Smart Ways To Handle A Highly Appreciated Investment

Let’s say you’re the lucky owner of a highly appreciated investment (stock, mutual fund) you’ve held for at least a year. What’s the best way to sell it? Or should you donate it? Here are several choices facing an early investor in Apple shares that I’ll call “Meg.”

Apple shares are valued at 246 per share. If Meg purchased the shares at 10, her gain is 236 dollars per share. If she owns 1,000 shares, that’s $236,000 of gains on $246,000 of proceeds. Her options include: 1) selling the shares outright and paying long-term capital gains, 2) gifting the shares to someone else or 3) gifting the shares outright to charity.

Option 1: Sell Your Shares Outright

Your long-term capital gains rate is determined by your taxable income and filing status. Current rates are 0%, 15% and 20%. These rates are relatively low and may go higher in the future. You can sell and pay taxes outright although gains may push you into a higher overall tax bracket. In our Apple example, Meg, the investor, qualifies for a 15% long term capital gain so she’ll pay $236,000 x 15% = $35,400 taxes. Meg is married and her taxable income falls between $78,751-$488,850. (note: there may be an additional 3.8% tax charge if her modified adjusted gross income exceeds $200,000 [single filers or heads of households] or $250,000 [married, filing jointly).

Option 2: Gift Shares to Someone Else (Typically a Family Member)

Complex “kiddie tax” and other rules are in place to thwart well-intentioned parents from gifting highly appreciated securities to their children. With all the rules and restrictions, it's probably better to gift a security that has *not* appreciated much in value, or to gift something in your estate (viz., when you're deceased). The reason for gifting a highly appreciated asset in your estate (NOT while you're alive) has to do with the "cost basis" aspect of any holding. If Meg gifts some Apple shares while she's alive, her "cost basis" passes to the recipient. Meg bought Apple shares for $10 and Jason (her nephew) has the same $10 per share cost basis on the shares he receives. This may work out well if Jason is in a 0% long term capital gains rate and the shares don't unwittingly push him into a higher income tax bracket. A*voiding the "kiddie tax" (for recipients under age 24) and other gifting rules require intensive research and/or your financial advisor/CPA weighing in on the matter.*

<u>Option 3: Gift to a Qualified Charity – Even Better If Done In a Year When You Itemized Deductions.</u>

Gifting to a qualified charity is a great option if you're charitably-inclined investors. Meg decides to retain 900 Apple shares and donate 100 of them (= $24,600) to charity in 2019. She'll never pay long-term capital gains tax. Even better, she may be able to save even more on taxes if she can itemize deductions. Meg typically donates up to $10,000 per year to charities. If she opens a donor advised charitable trust, she can dispense the $24,600 over a number of years while getting the full deduction on her Apple donation if she follows these steps:

1. Meg sets up a donor advised trust at e.g. Fidelity, Vanguard or another brokerage account. No attorney is needed – she sets this up online in less than 10 minutes. I refer Fidelity Charitable Trust to many of my clients because their minimum is $5,000.
2. Meg transfers $24,600 of Apple shares in 2019 to this trust. The shares immediately are sold (no capital gains) and held in cash or a mutual fund in her new donor advised charitable trust.

3. Without the Apple $24,600 donation, Meg does not clear the $24,000 automatic deduction in 2019 because she has 1) state/local taxes (capped at $10,000), 2) $8,000 mortgage interest and 3) $5,500 out of pocket medical. This totals $23,600 – less than the $24,000 standard deduction.
4. Meg can itemize deductions in 2019 because her Apple donation brings her total deductions to $48,100 in 2019. In other words, virtually all of her donation is tax-deductible and she avoids long-term capital gains tax.
5. Next year Meg expects to have $10,000 state/local taxes, mortgage interest and out of pocket medical, but NO charitable deductions. In 2020, Meg will accept the $24,400 automatic deduction – she won't itemize deductions because they won't exceed the 2020 $24,400 threshold.
6. Meg can take her time dispensing the $24,600 in her donor advised trust over a period of years. And she always can top up the balance by donating another highly appreciated security – preferably in a year when she can clear the standard deduction.