Partial Interest Gifts – Navigating Rocky Shoals and Avoiding Whirlpools

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By Craig Wruck, PG Calc Senior Advisor

Contributions of appreciated assets offer tax savvy opportunities for gift planning. But what if the donor is not eager to part with the entire asset? That's no problem if the asset is securities; our donor simply transfers as many shares as she chooses and keeps the rest for herself. However, other assets aren't so easily divided – things like real estate or bank, investment, or retirement accounts. A contribution of a partial interest can allow donors to give a portion of the property and retain the rest for themselves, their family, or others.

Navigating a contribution of a partial interest can be a bit like the challenges Odysseus faced on his journey home. It wasn't all smooth sailing. He had to navigate rocky shoals, whirlpools, and angry gods, but eventually, he made it home safely.

Among the candidates for partial interest gifts are:

> **Real Estate** – Residential or commercial properties that have appreciated in value make excellent charitable gifts. If the donor isn't ready to give the entire property, she can contribute a portion of the property, an "undivided partial interest," to charity and keep the rest for herself or others.
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> **Bank or Investment Accounts** – Designating a charity to receive a bank or investment account is a remarkably simple way to make a gift. It's usually as easy as filling out a form with the financial institution directing that charity receive a percentage of the balance in the account.

Retirement Accounts – Directing retirement accounts to a charity and leaving other non-taxed assets to heirs is a tax-smart strategy. It's a simple matter to direct the plan administrator to distribute a portion of the account to charity and the rest to heirs.

There is an income tax charitable deduction for a partial interest contribution. The amount of the deduction is based upon the total value of the property, but the deduction is limited to the fraction of the property that is contributed to charity. As with other gifts of appreciated property, the donor avoids capital gains tax on the portion of the property contributed to charity. Note that the donor cannot contribute only the gain in the property and retain the basis. The gain and the basis are apportioned equally among all of the partial interests.

Several gift planning vehicles lend themselves to creative applications of partial interest gifts.

Outright Current Gift – After completing a contribution of a partial interest, the charity can collaborate with the owner of the other partial interest to sell the property. At closing, the charity receives its proportionate share of the net proceeds from the sale. Like any other sale of an asset by the charity, the sale of the partial interest must be an arm's length transaction and for fair market value. If the owner of the other partial interest wishes to purchase the charity's interest, care should be exercised to avoid a pre-arranged sale and to ensure the charity receives full fair market value for its interest.

Charitable Remainder Trust with Cash Back – If a charitable remainder trust is appealing but the donor would like to receive some cash too, she could consider contributing a percentage interest in the property to the charitable trust and keep the remaining interest for herself. For example, if a donor owns a property worth $500,000, she could transfer a 60% interest in the property to a charitable remainder trust and retain the remaining 40% interest for herself. When the property is sold, the trust will receive $300,000 ($500,000 x 60%), and the donor will receive $200,000 ($500,000 x 40%). The donor will owe capital gains taxes on 40% of the total capital gain, but her income tax charitable deduction from the charitable remainder trust can help to reduce her tax bill.

Bargain Sale – Under certain circumstances, a charity might find it worthwhile to purchase a property from the donor at a discount. From the donor's perspective, the transaction is part sale and part charitable contribution. For example, if a charity agrees to purchase a property now worth $500,000 for $100,000, the donor will have made a charitable contribution of $400,000. Bargain sales can work especially well in cases where the charity has reason to acquire the property for its own purposes. A bargain sale can provide a solution when a donor is willing to consider contributing the appreciation in value but is intent on retrieving his initial investment in the property. In these cases, the donor should be advised in advance that he will still be liable for capital gains tax proportional to the interest he retained.

Retained Life Estate – Although it is not a true partial interest gift, but rather a split interest gift, a retained life estate can be appealing for a donor who is willing to consider giving his home (or even a vacation property) but wishes to retain the right to live in or use the home for life. With a retained life estate, the charity assumes ownership of the property now but is subject to the donor's right to continue living there. The income tax charitable deduction is based upon the fair market value of the residence at the time of the gift and the present value of the charity's remainder interest.

Bringing it Home - Partial interest gifts can open possibilities for reluctant donors. With some careful planning and attention to detail, you can bring them home without enduring years at sea or getting stranded on an island and imprisoned by a sea nymph.