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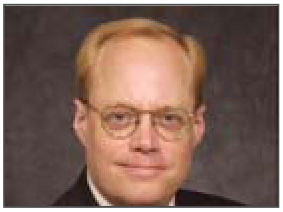

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THE TAX LAWYER

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With Taxes, Giving May Be Worse Than Receiving

The Bible suggests it is better to give than to receive, even when you give up a lot. In O. Henry's "The Gift of the Magi," a struggling young couple wants to exchange something special for Christmas. Della cuts off her flowing hair and sells it to a wig maker to buy a platinum chain for her husband Jim's heirloom pocket watch. Ironically, Jim sells his prized watch to buy combs for Della's hair.

Image via 123rf.co.kr

In "Two Thanksgiving Gentlemen," another O' Henry masterpiece, a vagabond is hosted annually to a grand Thanksgiving dinner by a successful businessman. Down on his luck for the first time but not wanting to disappoint the vagabond, the businessman starves for days to afford it. Ironically, the vagabond's stomach is bursting from ***two other*** holiday meals that day but he plays along knowing how important the ritual is to his kindly benefactor.

With today's tough economy, some might dispute whether it is best to give or receive. That can be particularly true when it comes to taxes. Taxes have a funny way of turning things on their heads. They can sometimes even make you wish you could take a gift back.

That's what happened in *Miller*, where the U.S. Tax Court considered a father who gave most of his company's stock to his son. That was good for estate planning. It also seemed good income tax planning, since the father was in the process of selling the company and wanted his son to benefit from owning shares. Owners of family companies often give shares away right before a sale so family members will get the cash and get taxed at their rate.

But there was one slight problem. Miller's company was an S corporation with taxes are paid at the shareholder level by reference to stock basis. See Choice of entity poses tax, liability issues. The father actually transferred the majority of his stock basis to his son. That meant the father ended up with a big tax bill.

In Tax Court, the father argued that he had given the stock away in January 2003, not in December 2002. Yet all the documents said 2002 and he had filed a gift tax return reporting the 2002 gift. The Tax Court didn't buy it. Then he argued this was really a sale—a sale also would have given him more basis in his stock to wipe out his tax bill. Again, no dice.

The moral? When it comes to giving, get some tax advice before you act.

For more, see:

Selling Your Business? Taxes Are Key

Small Business Sales Rise in Q1

IRS Publication 583, Starting a Business and Keeping Records

Choice of entity poses tax, liability issues

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