

# A Charitable Address

Donating real estate can be a beneficial strategy for both philanthropists and charities, if the property is easy to sell.

By Lani Luciano

**M**OST YEARS, LYNNE PANTALENA, director of Wealth Strategies for the Private Clients Group at FleetBoston Financial Bank, gets just one or two phone calls from property owners interested in donating a home, land or other real estate to charity, but this year she had received three inquiries by mid-January. By that time Philip Purcell, vice president for planned giving at Ball State University in Indiana, had already conducted two serious discussions with potential donors: one with a BSU graduate about donating his home in northern California, another with a local physician about contributing a nearby wooded tract that could be useful for scientific study.

Neither expert has been surprised to see interest in donating real estate blossom. According to U.S. Federal Reserve figures, the value of household noncash financial assets declined 6.5 percent between 1998 and 2002, while real estate holdings grew in value by 43.3 percent. While the major equity indices soared by over one-third last year, much of the value in many of our portfolios remains in real estate, rather than in liquid securities like stocks—a legacy of the stock market malaise of 2000 to 2002. “Right now, someone who wants to make a significant contribution to a favorite charity might not have the proper cash flow to do it but may have a highly appreciated second or third vacation home that is no longer needed,” says Pantalena.

Real estate donations are often attractive to both sides. The charity receives a donation it might not have otherwise obtained, while we get to deduct the full current market value of the asset on our taxes, and avoid the capital gains tax we would incur if we had sold it outright. We may also benefit from some help with estate planning and—if the gift is structured to generate an income stream—some extra cash flow. This additional capital has become an important benefit as many people find themselves rich in assets but short of liquidity. “Income security has been growing as an element in charitable giving,” Purcell explains.

Virtually any charity will accept a highly saleable property as a gift. As with all major donations, a recognized expert must certify the value of the property, but the paperwork is

not much more tedious than what we encounter when selling a house. The transfer of ownership immediately removes the asset from our taxable estates and the charitable deduction can be taken over as many as five years to avoid possible snags, such as triggering the alternative minimum tax.

However, few philanthropic organizations are in the real-estate management business. They generally want to sell these assets quickly to generate cash to support their work. More than a few would-be land donors have had rude awakenings when charities proved unwilling to accept their gifts of undulating country acreage. Others have assumed they might unload a hard-to-sell piece of land on a worthy cause, thereby escaping the property taxes. It can be especially tough to give away a commercial building or raw land; both generally take a long time to sell. By far, charities prefer donations of single-family homes with fashionable addresses.

## PRISTINE PROPERTIES

Conservation groups occasionally make an exception for truly remarkable properties. In 1994, Richard Wilson, now 73, and his wife, Jean, donated 245 pristine acres of scenic acreage near Flagstaff to the Nature Conservancy. The Hart Prairie Preserve is thick with old growth ponderosa pines, rare wildflowers, elk, deer and more than 40 species of birds. Wilson’s parents bought the property, now worth between \$2.5 million and \$3.5 million, in the 1920s and built a family compound of summer cabins. “It’s just spectacular,” says Anne Nash, the Conservancy’s director of complex gifts, “but fewer properties than you might think qualify for that kind of preservation, and even fewer charities are qualified to accept them.”

No matter how unique and valuable a property, only groups with significant endowments, such as the Nature Conservancy, the Trust for Public Lands, the American Farmland Trust, the Conservation Fund and the Land Trust Alliance, can afford to manage and maintain real estate even for a few years, much less forever. Nash adds that even well-funded conservation groups might simply disagree with a donor on a property’s conservation-worthiness. Without a shared vision, an offer of land for preservation might not find a taker.

If all parties can agree that the property has environmental, historic or other conservation value, it is possible to make a charitable real estate donation without giving up ownership at all. Putting a

**TOP VIEW** | Donating unwanted property to our favorite charity allows us to reap substantial tax benefits and make philanthropic use of assets that have appreciated greatly in value in recent years. But charities are not in the property management business; they seek assets that can be easily sold, and so are reluctant to accept undeveloped land or business properties. Alternatives to outright gifts exist, which may provide us with a stream of income or the ability to continue to live in our donated properties for years to come.

restrictive easement on the deed to stipulate that the property cannot be altered permanently reduces its market value, and the resulting loss can be taken as a tax deduction. Donna Ciuffo, tax partner with Clarfeld Financial Advisors in Tarrytown, N.Y., notes that conservation easements are mainly used for financial purposes. "It's a terrific way to soften the tax bite in a peak earning year," she says, adding that the move still has major philanthropic value. "The property can be sold or passed along, but it can never be exploited or degraded."

#### DOING GOOD AND WELL

Betsy and Alan Carpenter, both 73, are longtime members of the Nature Conservancy and were looking for a way to support its work. "We are strong believers in responsible stewardship of the Earth," says Betsy. "We gave our kids and grandkids lifetime memberships in the Conservancy because we want to pass along that specific value. Unfortunately, some of them ride dirt bikes, which just tears up the land. But we're still hoping."

In 2001, they found their opportunity to support the Conservancy, not by giving land, but by giving through a charitable remainder trust (CRT). In this approach, ownership is not transferred to the charity but to an irrevocable trust, which then sells the property to finance a tax-advantaged income stream payable to anyone the trustee designates.

The Carpenters had already sold a vacation home in the northern California mountains to prepare for their move to a life-care community that will provide access to support services as they age. They were not eager to tackle the sale of their main residence in Los Altos, near the Stanford University campus. "Selling a home is an incredible amount of trouble, especially in California where there are disclosures and a lot of paperwork, plus you have to arrange your furnishings like a stage set to attract buyers," Betsy says. "We just couldn't face it."

Instead, the pair opted to use their home to benefit their favorite cause. The Nature Conservancy set up a CRT according to the Carpenters' specifications and handled all the work of transforming the house into cash.

A CRT, which allows the giver to generate income from a property as well as to make a charitable donation, can be an attractive way to give when a donor is planning retirement, a prime time for contemplating both residential transitions and charitable ambitions, or simply when a portfolio has become too heavy with real estate. Income from a CRT can continue for a set period (though no more than 20 years, or for a beneficiary's lifetime); what remains in the trust after payments to the beneficiary end goes to the designated charity. Anyone can be named as income beneficiaries of a CRT, including children or employees or the trustees themselves, and nearly any tax-exempt organization can be named as recipient of the remainder interest, with a few strictures. The charitable tax deduction can be taken immediately and is calculated on the present, not the appreciated, value of the expected charitable remainder.

As with an outright gift, capital gains tax does not in any way reduce the value of the donated asset, so CRTs can be a highly tax-efficient way to rebalance a portfolio. Income payments are based on the proceeds of the sale of the donat-

ed property, plus actuarial and investment assumptions. The portion of trust assets disbursed to the income beneficiary is discretionary, within regulatory limits, but the greater the anticipated payout, the smaller the charitable remainder and, thus, the charitable tax deduction.

The trust can pay either a fixed percentage of its current assets, reset each year, or a fixed dollar amount. Payments based on a fixed percentage of assets factor in future appreciation, so this approach can offer a hedge against inflation. Fixed-dollar payments offer, at least in theory, a stable income, although if investment returns are inadequate to support the fixed amount, the trust can conceivably run out of money.

The Carpenters' trust will pay them monthly income over both their life times. The decision had no drawbacks, Betsy says. The couple was spared the drudgery of a home sale and got the satisfaction of advancing deeply held values. Their only small regret is timing: "The California market is so volatile, and 2001 was a down year," Betsy explains.

Besides market timing, the other critical ingredient to a happy CRT experience is unimpeachable tax advice. The significant financial benefits of CRTs attract the IRS's close scrutiny. The tax laws on this type of trust fall under the hazy heading of "complex giving," and Clarfeld's Ciuffo describes them as "fraught with pitfalls for the unwary, including reporting and compliance requirements." Financial planning advice is also indispensable because each of a CRT's many variables has wrinkles of its own. For example, annual payouts in excess of five figures to anyone but the donor or spouse will trigger a gift tax.

#### LIVING IN CHARITY

While an unwanted home is the likeliest target for donation, a treasured primary residence can still be a charitable vehicle, even if the donor wants to continue to live there. We cannot receive payments while occupying real estate held in a CRT, even if the charitable beneficiary is able to fund the payments without selling the asset; IRS regulations view this scenario as "self-dealing" and prohibit it. However, in most states we may give a residential property to charity, live in it, and receive an annuity income under a nontrust arrangement combining two contracts: a charitable gift annuity and a life tenancy. (The exceptions are New York, which prohibits this arrangement, and Arkansas, California, Florida, New Jersey and Wisconsin, which restrict it.)

The charitable component of this arrangement is similar to a CRT in that the contribution is calculated as the value of the donated asset net of the payments disbursed. But there is one major difference. Since the donated asset is not immediately sold, the charity must fund beneficiary payments from its own resources, repaying itself when it sells the property at the end of the annuity term, generally after the donor's death.

The financial obligations not only limit the number of charities willing and able to enter into such agreements, they also limit the advantages to donors. There have been cases in which the charity was not able to fulfill its end of the contractual bargain. Still, the arrangement can be useful for an older philanthropist determined to live out his or her days in a beloved home. 