

When Starbucks Comes Calling

Scenario: Joe, 61 and Connie, 58

Connie, a semi-retired real estate agent, found a great deal on a commercial property in downtown Charlestown many years ago. Today, the area is bustling and Starbucks wants to move in, with an offer of \$2,000,000.



Their purchase price was \$350,000 in 1986 and they have depreciated their cost basis down to \$100,000, the value of the land at the time.

Desired outcome: Create a lifetime income stream for retirement and leave an inheritance for their children, Jane, 42 and Jerry, 39.

Option 1: Sold outright, Joe and Connie will pay 25% on the taxable gain up to the original purchase price in depreciation recapture, then 20% of the gain up to the sales price in long term capital gains taxes. Plus, of course, the Medicare tax of 3.8% and whatever state taxes may be due. In addition, the large gain on their tax return will catapult them into the highest income tax bracket. In short, they could be looking at almost \$600,000 in taxes due on the sale!ⁱ

Option 2: Alternately, Joe and Connie can transfer the property into a Charitable Remainder Trust, resulting in \$0 taxes due on the sale because of the tax-exempt status of the Trust. Additionally, Joe and Connie will receive a large tax deduction for their contribution.

Joe and Connie will receive a lifetime income of 5% from the trust. Upon the death of the first spouse, the remaining spouse will receive all of the income for the remainder of his/her life. Then the children will split the income for life and the survivor of them will receive all of the income for the remainder of his/her life.

Sales Price: \$2,000,000 Cost Basis: \$100,000 Taxable Gain: \$1,900,000

	Outright Sale	Sale With Trust
Taxes due on sale	\$578,759	\$0
Net Investable Cash	\$1,421,241	\$2,000,000
Income at 5%	\$71,062	\$100,000
Tax Deduction	\$0	\$214,240

The joint life expectancy of the kids, Jane and Jerry, is 55.6 years. Assuming a 5.14% recalculating payout and 7% growth in the trust, the total of payments over the four lifetimes is \$5,249,638. Talk about stretching a dollar; that's a lot of lattes!

ⁱ \$250,000 of depreciation recapture, \$1,650,000 in long-term capital gains. Total AGI of \$2,014,701. Federal taxes total \$481,840 and state taxes total \$119,998. Prior to sale taxes were \$17,081 and \$5,998 respectively. Total taxes attributable to sale are \$578,759.