



Oklahoma City

Community
Foundation

consider this...



Jim Holloman

MR. HOLLOMAN, AN ATTORNEY WITH CROWE & DUNLEVY, HAS WRITTEN NUMEROUS ARTICLES AND GIVEN LECTURES ON TAX, ESTATE PLANNING AND CORPORATE LAW. HE WAS APPOINTED TO THE BOARD OF TRUSTEES OF THE COMMUNITY FOUNDATION IN JANUARY BY THE CHIEF JUDGE OF THE U.S. DISTRICT COURT OF WESTERN OKLAHOMA.

Gifts of Capital Assets Reduce Income Taxes

By James H. Holloman, Jr.

Many individuals seek to enhance the quality of life in our community by donating to a charitable cause. The Oklahoma City Community Foundation, a public charity, not only allows donors to pursue their charitable interests, it also provides them with tax benefits not available when donating to private charities. The Community Foundation has received wonderful support from such individuals in its 27 years of existence, permitting it to grow to over \$150 million in total funds.

One way donors can assist in continuing this growth is by donating *highly appreciated capital assets*. These capital assets may have grown through a securities investment portfolio or by growth of a closely held business. This appreciation is likely an *unrealized* long-term capital gain (in an asset held over one year). If such a capital asset were sold, the owner would be obligated to pay substantial federal and Oklahoma state income taxes on the capital gain that is realized in the sale.

The income tax laws permit a donor to give a capital asset to the Community Foundation without recognizing the inherent *unrealized* gain on that asset. The Community Foundation can then sell the capital asset as it deems it appropriate, with the advice of the donor, without incurring

any income tax consequences because of its tax exempt status. Thus, the donor can receive a charitable contribution income tax deduction for the *full fair market value* of the capital asset without having to recognize the unrealized long-term capital gain inherent in the asset.

Income Tax Rules on Charitable Gifts of Capital Assets

A gift of a capital asset, which has been held for the appropriate time period for long-term capital gains (currently one year), to the Community Foundation, a public charity, is deductible to the donor for both federal and Oklahoma state income tax purposes at the asset's fair market value without regard to the donor's income tax adjusted basis. This gift does not create a reportable long-term capital gain to the donor upon the asset's transfer to the Community Foundation. However, under Internal Revenue Code Section 170(b)(1)(B), the aggregate amount of deductions for such gifts of long-term capital gain assets to public charities is 30 percent of the donor's adjusted gross income instead of the normal 50 percent of the donor's adjusted gross income limit for cash gifts to public charities. A special rule permits an increase of the

limit to 50 percent if the donor elects to limit the deduction to only the donor's adjusted basis in the capital asset. This special rule, however, is only advantageous to a donor where there is not substantial appreciation in the capital asset.



In addition, in evaluating a gift of a long-term capital asset to the Community Foundation, the IRS Code limits itemized deductions if the individual donor has adjusted gross income in excess of a threshold

amount (\$114,700 for 1995, subject to an annual inflation adjustment). Under this limitation, if a highly appreciated capital asset is sold, the adjusted gross income of the owner is increased by the amount of the long-term capital gain recognized; therefore, an additional income tax burden occurs by reason of the donor's itemized deductions equal to the income tax rate on 3 percent of the recognized long-term capital gain.

Example of Substantially Reduced Income Taxes with Charitable Gift

As a result of the foregoing income tax rules, a donor who desires to contribute some value to the Community Foundation can substantially reduce his or her income taxes on a sale of a *highly appreciated capital asset*

“THE DONOR CAN RECEIVE A CHARITABLE CONTRIBUTION INCOME TAX DEDUCTION FOR THE FULL FAIR MARKET VALUE OF THE CAPITAL ASSET WITHOUT HAVING TO RECOGNIZE THE UNREALIZED LONG-TERM CAPITAL GAIN INHERENT IN THE ASSET.”

by diverting a major portion of those taxes into a gift to the Community Foundation instead of paying those amounts in taxes to the IRS and the Oklahoma Tax Commission. Stated simply, for charitable contributions below the 30 percent of adjusted gross income limitation, the economic cost of a charitable contribution of a *highly appreciated capital asset* will be allocated approximately 70 percent to reduced federal and Oklahoma state income taxes and approximately 30 percent to reduced after-tax proceeds to the donor. These percentages will vary depending upon the proportion of unrealized appreciation in the long-term capital asset. Please consider the following example assuming that the donor owns a highly appreciated long-term capital asset worth \$100,000, with an adjusted basis of \$1,000, for a potential long-term capital gain of \$99,000 and the combined

income tax rate on long-term capital gains is 35 percent (28 percent federal and 7 percent Oklahoma).

The example below indicates substantial savings. Of course, the actual amount of unrealized long-term capital gain and the donor's tax bracket (the long-term capital gains tax rate could change), would alter the exact computation amounts. However, the example does illustrate the benefit of donating highly appreciated long-term capital assets instead of simply selling such asset and making charitable contributions with after-tax proceeds.

Situations for Use of Capital Gain Asset Charitable Gifts

Portfolio Securities - Many times individuals have accumulated substantial investment securities in their portfolio. Circumstances arise in which sales of such securities are appropriate or are required. For example: A publicly traded

company, perhaps in a high growth industry, is the target for merger and/or acquisition by another company, and a cash buyout will be required for shareholders of the target company. Alternatively, a publicly traded company may be in a period of long-term decline of its industry and therefore the sale of such security is a prudent investment management decision in order to reduce investment risk exposure to the portfolio.

Closely Held Businesses - A family or other closely held business that was started by the donor or has greatly increased in value over a number of years of operation may be ready for sale by reason of retirement or family estate planning. In such circumstances, the Community Foundation, as a public charity, can receive gifts of interests in such closely held businesses and can then participate in the transaction in which disposition of the business occurs.

Methods for Charitable Gifts to the Community Foundation

As identified in the preceding example, a gift can be made of a portion of the highly appreciated capital asset shortly before the intended sale. In addition, these methods can be incorporated with the use of charitable remainder trusts in which similar income tax savings can be achieved.

The Community Foundation is happy to assist prospective donors in the planning and execution of these types of transactions. Please contact Nancy Anthony, Executive Director, at 405/235-5603 for further information. ■

EXAMPLE

SALE TRANSACTION ITEMS	DONOR SALE OF 100% OF CAPITAL ASSET	SALE OF 70% & GIFT OF 30% TO FOUNDATION
SALE PROCEEDS	100,000	70,000
DONOR'S ADJUSTED BASIS	1,000	700
LONG TERM CAPITAL GAIN [1-2]	99,000	69,300
CHARITABLE CONTRIBUTION TO FOUNDATION	-0-	30,000
INCOME TAXES (PAYABLE) [3x35%]	(34,650)	(24,255)
TAXES SAVED ON CHARITABLE CONTRIBUTION [4x35%]	-0-	10,500
TAXES (INCREASED) ON ITEMIZED DEDUCTIONS [3x3%x35%]	(1,040)	(728)
AFTER TAX PROCEEDS TO DONOR [1-5+6-7]	64,310	55,517
TOTAL INCOME TAXES (PAYABLE) [-5+6-7]	(35,690)	(14,483)
DONOR AFTER TAX PROCEEDS TO FOUNDATION [58-68]	-0-	8,793
INCOME TAXES DIVERTED TO FOUNDATION [59-69]	-0-	21,207