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For those who wish to make a significant charitable gift, real estate can be a practical and beneficial option.

In these pages, you'll discover a number of ways to make gifts of real estate that can complement your overall estate plans and enhance your financial security now and in future years.

And, if you are reviewing your plans in light of recent changes in federal tax laws or current economic conditions, real estate can offer a number of attractive charitable giving opportunities.

Outright gifts of real estate

If you own a home or other property you no longer wish to live in or manage, you may find such property can make an effective charitable gift.

When property has grown in value

If you sell real estate you have owned for a number of years, you may be faced with a substantial capital gains tax, especially if the property is not your principal residence.

By making an outright gift of the property, a double tax savings is possible. First, in most cases you will receive a charitable income tax deduction for the full value of the property—not just the original purchase price. In addition, you will not be liable for capital gains tax on the transfer because the property was donated rather than sold.

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Example: John Hammers invested $50,000 in a piece of property 20 years ago. It was recently valued at $250,000, so he would realize a $200,000 capital gain if he sold the property for the appraised price.

He decides instead to use this land to fund a pledge he had previously made. He is entitled to a deduction of $250,000 on his income tax return for the year of the gift. In his tax bracket, this saves him more in taxes than he originally paid for the property. Because he made a charitable gift, he will not owe capital gains tax that would be due on a sale of the property.

When property has decreased in value

If you own real estate that has decreased in value, giving the property will entitle you to a deduction for only the current fair market value of the property—less than what you paid for it.

It may be better to sell the property and give the cash proceeds. In this way, you realize a capital loss you may be able to use to offset tax on other income. You will also be entitled to a charitable deduction for the amount of the cash gift.

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Gifts that allow you to retain use of the property

If you would like to make a gift of your residence, or a vacation home or farm, you may do so in a way that allows you and your spouse or another loved one the right to enjoy the property for life or other period of time you choose.

A tax deduction is allowed for the value of the eventual charitable gift in the year the

gift is arranged. This type of gift is generally most attractive to people at or approaching retirement years, and the deduction is greater during times of lower interest rates.

Example: Mary Rogers, age 78, is a widow with three children who live elsewhere and are doing quite well financially. She is planning to leave the bulk of her estate to them and also intends to give her home to one of her charitable interests through her will. Mary has recently learned she will no longer owe federal estate taxes and is interested in ways to make her estate gift that could yield immediate tax savings.

In consultation with her children and her advisors, she decides to give her home now while reserving the right to live there for the remainder of her lifetime. Under the terms of her gift, she retains the full benefits and duties of ownership, including taxes and upkeep, as well as the right to any income should she later decide to rent the property.

The gift of her home entitles her to an immediate federal income tax deduction for approximately 75% of its value. Mary can use the deduction to reduce her income taxes for the year of her gift and in as many as five future tax years. The deduction may also make it possible to deduct certain other expenses she does not currently itemize on her tax return.

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Gifts that provide income

Charitable gifts of real estate can also result in additional income for life or another period of time you choose. There are several options available.

You may select fixed income, variable income or income that is temporarily or permanently tied to the earnings of the property used to make the gift. Regardless of the type of gift chosen, it is possible to avoid capital gains tax on the increase in value of the real estate at the time the gift is made.

You may also enjoy income as well as a current income tax deduction that is calculated based on the full value of the property. Assets used to fund such gifts may be removed from your probate and taxable estate. Property taxes and other expenses currently associated with the donated real estate will also be eliminated.

Example: Milton and Donna Callison, ages 73 and 71, own 160 acres of real estate near a growing residential area. They paid $400 per acre, or $64,000, for the land 22 years ago.

According to a recent appraisal, the land is now worth approximately $3,000 per acre, or $480,000. They would like to make a significant charitable gift but are hesitant to do so as they anticipate needing more income in retirement. They have considered selling the land and investing the net proceeds. In that event, however, they must pay federal and state capital gains tax on the $416,000 gain, leaving them about $360,000 to reinvest.

If they instead place the land in a special trust known as a charitable remainder trust, it is possible to bypass the tax on the increase in value of the land at the time the transfer to the trust is completed.

The Callisons will thus be able to earn income from the entire proceeds from the sale of the land placed in the trust. If the trust payout rate were set at 5%, for example, their income from the trust would initially be

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$24,000, which is more than if they sold the land and reinvested their $360,000 in after-tax proceeds.

In addition to their increased income, they are entitled to a charitable income tax deduction of more than $210,000, which may provide substantial income tax savings over a number of years.

Depending on the performance of the trust assets, it may be possible for the Callisons to enjoy increased payments over time that are taxed at lower rates than other income.

Choosing the right property

When deciding to make a charitable gift of real estate, it is important to choose property that meets a number of criteria.

The property should be readily marketable, especially if you anticipate making the gift in a form that provides income over time.

If a property is mortgaged, you may still enjoy tax and other benefits. You must, however, pay special attention to the manner in which the property is given. Check with us or your advisors for additional information or see the "mortgaged property" section in the technical advisory portion of this booklet.

As you can see, a gift of real estate could be greatly beneficial to both you and charity. We will be pleased to discuss these gift plans with you upon request.

As always, seek advice from your financial advisors when planning these types of gifts. The section that follows may be of particular interest to them.

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Technical Advisory Section

The preceding pages are intended as a general guideline when making charitable gifts of real estate. The information on the following pages provides more details for you and those who assist you in your estate and financial planning.

Amount of donor’s charitable contribution

Several characteristics of the real estate being given are taken into account when determining the donor’s tax benefits. Length of time the property has been owned and whether it has increased or decreased in value are two of the key factors.

Real estate held long-term: If an individual donates real estate held long-term (i.e., longer than one year) to a public charity, the amount they can claim as a charitable contribution for federal income tax purposes is generally the property’s fair market value on the date of the gift. See Internal Revenue Code section 170(b)(1)(A).

Depreciated real estate: If improved property for which depreciation has been claimed is donated, the donor’s charitable contribution is reduced by the amount of depreciation that would be recaptured as ordinary income if the property were sold. See IRC section 170(e)(1)(A).

If the depreciation claimed has been straight-line, the donor’s charitable contribution is generally not reduced (because straight-line depreciation is generally recaptured under IRC section 1250 as capital gain rather than ordinary income). This can make donating depreciated property for which straight-line depreciation has been claimed especially attractive. Under current law the amount of straight-line depreciation taken could be subject to a maximum tax rate of 25% if the property were sold. The depreciation could also be subject to the 3.8% Medicare contribution tax depending on the donor’s income level.

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Fair market value: For purposes of determining the amount of the donor's charitable gift, the fair market value of real estate is generally the price at which it would transfer between a willing buyer and a willing seller, each having full knowledge of all facts relevant to the property's value. See Regulation section 1.170A-1(c)(2).

Limits on the income tax charitable deduction

The federal income tax charitable deduction is subject to various percentage limitations.

Prior to the *Tax Cuts and Jobs Act of 2017* (TCJA), the charitable deduction was limited to 50% of adjusted gross income (AGI). Gifts to public charities of cash and short-term capital gain property of all types were generally deductible up to certain AGI limitation. See IRC section 170(b)(1)(A).

Gifts to public charities of appreciated real property held long-term (together with certain other types of long-term appreciated property contributions) are generally deductible up to certain AGI limitation. See IRC section 170(b)(1)(C).

The TCJA increased the amount of cash that can be deducted to 60% of AGI for gifts made between January 1, 2018 and December 31, 2025. See IRC section 170(b)(1)(G).

Excess contributions may be carried forward for up to five subsequent tax years. See IRC section 170(b)(1)(D).

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A special election

A donor of appreciated real estate or other appreciated assets subject to the 30% limitation may find the 30% limit too tight a restriction and wish that a higher AGI limitation be applied to the gift.

A donor in these circumstances may wish to use a special election under IRC section 170(b)(1)(C)(iii). The election permits the donor to deduct the adjusted cost basis of gifts of appreciated real estate and other qualified capital assets and take that amount as a charitable deduction subject to the higher limitation).

Determining gift value

A *qualified appraisal*—as that term is defined in Reg. section 1.170A-13(c)—is generally needed to sustain a claim of an income tax charitable deduction with respect to a donation of real estate if the claimed value of the property (or the aggregate claimed value of all real estate gifts made during the year) exceeds $5,000.

In addition to obtaining a qualified appraisal, the donor is required to file an appraisal summary—IRS Form 8283—with the federal income tax return on which the gift is first claimed or reported. See Reg. section 1.170A-13(c)(2). The appraisal summary must be acknowledged (signed) by the donee organization. In the case of noncash contributions valued at more than $500,000, a copy of the qualified appraisal must be attached to the return.

If the donee organization sells or otherwise disposes of donated property for which it has signed a Form 8283 within three years of the date of the gift, it must report the sale to both the IRS and the donor on IRS Form 8282. See Reg. section 1.170A-13(c)(4)(iii).

Other rules: Special receipts stating that no tangible benefits were received by a donor in connection with a gift are now required for gifts of cash or property valued at $250 or more. This requirement is in addition to the qualified appraisal rules described above. Donors should keep all receipts and letters of acknowledgment in order to substantiate their deductions. See IRS publications numbers 526 and 1771 (available online at **www.irs.gov**).

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Special gift opportunity with personal residences and farms

Under IRC section 170(f)(3)(B)(i), a current income tax charitable deduction is allowed for the donation of a remainder interest in a personal residence or farm. The remainder interest may take effect at the end of one or more person's lifetime or other period of time determined by the donor.

The term *personal residence* is not limited just to the donor's principal residence but includes secondary residences such as vacation homes (so long as the secondary residence does not fall into the category of rental or investment property).

The term *farm* is also defined broadly. It includes, for example, agricultural property leased to a tenant.

This gift arrangement can be an ideal way for an individual or a couple who plan to leave a farm or personal residence to a charitable interest at death and are no longer subject to estate tax to do so while enjoying immediate tax benefits.

Gifts of real estate with retained income

There are several ways real estate can be given for charitable use in such a way that donors retain income for life or other period of time for themselves and/or others of their choosing. Perhaps the most popular way to accomplish this is through the use of *charitable remainder trusts*. See IRC section 664 and regulations thereunder for the rules governing the tax considerations of such trusts.

There are several types of charitable remainder trusts:

- Trusts that pay a fixed amount each year regardless of the earnings and/or value of underlying trust assets are known as *charitable remainder annuity trusts*.
- *Charitable remainder unitrusts* feature income that varies over time with the investment performance of the trust.
- A *straight unitrust* pays a predetermined percentage of the value of the trust assets as valued annually.
- A *net income unitrust* pays the required percentage of the annual value of the trust assets or the actual earnings of the trust, whichever amount is less. A net income unitrust can be designed to "make up" in future years any amount by which the earnings fell short of the

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percentage payment amounts in one or more previous years. This is done using earnings that are in excess of the unitrust percentage payment amount required to be paid in such a future year.

Because real estate can sometimes require an extended time to liquidate via sale, and the net proceeds of a sale may not be readily predictable at the time a trust is funded, charitable remainder annuity trusts are rarely funded with real estate as they may require payments to begin before donated real estate has been liquidated. The vehicle of choice has traditionally been the net income unitrust with or without a makeup provision, as the donor chooses.

IRS regulations provide guidelines for another option known as a *flip unitrust*. Under the terms of such a trust, assets like real estate that may not be readily marketable are placed in a unitrust that functions as a net income trust until such time as the property is sold, or in the event of another "trigger event." At such time, the trust "flips" and becomes a straight unitrust that pays a set percentage of the trust assets each year beginning in the first year following the trigger event. See regulations in IRC section 664 for more information on this alternative.

It is sometimes possible to fund other life income gift plans, such as pooled income funds and gift annuities, using real estate as a funding source depending on state regulations, marketability of property and other factors.

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Mortgaged property

In general, if an appreciated asset is given to a charitable organization, the donor does not realize the appreciation as a capital gain for federal income tax purposes. This is because gain is generally realized only if an appreciated asset is sold or exchanged; a charitable contribution is merely a donative disposition.

If appreciated property subject to a mortgage is given to charity, however, the transaction is

treated as a *bargain sale* under Reg. section 1.1011-2, and the donor must realize a portion of the appreciation as a capital gain.

For example, if property worth $100,000, having a $40,000 adjusted basis in the donor's hands and subject to a $20,000 mortgage, is given outright to a charitable organization, the donor realizes a gain of ($100,000 - $40,000) x ($20,000/$100,000), or $12,000.

The donor is also entitled to claim a charitable deduction of $80,000—their equity in the donated property.

Note that in the case of property that has been subject to accelerated depreciation, a portion of the gain realized by the donor may be ordinary income—representing recapture of depreciation claimed in excess of straight-line.

Transfer of mortgaged property to a charitable remainder trust: The transfer of mortgaged property to a charitable remainder trust (as defined in IRC section 664) can involve several complex tax issues and result in the disqualification of the trust. Seek qualified tax counsel early in the planning process for this type of transaction.

Miscellaneous planning considerations

Those making gifts of real estate should also consider other pitfalls that could jeopardize the benefits of such gifts.

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Buyer-in-the-wings: A common problem encountered in planning a gift of real estate is if, before making the gift, the donor has engaged in negotiations with a potential buyer of the property. If the donee organization (or trustee, in the case of a charitable remainder trust) sells the property to this buyer, there is a risk (the degree of which varies from situation to situation) that the donor will be deemed to realize the gain on the sale under the theory that the donee (or trustee) is a mere conduit for carrying out a prearranged sale.

For donors' protection, they should not enter into a legally binding sale agreement prior to making a gift of real estate, and the donee organization (or trustee) should enter into independent negotiations with the buyer subsequent to the gift. In each case, however, the donor's own attorney needs to make an independent professional judgment as to how best to protect the client's tax position.

Hazardous waste: From a donee organization's standpoint, real estate gifts can pose special risks because of potential clean-up liability under the Superfund Clean-up Act (42 U.S.C. section 9601, et seq.). For this reason, before a gift of real estate is accepted, an environmental audit (a stage 1, or phase 1, audit) of the property is often performed.

Conclusion

Charitable gifts of real estate generally involve more tax and legal complexities than other types of donations. If we may be of assistance in planning a gift of real estate, please do not hesitate to contact us.

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