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Many planned giving programs include retained life estate arrangements (RLEs), whereby the donors contribute their home to the charitable organization, but retain the right to live in the residence for the rest of their lives. These can be tremendously effective examples of a split-interest gift – the charity receives a nice gift in the long run, but the donor derives a substantial benefit first, over a period of many years.

Many, if not most, donors of RLEs truly believe at the onset that they will reside in their homes until their dying days. Frequently, these are the homes in which they spent decades raising their children, and the house has endured as a central gathering place for poignant family moments. But what happens when the donors start to question whether they can continue to remain in their homes, in light of declining health or changed financial circumstances?

With the retained life estate arrangement, the donors reserve the *right* to occupy the residence until their deaths, and in no way can the charity force them to vacate the premises. The donors, however, are *under no requirement* to remain in the house if it no longer makes sense for them to do so. In this article, we'll take a brief look at what happens when the donors make the decision to move out of the residence.

When the RLE is created, the donors generally can take a charitable income tax deduction for a portion of the value of the property. This is where planned giving software (like PG Calc's Planned Giving Manager or "PGM") comes into play. The donors' charitable income tax deduction is computed by the use of IRS-sanctioned tables and formulae, but essentially, the process determines the projected value of the property at the end of the donors' life expectancies, discounted back to a present value. With the historically-low IRS discount rates in recent years, the charitable deductions for RLEs have been especially large – frequently 75% or more of the value of the property.

As with any split-interest charitable gift arrangement, it is helpful to look at the difference between the total funding value and the amount of the charitable deduction. The difference may be described as the value of the donors' right to occupy the residence for the remainder of their lives – essentially, the value of the life tenancy. Let’s look at a simplified example. The donors are 78 and 77, and the IRS discount rate is at 1.4%. If the property is worth $500,000, and the values of the land and buildings are of equal proportion, the charitable deduction would be approximately $373,000. The difference between the funding principal value and the charitable deduction is approximately $127,000, and it represents *the value of the donors’ life tenancy.*

That’s an important concept to remember when contemplating the voluntary relinquishing of the life tenancy at a later point. When a couple creates a RLE while they are in their 70s, and while they are still in relatively good health, they may believe they will never want to vacate the home. They may trust that, between the support of family and friends, and the availability of paid service providers, they can stay put, despite the gradual decline of abilities in their final years. But as family members become more geographically dispersed, and as increasingly more services are needed to keep the couple healthy – not to mention the services needed just to maintain the property itself – the donors may realize that they will be better off leaving the house and living in a more structured environment. Regardless of the manner in which the determination is made for the donors to move out of the house, there is a quantifiable value to the remaining years of life tenancy. The donors and their advisors should be made aware of that value as part of the decision-making process.

Let’s say the donors who created a RLE in their late 70s have now lived in the home for 10 years. For the most part, the couple has remained healthy, and they have been able to maintain the property pretty much the way they have always done. But in the last year or two, some significant health issues have begun to emerge, and their mobility has become somewhat impaired. Their residence no longer meets their physical needs and maintenance often goes unaddressed.

This is not an unfamiliar story to many organizations that have experience with retained life estate arrangements. As the donors continue to age in place, and as the circumstances begin to change, the decision to remain in the residence may be called into question*. All it takes is one bad fall, or a stroke, or some other serious health catastrophe, and the entire arrangement may become unworkable*. It’s probably a delicate conversation to start, and best not undertaken by the charity. In many cases, it will be the grown children, other family members, close friends, or even health care professionals who will suggest the possibility of making a change. It’s likely to be more palatable coming from loved ones who are obviously concerned about the couple’s well-being, than from the charity, who might appear to be more concerned about the property itself.

So what happens when the donors make that decision (sometimes with help from others) to vacate the property? Do they simply lose the value of their remaining life tenancy? Fortunately, that does not have to be the case. Just as was the case when the property was originally put into the retained life estate arrangement, we can run calculations now to determine the *value of the donors' right to live in the house for their remaining years*. Let's build on our previous example. If the original charitable deduction was $373,000, based on the house value of $500,000, what would the remaining life tenancy be worth now?

Let's assume our donors are exactly 10 years older now – 88 and 87. The house has increased in value, simply because of the general uptick in real estate values, so that it's worth $600,000 now. And we still assume the value of the building and the value of the land are 50% each. Believe it or not, *the value of the remaining life interest comes in at approximately $91,000*. Even though the donors are now in their 80s and have shorter remaining life expectancies than they did 10 years ago, with the slightly-increased value of the home, they could receive a $91,000 charitable income tax deduction. Think about it for a moment – they received a $373,000 deduction initially, they lived in the house for 10 years, and they now receive another deduction of $91,000. And the charitable organization will now receive the full benefit of owning the property – a residence that can be sold for $600,000. That's a great example of the financial leverage we see with so many split-interest charitable arrangements – we take a $500,000 property, and over the course of 10 years, *the benefits combined for all parties total well over $1 million!*

Of course, we have a couple of cautionary comments. The income tax deduction on the relinquishing of the remaining life tenancy doesn't come without some costs – any charitable deduction based on a gift of real estate must be supported by a qualified appraisal of the real estate. Just as when the property was first transferred to the charity, the IRS requires *a bone fide appraisal of the value of the property to justify taking any kind of charitable deduction based on the property.* And the donors have to pay for that appraisal.

In addition, the IRS requires a qualified appraisal of the value of the remaining life interest (life tenancy) whenever that amount is $5,000 or greater. In contrast to the real estate appraisal, *this document focuses solely on the value of the intangible*, the right to inhabit the premises. The donor is responsible for that appraisal as well.*

Beyond that, keep in mind that the ability to use the deduction is subject to the same limitations as with the initial deduction – the donors cannot use the deduction in excess of 30% of adjusted gross income for any tax year. But they get the 5-additional-year carryover ability.

There is another alternative, albeit much less common in practice, to the donors' taking a charitable income tax deduction for giving up the property. It is possible, if the parties concur, for the *charity to pay the donors for the value of their remaining interest*. If the charity wishes to hold the property for some reason (it's adjacent to the campus, for example), the organization could simply issue a check to the donors for the value of the interest. Alternatively, the charity and the donors could agree to sell the property and divide the proceeds proportionately, based on the calculations we have already described above. Keep in mind, however, that there are distinct tax implications in the donors' decision to follow these courses of action. There would be required tax reporting on the dollars received in either of these strategies, and the donors should consult with tax counsel prior to making any decisions.

In conclusion, we think it's important for the charities and the donors to be aware of these possible alternatives, when the donors are no longer able – or no longer choose – to live in the home. While it may be a sensitive topic, in many cases, donors are relieved to learn that they are not anchored to the home, and that they indeed have multiple options available to them. Relinquishing the remaining life tenancy not only allows the donors to take another charitable deduction, *it also allows the charity to use the money while the donors are still living*. And we typically hear that the donors are much better off – and much happier – residing in a safer and more supportive environment. This is another planned gift situation where it's possible for everyone to win.

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