

Now That I've Sold That Property ...

George Lewis was a successful business owner who took a portion of his growing wealth and bought a horse and purebred cattle farm about 30 miles from the edge of town. As a “gentleman farmer”, he concentrated on sending his horses to the track, and showing or selling his cattle in various auctions around the country. While he never made much of a profit over the last 25 years with his various livestock enterprises, he enjoyed a lifestyle that helped offset some of the stresses associated with running one of the best-known corporations in the country. As George and his wife Ellen got older, and his children moved away from their home, George found himself owning a significant tract of land in an area that had become suburbanized. After reviewing his options, George concluded that sometimes it was better to be lucky than smart, as his 1,200 acre tract was appraised at over \$25,000 per acre for its development potential. For that kind of money, the decision was a foregone conclusion. George had a dispersal sale for his livestock, listed the property with his realtor, and accepted an offer from a development company with plans for creating a championship golf course and a gated residential community. Once George had all of his ducks in a row, he approached his estate planning advisors and said, “You once said when I was ready to sell my farm, I should contact you about one of those charitable things, so here I am.”

This is a good news – bad news scenario.

If George had arranged to use a charitable remainder trust before he had an enforceable agreement binding him to sell his farm, he could have done some very useful things to conserve assets, reduce taxes, and redirect his social capital. Now, with a sale already in place, George was well past the cut-off for avoiding the recognition of the capital gains liability. If he had tried to put the farm into the trust before the sale, but after he signed the contract, he would have still triggered unnecessary tax. Typically, the IRS attacks prearranged sales with an assignment of income doctrine, which not only precludes capital gain treatment but may deny a charitable deduction for a transfer to charity or charitable trust. There are generally three tests to determine whether George may have crossed the line and is obliged to sell, and must thus recognize the taxable gain on the sale: (a) he has a written agreement; (b) he has signed a binding

letter of intent, (c) he has committed to a binding oral contract.

Two life 5% Lewis CRUT 68 and 66 years old	Sell Asset	Trust Asset
Fair Market Value (FMV)	\$30,000,000	\$30,000,000
Adjusted Cost Basis	\$1,200,000	
Gain on Sale	\$28,800,000	
Capital Gains Tax @ 22%	\$6,336,000	
Net Amount Invested	\$23,664,000	\$30,000,000
Investment Return @ 8%	\$1,893,120	
1 st Year 5% CRUT Payment		\$1,500,000
5% CRUT Average Paid Over Life of CRUT @ 8% Return		\$2,079,609
After-tax (42%) Cash Flow	\$1,098,009	\$1,206,173
Median Term of Trust	23 years	23 years
Cash Flow over 23 Years	\$25,254,221	\$27,741,979
Taxes Saved from Charitable Deduction of \$11,292,900 @ 42% Tax Rate		\$4,743,018
Total Tax Savings and Cash Flow over 23 Years	\$25,254,221	\$32,484,998
Total Increase in Cash Flow		\$7,230,777
Pre-tax Asset Value to Family	\$23,664,000	\$0
After Estate Tax Value @ 50%	\$11,832,000	\$0
Benefit to Family Advised Charity	\$0	\$57,255,875

A penny saved is a penny earned.

After the verbal fireworks, George admitted he had made a serious error. Overall, he and his wife decided that his children were already inheriting ample assets, and George really did not need the extra income that the farm sale provided. Advisors dread dealing with an annoyed client, it is unpleasant and stressful. If George had brought the experts and problem solvers into his transaction earlier, they could have identified the traps, priorities, and avoided problems.

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