HOW TO AVOID TAXES ON APPRECIATED PROPERTY

A SPECIAL PLANNING REPORT TO ASSIST YOU IN YOUR ESTATE & GIFT DESIGN

1300 India Hook Road, Rock HIll, SC 29732

PREPARED BY: Westminster Ministries Foundation for Westminster Presbyterian Church

PHONE: 803.366.8880

E-MAIL: elb@wpcgo.com

HOW TO AVOID TAXES ON APPRECIATED PROPERTY

There are many benefits available to an individual who gives property, especially if that property has appreciated in value, or has a distinct use by the organization or individual receiving it.

Whether real estate, stocks, bonds, mutual funds, or tangible personal property which can be used by Westminster Presbyterian Church, there are distinct advantages to making this kind of transfer.

One major advantage in making a gift of property is the ability to make a larger gift.

For many of us, the desire to gift exceeds the amount of money we have in the bank which is available to give.

If we have access to investments which can be transferred to fund a gift, without taking from cash flow used to meet our budgetary needs, our giving is not limited to what we can spare from a paycheck.

Or we may desire to perpetuate the support of an individual in service or a disabled or needy child. A gift of capital which has the ability to produce income can guarantee that support.

WHAT ARE THE TAX IMPLICATIONS OF OUR GIFTS?

Another specific advantage to gifts of appreciated property is the generous tax benefit our government has provided.

When we transfer appreciated property to WPC, we receive a charitable deduction equal to the full fair market value of the property at the time of the transfer.

If we sell the property and then make the gift, we will be taxed on the appreciation.

But that tax is avoided when we give appreciated property directly to WPC.

Example: Mr. Jones purchased stock in 1978 for $10,000, and that stock is valued at $15,000 today. If he sold the stock, he would be taxed on the $5,000 gain. This tax would be at his combined federal and state capital gains tax rate, and we'll assume that to be 22%. This means that he would pay a capital gains tax of $1,100, leaving only $13,900 with which to make his gift.

Assuming Mr. Jones made a gift of the remainder, he would realize an income tax savings of approximately $5,840, assuming he is in a 42% combined federal and state income tax bracket.

Let's assume, however, that instead of selling the stock, he gave it to WPC, and we sold the stock. Mr. Jones would receive an income tax charitable deduction for the full value of the stock, or $15,000, thus saving approximately $6,300 in taxes. And he would avoid the $1,100 tax on the capital gain.

Let's look at these two transactions, side-by-side.

	Sale then Gift	Gift then Sale
Fair Market Value	$15,000	$15,000
Tax on Capital Gains	1,100	0
Gift to Charity	$13,900	$15,000
Deduction Tax Savings	$5,840	$6,300
Net Benefit to Charity	$13,900	$15,000
Net Tax Savings to Donor	4,740	6,300
Combined Charitable and Personal Benefits	$18,640	$21,300

Comparison

Cost to Mr. Jones	$10,260	$8,700
Benefit to Charity	13,900	15,000

As you can see, the cost to Mr. Jones was $1,560 less, and he made a gift to charity of $1,100 more, for a total difference of $2,660.

We can not examine all the specifics relating to taxation of gifts of property here. But there are some general rules of which you should be aware.

- Gifts of cash or non-appreciated property are deductible up to 50% of adjusted gross income. However, when a gift is of property that has appreciated in value, that deduction is limited to 30% of adjusted gross income.

  If the gift exceeds the amount which can be deducted in one year, it can be carried over for five additional years.

- If the gift is of tangible personal property, its use must be related to the charitable function of the organization, or the deduction will be for cost basis only.

- Even though property has appreciated in value, it must be held one year or longer, or the deduction will be for cost basis and not the current fair market value.

- If property is held for a trade or business (such as real estate owned by a developer or automobiles owned by a dealer), the deduction will probably be for the cost basis of the property and not for its full fair market value.

We will be happy to work with you and your legal and tax counsel, to explore the tax implications of your gift.

SHOULD TAX SAVINGS BE USED TO MAXIMIZE GIFTS OR FOR PERSONAL BENEFIT?

Many people find joy in being able to maximize their gifts by giving their tax savings realized through the avoidance of capital gains tax on gifts of appreciated property, and from their charitable deductions.

In our example above, if Mr. Jones had made a contribution of his charitable deduction tax savings, the cost of making the gift would be slightly higher than the cost of selling the property, paying the taxes, and then making the gift. But the benefit to charity would be greatly increased.

Another Use of Tax Savings

Frequently, an individual wishes to make a substantial gift to WPC, but is concerned that the gift removes the property from the estate and therefore will not be available for personal beneficiaries.

By making the gift and using the tax savings created by the charitable deduction to purchase life insurance, the value of the policy purchased will many times be equal to or greater than the actual value of property given to WPC.

The amount of insurance coverage which the tax savings will purchase depends upon the age and income tax bracket of the donor.

There is an additional benefit if the donor's estate is taxable. Because of the unique provisions of life insurance, it may be possible to remove life insurance from the tax-able estate, without creating a gift tax.

This will increase the value of the property distributed to personal beneficiaries by the amount of the estate tax payable, which is a minimum of 41% and may be as great as 46%.

WHAT IF PROPERTY VALUE IS MORE THAN THE DESIRED GIFT?

Many times an individual wants to make a substantial gift to WPC or Westminster Ministries Foundation, taking advantage of the tax benefits available. But the property which would provide the greatest tax benefits may have a greater value than the desired gift.

There is a solution. It is called a "bargain sale." WPC or the Foundation will enter into an agreement to purchase property for the amount by which the value of the property exceeds the desired gift.

> ***Example:*** Mrs. Smith desires to make a gift of $20,000 to a project, and has property with a value of $35,000.
>
> Westminster Presbyterian Church enters into an agreement to purchase Mrs. Smith's property for $15,000. The remaining $20,000 is an outright gift to Westminster Presbyterian Church. The purchase agreement will provide for either a cash purchase, or a note for the difference, payable upon the sale of the property.

The tax advantages described above are available on the gift portion of the property. Capital gains tax is payable only on the gain attributed to that portion of the property purchased by the charitable organization.

And the charitable deduction will be for the difference between the purchase price paid by WPC or the Foundation, and the fair market value of the property.

PROPERTY GIFTS CAN ALSO PROVIDE INCOME

There are several ways to transfer property, retaining the income it produces.

> ***Example:*** Mr. and Mrs. Wilson own property valued at $100,000, which they purchased for $20,000. They want to make a gift of $30,000, but need to maintain the $5,000 annual income currently produced by the property.
>
> Mr. and Mrs. Wilson can transfer the property to WPC or the Foundation, who agrees to pay them $5,000 income each year for their lives.
>
> WPC or the Foundation will then set aside approximately $70,000 to secure the income payments, and the remaining $30,000 will provide an immediate gift.
>
> If Mr. and Mrs. Wilson sold the property and made a gift of the remainder, because they have a $20,000 cost basis in the property, they would pay capital gains tax on $80,000, or approximately $17,600 in taxes (assuming a 22% combined federal and state tax bracket).
>
> After setting aside $70,000 to secure their income, they will have only $12,400 available to make their gift, rather than $30,000. And this will reduce the savings from their charitable deduction by approximately $5,630.

There are several different vehicles which can be used in these circumstances. We will be happy to compare these vehicles for you, relating to your specific property and income needs. Please provide us the information requested on the enclosed response card, and we will prepare a personalized response for you.

THE SAME TAX RULES MAY APPLY FOR YOUR BUSINESS

Many individuals who contribute regularly to WPC, own their own businesses, and for legal or tax purposes have incorporated those businesses. Stock in a corporation can also make an ideal gift. But it presents two unique problems.

- The charitable organization may not have a buyer for the stock, and the stock will really be of no benefit to the organization.

- The owner of a closed corporation may not want someone else to own a part of the business.

There is a good solution. The corporation can purchase the stock from the charitable organization with the following results:

- The owner receives a tax deduction for the gift.
- The individual and the business maintain ownership of all of the stock.
- The charitable organization has the cash value of the gift.
- There are no capital gains taxes payable on the transfer.

These advantages are even greater if the business has a pension plan authorized to own stock in the corporation. If this is the case, then the purchase of the stock from the charitable organization can be made with tax deductible dollars, providing additional tax savings.

Or if a business owner has accumulated earnings in the corporation, the above transaction provides a way to reduce accumulated earnings, and avoid their negative tax implications.

CONCLUSION

The form in which a gift is made, the tax implications and the planning of that gift to maximize its benefit for Westminster Presbyterian Church and for you, are important.

That is why we have made the commitment to help you in the planning of your gift to provide maximum benefits. We are available to work with you and your legal and tax counsel, and look forward to that opportunity.

Note: The information in this planning report is of a general nature only, and should not be interpreted as legal advice. Illustrations were calculated using a 5% mid-term AFR rate. The rate in effect in the month of a transfer or in either of the two months preceding the transfer will be used to calculate the charitable deduction available for a specific gift.