Charitable Gifts of Real Estate

A Case Study in the Opportunities and Challenges

McLeod Professional Advisor Council
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Giving appreciated assets

- https://www.mcleodhealth.org/foundation/ways-to-donate/other-ways-to-give/appreciated-stock/
- Value of Stock $100,000
- Cost basis $ 50,000
- Long term rate 15%
- Income tax rate 24%
- Income tax savings $24,000
- LT tax savings $ 7,500

https://www.reninc.com/securities-donation-calculator/

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Three kinds of gifts

OUTRIGHT GIFTS	ESTATE GIFTS	LIFE INCOME GIFTS
• Immediate Gift	• Testamentary Will Bequest	• Gift Annuity ☆
☆ • Bargain Sale	• Testamentary Trust Bequest	• Charitable Trust ☆
☆ • Installment Bargain Sale	• Retained Life Estate	
• Retained Life Estate		

❖ Combination of above strategies

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Donor demographics?

- 1. Mission oriented
  - Previous donor history
- 2. Aging property owners
  - 65 or older
- 3. Ability to use tax benefits and carryforward tax benefits under 2018 tax law
  - 30% of AGI deduction for appreciated property
- 4. Relief from headaches of ownership and management

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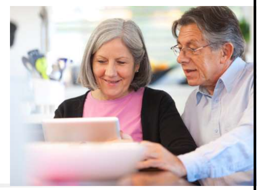

Donor demographics?

- 5. Desire income from low income or no-income property assets
  - Lots and land that produce no income
- 6. Desire deductions to offset other gains
- 7. Simplify family distribution decisions
- 8. Owns debt free or relatively small loan on property
- 9. Donating to knowledgeable charity that can accommodate gifting needs

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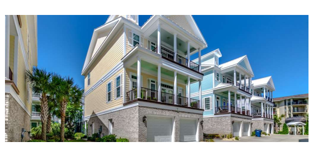
Trends: Second home real estate wealth

- In 2015 1 in 10 households owned 2 properties
  - 1 in 25 owned 3+ properties
- 6.6% of 3,141 counties are classified as vacation home counties
- The median sales price in vacation home counties rose 36% during 2013 to 2018 compared to 31% for all existing and new homes sold



Source: National Association of Realtors, 2018

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Fidelity Charitable
www.fidelitycharitable.org

Before you sell residential real estate and donate the net proceeds to charity, consider donating that property directly to a charity for two major benefits:

- A potential income tax charitable deduction for the fair market value.[1]
- A greater gift to charity—charities don't pay capital gains taxes, so the full value of your gift goes to causes you care about.

And there's a third benefit of donating real estate to a public charity with a *donor-advised fund* program such as the Fidelity Charitable *Giving Account*—the opportunity to recommend how the *contribution is invested* on a tax-free basis, potentially increasing the amount of charitable support over time.

[1]*Fair market value of the property, as determined by a qualified independent appraisal.*

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Reality gift fund
https://www.realtygiftfund.org

RGF
Realty Gift Fund

- To promote a transformation in charitable giving by accepting real estate gifts of any type… anywhere, fixing or remediating assets before converting them to cash, and using the excess proceeds to make grants to other non-profit organizations.
- Through its grants and educational efforts, RGF is committed to pioneering a meaningful impact on charitable giving through gifts of real estate.

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CERCLA statue

- Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (Superfund Act)
- Any person, or entity in the chain of title (even briefly) can be held liable for environmental cleanup, even if it did not in any way contribute t the hazardous waste
- Solutions:
  - Single Member Charitable LLC ⟹
  - Supporting Organization
  - FLIP charitable remainder unitrust

REAL ESTATE

After creating a special purpose, single-member LLC with RCF as the sole member to receive, hold and manage real estate, RCF accepts gifts of real estate as long as the donor has not entered into a binding agreement to sell.

Renaissance Charitable Foundation (RCF) is a §501(c)(3) publicly-supported charity that operates private-label donor-advised fund programs

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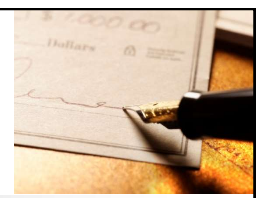
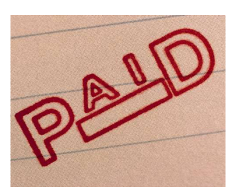
Mortgage on property



- Reduces equity of fair market value and creates a bargain sale
  - Recourse – against the property and the owner
  - Non-recourse – solely against the property
- Mortgage removal strategies
  - Pay off
  - Transfer to other property
  - Charity short term low interest loan
  - Charity purchase percentage interest



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Types of real estate

- Personal residence
- Vacation home
  - Non-rental
  - Rental property
- Commercial property
  - Used in taxpayers business
    - Motels, recreational parks, farms,
    - office buildings, golf courses,
    - mobile home parks, and more
- Condominium
- Farmland
- Investment real estate
  - Apartments, office buildings
- Raw land

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Forms of real estate interests

Type of Ownership	Description
Full Ownership	
Fee Simple Absolute	The most complete form of ownership; continues forever until conveyed.
Fee Simple Defeasible	Fee ownership, subject to a condition precedent or condition subsequent.
Fee Simple Determinable	Ownership ends upon the happening of an event, and the property reverts to the owner. For example, a donor makes a gift to the school board so long as the property is used for school purposes; if not used for school purposes, the property will revert to the donor.
Fee Tail	Ownership passes through lineal descendants; while possible to continue forever, ownership ceases when there is a generation without lineal descendants. This form of ownership is recognized only in Delaware, Maine, Massachusetts, and Rhode Island.
Partial/Shared Ownership Interests	
Tenancy in Common	Undivided interests in the whole (equal or unequal shares).
Joint Tenancy with Right of Survivorship	Equal undivided interests during the life of the tenants; when a tenant dies, that interest passes in equal shares to the remaining tenants.
Community Property	Under the laws of community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington; Wisconsin has similar laws), property acquired during marriage is owned equally by both spouses.
Tenancy by the Entirety	In some non-community property states, property purchased during marriage is owned by the husband and wife as tenants by the entirety. The property cannot be sold by the husband or wife individually during the marriage. The parties become tenants in common if the marriage is dissolved.
Condominiums	An exclusive right to own, occupy, sell, or transfer a specific unit, coupled with an undivided interest in the real and personal property in the common areas.
Life Estates	The right to occupy, use, and control the property for a stated life or other measuring term; at death, the life estate owner's rights in the property are extinguished.
Remainder Interests	The ownership of the full fee interest in real property subsequent to a life owner's rights in the property.

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Forms of real estate interests

Indirect Ownership Interests	
Partnerships	Real estate may be owned by a partnership, which passes through the character and amount of income, losses, and liability to partners. If an owner is a limited partner, liabilities may be limited to a stated amount. Debt-financed property can generate unrelated business taxable income.
Corporations	Corporations may also own real estate; owners hold stock in the corporation (either C or S) rather than direct interests in the real estate.
Limited Liability	A limited liability company—an entity defined by state law—can operate as a partnership (passing through the character of the income, losses, and liabilities) or as a corporation. If it operates as a partnership, watch out for unrelated business taxable income.
Real Estate Investment Trusts	Real estate investment trusts (REITS) are publicly traded companies that own, trade, and manage real estate. Most income and gains pass to shareholders of the company, but it is possible to generate unrelated business taxable income.
Irrevocable Trusts	Irrevocable trusts—trusts with terms that cannot be altered—for individuals or for charitable interests may hold or receive property. Use extreme care when transferring real property or a real property interest to a charitable remainder trust, since any unrelated business taxable income in a year will cause the trust to lose its tax-exempt status for the year.
Life Estates	The right to occupy, use, and control the property for a stated life or other measuring term; at death, the life estate owner's rights in the property are extinguished.
Revocable Trust	Management tools that place title to property in a trustee but leave equitable ownership in the assets and the income from them in the trust owner/beneficiary—can hold real estate.

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Gifts of real estate

- Outright or Fractional Interest
- Bargain sale
- Installment bargain sale
- Life Estate
- Gift annuity for 85% FMV
- 18 month Deferred annuity
- Simultaneous Closing
- Unitrust and sale
- FLIP Unitrust
- Charitable Lead Trust

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Bargain sale:
The transfer of an asset to a charity for less than fair market value in order to make a gift

Bargain Sale #1
York College of Pennsylvania

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Bargain Sale #1
York College of Pennsylvania

- Surviving spouse, mid 70s
- Inherited building, former physician office, two tenant apartments, step up basis
- Attorney driven bargain sale
- Appraised value $91,000
- Bargain sale price $20,000
- Income tax deduction $71,000
- Donor made additional IRA-QCD gift of $25,000
- Avoided capital gain and depreciation recapture (if any)
- Life simplification

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Installment bargain sale #2

- Jim K. family trust owns a campground not to far from Pinehurst hospital
  - 38.10 acres
- Hospital wants to build a 20 bed Hospice House
- Donor appraisal using three options: Cost, sale and income: $3,010,000
- Original cost $350,000,
  - improvements $1,000,000

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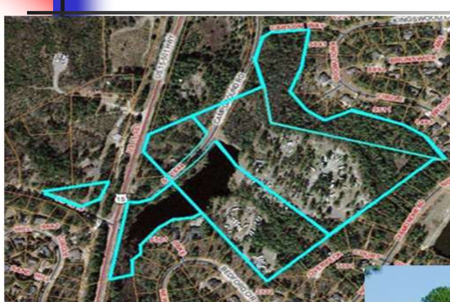
Installment bargain sale #2



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Installment bargain sale#2

- Hospital offer $1,500,000 note, 180 quarterly payments, 6% interest
- Counter offer - $1,800,000, 60 quarterly payments, 6% interest

Loan Calculator

Enter Values	
Loan Amount	$1,800,000.00
Annual Interest Rate	6.00 %
Loan Period in Years	15
Number of Payments Per Year	4
Start Date of Loan	1/1/2008
Optional Extra Payments	

Loan Summary	
Scheduled Payment	$ 45,708.17
Scheduled Number of Payments	60
Actual Number of Payments	60
Total Early Payments	$ -
Total Interest	$ 942,490.16

Lender Name: Kirkpatrick 15 years

Pmt No.	Payment Date	Beginning Balance	Scheduled Payment	Extra Payment	Total Payment	Principal	Interest	Ending Balance
1	4/1/2008	$ 1,800,000.00	$ 45,708.17	$ -	$ 45,708.17	$ 18,708.17	$ 27,000.00	$ 1,781,291.83
2	7/1/2008	1,781,291.83	45,708.17	-	45,708.17	18,988.79	26,719.38	1,762,303.04

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Bargain sale depreciated real estate #3

- Dr. Gerber sale of medical office building
- Appraisal - $590,000

No Bargain Sale			Capital Gain	Taxes	
FMV	$590,000	100.00%	$331,121	$75,330	Federal and State taxes
Expense (5%)	$0				
Loan repaid	$0				
Net to seller	$590,000				
Cost	$258,879	43.88%	**Recapture**		
Basis	$169,599	28.75%	$89,280	$29,239	Recapture taxes
				$104,569	
			Net to Donor	$485,431	

Note: size of gain may force taxpayer into the additonal 2.8% Obama investment tax

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Bargain sale depreciated real estate #3

- Dr. Gerber sale of medical office building
- Appraisal - $590,000

Bargain Sale caclulations for depreciated Real Estate $150,000 purchase price				
		Percentage		
Fair Market Value	$590,000	100.00%	Caital Gains Rate	15.00%
Loan Consideration	$0	0.00%	Depreciation Tax Rate 25% fed+7.75% NC	32.75%
Original Cost	$258,879	43.88%	State Income & Capital Gains Rate	7.75%
Depreciated Cost Basis	$169,599		Individual Marginal Tax Rate	25.00%
Bargain Sale Price	$150,000	25.42%		
Charitable Deduction	$440,000	74.58%		
Note: Hospital total cost	$150,000			

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Bargain sale depreciated real estate #3

- Dr. Gerber sale of medical office building
- Appraisal - $590,000

Bargain Sale Adjustment			Deduction	Bargain Price	Capital Gain	Rate	Taxes	Tax Savings	3% adj
FMV	$590,000	100.00%	$440,000	$150,000	$22,698	22.75%	$5,164	$373,418	$11,203
Cost	$258,879	43.88%	$193,062	$65,817	**Recapture**			32.75%	
Basis	$169,599	28.75%	$126,481	$43,118	$22,698	32.75%	$7,434	$122,294	
Recapture	$89,280	15.13%	$66,582	$22,698		Total Taxes	$12,598		
Recapture deduction from gift amount					$66,582		**Net taxes**	**-$109,697**	
Based on adjusted gross income of $165,900 and a 30% of AGI deduction limit							**Net to Donor**	**$259,697**	

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Real estate CGA case study #4

- Why a gift annuity strategy?
- Donor objectives
- Charity objectives
- Evaluation strategies
- Decision matrix
  - CEO, CFO, Board, Development
- IRS requirements
- Detail information in Newsletter at link--
  - www.connellandassoc.com/Newsletters/October2012issue.htm

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Real estate CGA case study #4

- June is a 85 year old
- Recently widowed
- Good health
- Financially secure
- Prior experience with gift annuities
- Florida resident considering relocation to be closer to family/friends
- Considering retirement community

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Real estate CGA case study asset #4

- Built in 2004
  - 3 bedrooms
  - 2 baths
  - Large lot
- 2,500 square ft
- Appraisal #1
  - $180,000
- Appraisal #2
  - $185,000
- No mortgage

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Real estate CGA case study asset #4

CHAPTERS
HEALTH SYSTEM℠

- Hospice that took care of deceased husband
- First real estate gift annuity
- Guidelines
  - FMV discount 10-15%
    - Considered outright gift, fully deductible
  - Rate discount -.05% of ACGA rates to max of 7.0%

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Proposal and Memorandum of Understanding

- Rights and responsibilities of each party
- FMV of asset for annuity $164,250
  - Average value of two appraisal $182,500
  - 10% discount = $18,250
  - Net value $164,250
- ACGA annuity rate for age 85 = 7.80%
- Maximum rate offered = 7.0%
- Two charitable deductions
  - One for discount $18,250
  - One for gift annuity $101,666
- Skip first short payment

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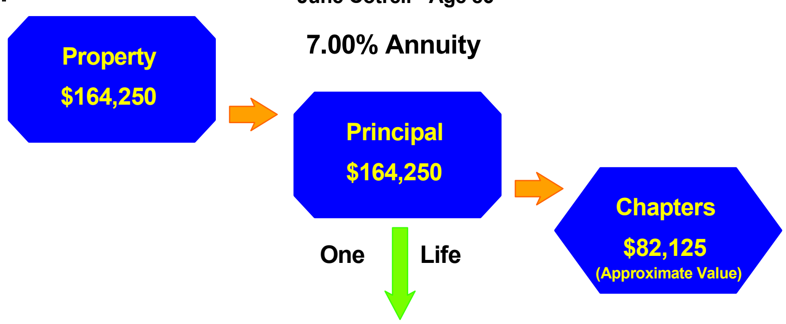
Charitable Gift Annuity

June Cotrell - Age 86



1. Gift property to charity. Donor receives contract for annuity payments. Income tax deduction of $101,666 may save $25,417.
2. Annuity of $11,497.52 for one life. Tax-free amount $9,772.89. Estimated one life payout of $81,632. Effective payout rate 10.6%.
3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.

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Real estate CGA case study #5

- David and Peggy
- Active retirees, ages 77 and 80

- Moving from NC to MD into a retirement community for her health reasons
- Former marketing executive, one son employed by world bank in India
- No gift annuity experience
- David initiated call to retirement community on what they could do if they gifted home for life income
- Preliminary attorney suggest gifts that were unworkable
  - **Issues**
- Retirement Foundation contracted with consultant

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Real estate CGA case study #5

- Home listed for sale, $650K, $625K, then $599K
- Local attorney recruited for paperwork
- One personal visit, balance by email and phone

- Complete by December 31st
- Solution: 90%-10% CGA, 5% payment
- Foundation attorney drafted CGA agreement
  - **Issues**
- Appraisals $549K & $540K
- Sale price $525,000, two years
- Two deductions:
  - 10% outright gift, $54,900
  - 90% gift annuity, $232.844

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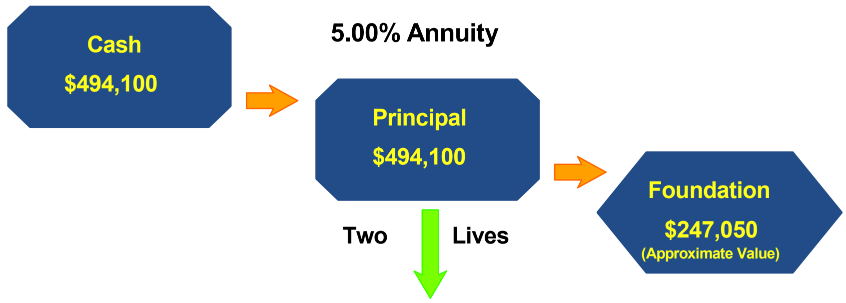
Charitable Gift Annuity

David B. - Age 77 Peggy B. - Age 80



1. Gift property to charity. Donor receives contract for annuity payments. Income tax deduction of $232,845 may save $58,211.
2. Annuity of $24,705.00 for two lives. Tax-free amount $18,800.51. Estimated two lives payout of $370,575. Effective payout rate 7.1%.
3. Quarterly payments for two lives. Property passes to charity with no probate fees. There are also no estate taxes, if married.

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Real estate CGA case study #6 18 month deferred annuity

- Charity agrees to pay fixed guaranteed annuity using 80% - 85% of the property value
- *Payments begin 18 months from closing or beyond*
- Deferred payment increases payment
- 0.10% increase for each 18 months
- Deferred payment increases deduction
- Can defer payments beyond 18 months

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Real estate FLIT CRT case study #7

- Created December, 1998 by tax law update
- Mostly used with hard to value property and real estate
- Starts as an net income only CRT
  - Can be makeup or no make up
- When a *trigger event* happens it FLIPs to a standard payment CRT beginning Jan 1 of the year following the trigger event
  - Trigger events may be any event: sale, retirement date certain, death of beneficiary, etc.

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Real estate FLIT CRT case study #7

- Jim (73)and Anne (69) Crabbe
- Iowa farmland and buildings, 239.69 acres
- FMV appraisal $944,000, cost $194,709
- Strategy: Sale 60% and FLIP Unitrust 40%
  - Cash out $566,640
  - Unitrust @6.50% $377,760, deduction $129,575
- Beneficiaries: 70% Hospital, 30% College
- No trust taxes = $166,881
- 60/40 sale/unitrust = $47,962 net taxes

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Flip CRT income generation

"Valley of Income" in the Post-Sale/Pre-Flip Period

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