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In the Giving Mood?

The Taxing Side of Gift-Giving this Holiday Season

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As the holidays approach, business people are naturally thinking about who has been naughty and nice, and among those who deserves a nice gift for the holidays? As part of one's planning that goes into holiday gift-giving, it is wise to think about the tax aspects, particularly what is and is not deductible. There are a number of fairly simple rules that can make this process less painful when it comes time to file a tax return.

You Better Watch Out

For starters, so long as the amount given to another person is truly a "gift," rather than compensation for services rendered or to be rendered, it is not taxable as income to the recipient.

The general rule under the Internal Revenue Code of 1986 calls for an annual limitation on deductions in the amount of \$25 for gifts to an individual recipient whether you purchased one gift or a series of gifts throughout the year. It is important to know that the amount of the gift, before applying the limitations discussed above, is the cost of the item to the donor, not its value to the recipient. Incidental costs such as engraving on jewelry, packaging, insurance, mailing or other delivery are not considered in the \$25 limitation.

Check Your List Twice!

As you begin to create your list of gift recipients, and perhaps this goes without saying, the gift must really be to someone having a relationship that is appropriate and helpful to the taxpayer's business. The cast of eligible recipients includes customers, business associates, clients and professional advisors. The fact that Uncle Frank was an inspiration to one's success does not make him a qualified recipient for a deductible gift.

Similarly, gifts made to delivery people and parking lot attendants have been held nondeductible by the IRS and the Courts for failure to demonstrate a direct connection between the gift and the taxpayer's business. Remember to keep in mind the connection that must be present when you give a gift involves demonstrating that this generosity is appropriate, customary and helpful, as well as closely related to the taxpayer's business.

Any Exceptions?

In the Giving Mood?, Continued

Gifts of "entertainment," are an exception to the rule. If a business person takes an associate to dinner or to see a show, that person starts with a 100 percent deduction, which is not limited to the \$25 maximum. This "gift" is subject to the 50 percent limitation on deductions of meals and entertainment, which has been part of the Internal Revenue Code since the Carter administration waged war on "three martini lunches."

But what if a person gives tickets to a sporting or cultural event as a gift? The donor has an option: a deduction of up to \$25 per gift subject to the limitations above, or the cost of the tickets can be treated as an "entertainment expense," rather than a gift, in which event 50 percent of the cost may be deductible without regard to the donor to donee limitations. Moreover, even if the donor gives away the tickets and doesn't attend the event, the entire amount is still eligible for deduction as an entertainment expense if the recipient meets the business relationship test.

Finally, there is another exception of sorts for what can be called "promotional" material. Gifts having a cost of \$4 on which the taxpayer's name is clearly and permanently imprinted - like pens, desk sets and plastic bags - are treated as business expenses, not subject to the gift rules, if each is one of a number of identical items distributed generally by the taxpayer. Also, signs, display racks or other promotional material to be used on the business premises of the recipient are also excluded from the gift rules.

These are just general comment, and are not intended as tax advice to anyone. The rules above do not apply to charitable contributions, which are the subject of a different set of rules, as well as to such things as employee achievement awards. If you are planning on a major gift-giving campaign, it would be wise to sit down and discuss it with your own tax advisor before you begin.

About the Author: George W. Connelly is an attorney who is a Shareholder as well as Practice Group Leader for the Tax Sections of Chamberlain, Hrdlicka, White, Williams & Martin law firm headquartered in Houston. George is also an associate member of the Silver Fox Advisors organization in Houston.