

Life Insurance Planning

Charitable gifts with retained life estates can provide tax and planning benefits.

By Chad Whitfield, JD



For many families, personal real estate is their most valuable asset. Depending on the owner's estate planning objectives, an eventual charitable gift of the property may be part of their overall plan.

However, many owners may be unaware that their residence offers the unique ability to obtain a current income tax deduction without relinquishing the use of the property during their lifetime through the use of a charitable gift with a retained life estate.

The following describes this technique and its tax reduction and planning benefits and provides an overview of considerations for charitably inclined owners of a personal residence.

Retained life estate

In a typical retained life estate scenario, the donor will convey or deed real estate to a charity but retain the right to live on the property for a specified term. Traditionally, this specified term is for the life or lives of the donor and the donor's spouse.

This conveyance essentially divides the real estate into two parts:

- One part, the life estate, retained by the donor, allows the donor full use and enjoyment of the property for their lifetime.
- The second part, the remainder interest, owned by the charity, provides complete ownership to the charity at the end of the life estate.

The gift of the remainder interest to the charity is permanent and irrevocable.

Note that real estate eligible for a charitable gift with a retained life estate is not limited to a primary home or residence but may also include a vacation home or farmland that includes a personal residence.

Income tax charitable deduction

By contributing the remainder interest in real estate to a charity, the donor receives a significant tax deduction today, yet, is permitted to live on the property for the rest of his or her life.

When the donor legally changes title to the real estate creating a life estate for the donor and a remainder



interest for a charity, the donor has made a charitable contribution in the year the remainder interest was created.¹

The tax deduction amount is based on the estimated present value of the charity's remainder interest, essentially an estimate of the value the charity is expected to receive in the future. The present value is determined using tables and formulas located in the IRS regulations and will depend largely on the donor's age and interest rates at the time of the contribution.

Note that an appraisal of the property by an individual or organization who is generally in the business of performing such appraisals will be necessary as well.

While the donor will be permitted a federal income tax deduction for the present value of the remainder interest, the tax deduction is typically limited to 30 percent of the donor's adjusted gross income (AGI). Nonetheless, by creating the remainder interest, the donor can

produce considerable cash currently by further reducing income taxes. If the donor is unable to utilize all the deduction in 2021, the unused portion may be carried forward for five additional years. Since the Applicable Federal Midterm Rate (AFR) in effect for the month of the retained life estate gift (or one of the prior two months) is applied as the interest factor to calculate the present value, now may be an excellent opportunity to evaluate retained life estate giving. Keep in mind that the lower the AFR, the higher the charitable deduction.

EXAMPLE. Assuming joint owners of personal real estate, both aged 65, the charitable income tax deduction can be significant, as shown below:

Property value:	\$500,000
7520 Rate:	1.2% (July 2021)
Joint ages:	65 / 65
Donation factor:	0.76467 (Per IRS Table R(2))
Charitable income tax deduction:	\$382,335

Gift agreement

The implementation of a retained life estate for charitable purposes, as part of an overall planning strategy, should always be coupled with a comprehensive gift agreement (GA). The GA should protect both the donor and the charity. A complete GA would address numerous issues and obligations such as utilities, property taxes, liability insurance, and repairs and maintenance, and include a conflict resolution process.

The donor, as owner of the life estate, typically absorbs the cost and expense of customary maintenance. However, expenses associated with improvements that benefit the owner of the remainder interest, the charity, should be agreed upon by the parties and sufficiently covered in the GA.

The capability to rent the real estate and receive rental income is one right typically maintained by the donor as well. Accordingly, the charity will likely expect to have significant involvement regarding the donor's selection of a lessee. Any agreed upon GA should properly adopt rules and provisions to cover a lessor/lessee relationship.

Unfortunately, the relationship between donor and charity may sometimes deteriorate. Therefore, a thoughtfully crafted GA will incorporate a process and procedure to resolve disputes that may arise between the parties.

Estate planning implications

By creating the remainder interest as part of the retained life estate design, the donor's heirs will not inherit the real estate or its value. This may

¹ Normally, no charitable deduction is permitted unless the donor relinquishes complete control over donated property, however an exception for personal residences is available under IRC §72(f)(3)(B)(i).

be a beneficial result if the donor has concerns regarding behavior and conflict issues among children/grandchildren that could arise in managing and sharing the property. The donor may look to alternate or additional assets that may provide a more prudent and effective means of inheritance for such heirs.

The retained life estate planning strategy may work best for the donor that has supplemental assets or life insurance to leave as an inheritance for loved ones. Alternatively, the donor may utilize additional cash created through the charitable deduction to fund a life insurance policy to replace or equalize the desired wealth passing to the next generation.

To further protect the life insurance proceeds from estate taxes and

creditors, the policy may be owned by a wealth replacement trust designed to meet the donor's specific planning goals and stipulations.

Estate tax minimization is an additional benefit of the retained life estate approach. If a donor's estate will be subject to the federal estate tax, under this planning tactic, the value of the real estate is not included in the federal taxable estate. This effectively removes the property outside the estate for estate tax purposes, yet allows the donor to fully use and enjoy the property during his or her lifetime.

Conclusion

A retained life estate offers several tax and planning benefits for a donor:

- An immediate charitable deduction.

- Lifetime use and enjoyment of gifted property.
- The removal of property value from the taxable estate.

Further, the donor can create the remainder interest for one charity or for multiple charities.

Additionally, if family conflict over real property is a concern, a retained life estate coupled with life insurance will minimize conflict yet maximize the family inheritance.

In addition to these benefits, now may be an optimum time to consider charitable remainder gifts due to the current low interest rates and high property values. Reach out to your financial advisors to discuss this planning opportunity and see if you could benefit both family and charity with a retained life estate.



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