

Life Estate Agreement Presentation Input Screen

Deduction Questions

Case Name	----- NEW CASE -----		
Name for Reports	Mary Stokes		
Value of Residence	1,000,000		
Cost Basis of Residence	200,000		
Debt on Residence (if any)	0		
Date of Transfer	Jun 8, 2016		
Trust Period Measured by	Lives (L)		
Depreciable Value	600,000		
Estimated Useful Life	40		
Salvage Value	200,000		

Beneficiary Information

	First Name	Date of Birth	IRS Age	Use
Donor	First name	Jun 1, 1946	70	Yes

Selection Method for AFMR	Use Best Rate
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v2016.5

Life Estate Agreement

Prepared for Mary Stokes

Prepared by Your Name

The following information is intended for educational purposes only and should not be construed as legal, accounting, tax, or investment advice. You should consult your professional advisors prior to relying on any information contained herein.

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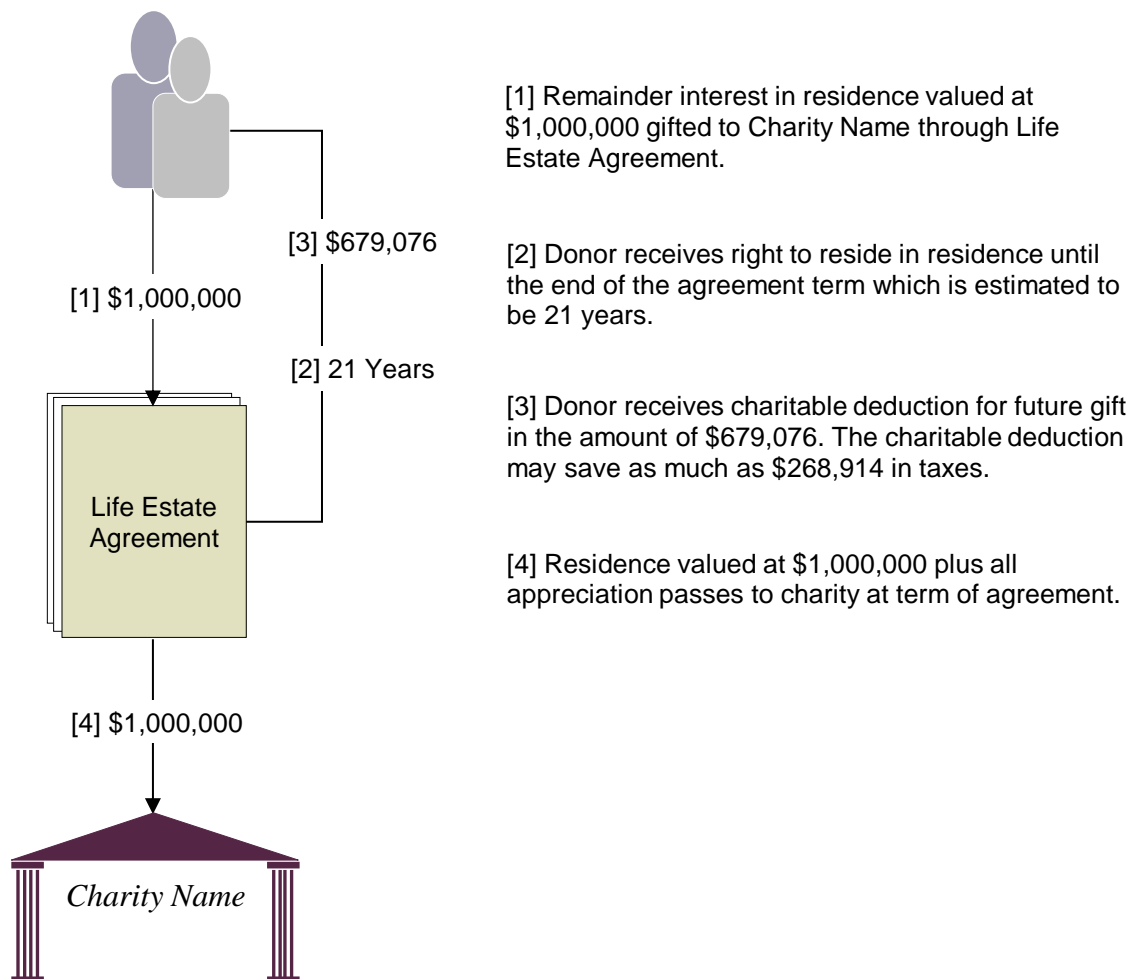
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What is a Life Estate Agreement?

A **Life Estate Agreement** is an arrangement whereby you transfer title to your personal residence or farm to a charitable organization with a retained right to the use of the property for a period of time specified in the gift agreement. At the conclusion of the measuring term, all rights in the property, called the remainder interest, are transferred to the charitable organization named in the agreement.

Life estate agreements can be measured by the life of one or more individuals, by a fixed term of years, or by a combination of the two. They are, however, most frequently established to operate for the life or lives of the owners of the contributed property.

Life estate agreements are ideal planning vehicles for individuals who desire to make a gift of real property to charity now and enjoy current tax benefits, yet retain the use of the property for their lifetimes or other term of their choice.



Tax and Financial Benefits

Life estate agreements offer several significant tax and financial benefits:

Current Income Tax Deduction

When you create a life estate agreement, you are making a current commitment to a future charitable gift. Because the gift is irrevocable, you receive a current income tax deduction for a significant portion of the property's value.

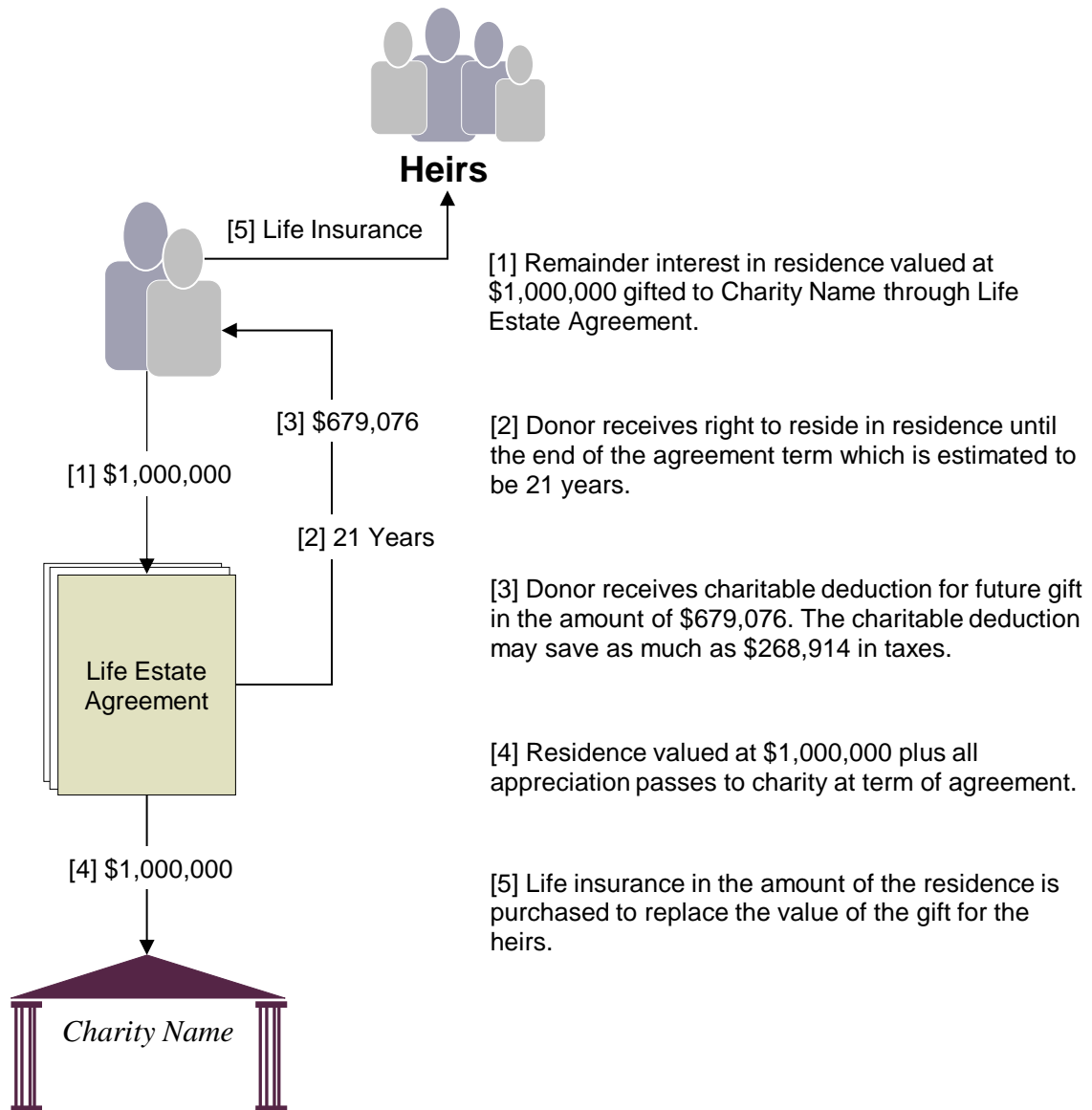
Gift and Estate Tax Planning

Property transferred to charity via a life estate agreement that names you (and/or your spouse) as tenants completely avoids both gift and estate taxes. Naming others, such as children or grandchildren, as tenants can reduce your gift and/or estate taxes as well.

In addition to removing the property from your taxable estate, the income tax savings created by the charitable income tax deduction can be coordinated with other estate planning techniques. The most common combination involves gifts of cash from the donor to an irrevocable life insurance trust or directly to family members that is then used to purchase insurance on the life or lives of the donor or donors. Commonly referred to as a wealth replacement trust, the concept often enables donors to give more to charity without disinheriting their heirs.

Tax and Financial Benefits

The following diagram illustrates the use of life insurance to replace the asset for the heirs.




Selecting a Measuring Term

Life estate agreements are most frequently measured by the lifetime of one or more individuals; however, the agreement can also be measured by a term of years that you select, or by the longer of the life or lives of individuals and a term of years.

If the agreement is measured by one or more lives, the individuals must be alive at the time the agreement is created. If the agreement is measured by a fixed term of years, there is no minimum or maximum term for federal tax purposes; however, state law may impose limitations. Check with your professional advisors.

Life Estate Options *The **Red vertical line** indicates end of trust term.*

[1] Lives Life estate terminates at the end of the lives of all beneficiaries 

The life estate lasts for the lives of all beneficiaries, then terminates and the residence passes to the charity.

[2] Term of Years Life estate terminates at the end of a term of years 

The life estate lasts for a term of years written in the agreement.

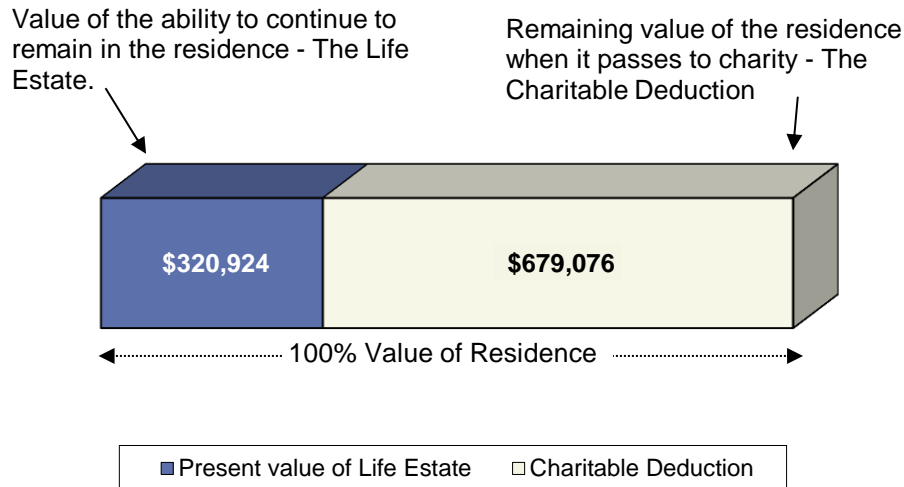
[3] The Longer of Lives or Term of Years Term of years
Lives of beneficiaries 

The life estate lasts for a term of years or the lives of the life tenant whichever is the longer of the two.

Planning note: When a tenant of the residence is other than the donor or donor's spouse, such as a child or grandchild of the donor, gift and estate tax ramifications of the trust design should be reviewed by the donor's council.

How the Deduction is Calculated

When you transfer property to charity with a retained life estate, you may qualify for a current income tax charitable deduction.



NOTE: Based on a contribution of a residence valued at \$1,000,000 net of debt, the charitable income tax deduction would be \$679,076, which may save as much as \$268,914 in taxes based on an ordinary income tax bracket of 39.6%.

The amount of the deduction is determined using IRS formulas that calculate the present value of your future charitable gift (called the remainder interest). Factors used in calculating the deduction include the:

- **Fair market value** of the depreciable (improvements) and non-depreciable (land) portions **of the property** transferred on the date of the gift.
- The **useful life** and **salvage value** of the depreciable portion of the property.
- **Measuring term of the agreement**, which may be based on a term of years, the age of the income beneficiaries, or a combination of the two.
- **Income payment frequency** (annual, semi-annual, quarterly, monthly).
- **Charitable Federal Midterm Rate (CFMR)** in effect for the month of the gift or (at the election of the donor) during either the two prior months. The lower the CFMR rate, the higher your deduction.

Claiming the Charitable Deduction

You may qualify for a charitable income tax deduction based on the present value of your future charitable gift. However, there are limitations and reduction rules that may limit or reduce the amount of deduction you can claim on your income tax return in any given year.

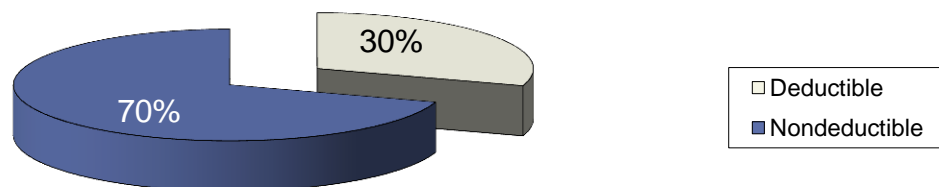
The tax rules are designed so taxpayers cannot use the charitable deduction alone to completely eliminate their income tax liability. Therefore, the amount of charitable deduction you can claim in any given year is limited to a percentage of your income. The percentage depends on the type of property you give, how you give it, and the type of charitable organization to which you give it. Furthermore, the amount of your deduction may be reduced based on the type of property you contribute.

The following rules apply for federal income tax purposes. The rules for state income tax purposes may vary. Consult with your tax professional.

Long-Term Capital Gain Property

If you have owned your residence for at least one year, it is considered long-term capital gain property. If the remainder interest will be paid to a public charity, the fair market value of the property is used to calculate the discounted present value of your gift. You can claim the resulting amount as a deduction against up to **30%** of your adjusted gross income in the year you create the trust.

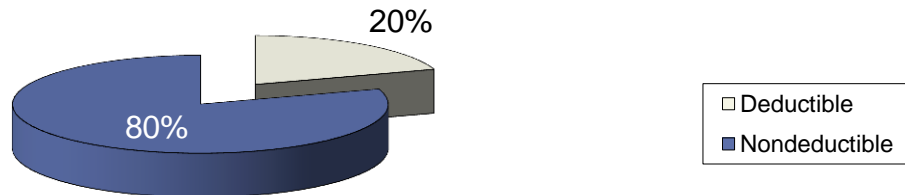
Long Term Capital Gain Property to Public Charity



If you name a private nonoperating foundation as remainderman, the deduction is based on the **lesser of the asset's fair market value and your cost basis**. The resulting deduction is subject to a 20% income limitation.

Claiming the Charitable Deduction

Long Term Capital Gain Property to Private Foundation

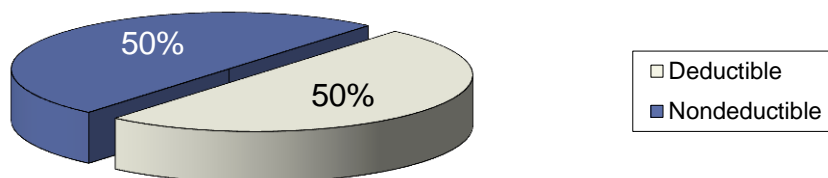


Ordinary Income Property

If you have held the residence for less than one year, it is considered ordinary income property. If the remainder interest will be paid to a public charity, you can use the deduction against up to **50%** of your adjusted gross income in the year of the gift; however, **the deduction must be calculated based on the lesser of the property's value or your adjusted cost basis** (generally the amount you originally paid plus any capital improvements, and less any claimed depreciation).

If the remainder interest will be paid to a private nonoperating foundation, the deduction is calculated in the same way; however, the percentage limited is reduced to **30%**.

Ordinary Income Property to Public Charity



Claiming the Charitable Deduction

Combination Property

You may have held your residence long-term, but if sold would produce both long-term capital gain and ordinary income. As an example, ordinary income could be produced by depreciation recapture created by depreciating a portion of your residence as an office. In such cases, for purposes of calculating your deduction, **the fair market value of the property is reduced by any amount that would be considered ordinary income** on the sale of the property. If you name a public charity as remainderman, the resulting deduction is subject to the **30%** limitation as described previously. If you name a private nonoperating foundation to receive the property, the limitation is **20%**.

Carryover Rule

In all cases, if you cannot use all of your deduction in the year of your contribution, you can carry any excess deduction over up to five more tax years, if necessary.

Years



Your deduction can be used in the year of the gift and 5 additional years

Questions and Answers

Following are frequently asked questions regarding life estate agreements:

Are life estate agreements recognized by the IRS?

Yes, life estate agreements are specifically approved and deductible for income, gift, and estate tax purposes in sections 170, 2522, and 2055 of the Internal Revenue Code.

How is a personal residence defined?

A "personal residence" is any property used by you as a personal residence even though it may not be your principal residence. For example, a vacation home is considered a personal residence, as is stock you own in a cooperative housing corporation. In addition, a condominium, mobile home, boat, or house trailer (that contains sleeping space, bathroom, and cooking facilities) might also be considered personal residences even though the IRS has not ruled whether they qualify for charitable deduction purposes. Make sure you consult your professional advisors.

How is a farm defined?

A "farm" is defined as any land used by you or your tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock. A farm also includes the improvements (structures) thereon, but does not include tangible personal property (such as farming equipment).

Who is responsible for paying ongoing expenses?

The life tenant remains responsible for all expenses associated with the property. These include maintenance and repair, utilities, property taxes, and maintaining insurance coverage. These responsibilities are discussed in the agreement.

Who can be a tenant under a life estate agreement?

In most cases, the property owner(s) retain the life estate in the property; however, other individuals (such as children or grandchildren) can be named as well. You should be aware that naming individuals other than yourself or your spouse as tenants might trigger gift or estate taxes. These rules can be fairly complex, so consult your professional advisors.

Can I transfer debt-encumbered property via a life estate agreement?

Debt encumbered property can be transferred to charity with a retained life estate; however, it should be noted that neither the Internal Revenue Code nor the Treasury Regulations address the tax consequences of this specific transaction. In the absence of clear authority, the IRS has issued only one private letter ruling that interprets this issue. It should be noted that a private letter ruling applies only to the individual taxpayer requesting it and cannot be relied upon by others as tax precedent. Therefore, it is important that you obtain qualified tax counsel to advise you in this area.

Questions and Answers

The IRS ruled that when debt encumbered property is transferred to charity by a life estate agreement, the transaction is treated for income tax purposes as though the charity has handed the donor cash in the amount of the indebtedness. In reality, however, the donor remains responsible for making payments. If the property is appreciated, the donor realizes gain in the same amount that would have been realized had the donor sold a fractional interest in the property equal to the indebtedness. In other words, the entire gain in the property is prorated in relation to the ratio the indebtedness bears to the entire fair market value of the property. The IRS also ruled that the present value of the gift (i.e., the donor's income tax charitable deduction) would be calculated based on the fair market value of the property less the total indebtedness. In the years that followed the contribution, the donor would also be entitled to claim additional charitable contribution deductions for the present value of the remainder interest attributable to the repayment of principal.

Based on this ruling, if the donor has a low cost basis, the realized gain can easily exceed the entire charitable contribution deduction. However, this result may not be as bad as it sounds. Under current law, an individual can exclude \$250,000 of capital gain (\$500,000 for qualifying married couples) from the sale or exchange of a personal residence if the taxpayer owned the property for at least five-years prior to the sale and used the property as their principal residence for at least two of those years. This rule applies to the sale of one residence every two years.

These rules may also apply if you sell a portion of the remainder interest in your property to charity. Although the Service has not specifically addressed this issue, it did issue a favorable ruling that permitted a donor to exclude gain (to the extent of the limitations of IRC §121) arising from the sale of a personal residence to charity in exchange for a charitable gift. The Service has not, however, ruled on whether or not gain from the sale of a remainder interest in debt-encumbered property to charity would qualify for exclusion. Please consult your professional advisors.

What happens if my circumstances change?

Individuals who plan to spend their final years in their current residence frequently contemplate life estate agreements. Circumstances and planning goals do change, however. What if you can no longer, because of age or health problems, maintain or occupy the property? What if you need additional income? Or what if you no longer need the property and want to accelerate your gift to charity?

Questions and Answers

The life tenant retains all beneficial lifetime rights in the property. This includes the ability to rent the property and receive the income for the remaining term of the agreement.

Another option available to donor and charity is to sell the property and divide the net sales proceeds according to each party's interest at the time of sale. For this purpose, a present value of the remainder interest is calculated using the net sales proceeds and the date of sale. Any expenses, such as outstanding property taxes that would otherwise be attributable to the life tenant are deducted from the life tenant's share prior to distribution. The present value of the remainder interest is then distributed to charity with the remaining proceeds distributed to the donor. The donor will then realize gain based on their proportionate share of the sales proceeds.

Yet a third option involves the donor contributing the balance of the life estate thereby accelerating the gift of the remainder interest. In such cases, the donor is entitled to receive an additional charitable contribution income tax deduction based on the present value of their remaining life or term of years estate.

Facts Used in This Analysis

Deduction Calculation for One Life

Prepared for Mary Stokes

Beneficiary Information

Name	Relationship	Date of Birth	IRS Age	Age at Mortality
First name Last Name	Donor	Jun, 1, 1946	70	83

Donor Contact Information

Address: _____
 City: _____ State: _____ Zip Code: _____
 Home Phone: _____ Business Phone: _____ Fax: _____
 email Address: _____
 Web Address: _____

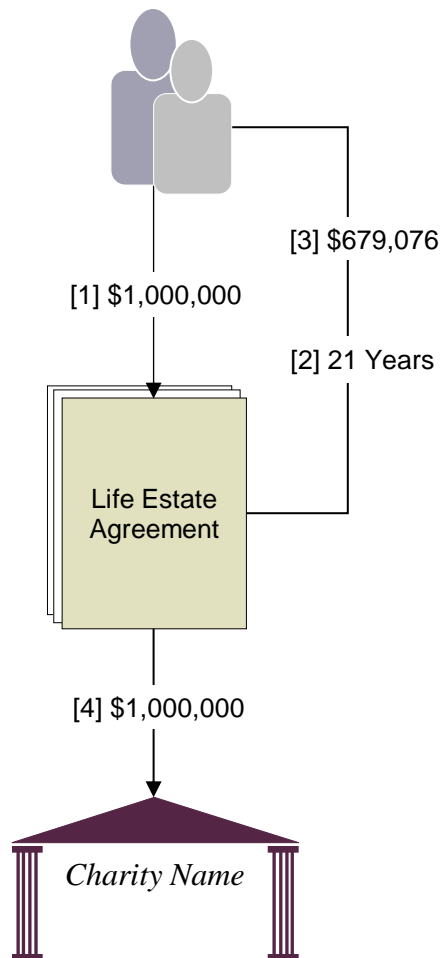
Illustration Information

Date of transfer	June 8, 2016
Ordinary income tax bracket of donor	39.6%
Capital gains tax bracket of donor	23.8%
Fair market value of residence	\$1,000,000
Amount of debt on residence	\$0
Fair market value of residence net of debt	\$1,000,000
Current value of depreciable property (improvements)	\$600,000
Estimated useful life of depreciable property in years	40
Expected salvage value of depreciable property	\$200,000
Selection method for AFMR	Use Best Rate
The discount rate (effective 6/2016) is	1.8%
Cost basis of residence	\$200,000
Remainder interest for this agreement is measured by	One Life

Life Estate Agreement Design Diagram

Life Interest for One Life

Prepared for Mary Stokes



[1] Remainder interest in residence valued at \$1,000,000 gifted to Charity Name through Life Estate Agreement.

[2] Donor receives right to reside in residence until the end of the agreement term which is estimated to be 21 years.

[3] Donor receives charitable deduction for future gift in the amount of \$679,076. The charitable deduction may save as much as \$268,914 in taxes.

[4] Residence valued at \$1,000,000 plus all appreciation passes to charity at term of agreement.

Assumptions

Date of transfer	June 8, 2016
Cost basis of residence	\$200,000
Amount of debt on residence	\$0
Ordinary income tax bracket of donor	39.6%
Capital gains tax bracket of donor	23.8%
The discount rate (effective 6/2016) is	1.8%
Remainder interest for this agreement is measured by	One Life

Life Estate Agreement

Deduction Calculation for One Life

Prepared for: Mary Stokes

A. Input Assumptions

Date of transfer	June 8, 2016
Fair market value of residence	\$1,000,000
Amount of debt on residence	\$0
Current value of depreciable property (improvements)	\$600,000
Expected salvage value of depreciable property	\$200,000
Estimated useful life of depreciable property in years	40
The discount rate (effective 6/2016) is	1.8%
The mortality table is based on the census taken in	2000

Beneficiary Name	Age	Term of Life Estate
First name	70	For life from the start of the trust

B. Calculation of Income Tax Deduction

1. Current fair market value of life estate property	\$1,000,000
2. Amount of debt on residence	\$0
3. Fair market value of residence net of debt	\$1,000,000
4. Net current value of depreciable portion of life estate property	\$600,000
5. Salvage value of depreciable life estate property	\$200,000
6. Portion of property considered to be depreciable (Line 4 - Line 5)	\$400,000
7. Net value of property not subject to depreciation (Line 3 - Line 6)	\$600,000
8. Remainder interest factor based on tenant ages from Table S	0.78256
9. Remainder interest factor for real property which depreciates	0.52385
10. Value of remainder interest in real property:	
(a) Value not subject to depreciation (Line 7 * Line 8)	\$469,536
(b) Value subject to depreciation (Line 6 * Line 9)	\$209,540
(c) Total value of remainder interest (Line 10(a) + Line 10(b)) (the tax deduction)	\$679,076