

Giving Real Estate

Contributions of real property represent one of the most complicated yet rewarding opportunities in charitable gift planning.

Amount of Donor's Charitable Contribution

Several characteristics of the property being given are taken into account in order to determine 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 a year) to a "public" charity, the amount he or she generally can claim as a charitable contribution for federal income tax purposes is 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).

Put a somewhat different way, 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 tax rate of 25 percent if the property were sold.

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).

If the claimed value of the property is more than \$5,000, the donor must obtain a qualified appraisal to support his or her claim of an income tax charitable deduction with respect to the gift. See Part B IRS Form 8283 and instructions and Reg. section 1.170A-13(e). If a deduction of more than \$500,000 is claimed, the qualified appraisal must be attached to the return when filed. See Code section 170(f)(1)(C) and (D).

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 other 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).

The interplay of the 60% and 30% limits and the carry-over rules establishes a hierarchy for deducting various types of gifts.

A Special Election

A contributor 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.

For example, the donated asset may be only slightly appreciated. Or the donation might be quite large relative to the donor's income, with the result that a large portion of the gift will have to be carried over into years when,

because of retirement or other circumstances, the donor will not be able to make the best use of deductions.

A donor in these circumstances may wish to avail himself or herself of a special election under IRC section 170(b)(1)(C)(iii). The election permits the donor to deduct all “30% gifts” at cost basis, but to take the reduced gifts as a charitable deduction subject to the higher limitation.

If the charitable contribution for a gift of appreciated real estate is reduced to the donor’s adjusted basis in the property because depreciation in excess of straight line has been claimed with respect to the property, this election makes it possible for the donor to deduct the adjusted cost basis of the property in an amount up to 60% of AGI, as if it were a gift of other property. See IRC section 170(b)(1)(A).

The election can be useful in some situations. However, it needs to be considered carefully because it applies to all gifts otherwise subject to the 30% limit (including carried-over contributions). The election cannot be made with respect to certain 30% gifts but not to others.

Substantiating 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, within three years of the date of gift, sells or otherwise disposes of donated property for which it has signed a IRS Form 8283, 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).

Requirements for a qualified appraisal: Full details of the requirements an appraisal must meet to be a qualified appraisal are beyond the scope of this discussion. Nonetheless, it is worth noting some of the items of information that, by definition, must be included in a qualified appraisal:

- The date or expected date of gift.
- The appraised fair market value on the date or expected date of gift.
- The appraiser’s tax ID number.
- A statement that the appraisal was prepared for federal income tax purposes.
- A description of the appraiser’s background, education, experience, and membership (if any) in professional appraisal associations.
- A description of the fee arrangement between the donor and the appraiser. See Reg. section 1.170A-13(c)(3)(ii).

In order for an appraisal to be a qualified appraisal, it must be obtained no earlier than 60 days before the date of gift and no later than the day before the due date of the income tax return on which the gift is first claimed or reported. Due date includes extensions of time to file the return. See Reg. section 1.170A-13(c)(3)(i)(A).

Substantiation rules: Special receipts are now required for gifts of cash or property valued at \$250 or more. This requirement does not affect the qualified appraisal rules described above. Donors should keep all receipts and letters of acknowledgment in order to substantiate their deductions. See IRS publication number 526 and 1771.

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 term personal residence is not limited 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 property).

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

This gift arrangement can be an ideal way for an individual or a couple who plan to eventually leave a farm or personal residence to a charitable interest to do so while enjoying immediate tax benefits and the use of the

property for lifetime or other period of time they choose.

Gifts of Real Estate with Retained Income

There are several ways that real estate can be donated for charitable use in such a way that a donor retains income for life or other period of time for himself and/or others of his choosing. Perhaps the most popular way to accomplish this result 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 a number of types of charitable remainder trusts. Fixed payment 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. The so-called straight unitrust pays a predetermined percentage of the value of the trust assets as valued annually. The 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 percentage payment amounts in one or more previous years, from 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 if ever funded with real estate. The vehicle of choice has traditionally been the net income unitrust with or without a makeup provision, as the donor chooses. Final IRS regulations issued in December 1998 provide guidelines for another option known as a flip unitrust. Under the terms of such a trust, assets such as real estate that are not readily marketable may be placed in a unitrust that functions as a net income trust until such time as the property is sold, or upon the occurrence 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 occurrence of the trigger event. See Reg. section 664-3 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 utilizing gifts of real estate as a funding source depending on state regulations, marketability of property and other factors.

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. The reason is that 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 does realize a portion of the appreciation as a capital gain.

Bargain sale formula: The amount of gain (G) realized when mortgaged property is given outright to a charitable organization can be determined using this formula:

$G = (FMV - B) \times (M/FMV)$, where:

- “FMV” is the fair market value of the donated property.
- “B” is the property’s adjusted basis in the donor’s hands.
- “M” is the amount of the mortgage debt. See Reg. section 1.1011-2(b).

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 $(\$100,000 - \$40,000) \times (\$20,000/\$100,000)$, or \$12,000.

The donor is also entitled to claim a charitable deduction of \$80,000 — his or her 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.

Most important, however, is the rule that no income of a charitable remainder trust may be used to pay mortgage debt on which the donor is personally liable. For this purpose, "income" includes realized capital gain as well as ordinary income such as dividends and interest. See Reg. section 1.671-2(b).

The reason for this rule is that payment of the donor's personal obligation by the trust would cause the trust to be a "grantor trust" under IRC section 677; by definition, a grantor trust cannot be a charitable remainder trust. See Reg. section 1.664-1(a)(4).

Special Considerations for Property Worth More than the Exclusion Amount

In the wake of the Taxpayer Relief Act of 1997, it may be wise to consider donation of property that is worth in excess of the \$250,000 per person exemption for gain on the sale of principal residences. Such property may be especially well suited for funding life income gifts, as it is no longer possible to roll over gains to new homes of equal or greater value.

Donation of a Real Estate Limited Partnership Interest

A donation of a limited partnership interest in a partnership holding real estate can bring into play various rules already covered, including the qualified appraisal rules and the bargain sale rules (i.e., if the partnership property is subject to mortgage debt).

A broad discussion of the tax consequences of donating limited partnership interests is beyond the scope of this publication. It is worth noting, however, that because a limited partner generally bears no personal liability for partnership debt, it is sometimes feasible to use a limited partnership interest to establish a charitable remainder trust (something not generally feasible, as indicated above, in the case of property subject to a mortgage on which the donor is personally liable).

Miscellaneous Planning Considerations

Buyer-in-the-wings: A common problem encountered in planning a gift of real estate is that 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 general notion that the donee (or trustee) is a mere conduit for carrying out a prearranged sale.

For the donor's protection, 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 so-called stage 1, or phase 1, audit) of the property is often performed.

Conclusion

Charitable gifts of real estate generally involve more tax and other legal complexities than other types of donations.

Over the years, however, such gifts have provided substantial benefits to both donors and donee organizations.

If we may be of assistance in planning a gift of real estate, please do not hesitate to contact us.

For further reading, see also from the Planned Giving Design Center:

Technical Reports:

- [Real Property](#)
- Life Estate Agreements

Articles:

- Gifts of Real Estate
- What to Do With the Empty Nest?
- Accepting and Retaining Gifts of Farmland

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