

# Gift of a Future Interest in Real Estate

## Reserved Life Estates Keep Owners in Control During Their Lifetimes



Landowners can convey a future interest in real property to a conservation organization or government but continue to live on or otherwise enjoy using the property during their lifetimes. If the property is a personal residence or a farm, a donation of a future interest can generate immediate tax benefits.

|  |   |
|--|---|
| Introduction .....   | 1 |
| Options for Conveying Property.....                                | 1 |
| Dividing Into Present and Future Interests .....                   | 2 |
| Benefits of a Gift of Future Interest .....                        | 2 |
| Downsides of a Gift of Future Interest .....                       | 3 |
| Getting Started .....  | 3 |
| Owners' Rights and Responsibilities .....                          | 3 |
| Taxes .....  | 4 |
| Insuring and Repairing Casualty Damage .....                       | 4 |
| Standards of Care; Compliance with Laws.....                       | 4 |
| Standards for Conservation of Resources.....                       | 5 |
| Liability; Indemnity .....   | 5 |
| Condemnation.....  | 5 |
| The Transaction .....  | 5 |
| Title as of Conveyance Date .....                                  | 5 |
| Realty Transfer Tax.....   | 6 |
| Federal Income Tax Benefit.....                                    | 6 |
| Personal Residence or Farm Only .....                              | 6 |
| Value of Contribution .....  | 6 |
| Claiming Deduction.....  | 6 |
| Property Subject to Mortgage.....                                  | 6 |
| Reservation for Life of Owner and Non-Owner.....                   | 6 |
| No Restrictions for Benefit of Owner .....                         | 6 |
| Miscellaneous .....  | 7 |
| Accelerating a Change of Ownership.....                            | 7 |
| Subsequent Liens .....   | 7 |
| Coupling a Conservation Easement with a Reserved Life Estate ..... | 7 |

## INTRODUCTION

### Options for Conveying Property

Landowners who want to continue to live on or otherwise enjoy using their property may wish to convey their property, upon their deaths, to a conservation organization. Their motive may be the general support of the organization with the expectation that the organization will sell the property and use the proceeds to fund its conservation work. Or the owners may want the organization to conserve the property.

For either situation, the conservation organization and owners have options to discuss that will allow the owners to continue owning the property until their deaths. Some options work better than others, depending upon the donors' particular tax and estate planning circumstances as well as family and personal preferences:

- **Testamentary gift.** The owners can [include in their will](#) a gift of the property, in whole or in part, to the organization. This shows a good intention but, for the conservation organization, provides no assurance that the gift will occur. Wills may be changed at any time for any reason right up to the moment of death. There is also the possibility that family members or others anticipating an inheritance may contest the will after death. (See the WeConservePA guides [Donation by Will](#) and [Donation Agreements](#).)
- **Purchase option exercisable upon death.** The owners can grant the conservation organization the

right to purchase the land from the estate within a period of time after their deaths. The purchase price can be set at any amount agreed to by the parties.<sup>1</sup> (See the WeConservePA guide [Purchase Options](#).)<sup>2</sup>

- **Gift of future ownership.** The owners can, in the present, transfer a future interest in the property to the conservation organization. The organization's full ownership will not begin until the deaths of the owners. Until then, the owners retain exclusive possession of the property and all ownership rights. In contrast with a gift by will, there is no uncertainty that this gift will be received. Also, unlike a gift by will, a gift of future ownership potentially offers substantial federal income tax benefits to the owners in the year of the gift (if the property is their personal residence or a farm).<sup>3</sup>

The gift of future ownership is the subject of this guide.

## Dividing Into Present and Future Interests

The ownership of real estate can be divided into a *present interest* (sometimes called a life estate) and a *future interest* (sometimes called a remainder interest). A landowner effectuates this division by delivering a deed for the property to the receiving organization that includes a clause reserving to the landowner a life estate in the property for the remainder of their lives.<sup>4</sup>

The transferring owner (the grantor) can donate, sell or bargain-sell the future interest to the recipient (the grantee) identified in the deed. Just as when one deeds a house or other real estate to another, the transfer of this future interest is not revocable.

Upon delivery of the deed, the grantors continue owning the present interest in the property for their lifetimes and are called life tenants or present owners. The grantee holds a future property interest automatically beginning upon the death of the last to die of the present owners. The holder of the future interest is sometimes called the *remainderman* and is usually referred to in this guide as the *future owner*.

This division of ownership into present and future interests has for centuries been recognized as valid under the law.

## Benefits of a Gift of Future Interest

### For Owners

#### *Continued Use and Enjoyment*

The present owners continue to enjoy all ownership rights of the property during their lives. They can live on it or earn income from it, until all of the present owners are deceased.

#### *Immediate Tax Benefits*

The donation (or partial donation) of a *personal residence* or a *farm* to a charity subject to a reserved life estate can provide the donor a federal income tax deduction in the year of the gift and for up to five years thereafter.

#### *Estate Planning*

The conveyance of a future interest takes it wholly out of the estate. Neither the executor nor the beneficiaries of the estate will have any rights or responsibilities with respect to the property. Some owners may find this attractive so as to avoid disagreements among family members. Another benefit is that the value of estate property as a whole is lowered for both estate and inheritance tax purposes. Also, the estate is relieved of the burden of paying property taxes and other carrying costs.

#### *Conservation*

If the owners desire to permanently protect the land's conservation values, coupling the donation of a future interest with the donation of a conservation easement may provide additional tax and conservation benefits.

### For Conservation Organizations

Many charities promote the donation of future interests with reserved life estates because this guarantees that the charity will ultimately receive a valuable gift—often the donor's largest asset. Once the life estate expires, the charity may (unless otherwise spelled out in the deed of conveyance or a donation agreement) sell the property and use the proceeds to advance its various programs.

Conservation organizations may do this the same as any other charity.<sup>5</sup>

**In situations where the land has compelling natural values that the conservation organization wishes to protect, the reserved life estate is an excellent tool to guard against the land falling into the hands of someone who will not be amenable to conserving it.** The conservation organization has time to plan and prepare for future ownership, which is absolutely certain to occur. Testamentary gifts are less certain: wills can be changed and contested.

## Downsides of a Gift of Future Interest

Although owners may value the right to enjoy their land for the rest of their lives, a life estate interest is difficult, if not impossible, to sell or mortgage. Actuarial tables can estimate life expectancy, but the present owners can die at any time and, when they do, the life estate interest simply disappears.

Once reserved, a life estate can be transferred to others (for example, parents to children) but the estate still will terminate on the deaths of the parents.

Likewise, the conservation organization, as future owner, must take into consideration that the burdens of ownership will fall to the organization immediately upon the death of the owners, which can happen at any time without warning.

## GETTING STARTED

The grantor and grantee will both need legal assistance in preparing the deed with reservation of the life estate and an agreement covering issues that may arise during the lifetimes of the donors and restrictions (if any) on the conservation organization's use of the property or proceeds of the sale of the property after their deaths.

If tax and estate planning considerations are a concern, the grantors will also need competent tax advice so as to achieve the desired tax benefit in conformity with the

guidance provided in internal revenue code regulations §1.170A-12. These issues are addressed briefly in the "Federal Income Tax Benefit" section below; however, a full (and continuously updated) description of tax consequences is outside the scope of this guide.

The grantor and grantee must come to agreement as to their respective rights and responsibilities during the term of the life estate. Both the grantors and the grantee will want to ensure that the agreement:

- **Establishes the responsibilities of the present owners and future owner during the term of the life estate.** Typically, these would include paying taxes, insuring the property, repairing structures in the event of damage, and generally maintaining the premises. (Note that, unless they have agreed otherwise, the present owners are not required to refrain from doing anything other than committing waste—that is, damaging and devaluing the property.)
- **Identifies remedies if the present owner or future owner fails to conform to the agreement.**

These and other issues are addressed in greater detail in the next section.

## OWNERS' RIGHTS AND RESPONSIBILITIES

When a conservation organization accepts a future interest in real property, it can *hope* that the property will be in good condition when the life estate ends. But if the organization wants assurance that the property will be kept in accordance with certain standards, those standards must be set forth in a legally enforceable life estate agreement with the present owner. The concerns of the future owner during a life estate are similar to those of a landlord during a tenancy—taxes, insurance, repair and maintenance, and other issues discussed below.

## Taxes

The document establishing on the public records the future interest subject to a reserved present interest is a deed of the property from grantor to grantee reserving a life estate in the grantors. The tax records will show the grantee (for example, a conservation organization) as legal owner. Notices from taxing authorities (assessment, non-payment, etc.) will be sent to the address of the grantee identified in the address certification required under Pennsylvania law. If taxes are not paid on a timely basis and a tax sale ensues, all ownership interests in the property (both present and future) will be extinguished.

### No legal duty absent contract

Case law developed over centuries has established the rule that (absent a contract between the parties) neither the present owners nor the future owner have any obligation to each other to pay property taxes. If the future owner ignores the tax bill and the present owner (upon learning of the delinquency) pays the taxes plus penalty and interest, the law does not recognize a right to reimbursement (absent a contract between the parties). Likewise, if the present owner ordinarily pays the taxes but, for some reason, fails to timely pay, the future owner is not entitled to reimbursement of advances or, if a tax sale ensues, the loss of its future interest (absent a contract). A contract between the parties allocating responsibility for payment of taxes is of prime importance as is a system for assuring that payment is timely made.

### Notice

If the present owners are to pay taxes, they will want bills forwarded to them promptly and may want the authority to appeal assessments.

### Payment

The owner who is not responsible for payment of taxes under the life estate agreement will want assurance from the paying owner that taxes payments have been timely made. (A typical lease arrangement is for the paying party to produce to the other party receipts evidencing payment

not later than the date such taxes last became due without penalty or interest.)

## Insuring and Repairing Casualty Damage

Under the law (absent a contract), neither the owner of the present interest nor the owner of the future interest owes any duty to the other to maintain, repair, or rebuild improvements on the property for the benefit of the other. Thus, if the property contains improvements, the agreement between the present and future owners must address these issues.

### Insurance

Who (if anyone) is responsible for carrying policies of insurance on the property? Is there any obligation on the part of either of the owners to reimburse the other for all or a portion of the premiums? For example, an elderly life tenant may view capital repairs and improvements with a useful life of 30 years or more as benefiting the future interest far more than his present interest. A reasonable resolution may be for the owners to share the cost of insurance. In any event, both owners have an insurable interest in the improvements and should both be named as insureds.

### Repair and restoration

The owner identified as loss payee on the policy of casualty insurance is ordinarily the party tasked (by agreement) with repairing the casualty damage. As mentioned above, the age and health of the present owner are factors that may bear on decisions to allocate rights to control, and responsibilities to repair and restore. Some present owners will want to control repair and restoration during their lifetimes and expect insurance proceeds to be available to them. Others may not be willing or able to carry out these tasks and, if so, the future owner may have an economic interest in restoring improvements (and having access to insurance proceeds for that purpose).

## Standards of Care; Compliance with Laws

If the future owner expects the real property to be maintained in accordance with certain standards, the life estate

agreement is the opportunity to evidence the present owners' acceptance of that responsibility. Before accepting a future interest, the future owner should perform the same due diligence inspections that a reasonably prudent purchaser would perform. If the property is not in the same condition and in compliance with applicable laws as of the end of the term of the life estate, the life estate agreement should provide an obligation surviving the death of the present owner and binding upon his estate to remedy the non-compliance.

## Standards for Conservation of Resources

If the future owner's intent is to conserve the land, it will want assurances that the conservation values of the property will be reasonably protected during the term of the life estate. Restrictions on construction, tree cutting, soil disturbance and other activities during the life estate, to the extent that these activities would diminish the land's conservation value, may be included in the life tenancy agreement.

If the intent is to conserve the property for all time, placing a [conservation easement](#) on the property prior to donating a future interest is likely to have better outcomes for the donating owners and conservation organization than simply placing restrictions in the life estate agreement. See "Coupling a Conservation Easement with a Reserved Life Estate" below.

## Liability; Indemnity

Under the legal rules governing present and future interests, absent a contract, neither the present owner nor the future owner has any duty to the other to keep the property in good, or a reasonably safe, condition during the life estate. Nevertheless, someone claiming loss or injury relating to the condition of the property during the life estate is likely to name the person identified as owner in the public records (the future owner identified as grantee in the deed) as responsible for the damage or harm. For that reason, the future owner has an interest in seeing that the present owners carry liability insurance and that the life

estate agreement includes an indemnity from the present owners so that the future owner does not have to defend claims for which it has no responsibility or liability.

Likewise, if during the life tenancy, the future owner has rights to enter the property for repair, programmatic use, or other purposes, then the present owners may similarly want to address liability insurance and indemnity to protect themselves from claims arising from the negligence of the conservation organization.

## Condemnation

If the property is condemned in whole or in part during the life estate, both owners may pursue their claims for compensation of the taking of their respective interests in the property. The life estate agreement can require the parties to cooperate with each other to obtain the full fair market value of the property taken and allocate the proceeds in accordance with a mutually agreeable formula.

# THE TRANSACTION

## Title as of Conveyance Date

Prior to acceptance of a future interest, the future owner will want to obtain a commitment to insure its title to the property. (The life estate will be shown as an exception to the title.)

If any mortgages or other liens are outstanding as of the date of the deed conveying the future ownership interest, the future owner must consider that its future interest is at risk should the present owners fail to satisfy the obligations. Arrangements to assure prompt payment so as not to jeopardize either the present or future interest should be addressed in the life estate agreement. Absent a contract, the present owner has no obligation to satisfy the liens so as to preserve the future interest.



## Realty Transfer Tax

Realty transfer tax is due upon recordation of the deed conveying the future interest and reserving the present interest. However, in Pennsylvania, a transfer to a conservancy recognized as a charitable organization under 501(c)(3) of the IRC is exempt from this tax.<sup>6</sup>

## FEDERAL INCOME TAX BENEFIT

### Personal Residence or Farm Only

The general federal tax rule set forth in Internal Revenue Code §170(f)(3)(A) is that a contribution of a *partial interest* in property is not deductible unless an exception applies. One of these exceptions is familiar to conservation organizations—a qualified conservation contribution commonly referred to as a conservation easement. Another exception found in IRC §170(f)(3)(B)(i) permits a deduction for the contribution of a *remainder interest in a personal residence or farm* to a charitable organization recognized under IRC §501(c)(3).

A *farm* is defined as “any land used by the taxpayer or his tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock”<sup>7</sup> together with the improvements thereon. A charitable contribution of a remainder interest in open space land not actively used for agricultural purposes is not deductible.

### Value of Contribution

The value of the charitable contribution of a remainder interest in a personal residence or farm is equal to the net present value of the charitable remainder interest. IRC §1.170A-12 provides guidance as to how that value is to be computed.<sup>8</sup> The value must be supported by a qualified appraisal if the deduction claimed exceeds \$5,000.

## Claiming Deduction

Assuming that the personal residence or farm is property held long-term by the donor and is donated to an organization recognized under §501(c)(3) of the Internal Revenue Code, then the present value of the remainder interest is deductible against 30% of the donor’s adjusted gross income the same as any other charitable donation. Any unused portion can be carried forward for up to five years.

### Property Subject to Mortgage

Transfer of a remainder interest in a property subject to a mortgage is treated as a bargain-sale for tax purposes and gain or loss may be recognized upon the transfer in accordance with applicable provisions of the Internal Revenue Code. These provisions include both the bargain sale rules set forth in IRC §1011(b) and applicable rules for exclusion of gain on sale or exchange of personal residence set forth in IRC §121. The recognition of gain may result in adverse tax consequences to the donor, a discussion of which is outside the scope of this discussion. Donors should seek the advice of a knowledgeable tax professional.

## Reservation for Life of Owner and Non-Owner

Sometimes an owner wants to reserve a life estate not only to themselves for their life but to another for their life as well. Reserving a life estate for the benefit of a non-owner is a gift that may have potential gift and estate tax ramifications that should be discussed with tax and estate planning professionals.

## No Restrictions for Benefit of Owner

To qualify for tax deductibility, the gift of the remainder interest must be unfettered and unconditional. For example, the life estate agreement cannot require the remainderman to join in a sale of the property if desired by the life tenant. Under Revenue Ruling 77-305, a contribution was disallowed even though the remainderman was entitled, under the life estate agreement, to share proportionately in the proceeds of sale.<sup>9</sup>

## MISCELLANEOUS

### Accelerating a Change of Ownership

A deed conveying a future interest and reserving a present interest for the lives of the grantors can include a provision that would accelerate the change of ownership upon the occurrence of certain events. For example, the permanent departure of the present owners from the property or a violation of certain terms of the life estate agreement might be used as triggers for a more immediate change in ownership.

### Subsequent Liens

After the division of ownership into a present interest and future interest, the future interest is not affected by a subsequent mortgage or other lien upon the present interest so long as the future owner does not join in, subordinate to, or otherwise agree to recognize the rights of mortgage holder in the property after the termination of the life estate. Likewise, a mortgage or other lien on the future interest has no effect on the present interest.

### Coupling a Conservation Easement with a Reserved Life Estate

If the intent is to conserve the property for all time (in other words, both the present and future owners agree that the conservation values of the property should be protected not only during the term of the life estate but also thereafter), it likely makes sense to couple the use of a reserved life estate with a [conservation easement](#). A conservation easement provides the holder of the easement the power to protect the property's conservation values as identified in the grant of easement.<sup>10</sup> The present owners would grant the conservation easement to the easement

holder<sup>11</sup> before delivering the deed conveying future ownership.

The easement donation can furnish a federal income tax benefit to the donors if it meets the standards of a qualified conservation contribution under the internal revenue code. The tax benefit generated by donating the easement is separate from and in addition to the tax benefit available from contributing the future interest.



[Patricia L. Pregmon](#), attorney at law, and [Andy Loza](#) are the authors.

WeConservePA offers this guide thanks to support from the William Penn Foundation and the Community Conservation Partnerships Program, Environmental Stewardship Fund, under the administration of the Pennsylvania Department of Conservation and Natural Resources, Bureau of Recreation and Conservation.

Nothing contained in this document is intended to be relied upon as legal advice or to create an attorney-client relationship. The material presented is generally provided in the context of Pennsylvania law and, depending on the subject, may have more or less applicability elsewhere. There is no guarantee that it is up to date or error free.

© 2023, 2015, 2009 WeConservePA

Text may be excerpted and reproduced with acknowledgement of WeConservePA.

v. 2/17/2023

<sup>1</sup> The owners might desire a purchase price of more than a nominal amount to provide funds for paying tax or other obligations of the estate.

<sup>2</sup> If the owners do not want to give the organization an absolute right to purchase the property, they may be willing to give the conservation

organization a [right of first offer](#). This provides the conservation organization the opportunity to purchase before the estate makes the property available to the general public. See the WeConservePA guide [Right of First Offer and Right of First Refusal](#).

<sup>3</sup> If the intent is to conserve the owners' specific property rather than to generally support the organization's mission, the owners can donate a conservation easement on their property to protect its natural and scenic resources. This can be done in conjunction with a gift of future ownership and provide additional tax benefits in the year of the gift.

<sup>4</sup> Alternatively, a grantor might choose to reserve rights to use the property for a term of years—a *leasehold interest*. Or a grantor might instead choose to reserve a present interest for someone else's lifetime (called an *estate pur autre vie*).

<sup>5</sup> A conservation organization should not feel compelled to conserve the land simply because it is a conservation organization, but it should be clear with donors as to its intent regarding the donated interest. The importance of clearly documenting the intent of both the donors and the conservation organization as to whether or not the gift is given with strings attached (restrictions on the use of the land or proceeds of the sale of the land) cannot be overemphasized.

<sup>6</sup> Regarding charities who are not conservancies, transfer tax regulations published in §91.165 of the Pennsylvania Code provide for the publication in the *Pennsylvania Bulletin* of tables to establish the fair market value of the remainder interest based upon the factors used by the Internal Revenue Service to determine same.

<sup>7</sup> The term *livestock* includes "cattle, hogs, horses, mules, donkeys, sheep, goats, captive fur-bearing animals, chickens, turkeys, pigeons and other poultry."

<sup>8</sup> In brief, the factors included in determining the value include:

- The fair market value of the property (including improvements) on the date of transfer.
- The fair market value of depreciable improvements attached to or depletable resources associated with the property on the date of transfer.
- The estimated useful life of the depreciable improvements.
- The salvage value of the depreciable improvements at the conclusion of their useful life.
- The measuring term of the agreement which, if measured by the life of one or more individuals, is measured from the date of birth of the individuals. This factor determines the period of time between the transfer and the end of the life estate.
- The "Applicable Federal Midterm Rate" in effect for the month of transfer or during either of the two preceding months. This factor determines the discount rate that will be applied to reduce the value as of the end of the life estate to its present value as of the date of transfer.

A detailed discussion of the factors and the computation is outside the scope of this guide.

<sup>9</sup> If the owners had contributed an undivided interest in fee simple instead of a remainder interest, the result would have been much better for the owners, which reinforces the importance of seeking professional assistance in planning a contribution of a partial interest.

<sup>10</sup> See the WeConservePA guide [\*The Nature of the Conservation Easement and the Document Granting It\*](#).

<sup>11</sup> For reason beyond the scope of this discussion, the future interest holder and easement holder likely should be separate entities.