

A P P R E C I A T E D  
P R O P E R T Y

*Uncover the Value of Your Appreciated Assets*

*a donor's guide*

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## APPRECIATED PROPERTY

Learn how to uncover the value of your appreciated assets.

**Y**ou're elated that your securities have grown throughout the years. Yet that same success carries with it a dark cloud in the form of unrealized gains. If you sell, you expose the appreciation to capital gains tax.

There is a silver lining to that dark cloud of capital gains tax, which can benefit you and your family. By donating securities held long term (more than one year) to a charitable organization, you completely avoid capital gains tax on the appreciation and receive a charitable deduction for the full fair market value of your donation. If your estate will be subject to federal estate tax, you could realize a third savings.

This brochure suggests alternatives to gifts of cash, whether you wish to make an outright gift or a deferred gift through a plan that can guarantee you income for life. Making the best use of your appreciated property through a charitable donation provides both personal and economic satisfaction.

### The Advantage of an Outright Gift

Illustrated here are the possible savings that can result from a charitable donation using appreciated stock vs. cash. Assume you have stock that you would sell for \$5,000, and it originally cost \$3,000. Due to appreciation, you have an untaxed capital gain of \$2,000. If your marginal income tax rate is 28 percent (15 percent on capital gains), the difference in net cost between giving cash or the stock can be quite significant.

## Giving Cash

Value of gift	\$5,000
Tax savings from use of deduction (28 percent rate)	(\$1,400)
Tax savings from avoidance of capital gains (15 percent rate)	N/A
NET COST OF CASH GIFT	\$3,600
COST AS % OF GIFT	72%

## Giving Appreciated Stock

Value of gift	\$5,000
Tax savings from use of deduction (28 percent rate)	(\$1,400)
Tax savings from avoidance of capital gains (15 percent rate)	(\$300)
NET COST OF CASH GIFT	\$3,300
COST AS % OF GIFT	66%

If you have more appreciation in the contributed stock or are in a higher combined federal and state tax bracket, your savings increase and the cost of your gift decreases.

## A Gift With Income to You

Some gift options produce income for the donor or the donor's named beneficiaries. If you wish to reduce your dependence on equities, secure an increased and steady income, and make a gift to a charitable organization, this might be the alternative for you. Of course, you'd prefer to make this change without erosion due to capital gains tax.

An appropriate and efficient solution is to select your most highly appreciated assets, or those with the least potential for

further growth, and transfer them to a *charitable remainder annuity trust* (CRAT). You specify a set amount of annual income you (or another income beneficiary) would like to receive from the trust, which may actually end up being two or three times the dividend rate of the stock you transferred to it.

The income could last for your lifetime (plus the lifetime of a subsequent income beneficiary, such as your spouse) or a term of years. After the trust term ends, a charitable organization you have named receives the remainder of the assets in the trust.

The year you establish the CRAT, you receive an income tax charitable deduction. This amount depends on the number of beneficiaries you've named to receive income from the trust, their life expectancies, the amount of income the CRAT will distribute to them (including how frequently the payments are made), and the current Treasury Department interest rate.

**Example:** Martin, age 75, places \$100,000 of stock currently generating \$1,200 per year (cost basis, \$70,000) in a one-life CRAT paying 5 percent in semiannual installments (with an applicable federal interest rate at the time of 4.6 percent). So, he'll receive \$5,000 annually. He is allowed a charitable deduction of \$60,061, which in his 28 percent tax bracket saves him \$16,817 of income tax. In addition, he avoids the capital gains tax on his \$30,000 appreciation in value, which amounts to a \$4,500 savings at the 15 percent tax rate. The net cost of his \$100,000 gift was only \$78,683, and he increases his income by \$3,800, or more than three times the original income stream.

## A Winning Plan for Closely Held Stock

If you're an owner of stock that is highly appreciated yet not readily marketable, such as shares in a family business, you may have the opportunity to be philanthropic at minimal cost. You could make an outright charitable gift of stock in your corporation. The corporation, preferring to keep its stock closely held, may subsequently offer to buy the stock from the charitable organization at its appraised value.

The charitable organization, preferring to hold marketable securities or usable cash, would more than likely choose to sell to the corporation. But beware: no sale between the charitable organization and the corporation can be prearranged if you wish to avoid the capital gains tax.

If you're the sole stockholder, you will still own 100 percent of the equity if the corporation buys back the stock and retires it as treasury stock. From the corporation's point of view, excess profits have been distributed without a penalty tax.

An alternative is for younger family members and key employees to purchase the stock. In addition to supporting our charitable mission, you will have effectively transferred some of the ownership without a capital gains tax or receipt of constructive dividends.

## Tax-Saving Results Using Real Estate

A gift of land or developed property, with a fair market value above the cost basis, produces the same double tax savings as a gift of securities, and certain types of real estate are favorable for unique reasons.

- Agricultural land, for example, tends to return a low percentage of its market value.
- Real property, such as land or a vacation home that is no longer used, has a cost of ownership.
- An older commercial building may be fully depreciated and costly and time-consuming to manage.
- Developed investment or commercial property on which straight-line depreciation was taken may provide significant capital gains savings.

For any of these reasons, a major charitable gift based on real estate can prove highly satisfying. However, there are special aspects of such gifts you should consider, particularly if you are considering using mortgaged property. Thus, it is important to discuss with us and your tax advisor the nature of your gift of property.

One further consideration is that each piece of real estate is unique. One property may sell readily, while another may require time to realize its full market value. A delay in sale of the gift is especially significant when the gift calls for an income distribution to the donor or person named by the donor.

When real estate is contributed to a charitable remainder trust, it may be best to use a charitable remainder unitrust (CRUT), which is a trust that pays the individual beneficiaries a percentage of annual market value rather than a fixed annuity amount. The CRUT is generally structured to limit annual distributions to the lower of actual income or the designated payment amount until the property is sold.

## Gift of Remainder Interest in a Home or Farm

A general rule of tax law is that no charitable deduction is allowed for the gift of a partial interest in property. An exception: gifts of a remainder interest in a personal residence or farm in which you retain a life estate. In a “retained life estate” situation, you deed the property to a charitable organization, but you (and/or others you name) still have lifetime use of the property. You continue to maintain and insure the property and pay property taxes.

Because this donation is irrevocable, you are allowed a current income tax charitable deduction equal to the market value of the property, reduced by your life income interest. This strategy is especially valuable to those donors who will not pay estate tax under the new estate tax structure, since it allows the donor to receive a current tax deduction for the gift.

## Gift by Estate Distribution

Lifetime transfers of appreciated real estate to a charitable organization provide two tax savings: an income tax charitable deduction and avoidance of capital gains tax. Depending on your willingness to give away property during your lifetime, a gift through a will or living trust may be a better choice.

A single property thus removed from your taxable estate may eliminate a federal estate tax, if applicable, and it avoids the costly process of selling the real property in order to obtain proceeds for distribution in an estate, as well. In addition, leaving property to a charitable organization in your estate plan allows you to retain access to the market value during your life should it ever be needed.

## Tangible Personal Property Gifts

Tangible personal property, such as works of art, rare books, collections and antiques, may also have appreciated substantially in value when compared to its original cost and can make a satisfying charitable gift.

For appreciated tangible personal property to be deductible at full fair market value, charitable organizations must be able to use the item in ways related to their charitable purpose.

## Bargain Sale: Another Option

The bargain sale as a charitable giving method is used when the value of appreciated gift property exceeds the value of the intended gift and it is impractical to divide the property into a portion to be given and another to be sold.

A potential alternative is to sell the property to a qualified charitable organization at a negotiated price significantly below its fair market value. The difference between the sale price and the higher market value is the deductible value of a charitable gift. An example follows on the next page:

## Bargain Sale: Another Option

Fair market value of gift property	\$50,000	100%
Bargain price (sale portion)	<u>(35,000)</u>	70%
Charitable deduction (gift portion)	\$15,000	\$15,000 30%
Marginal tax rate	x <u>.28</u>	
Tax savings from deduction	\$ 4,200	\$4,200
Fair market value of gift property	\$50,000	
Less cost basis	<u>(20,000)</u>	
Total long-term appreciation	\$30,000	
Sale share of transaction	x <u>.70</u>	
Capital gains taxed	\$21,000	
Capital gains tax rate	x <u>.15</u>	
	\$3,150	(3,150)
Net tax savings from deduction		\$1,050
Capital gains not taxed	\$9,000	
Capital gains tax rate	x <u>.15</u>	
Capital gains tax avoided	\$1,350	<u>\$1,350</u>
NET TAX SAVINGS	\$2,400	

The capital gains tax is partially avoided since you must recognize only the gain attributable to the sale portion of the transaction.

If the charitable gift portion of a bargain sale is valued at more than \$500, you must file IRS Form 8283 with your Form 1040. When the gift portion of a bargain sale is valued at more than \$5,000, a qualified independent appraisal may be required. By law, the appraisal is your responsibility and may be a tax-deductible expense.

## Other Considerations

One caution to keep in mind is that the donor of nonmarketable property should not attempt to provide the charitable recipient with a ready buyer for the property. Both the donor and the donee should avoid a private sale that was lined up before the gift was made.

However your charitable gift is structured, qualified counsel should be sought before it is finalized. Please ask our representatives to help you and your advisors plan the gift that best fits your individual circumstances.

The information in this brochure is not intended as legal advice. For legal advice, please consult an attorney. Figures cited in examples are based on current rates at the time of printing and are subject to change.