

### Should You Ask the Cost of a Gift?

Imagine this scenario. Your wealthy Uncle John is something of an art collector, buying paintings and sculptures from promising young artists. When he retires, he moves into a small condo in a retirement community and has to downsize his art collection. He gives away much of his art to family members, and you receive an abstract painting. He tells you that he paid \$5,000 for it only two years ago.

A few years later Uncle John passes away, and soon after that you decide to sell the painting. You're delighted when an art dealer offers you \$12,000 for the painting. Unfortunately the IRS audits your tax return for that year and informs you that you owe capital gains tax on the sale.

How much do you owe? In theory, you received Uncle John's cost basis in the picture when you received it as a gift. Your taxable gain would be \$7,000 (\$12,000 sales price less his \$5,000 cost basis). But unless you can document the purchase price, the IRS might well claim that you owe tax on a \$12,000 gain.

When you sell property you received as a gift, the general rule is that your basis is the donor's cost basis. If you sell at a loss, your basis is the lower of the donor's basis or the fair market value on the date you received the gift. There are adjustments to these numbers in some cases. But the important point is that without cost records, you have no way of proving the donor's basis and no way of disputing an IRS claim.

While it might seem embarrassing to ask for records of the cost when you receive a gift, it could save you a significant amount of taxes in the future. And if you have received valuable gifts in recent years, it might be worth going back to recover the cost records before they're lost forever. On the other hand, if you're the one making the gift, give the cost records at the same time. If you don't, you may end up giving a gift to the IRS in the form of unnecessary taxes.