The Power of a Complex Gift

Complex gifts of real estate can fulfill clients' philanthropic aspirations and community needs in a deeply personal way. Because tax obligations from real estate donations can complicate these gifts, advisors need to be vigilant to ensure that they are suggesting a giving strategy that benefits the charity, affords maximum tax benefit to the client, and also meets the client's financial and charitable goals.

For many donors, gifts of real estate may be ideal for donor-advised funds or charitable annuities. If the property being given has appreciated greatly, selling it will result in a capital gains tax for the donor. Leaving it to heirs can increase estate tax liability. If the property has been owned for some time, figuring out the adjusted cost basis upon which capital gains are calculated can be difficult. By giving these gifts to a public charity—either directly or through a donor-advised fund—or by funding a charitable annuity, donors can avoid the capital gains and estate tax burden, and can often claim a deduction based on the full fair market value of the asset.

Fulfilling Charitable Wishes

Bert Whitehead, J.D., M.B.A., president of Cambridge Connection, a fee-only planning firm based in Phoenix, recently helped a couple donate property to their local community foundation. "Last year, two clients of mine decided to parcel their farm into lots that would then be sold to various buyers," he says. "The farm, which they'd bought for a song 30 years ago, was now worth $5 million."

The charitably inclined couple wanted to make money off the sale, but also offset some of the capital gains. Whitehead advised them to donate one of the lots to the Capital Region Community Foundation, based in Lansing, Michigan, where they could satisfy a philanthropic goal and reduce their capital gains tax obligation.

Whitehead says that real estate donations work well when they are handled on a local basis, where the community foundation knows the donors, the land, and can learn about prospective buyers. Because the couple had supported the community foundation in the past, the gift was a natural fit.

Caprice Bragg, vice president for gift planning and donor relations at The Cleveland Foundation, notes that advisors need to query philanthropic-minded clients about illiquid assets that could be put to charitable use. "It's important to review how a gift of real estate can fit into an overall estate plan," says Bragg. "Because of the complexity involved, the foundation plays a role on a larger team that includes the donor, financial advisor, and attorney or CPA."

Bragg recently had the honor of working with sisters Betty and Jean Fairfax, longtime philanthropists and former Cleveland residents, with a special commitment to social justice and low-income and minority education. After reading an article in The New York Times about the challenges facing the Cleveland schools, the sisters were inspired to help. In 2002, they donated a residential property in Arizona to The Cleveland Foundation, using the proceeds from its sale to establish a charitable gift annuity, as well as the Betty H. and Jean E. Fairfax Fund in Support of Public Education. The sisters were able to claim a charitable deduction, will receive income for

life, and at death, the remainder will revert to the Fund.

Avoiding Pitfalls

Charities should proceed with caution when dealing with real estate. For one, if the property is going to be sold, the community foundation should perform due diligence to ensure that the property is saleable. "We don't hold or manage property, so we need to be sure we can sell it relatively quickly," says Bragg.

The timing of the gift can also be an issue. While a donor may take steps to line up a possible sale before the donation, the donor cannot go too far towards completing the transaction. "Donors may list a property, but they cannot accept an offer to purchase before gifting the property to charity, according to IRS regulations," says Whitehead. In the example of the parceled farm land, the donors already had a buyer in mind, but Whitehead made sure they did not sign a contract before they gifted the property, because that would have voided the charitable transaction. Also, real estate that is subject to a mortgage or other debt will reduce the deduction available.

Donors must obtain a qualified appraisal if they are claiming a charitable deduction of more than $5,000. This information is reported by the donor on Form 8283. In addition, the charity must complete Form 8282 if it sells the asset within two years after receipt of the gift. These forms are designed to prevent inflated appraisals and to ensure that the donor did not claim too high a deduction.

Because the rules around appraisals are so complicated, advisors should bring in not just an appraiser, but experts who specialize in the disposition of such assets.

While more documentation is required for noncash gifts such as real estate, the payoff, in terms of savings from capital gains taxes and the ability to assist clients to achieve their philanthropic goals, can be even greater.

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