Letter on Charitable Trusts Funded with Real Estate

Dear

On behalf of our organization, I am pleased to respond to your request for information on creating a life income plan through a gift of real estate to a charitable trust. What follows is a general introduction to charitable remainder trusts with a few words on real estate contributions. I encourage you to call me so that I can answer any questions you may have and provide you with further information tailored to your particular circumstances.

Real estate contributions to charitable trusts are usually sold and invested by the trustee to pay you income for life. Some charitable trusts last a specific term of years - twenty years is the longest term allowed - rather than for life. Most donors choose to have the trust last for their lifetimes. After the death of all income beneficiaries or the expiration of the specified term, what remains in the trust must pass entirely to nonprofit organizations.

Tax Benefits

Your trust provides you with some important tax benefits:

1) **An immediate income tax deduction for a percentage of your gift.** (I will be happy to give you an idea of the size of your deduction. I simply need to know the ages of the income beneficiary(ies) and the payment rate of the trust.)

2) **No tax on the sale of appreciated property.** Donors considering a contribution of appreciated real estate often find this their most important tax benefit. Sometimes thousands of dollars that would have gone in taxes remain in the trust generating income to the donors and a future benefit to good causes.

3) **Avoidance of estate tax.** Upon the death of the last surviving income beneficiaries, whatever remains in the trust passes free of estate tax to the cause of your choice. Be careful, however. If you name someone who is not your spouse as an income beneficiary, there may be gift tax or estate tax consequences. Call us for more information.

Gifts of Real Estate

Appreciated real estate is frequently used to fund charitable remainder trusts. The donor simply might be tired of being a landlord but still needs the income. Also an investment property that's been held many years may be earning a low rate of return when the net income is compared to the fair market value of the property. When the trustee sells these properties and reinvests the proceeds, donors may enjoy higher income than before, though this is not true in every case. Publicly traded stock is even easier to deal with than real estate because its value can be quickly determined. Real estate gifts require a third party appraisal. In any case, because your charitable trust will be selling the property, the capital gains tax is bypassed entirely when the real estate is sold.

Indebted Property and Appraisals

There are some IRS requirements that are important to remember if you plan to place real estate in a charitable trust:

1) If your property is not debt-free, you should proceed cautiously. Some donors simply clear the debt from the property before placing the real estate into the trust. Others receive some cash when the property is sold by the trust that compensates them for paying off the debt. I would be happy to discuss your case with you in detail.

2) A qualified professional who is not involved in its sale must formally appraise real estate transferred to a charitable remainder trust for you to calculate and claim your charitable deduction. The IRS wants to make sure the property is being sold for its full fair market value. Since that is what most owners want anyway, this usually offers no problem. But the IRS wants an appraiser to verify the value claimed on your income tax return. You cannot rely on the sale price alone.

Giving Part of Your Real Estate

Some people find it useful to give an undivided percentage interest of their property into a charitable trust rather than all of it. For example, a donor placed 75% of a highly appreciated lot into a charitable trust. The total value of the lot was $400,000. When the lot was sold, about $100,000 came directly to her from the sale while $300,000 remained in the trust. Almost all of her $100,000 was taxable, but she used the income tax deduction generated by her trust to offset the capital gain tax due on the $100,000 she received.

There are two basic types of charitable trusts. An **annuity** trust will pay you a **fixed** amount each year. Your payment never changes. Older people and others interested in predictable income may find annuity trusts attractive. The minimum payment must be five percent of the face value of your gift. The maximum allowable payment is determined by current economic circumstance and your age. Too high a payment will disqualify the trust from the beginning. We can help you determine the maximum payment allowed. You should keep in mind, however, that annuity trusts are very rigid instruments that allow the trustee little flexibility when payments are to be made to you. What happens when a payment is due and the real estate has not yet sold? Some donors anticipate this problem by making a gift of cash along with the real estate so the trustee has the liquidity to make the payment. Most donors simply choose a more flexible type of charitable trust called a unitrust.

A **unitrust** pays **variable** income. The income is determined each year based on a fixed percentage that you select when you establish your unitrust. Many donors who contribute real estate a charitable unitrust make sure the unitrust can pay them the net income the trust actually earns, or the required payment rate, whichever is *less*. This odd-sounding strategy has a very simple objective: to make sure the trustee doesn't have to come up with a payment to you if the property hasn't sold and the trust is not producing enough income to make the required payment. The year after the real estate has sold, the trust may then make the required payments, dropping the net-income provision.

I know this sounds complicated, but attorneys familiar with charitable trusts will make sure your trust is worded so that your real estate-funded unitrust handles smoothly the short-term complications of the sale as well as meets your long-term needs for income.

The unitrust may provide you with a possible hedge against inflation; if the value of your unitrust increases, your income increases with it. Of course, your income will decline if your unitrust decreases in value. The trustee applies the percentage requirement to the value of the unitrust each year. By law, your unitrust must pay you at least 5% of principal. You may choose a higher payment rate if you wish. Simply selecting the highest rate possible may not work in your best interests, because the value of the unitrust corpus may decline under the strain of meeting the higher payment rate, and your income may decline as well. A lower payment rate may allow your trust to grow and your income to grow with it. Also, for technical reasons, too high a payment rate may disqualify the unitrust at the outset. But what is “too high” or “too low” varies from donor-to-donor. Most donors simply choose a payment rate that fits their financial and charitable objectives and meets legal requirements. It’s easy to tell if your unitrust meets IRS requirements: your charitable deduction must be at least 10% of the face value of the gift. Call us for an estimate of your deduction.

Selecting a Trustee

Trustees of charitable trusts range from banks and trust companies, to individuals with experience in trust management, to someone selected by the donor, to the donor. There can be complications if you act as your own trustee, but it can be done if you understand and comply with the trust requirements and have the technical help needed to do the trust accounting, investing, and administration. The basic advantages of charitable trusts are not difficult to understand: bypass of capital gains tax on the sale of appreciated property, lifetime income, immediate income tax benefits, reduction of estate tax, and the satisfaction of providing for good causes. There are even ways of helping your heirs that we cannot cover in this letter. But the first thing you should do is to find out if a charitable trust makes sense for you.

For More Information

Our organization will be happy to provide you with tax and income calculations tailored to your particular situation. All information is provided confidentially and without cost or obligation. We hope this information will help you, under the guidance of your professional advisers, to make an informed decision as to whether a charitable trust meets your financial and philanthropic objectives. Any information provided by our organization, however, is not meant as a substitute for legal or financial advice. We encourage you to consult with qualified independent counsel.

I look forward to providing you with further information and thank you for your inquiry.

Sincerely,

PS: I enclose information on remembering our organization in your will.

**How to remember our organization
in your estate plan.**

Four of the most popular forms bequests can take are:

A fixed amount of money or a designated property:
"I give to (legal name and tax identification number), located in (City), (State), $_________(or describe the real or personal property, including exact location.)

A percentage of the estate:
"I give to (legal name and tax identification number), located in (City), (State), ________% of my estate."

A residual bequest:
"I give all the residue of my estate, including real and personal property, to (legal name and tax identification number), located in (City), (State),

A double-purpose bequest. You can provide a relative or friend with income for life through a special gift to our organization. You can do this by establishing a charitable trust through your Will. Upon your death, the trust pays income to the person you designate. After that person's death, whatever remains in the trust passes to our organization. Call our organization at (phone) for further information.

If you wish to have your bequest applied to a specific program, simply add "...for the benefit of (name of program)" to the language suggested above.

Consult an attorney when preparing legal documents.

We Want To Thank You

Dear

Our organization is pleased to recognize those who have left charitable bequests, established charitable trusts, or used some other form of estate planning to support our work. To enroll in our Legacy Circle, which honors those who have made this commitment, fill out and mail this form:

(Your organization's contact person)
(Address)

Dear (name of contact person),

Check one:

[ ] I have remembered your organization through a bequest in my will or trust or through some other form of estate gift. Please enroll me in your Legacy Circle. You may publish my name.

[ ] I have remembered your organization through a bequest in my will or trust or through some other form of estate gift. Please enroll me in the Legacy Circle. **Do not, however, publish my name.**

Donor comments (optional): ______________________________________

____

Name(s) (Please Print) ____

____

Address____

City____ State ___Zip __________

Signature____

Date ____

(Written documentation of your bequest is *not* required for Legacy Circle membership. However, if you wish to provide us with documentation, you need send only a copy of the page from your will, living trust or other legal document that references your gift and a simple identification of the document itself such as the first page. Doing so will help us both to plan for the future and to insure that your wishes are carried out.)

