

Gifts of Real Estate

Where Local Good Grows

Hendricks County Community Foundation

Gifts of Real Estate–Unlocking Financial Benefits

Many people own long-term, highly appreciated real estate they no longer use or no longer want to manage. In many cases, owners are looking for tax-efficient ways to pass the property on or convert it into an income stream. If you are one of these fortunate property owners, you may want to consider how philanthropy can unlock earning potential, create tax savings, and make an important difference to our work.

Why Make Real Estate Gifts?

Before thinking about ways to benefit charity, consider the real estate you own—a personal residence, vacation home, farmland, rental or investment property, office building, undeveloped land, inherited property—and consider these questions:

- Do you plan to move or stay in your home?
- Is the property more than you want to own? Are there headaches associated with managing or maintaining the property?
- Is the property generating appropriate rental income?
- If you sell the real estate, will you incur a significant capital gains tax?
- Would you like increased cash flow?
- Do you want a charitable deduction to shelter income?
- Is it a good idea to convert a non-performing asset into an income stream?

After you have clearly defined your goals, you will be in a better position to select the gift option that best fits your needs. Let's look at some possibilities.

Benefits of Outright Gifts

When you make an outright gift of real estate, you can claim an income tax deduction for its current fair market value if you itemize, subject to annual limits on the charitable deduction based on your adjusted gross income. You can claim this deduction in the year of your gift, and you have five subsequent years to claim any deduction that exceeds the limitation. You also avoid capital gains tax on a gift of long-term appreciated property (property held for more than one year). Finally, you remove the donated property from your estate, thus bypassing any potential federal estate tax.

Subdivided Property Gifts

You may subdivide real estate and make an outright gift of one or more of the parcels. You qualify for an immediate income tax charitable deduction for the gift and retain ownership of the land you wish to keep. The property subdivision option may also be attractive in situations where a gift of the entire property would create a deduction that is greater than the maximum deduction allowed in the year of the gift.

Gift with a Retained Life Estate

Under a life estate gift, you retain the right to live in or use the property for the remainder of your lifetime. Upon your death, the property is transferred to us and the gift is completed. A current income tax charitable deduction is allowed for your gift based on the present value of our remainder interest.

Even after you make this gift, you can explore options should you decide you no longer wish to live in or use the property. If you decide to relocate, you may want to donate your life estate to us, which would generate another income tax charitable deduction.

Gifts through a Will or Trust

You may transfer real estate to us through your will or trust. While a gift in your will does not generate income tax savings, it can qualify for an unlimited estate tax charitable deduction.

Gifts That Provide Income

You can also make real estate gifts using arrangements that pay an income for life or a term of years.

Charitable Remainder Trust
Charitable remainder trusts (CRTs) are one of the most popular gift planning techniques. By funding a CRT with real estate, you can postpone or spread out capital gains tax liability. The trustee sells the real estate and invests the proceeds in a diversified portfolio of stocks, bonds and other investments. The trust will pay an income to you (and/or others designated by you) for life, or for a term up to 20 years. You qualify for an immediate income tax charitable deduction for the present value of our remainder interest and reduce any potential estate tax liability by removing the asset from your estate.

EXAMPLE: Andrew is a 72-year-old widower whose wife had been a generous supporter of our programs and services. Andrew wants to establish a gift in her memory by creating a charitable remainder trust. Discussing the matter with his advisor, Andrew admits he no longer wants to contend with the constant maintenance and tenant problems associated with the commercial real estate he owns, which was recently appraised at $400,000. He decides to use the property to fund the CRT.

Andrew chooses a 5% payout for the charitable remainder trust. This means that every year, the trustee will assess the value of the trust assets and then pay him 5% of the total. Currently, the commercial real estate generates about $10,000 a year, or 2.5% of the current property value. The charitable remainder trust payout effectively doubles that annual return.

Of course, Andrew qualifies for an immediate income tax deduction for his future gift to us. The remainder is the amount expected to be in the trust at the end of the term—in this case, $224,352. If deduction limits prevent Andrew from deducting the full $224,352 in a single year, he can carry the deduction forward up to five successive years.*

Andrew originally purchased the property 30 years ago for $80,000. If he sold the property, Andrew would have realized a capital gain of $320,000 and paid taxes of $76,160 (20% capital gains tax rate, plus the 3.8% Medicare surtax on investment income). But, transferring the property to a charitable remainder trust does not trigger capital gains.

* Based on an AFR of 3.6% and an annual payment. This rate changes monthly and will affect the amount of the deduction.

Installment Bargain Sale

In appropriate circumstances, you may want to think about selling real estate to us for less than its fair market value. This is called a "bargain sale"—part gift, part sale. It provides you with immediate payment for the sale amount plus an income tax charitable deduction for the gift portion (the difference between the purchase price and the fair market value). You also avoid tax on a portion of the capital gain.

This option can be particularly useful when you need cash. It's also possible to arrange a bargain sale so that you receive cash up front and income for life or a period of years. When a charity pays the bargain price in installments, you receive a periodic cash flow—spreading gain over the payout period.

EXAMPLE: Mary paid $100,000 for 20 acres of unimproved real estate now appraised at $500,000. There is no debt on the property, and the location is attractive to us as a possible future building site. We agree to purchase the

property for $300,000 and to pay that sum in equal annual installments over 10 years.

The remaining $200,000 in value is Mary's gift to us, for which she receives a charitable income tax deduction if she itemizes. In her 35% tax bracket, the $200,000 charitable deduction will result in federal income tax savings of $70,000.

As in any bargain sale, Mary's $100,000 basis must be allocated between the gift and the sale portions of the transaction. Here, $60,000 is allocated to the sale portion and $40,000 to the gift portion. Mary's taxable gain on the sale portion is $240,000 ($300,000 sale price minus $60,000 allocated basis). Recognition of this gain for tax purposes is spread over the installment payment period. Mary will receive payments of $30,000 per year, and $24,000 of each payment will represent taxable gain.

Important Considerations in Planning Gifts of Real Estate

A gift of real estate requires special considerations. For us to accept real estate as a gift, the property must be saleable or suitable for our use. Here are some benchmark considerations associated with real estate gifts:

Marketability
Most outright gifts of real estate must be readily marketable. If the gift will fund a charitable remainder trust that provides income for you or your loved ones, a sale of the property is appropriate when the property does not provide income. Note that current law prohibits donors from agreeing to sell the property to a third party prior to donating it to us or to a charitable remainder trust.

Professional Appraisal
The IRS requires an appraisal from a qualified appraiser to substantiate the value of property claimed as the basis for a charitable deduction over $5,000.

Environmental Review
A gift of commercial real estate often requires at least a preliminary environmental review to ensure that the property is not subject to contamination. This may involve a site reconnaissance and inspection of town and state records, or securing the services of an environmental testing company, or having a survey prepared to determine the boundaries of a property. Gifts of residential real estate usually require a thorough inspection.

Other Considerations

Donated property should generally be free of debts, liens, mortgages, etc. A donor may need to transfer debt to another property or pay it off prior to donation. The property should be properly zoned for marketability purposes. The transfer of title usually requires a warranty deed.

If you are considering a gift of real estate, consult your advisors (attorney, accountant, etc.) and our development office. We can discuss the suitability of the gift and provide you and your advisors with detailed illustrations describing the potential tax savings, available income, and other advantages of specific gift plan ideas.



Let Us Hear from You

Gifts of real estate offer important opportunities to make large, meaningful charitable gifts and to enjoy substantial tax and financial benefits. The key is careful planning. To find out more about the exciting opportunities available to you through a gift of real estate, we invite you to contact our office. Be assured that you can explore the benefits without obligation and that your inquiry will receive prompt attention.

OUR MISSION:

The Hendricks County Community Foundation partners with generous people to realize their charitable goals while addressing community needs in meaningful and lasting ways.

OUR VISION:

Hendricks County is a vibrant, giving community.

Where Local Good Grows

Hendricks County Community Foundation

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