The Boston Globe

Rules on gift tax, in all its varieties, can confuse

This year's big stock gains and higher tax rates call for extra care in making donations

By Jay Fitzgerald - February 16, 2014

Scott Kaplowitch, a Boston tax accountant, recently counseled a couple on how to quickly help their daughter and son-in-law come up with money for a down payment on a new home.

His advice: Use the federal Annual Exclusion Gift to the max.

Within 30 days, the couple funneled $112,000 to their daughter and son-in-law, all of it in cash, tax free to recipients, and with minimal or no reporting requirements to the Internal Revenue Service.

"A lot of clients know about the annual exclusion gift, but they don't know how to use it," said Kaplowitch, a partner and CPA at Edelstein & Co. LLP. "There's a lot of different ways you can use the gift law but it can get confusing, depending on how you do it."

Conceptually, the annual exclusion gift is rather straightforward: Anyone can give anyone — relatives, friends, and even strangers — annual gifts of up to $14,000 a year without the recipients having to pay taxes. The gift limit was raised to $14,000 this year from last year's $13,000.

'A lot of clients know about the annual exclusion gift, but they don't know how to use it.'

Such annual gifts are not counted against the US estate tax exemption of $5.3 million when a person dies and leaves money and assets to recipients. The annual tax free gifts are in addition to that estate tax exemption.

Where the annual exclusion gift can get confusing — and yet remain highly beneficial — is exactly what, when, and how gifts are given to recipients.

Most annual gifts are made in the form of cash — a simple transaction commonly used by grandparents and parents to transfer money to their grandchildren and children. Technically, cash givers don't have to report the gifts to the Internal Revenue Service, though tax specialists say it's always best to keep records in case of a government tax audit.

But the annual gift exclusion is not limited to just cash.

Donors can give away a portion of the value of just about anything using the exclusion gift: homes, businesses, stocks and bonds, boats, artwork, family heirlooms, and even life insurance policies. One tax accountant said he knows of a client who gave away portions of his cherished wine collection, using the exclusion gift.

A typical example of a non-cash gift might be parents who, over time, gradually give away part of the value of their vacation home. If they have only one child, for instance, they can give him or

her annual $14,000 shares of the home. Over 20 years, that would amount to a $280,000 tax-free ownership stake in the property.

But most non-cash gifts require that the value of tangible assets — such as a home, business, paintings, and other items — must be appraised and recorded each year, under IRS rules, tax specialists say. The appraisals are required to establish the true value of assets and the percentage stakes of ownership in the assets.

And the giving away of non-cash assets, in the form of exclusion gifts, also usually requires establishing irrevocable trusts in which ownership stakes are recorded and maintained.

Parents who give away part of the value of a vacation home, for instance, would set up a trust recording the annual gifts toward partial ownership of the property. The givers would then have to legally send out so-called "Crummey letters" (named after a person involved in a previous gift tax legal case) that inform beneficiaries of their rights and terms of the trust.

"The person making the gift can still use and benefit from the asset," said Mark Alaimo, a principal and CPA at Wealth Management Advisors LLC in Tewksbury. "They're just giving away a portion of the value of the asset."

Since the giving of non-cash assets can get complicated, most tax specialists urge people to consult with a tax accountant or lawyer before proceeding.

Another area that often causes confusion is how much and when married couples can give exclusion gifts to recipients. The bottom line: Spouses can individually give an annual tax-free gift of $14,000 to a beneficiary.

In the case of Kaplowitch's clients who wanted to help their daughter and son-in-law buy a home, they each gave their daughter $14,000 in cash (for a combined $28,000) and their son-in-law the same amount (another combined $28,000) for a total of $56,000 in late December 2013.

After 2014 rang in last month, the couple repeated the process, $28,000 to their daughter, $28,000 their son-in-law. So within a span of less than 30 days, the couple's total exclusion gifts amounted to $112,000, which has been committed to a purchase of a home.

"Many times people will do this to help their kids to buy a home," said Kaplowitch. "There's a lot of ways to use the Annual Exclusion Gift. You just have to know how to do it."