GIFTS OF TANGIBLE AND INTANGIBLE PERSONAL PROPERTY

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INTRODUCTION

Except for museums that are accustomed to receiving gifts or art and artifacts, charities tend to focus on gifts of cash, securities, and real estate. In so doing, they may miss opportunities for valuable gifts of non-traditional assets that can be monetized and used for the charity's mission. Many individuals would be willing to part with items of art and collectibles. Others have intellectual property such as a copyright or patent with the potential to generate considerable royalties. Then there are the owners of oil and gas interests, who would consider a gift of all or a fraction of those interests. Even when a charity does not seek such assets and does not mention them in planned giving literature, it may occasionally be approached by a donor who inquires about the charity's willingness to accept them.

The purpose of this paper is to provide some basic information that will prepare gift planners to mention and discuss gifts of these types of assets. Gifts of tangible personal property will be covered in more detail because they are the more common than gifts of intellectual property and mineral interests, although the latter are rather common in the major oil and gas producing states. A charity should, of course, consult expert counsel regarding intellectual property and mineral interests gifts because they can be quite complex. The necessarily superficial treatment of those topics here can perhaps help a gift planner determine whether the gift is feasible and may produce the desired results for the charity and the donor.

PART I ─ GIFTS OF TANGIBLE PERSONAL PROPERTY

A. Definition

Tangible personal property refers to a physical item, other than real estate, that can be touched and that is generally movable. Examples include a painting, a stamp collection, an automobile, a boat, and fine china.

B. Means of Conveyance

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.

C. Outright Gifts of Tangible Personal Property

A. The Related-Use Rule

According to IRC Sec 170(e)(1)(B)(i), a donor of tangible personal property can deduct the full present market value, if the object is related to the exempt purpose of the charity. Examples would be a painting given to an art gallery and a wooden boat

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for display at a nautical museum. If the object is unrelated to the charity's exempt purpose, a donor's deduction will be the lesser of present fair market value and cost basis.

A gift of tangible personal property to a museum will be considered to be for a related use if the object is of a type normally retained in the museum's collections, unless the donor has been informed that the museum intends to sell or otherwise dispose of the object.

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. It is recommended that the donor secure from the charity a letter stating the charity's intent to use the property for a related use. Should changed circumstances necessitate the charity's selling the object sometime in the future, the donor's related-use deduction will not be disallowed, if the donor at the time of the contribution could reasonably expect the donated object to be used for a related purpose. See Reg. 1-170A-4(b)(3)(ii).

B. **Gifts of Fractional Interests in Tangible Personal Property**

A charitable deduction is allowed when a donor transfers title to a personal residence or farm and retains use of the property for life or a term of years, but a deduction is not allowed when a donor purports to transfer ownership of tangible personal property subject to the right to retain possession of the property. This would be a gift of a future interest, which is not allowed under Reg. Sec 1.170A-5(a)(4).

However, it is possible to give an undivided fractional interest in the property. The rules for fractional-interest gifts of artwork 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 property and whether it is put to a related use.

- When subsequent fractional interests are contributed, the deduction will be the lesser of the fair market value of such an interest at the time of the initial fractional interest contribution and the fair market value of the interest at the time of the current contribution.

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- If a donor fails to contribute all of his or her remaining interests in the property 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 object 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 property, the charity must have possession for three months of the year.

Prior to the new rules, a donor would often contribute the entire interest in an art work, or fractional interests in it, and at the request of the charity retain it in his or her home for safekeeping on behalf of the charity. Thereby, the rule disallowing an income tax charitable deduction for a gift of a future interest in tangible personal property was circumvented.

C. Used Car Donations

Because donors of used cars were often claiming deductions that were many times the sales proceeds realized by the charity, new rules were adopted. Where the charity sells the automobile, the donor's deduction is the lesser of the donor's cost-basis and the price for which the charity sells the automobile. If the car sells for less than $500, the deduction is for the lesser of the vehicle's fair market value and $500.

D. **Gifts of Gold and Silver**

Ways to invest in gold and silver

- Purchase coins

  Common gold coins are the American Eagle, Canada Maple Leaf, and the Krugerrand. A person might also purchase rare coins with numismatic value.

- Purchase bullion

  Gold bars and silver bars are available in different sizes. The owner must arrange for storage.

- Exchange Traded Funds (ETFs)

  Each share of an ETF represents a certain amount of the gold or silver, which is typically stored at a bank. The most common way people invest in gold and silver is through ETFs.

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- Purchase shares in mining companies

  The individual does not own the metal, as with an ETF, but has ownership in a company that is in the business of extracting the metal.

Tax implications of selling gold and silver investments

In the case of coins, bullion, or ETFs owned more than one year, the gain is subject to a maximum federal tax rate of 28 percent (31.8 percent including the health care surtax). An ETF share represents ownership of the metal itself, so a sale of the share is equivalent to sale of bullion.

In the case of shares of mining companies owned more than one year, the gain is subject to a maximum federal tax rate of 20 percent, (23.8 percent including the health care surtax) the same as the gain in shares of any company.

In the case of any of the above assets owned one year or less, the gain is taxed as ordinary income, subject to a 39.6 percent maximum federal rate.

Tax implications of contributing gold and silver instruments

Contribution of gold and silver mining stock are treated the same as contributions of any other stock.

The central question is whether coins, bullion, and ETFs are considered to be tangible personal property. If so, the deduction would be the lesser of market value and cost basis because the gift would be for an unrelated use, except in the very unlikely case coins would be retained and used for the charity's exempt purposes.

Inasmuch as the gain in all of these items is taxed at the rate applicable to tangible personal property, it would be consistent for the IRS to regard them as tangible personal property when they are contributed.

However, in PLR 9225036, dealing with a proposed gift of Krugerrand gold coins to a charitable remainder unitrust, the IRS took a different position. Here is the pertinent paragraph:

South African Krugerrand coins are more akin to money than to coins that have value as collector's items. South African Krugerrand gold coins are one of the

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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.

The IRS apparently was taking a different position in a later PLR that was withdrawn when the applicant died before issuance.

Thus, we must conclude that there is uncertainty as to whether coins, bullion, and ETFs would be treated as tangible personal property when contributed. In support of the position that they would not be tangible personal property, we have Rev. Rule 69-63 and PLR 9225036. However, doubt is raised by the fact that the IRS was apparently ready to reverse its position in the withdrawn PLR, and particularly by the fact that when these items are sold the gain in them is taxed as if they are tangible personal property. The author believes that the argument for treating gifts of gold and silver as gifts of tangible personal property is more compelling

If they are, indeed, tangible personal property (as we believe) the income tax charitable deduction for an unrelated-purpose gift, would be the lesser of current fair market role and cost basis.

<u>Example</u>. Donor contributes gold ETFs, which he purchased 10 years ago for $31,000. At the time he contributed them to a charity they were valued at $170,000. If the ETFs are tangible personal property, the income tax charitable deduction would be $31,000. If they are not regarded as tangible personal value because they have no numismatic value, the deduction would be $170,000. In either case, the donor would not be taxed on the capital gain.

E. **Instances Where Tangible Personal Property is Ordinary Income Property**
If an artwork or other tangible personal property was (1) created by the donor, (2) acquired by a gift from the creator, or (3) is part of the inventory of a dealer, it is ordinary income property. Even if it is contributed for a related purpose, the deduction will be the lesser of fair market value and cost basis. The cost basis for the creator would be the outlay for materials. The value of hours spent fashioning the object cannot be included in the cost basis.

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F. 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 Section B of Form 8283 with the tax return on which the deduction is claimed.
If artworks valued at more than $20,000 are contributed, a copy of the appraisal itself must be included with the tax return.

If an object of tangible personal property, other than an artwork, is contributed, and the value of the object is over $500,000, the donor must likewise attach a copy of the appraisal.

2. Contribution of Tangible Personal Property for a Gift Annuity

Some individuals, who own collectibles or gold and silver, would be willing to contribute these items in exchange for life payments and an income tax charitable deduction. They can accomplish these objectives with a gift annuity.

A. Examples of Gift Annuities Funded with Tangible Personal Property

Example 1 – Gift Annuity Funded with a stamp collection

Roger and Susan, both age 78, had a stamp collection, which was appraised for $120,000. They kept good records and recorded a cost basis of $16,000. Having lost interest in further collecting and wanting to enhance their retirement income, they offered to contribute it for a gift annuity. Prior to accepting the collection, the charity consulted a dealer in stamps and was informed that the collection probably would sell at an auction for about $120,000 and that commissions would likely be in the 15-20 percent range. Although the normal annuity rate for a two-life immediate gift annuity, where both annuitants are age 78, is 5.4 percent, the charity agreed to pay a rate of 4.5 percent. This was to take into consideration the fact that the charity's net sales proceeds might be only $100,000. Roger and Susan agreed. The gift was made in June of 2012, and the April Sec. 7520 rate of 1.4 percent was elected.

Roger and Susan's income tax charitable deduction was only $7,685 because the stamp collection was given for an unrelated purpose.

($16,000 cost basis / 120,000 FMV) x $57,635 gift value = $7,685

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However, they were able to convert an idle asset to payments of $5,400 per year for life. For the duration of their joint life expectancy, the payments will be taxed as follows:

Ordinary income	$977.40	
Capital gain	3,832.93	*
Tax-free return of capital	+ 589.67	
	$5,400.00	

* Currently, the capital gain would be taxed at a maximum rate of 28 percent.

<u>Example 2 – Gift Annuity funded with a painting</u>

An art museum was eager to acquire a painting by a well-known artist for its American collection. Helen, the owner was willing to part with the painting but only if she received payments in return. The Museum offered to accept the painting in exchange for a gift annuity, and Helen agreed. At the time of the gift, which is made on May 15, 2013, Helen was 76 years old, and for purposes of determining the charitable deduction and taxation of payments, she elected the April 2013 IRS Sec. 7520 rate of 1.4 percent. The painting was appraised for $300,000, and Helen's cost basis was $110,000 (the appraised value for estate tax purposes when she inherited it from her father). Here are the benefits to Helen:

Income tax charitable deduction	$125,823	(1)
Annual payments	18,000	
Taxation of annual payments during each full year of life expectancy:		
Ordinary income	3,438.00	
Capital gain	9,222.60	(2)
Tax-free return of capital	+ 5,339.40	
	$ 18,000.00	

(1) The deduction is much larger in this case because the object is given for a related use.

(2) Currently, the capital gain would be taxed at a maximum rate of 28 percent.

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Through the gift annuity, the museum acquires the painting at a discounted price. Helen increases her cash flow through both the annuity payments and the tax savings realized over the period she claims the charitable deduction.

Example 3 – gift annuity funded with gold

John, now age 72, purchased 300 ounces of gold in 1999, when it was selling for $279 per ounce. In August of 2012, it was selling for $1,600 per ounce. Knowing that gold prices are subject to significant fluctuations and wanting to lock in his gain, John had been thinking of selling the gold and simply paying the tax on the gain, which could be as much as $110,964. ($396,300 gain x 28%).

Instead of doing that, John contributed the gold for a gift annuity, realizing these results:

Income tax charitable deduction	$ 30,715 [1]
Annual annuity	$ 25,920
Payments taxed as follows during each full year of life expectancy:	
Ordinary income	4,976.64
Capital gain	17,291.37 [2]
Tax-free return of capital	+ 3,651.99
	$25,920.00

[1] The deduction assumes the gold is tangible personal property. If it is not so regarded, the deduction would be $176,146.

[2] Currently, the capital gain would be taxed at a maximum rate of 28 percent. The June 2012 Sec. 7520 rate of 1.2 percent was elected.

Even if, as we believe, the gold is tangible personal property, the gift annuity is appealing. Some of the gain will not be taxed and the taxable portion can be reported over life expectancy. Most important, John will have predictable payments for life and doesn't have to worry about changed economic conditions that could cause gold prices to tumble.

(In May of 2013, gold was selling for just over $1,400, which represents a decline over the past year. Still, many people purchased their gold when it was selling for a much

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lower price, so they have considerable gain in the asset and may be concerned about further price fluctuations.)

B. Implications for Gift Annuity Reserves

There are now no states that prohibit accepting tangible personal property for a gift annuity. The question is whether the value of property could count towards reserve requirements for the annuity. In a state, such as California, that regulates the types of acceptable reserve assets, the answer would be "no." It would be necessary for the charity to satisfy the reserve requirement for the annuity by transferring institutional assets.

Many states have adopted the prudent investor standard for gift annuity reserves. Whether tangible personal property would be considered a prudent investment may depend on how it fits in with other investments. If the value of the property is minimal compared with the fund as a whole, the inclusion of it in required reserves may not be questioned, but if the property would constitute a large portion of the reserves, raising questions about sufficient liquidity for making payments, it might not be allowed to count towards reserve requirements.

One possible complication is ownership of the property. In states that mandate a segregated reserve fund, it would have to be clear that the property is an asset of the reserve fund rather than a general asset of the charity.

Normally, the charity would either retain the property for its tax-exempt purposes, in which case it would have to satisfy reserve requirement with unrestricted funds, or it would sell the property as soon as possible. The sales proceeds could then replace whatever institutional assets had been temporarily transferred to meet reserve requirements.

3. Contribution of Tangible Personal Property for a Charitable Remainder Trust

A. Tax Implications

If a donor contributes tangible personal property to a charitable remainder trust, and the donor or a family member is an income beneficiary, no income tax charitable deduction will be allowed until the property is sold.

Suppose, for example, that Tim and Michelle contribute a painting to a charitable remainder unitrust in 2013, naming themselves as joint and survivor income beneficiaries, and the trustee sells the painting in 2015. Their income tax charitable deduction will be postponed until 2015, and it will be for the present value of the

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remainder interest determined as of the date of the sale. However, a gift tax charitable deduction for the present value of the remainder interest would be allowed at the time of the gift.

The reason for the postponement of the income tax charitable deduction is that IRC Sec. 170(a)(3) provides that a contribution of a future interest in tangible personal property is not considered to have been made until the expiration of the intervening interest in the property held by the donor or a related person. Upon the sale of the object, the donor holds an intervening interest in the sales proceeds but not in the property itself, so the deduction would then be allowed. This conclusion was confirmed in Private Letter Ruling 9452026 regarding the gift of a violin to a charitable remainder trust.

It would be inadvisable to transfer the object to either a charitable remainder annuity trust or a regular charitable remainder unitrust unless it is certain that the object can be sold before the trustee is required to make payments. The better alternative is a "flip" unitrust, which would convert to a regular unitrust as of January 1 of the year immediately following the year the object is sold. A donor who wants the fixed payments offered by an annuity trust could contribute cash or publicly-traded securities to the trust in addition to the item of tangible personal property. Then there would be liquid assets for payments prior to the sale.

Since the object will be sold in order to make trust payments, the use will necessarily be "unrelated." Consequently, the charitable deduction will be the remainder factor multiplied by the cost basis rather than the market value. The greatest benefit to the donor will likely be the ability to report taxable gain incrementally over time as payments are received.

The capital gains distributed under the four-tier system and reported on Form K-1 will currently be subject to a maximum rate of 28 percent. Gain realized from the sale of securities purchased with proceeds from the sale of tangible personal property would be taxed at the rate applicable to those securities — currently at a maximum rate of 20 percent if the securities were owned by the trust for more than a year. With the health care surtax, each of these tax rates would be increased by 3.8 percent.

B. Example of a Charitable Remainder Unitrust Funded with Artwork

In August of 2012, Howard and Paula, 70 and 68 respectively, established a "flip" unitrust with a 5.0 percent payout rate and transferred a decorative arts collection appraised at $300,000 for which they paid $120,000 many years ago. Assume the trustee sells the collection in July of 2014 for $290,000 net. Assume further that the IRS Sec. 7520 rate is 2.2 percent when the collection is sold.

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They receive no deduction in 2012 because they have retained an intervening interest in tangible personal property, but in 2014 they are entitled to an income tax charitable deduction of $51,104. This is determined by multiplying the remainder factor (.42587) by the $120,000 cost basis.

Beginning in January 2015, they will start receiving an annual unitrust amount equal to the fair market value of trust assets on January 1 multiplied by 5.0 percent. If that value were to be $295,000 on January 1, their 2015 payment would be $14,750. The gain in the collection is not taxed to Howard and Paula at the time of the gift, nor to the trust when the trustee sells the collection. The payments to them will be taxed under the four tier system, and the gain realized by the trust and paid to them will be subject to the tax rate applicable to gain and tangible personal property, which currently could be as high as 28% (or 31.8 percent with the healthcare surtax).`

A gift annuity could be the preferable instrument when donors want an immediate income tax deduction and immediate payments (assuming the charity is willing to issue an immediate gift annuity when the sales price and date are unknown.) A flip unitrust frees the charity from financial risk and offers the donors upside potential, but they may have to wait awhile for their payments and their income tax charitable deduction.

4. Bargain Sale of Tangible Personal Property

A. Tax Implications

A bargain sale refers to the sale of an object for less than the appraised value with the documented intent to make a charitable gift. Income and gift tax charitable deductions are allowed for the difference between the selling price and the appraised value (assuming, in the case of tangible personal property, that 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 property appraised at $200,000 with a cost basis of $60,000 were sold to the charity for $120,000, the taxable gain would be $84,000 ((120,000/200,000) x $140,000), and the remaining $56,000 of gain would not be taxed.

In most cases, the charity would purchase the object for its tax-exempt use. If the property in the above example were acquired for a related use, the charitable deduction would be $80,000. However, if the charity purchased the property for re-sale, the deduction would be only $24,000 ((80,000/200,000)) x $60,000). This is the portion of the cost basis that is allocated to the gift value.

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Particularly, when a charity wants to acquire an object of tangible personal property for its tax-exempt purpose, it should propose a bargain sale to the owner. Seeing that the net amount realized from a bargain is not substantially below the after-tax amount realized from a sale for full value, the owner might be willing to make a gift.

Suppose, in the above example that the owner of the object is subject to a 39.6 percent marginal income tax rate and would pay a 31.8 per tax rate on the gain (including the health care surtax).

If the object is sold for $200,000, the tax on the gain would be $44,520 (31.8% x $140,000), leaving $155,480 ($200,000 - $44,520) of after-tax proceeds.

If the object is sold to the charity for $120,000:

Sales proceeds	$120,000
Tax on gain	- 26,712
Tax savings from deduction	+ 31,680
Net benefit	$124,500

The net cost of a gift worth $80,000 to the charity is only $30,980 ($155,480 - $124,500).

B. **Installment Bargain Sale**

Instead of paying the purchase price in a lump sum, the charity might pay it in installments, possibly over a period of time equal to the life expectancy of the donor. An installment bargain sale resembles a gift annuity, but is 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.

As with the payments from a gift annuity, the installments will consist of interest, capital gain, and a tax-free return of basis. From the donor's standpoint, the installment bargain sale is appealing because taxation of gain can be spread out over a long period. The charity would welcome the transaction if finding funds for a lump-sum purchase would be difficult.

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The installment note must provide for a rate of interest no less than the IRS minimum. Otherwise, per IRC Sec 483, some part of the purchase price will be recharacterized as interest.

Unless the property is substantially related to the charity's exempt purpose, an installment bargain sale could cause it to be treated as "debt-financed property" resulting in taxation to the charity. The charity could realize a taxable gain if it sells the property before all of the installments have been paid.

C. Summary Comments Regarding Gifts of Tangible Personal Property

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 give it for 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. However, even if the use is unrelated to the charity's tax-exempt purposes and the deduction is relatively small, there 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 for a taxable estate. The benefit regarding capital gain is more significant than with the gift of appreciated securities or real estate because the maximum tax rate on the gain is higher than on those assets.

For all of these reasons it makes sense to encourage charitably-minded individuals to consider collectibles and other tangible assets for contributions.

PART II - GIFTS OF CERTAIN INTANGIBLE ASSETS

1. Gift of a Copyright

A. Definition

A copyright protects original works of authorship including literary, dramatic, and musical works and also computer software and architecture. The duration of the copyright is the life of the author plus a period of time, currently seventy years.

B. Means of Conveyance

The person owning the copyright exercises an assignment contract. The document conveying the copyright should be recorded with the United States Copyright Office.

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C. Tax Implications

The initial income tax charitable deduction for a gift of a copyright is the lesser of the taxpayer's basis and the fair market value of the copyright. (IRC Sec. 170(e)(1)(B)(iii). The cost basis is the out-of-pocket expenses incurred in the production of the work and securing the copyright, but it does not include the value of time spent in creating it. In addition to the initial deduction, a person who has donated the copyright and all royalty rights can deduct a declining percentage of royalty income paid to the charity over the next ten years. (IRC Sec. 170(m))

Year	Deduction Percentage
1	100%
2	90%
3	80%
4	70%
5	60%
6	50%
7	40%
8	30%
9	20%
10	10%

These additional deductions are permitted only to the extent that they exceed the initial deduction claimed by the donor. To qualify for them, the donor must notify the charity at the time of the contribution of the donor's intent to take the additional contributions. The charity must then provide information to the donor about the royalty payments.

D. Partial Interest Gifts

To donate the material object and not the copyright, or the copyright and not the material object, is not a qualified partial-interest gift for income tax purposes (possible exception if the material object has insubstantial value). However, for gift and estate tax purposes, the material object and the copyright are treated as distinct properties. Thus, a gift of either by itself will qualify for the gift or estate tax charitable deduction under IRC Secs. 2522(e)(3) and 2055(e)(4).

E. Assignment of Royalty Income

Suppose the donor is already receiving royalty income from a published work and retains the copyright. If that person assigns future royalty payments to the charity, he/she will continue to be taxed on them. However, a deduction should be allowed for payments actually paid to the charity. It is no different than if the donor personally received the royalty payments and then wrote checks contributing them to charity.

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F. Appraisal

Fair market value for the purpose of claiming an income tax charitable deduction requires an appraisal by an independent appraiser who meets all of the qualifications for appraising this kind of property, if the income tax deduction claimed will exceed $5,000.

2. Gift of a Patent

A. Definition

A patent is a property right that protects an invention. It gives the owner the exclusive right to make and sell an invention for a certain period – generally 20 years.

B. Means of Conveyance

The person owning the patent exercises an assignment contract or deed of gift and records the document in the United States Patent Office.

C. Tax Implications

Since the enactment of the JOBS Act in 2004, the tax implications of giving a patent are similar to those of giving a copyright. The initial income tax charitable deduction will be limited to the lesser of the patent owner's cost basis and the fair market value of the patent. Thereafter, the donor can deduct additional amounts of royalty income paid to the charity over a ten-year period per the above schedule and subject to the same conditions. As with a copyright, the cost basis of a patent is the out-of-pocket costs incurred in the invention of the object and obtaining the patent, but it does not include the value of the inventor's time.

D. Partial Interest Gifts

A donor who retains the right to license the patent to others or who places any other restriction on the gift will not have given his entire interest, and thus will not be entitled to an income tax charitable deduction.

However, an inventor may contribute an undivided fractional interest in his/her entire interest in a patent. The income and gift tax charitable deductions will be the fractional share of the deductions that would have been allowed if the donor had contributed the entire interest.

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E. Assignment of Royalty Income

If a donor has already conveyed a patent to a company and has a right to receive royalty payments, he/she will be taxed on those payments even if the right to receive them is assigned to the charity. A deduction should be allowed for each payment that is donated to the charity.

F. Appraisal

The appraisal requirements are the same for a patent as for a copyright.

3. Gifts of Mineral Interests

A. Definition

A mineral interest is the ownership of the right to mine or produce minerals lying beneath the surface of a property. These minerals include oil, gas, coal, iron ore, sulfur, and various precious metals. They do not include sand, gravel, building stone, and water, all of which belong to the surface owner.

A landowner who also owns all of the minerals under the land is said to have a "fee simple" ownership. However, ownership of the land and the minerals can be divided. For instance, this happens when a person who has a fee-simple interest sells or leases the mineral rights to someone else.

B. Means of Conveyance

It is a common practice for a person who has a fee-simple interest to lease the mineral rights to a company that is in the business of extracting certain minerals. The lessee will then hold a "leasehold interest," and normally will make cash payments to create and maintain the leasehold interest. There will be an agreement that specifies the term of the lease, the royalty to be paid, and a description of the interest. The lessee may pay the lessor a bonus to acquire the lease plus yearly payments while drilling is delayed. If oil or gas is found and production begins, the lessee would receive the specified royalty interest.

C. Tax Implications

If a fee-simple owner gives a charity the surface interest but retains ownership of the mineral rights, no charitable deduction will be allowed because the owner has not given the charity all of his/her rights. Likewise, no deduction will be allowed if the owner gives charity the mineral rights but retains the surface interest. However, an income tax charitable deduction would be allowed if the donor owns either the surface or mineral rights and assigns them to the charity because the donor will have given his or her entire interest.

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In the case of oil and gas, there are many types of interests a person may own. In most cases, those interests will be treated as a capital asset, and the gift will be deductible for both income and gift tax purposes. For instance, a person may own a royalty interest where he/she has a right to future income from the property. So long as the term of the royalty interest is co-extensive with the working interest, the value of the royalty interest will be deductible. If it is not co-extensive with the working interest (for example a production payment), it would be a non-deductible assignment of anticipatory income. In that case, no deduction would be allowed when the gift is made. The income payments to the charity would be taxable to the donor, but presumably a deduction would be allowed for the payments made directly to the charity.

If the value of the interest exceeds $5,000, which almost always will be the case, the donor must secure an appraisal from a qualified appraiser and file Form 8283 with the tax return on which the deduction is claimed. As a rule of thumb, the value of a royalty interest will be about four times the annual income received from the interest. Of course, situations vary, so a qualified appraisal is necessary.

D. Funding Specific Planned Giving Vehicles with Mineral Interests

Mineral interests are suitable as outright gifts. In most instances, the payments and royalties received will be passive income and will not constitute unrelated business taxable income (UBIT). However, the charity would be subject to UBIT if it receives a working interest and is liable for its share of development costs. See Reg. 1.512(b)-1(b).

A gift annuity, which provides for fixed payments, could put the charity at risk because the amount of royalty payments is uncertain. It might be considered if the charity could sell the interest after receiving it, is reasonably certain of the stream of royalty payments, or offers a lower-than-normal gift annuity rate.

A charitable remainder unitrust, particularly if it has a net income provision, could be a suitable instrument. The primary disadvantage is the necessity of annual valuations.

Example: Judson and Glenda, both age 65, fund a net-income unitrust with both the surface and mineral interests in a property. The trustee sells the surface interest and retains the mineral interest. Then the trustee leases the mineral interest and receives income based on actual production. The annual valuation of trust assets will take into consideration the reinvested proceeds from the sale of the surface interest and the value of the mineral interest, which will be approximately four times the annual income produced by the interest. The actual income received each year well exceeds the trust payout rate multiplied by the value of trust assets, so this surplus income is reinvested.

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The reinvested assets will grow as the production payments decline, so trust income is sustainable. The trust contains a flip provision stating that as of January 1 following the year of the sale of the surface interest, the beneficiaries will start receiving the stated percentage of trust assets following the sale of the surface interest.

A bequest is, of course, an ideal way to convey whatever interest the donor may hold at the time of his/her death, not only in mineral interests but in any tangible personal property or intellectual property. That is because an estate tax charitable deduction is allowed for the entire fair market value of the interest that is included in the taxable estate. There are certain partial interest gifts of such property that do not qualify for an income tax deduction but do qualify for an estate tax deduction.

CONCLUDING COMMENT

The CFO of a certain university once asked the Director of Planned Giving, "Why don't you just go out and get unrestricted gifts of cash?" The life of fundraisers would, indeed, be simpler if everyone contributed cash and things like publicly-traded securities that can be readily converted to cash. However, many people would be more inclined to make a significant gift if they can use unusual and more complicated assets.

If the charity mentions a willingness to accept such property, some of these individuals will be stimulated to come forward. Even if illustrations in the charity's planned giving literature pertain only to cash, publicly-traded securities, and perhaps real estate, there will from time to time be a surprise telephone call from someone asking for information about giving a collectible, gold bullion, an oil interest, or some other asset the planned giving officer may not be very well prepared to discuss.

As noted in the introduction, the purpose of this paper is to prepare gift planners to engage in such discussions and also to encourage them to expand the range of gifts promoted in planned giving marketing material. Not only will they raise more money, but they will also enjoy the intellectual stimulation.

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