Expert View

Regifting: Obama, The Nobel Prize And The IRS

Robert W. Wood, 11.19.09, 11:50 AM ET

Regifting has a long and honorable history. No doubt even ancient peoples did it, passing on to someone else a gift they didn't want or need. But the term itself is of recent origin--credited to a 1995 episode of Jerry Seinfeld's eponymous series.

Since then, regifting has literally come out of the closet. In an American Express poll, 60% of women and 40% of men admitted to having regifted. There's even a "Gift and Re-Gifts" neighborhood on eBay.

Even more respectable is the practice of regifting a cash award to charity. Most recently, President Obama said he'd be donating the $1.4 million Nobel Peace Prize to charity.

That raises the question: What are the tax implications of getting a gift or prize, and what are the tax consequences of regifting it? It turns out that the answers are different for gifts and prizes.

Gifts: 'Tis better to receive.

When you receive a gift, there's no taxable income to you, no matter how large the gift. You can also regift that gift, without worrying about the Internal Revenue Service--so long as its value is $13,000 or less. That's because under something known as the annual gift exclusion, anyone can give anyone up to $13,000 a year in money or property without worrying about gift taxes.

Each person also gets a $1 million exclusion from gift taxes. So if you give (or regift) something worth more than $13,000, you must either eat into that $1 million exclusion or, if you've used that up, pay gift taxes. But again, the recipient of your gift owes no tax. (For more on gift giving and taxes, click here.)

One cautionary note here: The IRS can always challenge whether what you received (or gave) was really a gift. For example, the IRS is likely to consider a large gift from an employer to an employee to be taxable compensation. (For more on this, click here.)

Prizes are another story.

In contrast to most gifts, prizes and awards are taxable. This was not always so. Prior to 1986, many prizes were tax-free, generally hinging on whether the person awarded the prize had to perform services to receive it. As long as no significant services were a predicate to getting the award, there was generally no tax.

Today, however, prizes and awards are taxable. In fact, about the only way you can avoid paying tax on an award is to assign it to a charitable organization. That, it turns out, is no mean feat.

Just say no?

You can decline an award, and there are some famous examples. George C. Scott declined an Academy Award for his role in *Patton* in 1971. But while Academy Awards usually bring many dollars in the future from other films, endorsements and advertisers, they do not involve cash prizes.

If you are awarded a cash prize such as a Nobel and decline it, you don't have income, so there is no tax to pay. That's curious, since the tax law routinely attributes taxable income to you when you could have received a payment but chose not to. The "assignment of income" doctrine usually prevents you from avoiding the tax hit of income coming your way. (See "When You've Got Taxable Income But No Cash.")

Regifting?

Short of declining an award to avoid the taxes, there's the option of regifting. If you win a Nobel and are handed $1.4 million, you can turn around and give it to charity. Unfortunately, though, the tax consequences of regifting can be problematic.

If President Obama collects his prize and then donates his prize money to the American Red Cross (or any other qualified charity), he can't necessarily write off the entire $1.4 million. Why? Because you can't deduct charitable contributions exceeding 50% of your "contribution base"--generally your adjusted gross income.

If his sole other income is his $400,000 presidential salary, his gross income (including the prize money) would be $1.8 million. The limit on deductible gifts to charity is 50% of his contribution base, derived from adjusted gross income. Thus, the $1.8 million gross is first reduced by certain adjustments, and then tested against the 50% limit. Any other charitable contributions President Obama has made will make his tax situation even worse.

The limit on the amount of adjusted gross income that can be offset is an even lower (30%) for gifts to certain charities such as certain private non-operating foundations, veterans organizations, fraternal societies and nonprofit cemeteries. You can carry over any excess deduction from one year to the next, and you have five years to use it up. In the meantime, though, you are paying tax on monies that you've given away. That hardly seems fair.

Collateral damage.

Moreover, there are some other negative tax implications of a regifting plan. The fact that you have to take the prize money into income means that you will likely lose other deductions and personal exemptions. Even if you give all the prize money to charity, you end up paying significantly more in taxes than you would have if you had never received the award. That hurts.

An alternative: plan ahead.

That brings us to the final possibility, assigning a prize before you take receipt of it. The idea is to keep the prize moving past you, redirecting it to someone else before its tax impact hurts you. Fortunately, the IRS has issued guidance on how to do this. See Rev. Proc. 87-54, 1987-2 C.B. 669.

First off, the recipient must be a qualified charity. That means you can't push off the award to your brother-in-law. (Well, you could do that, but if you do you must pay tax on the whole $1.4 million, and then also pay a gift tax when you regift it!)

Timing is important. You must make the assignment to charity before the award is presented to you. You can, however, make a partial assignment. You can keep the statuette or plaque, and even some of the cash, as long as it's clear precisely what amount you are assigning. Finally, for your charitable regift to be effective, some magic language in the paperwork is required.

Most of us won't have the chance to even dream of a Nobel Prize, let alone worry about its tax impact. But given many types of other awards and prizes you might encounter, it pays to know the tax impact and to plan ahead.

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