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The Retained Life Estate: A Most Underutilized Gift

Date:	March 25, 2021
Time:	1:00 – 2:30 Eastern
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Agenda

What is a retained life estate?

- Immediate income tax deduction
- Terms of the life estate agreement
- Due diligence, paying for costs
- Donor profile

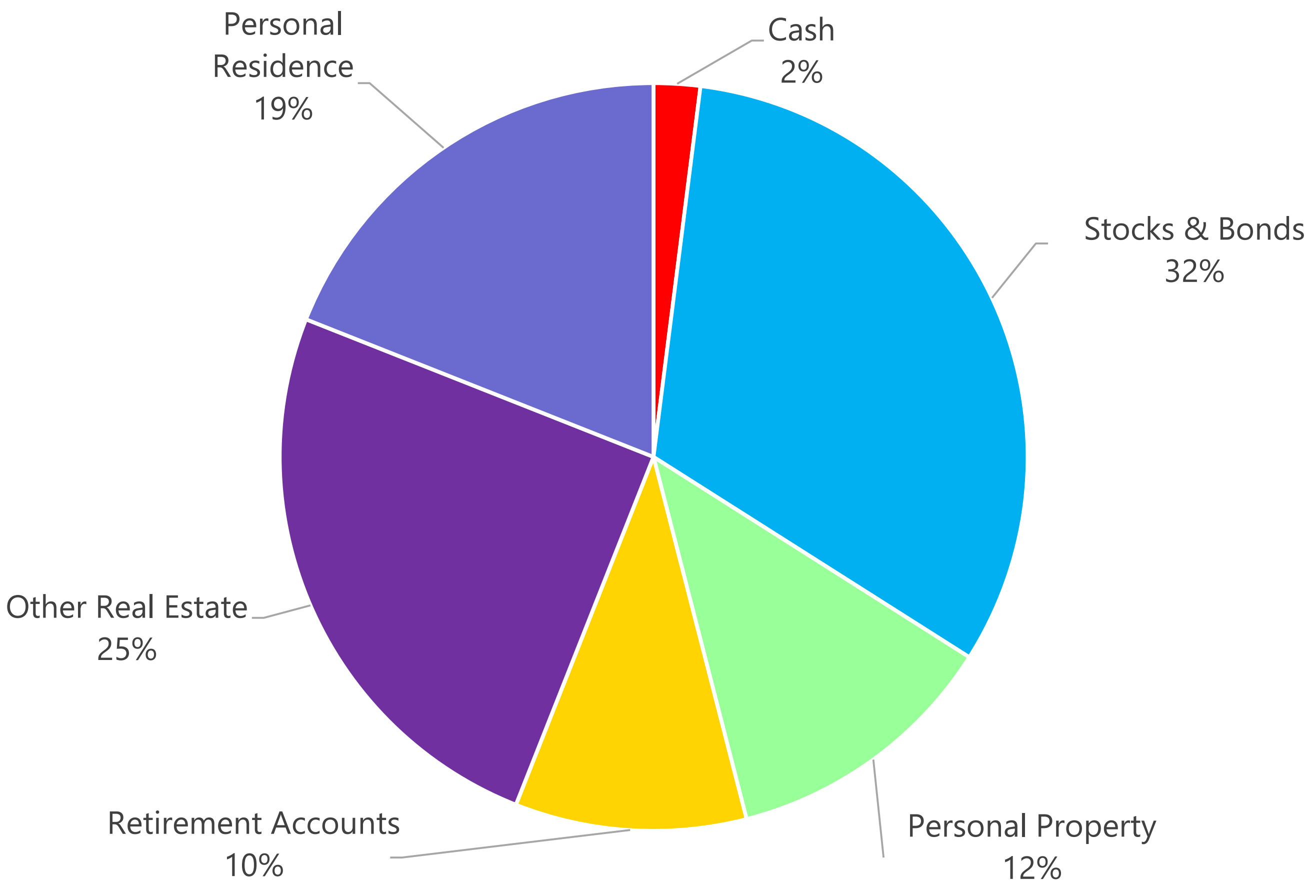
Case studies

- Personal residence
- Farm
- Bonus: life estate + gift annuity

Why Consider A Retained Life Estate?

- Personal residence is often most valuable single asset
- Usually plan to live there for several more years
- "Personal residence or farm" not necessarily "primary"
  - Seasonal or vacation home, perhaps used regularly but with no long-term plans
  - Farm (including the homestead or not)
  - Cautiously: houseboat, condo, mobile home
- Opportunity for charity to acquire properties for future

Show Me The Money



What Is A Retained Life Estate?

- Irrevocable deed given to charitable organization, but donor retains right to live in or use the property
- Essentially, donor gives up nothing now except right to sell the property and receives a charitable deduction
- Usually one or more lifetimes, but can be term of years
- Life tenants can be donor or others, irrevocably specified at the time gift is made
- At the end of the life tenancy, the charity may sell property or retain for its use

What Happens After The Retained Life Estate Is Given?

- Donor remains responsible for expenses of maintenance, taxes, insurance, etc.
- Capital items (those that add value or extend useful life) can be split or be an additional contribution by donor
- What if donor decides to vacate early?
  - Preferred response: “Thanks for accelerating your contribution. Not only will you have the satisfaction of seeing your gift at work now, you’ll get an additional charitable deduction too.”
  - Or, rent or sell the property, in collaboration with the charity, and split net rent or proceeds with charity

How Is The Charitable Deduction Calculated?

- Charitable deduction – similar to remainder value for CRT, but reacts inversely to IRS discount rate (AFR): a lower AFR yields a higher deduction
- Example: 75 year-old, home worth $400,000:
  - $329,000 deduction based upon 0.6% AFR
  - $257,000 based upon 3.2% AFR
  - $220,000 if AFR is 5.0%
- Today's AFRs are near historic lows, so retained life estate deductions are at all time highs

Depreciable Versus Non-depreciable Value

- Total fair market value = value of land plus value of structures … and depreciable items lose value over time (assume structures = 2/3 total value)
- Useful life – estimated time structures would remain usable assuming no capital repairs (assume 45 years)
- Salvage value – estimated value of structures at end of their useful life (assume 1/4 of initial value)
- Generally larger deduction results from larger:
  - Proportion of value attributed to land
  - Longer useful life
  - Greater salvage value

Effect Of Depreciable Portion On Charitable Deduction

Returning to our 75-year-old with the $400,000 house:

- $318,000 deduction assumes:
  - Value of structures = $266,667 (2/3)
  - Useful life = 45 years
  - Salvage value = $66,667 (1/4)
- But, deduction would be $305,000 if:
  - Value of structures = $300,000
  - Salvage value = $50,000

Terms Of The Life Estate Agreement

- On-going costs: donor responsible for property taxes, insurance, utilities, maintenance and minor repairs
- Capital expenses: apportionment of major repairs and remodeling to extend useful life and/or increase value
- Options for early termination
- Removal of personal property at end-of-life tenancy
- Representations regarding environmental hazards
- Right to periodic inspections
- Process for dispute resolution

Due Diligence And Costs

- This is a gift of real estate … What do your gift acceptance policies have to say?
- Physical inspection, title search, financial review, and, especially, environmental review
- Costs: appraisal, inspections, title work, legal counsel, filing and registration fees, possibly deed tax
- In general … donor should pay for appraisal, could pay for other items (but beware), and charity should pay for its own legal counsel

Donor Profile

- Older, probably 70 plus, who owns home outright, free of debt
- Motivated to make a testamentary gift and could be enticed by the opportunity to get an income tax deduction now
- Owns recreational or vacation property but has no plan to leave it to heirs
- Own a property the organization wishes to acquire in the future

Case Study – Personal Residence

A loyal donor, age 72, has made a bequest provision, owns her own home now worth $400,000

Retained Life Estate, personal residence	
Value of property	$400,000
Value of building(s)	$266,667
Estimated useful life	45 years
Salvage value	$66,667
Charitable deduction	$318,436

Case Study – Farm

A donor, age 78, owns a small farm which is contiguous to your organization's field study station. The farmer may be interested in supporting expansion of farm research.

Retained Life Estate, farm	
Value of property	$960,000
Value of building(s)	$200,000
Estimated useful life	45 years
Salvage value	$50,000
Charitable deduction	$878,737

Bonus: Retained Life Estate Plus Gift Annuity

Step One: Donor contributes remainder interest in home or farm, retains right to use property

- Donor remains responsible for maintenance, insurance, property taxes, et cetera
- When life estate ends, charity can use property or proceeds from sale

Step Two: Charity issues gift annuity based upon charitable value of retained life estate

- Donor receives charitable deduction for gift annuity
- Annuitant(s) could be donor and/or others

Bonus: Retained Life Estate Plus Gift Annuity

Donor, age 75, owns home worth $450,000, adjacent to your primary facility, and would consider giving it in his estate but is concerned about his income

Step #1 – Retained Life Estate Gift	
Value of property	$450,000
Cost basis of property	$180,000
Value of building(s)	$300,000
Estimated useful life	45 years
Salvage value	$75,000
Charitable value gift	$370,532

Step #2 – Charitable Gift Annuity	
Gift annuity contribution	$370,532
Charitable deduction	$157,913
Annuity (5.4%)	$20,009
Tax-free portion	$6,859
Capital gain income	$10,289
Ordinary income	$2,861

Bonus: Retained Life Estate Plus Gift Annuity

Notes:

- Charity must provide funds to make gift annuity payment … there is no immediate transfer of assets to fund the gift annuity
- Could provide a way for charity to acquire desired property with payments over time … but remember gift annuitants can – often do – exceed their life expectancy
- Check state law! Some states prohibit this arrangement as contrary to prudent investor standard

Still Have a Question?

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