

TAX TALK
BY JEFFREY D. SKOLNICK, CPA, M.S. TAXATION

THIRD PARTY PAYMENTS

Questions often arise as to who is allowed to take the deduction when payment is not made by the person who incurred the expense. Common examples of such expenses are real estate taxes and medical expenses.

Income Tax Implications

Generally speaking expenses are deductible only by the person that is obligated to pay them. In other words for a taxpayer to deduct real estate taxes on their return they would have to be the person responsible to pay the real estate taxes.

Recently there was a case decided in the tax court which sheds a little light on the subject. The question at hand was whether a taxpayer was allowed the deduction for real estate taxes and medical expenses paid by her mother. The taxpayer was not a dependent of her mother.

The IRS had originally ruled that the taxpayer was not entitled to these deductions on her return based on the fact that she did not pay them. In addition her mother could not deduct them because she was not legally obligated to pay the expenses.

The taxpayer argued that the payments made by her mother were actually gifts on her behalf and were therefore deductible.

The tax court ruled that although the payments were made directly by a third party, they were in fact gifts and the taxpayer was allowed to deduct the expenses.

It should be noted that if the taxpayer was a dependent of her mother, then the mother would be allowed the medical expenses as a deduction.

Gift Tax Implications

Taxpayers are allowed a lifetime limit for federal tax purposes of \$5,000,000 for combined estate and gift tax purposes. To state it another way under current law an individual will incur no federal estate tax if they pass away and have \$5,000,000 or less in assets. This number is reduced by any taxable gifts given.

Taxpayers are allowed to gift up to \$13,000 to any individual during a calendar year. Gifts in excess of \$13,000 per individual are reported on a gift tax return and reduce the \$5,000,000 lifetime limit.

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There are certain exceptions to this \$13,000 per year limit. Medical expenses paid directly to a provider and education expenses paid directly to an institution are exempt.

In the above referenced court case although total payments made by the mother exceeded \$13,000, the medical expenses (which had been paid directly to providers) were exempt and the real estate taxes were under \$13,000 and therefore there were no gift tax implications.

Conclusion

This article gives a very brief summary of how certain payments made by third parties are handled. The fact that these deductions are still being litigated shows that the area can be complex. I would encourage anyone who is involved in these types of transactions to contact a tax professional.