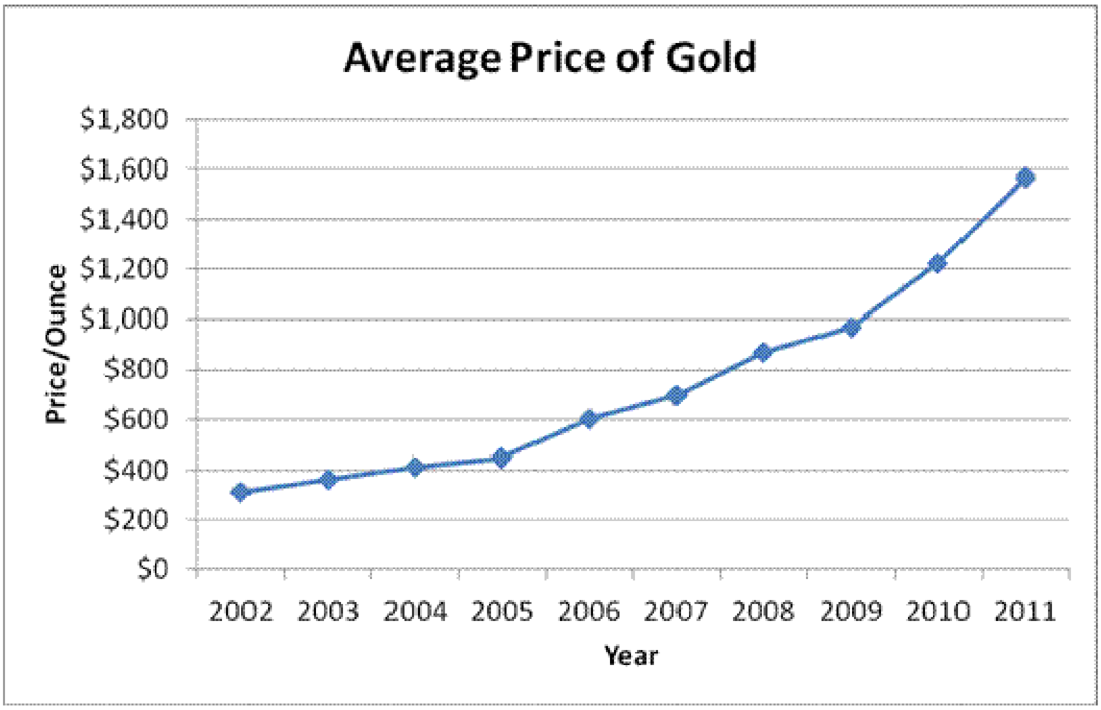
Gifts of Gold
PG Calc Featured Article, March 2012
http://www.pgcalc.com/about/featured-article-march-2012.htm

When investors become skittish about the economy, many of them sell their publicly-traded securities and buy gold. This has certainly been the case over the last ten years. While publicly-traded securities have fared poorly over the last decade, the skyrocketing demand for gold in the face of a static supply has caused gold prices to rise dramatically. An ounce of gold sells today for about five times what it sold for ten years ago. Its price has more than doubled in just the last four.

The graph below shows that the average price of gold has risen in each of the last ten years.



Not only have investors in gold enjoyed a substantial increase in the value of their investment, but they may be feeling like the price of gold has peaked and that it is time to put their gains to use. Gold prices have declined about 15% since they reached nearly $1,900/ounce last August and are known to be volatile as a rule.

Ways to Invest in Gold
Investments in gold can take a number forms, all of them readily marketable.

- Own shares in a gold mining company or in an Exchange-Traded Fund (ETF) that invests in gold mining companies. This is an indirect way to own gold. The owner purchases shares in a company that is mining gold, rather than gold itself, with the expectation that the mining company and its share price (or the share price of the ETF that invests in such companies) will prosper when the price of gold goes up.

- Own gold coins. Purchase gold coins, such as South African Krugerrands, Canadian Maple Leafs, or U.S. American Eagles. The value of these coins lies in the value of the gold contained within them rather than in their face value.
- Own gold bullion. Purchase gold bars, which can be as small as one ounce.
- Own shares in a Gold ETF. Purchase shares in a form of mutual fund that invests strictly in gold bullion. The largest gold ETF owns gold bullion worth about $70 billion.

Tax Implications of Selling Gold

Gold coins and gold bullion are considered collectibles for tax purposes. So are ETFs that invest in gold bullion. Even though an ETF share is just paper (or more likely just bytes), it represents ownership of the metal itself and that's enough to make it a collectible for tax purposes.

Because they are collectibles, the long term capital gain realized when an investor sells any of these forms of gold is subject to a maximum federal rate of 28% rather than the usual 15% that applies to realized gain in publicly-traded securities or non-commercial real estate. This means that an investor who purchased in gold in 2004 for one quarter its current price of $100,000 would owe $21,000 in capital gains tax if he were to sell that gold today.

Shares in a specific gold mining company or in an ETF that invests in them are considered securities for tax purposes, like shares in any publicly-traded company. As a result, the long term capital gain realized when an investor sells these shares is subject to a maximum federal rate of 15%. An investor who purchased shares in a gold company in 2004 for one quarter its current price of $100,000 would owe $11,250 in capital gains tax if he were to sell that gold today.

Tax Implications of Contributing Gold to Charity

Contributions of gold mining stock or shares in an ETF that invests in gold mines are treated the same way as any contribution of stock: if held more than one year, the donor's charitable deduction will be based on the fair market value of the stock on the day of donation; if held one year or less it will be based on the donor's cost basis in the stock.

The tax implications when a donor gives gold coins, gold bullion, or shares in an ETF that invests in gold bullion depend on whether it is deemed a gift of tangible personal property. If it is, the donor's deduction is limited to the lesser of market value and cost basis except in the unlikely instance that the gift would be for related use. A related use would be, for example, a gift of gold coins that will be retained and displayed by a numismatic museum. In this case, the donor could deduct the full fair market value of the coins.

Since the gain in all of these items when sold is taxed at the rate applicable to tangible personal property (up to 28%), you may wonder why there would be any doubt about their deductibility. Here's why. In PLR 9225036, dealing with a proposed gift of Krugerrand gold coins to a charitable remainder unitrust, the IRS said:

> *South African Krugerrand coins are more akin to money than to coins that have value as collection's items. South African Krugerrand gold coins are one of the best known types of gold bullion coins. They have no numismatic value. Moreover, in the case at hand, the trustee is authorized to dispose of the coins. Therefore, pursuant to the rationale of Rev. Rul.69-63, we conclude that South African gold coins are not tangible personal property within the meaning of section 170(a)(3) of the Code.*

However, the IRS apparently was ready to reverse its position in a later PLR that was withdrawn because the taxpayer died. In addition, the position described above is inconsistent with the reality that when sold the gain in Krugerrands (and other gold coins), gold bullion, and shares in ETFs that invest in gold bullion is taxed as if they are tangible personal property.

While there appears to be uncertainty as to whether gold coins such as Krugerrands are tangible personal property for purposes of determining a charitable deduction, most practitioners take the safer and more consistent position that they are. There is little doubt that gifts of gold bullion or of shares in a gold bullion ETF are gifts of tangible personal property.

Examples

The examples below illustrate a gift of gold bullion, but apply equally to a gift of gold coins (taking the position that gold coins are tangible personal property) and shares of ETFs invested in gold bullion.

Outright gift of gold bullion

John Franklin, age 72, purchased 100 ounces of gold bullion for $31,000. On the day he contributes the gold to your charity its value is $161,500. After working through the tax savings below, it becomes apparent that Mr. Franklin's net cost is about 70 cents on the dollar.

Charitable deduction	$31,000
Income tax savings (35% x $31,000)	$10,850
Capital gains tax savings (28% x $130,500)	$36,540
Net cost of gift ($161,500 - $10,850 - $36,540)	$114,110

Gift annuity funded with gold bullion

Suppose that instead of contributing the bullion outright, Mr. Franklin contributed it in exchange for a gift annuity. The charitable deduction is computed using December's 1.6% IRS discount rate.

Charitable deduction	$11,996
Income tax savings (35% x $11,996)	$4,199
Capital gains tax savings (28% x $50,501)	$14,140
Net cost of gift ($161,500 - $4,199 - $14,140)	$143,161
Gift annuity payment (5.4%)	$8,721
Annuity taxed as follows: Tax-free Capital gain (taxed at 28% rate) Ordinary income (taxed at 35% rate)	 $1,310 $5,518 $1,893
After-tax cash flow	$6,513

If Mr. Franklin were to sell his bullion instead and invest his after-tax proceeds in bonds yielding 4.0 percent, his annual after-tax income would be about $3,250, half the $6,500 cash flow from the gift annuity. For a charitably-minded Mr. Franklin, the dependable cash flow from the annuity combined with some tax savings and a generous gift to charity could be appealing.

Charitable remainder trust funded with gold bullion
What if Mr. Franklin were to fund a 5% charitable remainder unitrust with his bullion rather than give it outright or in exchange for a gift annuity. Assume that the trustee is able to sell the bullion a few days later.

Charitable deduction (Allowed only when the bullion is sold. This shouldn't be an issue for gold bullion, which is readily marketable, except perhaps when funding occurs at the very end of the year)	$17,150
Income tax savings (35% x $17,150)	$6,003
Capital gains tax savings (28% x $130,500) (Note that gain reported under the four-tier system for taxing unitrust payments will be taxed at 28% until all gain attributable to the bullion has been distributed).	$36,540
Net cost of gift ($161,000 - $6,003 - $36,540)	$118,457
Payment from trust in first year	$5,000

As with the gift annuity, a charitably-minded Mr. Franklin who is interested in augmenting his cash flow might be attracted to a gift arrangement that allows him to dispose of a volatile yet highly appreciated asset, pay no immediate tax on his gain, receive income from all proceeds of selling his bullion, and make a generous gift to charity.

Other considerations
A gift of physical gold, be it bullion or coins, means you have to worry about how you will take possession of it. If the donor lives nearby, he or she could deliver it in person. If that is not a practical option, registered U.S. Mail is commonly used (FedEx and UPS will not ship gold). For large amounts of gold, other delivery options will need to be explored, such as delivery directly to a dealer. Regardless, sale through a reputable dealer will also need to be arranged. In addition, and this includes a gift of shares in a gold bullion ETF, the donor will need to file a Form 8283 that describes the gift. If declaring a deduction of $5,000 or more, he will also need to attach a qualified appraisal that substantiates the gold's value. The charity, of course, will need to file a Form 8282 if it sells the bullion or ETF shares within two years of receiving the gift, which almost certainly it would.

Summary
Gold is one asset that has appreciated steadily and substantially for the last ten years, attracting many investors along the way. You may have donors who have accumulated significant holdings in gold… and substantial capital gains to go with them. With the gold market perhaps beyond its peak and ever volatile, some of these donors may be ready to put the value of their gold to good use by making a charitable gift. For those who are interested in life income, a gift annuity or charitable remainder unitrust are both reasonable alternatives to giving gold outright.