What to Know Regarding Implications of Gifts and Medicaid Eligibility

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In estate planning, there are few topics that generate more questions and confusion than gifts. Most people are familiar with some of the rules, but rarely do they know all of them and how they intersect. However, it's the intersection of tax and Medicaid rules that create most of the problems clients encounter. Here are some answers to common questions clients pose about gifting.

Is it true I can only give away $17,000 per year?
No. There is no limit on the amount someone can give away. The $17,000 annual exclusion rule only refers to the limit on what you can give away to any individual person in any given year and not have to file a gift tax return to report the gift.

Are gifts in excess of $17,000 subject to gift tax?
Yes. However, taxpayers have a lifetime exemption against estate and gift taxes that they can use to avoid paying gift tax on larger gifts. Once someone exhausts their lifetime exemption (currently $12.92 million), lifetime gifts (except those covered by the $17,000 annual exclusion) will trigger the payment of gift tax.

Is it true that the $17,000 annual exclusion gift rule also applies to Medicaid?
Absolutely not. Medicaid has much more stringent rules about gifts. Generally, if you give away more than $500 to anyone for any reason in any given month, you risk having the gift create a period of Medicaid ineligibility if you or your spouse apply for benefits. The more you give away, the longer the period of ineligibility.

Are gifts considered income to the recipient?
No. Gifts are not considered income to the recipient.

Are transfers to a trust considered a gift?
It depends on the type of trust. Gifts to a revocable trust are not "completed" gifts and do not have to be reported. Gifts to most irrevocable trusts are completed gifts and they may not qualify for the $17,000 annual exclusion rule depending on how the trust is worded.

Does Pennsylvania tax gifts?
No. Pennsylvania does not have a gift tax. However, it does impose its inheritance tax on gifts made within a year of death under its "gifts in contemplation of death rule."

Is a bargain sale a gift?
Yes. If you sell something for less than it's worth, e.g., the old sale of a house for a $1.00 trick, that's really a gift equal to the value of the home minus $1.00.

Do gifts have other tax consequences?

Yes. If you give away an appreciated asset, your tax basis in the asset transfers to the recipient. When he or she goes to sell that asset, the recipient will likely have to pay capital gains tax based on your historic tax basis.

Isn't there a five-year lookback rule for gifts?

Yes. Medicaid scrutinizes gifts made within five years of applying for Medicaid benefits, but the IRS can look back for unreported gifts for an indefinite period of time.

The bottom line is that giving away assets raises many issues. We help guide clients through the analysis to determine when and how to make gifts to maximum planning effect. It can be a tricky analysis depending on your unique circumstances. What strategy works for one person may not be appropriate for another. If you have any questions regarding gift implications or the implementation of a gift strategy, please contact any member of Barley Snyder's Trusts & Estates Practice Group.