

# **Don't Forget Gifts of Tangible Personal Property**

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Except for museums that are accustomed to receiving gifts of art and artifacts, charities tend to focus on gifts of cash, securities, and real estate. In the process, they may be missing opportunities to attract valuable gifts of tangible assets.

Any physical object of value could make a great gift to your organization. The list includes, but certainly isn't limited to, artwork; antiques; stamp, coin, and other collections; gold and silver; cars and other vehicles; and boats.

The person making the gift executes a deed of gift conveying ownership and delivers the object to the charity. The gift is complete when both of these events have occurred.

There are a number of issues to keep in mind when working with a supporter who is considering a gift of tangible personal property.

### **Will Your Organization Put the Gift to a Related Use?**

In order for a donor of tangible personal property to be able to deduct its full fair market value, the charity must use the object in a manner that is related to its exempt purpose. Examples would be a painting that is added to the collection of an art museum and a wooden boat put on display at a nautical museum. If the object is unrelated to the charity's exempt purpose, however, the donor's deduction is the lesser of the object's fair market value on the date of gift and the donor's cost basis.

For instance, if a donor gives a painting worth \$100,000 that she bought for \$10,000 to an art museum that will keep the painting, the donor can deduct the full \$100,000 value of the painting. If she gives the same painting to a conservation organization that will sell it and use the proceeds, she can deduct only her \$10,000 cost. It is the donor's responsibility to establish "related use," so the donor should secure from the charity a letter stating the charity's intent to use the property for a purpose related to its mission.

Even if the object is potentially related to the charity's mission (for example, a painting given to an art museum), if the charity's intention is to sell it upon receipt, then the gift is not for a related use and the donor's deduction will be limited accordingly.

Conversely, a gift of artwork doesn't necessarily have to be to a museum to be considered for a related use. In Private Letter Ruling 9833011, the IRS ruled that gifts of artworks to a Jewish community center would be for a related use because they would have religious and cultural

significance. Similarly, gifts of artworks to a hospital may be for a related use if their display in common and patient rooms contributes to a healing environment.

### **Will the Donor Give Her Entire Interest in the Property?**

A charitable deduction is not allowed when a donor transfers ownership of tangible personal property but retains possession of the property. This is a gift of a future interest, for which a deduction is not allowed under Reg. Sec 1.170A-5(a)(4).

However, it is possible to give an undivided fractional interest in the property, such as full possession of an object for a part of each year. The rules for fractional-interest gifts of artwork, in particular, were considerably tightened in the Pension Protection Act of 2006 and may be summarized as follows:

- When the initial fractional interest is contributed, the income tax charitable deduction will be based on the fair market value of the artwork and whether it is put to a related use.
- When subsequent fractional interests are contributed, the fair market value used in determining the deduction will be the lesser of the fair market value of the fractional interest at the time of the initial contribution and the fair market value of the interest at the time of the current contribution. In other words, the donor cannot deduct any appreciation in the value of the object that occurs after the initial gift. At the same time, if the object declines in value after the initial gift, the donor must base her deduction for the gift of another fractional interest on the artwork's now lower value.
- If a donor fails to contribute all of his or her remaining interests in the artwork within 10 years of the initial gift, the donor's income and gift tax deductions for all previous contributions will be recaptured.
- The charity must have physical possession of the artwork for the fraction of each year equal to the fraction of ownership conveyed through all contributions. For example, if a donor contributes a 25-percent fractional interest in the artwork, the charity must have possession of the artwork for three months of the year.

### **How Did the Donor Come to Own the Property?**

If the donor purchased the property for personal use or enjoyment, or inherited it, then its deductibility will depend on whether it is given for a related use as described earlier. However, if the donor of an artwork or other tangible personal property (1) created the object, (2) received it as a gift from the creator, or (3) is a dealer who owns the object as inventory, the object is ordinary income property. In this case, the donor's deduction will be the lesser of fair market value and her cost basis, even if she contributes the object for a related purpose. This rule applies

to all gifts of ordinary income property, not just those of tangible personal property. The cost basis for an object's creator, as well as for a donor who receives the object from its creator as a gift, is the creator's outlay for materials. The value of the hours spent fashioning the object cannot be included in the cost basis.

### **Appraisal Requirements**

If the deduction claimed for a gift of tangible personal property exceeds \$5,000, the donor must secure an appraisal from a qualified appraiser and submit Form 8283 with the tax return on which the deduction is claimed. If a donor contributes artwork valued at more than \$20,000, the donor must include a copy of the appraisal with the tax return. If a donor contributes tangible personal property other than an artwork, and the value of the object is over \$500,000, the donor must attach the appraisal itself to the tax return.

### **Capital Gains Tax Rate Higher on Collectibles**

The maximum federal tax rate on long term capital gain realized on the sale of securities or real estate is 20%. The tax rate on long term capital gain realized on the sale of "collectibles," such as artwork, antiques, stamps, and coins, is 28%. This means that in many instances a donor can save more capital gains tax when giving tangible personal property than when giving securities or real estate.

### **Options for Giving Tangible Personal Property**

The simplest way for a donor to give tangible personal property is outright, but it's certainly not the only option.

**Gift Annuities:** The charity could offer a gift annuity in exchange for a contribution of such an asset. In this case, it would be in the charity's interest to investigate not only the value of the object, but also the likely costs of selling it, so that it can determine a proper annuity amount. For example, if a donor wants to fund a gift annuity with a stamp collection and commissions to sell it would likely be in the 15-20 percent range, it would be wise for the charity to offer an annuity rate that is about 20% below the American Council on Gift Annuities rate. While the donor's deduction will be based on the lesser of fair market value and cost basis, the gift annuity provides a way to generate cash flow from a non-income producing asset, reduce the amount of capital gain the donor must report, and make a generous charitable gift.

No states prohibit accepting tangible personal property for a gift annuity. However, in a state that regulates the types of acceptable reserve assets, such as California, the charity will need to satisfy its reserve requirement for the annuity by transferring institutional assets into its reserve pool.

**Charitable Remainder Trusts:** A “flip” unitrust is ordinarily the best form of charitable remainder trust to fund with tangible personal property. The unitrust can convert from a net income unitrust to a regular unitrust after it sells the object used to fund it. Meanwhile, the trustee can take whatever time is necessary to sell the property at a fair price without needing to make beneficiary payments. A donor who wants the fixed payments offered by an annuity trust would be wise to contribute cash or publicly-traded securities to the trust in addition to the tangible personal property so that there are liquid assets for making payments prior to the sale.

When a donor contributes tangible personal property to a charitable remainder trust, and the donor or a family member is an income beneficiary (which is almost always the case), no income tax charitable deduction will be allowed until the trust sells the property. The donor will then be allowed a deduction for the value of the charity’s remainder interest as of the date of the sale. (IRC Sec. 170(a)(3)). The amount of the deduction will be based on the lesser of the fair market value and the donor’s cost basis, since a gift to a charitable remainder trust cannot be for a related use, as well as the IRS discount rate and actuarial ages of the beneficiaries as of the date of sale.

**Bargain Sale:** A donor can sell an object to the charity for less than the appraised value. An income tax deduction is then allowed for the difference between the selling price and the appraised value if the object is acquired for a related use. The donor is taxed on the capital gain attributable to the sales price but not on the gain attributable to the deductible amount. For example, if a donor sells property appraised at \$200,000 with a cost basis of \$60,000 to the charity for \$120,000, the resulting deduction is \$80,000, the taxable gain is \$84,000  $((120,000/200,000) \times (\$200,000 - \$60,000))$ , and the remaining \$56,000 of gain is not taxed. However, if the charity purchases the property for re-sale, the donor’s deduction will be only \$24,000  $((80,000/200,000) \times \$60,000)$ .

**Installment Bargain Sale:** Instead of paying the donor a bargain price in a lump sum, a charity can pay it in installments. This approach may make the purchase easier for the charity to take on or may fit the donor’s needs better. An installment bargain sale resembles a gift annuity, but could be a preferable alternative if:

- The donor wants payments for a term of years.
- The donor wants heirs to receive the payments for the balance of the amortization period, if he or she does not live that long.
- The charity either does not offer gift annuities or is unwilling to issue one in exchange for tangible personal property.

## Summary

There are many ways donors can give tangible personal property, depending on their objectives. If they want the charity to have immediate use of the property, they can simply give it outright. If they want to convert the property to a stream of payments, they can use it to fund a gift annuity or a charitable remainder trust, or sell it to the charity under an installment bargain sale arrangement.

The charitable deduction can be significant if the property is given to the charity for a related use. Even if the gift is not for a related use and the deduction is therefore relatively small, there still can be other significant financial benefits: payments for life or a term of years, avoidance or postponement of tax on the capital gain, and removal of the property from the taxable estate. The benefit regarding capital gain is more significant than with a gift of appreciated securities or real estate because the maximum tax rate on gain in collectibles is higher than on those other assets.

For all of these reasons it makes sense for your charity to encourage gifts of tangible assets. Keep your eyes and ears open for these opportunities when meeting with donors. Include a donor story in your newsletter or on your website about such a gift. Seek ways to remind your organization's supporters that a valuable object or collection can make a great gift.