

# The Retained Life Estate – An Underutilized Gift



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# The Retained Life Estate – An Underutilized Gift

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1. Real estate gift trends
2. Retained life estate basics
3. Retained life estate agreement
4. Particular situations
5. Comparison: retained life estate vs. bequest
6. Finding retained life estate opportunities
7. Cautions
8. Case Study #1: A Texas ranch
9. Case Study #2: A New York City coop
10. Questions

# *1. Real estate gift trends*

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- Development offices continue to turn more attention to real estate.
- Growing understanding that real estate is the single largest asset category for American households.
- Dramatic increase in marketing of real estate gifts.
- There is an increasingly accepted set of best practices regarding real estate gifts, providing comfort level to previously-wary institutions.
- Anecdotally, there has been a considerable increase in real estate gift activity in the last 36 months.

# *1. Real estate gift trends*

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*There is a growing understanding about who to target in pursuing real estate gifts*

- Age 65+
- Own multiple pieces of real estate, likely in multiple states—much of it is appreciated.
- No heirs, or children moved away and not interested in the real estate.
- If there are children, there are other assets to pass on to them. Want to preserve their liquidity.

# *1. Real estate gift trends*

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*There is growing understanding about who to target in pursuing real estate gifts*

- Burdened by continued ownership/management of some of their real estate.
- Capacity to use charitable income tax deductions.
- Charitable motivation.
- May or may not have a strong giving record.
- May or may not show up on wealth screening.

# 1. Real estate gift trends

*More proactive approaches produce results*



# *1. Real estate gift trends*

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## ***Types of Properties Reported Given:***

✓ Second/vacation homes and rental residential properties	30%
✓ Primary residence	20%
✓ Undeveloped land	17%
✓ Commercial properties	12%
✓ Farms and ranches	12%
✓ Land with conservation value	3%
✓ Time shares	2%
✓ Industrial properties	1%
✓ Other	1%

Source: 2008 Survey of Membership of National Committee on Planned Giving

# 1. Real estate gift trends

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## *Real estate gift structures used very or somewhat frequently:*

✓	Bequest	51%
✓	Outright	47%
✓	Charitable remainder trust	44%
✓	<b>Retained life estate</b>	<b>27%</b>
✓	Undivided/fractional interest	19%
✓	<b>Charitable gift annuity</b>	<b>18%</b>
✓	Bargain sale	11%
✓	Retained life estate/CGA	6%
✓	Charitable lead trust	5%

Source: 2008 Survey of Membership of National Committee on Planned Giving



## 2. *Retained Life Estate Basics*

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- A personal residence or farm is donated to a charity, with one or more donors (or another party) retaining rights to use the property for life or for a term of years.
- The donor is donating the *remainder interest* (generally a deductible gift), and *retaining (or reserving) a life estate* or *retaining a tenancy*.
- Charity assumes ownership of the property, but not possession.
- A creature of federal tax law – IRC 170(f)(3)(B)(i).

## *2. Retained Life Estate Basics*

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- State law must be consulted regarding real estate conveyancing, etc.
- The “life tenants” maintain full use and control of the property, along with full responsibility for property taxes, insurance, and normal property maintenance.
- A clear written agreement between donor and charity should cover such matters as responsibility for major improvements, incapacity of the life tenant, vacating the property, etc.

## *2. Retained Life Estate Basics*

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### *Property That Can Be Given*

- Personal residences
  - Doesn't have to be a principal residence
  - Can include improvements and permanent fixtures
    - ✓ But not tangible personal property (e.g. furniture)
  - Houseboats, mobile home, trailer
  - The shares of a cooperative corporation

## *2. Retained Life Estate Basics*

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### *Property That Can Be Given (Cont.)*

- Farms
  - Doesn't have to provide income for the owner (i.e. it can be a “hobby farm” or “country estate”)
  - Can include improvements and fixtures (barns, houses, silos, etc.)
    - ✓ But not farm equipment and machinery

### *Term*

- Life of donor(s) or life of other individuals (e.g. a tenant)
- Or, period of years

## *2. Retained Life Estate Basics*

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### *Valuation of the Remainder Interest is Based on:*

- Fair market value at time of gift
- Length of time – life expectancy or term of years
- Value of improvements (subject to depreciation) and natural resources (subject to depletion)
- Estimated useful life of improvements
- Salvage value of improvements
- IRS discount rate (for month of gift or either of the two previous months)
  - ✓ Low discount rates increase value of the remainder interest/deduction

## *2. Retained Life Estate Basics*

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### *Retained Life Estate IRS Deduction Percentages (approximate)*

<u>Single Life</u>	<u>%</u>	<u>Joint Lives</u>	<u>%</u>
56	48%	56, 54	37%
66	61%	66, 64	50%
76	73%	76, 74	63%
86	84%	86, 84	77%
96	91%	96, 94	87%

Assumed discount rate: 2.0%

## *2. Retained Life Estate Basics*

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### *Income Tax Deductions*

- For property held more than one year, charitable deductions up to 30% of Adjusted Gross Income
- For property held less than one year, charitable deductions limited to lesser of remainder value or donor's cost basis.
- 5-year carry-forward allowed
  - ✓ Use of partial interest donation can effectively extend this carry-forward period
- Charitable deduction claimed on Form 8283, signed by qualified appraiser completing a qualified appraisal

### *3. Retained Life Estate Agreement*

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#### *A Really Important Document*

Key components, consistent with state law:

- Ongoing tenant responsibilities: property taxes, utilities, insurance, repairs and maintenance
- Capital improvements
  - ✓ Actuarial formula is best
  - ✓ Who authorizes improvements?
- No waste
- Access for visits/right of entry
- Use issues, including whether renting is allowed



### *3. Retained Life Estate Agreement*

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#### Key components (cont.)

- No encumbrances/mortgages
- Dealing with incapacity
  - ✓ Durable power of attorney is advisable
- Dealing with vacancy.
  - Rights of entry and right to correct/pay
- Options:
  - ✓ Tenant donates remaining interest (deductible)
  - ✓ Lease the property
  - ✓ Cooperation in selling the property

## *4. Particular Situations*

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### *Existing mortgage*

- Either:
  - ✓ Assume mortgage will be paid off prior to transfer, therefore no effect on deduction; or
  - ✓ If remaining mortgage term exceeds life expectancy, then projected principal at time of transfer should reduce the amount of deduction

### *Additional property improvements by tenant*

- Can also be treated as gifts, subject to retained life estate.

## 4. *Particular Situations*

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### *Partial Interests*

- A fractional interest in property can be donated, subject to a retained life estate.
  - ✓ Helpful for spreading out the deduction for more than six years
  - ✓ Appraisal might need to reflect fractional interest discount
- Or fractional interest can be donated to charity, with balance of property transferred to a private party.
- Charity must have an agreement with donor that assures it will eventually have 100% ownership, or that in some other way it's ownership interest will be marketable.

## *4. Particular Situations*

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### *Conservation or preservation easement*

- Should be conveyed prior to conveying remainder interest
- A separate tax deduction

### *Making a partial cash payment for the remainder interest*

- A bargain sale
- ✓ Requires liquidity on part of charity

## *4. Particular Situations*

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### *Charitable Gift Annuity/Retained Life Estate*

- The “Charitable Reverse Mortgage”
- Instead of donor claiming a deduction for the value of the remainder interest, use it instead to fund a CGA
- Requires liquidity on charity’s part to meet CGA payments prior to taking possession and selling the property
- Some charities invest endowment funds in these arrangements, based on a conservative calculation of ROI of the investment.

## 5. *Retained Life Estate vs. Bequest Comparison*

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	<b>Bequest</b>	<b>Retained Life Estate</b>
Continued use of property	Yes	Yes
Continued responsibility for taxes, repairs, etc	Yes	Yes
Removal of asset from taxable estate	Yes	Yes
Charitable income tax deduction	No	Yes
Recognized now for generous gift?	No	Yes
Asset avoids probate process	No	Yes
Decision is	Revocable	Irrevocable

## *6. Finding retained life estate opportunities*

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### *Bequest intentions likely involving a residence or a farm?*

- Visit them next week!
- Assume they have not been introduced to the retained life estate concept by their advisors

### *Leadership gifts*

- *“A real estate gift is sitting at the table at every Board meeting. It’s just that no one has ever connected the dots.”*

-- John Brown

## *6. Finding retained life estate opportunities*

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### *Marketing*

- Emphasize problem solving, understanding of the prospect's situation.
- Repeat the message in many forums – newsletter, annual report, emails, website...
- Testimonials and case studies are most effective.
- A prompt, user-friendly response when the call comes is critical.



## 7. *Cautions*

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*Retained Life Estate arrangements should be entered into very carefully*

- It's a long-term relationship to be entered into with care and commitment by the parties.
- Approach the due diligence as if it's an immediate outright gift.
- Some motivated donors may need to be talked out of doing a retained life estate if they don't have sufficient other assets.

## *8. Case Study #1: Retained Life Estate and a Texas Ranch*

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### *National Wildlife Federation and the Jacksons' Texas Ranch*

- The Jacksons, long-time NWF members and San Antonio residents, enjoyed their ranch in the country as a base for birding outings.
- They had no children, and had wanted to leave their ranch through their wills to NWF.
- They became aware of the option of deeding over the property now, but retaining the right to use it for the rest of their lives.
- The Jacksons had leased their mineral rights to an exploration company.
- They wanted to generate current tax deductions.

## *8. Case Study #1: Retained Life Estate and a Texas Ranch*

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### *National Wildlife Federation and the Jacksons' Texas Ranch*

- The Jacksons approached NWF about the retained life estate alternative.
- NWF was interested, provided the mineral rights (subject to lease) would be included in the conveyance (to assure deductibility of the gift.)
- Due diligence: Title search, environmental assessment, consultation with local brokers, review of the mineral lease -- all revealed no challenges.
- A gift acceptance letter was agreed to by the parties.
- The Jacksons and NWF worked out a life estate agreement detailing the responsibilities of the parties.

## 8. Case Study #1: Retained Life Estate and a Texas Ranch

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### *National Wildlife Federation and the Jacksons' Texas Ranch*

- The Jacksons obtained a qualified appraisal.
- NWF and the Jacksons' advisors estimated the tax deduction that would be generated by the gift.
  - ✓ The Jacksons decided to gift 50% of the property immediately, while agreeing to gift the balance at a later date – in order to increase their chances of using all of the available deductions over as much as twelve years.
- The property was deeded over, and the life estate agreement was signed.
- An “agreement to convey” was also executed, assuring that NWF would wind up with 100% of the property one way or the other.

## *8. Case Study #1: Retained Life Estate and a Texas Ranch*

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### *National Wildlife Federation and the Jacksons' Texas Ranch*

#### *Benefits for the Donors*

- The Jacksons continued to use the property as they had before, and retained full responsibility for taxes, maintenance, utilities, etc.
- They continued to receive mineral lease royalty payments.
- They triggered charitable tax deductions they would use for many years ahead.
- They had the satisfaction of being recognized for a generous gift in their lifetime.

## *8. Case Study #1: Retained Life Estate and a Texas Ranch*

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### *National Wildlife Federation and the Jacksons' Texas Ranch*

#### *Benefits for NWF*

- Unlike a bequest intention, which is subject to revocation, the gift was completed here and now.
- NWF could count on proceeds from sale of the property at some point in the future.
- NWF was able to publicize this gift – inspiring other property owners to inquire about retained life estate gifts.
- Mr. Jackson died last year. The property is now being marketed.

## *9. Case Study #2: Retained Life Estate and a New York City Coop*

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### *Pioneer Medical School and the Jacobs' NYC Residential Coop*

- Dr. Jacobs, a Medical School graduate, and his wife, are owners of a very valuable – estimated \$8 million – New York City coop apartment.
- As he approaches retirement, they would like to make a substantial “naming opportunity” gift.
- They had considered leaving their coop to the Medical School in their wills.
- They would like to increase their current after-tax income.
- Medical School development staff and Dr. Jacobs are exploring the possible gift of the coop subject to a retained life estate.

## *9. Case Study #2: Retained Life Estate and a New York City Coop*

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### *Pioneer Medical School and the Jacobs' NYC Residential Coop*

#### *Technical Issues*

- The assets gifted would be the Jacobs' shares in their cooperative housing corporation.
- Their coop lease would transfer to the Medical School, and the Medical School would sublease the property back to them.
- The RLE agreement would need to address which party votes the corporate shares, depending on circumstances.
- The Board of the coop corporation would need to be assured that the Medical School would follow all corporation rules and regulations re. leasing, right of first refusal, etc.



## *9. Case Study #2: Retained Life Estate and a New York City Coop*

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### *Pioneer Medical School and the Jacobs' NYC Residential Coop*

#### *Benefits Being Considered by the Jacobs*

- They would continue to enjoy their New York residence.
- They would realize increased after-tax income.
- They would avoid any possibility of capital gains tax.
- They could experience the satisfaction of a named building now.
- Neither they nor their children would have to worry about selling the coop.
- They retain all of their liquid assets.

## *9. Case Study #2: Retained Life Estate and a New York City Coop*

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### *Pioneer Medical School and the Jacobs' NYC Residential Coop*

#### *Benefits Being Considered by the Medical School*

- The gift would be irrevocable.
- The gift could be publicized to inspire others in similar situations to consider doing likewise.
- The Jacobs' other assets – cash, insurance, other real estate, retirement funds -- remain as possible future gifts.

#### *Stay Tuned*

# Thank You.

# Questions?

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