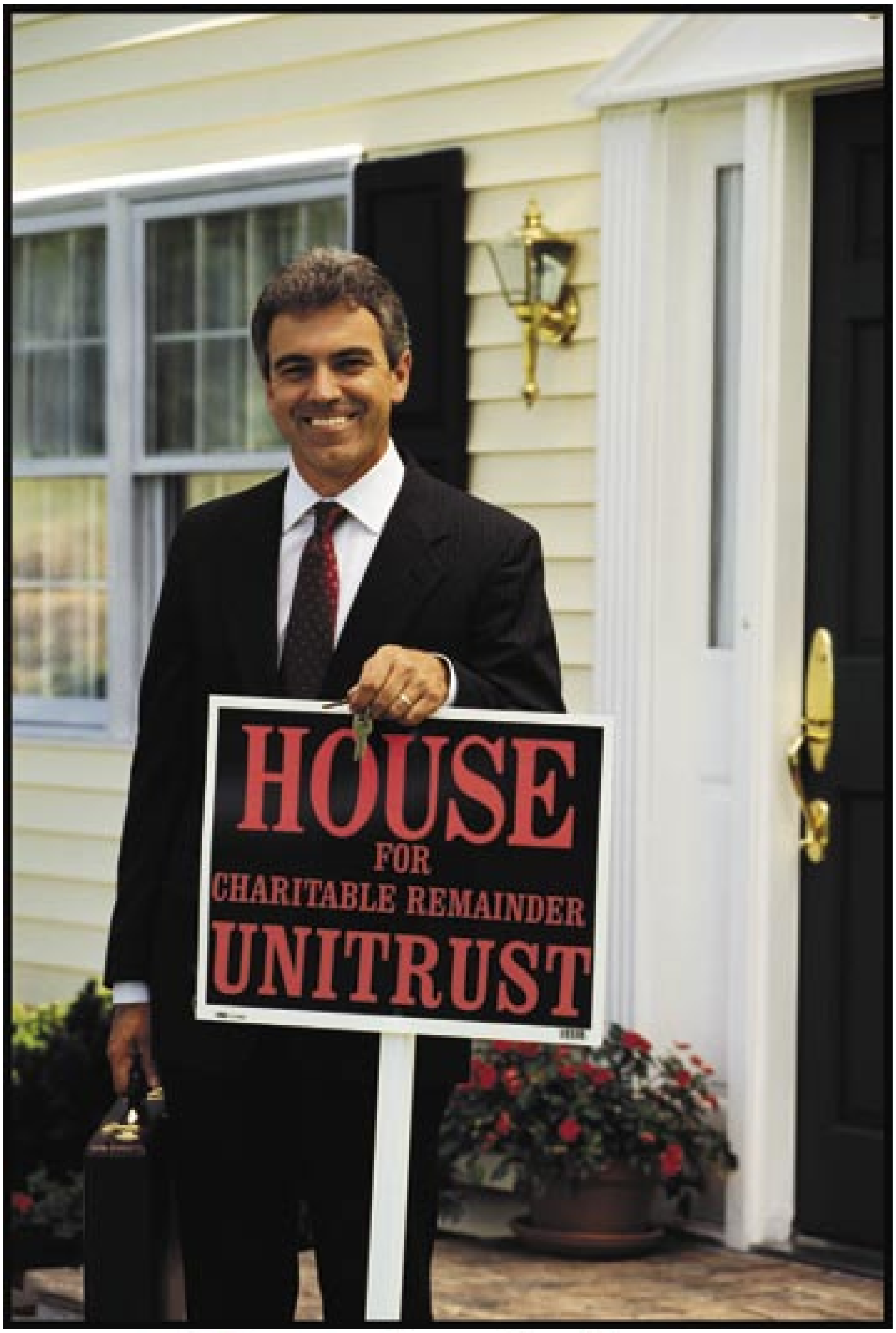
A Reprint from *Tierra Grande*



DOING Well by DOING Good

By Charles E. Gilliland

A real estate agent and a buyer have located a property ideal for the buyer's needs. The property is not for sale, however, so the agent contacts the property owner to ask if he might be interested in selling. The owner explains that although he has little current use for the property, the sizeable capital gain tax liability the sale would generate is keeping him from marketing it.

So that's that, right? The deal is dead.

Maybe not. A knowledgeable agent might be able to break the log jam and bring the property to the market for the eager buyer by suggesting the owner consider a charitable remainder unitrust. This Internal Revenue Code (IRC) provision allows a property owner to avoid a tax on capital gain at the time of the sale, offers an income tax deduction and lets the owner convert the unneeded property into a steady income stream.

Here's how it works. The property owner transfers a real property to a qualified charitable remainder unitrust, specifying the trust period and a percentage of the market value of the trust principal he or she will receive as income from the trust each year. A qualified charity is designated to receive the remainder of funds when the trust ends.

The owner receives a deduction from taxable income equal to the present value of the remainder of the trust. That value is calculated under IRS guidelines and represents the amount remaining for the charity when the trust terminates.

The trustee of the charitable remainder unitrust markets the property and invests the net proceeds. From that investment, the trustee distributes payments as directed in the trust. At the end of the specified trust period, the trustee transfers the remainder of the proceeds to the charity specified in the trust agreement.

Real estate professionals stand to gain both directly and indirectly when property owners create charitable remainder unitrusts. First, the newly available property means a sales transaction can proceed. Second, trustees often list donated properties with an agent when they market them. An agent who informed a donor about the unitrust may have an advantage in the competition for that listing.

Third, people financially able to donate through a charitable remainder unitrust frequently have other holdings and may need the services of a real estate agent from time to time. Having assisted in converting a surplus asset into an income stream and tax deductions may create goodwill in the donor's mind. Finally, by encouraging charitable remainder unitrusts, the agent establishes a reputation for community service.

Interested agents should become familiar with the basics of trust operations. They can identify charities and trusts that accept real estate donations and contact those entities to learn about their donation policies. Typical requirements include an appraisal that meets IRS requirements and a Phase 1 environmental assessment of the real estate. An agent could help provide required documentation and assist in securing an agreement to accept the gift.

> *Real estate professionals stand to gain both directly and indirectly when property owners create charitable remainder unitrusts.*

Qualified Charities, Trustees

A qualified charity is an organization operated for "religious, charitable, educational, scientific, literary, educational purposes or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to animals" (IRC Section 170[c]).

The organization may be a corporation, community chest, fund or foundation that exclusively pursues one or more of the exempt purposes prescribed. This includes organizations as diverse as The Nature Conservancy, The American Red Cross, the Texas A&M Foundation and the UT Foundation Inc. Many of these organizations will also serve as trustee of unitrusts funded with real estate.

Administration of trusts is a complicated endeavor that involves compliance with IRS rules and regulations. Donors should use care in selecting a trustee to ensure competent administration and continuity over the life of the trust. Acceptable trustees may include commercial institutions such as the trust department of a bank or trust company, charities, individuals or a combination of these. The trustee sells the real estate, invests the proceeds, files reports and forms and distributes income and proceeds.

Sample Savings

Consider a hypothetical, typical charitable unitrust administered by the Texas A&M Foundation Trust Company. A donor aged 70 transfers a property valued at $1 million with a tax basis of $250,000 to a qualified charitable remainder unitrust. The donor opts to receive payments amounting to 7 percent of the unitrust principal for the remainder of his life. When the donor dies, the unitrust remainder will go to the Texas A&M Foundation.

The donor initially avoids capital gains tax of 15 percent on $750,000, saving $112,500. The IRS allows a deduction from current income for the charitable gift of the remainder even though the charity will not receive the proceeds for an estimated 17 years, the life expectancy of the donor.

The donor's ability to use the full deduction in a single year is limited by IRS rules, but the excess may be carried forward for up to five years. The amount of the allowed deduction is the result of a complex calculation following IRS instructions. It amounts to a percentage of the property value adjusted according to the age of the donor and the percentage payout selected by the donor.

In this case, the estimated charitable deduction is $436,220, which translates to savings of $143,953 on current income taxes, assuming a 33 percent marginal tax rate.

If the donor had specified a lower percentage payout, the income tax deduction would have been greater. For example, a 5 percent rate would produce a deduction of $540,970 with projected tax savings of $178,520 at a 33 percent marginal tax rate. Given the 7 percent unitrust rate and the charitable income tax deduction, the benefits are comparable to an investment providing an 8.18 percent return.

Assuming that the trust earns 7 percent on the invested proceeds from the property sale and pays the donor 7 percent, the Texas A&M Foundation will realize a $1 million donation when the donor dies. If the donor had selected a 5 percent payout rate, the donation would have increased to $1,400,241 as the added 2 percent return accrued to the trust balance through the years. Whether the donor was single or married, those proceeds would transfer to the charity without probate expense or estate taxes.

Calculated deductions and benefits in these examples reflect provisions in Section 664 of the Internal Revenue Code as specified in the IRS publication 1458. Each situation has unique features that yield different results. Many charitable organizations have websites with computer programs that calculate projected benefits for specific circumstances.

Because of the financial and legal complexities involved in charitable remainder unitrusts, agents and prospective donors should consult with trust companies, charitable organizations and tax professionals. Nevertheless, agents who are well informed about available trust options may find this knowledge a valuable tool in expanding their businesses.

Dr. Gilliland (c-gilliland@tamu.edu) is a research economist with the Real Estate Center at Texas A&M University.

MAYS BUSINESS SCHOOL

Texas A&M University
2115 TAMU
College Station, TX 77843-2115

http://recenter.tamu.edu
979-845-2031

Tierra Grande (ISSN 1070-0234), formerly *Real Estate Center Journal*, is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, $20 per year. Views expressed are those of the authors and do not imply endorsement by the Real Estate Center, Mays Business School or Texas A&M University. The Texas A&M University System serves people of all ages, regardless of socioeconomic level, race, color, sex, religion, disability or national origin. **Photography/Illustrations:** Real Estate Center files.