can make contributions to a child's Roth individual retirement account, up to a total of $5,500 per account a year. The child must have earned income at least equal to the total amount put into the account each year, so this option is often more appropriate for older children who already have part-time jobs.

One major advantage of a Roth is that the investments can grow tax-free until withdrawal, and that can help show how saving even a little bit of money now can have a big payoff down the road. There is no penalty for withdrawals after age 59½.

Funds in a Roth also can be tapped earlier without tax or penalty to pay for college tuition or certain related expenses, and to make a contribution of up to $10,000 for an individual, or $20,000 for a married couple, toward the down payment on a first home.

Cash Is King

If you want to make a much larger financial gift, it is worth knowing the gift-tax rules. For example, married couples can combine their individual $14,000 gift exemptions to give up to $28,000 to someone each year without owing gift tax.

Erwin Freed, 74, says he and his wife, Carolyn, opened 529 college-savings plans for their three grandchildren four years ago with the help of their financial planner, Christopher Parr in Columbia, Md. They put $5,000 a year into each grandchild's account.

Mr. Freed says the gifts will help his grandchildren get a head start on the future, and will be of more lasting value than a present they would outgrow. "Kids have too many material items these days. It's ridiculous to buy toys. How many stuffed animals do you need?" he says.

You can put five years of gifts into a 529 plan at once. A married couple, for example, could deposit $140,000 into a grandchild's 529 account this year without paying gift tax. But the couple couldn't make any more financial gifts to that child for the next four years, based on the current $14,000 exemption.

Gifts can be made to more than one person in the same year, too. A married couple with two married children and six grandchildren could use their combined exemptions to give a total of $280,000 to those 10 family members, tax-free. There is no annual limit on the amount of money one spouse can give to the other as long as they are both U.S. citizens.

If such gifts don't exceed the annual exemption, they have no impact on the amount of money an individual or couple can pass along at death without paying tax on the estate. Currently, no tax is due on estates of $5.34 million or less for individuals and $10.68 million or less for couples.

But be careful: If you give someone an amount that exceeds the annual gift-tax exemption, the excess gets subtracted from the amount that you can pass on in an estate without taxes being due.

For example, if a couple gave each of 10 relatives $38,000 in a year—or $10,000 above the per-person exemption—their lifetime estate- and gift-tax exemption would be cut by $100,000. In addition, the couple would have to file a gift-tax form even though no tax was due.

Giving substantial cash gifts each year over several years can be one way to transfer money to younger generations without tax consequences.

Avoid the Taxman

There are other maneuvers that can lower the amount of tax that you or the recipient of your generosity might have to pay.

For example, you can pay a student's tuition bill directly, rather than making a gift to the student or to a 529 account. The payment isn't taxed, and you still can give the student up to $14,000 in addition.

Similarly, you can pay a medical bill directly. So a woman could send a check to the doctor who treated her nephew's broken arm and still give that nephew up to $14,000 in the same year, tax-free.

If you want to give stocks or other securities as gifts, however, be careful how you do it, as the tax consequences can vary greatly.

It is worth figuring out first whether the securities have gained in value significantly since you bought them, as many stocks have in the current bull market.

If you give appreciated stock to someone while you are alive, for example, the recipient will have to pay capital-gains tax when they sell it based on the change in value since you purchased it. So if many years ago you paid $10 for a stock that is now worth $100, the recipient would owe capital-gains tax on $90 if they sold it immediately.

On the other hand, if you give that same stock away as part of your estate, the heir will owe capital-gains taxes only on any gains above the value on the day of your death.

Another factor to consider is the rate at which the recipient will owe federal income tax. If the recipient is in the 15% bracket or lower when the stock is sold, no capital-gains tax will be due.

That means if you are in the highest income-tax bracket, you can give appreciated stock to someone in the lowest bracket and preserve more of the investment gains while limiting the capital-gains tax due.

If you recently purchased an asset that you believe will be worth considerably more down the road, giving it to someone in a lower tax bracket means he will owe less than you would have when he sells it.

"The general rule is if you have an asset that you expect will appreciate in value, that is good for a family gift," says Mr. Speiss of EisnerAmper.

Give to Charity

By the same logic, securities that you purchased long ago and that have risen significantly in value can be strong candidates for charitable gifts because charities aren't subject to capital-gains taxes when they sell and the donor can take an income-tax deduction, says Clifford Caplan, president of Neponset Valley Financial Partners, a financial-planning firm in Norwood, Mass.

"It allows you to kill two birds with one stone," he says. When planning charitable giving "you should do something that benefits you tax-wise."

If the securities have been owned for more than one year, the donor can generally take a deduction on the market value up to 30% of adjusted gross income, and can carry any remaining amount forward up to five years, says Mr. Bishop of STA Wealth Advisors.

You also can help loved ones support charities that are important to them either by giving to the charities directly or by making contributions to donor-advised funds. Gifts to such funds are irrevocable and the donor can take a tax deduction. The money can grow tax-free until a charity is designated to receive the funds.

The four largest donor-advised funds are the Fidelity Charitable Gift Fund, the Schwab Charitable Fund, the Vanguard Charitable Endowment Program and the National Philanthropic Trust.

The minimum initial contribution is $5,000 at Fidelity and Schwab, while the minimum is $25,000 at Vanguard and National Philanthropic Trust.

You also can give family members advisory privileges on your account, which allows them to select which charities receive funds. Keep in mind that if you give those privileges to an adult, he or she doesn't need your approval to make a selection for some or all of the funds, so this option may be best if you have a strong relationship and similar views on giving.

Another alternative is to set up and contribute to an account with a donor-advised fund in the recipient's name, as a gift. That way, the recipient gains the power to make a financial gift of their own.

—Anna Prior contributed to this article.

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