Charitable gifts of remainder interests in homes and farms

Russell James, J.D., Ph.D., CFP®, Director of Graduate Studies in Charitable Planning, Texas Tech University

General rule: you can’t deduct a partial interest gift

A partial interest gift occurs when a donor gives some rights to property but keeps others

General rule: you can't deduct a partial interest gift

But, you can deduct a remainder interest in a home or farm

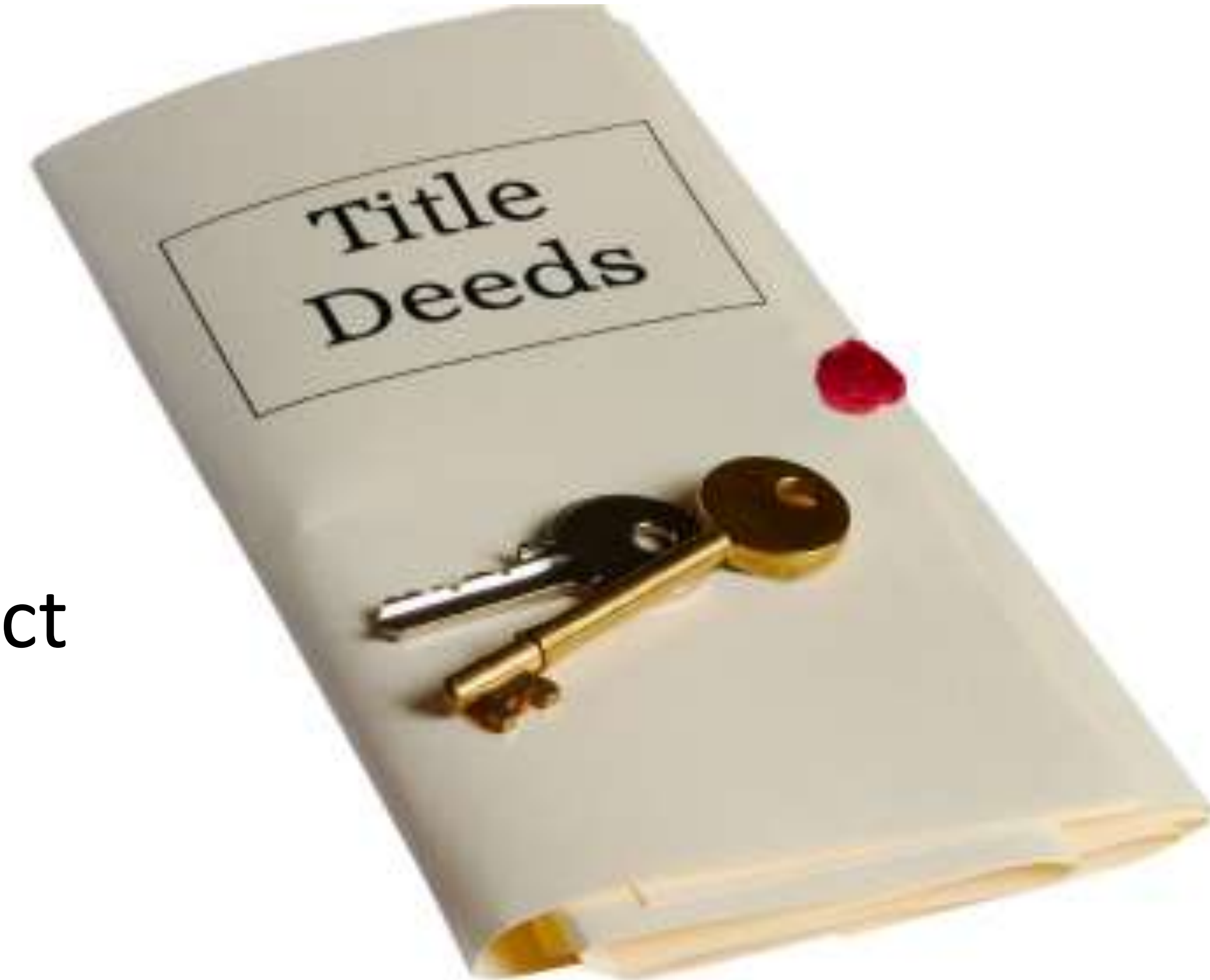
Other Exceptions

- Giving all or an “undivided portion” of a property interest
- Charitable remainder/ lead trust or pooled income fund
- Qualified conservation easement

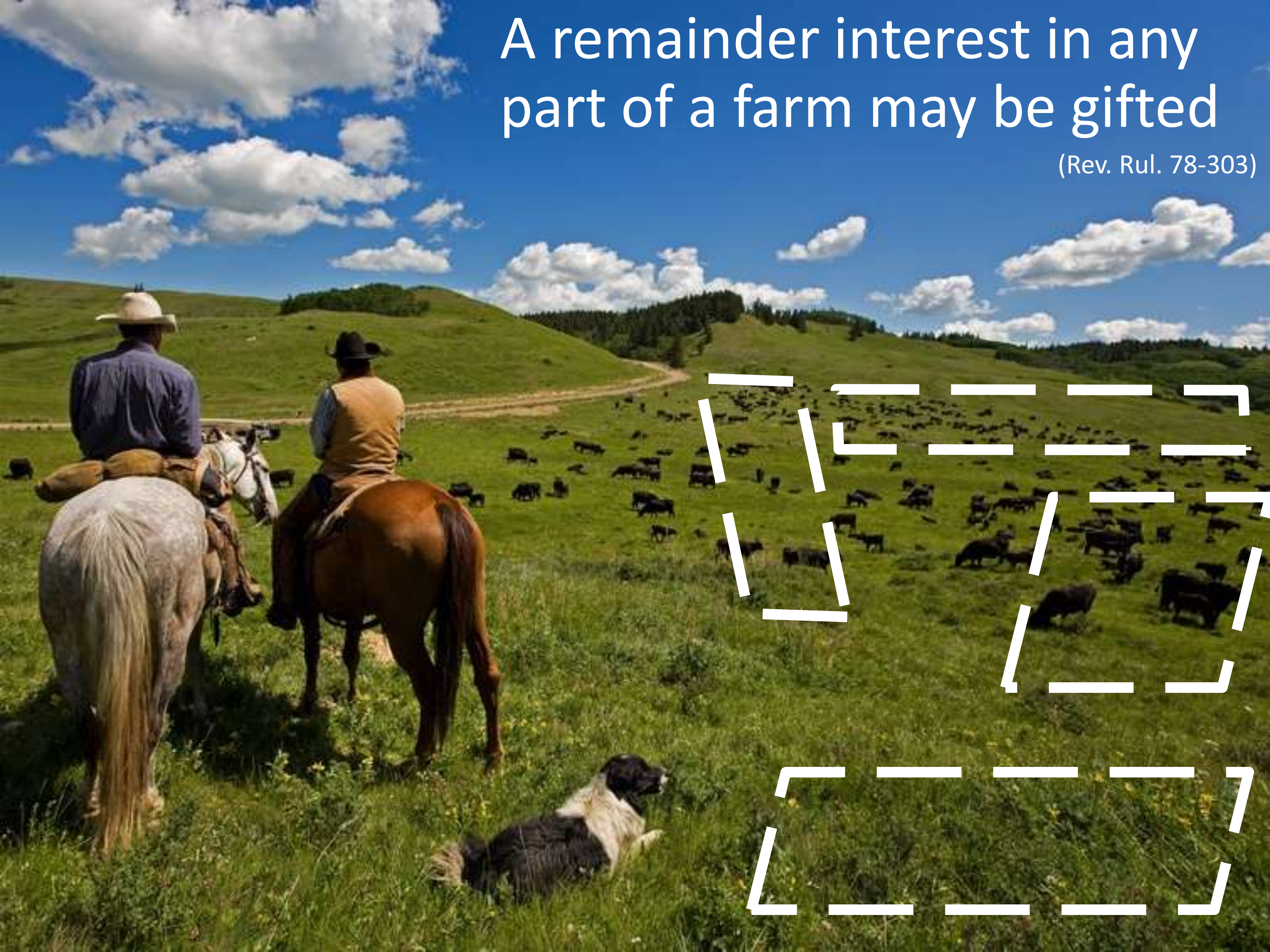
A remainder interest gives the right to own the property after a set time or after the death of a person

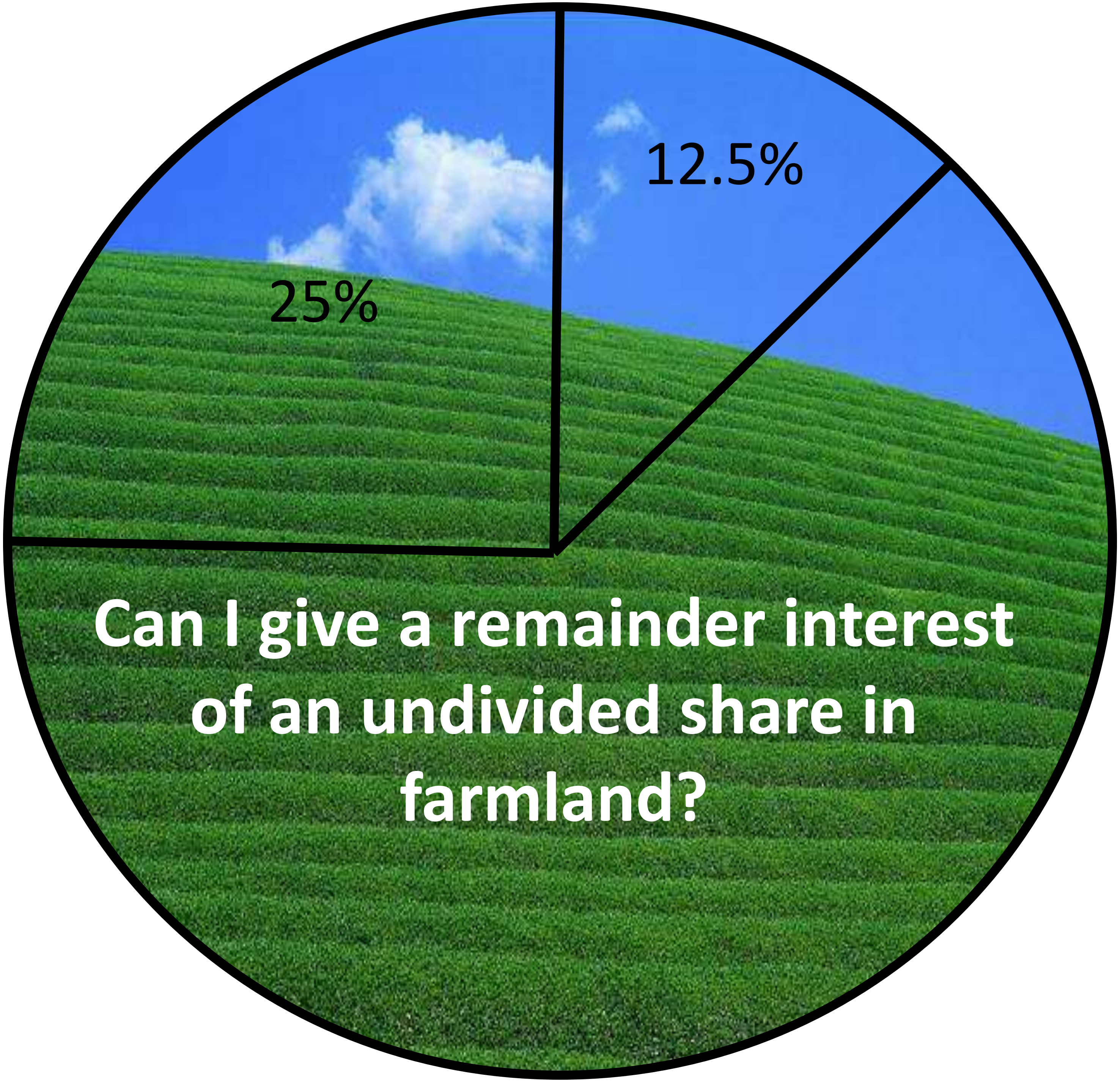
Unlike a will, a remainder interest is not revocable, and can even be sold

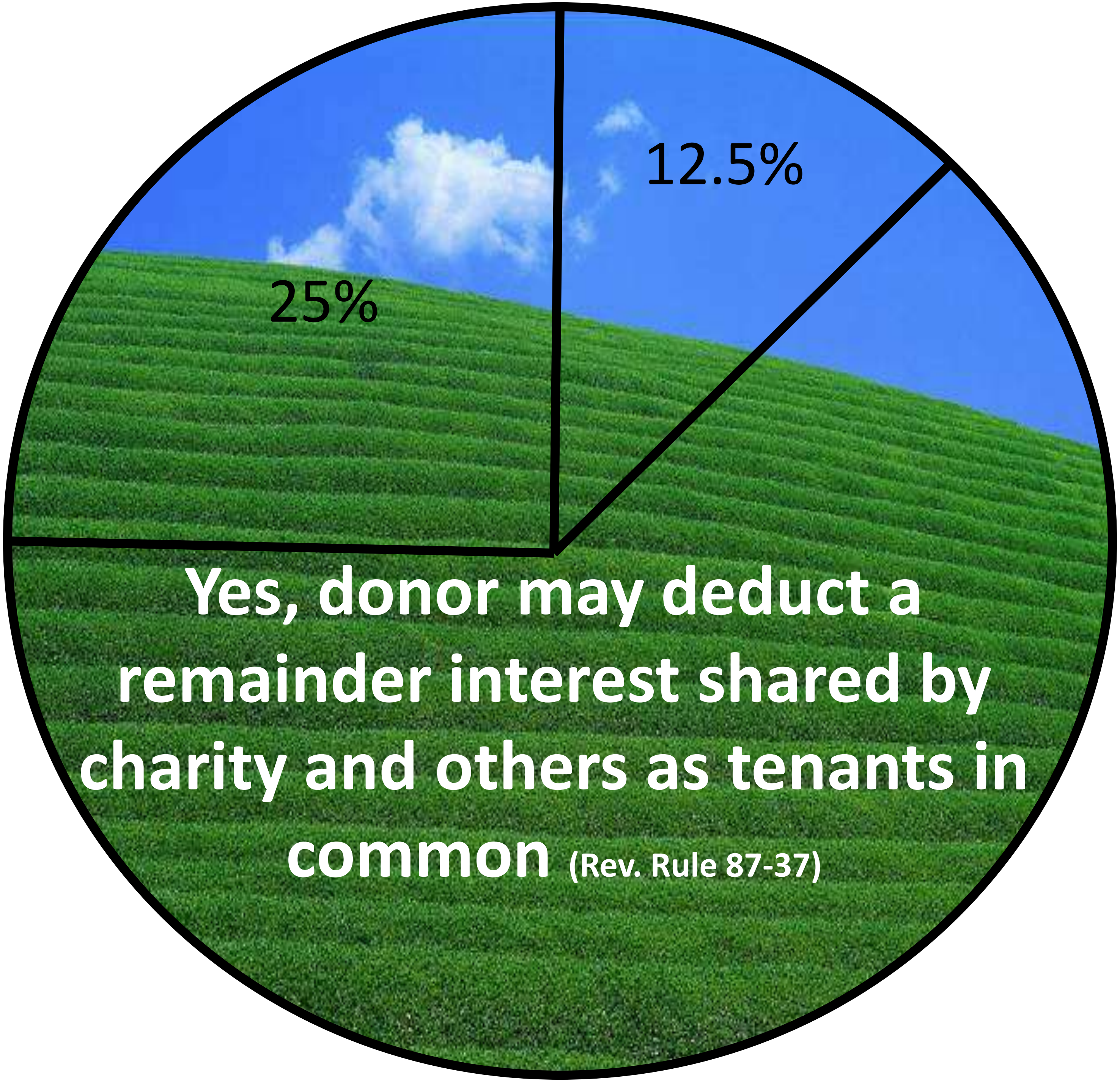
A deductible remainder interest in farmland or a home must be transferred by deed, not by trust or contract

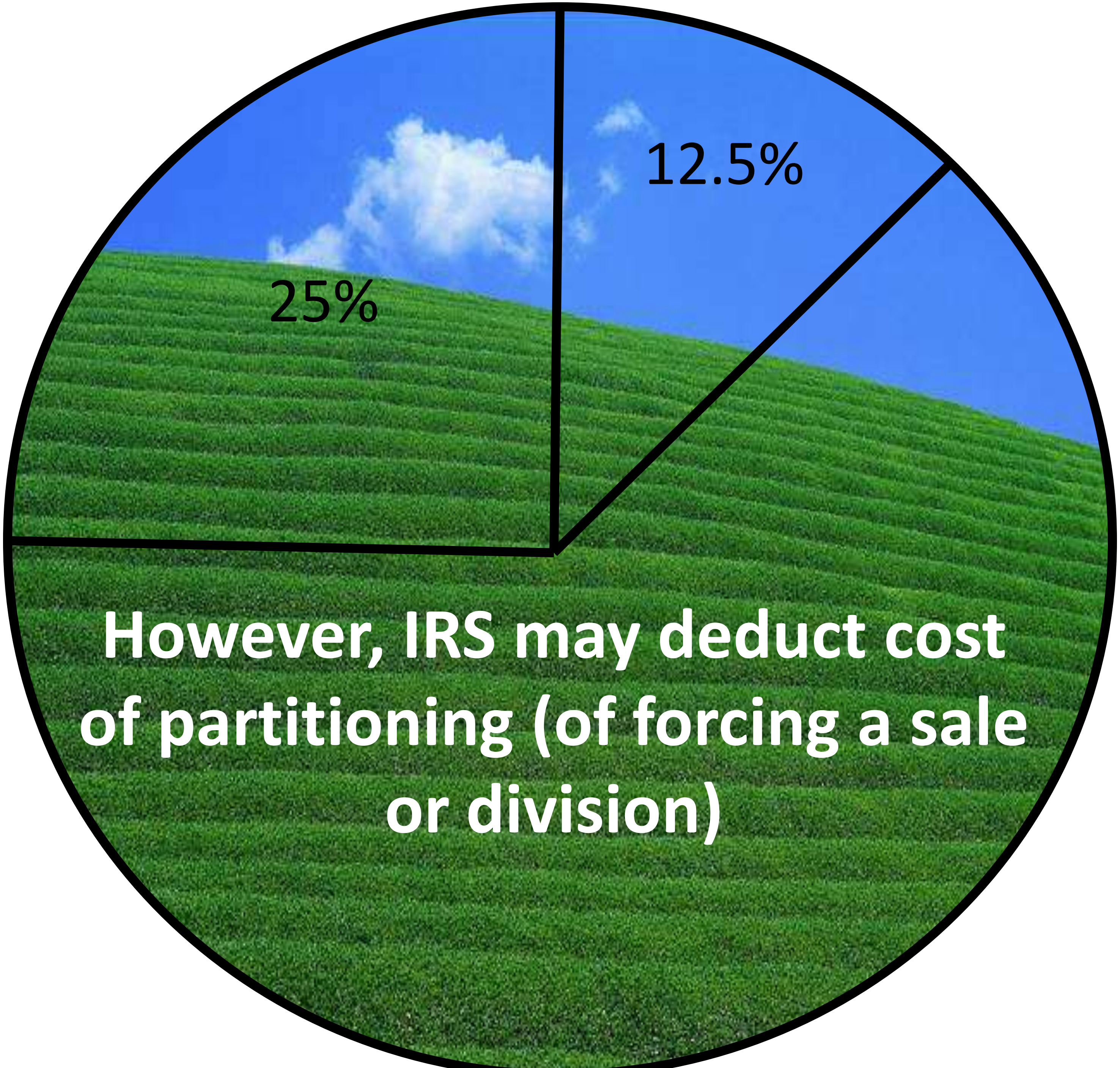



A farm is any land and
improvements used
(even by a tenant)
to raise crops or livestock


A remainder interest in any part of a farm may be gifted
(Rev. Rul. 78-303)


12.5%
25%
Can I give a remainder interest of an undivided share in farmland?


12.5%
25%
Yes, donor may deduct a remainder interest shared by charity and others as tenants in common (Rev. Rule 87-37)


12.5%
25%
However, IRS may deduct cost of partitioning (of forcing a sale or division)

mineral rights

- No deduction for remainder just in mineral rights because it is not a “farm” Reg. 1.170A-7(b)(4)
- Can gift remainder in entire “fee simple” farm (even if land and mineral rights go to separate charities) PLR 8316037
- Can gift remainder in farm without mineral rights if you don’t owned them

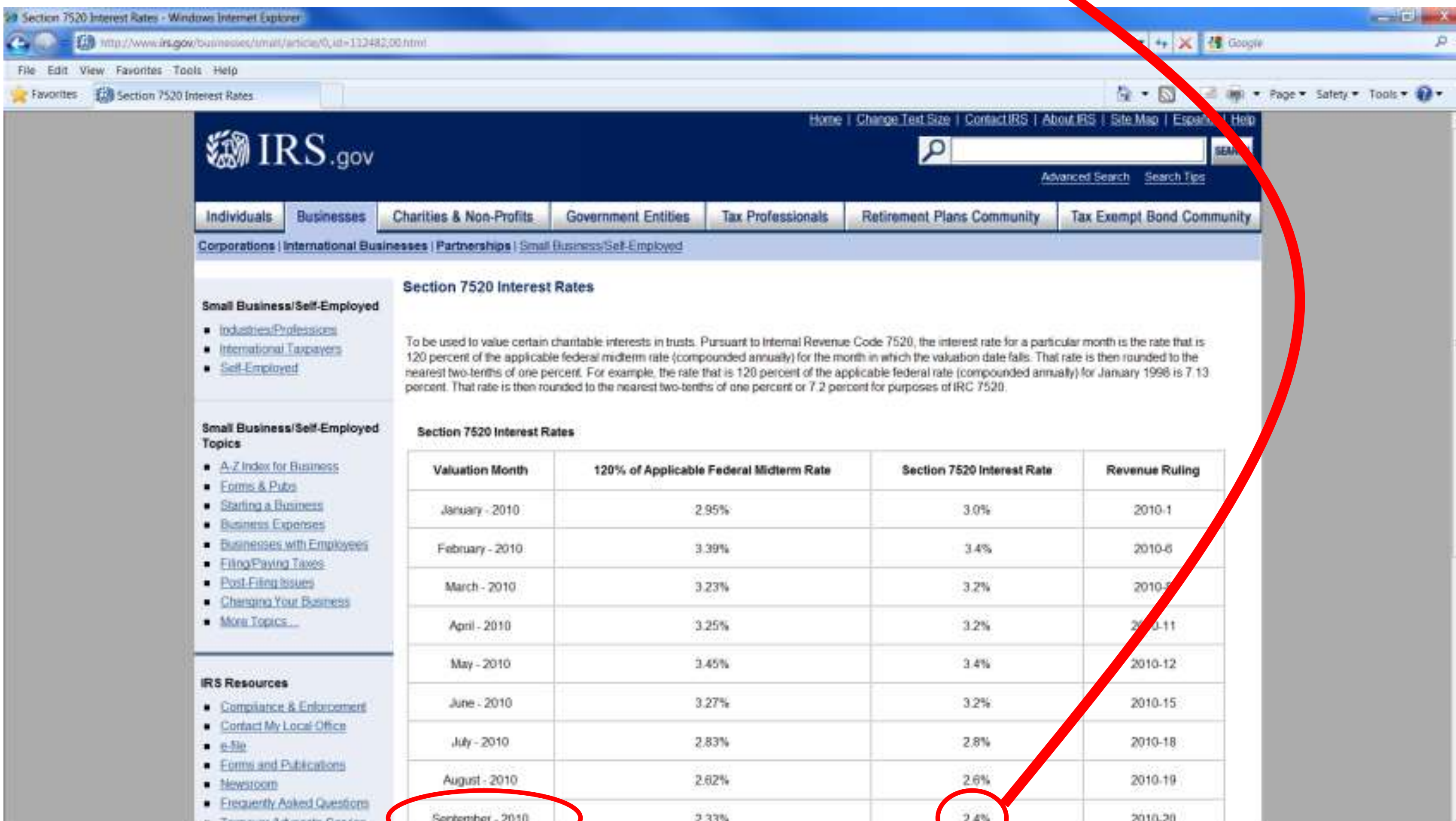
How do you calculate the deduction for a remainder interest in farmland?

1. Find the §7520 interest rate
   (http://www.irs.gov/businesses/small/article/0,,id=112482,00.html)
2. Multiply value of land by remainder percentage in IRS Pub. 1457 (one or two lives or specific term)
   (http://www.irs.gov/retirement/article/0,,id=206601,00.html)

Ex: A remainder interest in $100,000 of farmland given by a 59 year old donor on 9/6/10

1. Find the §7520 interest rate **2.4%**

(http://www.irs.gov/businesses/small/article/0,,id=112482,00.html)



Section 7520 Interest Rates - Windows Internet Explorer

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Section 7520 Interest Rates

To be used to value certain charitable interests in trusts. Pursuant to Internal Revenue Code 7520, the interest rate for a particular month is the rate that is 120 percent of the applicable federal midterm rate (compounded annually) for the month in which the valuation date falls. That rate is then rounded to the nearest two-tenths of one percent. For example, the rate that is 120 percent of the applicable federal rate (compounded annually) for January 1998 is 7.13 percent. That rate is then rounded to the nearest two-tenths of one percent or 7.2 percent for purposes of IRC 7520.

Section 7520 Interest Rates

Valuation Month	120% of Applicable Federal Midterm Rate	Section 7520 Interest Rate	Revenue Ruling
January - 2010	2.95%	3.0%	2010-1
February - 2010	3.39%	3.4%	2010-6
March - 2010	3.23%	3.2%	2010-[illegible]
April - 2010	3.25%	3.2%	2010-11
May - 2010	3.45%	3.4%	2010-12
June - 2010	3.27%	3.2%	2010-15
July - 2010	2.83%	2.8%	2010-18
August - 2010	2.62%	2.6%	2010-19
September - 2010	2.33%	2.4%	2010-20

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$100,000
X 0.60589
= $60,589

Section 1 **Table S - Based on Life Table 2000CM**

Interest at 2.4 Percent

Age	Annuity	Life Estate	Remainder	Age	Annuity	Life Estate	Remainder
0	34.2376	0.82170	0.17830	55	18.1993	0.43678	0.56322
1	34.3011	0.82323	0.17677	56	17.7570	0.42617	0.57383
2	34.1418	0.81940	0.18060	57	17.3129	0.41551	0.58449
3	33.9727	0.81534	0.18466	58	16.8678	0.40483	0.59517
4	33.7967	0.81112	0.18888	59	16.4213	0.39411	0.60589


Charitable
Deduction
Interest Rates

Deduction for remainder interest in $100,000 farm by age 59 donor

11.6% (May 89)

$15,684

2.0% (Oct 10)

$65,553

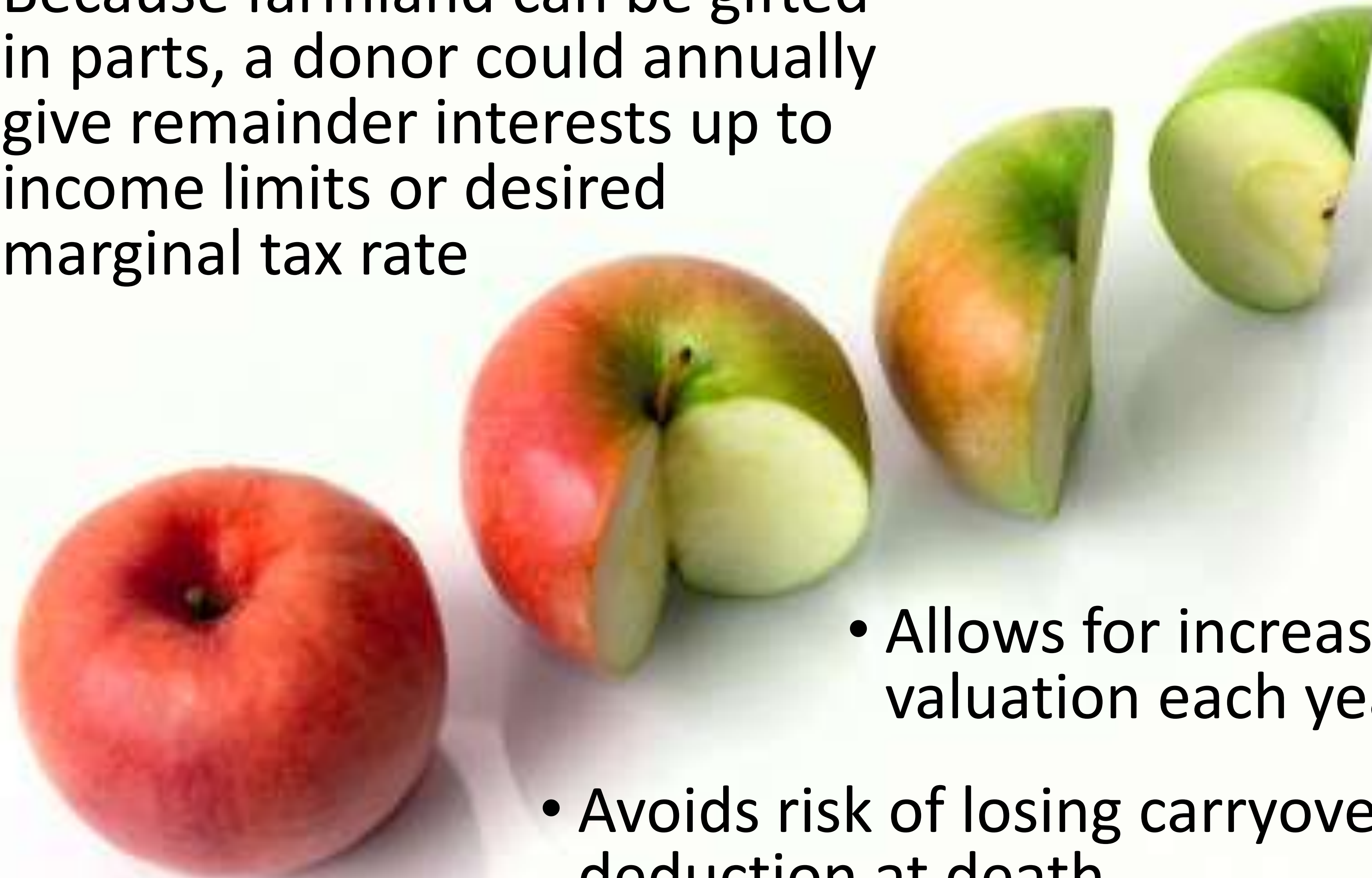
Leaving land to charity **by will**

- Revocable
- $0 income tax deduction
- Impacts charity after death

Leaving land to charity **by remainder interest**

- Irrevocable
- $60,589 immediate income tax deduction
- Impacts charity after death or immediately if charity sells remainder interest

Because farmland can be gifted in parts, a donor could annually give remainder interests up to income limits or desired marginal tax rate



- Allows for increasing valuation each year
- Avoids risk of losing carryover deduction at death
- Could use value of annual deductions to pay for ILIT life insurance passing tax free to heirs

Donor can use money from remainder tax deduction to buy tax free life insurance (ILIT) for children's inheritance

Age 59 wealthy donor with $100,000 farmland on 9/1/10

remainder interest in farmland given to charity

$60,589 tax deduction x 41% combined tax rate = $24,841

$24,841 buys est. $70,000 paid up ILIT life insurance

will divides farmland 10% to charity 90% to children

farmland worth $125,000 at death

charity receives $125,000 farmland

children receive $70,000 (tax free from ILIT)

children receive $50,625 (90% x 125,000 = 112,500, less 55% for estate taxes)

charity receives $12,500 (10% x $125,000)

Gifts of remainder interests in personal residences can also be deducted

Includes second homes, vacation homes, even a boat with bathroom, cooking, and sleeping facilities, if used by the donor as a residence

Deduction for a house is reduced because, unlike land, it is depreciable (it wears out)

Rules in IRS Pub. 1459 http://www.irs.gov/pub/irs-pdf/p1459.pdf

59 year old donor giving on 9/6/10

Remainder interest in $100,000 farm

.60589 x $100,000

$60,589 Deduction

Remainder interest in $100,000 home

.60589 x $20,000 (land)
.60589 x $10,000 (salvage)
.33768* x $70,000

$41,814 Deduction

*.60589 less .26821 depreciation reduction calculated on next slide

Depreciation reduction factor

$$\frac{\text{R factor age now} - \text{R factor age after useful life of house}}{\text{D factor age now X Useful life of house}}$$

Appraiser can estimate.
IRS examples use 45 years.

Table C(2.4)

Factors for Reducing Assurances - Based on Table 2000CM

Interest at 2.4 Percent

Age x	Remainder Factors	R-Factors R_x-0.5M_x	D-Factors D_x	Age x	Remainder Factors	R-Factors R_x-0.5M_x	D-Factors D_x
0	.17830	1202916	100000.0	**55**	.56322	317860.0	24748.54
1	.17677	1185429	96977.54	**56**	.57383	304002.2	24008.45
2	.18060	1168311	94656.94	**57**	.58449	290311.8	23274.97
3	.18466	1151231	92407.69	**58**	.59517	276800.1	22547.02
4	.18888	1134179	90219.15	**59**	.60589	263478.6	21825.10
…	……	…	…	…	……	…	…
48	.49158	418809.2	30218.64	**103**	.95802	60.91156	35.63595
49	.50143	404011.4	29397.77	**104**	.96077	33.72948	21.05020

Table C at http://www.irs.gov/retirement/article/0,,id=206601,00.html

$$\frac{263478.6-60.91156}{21825.1 \cdot 45}=.26821$$

What if the donor leaves?

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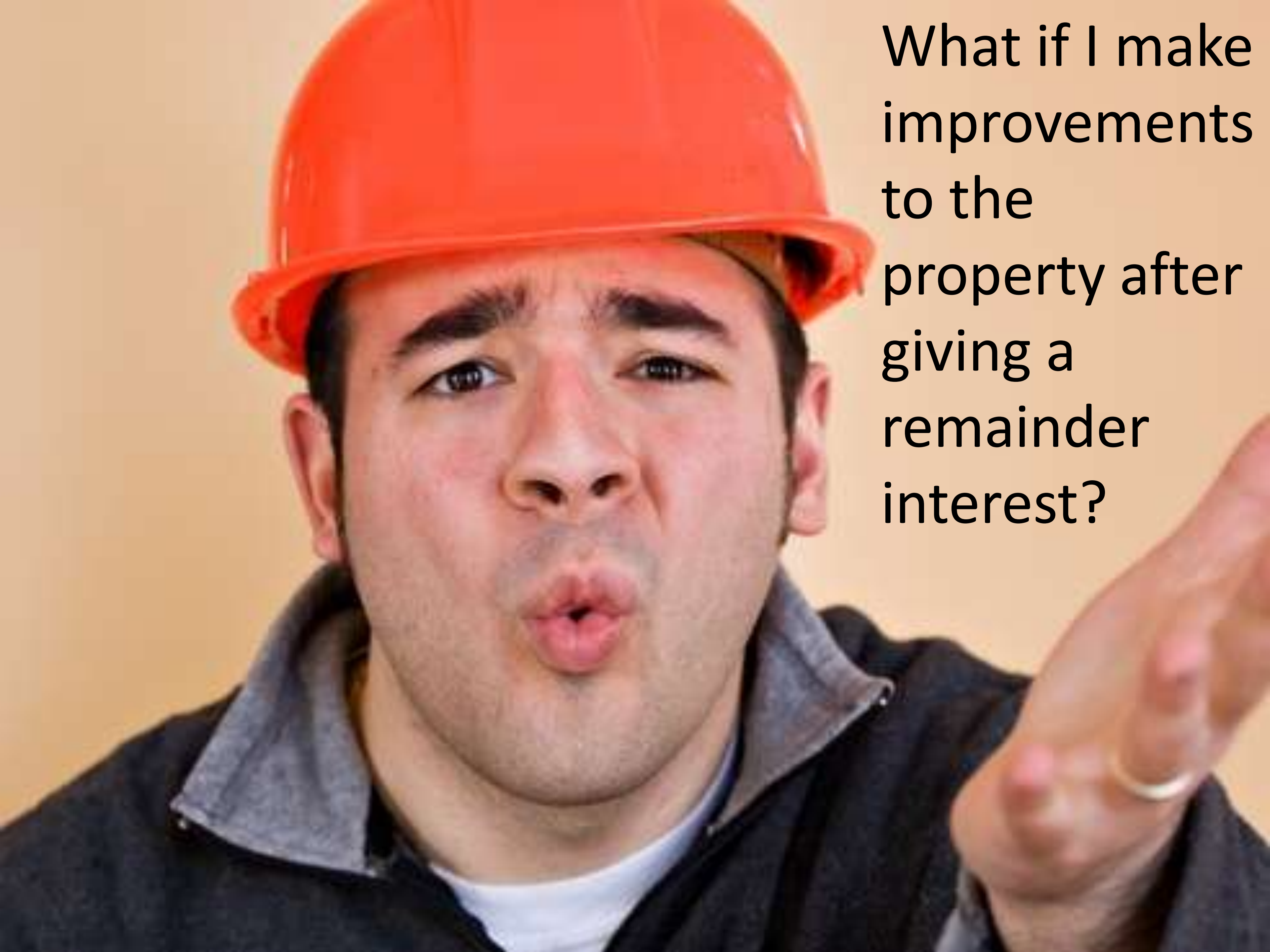
Give life estate to charity	
Agree with the charity to a joint sale and divide proceeds	Give life estate to charity in exchange for a gift annuity
Rent property	Sell life estate

Will the donor maintain the property?

Will the donor maintain the property?

- Common law requires the “life tenant” to Maintain, Insure, and pay Taxes on the property
- Some charities also require a written MIT contract



What if I make improvements to the property after giving a remainder interest?

You can deduct the remainder value of major improvements as additional gifts

PLR 9329017; PLR 8529014

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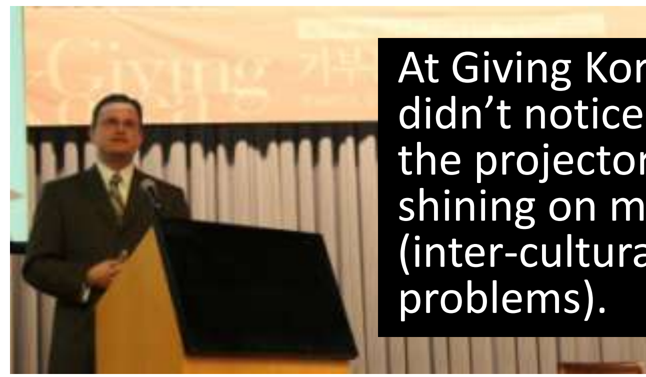
About the Author

Russell James, J.D., Ph.D., CFP® is an Associate Professor and the Director of Graduate Studies in Charitable Planning in the Division of Personal Financial Planning at Texas Tech University. He graduated, *cum laude*, from the University of Missouri School of Law where he was a member of the Missouri Law Review. While in law school he received the United Missouri Bank Award for Most Outstanding Work in Gift and Estate Taxation and Planning and the American Jurisprudence Award for Most Outstanding Work in Federal Income Taxation. After graduation, he worked as the Director of Planned Giving for Central Christian College, Moberly, Missouri for six years and also built a successful law practice limited to estate and gift planning. He later served as president of the college for more than five years, where he had direct and supervisory responsibility for all fundraising. Dr. James received his Ph.D. in Consumer & Family Economics from the University of Missouri where his dissertation was on the topic of charitable giving. Dr. James has over 100 publications in print or in press in academic journals, conference proceedings, professional periodicals, and books. He writes regularly for Advancing Philanthropy, the magazine of the Association of Fundraising Professionals. He has presented his research in the U.S. and across the world including as an invited speaker in Ireland, Scotland, England, The Netherlands, Spain, Germany, and South Korea. (click here for complete CV)

Me (about 5 years ago)

Lecturing in Germany. 75 extra students showed up. I thought it was for me until I found out there was free beer afterwards.



At Giving Korea 2010. I didn't notice until later the projector was shining on my head (inter-cultural height problems).