

## Affordable Housing Preservation Options for Martha's Vineyard

### *A Guide for Homeowners<sup>1</sup>*

This document explains how to protect the complex fabric of landscapes, traditions, and people of Martha's Vineyard through housing preservation that has been employed successfully by other property owners. Often, housing preservation methods offer attractive tax advantages, helping homeowners to reduce estate, income, and property taxes, thus making housing more affordable. Protecting housing can involve complicated financial and legal decisions; careful thought and good advice are essential. What is most important is your and your family's love and concern for the preservation of our priceless community and the desire to see it nurtured and conserved.

### **Finding the Path to Affordable Housing Protection**

(Combinations of options are often used to achieve specific goals)

<i>Do you wish to retain ownership of your property?</i>	
YES	NO
<p><i>Do you wish to protect your property permanently?</i></p> <p><i>If Yes...</i></p> <ul style="list-style-type: none"> <li>Affordable Housing Restriction (page 4)</li> <li>Donation of an Undivided Interest (page 4)</li> <li>Donation of Land by Will (page 3)</li> <li>Donation of a Life Estate (page 3)</li> </ul> <p><i>If No...</i></p> <ul style="list-style-type: none"> <li>Lease under Rental Conversion (page 6)</li> </ul>	<p><i>Is monetary compensation needed?</i></p> <p><i>If Yes....</i></p> <ul style="list-style-type: none"> <li>Sale at Fair Market Value (page 5)</li> <li>Bargain Sale (page 5)</li> <li>Installment Sale (page 5)</li> </ul> <p><i>If No....</i></p> <ul style="list-style-type: none"> <li>Donation of Property or House (page 3)</li> <li>Donation by Will (page 3)</li> <li>Donation of Life Estate (page 3)</li> <li>Donation of Undivided Interest (page 4)</li> </ul> <p style="text-align: center;"><i>Do you wish to limit the future use of the Property when you convey title?</i></p> <p><i>If Yes...</i></p> <ul style="list-style-type: none"> <li>Affordable Housing Restriction (page 4)</li> </ul> <p><i>If No...</i></p> <ul style="list-style-type: none"> <li>"Free and Clear" Donation (page 3)</li> <li>Bargain Sale (page 5)</li> <li>Sale a Fair Market Value (page 5)</li> </ul>

#### WHERE TO BEGIN?

We suggest that you call Philippe Jordi at the Island Housing Trust at (508) 693-1117 to discuss your property and your concerns in general.

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<sup>1</sup> Based on a publication entitled *Land Conservation Options – A Guide for Massachusetts Landowners* published by the Essex County Greenbelt Association, Inc. and The Trustees of Reservations.

## INCOME AND ESTATE TAX ADVANTAGES

Income tax and estate tax advantages have encouraged many property owners to pursue housing preservation opportunities. The tax implications of your transaction will depend on the value of your gift, your financial circumstances, the tax rules in effect at the time, and other factors. Where substantial dollars or the future of your property is at stake, you should always consult with an experienced attorney or qualified tax advisor before giving, or making bargain sales of property or restrictions.

### BASIC PRINCIPLES

A few basic principles should be remembered when you consider making a conservation gift.

1. Where the gift of property or interest in land meets IRS criteria for deductibility, donors are permitted an income tax deduction on their federal and Massachusetts income tax return for the gift, subject to certain limitations and substantiation requirements described below.
2. Qualified property gifts made during the donor's lifetime or by will also remove the donated property from the donor's estate, thereby reducing his or her federal estate taxes.
3. The recipient of the gift must qualify under IRS rules. Qualified recipients are governmental agencies and religious, charitable, educational and scientific organizations (including land trusts) that have been determined to be tax-exempt under Section 501(c)(3) of the Internal Revenue Code.
4. If a partial interest in property (for example, a life estate or affordable housing restriction) is donated, it must meet specific IRS standards for deductibility.
5. In the case of an affordable housing restriction on property that has been mortgaged, the mortgage must be subordinated to the restriction.
6. In the case of bargain sales, the cost basis of the property must be correctly apportioned between the sale portion and the gift portion of the transaction.
7. Each claim of a charitable deduction on an income tax return must be properly acknowledged in writing by the recipient.
8. If the charitable deduction exceeds \$5,000, rigorous IRS procedures and standards for appraising the gift must be followed.

### INCOME TAX DEDUCTIONS

The IRS limits the maximum annual charitable deduction you can take against your income. Generally, for a gift of appreciated property (which includes most gifts of property and affordable housing restrictions), the amount you can deduct from your income in one year is limited to 30 percent of your adjusted gross income. If the value of your gift exceeds that level, you may carry forward the excess contribution for up to five years, applying the 30 percent limit each year.

There is an alternative to the 30 percent limitation. You may claim as a deduction only the property's cost basis (at the time you took ownership). In this case, an annual deduction of up to 50 percent of the adjusted gross income is allowed, with any excess carried further for an additional five years.

### COST INCURRED MAKING A CHARITABLE GIFT

Legal and appraisal fees associated with a charitable gift of property or affordable housing restrictions can generally be deducted (as a business expense, not as charitable donations) if, in combination with other miscellaneous deductions, they exceed two percent of your adjusted gross income.

## DONATING REAL ESTATE OR RESTRICTIONS FOR HOUSING PRESERVATION

Donating real estate to a private, non-profit housing organization or to a public housing agency is the most straightforward method of permanent housing preservation. It transfers ownership and management responsibilities to the organization or agency, thereby ending the burden of property taxes. Donation of real estate as a charitable contribution provides maximum income tax and estate tax benefits and avoids capital gains tax. You may donate land or your house during your lifetime or upon your death as you direct in your will. You may donate an entire property, small parcel, portions of a parcel, or an undivided interest in a parcel.

If you fit one or more of the following categories, you may find donating real estate attractive:

- You want to build a new house on your property and want to see your existing house put to good use;
- You are committed to permanent preservation of your property for a charitable good;
- The value of your property has appreciated greatly and its sale would result in high capital gains taxes;
- You own property, perhaps a vacation retreat, that you or your heir no longer wish to use or maintain;
- You hold substantial real estate and wish to reduce the estate tax burden for your heirs.

### FUTURE MANAGEMENT

Quite understandably, donors often want to influence how the organization or agency will use the property or develop the land in the future. Appropriately, donors may work with the recipient to develop a management plan or site plan, in which it will do its best to accommodate those desires, while retaining the right to make necessary and desirable manage or development decisions as circumstances change.

### RECYCLING HOUSES

Instead of demolishing your house in order to build anew, you may want (or be required in Edgartown under current zoning by-laws) to donate your house to the Island Housing Trust to be moved. Many Island houses have been donated and moved for affordable housing. In many cases property owners have donated back the tax benefits received from the donated house, which has funded the house move to a suitable parcel of land.

### LIFE ESTATE

This technique allows you to donate real estate during your lifetime, which reserving the right for yourself, and other persons you specifically designate, to continue using the property during your and their lifetimes or for a shorter period of years. When you and those you have specified either die or release their life interests, the recipient assumes full title and control over the property.

The value of the gift for tax purposes is determined by subtracting the value of the reserved life estate or term of years from the appraised fair market value of the property. These values are determined from IRS actuarial tables based on average life expectancies. The holder of a reserved life estate continues to be responsible for property taxes until the recipient obtains full title to the property.

### WILLING REAL ESTATE

Many properties have been donated to housing organizations or agencies by will – also known as bequest, testamentary gifts, or devises. Although you receive no income tax benefit and continue to be responsible for property taxes, donating real estate by can significantly reduce tax burden faced by your heirs, ensure preservation of your real estate while allowing you to enjoy the benefits of full ownership during your lifetime, and finally allows you to re-write your will at anytime or remove the donation if your financial situation or intentions change.

#### DONATING UNDIVIDED INTEREST

To take advantage of the potential charitable donations generated by a large gift, donors may spread the gift over two or more years by donating a series of fractional portions, call undivided interests. These are not separate parcels, but are share of the whole, say 10%, 20%, 30%, etc. This technique allows you to tailor the size and number of charitable deductions to the amounts you can use from year to year, given your tax situation.

#### DONATING LAND FOR CONSERVATION AND HOUSING

Many conservation groups have worked with housing organizations and agencies to broker the purchase of ecologically sensitive or recreational lands, while allowing for the thoughtful development of smaller non-conservation properties along side.

#### DONATION OF AN AFFORDABLE HOUSING RESTRICTION

One of the best ways of protecting perpetual affordability while retaining ownership is to donate a permanent affordable housing restriction. You retain full ownership and ability to sell or convey the property, by deed or will, through gift or sale, to a family member or to anyone else. Such a sale or conveyance will always be subject to the terms of the affordability restriction document that subordinates any mortgage on the property. In effect, that document becomes part of the deed to the property. The restrictions must be accepted by the recipient agency or a qualified housing organization, which is then legally empowered to monitor and enforce this agreement.

These permanent restrictions are authorized by Massachusetts' law (M.G.L. Chapter 184, Section 31-33) to limit the use of all or part of the property or restrict the resale price to occupancy by persons, or families of low or moderate income<sup>2</sup> in either rental housing or home ownership. Affordable housing restrictions under Massachusetts law requires approval by the Department of Housing and Community Development (DHCD) when held by a government agency, and when held by a charitable corporation or trust requires the additional approval of the town's selectmen or town meeting.

To qualify as a tax-deductible gift, an affordable housing restriction must be written to be effective in perpetuity. The most important federal income tax rules affecting affordable housing restrictions relate to "charitable contribution" as defined in Section 170(c) of the Internal Revenue Code. Appraising gifts of affordable housing restrictions is a highly specialized craft. The appraiser must give very careful attention to the specific terms of the restriction at hand, and must be able to estimate their effects on the value of the land being restricted. That diminution of value is deductible for tax purposes, provided that all other requirements of the tax code are met.

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<sup>2</sup> Low and moderate income is defined 80% or less of the area's median income. The area median income is published annually by the US Department of Housing and Urban Development (HUD).

## SELLING REAL ESTATE OR RESTRICTIONS FOR HOUSING PRESERVATION

In spite of limited funding, nonprofit housing organizations and public agencies on Martha's Vineyard are making substantial investments in permanently protected affordable housing through purchase. Often these purchases are the result of expressions of interest by landowners themselves.

### SALE AT FAIR MARKET VALUE

While selling real estate at its fair market value to a housing organization or agency may be ideal from the property owner's point of view, funds are rarely available for such a purchase. A sale at full market value may not be as desirable as it may seem at first glance. Capital gains taxes for investment properties and transaction costs can cut deeply into sale proceeds and revenues, particularly for property owners in higher tax brackets or those selling highly appreciated property.

### BARGAIN SALE

A bargain sale is a sale to a charitable organization or governmental agency at less than fair market value. The difference between the appraised market value and the sale price to a qualified buyer is considered a tax-deductible charitable contribution for federal and state income tax purposes. The charitable deduction is taken in the year of the sale, and unused portions of the deduction can be spread over the subsequent five years. The deduction can be used to offset up to 30 percent of annual income. The capital gain from the sale will also be reduced, for both federal and state purposes, by the reduced price. When combined with other savings, including a broker's commission, the landowner may achieve nearly the same after-tax financial return as from a fair market value sale, while also providing a substantial public benefit.

You should state in writing, preferably in the purchase and sale agreement, the intent to make a charitable bargain sale; doing so establishes your charitable intent for tax purposes. For any bargain component greater than \$5,000, the value of the gift must be substantiated by a qualified appraisal to validate the tax deduction.

### INSTALLMENT SALE

In an installment sale, the seller accepts a series of payments over time rather than one lump sum. An installment sale may benefit a landowner by spreading income and taxable gain over several years, subject to special tax limitations.

### OPTION TO PURCHASE

If funds are not readily available to allow an immediate purchase, the owner may be willing to consider granting the organization an option to purchase the property. Under an option, seller and buyer agree on a specific sale price and terms and the buyer is given a specific amount of time in which to exercise the option and complete the purchase.

### RIGHT OF FIRST REFUSAL

You may grant a right of first refusal to buy a property in the future. Under a right of first refusal, the organization has a certain specific period of time in which to match any bona fide offer from an other purchaser.

### SALE OF AN AFFORDABLE HOUSING RESTRICTION

One of the best ways of protecting perpetual affordability while retaining ownership is to sell a permanent affordable housing restriction. As with donating affordable housing restrictions (see page 4), an appraisal of the property to determine the value before and after the restriction must be conducted by a professional appraiser.

## OTHER INTERIM TECHNIQUES

Sales or gifts of property or of undivided interests in property are usually intended to be permanent. However, a property owner may prefer a short-term approach, even without the income and estate tax advantages available when permanent gifts are made.

### LEASE UNDER RENTAL CONVERSION

The Dukes County Regional Housing Authority, with funding from the Island Affordable Housing Fund, has a program that provides homeowners with incentives to lease their property year-round to income eligible Island families and individuals.