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Using John Edwards' "It Was A Gift" Defense

Many people use this as an excuse why they didn't pay tax on something they received. It is a little like the "it was a gift, not a campaign contribution" defense being mounted by John Edwards. See [Surprising Tax Lessons From John Edwards's Indictment](#).

A gift isn't taxable to the recipient, and any gift tax must be paid by the donor. It sounds like a slick argument, but does it work? Unfortunately, most such claims fail.

Income is taxable whether in cash or in kind. If you receive it in kind, its fair market value is taxed. Examples include that cash bonus from your boss at year-end, the fancy briefcase your employer gave you when you were promoted, the free country club membership you got from a grateful client, you name it.

All are income. In an employment setting you face employment taxes too, creating withholding problems. Your employer must withhold extra taxes from your cash pay to make up for the value of the property you received in kind.

How do you distinguish between income and a gift? It depends on the intent of the person and the surrounding circumstances. Gifts are made out of "detached and disinterested generosity." Was the transfer of the briefcase or the country club membership detached and disinterested?

The IRS would say no, since they were surely meant to reward you for a job well done. That makes them income. They may also be intended to secure additional services in the future. The IRS can challenge whether what you received (or gave) was really a gift. The IRS is likely to consider large gifts from employer to employee as taxable compensation.

There is an exception for small holiday gifts to employees. The [IRS says](#), you can hand out turkeys and holiday baskets to your staff provided the gifts don't exceed \$100 in value. But if a worker puts in extra, unpaid overtime and you reward him with tickets to the Super Bowl, that's wages. Just how do you withhold on Super Bowl tickets?

You're supposed to increase the withholding on his cash wages to reflect the value of the tickets. Obviously, that works only if you pay your employee with a combination of cash and goods. If a buddy who isn't a regular employee helps you out at your business occasionally and you thank him with Super Bowl tickets, then the IRS will likely view them as taxable pay on a [Form 1099](#), not a tax-free gift.

Gifts are usually between people who have family relationships, like your grandmother who gives you something special for your college graduation. But gifts aren't limited to family. Under the [annual gift exclusion](#), anyone can give anyone else up to \$13,000 a year in money or property without worrying about gift taxes. Your grandmother could give you and your spouse \$13,000 each—a total of \$26,000 per year—with no gift tax.

Gifts in excess of \$13,000 per year per donee are taxable, but your grandmother won't necessarily have to pay any gift tax. Under the gift and estate tax law in effect for 2011 and 2012, each person gets a \$5 million lifetime exclusion from gift (and estate) taxes. It's not yet clear what will happen to the gift and estate tax law in 2013.

For more, see:

[IRS Mines Real Estate Deeds To Collect Gift Tax](#)

[John Edwards' cheat sheet: What are the facts, and do they make him a criminal?](#)

[IRS: Gift Tax FAQ](#)

[IRS: What's New – Estate and Gift Tax](#)

[IRS: Introduction to Estate and Gift Taxes](#)

[IRS Halts Gift Tax Enforcement For Contributions To Political Nonprofits](#)

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