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Leslie A. Cesario, Ltd. Monthly Newsletter

Take Advantage of the IRA-to-Charity Provision

Article Highlights

- IRA-to-Charity Transfer Provision Made Permanent
- Required Minimum Distribution
- How the Provision Plays Out on a Tax Return
- Tax Benefits of the Provision

Individuals age 70.5 or over—who must withdraw annual required minimum distributions (RMDs) from their IRAs—will be pleased to learn that the temporary provision allowing taxpayers to transfer up to $100,000 annually from their IRAs to qualified charities has been made permanent. If you are age 70.5 or over and have an IRA, taking advantage of this provision may provide significant tax benefits, especially if you would be making a large donation to a charity anyway.

Here is how this provision, if utilized, plays out on a tax return:

(1) The IRA distribution is excluded from income;
(2) The distribution counts towards the taxpayer's RMD for the year; and
(3) The distribution does NOT count as a charitable contribution.

At first glance, this may not appear to provide a tax benefit. However, by excluding the distribution, a taxpayer with itemized deductions lowers his or her adjusted gross income (AGI), which helps for other tax breaks (or punishments) that are pegged at AGI levels, such as medical expenses, passive losses, taxable Social Security income, and so on. In addition, non-itemizers essentially receive the benefit of a charitable contribution to offset the IRA distribution.

If you think that this tax provision may affect you and would like to explore its possibilities, please call this office.

Proving Noncash Charitable Contributions

Article Highlights:

- Noncash Charitable Contributions
- Establishing Donation Value
- Fair Market Value
- Documentation Requirements
- Appraisal Requirements

One of the most common tax-deductible charitable contributions encountered is that of household goods and used clothing. The major complication of this type of contribution is establishing the dollar value of the contribution. According to the tax code, this is the fair market value (FMV), which is defined as the value that a willing buyer would pay a willing seller for the item. FMV is not always easily determined and varies significantly based upon the condition of the item donated. For example, compare the condition of an article of clothing you purchased and only wore once to that of one that has been worn many times. The almost-new one certainly will be worth more, but if the hardly worn item had been purchased a few years ago and become grossly out of style, the more extensively used piece of clothing could actually be worth more. In either case, the clothing article is still a used item, so its value cannot be anywhere near as high as the original cost. Determining this value is not an exact science. The IRS recognizes this issue and in some cases requires the value to be established by a qualified appraiser.

Remember that when establishing FMV, any value you claim can be challenged in an audit and that the burden of proof is with you (the taxpayer), not with the IRS. For substantial noncash donations, it might be appropriate for you to visit your charity's local thrift shop or even a consignment store to get an idea of the FMV of used items.

The next big issue is documenting your contribution. Many taxpayers believe that the doorknob hanger left by the charity's pickup driver is sufficient proof of a donation. Unfortunately, that is not the case, as a recent United States Tax Court case (Kunkel T.C. Memo 2015-71) pointed out. In that case, the court denied the taxpayer's charitable contributions, which were based solely upon doorknob hangers left by the drivers who picked up the donated items for the charities. The court stated that "these doorknob hangers are undated; they are not specific to petitioners; they do not describe the property contributed; and they contain none of the other required information."

The IRS requires the following documentation for noncash contributions based on the total value of the donation:

- **Deductions of Less Than $250 -** A taxpayer claiming a noncash contribution with a value under $250 must keep a receipt from the charitable organization that shows:
    1. The name of the charitable organization,
    2. The date and location of the charitable contribution, and
    3. A reasonably detailed description of the property.

  Note: The taxpayer is not required to have a receipt if it is impractical to get one (for example, if the property was left at a charity's unattended drop site).

- **Deductions of at Least $250 But Not More Than $500 -** If a taxpayer claims a deduction of at least $250 but not more than $500 for a noncash charitable contribution, he or she must keep an acknowledgment of the contribution from the qualified organization. If the deduction includes more than one contribution of $250 or more, the taxpayer must have either a separate acknowledgment for each donation or a single acknowledgment that shows the total contribution. The acknowledgment(s) must be written and must include:
    1. The name of the charitable organization,
    2. The date and location of the charitable contribution,
    3. A reasonably detailed description of any property contributed (but not necessarily its value), and

4. Whether or not the qualified organization gave the taxpayer any goods or services as a result of the contribution (other than certain token items and membership benefits).

If the charitable organization provided goods and/or services to the taxpayer, the acknowledgement must include a description and a good-faith estimate of the value of those goods or services. If the only benefit received was an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in a commercial transaction outside the donative context, the acknowledgment must say so, and in this case, the acknowledgment does not need to describe or estimate the value of the benefit.

- **Deductions Over $500 But Not Over $5,000 -** If a taxpayer claims a deduction over $500 but not over $5,000 for a noncash charitable contribution, he or she must attach a completed Form 8283 to the income tax return and must provide the same acknowledgement and written records that are required for contributions of at least $250 but not more than $500 (as described above). In addition, the records must also include:
    1. How the property was obtained (for example, purchase, gift, bequest, inheritance, or exchange),
    2. The approximate date the property was obtained or—if created, produced, or manufactured by the taxpayer—the approximate date when the property was substantially completed, and
    3. The cost or other basis, and any adjustments to this basis, for property held for less than 12 months and (if available) the cost or other basis for property held for 12 months or more (this requirement, however, does not apply to publicly traded securities).

If the taxpayer has a reasonable case for not being able to provide information on either the date the property was obtained or the cost basis of the property, he or she can attach a statement of explanation to the return.

- **Deductions Over $5,000 –** These donations require time-sensitive appraisals by a "qualified appraiser" in addition to other documentation. When contemplating such a donation, please call this office for further guidance about the documentation and forms that will be needed.

Caution: The value of similar items of property that are donated in the same year must be combined when determining what level of documentation is needed. Similar items of property are items of the same generic category or type, such as coin collections, paintings, books, clothing, jewelry, privately traded stock, land, and buildings. For example, say you donated $5,300 of used furniture to 3 different charitable organizations during the year (a bedroom set valued at $800, a dining set worth $1,000, and living room furniture worth $3,500). Because the value of the donations of similar property (furniture) exceeds $5,000, you would need to obtain an appraisal of the furniture to satisfy the substantiation requirements—even if you donated the furniture to different organizations and at different times during the year. The IRS has strict rules as to who is considered a qualified appraiser.

To help you document some of these noncash contributions, you can download a fillable Noncash Charitable Contribution statement (http://images.client-sites.com/NonCash_Contribution2010.pdf). The statement includes an area for the charity's agent to verify the contribution and a check box denoting whether the qualified organization provided any goods or services as a result of the contribution. Although not specifically blessed by the IRS, this statement includes everything needed for noncash contributions of up to $500—provided, of course, that you and the charitable organization's representative accurately complete the form.

Do not include items of *de minimis* value, such as undergarments and socks, in the deductible amount of your contribution, as they specifically are not allowed.

Please call this office with any questions about documenting or valuing your noncash contributions.

Asset Sales Versus Stock Sales: What You Need to Know

Selling a business is never a decision that should be made lightly. A business is something that you've likely worked hard to build from the ground up into the entity that you always hoped it could be - you don't want to sell yourself short now that you're moving onto bigger and better things. When it comes to selling a business, one of the most important decisions that you'll have to make has to do with how the sale itself will be structured. In this situation, there are two main types that you have to decide between - an asset sale and a stock sale. What is the difference between these two options? Who benefits the most from each type of scenario? Thankfully, the answers are relatively straightforward.

What is an Asset Sale?

When selling a business as an asset sale, the important thing to understand is that the seller actually retains possession of the legal entity that represents the business. What the buyer is purchasing are the individual assets that the company holds. Those can include things like equipment and fixtures, but also extends all the way up to trade secrets, telephone numbers of customers and business contacts, inventory items and more.

An asset sale usually does not include any cash-based assets and the seller actually retains any long-term debt obligations that the business holds along with the legal entity of the business itself. However, normalized net working capital is also usually one of the assets that is handed over from seller to buyer in this type of a sale. This can include certain elements like accounts receivable, accounts payable, accrued expenses and more.

What is a Stock Sale?

With a stock sale, on the other hand, the buyer is really purchasing the shareholder's stock of the seller directly. Even though the assets and liabilities that are transferred as a result of this type of sale tend to be very similar to an asset sale, the seller is also getting the legal entity or stake in the business at the exact same time. In a stock sale, any particular asset or liability that the buyer doesn't expressly want will either be distributed (in the case of assets) or paid off entirely (in the case of liabilities) prior to the sale being completed.
An important difference between an asset sale and a stock sale is that in a stock sale, no separate conveyance of individual assets is required for the sale itself to be completed. This is largely due to the fact that the original title of each asset rests within the corporation, meaning that both are transferred from seller to buyer at the exact same time.

Who Benefits from Each Type of Sale?

Once you understand a little more about the differences between an asset sale and a stock sale, you must also understand which benefits in each type of situation. As is common with most business decisions, the different parties involved will usually favor one or the other depending on which side of the fence they fall on. Buyers tend to prefer asset sales, for example, as it affords them certain tax benefits that they won't get from a stock sale. Sellers, on the other hand, tend to prefer stock sales because it often makes them less responsible for certain future liabilities that may present themselves like product liability claims, employee lawsuits and even benefit plans.

Perhaps the biggest reason why an asset sale is preferred from the point of view of the buyer is because the company's depreciable basis regarding its assets is highly accelerated. An asset sale typically gives a higher value for assets that depreciate quickly. A particular piece of equipment that the business owns, for example, likely has a three- to seven-year shelf life. At the same time, lower values are given to certain assets that amortize much more slowly. Goodwill, for example, is generally considered to have a 15-year shelf life. This generates additional tax benefits on behalf of the buyer, doing a lot to reduce taxes as quickly as possible and thus improving the overall cash flow of the company during the first few years of its life. Buyers also tend to prefer asset sales because it's much, much easier to avoid any potential liabilities like contract disputes or product warranty issues as a result.

This doesn't mean that asset sales are universally easier for buyers, however. Certain types of assets are inherently hard to transfer due to certain issues like legal ownership and any third party consent that may be required. Intellectual property, for example, would likely require the seller to obtain some type of consent that can slow down the process of a sale dramatically.

One of the major reasons why sellers tend to prefer stock sales is because all of the proceeds they get from the sale are taxed at a much lower capital gains rate. When dealing with C-corporations, corporate level taxes are avoided entirely. Also, in a stock sale the seller is usually less responsible for any future liabilities - a products liability claim officially becomes the problem of the buyer at that point.

The Popularity of Asset Sales versus Stock Sales

According to research, approximately 30 percent of all business sales in the last few years were stock sales. It's important to keep in mind, though, that this number varies wildly based on the size of the company that is being sold. Larger companies have a much higher chance of being stock sales than asset sales.