NonProfit TRENDS

Follow us on

July 2016

"Divide" and Conquer Contribution Deduction Limitations: Advice for Donors and Not-for-Profit Organizations

By Howard H. Cohen | Partner
Israel Tannenbaum | Senior Manager

It is not unusual for a not-for-profit to receive an outright donation of real property. However, there has been an increasing trend whereby donors are contributing these interests "over time or piecemeal."

Generally, you cannot deduct a charitable contribution of less than your entire interest in a property.[1] Additionally, a contribution of *the right to use property* is considered a contribution of less than your entire interest in that property, and is not deductible. A common example of this is providing space in a building rent free to a 501(c)(3) organization. Since you are still the owner of the building, this would not be deductible.

However, as with most tax law, there are several exceptions that accomplish the same purpose and are not restricted. The most common method is having the donation consist of an "undivided fractional or percentage interest in the donor's entire interest in the property."

While this can provide donors who are unable to absorb a large "one time" charitable deduction the ability to maximize the value of their deduction by spreading it over multiple tax years, as well as accelerate the timeframe in which charitable organizations will receive a contribution (otherwise a donor may delay their contribution until they can use the entire property's value as a deduction), there are a number of important items to note for both parties.

1 § 1.170A-7(a)(1)

Donors
There are several rules that govern the donation of a fractional interest in tangible personal property that is eligible for a charitable deduction.

Firstly, you cannot deduct a charitable contribution of a fractional interest in tangible personal property unless all interests in the property are held immediately before the contribution by:

1. The Donor, or
2. The Donor and the qualifying organization receiving the contribution.

Secondly, if you contributed a fractional interest in tangible personal property for which you took a deduction, and did not contribute the rest of your interest within 10 years of the date of the original contribution, you are required to "recapture" your deduction as income, as well as pay interest and an additional tax equal to 10% of the amount recaptured.

"…this can provide donors who are unable to absorb a large "one time" charitable deduction the ability to maximize the value of their deduction by spreading it over multiple tax years."

Organizations
There are several key items that an organization must take into account when contemplating accepting such a donation:

1. **Get It in Writing**: With a fractional gift, the ensuing ownership as tenants-in-common, during the years of co-ownership, raises complex issues between a donor and a charity. As with gifts of remainder interests, state law provides default rules, but it is generally advisable that the parties expressly address the issues of co-ownership in a written agreement signed when the first fractional or percentage interest gift is made. This is particularly important if there are carrying costs that are to be allocated entirely to the donor during the period that the tenancy-in-common continues. A charity should ordinarily insist that the donor execute a binding agreement to donate his or her entire interest in the real property at, or before, death, but definitely keep it out of the donor's estate.

2. **Exposure**: Often, charities will ask for broad indemnities and environmental audits before they will accept a gift of real estate. Indeed, a charity may insist that the real estate be placed in a limited liability company and that the LLC interest be donated, in order to insulate the charity to the extent possible from liabilities associated with the property. When keeping the charity out of the chain of title is of paramount importance, a supporting organization might be used to accept and dispose of the gift.

3. **Liquidity**: With virtually any type of real estate, lack of liquidity is a concern. That concern is heightened if there are substantial carrying costs such as taxes, insurance, or maintenance, or if there is a limited ability to make the property produce income (ideally, tax-free rental income) during the period before sale. A charity should insist on doing a great deal of due diligence on marketability and carrying costs before agreeing to accept a gift of real estate.

These same rules also apply to corporate, partnership and other qualified donors.

Ultimately, as long as one is mindful of the rules and collateral effects, taking advantage of this contribution structure can provide distinct advantages for both donors and recipient organizations.

Please do not hesitate to reach out to our experts if you have any questions. We will also be available to answer your concerns about accounting for these transactions.

For more information contact:

Howard H. Cohen | Partner
212.375.6587
Howard.Cohen@WeiserMazars.com

Israel Tannenbaum | Senior Manager
646.225.5915
Israel.Tannenbaum@WeiserMazars.com

Visit us on **www.weisermazars.com**