Real Estate Gifts: Planning Considerations

The choice of real estate as an asset to use when making a gift to The Mother Church, while it involves a process of evaluation and careful planning, can be beneficial to the donor in many ways.

Income Tax Deductions. The current value of appreciated real estate held long-term (more than one year) is deductible by the donor, less any indebtedness, if transferred to The First Church of Christ, Scientist or other qualified organizations. Deductions for real estate with short-term gain are limited to the donor's adjusted basis.

Capital Gains Considerations. No gain is reportable when donors give real estate. The deduction is not reduced where depreciation deductions have been taken on commercial or investment real estate, unless the donor took accelerated depreciation that would have resulted in the recapture of ordinary income upon a sale. Capital gain must be reported from any bargain sale. Gifts of mortgaged property are treated as "bargain sales" to charity, with the mortgage debt being considered an amount realized by the donor. Two results: (1) The donor's contribution is reduced by the amount of the outstanding debt, and (2) the donor must report a pro-rata share of the capital gain equal to the ratio the debt bears to the fair market value of the property.

> *Example:* Sara gives real property worth $20,000, cost basis of $12,000, to the Church. The property is subject to a mortgage of $10,000. Her charitable contribution is $10,000 ($20,000 minus $10,000 debt). Furthermore, she must report one-half the capital gain: $10,000/$20,000 x $8,000 (or $4,000), but she nonetheless saves capital gains taxes on the gift portion, and her deduction more than erases any tax liability.

Date That Gifts Are Effective. The gift is effective for tax purposes on the date an executed deed is delivered to a charity or its agent. If the deed is mailed, the postmark determines the date of the gift. In some states, the date of the gift may be when the deed is recorded.

Method of Transfer. Transfer of title of contributed realty is generally made by a quit-claim deed, unless a warranty deed is deemed necessary by either of the parties. Environment inspections are generally required before deeds can be accepted.

Valuation of Gift Assets. The value is established by an independent appraisal. Comparable selling prices for similar properties may be the best evidence of value. Indebtedness reduces value for deduction purposes.

Substantiation Requirements. A receipt from the Church and a statement that no goods or services were provided to the donor are required. For deductions exceeding $5,000, donors need qualified appraisals and must complete Sections A and B of Form 8283, including a declaration by the appraiser and a donee acknowledgment.

Buyer Waiting in the Wings. It may be risky for donors to transfer appreciated property to charity under circumstances in which the donor has already secured a purchaser for the property and all that is left for the charity to do is step into the donor's shoes and consummate the sale. The IRS in several cases has attributed the sale of the property to the donor and saddled him with reportable gain. Even donors who are merely trying to be helpful to charity should be cautioned against lining up a future buyer. On the other hand, there does not seem to be anything wrong with the charitable donee seeking out a buyer in anticipation of a gift of property. Indeed, this may be a sensible plan in many cases, as where a charity accepts real estate or other property in exchange for a charitable gift annuity, and the value must be predetermined with certainty before the gift.

Special Gift Opportunities with Real Estate

Retained Life Occupancy. If you own your home, farm or ranch – or even a vacation home – you may be able to make a gift of the property, obtain an immediate income tax deduction and still continue to use the property for as long as you wish. How does this work? Simply give the property, but retain the right to use it for your life (a "life estate"). You can continue to live in your home or receive income from agricultural property, and only after your death will the property pass for our benefit. By arranging this gift now, rather than in your will, you receive an immediate income tax deduction for the present value of our future right to receive the property.

Let's look at how this type of gift might fit into the plans of a couple we'll call Ken and Francine. Ken is 77 years old and Francine is 75. They are retired, but pay substantial income tax each year. Ken owns the home that they live in (currently worth $500,000) and he finished paying off the mortgage ten years ago. Ken and Francine plan to live in their home for the rest of their lives. However, they also would like to make a significant gift to assist The First Church of Christ, Scientist. Ken has decided to deed the home to the Church, retaining use of the home for his life and for Francine's life. Based on their ages and other factors, Ken will receive an income tax deduction this year of about $250,000.

Give Just a Slice. You also can give a "partial interest" in property that you intend to sell, and receive an immediate income tax deduction. For example, you could make the Church owner of a 10% interest in your vacation home. We would receive 10% of the proceeds when the vacation home is sold, and you will also avoid capital gains taxes on the portion contributed to the Church. You would be entitled to a deduction for roughly 10% of the property's value.

Minimize Taxes from Like-Kind Exchanges. Jean is a real estate investor who has done well over the years trading property on a tax-deferred basis – so-called like-kind exchanges. As a result, she owns several parcels of highly appreciated land, each with a very low cost basis. Jean wants to cash in on her investment success and use the proceeds to live well in retirement. But she faces severe capital gains taxes if and when she sells. Jean's adviser suggested she might consider, prior to any sale, contributing part of some property worth $500,000. One option would be to make a charitable gift of an undivided fractional interest – a portion worth $100,000, for example – and deduct $100,000 without owing capital gains taxes. The deduction would save $35,000 in taxes in her 35% tax bracket. If the capital gain on the part she retained were $200,000, her capital gains tax would be $30,000, which is more than eliminated by her charitable deduction tax savings.

Keep Lifetime Income. An ideal way to use real estate to accomplish your financial objectives while supporting the Church is to set up a charitable remainder unitrust. What is a unitrust? Basically it is a trust in which you irrevocably place property, but retain a specified income, usually for life. At the end of the trust, the trustee distributes the property to the Church. But because you set up the trust now, rather than leave the property through your will, you are entitled to a substantial income tax charitable deduction. By setting up a unitrust, you can:

- establish an income for life – one that can grow with inflation;
- reinvest a highly appreciated, low-yield asset, without incurring capital gains tax;
- reduce income taxes significantly;
- gain the investment and administrative services of a trustee;
- get rid of the financial and personal burdens of property management;
- make a magnificent gift to the Church.

In the previous example of Jean, the real estate investor, an even better idea might be for her to transfer part or all of her land to a tax-exempt charitable remainder unitrust, avoid all capital gains taxes, retain an income for life and receive a sizable tax deduction in the bargain. After the real estate is sold, the trust will pay Jean a fixed percentage of the value of the trust assets every year. The Church benefits when the trust comes to an end.

Retire from Property Management. Allen is 72 and owns an apartment building worth $900,000 that he purchased many years ago for $300,000. He has taken straight-line depreciation deductions on the building and now has an adjusted basis of only $40,000. Allen plans to move to a retirement community and wants to sell the apartment building and invest for a good retirement income, even though he had long hoped that he could hold onto the property and then ultimately leave it to the Church as an expression of his gratitude.

In addition to his plans to move, now Allen would like to be free of the responsibilities of managing his property. But capital gains taxes would take $155,000 of his profit if he were to sell the property outright. This type of situation presents an opportunity for a gift plan that would meet all of Allen's needs: To give a gift to The Mother Church, maintain an income stream during his retirement years, and even to provide for his wife Marge as well.

Allen can transfer the apartment to a charitable remainder unitrust, set up with The Mother Church, that may pay him and his wife Marge, age 70, 5% of the value of the trust each year for the rest of their lives. The $155,000 capital gains tax won't come due when the trustee sells and reinvests, so Allen and Marge will begin receiving trust income based on the full $900,000 – about $45,000 a year. Based on their ages and other factors, Allen also will receive a charitable deduction of about $348,000. To summarize, Allen has:

- established a lifetime income for himself and Marge;
- reinvested a highly appreciated asset without incurring capital gains tax, which would have included $600,000 taxed at a 15% rate and $240,000 taxable at 25% under depreciation "recapture" rules;
- reduced his income taxes significantly (the $348,000 gift will be deductible up to 30% of the couple's adjusted gross income, with a five-year carryover for any excess deductions);
- gained the investment and management services of a trustee;
- put an end to ceaseless phone calls from tenants;
- helped to provide ultimate support for the Church's core activities.

Allen's gift plan would work equally well for people who own office buildings or undeveloped real estate and wish to sell and reinvest without paying capital gains taxes. For land that does not produce income (such as a vacant lot) the unitrust would probably be arranged so that income payments are postponed until after the trustee sells the property.

Flip Unitrusts Make Sense with Real Estate. Donors who fund trusts with real estate, closely held stock and other nonliquid assets often use a net-income or net-income with make-up unitrust, which permits the trustee to avoid or postpone income payments prior to the sale of the trust assets. Once the property is sold, however, most donors prefer the fixed percentage payments offered by a straight unitrust.

Under recent Internal Revenue Code (IRC) §664 regulations, a unitrust created after December 9, 1998, would be allowed to "flip" from a net-income trust to a standard unitrust upon the occurrence of a specific triggering event, which must be outside the control of the trustees or any other persons. The final regulations include examples of permissible triggering events (a beneficiary achieving a particular age, marriage, divorce, death, birth of a child and sale of unmarketable assets, such as real estate) and impermissible events (sale of marketable assets or a request from a beneficiary to convert to fixed percentage payouts). Conversion must occur at the start of the taxable year immediately following the year in which the triggering date or event occurs, and any make-up amounts are forfeited. Unmarketable assets are defined as anything other than cash, cash equivalents or assets that can be readily converted to cash or cash equivalents.

How to Proceed

If you are interested in making a gift of real estate to The First Church of Christ, Scientist, please e-mail, call or write our office.

We are pleased to advise you:

1. Our correct legal name, for use by your attorney in drafting deeds or other documents
2. The approximate income tax and capital gains tax savings available from your gift
3. Appraisal and environmental issues for gifts of real estate
4. Details of the transfer and gift acceptance process

You will need to share with us:

1. The type of real estate you propose to contribute and an estimate of its current value
2. Any existing mortgages or other loans against the property
3. Your basis in the property, as adjusted for capital improvements or depreciation
4. Whether a sale of the property is currently pending
5. Whether you wish to reserve lifetime income from your gift for a family member

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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