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BARGAIN SALES

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September 2000

A bargain sale is a transfer to an Internal Revenue Code (IRC) Section 501(c)(3) tax-exempt organization (a "charity") for a sales price less than the fair market value of the property.

A bargain sale is treated for tax purposes in part as a charitable contribution and in part as a sale or exchange of the property.

The part of the bargain sale that is treated as a gift is equal to the excess of the fair market value of the property over the purchase price paid by the charity. The gift portion is deductible under IRC Section 170 as a charitable contribution.

The sale portion of a bargain sale is governed by the general rules pertaining to property dispositions, under which gain or loss is determined with reference to the difference between the amount realized and the adjusted basis of the property.

In a bargain sale, the adjusted basis for determining gain from the sale is that portion of the adjusted basis that bears the same ratio to the adjusted basis as the purchase price bears to the fair market value of the property.

Example: Taxpayer sells property to a charity for \$60,000. At the time of sale, the property had a fair market value of \$100,000 and an adjusted basis of \$60,000. Because the charity paid less than the fair market value, the bargain sale rule applies.

The gift portion of the bargain sale is \$40,000 (\$100,000 fair market value minus \$60,000 purchase price).

The adjusted basis for purposes of determining gain (the part allocated to the sale) is \$36,000.

$$\begin{array}{rcl} \frac{\$60,000 \text{ purchase price}}{\$100,000 \text{ fair market value}} & \times & \$60,000 \text{ adjusted basis} \\ & & = \$36,000 \end{array}$$

Thus, the taxpayer must recognize a gain on the sale portion of \$24,000 (\$60,000 amount realized minus \$36,000 allocable adjusted basis).

A taxpayer in the 36% combined federal and state income tax bracket would have a tax savings of \$14,400 (36% of \$40,000 charitable contribution deduction). The taxpayer would pay \$8,640 in tax on the gain (36% of \$24,000 gain on sale). The taxpayer would net \$65,760 from this sale (\$60,000 sales price plus \$14,400 tax savings minus \$8,640 tax on gain).

Compare this example to a taxpayer who sells the property to a charity for its fair market value (no bargain sale). In the above example, the taxpayer who sold the property for \$100,000 would have a gain of \$40,000 (\$100,000 sales price minus \$60,000 adjusted basis). In the 36% combined federal and state income tax bracket, the taxpayer would pay \$14,400 in tax on the gain (36% of \$40,000 gain on sale). The taxpayer would net \$85,600 from this sale (\$100,000 sales price minus \$14,400 tax on gain).

If a taxpayer can sell property for its full fair market value, the taxpayer will always net more by doing so than by a bargain sale to a charity. A bargain sale is attractive to a taxpayer when:

the taxpayer desires to make a gift to the charity, or

the taxpayer is unwilling or unable to wait until a full fair market value offer on the property is received.

Compare the above example to a taxpayer who, desiring a quick sale, sells the property to a private party for \$70,000. The taxpayer would have a gain of \$10,000 (\$70,000 sales price minus \$60,000 adjusted basis). In the 36% combined federal and state income tax bracket, the taxpayer would pay \$3,600 in tax on the gain (36% of \$10,000 gain on sale). The taxpayer would net \$66,400 from this sale (\$70,000 sales price minus \$3,600 tax on gain).

This is not much more than the sale to a charity for \$60,000. In fact, since certain sales costs are based on the sales price, the taxpayer in this example might net more by selling to a charity for \$60,000 than by selling to a private party for \$70,000.