Life Estates: Planning Considerations
Gifts of Homes and Farms with Retained Use

We sometimes hear from friends that they intend to leave their residences, or perhaps farm property, to The First Church of Christ, Scientist, in their wills. For many of these people, it may make more sense to deed their property to the Church now, but retain the absolute right to live in the house or use the farm property for the rest of their lives. The Church eventually benefits, just as if the property had been left to us through a will or living trust, but the donors receive immediate, sizable income tax charitable deductions that can produce tax savings, which can be invested for additional retirement income. The legal name of this arrangement is a gift of a remainder interest, with a retained life estate.

Perhaps the most attractive thing about deeding a personal residence or farm to the Church and retaining lifetime use is that, while carrying out charitable intentions and reducing their income tax liability, donors do not change their style of living or that of their families. The property need not be transferred to a charitable trust, which would require donors to cease using the land or house, under IRS rules. Alternatively, a residence or farm can be bequeathed to the Church in a donor's will, with lifetime use reserved for a survivor, such as a spouse or other family member. Important estate tax savings may result.

The term "personal residence" includes any property where the donor lives for part or all of the year. It is not necessary that the property be the person's primary residence. So contributions of vacation homes, condominiums or stock owned in a cooperative housing corporation are deductible, with donors retaining the right to lifetime occupancy. Furnishings or personal property located in a home are not deductible, however. Personal property either should be bequeathed outright to the Church or left to the surviving spouse or other beneficiary.

IRS regulations define the term "farm" as including land and improvements used by the donor or a tenant for the production of crops, fruits, other agricultural products, or the raising of livestock, including cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals, chickens, turkeys, pigeons and other poultry.

How significant are the income tax deductions?

IRS actuarial tables are used to calculate deductions for a gift of a home or farm with lifetime use retained. Certain facts must first be determined:

- the current value of both the land and the structures on the property;

- the estimated useful life of any structures on the property (e.g., the residence itself, or a barn);
- the expected value of any structure at the end of its estimated useful life;
- the age or ages of the people who will have lifetime occupancy; and
- the applicable federal interest rate in effect at the time of the gift.

The lifetime occupants of the residence or possessors of the farm have an obligation to maintain the property, either as a matter of agreement or as a matter of state law. The existence of this obligation should tend to enhance the expected value of any depreciable property at the end of its estimated useful life as well as prolong the useful life. This in turn should result in smaller depreciation and therefore a larger charitable contribution. To support the claim for deduction, all relevant values should be based on a detailed appraisal report by a qualified appraiser.

The deduction example we discussed previously involved a married couple aged 77 and 75. Their home is currently worth $500,000 and the mortgage has been paid off. If the house is worth $400,000, with a salvage value of $40,000, and the lot is appraised at $100,000, their income tax deduction will be about $318,000 (64%) if the gift occurs in a month when the applicable interest rate is 1.2%. They can deduct their gift up to 30% of their adjusted gross income, with a five-year carryover for any excess deductions.

Deductions are higher for farm property that consists primarily of land, such as pasture or cropland. Deductions also are higher where lifetime use is reserved for only one person, and when applicable federal interest rates are low. Example: Farmer Jones, age 75, has 100 acres of pasture land worth $600,000 that he has included in his will as a bequest to the Church. If he accelerated that bequest into a lifetime gift of a remainder interest he could deduct $527,106 (88%), applicable interest rate of 1.2%. Jones can continue to farm the 100 acres or lease the land out to another farmer.

Can part of my residence pass to family members upon my passing?

A house or farm is often the major asset of a person's estate, and a charitable gift may be made of only a portion of the remainder interest. A donor might give 50% or 30% of a remainder interest in a farm or home to the Church and have the rest pass to children in his or her will. The Church and the children most likely would sell the property and divide the sale proceeds.

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What happens if I decide to move to a different house or city?

At the time a gift of a remainder interest in a personal residence is made, an agreement will be entered into as to what will happen if the donor wishes to give up his or her retained life interest in the residence at some point in the future. Some alternatives are for the donor to sell his or her retained life estate to the Church or contribute it to the Church (and take a charitable deduction), or agree with the Church that the entire property will be sold, with the proceeds divided ratably between the Church and the donor.

Who will be responsible for future taxes, insurance, maintenance and repairs?

After the gift, the donor continues to be responsible for upkeep of the property, including payment of any real estate taxes and insurance. The Church cannot pay these expenses without jeopardizing the donor's deduction. To avoid misunderstanding in this regard, the donor enters into an agreement with the Church accepting responsibility for maintenance and upkeep of the property.

What if I later make improvements to the property?

The IRS issued a favorable ruling where a donor gave a remainder interest in his home and later decided to install a new heating and air conditioning system, both of which became permanent fixtures to the house. The donor obviously increased the value of his home and, at the same time, the value of the charity's future gift. But could he take an additional charitable deduction? The IRS said yes; however, the deduction would be limited to the charity's remainder interest in the fair market value of the systems, not the donor's cost of installation.

What if the property is mortgaged?

The IRS has ruled that the donor of a farm with a fair market value of $110,000 and an $80,000 mortgage was entitled to a deduction only for the remainder interest in his $30,000 equity. Each year, he would be entitled to additional deductions on the remainder portion of the principal payments on his mortgage. The IRS also ruled that the donor was required to report capital gain under the bargain sale rules – and take the full amount of the mortgage into account when reporting his gain. We would be happy to discuss this issue with you, but it is possible that the Church would not accept a property with a mortgage or liens in this type of gift arrangement.

What if I own property overseas?

The IRS issued a private letter ruling that a charitable deduction was available for the transfer of a remainder interest in a taxpayer's personal residence that was located outside the United States. The IRS noted that even though the residence was situated in a foreign country, the charities themselves were qualified United States charitable organizations – so the gift of the remainder interest in the taxpayer's foreign residence qualified for the income tax charitable deduction.

Can I later rent my house to tenants?

The law requires only that you have used the home as a personal residence prior to the gift – not that you continue to live there in the future. Also, one taxpayer received an IRS ruling that she could have a deduction where part of her home was rented out at the time of the transfer. Please be advised, however, that this issue is subject to our gift acceptance policy and the agreement that will be entered into between the donor and the Church. Rental of the property may not be acceptable in this type of arrangement, although legally it appears to be permissible by the IRS.

I'm converting to a Roth IRA. Could a retained life estate gift be helpful?

People who convert from a traditional IRA to a tax-free Roth IRA generally face heavy taxes. Those taxes would be reduced if itemized deductions could be increased during the year of conversion. One strategy would be to deed part or all of a personal residence or farmland to the Church, while reserving a life estate. Charitable deductions are currently unusually high for such an arrangement.

Suppose Maggie, age 65, has a lakeside vacation home worth $500,000 (the lot represents $100,000 of the total value). She deeds the property to The First Church of Christ, Scientist, and keeps a life estate – and receives a charitable deduction in excess of $283,000 that reduces taxes on her Roth conversion. Note: Her deduction will be subject to a 30%-of-AGI ceiling, with a five-year carryover for any excess. Alternatively, she could deed a fractional undivided interest in the property to the Church (50%, for example) and retain a life estate as to that portion. At death, 50% of the property would pass to the Church and 50% to beneficiaries named in her will.

Deductions for remainder interests in farmland are higher than those for personal residences, since depreciation and depletion are not taken into account. Example: Farmer Jones, age 70, has 100 acres of crop land worth $600,000 that he has included in his will as a bequest to the Church. If he accelerates that bequest into a lifetime gift of a remainder interest in the property, he can deduct $500,000, depending on current interest rates. Jones can continue to farm the 100 acres or lease the land to another farmer.

How to Proceed

All real estate gifts require close consultation and coordination with our office. If you are interested in contributing a home or farm, while reserving lifetime occupancy for yourself or someone else, please e-mail, call or write our office.

We are pleased to advise you:

1. The portion of your gift that would be tax deductible
2. Appraisal requirements, the process for transferring title, and necessary forms and receipts you will need
3. Your rights and responsibilities after the gift occurs
4. Possible options in the future event that you no longer wish to use the property

You will need to share with us:

1. The current value of the land
2. The current value of any house or other structures on the property
3. Your date of birth, and the date of birth of any other person (such as a spouse) who will have continued use of the property
4. Information on any mortgage or lien against the property
5. Your adjusted basis in the property, if there is a mortgage or other loan outstanding

A simple telephone call or letter can get the process started. You can contact our office at philanthropy@csps.com, by phone at 1-800-288-7155, extension 3288, or write to us at the address below. We look forward to hearing from you.

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