Keys to Effective Charitable Giving

EXIT STRATEGIES FOR REAL ESTATE INVESTORS

Dave Smith was a man with the golden touch. Throughout his life, it seemed every investment idea he touched turned to gold. Dave experienced tremendous success with real estate investments. They became his passion.

Amazingly, Dave continued to buy and sell real estate even at the age of 85. Dave discovered a great "fixer-upper" in a good area. While similar commercial buildings in the area sold for over $2 million, the seller needed to sell quickly and was asking just $1 million. The condition of the building turned many buyers away, but Dave was not deterred. He could see great potential with the building and realized it would not take much to bring it to market condition. Therefore, Dave bought the building for $1 million and quickly hired contractors to refurbish the place.

After three months of hard work refurbishing the building, it looked brand new! Dave's refurbishing costs came to $250,000, bringing his total investment in the building to $1.25 million. One month after completion of the work, a potential buyer contacted Dave informally to express interest in the building—a $2 million interest!

There was one downside to the idea of selling. Dave had held the property for only four months, which meant the gain from the sale would be a short-term capital gain. In other words, the applicable federal tax rate would be 35 percent, not the 15 percent associated with long-term capital gains. Dave cringed at the thought of paying more than one-third of his gain to the government. At the same time, Dave knew the hot real estate market might not last forever and could change with rising interest rates. So while Dave wanted the 15 percent tax rate, he did not want to risk holding the property for another eight months.

Dave wanted a zero tax exit strategy.
In other words, he wanted to sell the property and pay no tax. Based on Dave's situation and goals, a combination "Sale and Charitable Remainder FLIP Trust" (FLIP CRUT) would provide an excellent option. Prior to any binding sales agreement, Dave could transfer an undivided interest in a portion of his property into the FLIP CRUT. Because there was no legally binding agreement between Dave and any buyer, there was no prearranged sale problem. Once the undivided interest in the property was transferred to the FLIP CRUT, the trust would list and sell the property. It would be advisable for the trust to handle the sale of Dave's portion as well. The trust would owe no taxes on its portion of the sale because the trust would be exempt

from income taxes. Accordingly, the FLIP CRUT would meet Dave's first goal—avoiding an immediate 35 percent tax bite. However, he would retain taxable income from the sale of his portion of the property. Thus, the goal was to use the FLIP CRUT charitable deduction to offset any taxable income from the sale of his portion of the property.

The key question for Dave was what percentage to transfer to the FLIP CRUT and what percentage to retain. Pursuant to IRC Sec 170(e),

Dave would receive a charitable income tax deduction based upon his cost basis in the property, not its fair market value.

The donor cannot claim a charitable income tax deduction for a longterm gain on the property. In this case, all of the gain on the property would be short-term capital gain, so IRC Section 170(e) would apply. The reduced deduction would ultimately affect the zero tax calculation.

Based upon these considerations, Dave decided to transfer 45 percent of his property into the FLIP CRUT and retain 55 percent of the property. Upon sale of the property for $2 million, the trust received $900,000 and Dave received $1.1 million. Dave's charitable deduction was $419,434 and it saved him about $146,802 in taxes. The deduction was subject to the 50 percent AGI limitation, since it was a "basis" deduction. However, given Dave's enormous AGI for the year, the limitation would pose no problem. Dave owed $144,375 in taxes as a result of the sale of his portion of the property.

However, Dave's $146,802 charitable deduction fully offset his $144,375 tax liability, resulting in a zero tax sale—exactly what he wanted! The zero tax sale plan clearly met all of Dave's objectives.

In the end, Dave walked away with $1.1 million in cash, a $900,000 FLIP CRUT, and no tax payment to the government.

The Charitable Remainder Trust can be tailored to meet your individual goals and objectives. It can be a rewarding part of your investment plans, your retirement plans, and your estate plans. It can be a means of increasing your income or providing income for another person.

Please contact Kathleen Brubaker at our Cru Foundation, previously known as The Great Commission Foundation of Campus Crusade for Christ, Inc. to discuss your specific objectives and/or how a custom CRT may be designed for you. You can reach Kathleen by calling her toll free at (407) 487-6004 or email her at kathleen.brubaker@cru.org.

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