

OUTLINE: CHARITABLE GIFTS OF REAL ESTATE
PRIVATE FOUNDATION ISSUES

Sue Guitar
October 18, 2001

- **Section 4947(a)(2) of the Internal Revenue Code of 1986, as amended, (the “Code”) provides that certain excise tax rules applicable to private foundations apply as well to split-interest trusts.**
 - Examples of split-interest trusts include:
 - A charitable remainder trust (“CRT”), which provides an annual specified distribution to one or more beneficiaries (at least one of which is not a charity) during his or her life or for a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, a charity.
 - A charitable lead trust (“CLT”), which is the mirror image of a charitable remainder trust.
 - Thus, both CRTs and CLTs, which will be the focus of the discussion below, are subject to certain excise tax rules.
 - Pooled income funds, which involve a number of individuals willing to make a gift to charity subject to a retained life income who agree to pool their gifts in a common investment fund, are subject to the prohibition against self-dealing, but the donor is less likely to be a "substantial contributor," defined below.
 - The excise tax rules to which CRTs and CLTs are subject include the following:
 - The self-dealing rules of Code § 4941;
 - The excess business holding rules of Code § 4943;
 - The rules relating to investments which jeopardize charitable purposes in Code § 4944; and
 - The taxable expenditure rules of Code § 4945.
- **Of these excise tax rules mentioned above, the prohibition on self-dealing has the greatest application in the context of making charitable gifts of real estate.**

- **Code § 4941(a) imposes an excise tax in the amount of 5% of the amount involved on each act of self-dealing between a disqualified person and a private foundation.** The tax is imposed upon the disqualified person who participates in the act of self-dealing. There is also a 2 ½ % tax imposed any foundation manager/trustee who knows of the self-dealing act.
 - It is worth noting that if the act is not corrected within the taxable period, the excise tax imposed upon the disqualified person is increased to 200% of the amount involved, while the tax imposed upon the foundation manager/trustee is increased to 50% of the amount involved.
- **A disqualified person** is defined in Code § 4946 to include the following:
 - A “substantial contributor,” who is a person whose aggregate gifts are more than \$5,000 and exceed 2% of the total contributions received by the trust from its inception;
 - Given that a contribution of real estate is likely to involve more than \$5,000 and given that charitable remainder trusts tend to be funded by a single donor -- or a donor and his or her spouse -- the donor is almost certain to be a substantial contributor to the trust.
 - A foundation manager or a trustee of a trust;
 - A more than 20% owner of an entity which is a substantial contributor;
 - A “family member”, within the meaning of Code § 4946(d), of a substantial contributor, trustee or a more than 20% owner;
 - A corporation, partnership, trust or estate that is more than 35% owned by those listed above; or
 - A government official for purposes of self-dealing.
- Accordingly, self-dealing transactions between the donor and the trust could subject the donor and trustee to the taxes on self-dealing.

- **Self-dealing is defined** in Code § 4941(d)(1) as “any direct or indirect
 - (A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;
 - (B) lending of money or other extension of credit between a private foundation and a disqualified person;
 - (C) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
 - (D) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person; [or]
 - (E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.”

- A CRT is required to include a provision prohibiting acts of self-dealing.

- **The acts of self-dealing that are most likely to arise in connection with the transfer of encumbered property to a CRT are described in Sections 4941(d)(1)(A), (B) and (E), as follows:**
 - Any sale or exchange, or leasing, of property between a private foundation and a disqualified person.
 - Any lending of money or other extension of credit between a private foundation and a disqualified person.
 - Any transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

- **Instances in which self-dealing may occur:**
 - Those involving the sale of property:
 - The **sale of real estate** by a disqualified person to a CRT.

- The contribution to a CRT of **encumbered property** which is treated as a sale for the amount of the indebtedness (Note: this may trigger the bargain sale rules), unless:
 - The mortgage is more than 10 years old; or
 - The donor/family member/disqualified person did not encumber the property.
- A disqualified person's purchase of CRT property at a public auction.
- Those involving the lending of money or extension of credit:
 - **An installment sale** of real property to a CRT may constitute a lending of money or other extension of credit between a private foundation and a disqualified person.
- Those involving the use by or for the benefit of a disqualified person:
 - If a CRT makes a grant or other **payment that satisfies the legal obligation** of a disqualified person, such grant or payment will ordinarily constitute an act of self-dealing. Thus, if a disqualified person **fails to make mortgage payments** of real estate, and the trustee of the CRT makes these payments to protect its interest, an act of self-dealing may occur.
 - Furthermore, an act of self-dealing may occur if the **property continues to secure the disqualified person's indebtedness**. Here, there is an **indirect guarantee of the disqualified person's debt**, which may constitute use of the property for the disqualified person's benefit.
 - **It is not clear whether the Service would find that the mere co-ownership of property may constitute self-dealing. It appears, however, that the Service will not treat the co-ownership of real property as an act of self-dealing unless the disqualified person makes any use of the asset or enters into an arrangement to develop the property.**

- One should note, however, that in PLR 9114025, the Service originally ruled that the mere co-ownership of property would constitute self-dealing. However, in response to the taxpayer's modified ruling request, the Service found that when a donor transfers real estate to a partnership, and an independent trustee authorizes the disposition of partnership units to a CRT, an act of self-dealing does not occur. However, prior to issuing this ruling, the Service reviewed the partnership agreement. Thus, this favorable ruling may be based on what provisions were included in the partnership agreement.

- **It is important to note that there are ways to avoid the imposition of self-dealing excise taxes.** One should refer to this discussion on pages 16 through 19 of the materials. An example of a way to avoid the imposition of self-dealing taxes is for the donor to satisfy the mortgage before transferring the property to the CRT.

