Real Estate Gifts: Benefiting Future Generations Through Philanthropy

~ Erin H. Christy

Through generations of families, Florida has become a place to retreat from cold winters and large cities. As a result, many homes in Florida are not the homes families grew up in or are second homes to enjoy and use seasonally. Florida's home prices continue to rise, making real estate a significant portion of any estate. What do you do when your children do not want the burden of real estate, already own a home, or have a vacation home elsewhere they prefer to visit? Planning ahead to give the property to charity can help reduce stress on you and your family by reducing the responsibility and costs of ownership.

For those who are charitably inclined, real estate gifts are often overlooked because they can be complicated. However, careful planning allows a family to achieve its philanthropic goals by leveraging a significant illiquid asset or avoiding the payment of capital gains taxes on appreciated property, all while lifting the burden of disposing of real estate after the owner's death.

If you have a home or vacant land that isn't being used, are living in a home you plan to stay in but you do not plan to pass on to your family, or you have no abundance of liquid assets but would like to make a gift that supports your passions, you may consider a gift of real estate and discuss it with your legal and tax advisors.

There are various ways to gift real estate, and based on your own circumstances, some ways will make sense while others may be impossible to accomplish. Many organizations require property to be mortgage-free before accepting a gift; therefore these examples will assume the property is unencumbered by a mortgage. For simplicity's sake, we will also assume the gift is to a public charity rather than to a private foundation.

Outright Gift

The simplest way to donate a gift of real estate is to make an outright gift of the property directly to a charity. Real estate is a capital asset, which means if you experienced high appreciation over your cost basis (the amount for which you purchased the property), there can be significant tax liability for you when you sell the property. By using real property as your charitable gift, you can avoid payment of the capital gains taxes that would apply at the sale of the property.

If the property is an appreciated long-term capital asset, meaning you have held it more than one year, the gift of real estate can entitle you to a tax deduction for the full market value. The deduction is generally limited to 30 percent of your adjusted gross income, with a five-year carryover period for any amount that exceeds the 30 percent ceiling.

Although this is the simplest way to achieve a gift of real estate, many families need additional flexibility regarding their real estate.

Gift with Retained Life Estate

Another option allows you to stay in your home during your life—or your life and another person's life—and contribute the property to a charity when you and that person no longer need the home. You can accomplish this and still achieve an immediate income tax deduction. With a gift of this type, the property must be a personal residence or farm, but it does not have to be a primary residence. For example, you may donate a vacation home you use but one that won't necessarily be used by your family after your lifetime. Unlike an outright gift, a life estate allows you to retain the right to use or rent your home during your lifetime, while you remain responsible for the regular expenses of maintaining the property, including insurance, property taxes, maintenance fees, and repairs.

A life estate also allows for greater flexibility because you can decide at any point to vacate the property and either gift it to the organization at that point or work with the organization to sell the property together and split the proceeds with the organization. Each situation carries different tax implications you and your legal and tax advisor should consider in your larger estate plan to determine what is best for you.

A gift of a remainder interest to charity with a retained life estate requires that you prepare a deed to the organization, one that reserves to you, as the donor of the property, an interest for life in the property. This deed is generally accompanied by an agreement with the organization, outlining the rights and responsibilities of each party. The gift agreement should consider real estate taxes, major repairs, natural disasters, and other circumstances that may affect maintenance of the property prior to the organization taking full ownership. Your family and the organization can prepare for a smooth transition by working with legal counsel to prepare this agreement.

Bargain Sale to Charity

A bargain sale to charity is characterized as part sale and part gift. In a bargain sale of real estate, you sell your home to the organization for less than it is worth. This type of real estate gift is best if you wish to make a major contribution to an organization but would also like some return of cash from the sale of the property.

For example, let's say you own a house next-door to a charity that must expand its facility. You wish to make a significant gift to the charity but also want to receive income from the sale of the property. You can sell the house to the organization for less than it is worth, and while you can expect some income tax liability, it should be accompanied by an income tax deduction.

For a bargain sale to qualify as a charitable deduction, there must be an acknowledgement letter from the charity stating the amount the charity paid for the property, a qualified appraisal, and donative intent. If these three requirements are not met, you may experience a greater tax liability because the bargain sale will not be considered a charitable gift. It is important to understand you cannot offer to sell your property to a nonprofit, negotiate endlessly, settle on a reduced sales price, and then claim a bargain sale for a charitable deduction. All gifts require a genuine desire to be charitable: in this case, however, you may need to prove actual intent to the IRS to claim the deduction.

Flip Charitable Remainder Trust

Another way to produce income for a donor through a transfer of real estate to a nonprofit is through a flip charitable remainder trust, which is often considered the best vehicle for an illiquid asset like real estate. A flip charitable remainder trust can be set up to make lifetime payments to you or any other recipient you name, with these payments beginning after you sell the property. At the time of your death, the charity receives the remainder in the trust. This type of gift requires careful planning, but it can allow you to make an immediate gift to a charity, avoid immediate capital gains taxes that would have applied through a traditional sale of property, receive an immediate income tax deduction for part of the value, generate income for you, and reduce the burden of property taxes, maintenance, and other costs associated with maintaining the property.

Practical Considerations

Gifts of real estate require careful planning. Qualified legal and tax counsel can assist in making sure the gift accomplishes the goals of both you and the charity. There are practical considerations that are also important—ones you should anticipate before you make this decision.

Making a gift of real estate will take more time than an outright gift of cash because you must arrange to transfer the property and allow time for the organization to review and accept the gift. The charity will take into consideration the marketability of the gift and the usefulness of the property if it's not marketable. It will likely require a gift agreement that may go through several drafts between you and the charity before you finalize it. You and the charity must also consider the carrying costs, transfer taxes, and other ramifications of gifting property, things that are not factors in a cash gift.

Consider the following items if you are thinking of making any gift of real estate to a charity:

Description of the property. Whether the property is a personal residence, a vacant lot, a commercial building, a farm, or even grove land may determine the best option for the potential to use it as a charitable gift. Talk with your attorney about the type of gift that is best for your specific property.

Ownership of the property. There are several ways to own property, and how property is owned carries different rights and tax consequences. Property owned only by an individual may enjoy different opportunities than property owned together with a business partner or in trust with a spouse.

Date and cost of acquisition. Whether the property is a long-term capital asset or short-term capital asset can greatly affect the tax benefits you and your family enjoy. It will also be important to understand the appreciation or depreciation the property has experienced in determining the most beneficial type of gift for you and for the charity.

Appraisal. A qualified appraisal is needed for most types of gifts of real estate. Not only will the IRS require a qualified appraisal to determine tax consequences, but the charity will also use the qualified appraisal to determine its ability to accept the gift and to determine the most appropriate recognition for you in honor of the gift. The appraisal must distinguish between the value of the land and the value of the building (assuming there are improvements) if the gift is to be a retained life estate, because those values are both considered separately in determining the tax deduction you enjoy. The IRS expects the qualified appraisal to meet certain requirements, as well.

A charity may also need to understand how the property was acquired by the donor; the annual property taxes; how the property is zoned; whether or not the property is subject to restrictions, easements, or liens; and whether the property is occupied by a tenant.

Qualified legal counsel can assist you and the charity in building a checklist appropriate for the type of property you wish to gift and the gift structure you arrange.

While gifting real estate requires more careful consideration than a cash contribution, a donation of this kind can provide not only an immediate income tax charitable deduction and the avoidance of capital gains taxes, but it can also ease the burden of dealing with real estate matters for your family while it provides a lasting legacy for a charitable organization of your choice for generations to come.

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