Please Note:

Issues of *Futures* appear as they were originally published. Information in these publications has not been updated to reflect changes that could affect calculations given in case examples.

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THE DAYTON FOUNDATION
We're here for good.

Futures

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A no-nonsense newsletter for estate planners and financial advisors from The Dayton Foundation

Real Estate and Charitable Intent: How They Equate

By Alan B. Schaeffer, Esq., and John E. Clough, Esq., Pickrel, Schaeffer & Ebeling Co. L.P.A.

"…cash and cash equivalents… are not the only methods by which a client can make a charitable contribution to The Dayton Foundation. …An excellent one… would be real estate."

ALAN SCHAEFFER, ESQ.

JOHN CLOUGH, ESQ.

When we think of making a donation to The Dayton Foundation, typically we think of cash or cash equivalents, such as appreciated stock.

For the donor, the gift of cash is a dollar-for-dollar transaction. The donor gives a dollar. The Foundation receives a dollar. Nothing more, nothing less.

A gift of appreciated stock to The Dayton Foundation, however, has all kinds of interesting advantages that go along with the gift.

This is how it works.

- The donor gives stock (which he had owned for more than one year) worth $10,000 to The Dayton Foundation.
- The donor has a basis of $1,000 in the stock gifted to The Dayton Foundation.
- Upon receipt of the appreciated stock, The Dayton Foundation sells it for $10,000.
- The donor would be entitled to a $10,000 charitable deduction against income, subject to a limitation of 30% of donor's adjusted gross income in any one year and a maximum five-year carry forward.
- The donor pays no tax on the $9,000 built-in gain the donor had in the stock.
- The Dayton Foundation gets $10,000 and pays no tax on the transaction.

If the donor sold the stock first, the donor would pay capital gains tax on the $9,000 gain, leaving something less than $10,000 the donor could gift to The Dayton Foundation. The benefits of a direct gift of appreciated stock to The Dayton Foundation are obvious. It is what makes such gifts so popular with donors and with The Dayton Foundation.

Do the same benefits flow to illiquid appreciated assets? The answer is YES!

Appreciated objects of art – and what this article is all about, real estate – come to mind as two obvious illiquid assets that can be used to make gifts to charity. An excellent one to gift to The Dayton Foundation would be real estate.

Gifts of Real Estate

Real estate comes in all shapes and sizes, and is used in a myriad of ways: unimproved, improved, residential, retail, commercial, industrial, warehouse, etc.

The common denominator between stock as a gift and real estate as a gift is the "appreciation." It is the appreciation that is sheltered in any such gift. Remember, in the above example of the gift of appreciated stock, the donor effectively sheltered all of the gain in that stock. The same concept applies to the appreciated real estate asset.

The concept of appreciation as it relates to stock is really a very easy one. The concept of appreciation as it relates to real estate, however, requires a bit more thought and, from The Dayton Foundation's perspective, definition.

Appreciated real estate that is highly leveraged (mortgaged up to/close to its fair market value) is certainly an appreciated asset. The debt needs to be paid, however, before the property is gifted. Once the debt is paid off, there may be very little in actual cash left to gift. Let's look at a more detailed example.

An Example

- Donor owns improved real estate, which donor occupies with his business.
- The real estate has a fair market value of $500,000.
- The real estate has a basis of $100,000.

Assuming that after the exercise of due diligence, the Foundation determines there are no environmental issues and no title issues, then upon the gift of the real estate by the donor to The Dayton Foundation, the donor could be entitled to a charitable deduction

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for the amount of the fair market value ($500,000) of the property contributed.

Being real estate, it should be noted that the total deductible amount may be subject to reduction for ordinary income recapture and the 30% limitation. To the extent the deduction is limited by the 30% rule, the donor will be allowed to carry the excess forward for a maximum of five years.

- The Dayton Foundation (after it sells the real estate) will have $500,000 to be used for charitable purposes as directed by the donor.
- The donor pays no tax on the $400,000 "gain," minus any deductions noted above, being the difference between the fair market value of the property and the donor's basis in the property.

The example assumes a very simple fact pattern, using a highly appreciated developed piece of property as the "gift" property.

Unimproved real estate, agricultural use real estate, as well as industrial, retail, multifamily, single-use property, etc., are all subjects to be considered for gifting purposes.

Collateral benefits can be achieved, if desired, as part of a gift of real estate. At the time of the gift, the donor may desire to create a conservation easement on the property, which will allow the property to remain protected/undeveloped. Although a conservation easement may reduce the value of the property, The Dayton Foundation still will receive value; the donor still will be entitled to a charitable deduction; and the donor's intent to conserve will have been met.

"[The Foundation has] attorneys and accountants on staff, who can converse knowledgeably with professional advisors about a range of giving options…."

– Alan Schaeffer, Esq., and John Clough, Esq.

Working with The Dayton Foundation

Because every piece of real estate, whether improved or not, carries its own unique set of circumstances, The Dayton Foundation has established a policy for gifts of real estate. For instance, The Dayton Foundation's real estate gift policy discourages the gifting of mortgaged property, although it certainly doesn't prohibit such a gift. Also, before a gift of real estate can be finally accepted, the Foundation will insist upon a) an appraisal, b) an environmental phase I report and c) a title commitment sufficient to support an owner's policy of title insurance.

Not all proposed gifts of real estate are going to be appropriate for The Dayton Foundation and not all real estate is an acceptable gift from the donor's perspective. The real point of this article is to plant the seed that cash and cash equivalents, e.g., appreciated stock, are not the only methods by which a client can make a charitable contribution to The Dayton Foundation.

We have found in our work over the years, that The Dayton Foundation is very well staffed with excellent people, who would be happy to assist you. They have attorneys and accountants on staff, who can converse knowledgeably with professional advisors about a range of giving options for clients, including gifts of real estate.

Note: Solutions will differ from case to case. The above does not constitute professional financial or tax advice.

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GiftLaw Now Available Online

The Dayton Foundation is pleased to offer GiftLaw free to professional advisors.

GiftLaw is a web-based gift planning tool for attorneys, accountants and other professional advisors interested in charitable gift planning strategies. GiftLaw provides weekly overviews of new legislation and legislative proposals, summaries of recent IRS private letter rulings, case-of-the-week presentations covering a variety of charitable tax topics, and a charitable gift planning article of the month.

GiftLaw is available on the Foundation's web site, located at www.daytonfoundation.org/giftlaw.html. If you prefer, you may request to receive this information via e-mail. Simply contact Debra Seger at the Foundation at (937) 225-9964 or at dseger@daytonfoundation.org for your free e-mail GiftLaw newsletter.

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