



BARGAIN SALES TO CHARITIES: CHARITABLE DEDUCTIONS AND CAPITAL GAINS SAVINGS

The donor allocates the property's cost basis between the gift element and the sale element, based on the fair market value of each part.

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Conrad Teitell, a Principal in the Private Clients Group of Cummings & Lockwood and Chair of the National Charitable Planning Group wrote an article for the New York Law Journal entitled, "Bargain Sales to Charities: Charitable Deductions and Capital Gains Savings."

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Q: *What was the first bargain sale in North America?*

A: *Manhattan Island.*

Q: *What was the purchase price?*

A: *\$24 worth of trinkets.*

Q: *Was that for the entire island?*

A: *No, the Battery was extra.*

Q: *What is a bargain sale to charity in today's tax world?*

A: *It's a sale of long-term-appreciated property to a public charity at a price lower than its present fair market value. A charitable deduction for an itemizer is generally allowed for the difference between the sales price and the property's fair market value.*

How it works. The donor allocates the property's cost basis between the gift element and the sale element, based on the fair market value of each part. The donor incurs gain on the difference between the sales price and the cost basis allocated to the sale element, but isn't taxed on the gain allocated to the gift element.

Example. The donor sells long-term real property that cost \$250,000 (and is now worth \$1,250,000) to her college for \$250,000. The donor's contribution is \$1,000,000 (\$1,250,000 fair market value minus \$250,000 sales price). Donor's capital gain is \$200,000 (\$250,000 sales price minus \$50,000 basis allocated to sale element).

Caveat: If a donor bargain-sells property that is subject to an indebtedness, the amount of the indebtedness is treated as an amount realized on the sale of the property even though the transferee doesn't agree to assume or pay the debt. Similarly, a gift of mortgaged property is considered a bargain sale even though no payment is made to the donor.

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Charitable intent. The donor should clearly express his or her intention to make a charitable gift of the difference between the sales price and the property's fair market value. The donor's characterization of the transaction as a bargain sale shouldn't just be oral; written instruments and correspondence will help substantiate the deduction. And the qualified appraisal and substantiation rules must be satisfied.

Q: Why a bargain sale?

A: Typical situation: *A college needs additional land to expand its campus. The owner of adjacent land needs some cash and is considering selling the highly appreciated land. If he sells the land, he'll have a large capital gain.*

Although he is a supporter of the college, he can't afford to make a gift of all the land—and, as stated, he needs cash. A part gift, part sale could be the answer. He'll reduce capital gains and get a charitable deduction. This only works if he has "donative intent." He's better off financially with a regular and not a bargain sale. A bargain sale, however, reduces the cost of generosity—tax savings of smaller capital gains tax and a charitable deduction for itemizers.

Capital Gain, Charitable Deduction and Ceilings

Bargain sale of appreciated securities or real estate held long-term (more than one year). The long-term capital gain is the sale price minus the basis allocated to the sale. The amount of the contribution is the property's fair market value minus the sale price. The ceiling on deductibility is 30 percent of adjusted gross income, or 50 percent of AGI if the donor elects (for all long-term property gifts during the year or carried over from previous years) to deduct the fair market value minus 100 percent of the appreciation. For a bargain sale, that means that the charitable contribution is the cost basis allocable to the gift element.

Bargain sale of tangible personal property (e.g., art works, antiques) held long-term when the use of the property is related to the donee's exempt function: The long-term capital gain is the sale price minus the basis allocated to the sale. The amount of the contribution is the property's fair market value minus the sale price. The ceiling on deductibility is 30 percent of adjusted gross income or 50 percent of adjusted gross income if the donor makes the election described above.

Bargain sale of tangible personal property held long-term when the use of the property is unrelated to the donee's exempt function: The long-term capital gain is the sale price minus the basis allocated to the sale. The amount of the contribution is the cost basis allocable to the gift element. The ceiling on deductibility is 50 percent of adjusted gross income.

Bargain sale of securities, real estate and tangible personal property held short-term (one year or less): The short-term gain is the sale price minus the basis allocated to the sale. The amount of the contribution is the cost basis allocable to the gift element. The ceiling on deductibility is 50 percent of AGI.

Bargain sale of ordinary income property (crops grown by farmer, artwork produced by the donor, inventory): The ordinary income is the sale price minus the basis allocable to the sale. The amount of the contribution is the cost basis allocable to the gift element. The ceiling on deductibility is 50 percent of adjusted gross income.

I conclude with a tax court case allowing a \$5 million charitable deduction. The donor bargain sold land he valued at \$12 million to the state for \$6 million, claiming a \$6 million income tax charitable deduction (difference between his \$12 million valuation and the \$6 million sales price). IRS disallowed the deduction altogether, claiming the land was only worth the sales price.

Tax court rules. The property's highest and best use was as a residential subdivision. The court disregarded appraisals submitted by the donor and IRS. After computing what the land would be worth as subdivided lots—considering development costs, number of lots that could be developed, time needed to sell them and selling expenses—the court determined that the property was worth \$11 million. The court rejected IRS's contention that

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a permit granted to the donor by the state to harvest hay on part of the property reduced the property's value. The donor testified that it cost him more to grow and harvest the hay than the hay was actually worth. Further, the state had the power to terminate the power at any time and for any reason.

Comment. The donor was allowed \$5 million of his \$6 million claimed charitable deduction. And that ain't hay—or chopped liver.

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