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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

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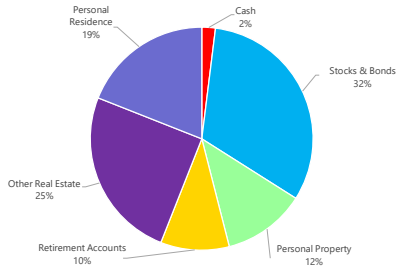
Why Consider A Retained Life Estate?

- 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

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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


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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		Step #2 – Charitable Gift Annuity	
Value of property	\$450,000	Gift annuity contribution	\$370,532
Cost basis of property	\$180,000	Charitable deduction	\$157,913
Value of building(s)	\$300,000	Annuity (5.4%)	\$20,009
Estimated useful life	45 years	Tax-free portion	\$6,859
Salvage value	\$75,000	Capital gain income	\$10,289
Charitable value gift	\$370,532	Ordinary income	\$2,861

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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

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Still Have a Question?

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