Charitable Planning
"Wash Out" Strategies With Real Estate

By K. Gene Christian

For nearly 30 years, Portland and Southwest Washington real estate markets have risen steadily. As Metro continues to maintain a tight urban growth boundary, real estate values in our area will likely continue to outpace other fast-growing areas around the United States.

Do your clients have a farm, vacation home, or commercial / residential rental property that has experienced tremendous appreciation over time? At the same time has that property been depreciated for tax purposes? If so, is your client ready to sell the property but concerned about the effect of federal and state capital gain, as well as recapture capital gain taxes?

In many instances people simply opt for a 1031 exchange, hoping to get a property that will minimize their workload and have less of a "hassle factor" associated with it. However, in the back of their minds, your clients realize that they are still carrying forward their depreciated basis into the new property. At some point... sooner or later...the capital gain tax will have to be paid. NOTE: The only way they can avoid the tax is to pass away owning the property. In that case, their heirs will receive the property at a stepped-up cost basis.

However, some people don't want the hassles associated with property ownership in their retirement years; they may want to get a higher rate of income than they have been receiving with the rental; or they may not want all their assets to go to their children. Whatever the case, often a Charitable Remainder Unitrust (CRT) can be a perfect tool for people to accomplish their personal and charitable objectives. Consider the following scenario:

George and Betty Chambers, ages 80 and 74, have owned a 9-acre nursery farm for the past 31 years. Because of their location along a major highway, they have seen the property grow in value from the $100,000 they paid for it many years ago to $2,200,000 today. They want to simplify their lives, get a high level of income from the property, but they don't want to create a huge tax burden in the process.

In their case, an appropriate alternative to the 1031 exchange is a **Charitable Remainder Trust** (CRT). Charitable trusts are the only place in the tax code in which the Chambers couple could potentially realize up ▶

to five favorable tax outcomes by virtue of one financial transaction. They are:

1. Avoidance of all initial capital gain and recapture tax
2. Sizeable income tax deduction
3. Tax-free compounding inside the CRT
4. Potential for trust payments taxed at lower than ordinary income rates
5. Estate tax elimination on the donated asset

One of the most popular strategies today is called a *Wash Out Tax Plan*. It allows George and Betty to divide the property by deed, selling a portion of the property outright while placing the remaining portion in a CRT. By doing so, the charitable deduction afforded the couple from the portion of land placed in the CRT is used to help *wash out* the tax that will be owed on the portion of land they decide to keep and sell outright. In many instances, with proper planning, a person/couple can effectively eliminate initial capital gain and recapture tax on the sale of property if they are willing to use a CRT in a significant way.

Since 1969 the federal government has been fully in favor of giving people these tax breaks when they complete a CRT, which will ultimately benefit a charitable organization of their choosing. If you or someone you know wants to consider how to avoid taxation while simplifying their lifestyle, a CRT may be the answer.

The OSCPA Educational Foundation's goal is to provide accurate and timely information that will allow you, or your clients, to make informed decisions about the appropriateness of a CRT in their particular situation. For more information, contact OSCPA President Cheryl Langley at 503-641-7200/1-800-255-1470, ext. 25; clangley@orcpa.org. She will be happy to have a confidential illustration prepared for you free of charge. ■