BOOMING INCENTIVES TO DONATE REAL PROPERTY IN A BUSTING ECONOMY

I. INTRODUCTION

An economic recession always influences spending, and the current stock market dips and housing market busts are creating a recession atmosphere.[1] Economic turmoil leads people to cut back on luxuries or delete them from their budget entirely.[2] Among the first "fat" trimmed from a budget is charitable giving.[3] The irony is that as the economic downturn continues, more people need help from charitable organizations and fewer people aid in funding those organizations that provide the increased workload and support.[4] People focus their spending on providing the basics for their families, and those who do continue to fund charities shift their focus to gifts with the best tax incentives instead of funding preferred or pet

1. *See* Randa Safady & Jim Noffke, *Fund Raising in Recessionary Times for UT Presidents and Chief Development Officers*, UT SYSTEM, Oct. 2008, http://www.utsystem.edu/cdl/files/FundRaisinginRecessionaryTimes.pdf.
2. *See, e.g.*, Martin M. Shenkman, *Charitable Planning Through Economic Turmoil*, http://www.laweasy.com/t/Charitable_Planning_Through_Economic_Turmoil (last visited Oct. 10, 2010).
3. *See id.*
4. *Id.*

charities.[5] These shifts in donor behavior change the way charitable organizations solicit donations.[6] This comment will discuss recession-wise giving through donations of real estate.

The government prefers to give tax deductions to donors who fund organizations that provide social services instead of funding and providing these services.[7] Charitable organizations can specialize in certain services allowing for more effective and efficient administration than the government can provide.[8] This is especially true in times of economic hardships when the government cuts funding for many programs.[9] The nonprofit organizations must increase fundraising to provide for the increased need for services and overcome the decreased government funding.[10]

This comment will discuss the history and background of the charitable donation tax deduction, and it will look into the changing trends of donating real property, including the decision to donate, how much to donate, and to which charity to donate. Moreover, this comment will address proposed legislation and recommendations toward donation decisions in the best interest of the donors and the charities. Ultimately, this comment will show how individuals and businesses can focus on donations of real estate toward tax benefits, while giving the greatest benefits possible to the chosen charity.

II. HISTORY AND BACKGROUND

The War Revenue Act of 1917 allowed the first tax deductions for charitable contributions, specifically for those gifts made to "corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes . . . ."[11] Congress then created the Revenue Act of 1918 to maintain the deduction allowance for individual donors and households.[12] The deduction was framed as a benefit to the charitable organization to enable successful donation solicitation, not as a

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5. *See id. But see* Safady, *supra* note 1.

6. Dennis Bidwell, *Real Estate Gifts in Challenging Times*, PLANNED GIVING DESIGN CENTER, May 11, 2009, *available at* http://www.pgdc.com/print/947106.

7. *See* Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1397–1407 (1988) (discussing how charities can provide important public goods more efficiently and effectively than the government can provide the same goods or services).

8. *See id.*

9. *See* David Crary, *Recession Delivers a Double Blow to Many Charities*, THE BOSTON GLOBE, Sept. 29, 2009, *available at* http://www.boston.com/news/nation/articles/2009/09/30/recession_delivers_a_double_blow_to_many_charities/.

10. *See id.*

11. Lyndon Sommer, *Charitable To Whom? Rethinking the Method by Which Charitable Donations are Made to Support Missionary Work*, 15 S. ILL. U. L.J. 373, 375 (1990) (citing the War Revenue Act of 1917, Pub. L. No. 65-50, 40 Stat. 300 (1917)).

12. Revenue Act of 1918, Pub. L. No. 65-254, 40 Stat. 1057 (1919).

benefit to the taxpayer.[13] The deduction allowance has changed over time, but essentially, it is the amount the federal government, through the Internal Revenue Service (IRS), allows taxpayers to deduct from their gross income before taxes are assessed.[14] Basically, the total amount of the donation, up to a specified percent of a taxpayer's annual income, is deducted from the overall income, creating a lower base income from which to deduct taxes.[15] In turn, this lowers overall taxes assessed to the donor.[16] It was not until 1935 that Congress allowed charitable contribution deductions for corporations and businesses in addition to individual taxpayers, although they instated different caps and percentages for corporate deductions.[17]

Historically, people donated for purely altruistic purposes, but now many people use charitable donations strategically, for tax planning (and sometimes tax avoidance) purposes.[18] For example, a person who donates his family farm (worth $100,000 of their $5,000,000 estate) to a public charity can deduct the full $100,000 value in the year of the donation. In doing so, the donor will save about $35,000 in income taxes for the year.[19] This is beneficial to those who do not use the family farm or whose property is more burdened than the owner can handle. Although some people believe that tax planning is not a good incentive for donations, charitable organizations need the boost in donations to maintain the quality and quantity of services they provide.[20] Any individual tax benefits or incentives are almost a necessity for many nonprofits to remain afloat during times of economic recession.

III. DONATION TRENDS DURING PREVIOUS RECESSIONS & HOUSING MARKET CRASHES

Of course the current economic slump is not the first time the United States economy has seen hard times. The National Bureau of Economic Research (NBER) determines recessions based on GDP, income, employment, industrial production, and wholesale and retail sales.[21] The

13. *See* David A. Brennen, *The Proposed Corporate Sponsorship Regulations: Is the Treasury Department "Sleeping with the Enemy?*,*"* 6 KAN. J.L. & PUB. POL'Y 49, 51 n.14 (1996).

14. *See* I.R.C. § 170 (2008); 26 C.F.R. § 1.170A-1 (2008).

15. *See* I.R.C. § 170.

16. *See id.*

17. Revenue Act of 1935, ch. 829, sec. 102, 49 Stat. 1014, 1016 (codified as amended at I.R.C. § 170 (2000)).

18. Mark A. Hall and John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1398–1416 (1992).

19. *See* I.R.C. § 1(a) (2008). The calculations are based on married individuals filing jointly in 2008.

20. *See generally*, John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657 (2001) (discussing the theories of tax deductions and the effects on philanthropy).

21. NBER Home Page, http://www.nber.org (last visited Oct. 10, 2010).

most recent recessions were 1980–1982, 1989–1993, and 2000–2002 after the dot-com boom.[22] In the early 1980s, a similar housing market crash accompanied the recession. Added to these economic problems, the Reagan administration changed tax incentives, especially those affecting the wealthy, which decreased incentives to donate and caused a stark decrease in charitable giving, including real property donations.[23]

Recessions generally bring about tax reform, along with other economic policies, to restore the economy.[24] Reagan's 1986 reforms took a toll on charitable giving that lasted for years; even though he called for altruistic philanthropy, it was not enough to boost donations during the recession of the late 1980s.[25] Other reform methods may have been more successful.

A. Incentives to Give During a Recession

There are many reasons to donate during difficult economic times. As discussed earlier, recessions create a greater need for the services provided by nonprofit organizations, but in many cases federal and other funding to these charities is decreased, if not cut altogether.[26] Modern technology and new ideas may enhance recession funding. The Internet era has increased the ability of people to give through using websites that donate money for each dollar consumers spend through that site.[27] Furthermore, people can still donate old clothing and cell phones to many charities for different purposes, and at least one charity even accepts donations of unused airline points to transport military personnel home or sick children seeking medical aid to hospitals.[28]

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22. Charles Linn, *The Silver Lining Is. . . .We've Been Here Before: A Glance at Past Recessions Gives Us Good Reasons to be Optimistic Today*, ARCHITECTURAL RECORD, Mar. 2009, *available at* http://archrecord.construction.com/ news/economy/archive/0903silverlining.asp.

23. Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving* xi (University of Chicago Press 1985), *available at* http://www.nber.org/chapters/c6771.pdf?newwindow=1. President Reagan increased tax advantages for the wealthy by rearranging the tax brackets. *See id.* He also believed philanthropy should shift back to its altruistic roots, so his administration subsequently cut funding to many nonprofit organizations and lowered the deduction allowance for individuals and corporations. *Id.* He then called for individual and corporate support for these organizations, but he refused to give the same tax incentives for the support. *Id.* Reagan went as far as to say that "Americans 'are the most generous people on earth' and that they would remain so without a deduction." *Id.* (citing WALL ST. J., July 7, 1982, at 4).

24. *See generally id.*

25. *Id.*

26. *See supra* Part I.

27. *E.g.*, Give and Shop, www.giveandshop.com (last visited Oct. 10, 2010); Give Spot, www.givespot.com (last visited Oct. 10, 2010) (showing how websites use social networking, cell phone applications, and other methods to solicit donations for charities).

28. eHow.com, *How to be Charitable During a Recession*, http://www.ehow.com/how_4584970_be-charitable-during-recession.html (last visited Jan. 23, 2010).

The federal government can reform taxes to increase incentives to donate. First, the government taxes individuals and corporations to create federal, state, and local revenue toward roads, schools, and other government funded programs.[29] Certain tax laws go even further to help stimulate the economy in times of recession.[30] Tax reform can also increase or decrease the gap between the upper and lower classes.[31] The government then gives tax incentives for activities that benefit society, such as charitable giving, home ownership, energy efficiency, and education, while imposing disincentives for disliked activities such as smoking, drinking, gambling, and even luxury taxes on goods like gasoline.[32]

Over most of our recent history, the government allowed a tax deduction for charitable donations to encourage individuals and corporations to give to these organizations.[33] As previously discussed, many charitable organizations depend on the government to continue these incentive programs so individuals and companies will continue to fund the organizations, especially during economic turmoil and times of financial insecurity.[34]

A recession coupled with a housing market crash creates an optimal prospect for the donation of real property.[35] The 2007–2008 housing market was bleak for many sellers, and many others foreclosed on their properties.[36] Of course, donating real property is not ideal for the individual with no other assets and low income, but it would be beneficial for many with commercial property on the market.[37]

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29. *See, e.g.*, Robin Broadway & Maurice Marchand, *The Use of Public Expenditures for Redistributive Purposes*, 47 OXFORD ECON. PAPERS 45 (Jan. 1995) (discussing taxation among other methods of redistributing funding from private income to public goods).

30. *See* The Tax Policy Briefing Book, *Taxation and the Family: What Is the Earned Income Tax Credit?* Tax Policy Center: Urban Institute and Brookings Institution, http://tpcprod.urban.org/briefing-book/key-elements/family/eitc.cfm (discussing President George W. Bush's administration's use of tax refunds through the earned income tax credit, promoted as an economic stimulus to help boost the slowing economy).

31. *See* Susan Pace Hamill, *An Evaluation of Federal Tax Policy Based on Judeo-Christian Ethics*, 25 VA. TAX REV. 671, 694–98 (2006).

32. Lily L. Batchelder, Fred T. Goldberg, Jr. & Peter R. Orszag, *Efficiency and Tax Incentives: The Case for Refundable Tax Credits*, 59 STAN. L. REV. 23, 24 (2006).

33. *See supra* notes 11–16 and accompanying text.

34. *See* discussion *supra* Part I (explaining that nonprofit organizations rely on the government to continue to enforce charitable deductions to make sure the organizations maintain necessary donation levels).

35. *See, e.g.*, About.com, http://useconomy.about.com/b/2008/01/15/housing-market-2008-outlook-its-a-bust.htm. This is one of many websites and articles that describe the recent and current housing market.

36. *See id.*

37. *See* discussion *infra* Part IV.B.

1. Revenue Reconciliation Act of 1990

Section 11344 of the Revenue Reconciliation Act of 1990 (Revenue Reconciliation Act) temporarily amended section 57(a)(6) of the Internal Revenue Code (IRC) to exclude all appreciated tangible property, including real property, donated to public charities from the individual's alternative minimum taxable income.[38] At the time of the Revenue Reconciliation Act, the alternative minimum tax affected mostly high-income donors, those given a disincentive by the 1986 reforms, and those who are more likely to donate real property.[39] The reform reinstated the total 100% deduction for donations of appreciated tangible property made by those subject to the alternative minimum tax.[40] This reform minimizes the strict regulations on deductions imposed by the 1986 reforms, but it only applies narrowly to tangible capital gains property—real and personal property held for more than one year in an effort to make a financial gain (not a primary residence, or stocks).[41]

Although Congress intended the amendment as a temporary measure, President Bush further extended the amendment.[42] It was finally repealed with the Omnibus Budget Reconciliation Act of 1993.[43] In the same year, President Clinton signed the Revenue Reconciliation Act of 1993, which eliminated the cap on the donation of appreciated property.[44]

Prior to 1993, tax benefits from donations of appreciated property, including real property, could not exceed the owner's basis in the property.[45] Under the new Act, property owners receive the full benefits, up to the total fair market value of the property, including any tax incentives that exceed the owner's original basis.[46] President George W. Bush continued the increases in tax incentives for charitable giving; he attempted to equalize the incentives between public and private charities, especially pushing certain favored religious organizations.[47] The dollar-for-dollar deduction at each tax bracket remained the norm throughout his presidency,

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38. Mara Lozier, *New Incentives to Give: Impacts of the 1990 Amendment to Section 57 on Charitable Contributions of Appreciated Tangible Property*, 44 TAX LAW. 885, 885–86 (1991).

39. *Id.*; *infra* notes 100–02 and accompanying text.

40. Lozier, *supra* note 38, at 885.

41. *Id.* For example, donations from the $500,000–$1,000,000 tax bracket fell from $21,095 in 1986 to $16,062 in 1987–88. Also, after the donation amount rose from 12.3% to 13.1% of income for those in the over $1,000,000 tax bracket, but it fell to 8.6% in 1987 and down to 7.1% in 1988. Cherie J. O'Neil, Richard S. Steinbert & G. Rodney Thompson, *Reassessing the Tax-Favored Status of the Charitable Deduction for Gifts of Appreciated Assets*, NAT'L TAX J., 215, 216 (June 1996).

42. Ralph E. Lerner, *Income Tax Benefits from Private Funding for the Arts*, 13 ENT. & SPORTS LAW. 3, 4 (1995).

43. *Id.*

44. *Id.* at 5.

45. *Id.*

46. *Id.*

47. *See* Philip C. Aka, *Assessing the Constitutionality of President George W. Bush's Faith-Based Initiatives*, 9 J.L. SOC'Y 53, 84 (2008).

but it is now subject to the changes in the American Recovery and Reinvestment Act of 2009.[48]

The ever-changing Internal Revenue Code, with shifting incentives on all types of charitable giving, creates an unstable atmosphere for professional nonprofit fundraisers.[49] Nonprofit fundraising organizations must find ways outside of the tax benefits to woo current and potential donors to continue to make donations regardless of the fluctuating tax benefits.[50] Professional fundraisers are well versed in many methods of solicitation, but in reality many donors, especially the wealthy, know about the tax advantages of different types of giving and have the resources to achieve the best benefits through calculated, deliberate donating.[51] The decisions affecting these donors' behavior greatly affect the bottom-line of many nonprofit organizations.[52]

Changing tax laws affect the benefits of charitable giving and can be especially helpful to increase individual and corporate donations during economic recession periods. However, there are other reasons to give to charity during economic turmoil and downturns, such as altruism, efficiency, and cost of upkeep that are unrelated to taxes.

B. Effects of the Housing Market

The real estate market boomed in many areas through the mid-2000s, which caused many companies to move their headquarters, many people to buy houses (some with subprime mortgages), and many entrepreneurs to start new businesses and franchises.[53] As a result, many properties substantially increased in value during this time.[54] In the current recession, companies and families are cutting back. They are downsizing by getting rid of unnecessary real and personal property. Many other companies are closing their doors for good.

If a property owner has held his property for more than one year and it has appreciated in value, the owner must pay capital gains taxes upon the sale of the property.[55] If property has appreciated a large amount, like many properties held for long periods of time, the high capital gains taxes can

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48. *See* discussion *infra* Part IV.A (discussing the American Recovery and Reinvestment Act of 2009, including increased tax cuts and increased alternative minimum tax).

49. *See* Wachovia Trust Nonprofit and Philanthropic Services, *The Impact of Changes in Tax Rates on Charitable Giving*, PHILANTHROPY JOURNAL, Dec. 2008, http://www.philanthropyjournal.org/resources/fundraisinggiving/impact-changes-tax-rates-charitable-giving.

50. *Id.*

51. *Id.*

52. *Id.*

53. *See* Boom, Bust & Blame: The Inside Story of America's Economic Crisis, *The Great Housing Boom*, CNBC, 2009, http://www.cnbc.com/id/31189220 (last visited Nov. 6, 2010).

54. *See id.*

55. I.R.C. § 1031 (2008).

exceed the amount of the benefit the donor will receive if they donate the property.[56] Some people prefer to transfer property at their death, but they may want to rethink their plans. Inter vivos gifts allow the donor to receive the benefits of the tax credit while he is alive. This option allows the donor to use the income instead of holding it solely for estate planning purposes, which carries the possibility of increased estate taxes.[57]

1. Who Really Benefits from These Donations

Donations of real property are not for everyone, not even for everyone selling his property.[58] Many families and individuals who fell victim to the subprime mortgage crisis and those that no longer have jobs to make payments on their homes are not likely the best candidates for real property donations. The best real property donors need to have enough income to offset the donation on their taxes, because a taxpayer needs annual income to take the donation deduction against. Furthermore, the donor must be able to survive without the property and without immediate money for the property (generally, property that was a gift, or investment property, not those who put their life savings into the property). Another likely donor is one who owns highly appreciated long-term capital gains property, because donating the property cancels any capital gains taxes due on the property, which, in many cases, would be rather high due to recent market inflation.[59]

Perhaps, the best suited real property donors are those holding unused commercial property.[60] Businesses generally have more financial backing and can afford to get rid of the property for the tax benefit. Medium to large businesses can use the tax benefit most advantageously because their high income creates an incentive toward charitable donations to offset some of their tax responsibility. Unused property is an easy donation for corporate donors because they get more out of the donation than many individuals would.[61] Generally, commercial property is larger, worth more money, and has appreciated at a higher rate than other property, so donating would offset high capital gains taxes. Furthermore, donations are beneficial

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56. *See, e.g.*, *Bulldog Properties & Bulldog Guide to Giving Real Property*, Mississippi State University, http://www.msufoundation.com/pdf/msu_estate.pdf (last visited Jan. 23, 2010). One donor went as far as to say, "My investment property has appreciated as much as it's going to. I can't afford the capital gains taxes if I sell it now." *Id.* at 4.

57. *See* I.R.C. § 170 (2008); *see also* discussion *infra* Part VI.D.

58. *See* discussion *supra* Part II.

59. *Supra* notes 51–53 and accompanying text. Inflation caused an unnatural skew in the market, increasing prices. Long-term capital gains property, investment property held for longer than one year, grew exponentially during the housing bubble, as prices increased with inflation, which also increased the capital gains taxes due on property upon sale or disposition. *Supra* notes 51–53.

60. *See* discussion *infra* Part II.

61. *See* discussion *infra* Part II; *see also* discussion *infra* Part IV.A.

for nonmonetary reasons, such as publicity of the donation, which will create goodwill for the company—a priceless asset to many companies.[62]

The less visible donor is the individual or family with real property that will not sell in the market, so long as the donor can live comfortably without any income from a sale of the property. When property remains on the market over long periods of time, it accumulates high costs such as constant upkeep of the property and payment of taxes, electricity, water, and in some cases the mortgage on the property.[63] If the potential donor is downsizing, upsizing, or just moving locations but continues to make a good living, donation of the property may save money over time. Again, donation would only be beneficial if the donor has enough annual income to recuperate the deduction as the IRC allows.

The same principles apply to those who gained property through inter vivos or testamentary gifts, especially those who can no longer afford the maintenance and upkeep on the property.[64] Again, the property owner must have enough annual income to benefit from the donation tax offset, but this donor will not take a financial hit for the donation because he did not personally invest much, or anything, into the property.

These are the likeliest potential donors to benefit from donating real property. Still, many factors lead to the decision to donate, and donation may not be the best option for everyone that falls into a category above.[65] Making donations, especially large donations such as real property, is a personal decision that must be considered thoroughly before donating. A donor must consider many factors such as tax benefits, goodwill, and altruism. He must also consider additional costs, how the property will be used, restrictions the donor may place on use of the property, etc. Professionals in the tax field and professional nonprofit fundraisers can aid individuals and corporations in the decision-making process.

IV. HOW TO DONATE

Currently, IRC section 170 codifies a deduction allowance for a qualifying charitable deduction, including contributions of real property, by calculating the fair market value of the property as the deduction.[66] There

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62. Michael E. Porter and Mark. R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARVARD BUS. REVIEW (Dec. 2002), *available at* http://www.expert2business.com/itson/Porter%20HBR%20Corporate%20philanthropy.pdf (focusing on cause-related marketing: a system where a for profit company sponsors a nonprofit organization to create goodwill for the for profit company through advertising the partnership).

63. *See* discussion *supra* Part II.

64. *See* discussion *supra* Part II.

65. *See* discussion *infra* Part IV.

66. I.R.C. § 170 (2008). "Fair market value (FMV) is the price that property would sell for on the open market . . . between a willing buyer and a willing seller . . . ." Internal Revenue Service, Publication 561, *available at* http://www.irs.gov/pub.irs-pdf/p561.pdf (April 2007). Furthermore,

are, however, specific circumstances that make real property donations more beneficial to certain donors.

"For example, a 69 year old widow owns an office building. She would like to maximize the benefits of the asset for her children, and support her favorite charity, if possible . . . . After careful consideration, she found the greatest benefit to her children and the charity was to donate the building."[67] Circumstances in this hypothetical make a charitable donation of the office property the best result for this widow, although it may not be the most beneficial tax move for every donor.[68]

Because the property was vacant and not producing income, it increased the widow's value in a charitable donation opposed to a sale of the property.[69] Furthermore, the donation of the property exempted the widow from additional capital gains taxes she would have had to pay if she sold the property in the market.[70] An additional advantage of donation is the widow's exemption from a federal estate tax that would apply on the sale or any disposition of the property if the widow waited until her death.[71] Each of these very different benefits, in isolation, may or may not create a large enough incentive for the widow to donate the property, but taken together, the widow's situation created an opportunity to maximize her benefits through donating the real property.[72]

Many factors determine whether or not a particular owner will benefit from donating real property. One important consideration is the potential charitable use and disposition of the property and whether it brings a profit.[73] In the above example, the widow's vacant office building was not creating income and likely costing money in upkeep and taxes.[74] If the property were profitable, the widow may benefit more from a testamentary gift to her children who may have continued to see a long-term profit from the property, which may increase financial rewards to the children.

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restrictions on the use of the property must be considered and will generally decrease the fair market value of the property. *Id.*

67. Real Estate for Charities, http://www.realestateforcharities.org (follow "FAQ's" hyperlink) (last visited Jan. 23, 2010).

68. *See id.*

69. *See id.*

70. *See id.*

71. *See id.* The widow's total estate, including the office building, would put her total estate above the current estate tax exemption. *Id.* See discussion *infra* Part VI.C for a more complete discussion of the impact of estate taxes on decisions toward charitable donations of real property.

72. *See supra* Part III.A.

73. *See* Real Estate for Charities, *supra* note 67 (showing that unused property and property not creating a profit has a high cost to the property owner).

74. *See id.*

Another important factor toward donor decision-making is whether there is a viable market for the property.[75] Unused property may sell at a loss to the owner, especially in a recession and housing-market crash. If the property is not burdened by loans or other debts, the owner may benefit from the tax advantages of donation because the value of the deduction will likely exceed the amount the owner can sell the property for in a bad market.[76] A potential donor must then consider whether the property has increased in value and whether he would have to pay capital gains taxes on a sale or gift of the real property.[77] The owner should also consider the costs of continued upkeep of the property until his death as well as the potential value of the property upon the owner's death.[78] This will estimate whether estate taxes will apply to the overall estate in excess of the exemption amount.[79]

Many current corporate situations reflect the widow's scenario, especially businesses that have succumbed to the poor economic climate and are no longer profitable.[80] Donating real estate is especially beneficial to those who have assets as well as the ability to make large financial donations without upsetting tied up securities or extensive estate plans.[81]

A. Interests in Real Property

Many types of real property and interests in real property, including residential, commercial, vacation homes, interests in timeshare property, future remainder interests, and charitable (and charitable lead) trusts are valuable donation property interests.[82] Although donors' reasons for donating may differ and the tax benefits may vary based on capital gains and types of appraisals, all types of property owned in fee simple use IRS Publication 561 to value property for donation purposes.[83]

The calculated values apply as the donor's tax deduction, which does not change based on how the charity uses the donated property.[84] Generally, charitable organizations will sell donated property and keep the sale profits to fund the organization.[85] Other organizations may use the property "as is" or fix it to suit their needs, sometimes using outside

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75. *See* discussion *supra* Part III.B.
76. *See* discussion *supra* Part III.B.
77. *See* discussion *infra* Part VI.C.
78. *See* discussion *infra* Part VI.D.
79. *See* discussion *infra* Part VI.D.
80. *See* Real Estate for Charities, *supra* note 67.
81. *See* Toledo Community Foundation, *Unearthing Charitable Dreams: Donating Property*, http://www.toledocf.org/clientuploads/directory/pdf_library/ (follow "Article-Donating Property.pdf" hyperlink) (last visited Jan. 23, 2010).
82. *See* Bidwell, *supra* note 6.
83. I.R.S. Publication 561 (revised Apr. 2007); *see* discussion *infra* Part V.A.
84. I.R.S. Publication 561 (revised Apr. 2007).
85. *See* Real Estate for Charities, *supra* note 67.

funding for property maintenance and upkeep for certain uses by the charity.[86]

Donors have many choices in how they donate fee simple property to a charity.[87] Many choose the bargain sale, where a donor sells real property to a charity at well below fair market value.[88] Many charities buy real property at a price lower than fair market value; the donors can pocket money from the sale up front.[89] Because it is below the actual value, the donor also receives a tax deduction for the difference between the fair market value and the bargain sale price.[90] Bargain sale donors receive further benefits by saving many real estate transaction costs, such as marketing, real estate agents, brokers, and closing costs.[91]

Still, there are other ways to donate property and receive tax benefits. Many donors can donate real property outright, without receiving the upfront payment provided by a bargain sale.[92] Idle property, a property that will not reach its potential value, property that an owner has already taken full depreciation benefits, and property that endured an uninsured catastrophe or other loss that does not fall within IRC section 165 are prime candidates for outright property donations.[93] Individuals, organizations, or companies may also donate partial interests in real property for charitable use.[94]

Many charities specifically request temporal partial property interests, such as a vacation property, as a tax-deductible donation, but in reality, these donors should not take tax deductions for these donations.[95] Some organizations allow tax deductions for donations of these properties when a donor owns the vacation property outright and donates the use of the property for a portion of the year.[96] The donor can still use the vacation

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86. *See id.* The property can be used for anything from camping ground for the Boy Scouts, general office use for the administration of the Kidney Foundation, storage for the local food bank, or housing for battered women, among other uses.

87. *See, e.g.*, Real Estate for Charities, *supra* note 67; Real Estate with Causes, http://www.realestatewithcauses.org (follow "Why Donate" hyperlink) (last visited Jan. 23, 2010).

88. BLACK'S LAW DICTIONARY 159 (8th ed. 2004).

89. *See* Real Estate for Charities, *supra* note 67.

90. *See id.*

91. *See id.*

92. *See, e.g.*, *id.*; *see also* Real Estate with Causes, *supra* note 87; *see also* Bidwell, *supra* note 6. These websites, along with many others, discuss how and why donors give property in fee simple, the easiest method of real property donation.

93. Real Estate with Causes, *supra* note 87; Treas. Reg. § 1.165-1(e)(3) (as amended by T.D. 6445, 1960-1 C.B. 15, T.D. 6753, 1964-2 C.B. 18, T.D. 7301, 1974-1 C.B. 3, and T.D. 7522, 1978-1 C.B. 15). Many external events that cause negative market fluctuations are not covered by IRC section 165. For example, when a mudslide causes other property values in the immediate neighborhood to decrease in value, the unharmed homes still suffer a negative market fluctuation. *See id.*

94. Rev. Rule 89-51, 1989-15 I.R.B. 5. These types of gifts should be treated as a donation of a person's time, not an interest in property with a value; therefore, it does not warrant a deduction. *See id.*

95. *Id.*

96. *See, e.g.*, UJA Federation of New York, http://www.ujafedny.org/chritable-gift-annuities/ (last visited Oct. 9, 2010).

property, personally or for profit, for the remainder of the year, so the donor only receives a tax deduction for the fair market value of the fractional interest in the property the donor gives to the charity—a charitable remainder interest.[97] However, this use still appears to be a "rent free" use of the property and not deductible under Revenue Rule 89-51.[98]

Donors can also give future interests by donating real property in fee simple, while maintaining a life estate in the property.[99] In doing so, the donor may live in and use the property until it transfers to the charity upon the death of the donor.[100] In some cases, the charity will also allow a life estate pur autre vie, which enables a husband and wife (or even their children) enjoyment and use of the property throughout their lives, instead of the life of the owner, before it transfers in fee simple to the charity.[101] This option is especially useful for spouses without children, those who no longer want to keep the property in their family, or those who do not want to burden their families with a gift of burdened or encumbered property.[102] Future interest property donors must understand they have the same duties as any other life estate holder, including upkeep, maintenance, and responsibility not to commit waste.[103]

B. Charitable Uses of Real Property

The next decision requires a choice between donating to a charity that will use the property or a charity the will use the proceeds of a private sale of the property. This choice is very personal. Some donors may have strong connections to the property and want to see the charity physically use the property, not just the proceeds. Many who donate property purely for tax benefits do not distinguish between the charities use of the donated property.[104] The IRC does not differentiate tax benefits between the uses of the donated property by the charity; however, choosing one charity over another charity may create a disparity in the tax deduction the donor is allowed.[105]

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97. *See, e.g.*, Planned Giving: Gifts of Real Estate, http://www.ujafedny.org/ (last visited Oct. 9, 2010); Treas. Reg. § 1.170A-1(g) (1972) (explaining that a person does not have a basis in services provided, time donated, therefore there is no tax deduction for donations of services); Rev. Rule 89-51, 1989-15 I.R.B. 5.

98. *See* Rev. Rule 89-51, 1989-15 I.R.B. 5.

99. *See* Real Estate with Causes, *supra* note 87; http://www.cityofhope.com (follow "Giving" hyperlink; then follow "Planned Giving" hyperlink; then follow "Retain Life Estate" hyperlink) (last visited Jan. 23, 2010).

100. *See supra* note 92 and accompanying text.

101. *See* Real Estate with Causes, *supra* note 87.

102. *See id.*

103. *City of Hope*, *supra* note 99; 31 C.J.S. *Estates* § 50 (2009).

104. *See City of Hope*, *supra* note 99.

105. *See supra* notes 98–101 and accompanying text.

The IRC categorizes charities as either public or private, which carry different tax benefits and significantly affect donor decision-making.[106] When property values are higher than the individual or business deduction cap, many will choose to give to a public charity so they can recuperate more through tax deductions.[107] The IRC caps public charity deductions at 50% of the donor's income, compared to only a 30% cap on donations to private charities.[108] Donors can claim the cap in the donation year, and the IRC provides for additional, future deductions through a carry-over of the remaining amount for up to the next five years of tax returns.[109] This allows donors to more fully recuperate deductions on large donations.[110] Even with the carry-over, 50% is larger than 30%, so donors to public charities will gain a larger tax benefit.

To illustrate, a person with an adjusted gross income (AGI) of $500,000 who donates land worth $350,000 to a public charity can only deduct up to 50% of his AGI in the year of the donation: $250,000.[111] Because the donation was worth a total of $350,000, the donor can continue to take deductions in future years for the remainder of the donation.[112] If the donor makes a loss in the next year and has no AGI, there is no income to take the deduction against; the full $100,000 continues to carry forward to the following year.[113] In the next year, if the donor has $1,000,000 of AGI, he could take the full remainder of $100,000 as an itemized deduction for that year.[114] Donors must be acutely aware of their AGI and the percentage deduction allowed based on the charity chosen to assess the individual benefits of each donation.[115] Tax incentives may only have a small or nil effect on the personal choice of which charity a donor will support.[116]

The recent economic turmoil combined with the unstable housing market caused visible changes in donor behavior and donation trends.[117] Continued changes in economic security as well as changing tax laws have

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106. *Compare* I.R.C. § 170(b)(1)(A) (2008) *with* I.R.C. § 170(b)(1)(B) (2008) (itemizing public charities (A) and lumping together all others as private charities (B) and discussing the tax limitations on each).

107. *See id.*

108. *See* I.R.C. § 170.

109. I.R.C. § 170(b).

110. *See id.; see also* James Edward Harris, *Level Five Philanthropy: Designing a Plan for Strategic, Effective, Efficient Giving*, 26 U. ARK. LITTLE ROCK L. REV. 19, 51 (2003) (discussing the tax differences in donating to public versus private charities).

111. *See* I.R.C. § 170.

112. *Id.*

113. *Id.*

114. *Id.*

115. *See id.*

116. *See generally* Clotfelter, *supra* note 23 (describing multiple ways tax deductions influence individual choice in charitable giving).

117. *See* Bidwell, *supra* note 6.

somewhat altered the landscape of charitable giving, especially in the area of real property donations.[118]

V. CURRENT TRENDS OF REAL PROPERTY DONATIONS

Charitable organizations have moved slowly toward accepting donations of real property.[119] The process involves many new costly procedures such as the creation and implementation of programs including staff training on proper and effective solicitation methods, property valuation methods in accordance with IRS guidelines, and appropriate property acceptance procedures.[120] Furthermore, the nonprofit managers must learn property-handling procedures for the organization; whether they keep and maintain the property for charitable uses or sell the property for financial gain, the nonprofit managers must follow rules and laws governing the charity's disposition of the property.[121] Enacting this new program also takes time and money in advertising and solicitation.[122] As more nonprofits accept these types of donations, the process is becoming more accessible and prevalent with donors.[123]

Nonprofit managers realize that economic conditions make it difficult for donors to give cash to charities; to accommodate this difficulty, charities are slowly looking toward the "largely untapped" resource of real property.[124] A typical family's overall assets include over 35% real estate, but only about 3% of charitable giving is in the form of real estate gifts.[125] This gap opens a door of potential charitable gifts, which are subject to the persuasive requests of educated development directors and professional nonprofit fundraisers.[126]

The large potential benefits of real property donations generally outweigh the costs and risks associated with retraining fundraisers.[127] One of the best ways for the average person to donate real property is by making a testamentary gift through planned giving. Donors can give during their lifetime and get the immediate tax benefits, but this method is only available to a limited class of donors who are wealthy enough to sell the property and give all the proceeds to charity.[128] Even if a charity only

118. *See* discussion *infra* Part V.

119. *See* Bidwell, *supra* note 6.

120. *Id.*

121. *See id.*

122. *See id.*

123. *Id.* "At the same time [as charities are shifting their focus], lawyers, CPAs, philanthropic advisors, financial advisors and realtors are looking to provide an expanded menu of planning options for their clients, including the wide range of charitable gift options involving real estate." *Id.*

124. *See id.*

125. *Id.*

126. *See id.*

127. *See id.*

128. *See* Real Estate for Charities, *supra* note 67.

allows these inter vivos gifts, donors still have the benefit of cutting out the middleman in the real estate process, increasing the donor's tax break and the income to the charity.[129]

Still, the savings do entice potential donors toward property donation. For example, a person who owes money on a property mortgage continues to pay the mortgage premium while the property is on the market, which could be thousands of dollars each month. Furthermore, the potential donor would have to pay for MLS listings and put in time and energy toward advertising the property. Property owners generally hire realtors who receive a 2% to 6% fee based on the sale price.[130] Overall, a person could save thousands, even tens of thousands of dollars, through a direct real estate donation. This is a simplification of the most common direct donation, however, a more modern approach, the 561 Property Exchange, may increase the property owner's benefits of donation.[131]

A. The 561 Exchange

Seed America, a charity seeking to raise $100 million to build and run a new Christian business school, started the new 561 Exchange process.[132] Nonprofit and fundraising professionals have now taken sides on the 561 Exchange battle; some believe the new program is the best way to solicit and receive donations, while others hold that the system is "ripe for abuse."[133] This program stems from IRS Publication 561, which describes methods to value tax donations of property (real and personal) for tax-deduction purposes.[134] Charities have always used the publication for property valuation; however, the change is in the methodology.[135]

The 561 Exchange program finds property that is more valuable than the likely market sale price.[136] As with most real property donations, this works best for donors looking to divest themselves of burdensome, generally vacant, commercial property.[137] Prior to IRS Publication 561, many donors used and continue to use the 1031 Exchange when divesting real property toward a tax benefit. The 1031 Exchange, based on IRC

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129. *See id.*

130. Danial Schorn, *Chipping Away at Realtor's Six Percent*, CBS NEWS, May 13, 2007, http://www.cbsnews.com/stories/2007/05/11/60minutes/main2790865.shtml (including a video clip of the show that discusses the job of a realtor).

131. *See* discussion *infra* Part V.A.

132. Peter Panepento, *How a Charity Pitches Its Plan*, CHRONICLE OF PHILANTHROPY, Aug. 21, 2008, at 29.

133. *See id.*

134. *See id.*

135. *See id.*

136. *Id.*

137. *See* Karen Buckley Washington, *Not the Typical Real Estate Donation: Realizing the Rewards of the 561 Exchange*, http://www.articleclick.com/Article/Not-The-Typical-Real-Estate-Donation-Realizing-the-Rewards-of-the-561-Exchange/925515 (last visited Jan. 23, 2010).

section 1031, applies to commercial and other real property, and benefits participants by deferring federal and state capital gains taxes and depreciation recapture on the sale of investment or business property.[138] However, the 1031 Exchange program requires an immediate sale of the property to the exchange and allows the owner only forty-five days from that sale to find another property to acquire.[139] Then the owner has 180 days from the sale of the original property to acquire the new property.[140]

The new 561 Exchange program still regulates acquisition of new property within 180 days of the original sale, and it offers the same benefits of section 1031: capital gains deferral and no depreciation recapture.[141] Many times the donation value is based on a bargain sale, which further decreases the tax benefits.[142] With the 561 Exchange, the donor can also use a bargain sale or another method to get rid of the property, but the donor also has the option to divest the property completely and donate it outright without having to invest in new real estate—he can get out of the real estate market altogether.[143]

Many charitable organizations and tax professionals question the legality and validity of the 561 Exchange and the proffered benefits. One charity founder stated that Seed America employees "simply know how to find properties that will be appraised higher than what the owner is willing to sell it for due to high carrying costs, urgency, and other issues related to the owner."[144] Everyone agrees that this system benefits the donor who otherwise would take a financial hit on the sale of the property, but through this program he can donate the property at an increased value, increasing the donor's tax deduction.[145]

However, many remain skeptical about valuing donation property at sometimes as much as twice the expected sale price.[146] Are Seed America and the 561 Exchange helping donors get rid of unwanted property in a tax-friendly manner, or are they scamming the federal government?[147] Although Seed America requires an outside, third-party appraisal, a donor can easily find an appraiser who will fudge numbers to help with a tax deduction, especially if he or she receives a kickback for the high appraisal.[148]

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138. Christine Latulip, *Cash, Contribution, Bargain Sale, Installment Note & Section 1031*, http://www.1031taxexchange.org/Articles/cash-contribution-bargain-sale-installment-note--section-1031.html (last visited Jan. 23, 2010).

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. *See* Washington, *supra* note 137.

144. Panepento, *supra* note 132, at 29.

145. *See id.*

146. *See id.*

147. *See id.*

148. *See id.*

Seed America and other fundraising nonprofit organizations can benefit from this legitimate program as long as Seed America and future organizations target the right population: corporations with property that have a negative or zero-sum cash flow.[149] Like other donations of real property, the deduction is subject to the AGI cap rules of IRC section 170, and donors can deduct in one year or spread them out over up to five years of tax returns in compliance with IRC section 170.[150] The difference in this system is the way appraisers use Publication 561 to value property.[151] Taken in its entirety, the publication includes many valuation methods; some methods allow external economic or social factors into the property assessment.[152] Generally, appraisers calculate all the factors into the appraisal, including the current market conditions.[153] In a recession or housing market slump, market conditions cause appraisal values to decrease significantly to accurately portray the economic climate.[154]

Using the 561 Exchange, appraisers can combine available approaches toward a more beneficial market value; generally, the favorable value comes from a combination of comparable recent sales prices, capitalization of income, and replacement cost minus the amount of depreciation the owner has already realized.[155] Previously, appraisers concentrated on one listed method in the publication, which created a more objective valuation in real estate market conditions. The new method takes market and economic conditions out of the equation and creates a greater incentive to donate in a slow real estate market.[156] The 561 Exchange could easily be abused, but when used properly, it creates more opportunities for property owners to donate to charities because of the increased tax benefits, good will, and sometimes even good media achieved by philanthropic support and community development.[157]

The 561 Exchange is new and requires oversight toward proper use in charitable giving. Upcoming changes in tax law may affect the 561 Exchange as well as other donation methods and procedures, so charities using or planning to use the program must stay up-to-date on regulations and procedures to create and maintain the validity of the 561 Exchange and any other programs affected by reforms.[158]

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149. *See* Washington, *supra* note 137.

150. *Id.*

151. *See id.*

152. *See id.*

152. *See* Washington, *supra* note 137

154. *See id.*; *see also* Internal Revenue Service, Publication 561, *available at* http://www.irs.gov/pub/irs-pdf/p561.pdf (revised Apr. 2007).

155. *See* Washington, *supra* note 136; *see also* Internal Revenue Service, Publication 561, *at* 29.

156. *See* Panepento, *supra* note 132, at 29.

157. *See* Washington, *supra* note 137.

158. *See* discussion *infra* Part VI.

VI. PROPOSED & UPCOMING TAX LEGISLATION

A. American Recovery & Reinvestment Act of 2009

The 111th Congress passed The American Recovery and Reinvestment Act of 2009 (ARRA), an economic stimulus package based on President Obama's proposals to motivate the economy during the economic downturn.[159] The ARRA included federal tax cuts and other measures worth more than $787 billion.[160] Importantly, the bill includes an increase in the alternative minimum tax (AMT) for 2009.[161]

The AMT begins with the taxpayer's regular income, adjusts it with certain deductions and exemptions, and then multiplies it by either 26% or 28% to find the minimum tax.[162] A taxpayer uses AMT if the minimum tax is greater than the regular tax.[163] This system ensures that wealthy people do not use "favorable tax activities" to avoid taxes due based on gross income (not adjusted gross income).[164]

Recently, the AMT has applied to many middle-class taxpayers as well.[165] Because the AMT affects more taxpayers, in turn it increasingly shapes the federal government's income tax collection methods and ability.[166] In 2009, through the ARRA, taxpayers received relief "by (1) increasing the exemption amounts above last year's levels and (2) allowing nonrefundable credits to offset AMT as well as regular tax."[167] The increased tax exemptions allow taxpayers to pay taxes on less of their annual gross income than required in previous years.[168] Ultimately, this provides immediate stimulus to the American public by allowing them to keep more of their income—likely in hopes the people will flood the markets with this cash to help the economic recession.

Tax credits apply to taxpayers in addition to tax deductions as a separate part of the tax scheme, but put briefly, the federal government

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159. *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 (codified as amended at I.R.C. § 1).

159. *See* Press Release, Council of Economic Advisors, Economic Impact of the American Recovery and Reinvestment Act of 2009, Second Quarterly Report (Jan. 13, 2010), *available at* http://www.whitehouse.gov/the-press-office/economic-impact-american-recovery-and-reinvestment-act-2009-second-quarterly-report.

160. *Id.*

162. *See* Scott E. Vincent, *American Recovery and Reinvestment Act of 2009—Multiple Provisions for Business and Individual Taxpayers*, 65 JOURNAL OF THE MISSOURI BAR 92, 94 (2009), *available at* http://www.mobar.org/e77ea4b3-1d5f-464c-92ef-e6667975c451.aspx.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

gives tax credits for different types of expenses.[169] For a person to receive a nonrefundable tax credit, the taxpayer must take the credit against a tax liability.[170] To illustrate, Tax Payer owes the federal government $1,500 in taxes for 2009 and has a nonrefundable credit for $500, with this credit deducted from the $1,500 liability, he must pay a total of $1,000 in taxes for the year.[171] Tax credits put money directly in the pocket of taxpayers toward stimulating the economy.

The increased use of the AMT means changes will affect more people, and therefore, more real estate donors than in previous years.[172] The changes will increase allowed exemptions, which will increase the tax value of large donations because the tax payer can exclude higher overall maximums from their gross income, thus lowering their overall tax liability.[173] Additionally, the nonrefundable tax credits will decrease the taxpayer's overall tax liability when he donates real property to a charity, a favorable tax activity for tax credit purposes.[175] The ARRA reforms began in 2009, but Congress is working on further changes for upcoming years that may affect when, or whether, potential donors give real property.[176]

B. Obama's 2010 Proposed Budget

President Obama changed the direction of tax deductions for charitable donations. President Obama's proposed fiscal year 2010 (FY 2010) budget decreases tax deductions for donors whose income exceeds $200,000 single or $250,000 married.[177] In addition to reducing tax incentives, the proposed budget increases the tax rate of the highest tax bracket.[178] The policy reasons for the changes aim to create federal income to fund the national health care plan.[179] This proposal has many nonprofit managers terrified that they will not meet goals, and they will fall further behind during the current financial pinch.[180] But will the new budget really create significant

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169. *See* Jonathan D. Boyer, *Education Tax Credits: School Choice Initiatives Capable of Surmounting Blaine Amendments*, 43 COLUM. J.L. & SOC. PROBS. 117, 143 (2009). Congress generally gives tax credits to taxpayers in response to the national economy or other factors. *Id.* For example, the federal government wants the American public to "go green" and over the past decade, has added tax credits for energy efficient appliances and vehicles, among other green products. *See* I.R.C. §§ 30B, 45M (2009).

170. *See id.*

171. *Id.*

172. *See* Vincent, *supra* note 162.

173. *See* Vincent, *supra* note 162.

175. *See* Vincent, *supra* note 162.

176. *See* discussion *infra* Part VI.B–D.

177. *See* Ryan Messmore, *Proposed Decrease in Charitable Tax Deduction Crowds Out Civil Society*, BACKGROUNDER, Apr. 10, 2009, http://www.heritage.org/research/reports/2009/04/proposed-decrease-in-charitable-tax-deduction-crowds-out-civil-society/.

178. *Id.*

179. *Id.*

180. *Id.*

decreases in charitable giving and the bottom lines of nonprofit organizations?

The following is an example of the logistics of the reforms. The highest tax bracket consists of taxpayers who make more than $200,000 annually (for an individual and $250,000 for a married couple).[181] In 2009, this bracket was taxed at 35%, and the corresponding deduction was 35%; therefore, completely counteracting the tax so the donor does not pay any tax on the amount of the donation.[182] Under the new proposal, families and individuals in the highest tax bracket are taxed at a higher rate of 39.6%, and instead of maintaining the equal charitable tax deduction it will decrease the deduction amount to 28% of the donated value.[183] In 2009, a $10,000 donation creates a $3,500 tax break, because the taxpayer owes no tax on the $10,000 of income donated.[184] Under Obama's plan, the same $10,000 donation will create only a $2,800 tax write-off, and leave $1,160 of the donation as taxable income.[185]

Next, the taxpayer includes the $1,160 in his total taxable income, which is taxed at the highest rate of 39.6%, meaning the taxpayer owes an additional $460 to the IRS.[186] If the taxpayer did not donate, he would pay taxes on the entire $10,000 of income at the highest rate, causing a tax liability increase of $3,960 from the $10,000.[187] Still, a donor can choose to donate to a specific charity instead of blindly giving money to the government. Even with the reforms, the donor still retains a generous tax deduction at the 28% level, saving almost 90% of the taxes he would pay on the entire amount if not donated.[188]

However, most taxpayers and many individuals do not fall in the highest tax bracket, and the reforms do not affect the tax breaks of those who itemize deductions but fall in any other tax bracket.[189] The donors in lower tax brackets maintain the 100% tax break for each dollar given to a qualifying charity.[190] Philanthropy scholars posit that these changes will mostly affect universities and other organizations that rely on large

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181. *Id.*

182. *Id.*

183. *Id.*; *see also* I.R.C. § 1 (2009) (showing a breakdown of the tax brackets by a taxpayer's income).

184. *See* Messmore, *supra* note 176. Calculated as $10,000 (income) * 35% (tax) = $3,500 in tax liability on the $10,000.

185. *See* Messmore, *supra* note 176. Calculated as $10,000 (donation) * 28% (deduction amount) = $2,800 tax deduction. $3,960 (taxes owed on the original $10,000) – $2,800 (tax deduction) = $1,160 that is still taxable as income.

186. *See* Messmore, *supra* note 176. Calculated as $1,160 (taxable income on donated property) * 39.6% (tax) = $460 in total tax liability on the donated property.

187. *See* Messmore, *supra* note 176. Calculated as $10,000 (income) * 39.6% (tax) = $3,960 in tax liability on the $10,000.

188. *See supra* notes 183–86 and accompanying text.

189. *See* Messmore, *supra* note 176.

190. *See* Messmore, *supra* note 176.

donations from high-income donors.[191] The effects will be quite high on the donation of real property because real property is generally valuable, and those who can afford to give property are generally those in a higher tax bracket.

These tax changes may increase 2010 property donations, so donors receive full tax benefits before the changes take effect.[192] Professional fundraisers refer to this phenomenon as a "prepaid donation." This also occurred in the 1980s when many nonprofits experienced an increase in donations in 1986, prior to the enactment of President Reagan's 1986 Tax Reform Act, which decreased the highest tax rate from 50% to 28%.[193] Then in 1987, because of prepaid donations, charitable donation amounts dropped significantly.[194] The passage of the FY 2010 budget with these reforms will likely increase gifts of real property and other large gifts for full donor benefits prior to the application of the new laws.[195] Many nonprofits and donors are voicing concerns about this phenomenon through blogs, articles, and even lobbying at the Capitol.[196]

If nonprofit managers already expect the prepaid gifts, they can anticipate the boom-and-bust cycle and plan for the future more effectively by saving some of the gifts for future use during the decrease donation phase. Large, prepaid gifts of real property could benefit both the donors and charities if used properly during this time. Taxpayers can donate to avoid paying capital gains taxes and choose the current donation year to ensure the full 35% income tax deduction.[197] Once the charity receives the property, it can hold some or all of the property for use in future years to increase future funding in anticipation of a drop in donations.[198] Otherwise, the charity can sell the property quickly and keep the funds in an interest producing account, providing the charity the additional benefit of interest on the donation.

Regardless of individual beliefs, costs, and benefits of the reforms, a fundamental flaw undermines the policy of these changes. Congress creates and enforces tax incentives, such as tax deductions for charitable giving, to increase charitable giving. President Obama wants to reform charitable tax incentives for the highest tax bracket to increase federal funding toward the national healthcare plan.[199] The outcomes are unfair to some charities

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191. *See* Messmore, *supra* note 176.

192. *See* Chris Hoyt, *How Obama's Budget May Affect Charitable Gifts*, North Carolina Estate Planning Blog, Feb. 27, 2009, http://ncestateplanningblog.com/2009/02/articles/estate-planning/charitable-gift-planning/ how-obamas-budget-may-affect-charitable-gifts/.

193. *Id.*

194. *Id.*

195. *Id.*

196. *See id.*

197. *See* discussion *infra* Part VI.C.

196. *See* discussion *infra* Part VI.V.

199. *See* Messmore, s*upra* note 175.

seeking funding from donors affected by the tax changes. The goal of funding healthcare would be more reasonable if the tax burden only affected the large nonprofit charities in the medical and healthcare industries. The creation and implementation of an adequate national healthcare policy may vitiate the need for many healthcare related nonprofit organizations. Those charities that will require less funding in the wake of the newly funded healthcare plan should bear the burden of the losses in charitable deductions, not the organizations unaffected by healthcare policy.

For example, organizations like the Cancer Society, the National Kidney Foundation, and the Muscular Dystrophy Association use donation funds to pay for medical services that may decrease in cost under national healthcare coverage or even a public option.[200] On the other hand, organizations such as Habitat for Humanity and the SPCA are not health related charities, so they have no chance of benefiting from the national healthcare plan. The tax reforms only hurt these organizations with the decreased tax incentives.[201]

The drastic reforms create fears of decreased donations and overall nonprofit funding. However, the reforms only affect those in the top tax bracket, and the actual changes still make donation a more advantageous choice for many, especially when combined with the goodwill donating creates. Hopefully, the reforms will not vitally harm nonprofit funding in the name of national healthcare, and in the future the organizations that will not benefit from the national healthcare plan should be exempted from this particular tax disincentive.

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200. Organizations that assist clients with healthcare costs, including nonprofit hospitals, will receive more benefits from a mandatory public option healthcare plan than non-healthcare organizations. For example, the Muscular Dystrophy Association pays for clients' clinic visits, therapy, and some durable medical equipment. A mandatory healthcare plan may mitigate some of MDA's costs. Many other charities and nonprofit organizations will be directly or indirectly benefitted from the legislation, but the many non-healthcare organizations will not be equally served by the legislation. The non-healthcare organizations should not bear the burden of decreased funding due to tax incentive decreases when the benefits are unequally distributed. *Compare* The American Cancer Society—Mission Statement, http://www.cancer.org/AboutUs/ WhoWeAre/acsmissionstatements. ("The American Cancer Society is the nationwide, community-based, voluntary health organization dedicated to eliminating cancer as a major health problem by preventing cancer, saving lives, and diminishing suffering from cancer, through research, education, advocacy, and service") *and* St. Jude's—Mission Statement, http://www.stjude.org/SJFile/_mission_vision_sr2007_08au07.pdf ("[T]o advance cures, and means of prevention, for pediatric catastrophic diseases through research and treatment. Consistent with the vision of our founder Danny Thomas, no child is denied treatment based on race, religion or a family's ability to pay."), *with* Habitat for Humanity—Mission Statement, http://www.habitat.org/how/ mission_statement.aspx ("Habitat for Humanity works in partnership with God and people everywhere, from all walks of life, to develop communities with people in need by building and renovating houses so that there are decent houses in decent communities in which every person can experience God's love and can live and grow into all that God intends."). *Id.*

201. *See supra* note 199 and accompanying text.

C. 2011 Capital Gains Changes

The Obama Administration also proposes an increase in capital gains taxes, which will affect charitable giving of real property.[202] In 2003, Congress passed tax cuts for capital gains taxes, but they will expire in 2011.[203] Many economists posit that the increase will affect the market causing people to keep long-term capital gain property off the market so owners will not have to pay increased taxes on the property.[204] Although this increase may unnaturally skew the economic market, it may also create positive externalities, temporarily increasing donations of real property.[205]

A taxpayer, donating real property to an IRC-qualifying public charitable organization will still receive many benefits from the transfer. One prominent benefit is the exemption from paying capital gains taxes on donated property. Therefore, the proposed capital gains tax increase will not apply to a donor but only those who sell property in the market.[206] This creates a large incentive to donate property, especially capital gains property that has greatly appreciated. However, this reform does not create a time sensitive change, thus, it should not increase any prepaid donations like the tax deduction reforms.[207] In fact, taxpayers may hold the property until this change takes effect so they can use the 561 Exchange, bargain-sale method to receive some immediate value for their property and avoid paying the new, higher capital gains taxes.[208]

D. Changes in the Estate Tax Exemption

The government also receives income through estate taxes; however, in 2009, estates worth up $3,500,000 were exempt from paying federal estate taxes.[209] In 2010, the exemption amount will be unlimited; meaning no estate of any value will owe estate taxes for 2010. But the exemption will reappear in 2011, decreasing to only $1 million (the amount allowed in

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202. *See* Curtis S. Dubay, *The Economic Impact of the Proposed Capital Gains Tax Increase*, The Heritage Foundation, Apr. 29, 2009, http://www.heritage.org/Research/Taxes/wm2418.cfm.

203. *See* Wachovia Trust Nonprofit and Philanthropic Services, *The Impact of Changes in Tax Rates on Charitable Giving*, PHILANTHROPY JOURNAL, Dec. 15 2008, http://www.philanthropyjournal.org/resources/fundraisinggiving/impact-changes-tax-rates-charitable-giving.

204. *Id.*

205. *See id.*

206. I.R.C. § 170(e) (2008); *see also* Treas. Reg. 1.170A-4(b)(2) (defining I.R.C. § 170(e) capital gains property).

207. *See id.*

208. *See id.*

209. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 501(a)(1)(B), 111 Stat. 788 (amending I.R.C. § 2010) (increasing the estate tax exemption is shown to aid in economic stimulation). "Each taxpayer's lifetime exemption from estate taxes gradually increases from $675,000 in 2001 to $3.5 million in 2009." Steven D. Nofziger, *EGGTRA and the Past, Present, and Future of Oregon's Inheritance Tax System*, 84 OR. L. REV. 317, 320 (2005).

2000).[210] Of course, estate taxes are only due in the year the property owner dies. Because people cannot predict or choose when they will die, a wealthy property owner can take precautionary measures to plan and prepare for upcoming estate tax changes.[211] Making a charitable inter vivos donation can decrease the overall amount of the future estate, which can help decrease taxes due on the estate upon the owner's death.[212] These savings may even increase the net income to estate beneficiaries.

Similar to the decrease in the deduction allowance, the changing estate tax exemption may affect the timing of certain donations.[213] Potential donors may wait to make inter vivos charitable donations until after the 2011 changes take effect because of the expense required to change complicated estate plans, such as those affected by the decreased minimum exemption.[214] If the owner is still alive after the decrease takes effect, the costs of changing the testamentary documents toward inter vivos charitable gifts of real property may be worthwhile, considering the estate tax and long term capital gains savings.[215]

Estate planners need to think about changes in estate taxes, and these upcoming reforms create another beneficial reason for potential donors to give real property to charity while maintaining a life estate or a life estate pur autre vie.[216] When donors give an inter vivos donation to a charitable organization, they can use the property throughout their lives, but the future property interest is irrevocably deeded to the charitable organization on the date of the donation.[217] This means the interest in the property vests in the charity immediately upon the donor's death, so the property is not calculated as part of the donor's estate for estate tax or disbursement purposes.[218]

VII. CONCLUSION

The economic downturn coupled with the federal government's multitude of goals turns much attention away from maintaining or

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210. *See* Nofziger, *infra* note 208.

211. *See, e.g.*, Jennifer M. Spitz, *Planning for Other States' Estate Taxes*. 37 COLO. LAW. 73, 75–76 (Sept. 2008). People can make inter vivos donations of property and assets to family members, loved ones, or a charity to avoid large estate taxes, but the most common method is a private or charitable trust to give away property while maintaining some control over the future use of the property. *Id.*

212. *See id.*

213. *See id.*

214. *See id.*

215. *See id.*

216. *See* Threlfall v. United States, 302 F. Supp. 1114, 1119 (D.C. Wisc. 1969) (citing Jost v. Wolf, 130 Wis. 37, 44, 110 N.W. 232 (1906)).

217. *See* Spitz, *infra* note 210.

218. *See id.*

increasing levels of charitable giving.[219] As stated earlier, economic hard times create a paradox for most nonprofit organizations because more people need services and fewer people can afford to fund the charities that provide those services.[220]

Originally, the government taxed individuals and corporations toward funding federal programs.[221] Past government actors have tweaked tax brackets, scales, deductions, and exclusions to promote certain desirable taxpayer behavior.[222] IRC §170 codified a financial incentive for those who donate to charities.[223] The federal government appreciates that private nonprofits can specialize to work more effectively and efficiently toward a single mission than the federal government could.[224] Section 170 provides donor incentives specifically for the donation of real property, including up to 100% deductions and allowing the donor to carry forward deductions for up to five years.[225] Recent and upcoming changes in capital gains taxes and the estate tax exemption will change donor decision making when gifting real property.[226]

Donating real property is a big decision for any individual or company and cannot be taken lightly. Potential donors must consider the type of property they plan to donate (residential, commercial, agriculture, mineral interest, etc.); the type of charity and exact charity they will donate to; the interest in the property they wish to donate (future interest, temporal interest, or fee simple interest); and many external costs and benefits of donating real property.[227]

In our current economy, many vacant properties (and properties that remain unsold in the market for long amounts of time) lose property owners large amounts of money.[228] In these and other situations, donors have many reasons to make large charitable contributions of real property, even during an economic downturn.[229] In the right circumstances, where a property owner will owe steep capital gains taxes or must maintain expensive upkeep on unused property, a charitable gift may be the donor's most financially rewarding use of the property.

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219. White House Issues website displays important new legislation and information on topics from civil rights to veterans and health care to homeland security. White House Issues, http://www.whitehouse.gov/ISSUES (last visited Jan. 23, 2010).

220. *See supra* Part I.

221. Clotfeller, s*upra* note 23.

222. *See* discussion *supra* Part III.

223. *See* I.R.C. § 170 (2008); *see* discussion *supra* Part II.

224. *See supra* notes 7–8 and accompanying text.

225. *See* I.R.C. § 170(d) (2008).

226. *See* discussion *supra* Part VI.C–D.

227. *See* discussion *supra* Part IV.

228. *Supra* Part III.B.

229. *See* discussion *supra* Part III.

The actual amount of a donor's tax benefits depends on the value of the property and whether the donation goes to a public or private charity.[230] Donors and professional fundraisers must remain aware of the different valuation methods available under IRS Publication 561 to determine the actual value of the property.[231] One more modern and controversial approach, coined the 561 Exchange, increased the value and number of real property donations to at least one charity, helping the organization meet its inspirational goals during the slow economy.[232]

In addition to the new fundraising trends, the federal government continues attempts toward tax reform similar to the charitable contribution deduction increase of 1990.[233] However, each taxpayer must carefully follow changes in tax law and decide whether it is in his best interest to donate during a recession.

The American Recovery and Reinvestment Act of 2009 decreased tax liability toward economic stimulation.[234] This increased the alternative minimum tax to regulate certain unfavorable tax planning methods to reduce tax avoidance.[235] The Act also provides many middle-class taxpayers tax relief by increasing exemptions and allowing tax offsets through nonrefundable tax credits.[236]

However, while the nonrefundable tax credits apply to donations when the taxpayer has a tax liability to take the credit against, the FY 2010 budget proposal decreases other donation incentives.[237] Most controversial and popular are the changes in the highest tax bracket, increasing the overall tax amount from 35% to 39.6%, while decreasing the charitable deduction from 35% to 28%.[238] Some speculate that this will dramatically decrease charitable giving of the wealthiest donors; however, the theory remains unproven.[239] Philanthropy professionals also fear a repeat of the prepaid donations that destroyed the industry in the late 1980s.[240]

Nonprofit managers also need to consider the 2011 increase in capital gains taxes and decrease in the estate tax exemption, which should create positive externalities increasing donations of real property.[241] The 2011 capital gains tax increase may expand the market of property owners who will benefit from the donation of highly appreciated capital gains

230. *Supra* notes 98–100 and accompanying text.
231. *See supra* Parts IV–V.
232. *Supra* Part V.A.
233. *See supra* Part V.
234. *Supra* Part VI.A.1.
235. *See supra* Part VI.A.1.
236. *Supra* Part VI.A.1.
237. *Supra* Part VI.B.
238. *Supra* Part VI.B.
239. *See supra* Part VI.B.
240. *See supra* Part VI.B.
241. *See supra* Part VI.C–D.

property.[242] Donating would allow the taxpayer to fully avoid the increased taxes; enticing donors to give highly appreciated property, which will increase the value to the charity.[243] The 2011 decrease in the estate tax will urge people to decrease the value of their estates, possibly through inter vivos donations of valuable real property, so the estate will remain below current estate tax exemption amounts.[244]

Even in the subpar economy, many reasons still entice people to donate to charity. Whether a person can afford to donate a penny, a used jacket, volunteer his time, or give real property, his decision will assist the future of America. However, each potential donor must assess his needs, assets, and goals to determine whether and when to donate. Despite the tax reforms, many advantages still exist to those donating real property. Although some tax reforms may complicate the decisions, especially for some of the wealthiest donors, hopefully altruism and goodwill compensate for the tax deduction shortcomings.

by Sarah Rose

242. *See supra* Part VI.C.
243. *See supra* Part VI.C.
244. *See supra* Part VI.D.