Charitable (or Bargain) Sales for Land Conservation

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Charitable sales are an often overlooked method of stretching limited public and nonprofit land conservation dollars in a manner that can be advantageous for both the seller and buyer. In general, charitable sales, also sometimes called "bargain sales," are most feasible when a landowner is motivated to conserve his or her land. However, depending on the landowner's financial circumstances and other factors, charitable sales can often also provide net (after tax) revenue comparable to a fair market value sale to a non-charitable entity. This achieves community goals by allowing the land to be protected, while generating significant revenue and tax advantages for the owner. In some cases, presenting information on the financial benefits of a charitable sale may be effective in persuading a landowner to consider this approach as a sound business alternative to a sale at fair market value, even when the landowner has already been seriously considering selling the property for development.

In May 2000, The Compact of Cape Cod Conservation Trusts and the Cape Cod Commission convened a workshop on Cape Cod for land trusts and municipal land bank committees to explore the potential tax advantages of charitable sales. While landowners should always be counseled to consult with tax advisors when considering a bargain sale, volunteers and professionals involved in land conservation should be able to go beyond merely suggesting that landowners investigate charitable sales, and actually help them work through some examples to show them the potential benefits that could result from such an approach. Ideally, these examples would be "customized" to reflect the specifics of the landowner's financial situation. This information can be of assistance in encouraging landowners who have not previously considered the charitable sale approach, to determine whether and how a conservation alternative can successfully "compete" with a fair market value sale with regard to net after tax return.

What is a Charitable Sale or Bargain Sale?

A "bargain sale" is the term used by the Internal Revenue Service to describe a sale of land (or interest in land such as a conservation restriction) for less than fair market value to a non-profit land trust or government agency when the land is to be used for a public purpose, including conservation, recreation and water supply. Technically, in a charitable sale, a portion of the value of the land is sold and a portion is donated. The relative proportions of the sale and the donation are determined through negotiation between buyer and seller. The landowner is able to take a charitable deduction determined by the difference between the sales price and the appraised fair market value on his or her income tax return under Section 170 of the Internal Revenue Code, resulting in tax savings. Landowners often shy away from the term "bargain sale" as it implies that they are giving away their land for a "bargain." Hence, many organizations are increasingly using the term "charitable sale" as it better describes the nature of the transaction -- a sale to a charitable nonprofit organization or tax exempt agency -- that results in an income tax deduction.

What are the Benefits of a Charitable Sale?

There are several benefits that may accrue to a landowner from a charitable sale:

- A charitable deduction may be able to be taken on the landowner's federal income tax return. The amount of savings will depend on the landowner's tax bracket. More information on calculating the deduction can be found below.
- A charitable sale may reduce the capital gains tax that would otherwise be due on the proceeds of a sale at fair market value. This may be significant, particularly for properties with high appreciated value and/or low basis.
- If the property has not been listed with a broker, no real estate commission will be due. Typically, this can be 6% to 10% of the selling price for undeveloped land.
- For sales to municipalities, no transfer stamps are due upon recording at the Registry of Deeds. This is $5.70 per thousand of sale price in Barnstable County.
- Often a land trust or government agency is able to close the deal more quickly and with fewer contingencies than a developer or other buyer. This lower level of risk to the landowner may translate into "cash in hand" more quickly than when land is being sold for development.

Under particularly favorable conditions, a landowner can "break even" on a charitable sale when compared to the cost of selling for fair market value. It is clear that the benefits of a charitable sale will vary depending on a particular landowner's situation. The only way to know for sure is to "run the numbers" in conjunction with the landowner and his or her tax advisor. This will determine the net after tax return from a charitable sale versus a fair market value sale. Even if the seller does not "break even," the tax advantages of a charitable sale will always "cushion the blow" on price.

What Information is Needed to Document a Bargain Sale?

The landowner is required to demonstrate donative intent, specifically that the landowner will receive no special quid pro quo for the charitable sale. For example, a landowner that receives a development permit in exchange for the charitable sale, might be making the charitable sale in order to encourage the permitting agency to look favorably on the permit. In such instance, the IRS might question the landowner's charitable intentions.

To help demonstrate donative intent, language should be put in the purchase and sales agreement to the effect that:

"BUYER acknowledges that SELLER intends to claim this sale as a bargain sale for charitable purposes and BUYER agrees to sign the property receipt acknowledgment on Form 8283 for the SELLER's federal income tax return. BUYER makes no acknowledgment as to the amount of any deduction claimed by the SELLER."

In order to substantiate the charitable sale, the landowner is required to have a complete appraisal prepared by a qualified appraiser no sooner than 60 days prior to the completion of the transaction. IRS Form 8283 must be attached to the landowner's federal tax return and must be signed by the appraiser, the seller, and the buyer. There are penalties for overstating the value of a charitable sale to both the landowner and his or her appraiser. In particular, it is important to document the fair market value, not just the asking price -- particularly for a property that has been on the market for some time and may be overpriced.

How are the Potential Tax Benefits of a Charitable or Bargain Sale Determined?

Any landowner contemplating a charitable sale should consult with a qualified tax attorney or tax advisor in order to determine how the tax benefits of a charitable sale will apply in his or her particular income and tax circumstances. Ideally this should occur as early in the process as possible.

As noted above, the amount of the charitable deduction is determined by the fair market value (FMV) of the property minus the sales price.

In general, the deduction for appreciated real property is limited to 30% of the landowners Adjusted Gross Income (AGI). If the full amount cannot be deducted in the first year, any unused deduction may be carried forward for five additional years. After this time, any unused deduction is lost. In addition, total charitable deductions in any one year (appreciated real property, stock, cash and noncash contributions) are further limited to 50% of AGI. Both limitations must be respected on any given year's tax return. Land conservation organizations and agencies that want to "run the numbers" for a landowner need to either obtain information about anticipated income and deductions from the landowner or clearly point out the assumptions that are used in the calculations.

Two important factors in determining the ability of a landowner to benefit from a charitable sale are the basis of the property and the tax bracket of the landowner. In general, the landowner that will benefit most from a charitable sale is one that is in a high tax bracket and has a property with a relatively low basis compared to the fair market value. However, either one of these conditions (high income or low basis) can serve as the "engine" that makes a charitable sale work for the landowner.

The basis of a property must be determined in order to calculate the capital gain (or loss) that will be reported upon its sale. For land that was purchased by the landowner, the basis is what the landowner paid for it, plus the value of any improvements that have been made. The basis for inherited property is the value on the date of death of the previous owner plus the value of any improvements. The basis for gifted property is the basis of the original owner plus any improvements (the previous basis transfers to the new owner). It is important to note that charitable sales are treated as part gift and part sale. The basis needs to divided proportionately between the sale and the donation.

In some instances, charitable sales are less likely to be attractive to landowners. These include situations where the owner has no interest in conservation or is otherwise not motivated to invest the effort to make a charitable sale work, and cases where a landowner has already used up their charitable deduction (for example, through donations of appreciated stock). A charitable sale is likely to be less beneficial for properties with a high basis or landowners who have little income, thus placing them in a lower tax bracket. In addition, some corporations and nonprofits that hold land may not be able to benefit from the tax advantages of a charitable sale.