What to Consider Before Accepting a Property Contribution

By Ted Batson, Partner

A gift of property can be very generous. If your nonprofit is offered such a contribution, you might be tempted to jump at the opportunity. But it's crucial to carefully consider gifts of real property (real estate) to avoid any unpleasant surprises and negative consequences.

Start by reviewing whether the potential gift meets the requirements of your organization's gift acceptance policy. Then conduct pre-acceptance due diligence by taking the following considerations into account.

- Does the donor hold title to the property? This assurance can be obtained by acquiring a copy of the registered deed showing the donor is the titleholder, obtaining a copy of a title insurance policy insuring the donor's title to the property, and confirming that the donor is shown as the titleholder on the property tax records of the jurisdiction where the property is located.
- Are there any liens on the property? The big items to look for include unpaid property taxes; a mortgage, land contract, or other similar encumbrance; mechanics' liens; and unpaid utility bills. We suggest creating a gift agreement in which the donor represents the absence of liens and agrees to indemnify your organization if anything surfaces at a later date.

Conduct pre-acceptance due diligence by taking these considerations into account.

- Will your organization receive a clean title? This starts with ascertaining whether the donor plans to give your organization a general warranty deed or a quitclaim deed. In the case of a general warranty deed, the donor is warranting title (among other things) to the property. This is valuable to the donee organization, but only if the donor is able to cure any defects in title that may arise, including paying any amounts that must be paid to cure those defects. For this reason, it is also advisable for your organization to be named the beneficiary of a title insurance policy. This could be paid for by the donor or by your organization. If the donor is to pay, this should be spelled out in the gift agreement.

  In general, it's advisable to avoid a quitclaim deed, which only transfers whatever rights the donor has in the property to the donee. If there are defects in the donor's title, he or she has no obligation to cure them. If your organization is willing to accept a quitclaim deed, it's doubly important to obtain a title insurance policy. A quitclaim deed could also impair your ability to sell the property in the future, depending on the circumstances.
- Are there any environmental hazards? Your due diligence should include a Phase 1 Environmental Site Assessment (ESA) for residential real estate or similar low-risk real property. A Phase 2 ESA is recommended for industrial or commercial property. You should obtain the advice of a qualified environmental specialist to confirm the proper assessment.
- Do you understand the property and its surroundings? Start with a survey of the property to understand its boundaries and what your organization will be acquiring. Next, conduct a visual inspection of the property and its surroundings to observe the condition of the property, the nature of the surrounding properties, and the impact of these factors on the potential salability of the property. In some cases, this process may include an inspection by a qualified inspector.

- What other consents need to be obtained? If the property is owned by a business entity or there are multiple owners, make sure there are no other parties from whom consent to the transfer must be obtained. A representation as to this fact should be included in the gift agreement.
- How will the property be insured? Donated real property should be insured against loss and liability from the moment of transfer. Even raw (undeveloped) land should be covered by some form of insurance policy against liability arising from those entering the property. Before accepting the gift, make sure your organization is prepared to obtain this insurance and pay the premium. The donor may be willing to assist with an additional cash contribution.
- How will the property be maintained? If the property has structures, you should have a plan to defray the ongoing repair and maintenance costs. This may be covered by rents from existing tenants, or you may need to be ready to cover these costs out of operating funds.

How will the property be insured? How will it be maintained?

- If the property is leased:
    - If there are tenants, are the lease agreements assignable? Who is responsible for effecting the assignments? In general, lease agreements are assignable unless assignment is prohibited or the tenants' consent is required under the terms of the agreement. Review any existing lease agreements for this. In addition, the gift agreement should spell out which party is responsible for preparing the assignments (which must be signed by the donor) and notifying the tenants (and obtaining tenant consents if required by the lease agreement).
    - Are there any special lease terms that will bind your organization to specific performance? Lease agreements may require a landlord to perform maintenance or make updates or renovations at specific intervals. This may take cash your organization does not have to invest. Review the lease agreements for these commitments.
    - Is the property producing net cash flow? Ask to see both an income statement and a balance sheet for cash flowing property. This will help you ensure the property is self-sustaining and will not be a drain on your organization's resources, even if the property is only expected to be held for a brief period. In addition, examine whether the existing rents are market rate rents and whether the existing expenditures for management, maintenance, and repairs are reasonable.
    - Are there any outstanding contracts or agreements? If so, what are the terms? The donor may have engaged the services of a property management firm whose contract will transfer to your organization. Other possible contracts include maintenance contracts for heating, cooling, and ventilation equipment, landscaping and lawn care, elevator maintenance, and general maintenance.
    - Will security deposits be transferred along with the property? Prepare for the transfer of existing security deposits from the donor to your organization. Otherwise, your organization will need to refund security deposits from your operating funds.
- Are there any existing offers to purchase the property? Has the donor made any commitments to sell the property? The existence of such offers or commitments may make the property more or less desirable as a charitable gift, particularly if you anticipate using the property in fulfilling your charitable mission.
- What is the value of the property? The best evidence of value is a qualified appraisal of the property, which the donor will also need to claim an income tax deduction for the gift. It's important to understand the property's value when evaluating the economics of the transfer. If it's a high-value property that is immediately salable, your organization may be willing to incur some expense to accept the property. If the property is of little value, you may decide it's not worth expending significant effort to obtain it.
- Will the donor transfer all of the donor's interest, or only part? A partial interest gift in real property is a permissible gift for income tax purposes as long as the donor gifts a pro rata share of every interest the donor has in the property. Such a gift can be achieved by subdividing the property or contributing an undivided interest and

thereby creating a cotenancy. This question is important because it affects the salability of the property. If the donor doesn't plan to sell, your organization may be stuck with property on which you must pay property tax and, in the case of unleased property, no cashflow from the property to pay the tax. Weigh this carefully. In a gift agreement, the donor may pledge to not withhold his or her consent to sell the property.

- How will your organization hold the property? You may choose to accept the property as a direct gift to your organization. The potential issue here is that latent liabilities (e.g., environmental liabilities) may follow the donated property to your organization. For this reason, it is often advisable for donee organizations to form a single-member limited liability company to accept the property. The IRS acknowledged the validity of this technique in IRS Notice 2012-52.

Working through and planning for these considerations can help you accept a real property gift that provides real value for your organization. We can help you assess and plan for gifts of real property as well as other contributions. Please contact us to learn more.

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As a certified public accountant and tax counsel, Ted advises exempt organizations of all sizes on a wide range of issues. This includes consulting on tax and employee benefit related matters, representation before state and federal tax authorities, and assistance with firm audit or advisory engagements to formulate advice and counsel on important operating and tax issues. Ted also leads the firm's tax preparation practice, including IRS Forms 990 and 990-T and related state forms.

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