

A stylized, isometric illustration of a cityscape. In the center is a tall, multi-story building with many windows. To its right are smaller, colorful houses. In the foreground, there are large, stylized dollar bills. A man in a dark suit and blue tie is standing on the right side, looking down. The background features more buildings and a green field.

# The Advisor's Guide to Donating Illiquid Assets

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## About the author:



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Barbara oversees Schwab Charitable's investment and complex gift acceptance programs and is responsible for its enterprise risk management. Barbara joined Schwab Charitable in 2009, following an 18-year tenure as a wealth management executive. Most recently, she served as Vice President of Planning & Investments and Chief Compliance Officer for Union Square Investment Company, an SEC-registered investment advisory firm. Earlier in her career, Barbara held numerous management roles in finance and product management capacities in the telecommunications industry. Barbara holds a degree in economics from American University.

## I. Introduction

What might an appreciated stock holding, a piece of real estate, shares in a privately held company, and interests in private equity, venture or hedge funds have in common? Whether they were purchased for emotional reasons or investment purposes, they could be among the best items for a donor to contribute to his or her favorite charities to realize maximum tax benefits.

It is vital for advisors and donors to understand not only how appreciated investments can be an important part of a philanthropic wealth management strategy, but also the appropriate giving vehicles for these particular assets that will help the donor reach his or her charitable goals.

It is beyond the scope of this paper to provide an analysis of the various charitable giving vehicles which may be employed alone or in combination to achieve clients' philanthropic goals. Options may include direct donations, charitable trusts, donor-advised funds, private foundations and other vehicles, involving a wide range of administrative complexity, cost, donor involvement, privacy and tax efficiency. (See Appendix C for a brief summary of some of the options.) In this paper, we limit ourselves to the tax characteristics of non-cash donations utilizing various charitable vehicles.

## II. Initial Considerations that Can Guide Gift Planning

### A. What is the client's income tax situation for the current tax year?

It is important to review a client's current income tax situation and whether that situation will change over the next few years. Will the client be experiencing a spike in income for the current or future years? Is the client retiring and expecting a decrease in income in the near future? Knowing the client's income tax situation by including the client's tax advisor in the conversation can inform an appropriate giving strategy tailored to his or her situation.

### B. Does the client have a taxable estate? Does the client have heirs?

Any planned giving strategy should be incorporated as part of a client's overall financial and estate plan to ensure that all planning works together to meet the desired objectives.

Advisors should review the assets that are being left to heirs versus charitable beneficiaries of the estate. For example, a large Individual Retirement Account (IRA) left to an heir will be taxable as he or she takes distributions. On the other hand, IRA funds left to a charity will generally not result in an income tax liability to the charity. Naming charitable beneficiaries on an IRA allows the client to leave other appreciated capital assets to his or her heirs. Capital assets left to a client's heirs will generally receive a step up in basis resulting in little, if any, capital gains tax liability when sold by the heir.<sup>1</sup>

### C. What are the client's holdings in illiquid assets and is the entire portfolio diversified? Are there upcoming liquidity events for any of the assets?

Liquidity events can create a large tax bill for clients. Planned giving can help to offset the income tax burden and offer a tax efficient way to diversify concentrated holdings while funding the client's future philanthropy.

### D. Will the client need supplemental income for retirement? If not, is or will the client be receiving IRA distributions that are in excess of his/her needs?

1. Certain planned giving vehicles can be structured to provide the client a lifetime income stream either immediately or at retirement. The most common vehicles that provide an income stream to a non-charitable beneficiary include a charitable remainder trust (CRT), charitable gift annuity, and a pooled income fund.<sup>2</sup>

<sup>1</sup> 26 U.S. Code § 1014.

<sup>2</sup> Generally, under the partial interest rule, no deduction is allowed for less than a donor's entire interest in property unless the contribution is in the form of a qualified trust – a charitable remainder annuity trust (CRAT), charitable remainder unitrust, pooled income fund, form of a guaranteed annuity, or a fixed percentage of the fair market value that is annually distributed. IRC §§ 170(f)(2)(A); 2522(c)(2); 2055(e)(2).

2. If a client is subject to required minimum distributions from an IRA, the client may be able to direct those distributions (up to \$100,000 per year) to a public charity without realizing income on the distribution/contribution. This may be a good option for a client who does not need the retirement income, does not itemize deductions on his/her income tax return, or wants to limit his/her income for tax purposes.<sup>3</sup>
  - a. Generally, a qualified charitable distribution (QCD) is an otherwise taxable distribution from an IRA, other than from an ongoing Simplified Employee Pension Plan (SEP) or SIMPLE IRA, owned by an individual who is age 70 ½ or over that is paid directly from the IRA to a qualified charity (excluding a private foundation, a supporting organization, or a donor-advised fund). The gift cannot be made to establish a charitable gift annuity or fund a CRT because the gifts must be outright. The QCD can satisfy all or part of the amount of a client's required minimum distribution up to a \$100,000 limit.<sup>4</sup> Because the QCD is not included in the taxpayer's income, the distribution cannot also be deducted as a charitable contribution.
  - b. A beneficiary of an inherited IRA may also be eligible to make a QCD, as long as the beneficiary is at least 70 ½ on the date of distribution.<sup>5</sup>

**E. Does the client currently contribute regularly to specific charities? If so, what assets are typically contributed and how often?**

As explained below, many donors contribute cash to their favorite charities on a fairly regular basis. Although writing a check may enable a donor to claim a charitable income tax deduction, a contribution of appreciated assets will afford the same deduction plus potential capital gains tax savings. By funding certain planned giving vehicles with appreciated assets, the client may be able to take the deduction in the year of the contribution and then grant those funds to multiple charities over time.

### **III. Choosing the Most Appropriate Asset for Contribution**

Assets held for longer than one year that have appreciated in value can be among the most tax-advantaged items to contribute to charity because a donor can enjoy a current year tax deduction and potentially eliminate capital gains tax liability on their sale. This allows a donor to pay lower taxes and also allows the charities to receive the most money possible. Yet studies show that most Americans do not take advantage of the benefits of contributing these types of assets. For example, between 2010 and 2013, only 22% of high-net-worth households gave appreciated investments to charity, while 88% made donations using cash or checks.<sup>6</sup>

**A. Considerations applicable to all non-cash assets**

Charitable donations may be eligible for a current year income tax deduction, subject to certain limitations that depend not only on the nature of the asset itself, but also on the type of charity or planned giving vehicle (i.e. public charity or private foundation). Relevant deduction values and Adjusted Gross Income (AGI) limitations for the most common planned giving vehicles can be found in Appendix C.

**1. Computing the limitation for multiple contributions**

In computing the limitation for multiple contributions in a tax year, cash contributions to public charities (50% charities) are considered before contributions to private foundations (non-50% charities) and contributions of capital gain property to 50% charities is considered after cash contributions to non-50% charities, but before capital gain property contributions to non-50% charities. This ensures that the deduction for all charitable gifts never exceed 50% of the contribution base, regardless of how the gifts are distributed between 50% and 30% charities.<sup>7</sup>

<sup>3</sup> The law allowing qualified charitable distributions was made permanent by the Protecting Americans from Tax Hikes (PATH) Act of 2015; see also IRC § 408(d)(8) (requirements for making qualified charitable distributions).

<sup>4</sup> IRC § 408(d)(8).

<sup>5</sup> IRS Notice 2007-7, Q&A-37.

<sup>6</sup> The 2014 Bank of America Study of High Net Worth Philanthropy.

<sup>7</sup> IRC Section 170(b)(1)(B).

**Example:** Donor's AGI for 2016 is \$200,000. During the 2016 tax year, donor made a gift of \$10,000 cash, and real estate valued at \$100,000 to his donor-advised fund (a 50% charity). Donor also made a contribution of publicly traded stock valued at \$20,000 to his private foundation (non-50% charity). The amount the donor may deduct in 2016 is \$70,000 due to the application of the AGI limitations:

- a. Because the donor-advised fund is a 50% charity, the \$10,000 cash donation is applied first and can be deducted in full.
- b. The next category includes contributions of cash and noncapital gain property to non-50% charities. Donor did not make any contributions in this category for 2016.
- c. Third, the real estate contribution is considered. The 30% limit is applied to the fair market value (FMV) of the real estate. Thirty percent of the donor's AGI is \$60,000. Therefore, the maximum that the donor can deduct for the real estate in 2016, is \$60,000 of the \$100,000.
- d. Finally, the contribution of capital gain property to non-50% charities cannot be deducted because the donor used the full amount of the 30% limit for the real estate deduction.

Therefore, the full amount the donor may deduct for 2016 is \$70,000, and the excess of \$60,000 can be carried over for five years, subject to the 30% (public charity) and 20% (private foundation) AGI limits.

## 2. Limitation on deductions for high income earners

The American Taxpayer Relief Act of 2012 (ATRA) reinstated the reduction in the amount of itemized deductions for certain high-income taxpayers. Certain itemized deductions are phased out once a donor's AGI reaches certain thresholds (Pease Limitation).<sup>8</sup> For 2016, the threshold for Married Filing Jointly is \$311,300 (\$259,400 for Single). Taxpayers are required to reduce (by up to 80%) the amount of certain otherwise allowable itemized deductions by 3% of the excess of the taxpayer's AGI over the threshold amount. The itemized deductions subject to this limitation are state and local taxes, mortgage interest, charitable contributions, and miscellaneous itemized deductions.

**Example:** In 2016, a married couple filing jointly has \$500K in AGI and claims \$50,000 in itemized deductions. Under the ATRA, the threshold for the Pease Limitation adjusted for inflation is \$311,300. The couple's itemized deductions would be reduced by 3% of the amount that their AGI exceeds \$311,300 (\$188,700). Applying the Pease Limitation, the couple's itemized deductions may be reduced by the **lesser** of \$5,661 (\$188,700 x .03) or 80% of the itemized deductions (\$40,000). Since \$5,661 is less than \$40,000, the couple's itemized deductions will be reduced from \$50,000 to \$44,339.

## 3. Valuation of charitable contributions that are not capital gain property<sup>9</sup>

- a. **Ordinary income property.** Property is ordinary income property if the donor would have realized ordinary income if the asset was sold on the date of contribution. The deduction is based on the FMV of the property less the amount of ordinary income that the donor would recognize if the property was sold at FMV on the contribution date.<sup>10</sup> Examples ordinary income property include: property held by the donor primarily for sale to customers in the ordinary course of his or her trade or business (inventory property); a work of art created by the donor; a manuscript prepared by the donor; letters and memoranda prepared by or for the donor; and a capital asset held for less than one year.

**Example:** Donor purchases publicly traded stock on March 15th for \$5,000. The stock appreciates over the summer and in November of the same year, the donor makes a contribution of the stock that is valued on the date of contribution at \$10,000. The donor's deduction is limited to \$5,000 (FMV less the short term gain).

<sup>8</sup> 26 U.S. Code § 68.

<sup>9</sup> Property is capital gain property if the donor would have recognized long term capital gain if sold at FMV on the date of contribution.

<sup>10</sup> Ordinary income property is defined as "property any portion of the gain on which would not have been long-term capital gain if the property had been sold by the donor at its FMV at the time of its contribution to the charitable organization." Treas. Reg. § 170A-4(b)(1).

- b. **Tangible personal property.** In situations where a donor wishes to fund a charitable giving vehicle with tangible property, the donor should be aware that if the donee vehicle or charity uses the property for a purpose unrelated to the organization's exempt purpose, the amount of the deduction is reduced by the amount of gain that would have been realized had the property been sold by the taxpayer for FMV at the time of its contribution to the charity. The donor may have to reduce his or her contribution deduction by the amount of the gain even if the use of the property is related to the donee's exempt purposes if the donee sells the property before the end of the taxable year in which the donor made the contribution.<sup>11</sup>

**Example:** Donor contributes a sculpture that she purchased 20 years ago for \$10,000 to her donor-advised fund. The FMV of the sculpture on the date of contribution is \$60,000. Because the donor-advised fund immediately sold the sculpture and did not use it as part of its exempt purpose, the donor's deduction is limited to \$10,000 (FMV less the amount that would have been gain).

## **B. Making the most of your clients' illiquid contributions: Pave the way for a smoother charitable contribution**

Donating illiquid assets to charity outright or through a planned giving vehicle has definite tax advantages. However, it is important for clients to obtain appropriate legal and tax advice to ensure they are obtaining the maximum tax benefit of the contribution. The following considerations apply to all illiquid asset contributions. Other considerations that are unique to each asset type are included separately below.

### **1. Contribute appreciated assets held for longer than one year**

For maximum tax efficiency, assets must be held for more than one year and should be directly transferred to the charity or planned giving vehicle. Selling the appreciated asset before contribution may trigger capital gains tax liability. Appreciated assets held for more than one year and donated directly to a public charity or a planned giving vehicle are often deductible at FMV without recognizing any capital gain.<sup>12</sup> However, if a donor owns an asset that has depreciated, he or she should first sell the asset to realize the capital loss and then contribute the proceeds.

*Note on inherited assets:* If a client inherited assets from someone who died before or after 2010, or from someone who died in 2010 and the executor of the decedent's estate did not elect to file Form 8939, the client's capital gain or loss on any later sale of that property is treated as long-term gain or loss, regardless of how long the client held the property.<sup>13</sup> If the cost basis of the assets received a step up to the FMV as of the decedent's death,<sup>14</sup> that is the cost basis the client will use for contribution purposes.

**Example:** Susan inherited an expensive painting from her grandparents. Susan didn't care for the art, and decided to donate the painting to her donor-advised fund so that she could support multiple charitable causes. Since the painting's cost basis was stepped up to its FMV as of her grandparent's death, the fact that she was donating the painting for a non-related use did not materially reduce the value of her charitable deduction because the cost basis was very close to the FMV as of the date of contribution.

### **2. Donor must irrevocably contribute his or her entire interest in the illiquid asset<sup>15</sup>**

A donor cannot claim a deduction if he/she contributes some rights to the asset, but keeps other rights. For example, if a donor contributes a parcel of land to charity, but retains the right to the minerals, the donor cannot claim a deduction.

<sup>11</sup> Treas. Reg. §1.170A-4(b)(3)(i).

<sup>12</sup> IRC §170(e)(1); Treas. Reg. §1.170A-1(c)(1).

<sup>13</sup> IRC Sec. 1223(9).

<sup>14</sup> IRC Sec. 1014.

<sup>15</sup> IRC § 170(f)(3).

### **3. Generally, assets other than cash or publicly traded securities valued in excess of \$5,000 (\$10,000 for private stock) will require a qualified appraisal from a qualified appraiser<sup>16</sup>**

See Appendix A for reference chart. Without a proper qualified appraisal, the IRS may disallow the deduction.<sup>17</sup> The qualified appraisal must be arranged and paid for by the donor.

### **4. Gifts of encumbered interests could lead to tax consequences for donors and recipients**

The tax rules that are important to consider are the bargain sale rules<sup>18</sup> and the debt-financed income rules.<sup>19</sup> If the recipient is a private foundation, “self-dealing rules” may also apply.<sup>20</sup> The bargain sale rules may treat the contribution as two separate transactions: (1) a sale of the debt, and (2) a contribution of the equity. The client may be required to report the amount of the debt as income for the tax year while taking his or her deduction only on the equity portion. Cost basis is prorated between each portion of the contribution.

**Example:** A donor makes a contribution of real estate that is encumbered by a \$50,000 mortgage. The property was purchased 10 years ago for \$100,000 and the FMV of the on the date of contribution is \$400,000. The donor may have to realize \$37,500 of ordinary income (debt – allocated basis of 12.5% of \$100,000). The donor may deduct \$350,000 (FMV – debt = equity).

### **5. There should be no obligation for the charity to sell the asset**

In other words, there should be no legally binding purchase contract, binding letter of intent, shareholder approval or tender of stock by a majority of shareholders prior to contribution. Otherwise, the IRS may treat the donor as though he or she sold the asset and then donated the proceeds to charity resulting in a capital gains tax liability for the client.<sup>21</sup> It is important for donors to obtain appropriate tax or legal advice as to the progress of any pending sale or exchange transaction prior to contribution.

### **6. Be careful on timing of year-end transfers**

Donating illiquid assets may take additional time to process due to legal and tax requirements. With increased activity at year end, donors should plan charitable gifts as early as possible.

## **C. Review of non-cash assets to donate**

### **1. Publicly traded unrestricted securities**

Shares of appreciated publicly traded securities are generally straightforward assets to donate. FMV is generally determined by the average of the high and low selling prices on the day of contribution unless the stock is subject to resale and transfer restrictions.<sup>22</sup> Publicly traded unrestricted securities are typically ideal for most outright gifts and planned giving vehicles.

### **2. Publicly traded partnerships and master limited partnerships**

Donated publicly traded partnerships (PTP) — in particular master limited partnerships (MLPs) — are operating business that are structured as limited partnerships. MLP units are publicly traded, but are pass-through investments. One tax advantage in owning MLP units is that the owner may take depreciation deductions which reduce the owner’s taxable income. However, when the owner sells or gifts the asset, any gain up to the amount depreciated is recognized as ordinary income.<sup>23</sup> Donors should review all MLP/PTP donations with their tax advisor prior to contribution.

<sup>16</sup> IRC § 170(f)(11).

<sup>17</sup> IRC § 170(f)(11)(A)(i).

<sup>18</sup> IRC § 1011; Treas. Reg. § 1.1011-2

<sup>19</sup> IRC Sec. 514; Treas. Reg. Sec. 1.514(c)-1(b)(3)(ii). If the mortgage was placed on the property more than five years before the date of the gift, and the donor had owned the property more than five years prior to the gift, the mortgage will not be considered “acquisition indebtedness” during the 10 years after the donation. Since the mortgage is not considered “acquisition indebtedness,” the property is not considered “debt-financed” and therefore none of the income is subject to unrelated business income tax during the 10-year period. This exception does not apply if the donee assumes the mortgage (rather than taking the property subject to the mortgage) or pays the donors anything for their equity in the property.

<sup>20</sup> IRC § 4941(d)(1)(A). Sales between a private foundation and the donor are prohibited and a “bargain sale” may fall under this definition Treas. Reg. § 53.4941(d)-2(a).

<sup>21</sup> Rev. Rul. 78-197; *Ferguson v. Commissioner*, 108 T.C. #14 (1997)

<sup>22</sup> Treas. Reg. § 20.2031-2

<sup>23</sup> IRC §§ 1245, 1250

### 3. Restricted stock

- a. **Otherwise publicly traded stock.** Executives with concentrated and restricted positions in public company stock may think about donating shares to help reduce tax exposure in their portfolios. However, shares held by “affiliates” of the issuing company may be restricted as “control securities.” These shares cannot be sold unless an exception applies to the sale under the Securities Act of 1933. A common exception to sell restricted stock is Rule 144, which allows the sale during specific windows provided certain requirements are met. If the executive is subject to Rule 144 public sale restrictions, and/or is considered a “control person” in the company, the company’s general counsel must give permission to transfer and later sell the shares at acceptable times.
- b. **Appraisal requirement.** Generally, publicly traded securities for which market quotations are “readily available on an established securities market” are excepted from the appraisal requirement.<sup>24</sup> However, publicly traded securities that are subject to restrictions may not fall under this exception unless the restrictions do not “materially affect” the value of the shares or prevent the charity from freely selling the shares.<sup>25</sup>
- c. **Restricted stock units (RSUs).** RSUs cannot be transferred because company stock is not obtained at the time of the grant and they are therefore not an asset owned by the client.

### 4. Privately held stock (C-Corp and S-Corp)

Similar to a publicly traded security, if a donor is considering selling shares in a privately held company, donating a portion of the shares to a charity or planned giving vehicle before the sale of the shares can help reduce the donor’s tax burden on the sale and enable a charitable gift.<sup>26</sup>

#### Considerations include:

- a. The company’s shareholder agreements and other governing documents must be reviewed to understand transfer restrictions, timing, and process to complete the charitable transfer.
- b. Additional considerations for S-Corp stock:
  - 1) The charity or charitable vehicle will generally be subject to unrelated business income tax (UBIT) on its gain from the sale of the shares and on its share of any income generated by the S-Corp during the charity’s ownership.<sup>27</sup> The charity may use the proceeds of the sale to pay these taxes and may escrow a portion of the proceeds in a separate account for three years to match the IRS “look back” period, during which the IRS can challenge the cost basis of the shares and the taxes paid.
  - 2) If the donor contributes the stock to a public charity that is structured in corporate form, it is subject to corporate income tax rates and limited to a 10% charitable deduction for any offsetting grants to other charities. If it is structured as a trust, however, the applicable tax rate is the individual capital gain rate and it could claim up to a 50% deduction against the UBIT for such charitable giving.<sup>28</sup>
  - 3) Subchapter S stock should never be used to fund a CRT because a CRT is not an eligible S-Corp shareholder.

<sup>24</sup> IRC § 170(f)(11)(A)(ii)(I); Treas. Regs. §§1.170A-13(c)(1)(i); 1.170A-13(c)(7)(xi).

<sup>25</sup> See Treas. Reg. § 1.170A-13(c)(7)(xi)(C)(1).

<sup>26</sup> This article addresses gifts of appreciated assets that have been held for more than a year. The tax deduction for non-cash gifts to a public charity or donor-advised fund account may be used to offset up to 30 percent of adjusted gross income and can be carried forward for five years. IRC Section 170(b)(1)(D)(iii). The donor must file IRS Form 8283 for contributed securities valued at greater than \$500. For gifts other than cash and publicly traded securities in excess of \$5,000 (\$10,000 for closely held stock), the donor must also obtain a qualified appraisal.

<sup>27</sup> IRC § 512(e)(1)(B)(ii).

<sup>28</sup> IRC § 512(b)(10), (11).



## Illustration of Tax Treatment<sup>29</sup>

	Gift to Charity in Trust Form	Gift to Charity in Corporate Form
<b>Asset Value</b>	\$1,000,000	\$1,000,000
<b>Capital Gains (100% Long-Term)</b>	\$800,000	\$800,000
<b>Charity's Charitable Deduction (50% Trust, 10% Corporate)</b>	\$400,000	\$80,000
<b>Charity's Taxes and Expenses Paid</b>	\$110,000	\$354,000
<b>Donor Gift to Charity</b>	<b>\$890,000</b>	<b>\$646,000</b>
<b>Donor Capital Gains Tax Potentially Eliminated</b>	\$230,400	\$230,400
<b>Donor Charitable Deduction<sup>30</sup></b>	\$800,000	\$800,000
<b>Donor Tax Benefit<sup>31</sup></b>	\$587,200	\$587,200

### 5. Executives, affiliates and early investors in companies going public: Initial Public Offering (IPO) shares

Those considering current year charitable contributions who are also facing long term capital gains tax on the sale of highly appreciated shares after an IPO may realize a much more favorable income tax result and charitable impact by making a timely donation of a portion of their IPO shares (either during or after the lock up period) directly to charity. Considerations:

#### a. How long have the shares been held?

In order to realize the optimal tax savings from the charitable donation of IPO stock, the initial investment(s) must have been made more than a year before the shares are donated and the shares should have appreciated in value from the time of the initial investment(s).

#### b. Are the shares subject to a lock up period?

This is commonly the case and the decision of whether and how charitable gifts of shares may be made during a lock up period is determined by the issuer's counsel. In cases where gifts can be made during a lock up period, the FMV will be the market value at the time of contribution *less a discount based on the holding period specified in the lock up agreement (or any other restriction on sale)*. For gifts of shares valued at over \$10,000 subject to restrictions that materially affect the value of the shares to the donor or prevent the shares from being freely traded, the donor must engage a qualified appraiser to determine the discounted FMV.<sup>32</sup>

<sup>29</sup> Hypothetical, for illustrative purposes only. Assumes cost basis of \$200,000, that the investment has been held for more than a year and that gains realized by the charitable trust are subject to a 20% federal tax rate and no state tax, while gains realized by the incorporated charity are subject to a 40% federal tax plus a 5% state tax. State taxes vary and this example does not account for local taxes. Costs to arrange sale of an S-Corp vary; 3% selling cost was used in this example. This example assumes federal AMT does not apply and does not account for local taxes. The example assumes full deductibility (gifts of long-term property are generally limited to 30% of AGI with a 5-year carryover of unused amount). Certain federal income tax deductions, including the charitable contribution, are available only to taxpayers who itemize deductions, and may be subject to reduction for taxpayers with AGI above certain levels. In addition, deductions for charitable contributions may be limited based on the type of property donated, the type of charity, and the donor's AGI.

<sup>30</sup> Gifts to charity of S-Corp shares greater than \$10,000 are typically deductible at FMV determined by a qualified appraisal. Such appraisals may be discounted to reflect the lack of control, marketability and other considerations. A 20% discount was assumed for this example.

<sup>31</sup> Assumes donor is subject to the maximum 39.6% federal tax and 5% state income tax. State taxes vary and this example does not account for local taxes.

<sup>32</sup> See Reg. § 1.170A-13(c)(7)(xi)(C)(1).

What happens when the lock up expires? Upon receipt of the stock, the charity controls the sale process. Most charities will generally sell contributed securities promptly, but may reserve the right to sell at any time.

**c. Is the donor considered an affiliate of the issuing company?**

If the donor is a 10% shareholder, a director, or otherwise deemed to have “insider status” (i.e., in possession of influential or non-public information), it does not impede the gift, but does require extra steps and may take additional processing time.

**d. Are there other potential tax issues inherent in the gift?**

Every individual tax situation is unique. Before proceeding, it is best to review the details of your client’s specific situation with a qualified tax advisor to make sure such a gift is structured and timed appropriately.

**6. Limited partnerships or limited liability companies (LLCs)**

Deductibility rules, holding-period considerations, and AGI limits are generally the same as those for privately held stock. Illiquidity and minority discounts may apply to the appraisal. Unless the interest can be sold back to the entity, a sale may be difficult to arrange. If the interest can be sold, the charity or charitable vehicle will negotiate the sale price and control the sale. Partnerships and most multi-member LLCs are taxed as flow-through entities; thus, if they engage in an active trade or business or have acquired assets with debt, the charity or charitable vehicle may be subject to UBIT on its share of the entity’s income under IRC § 511. Gifts of indebted interests may trigger negative tax consequences for donors and recipients. If the contribution is characterized as a bargain sale due to forgiveness of debt, contribution to a private foundation may result not only in recognition of the sale element by the donor under IRC § 752(d), but may be prohibited as an act of self-dealing under IRC § 4941.<sup>33</sup> In addition, the charitable deduction must be reduced by the amount of ordinary income that would have been realized if the interest had been sold at FMV on the date contributed.<sup>34</sup>

**7. Private Equity Investments**

Many private equity firms see substantial growth in values over the life of the funds they manage, and investors in seasoned funds – be they general partners (GP), minority limited partners or private equity fund employees – face taxable distributions as the funds mature and begin to realize these gains. For philanthropically minded investors, assets such as these that have appreciated in value can be among the most tax-advantaged items to contribute to charity because donors can enjoy a current year tax deduction and potentially eliminate capital gains tax liability on the distribution, transfer, or sale of the shares while allowing supported charities to receive the most money possible. Contribution of similar assets to a private foundation is generally deductible at the lower of cost basis or market value.<sup>35</sup>

a. Private equity fund general partners typically oversee transferability of fund shares, and limited partners who wish to donate a portion of their investment to charity can work with the general partner to achieve this goal. In some cases, general partners have established charitable giving programs to enable their investors to achieve their philanthropic goals by permitting charitable transfers of partnership interests or distribution of portfolio company stock prior to a sale. Such programs require the active involvement of the fund’s general partner, may be complex, and take time to establish, so initiating discussions well in advance of a liquidity event is critical.

b. Considerations:

1) A charity or charitable vehicle will generally not assume liabilities associated with these investments. Individuals should plan to contribute sufficient liquid assets to cover granting as well

<sup>33</sup> IRC § 4941(d)(1)(A); Treas. Reg. §53.4941(d)-2(a)(1)

<sup>34</sup> IRC § 170(e)(1); Treas. Reg. § 1.170A-1(c)(1).

<sup>35</sup> I.R.C. §170(e)(1)(B)(ii).

as private equity fund open commitments, UBIT, or other liabilities.

- 2) Minority limited partnership interests in private equity funds are highly illiquid until fund investments are fully realized and interests are redeemed by the general partner. Sales of these interests in the secondary marketplace may be subject to steep discounts. Some charities and donor-advised fund providers may be able to hold private equity or venture fund interests until scheduled termination dates in order to realize the full value of the investment.
- 3) The donor's FMV tax deduction will generally be determined by a qualified appraisal of the contributed interest.
- 4) The deduction for a donation to a private foundation is limited to the lesser of cost basis or FMV.
- 5) If the fund carries debt, the donor may be liable for taxes if the contribution is treated as a bargain sale. As previously discussed, the donation of property subject to a debt is treated as part sale (amount of debt) and part equity (donation).

**Example:** A donor's partnership interest is valued at \$100, with an adjusted basis of \$30.00. The donor's share of partnership debt is \$60, so the gross value of the donor's partnership interest is \$160. The basis of \$30 is allocated between the sale (\$60) and equity portion (\$100). The basis allocation for the sale (debt) portion is \$60/\$160. Therefore, 37.5% of the basis equates to \$11.25, leaving a taxable gain of \$48.75 (\$60.00 – \$11.25).

## 8. Hedge fund investments

The charity or charitable vehicle should be able to redeem or sell donated hedge fund interests. Most hedge fund interests can be redeemed periodically at net asset value after an initial lockup period. Considerations:

- a. A charity or charitable vehicle will generally not assume liabilities associated with these investments. Individuals should plan to contribute sufficient liquid assets to cover granting, UBIT, or other liabilities until the hedge fund interest can be redeemed.
- b. The donor's FMV tax deduction will generally be determined by a qualified appraisal of the contributed interest.
- c. The deduction for a donation to a private foundation is limited to the lesser of basis or FMV.

## 9. Real estate

- a. Contributing highly appreciated real estate to a public charity or charitable vehicle may entitle the donor to claim a full, FMV tax deduction for the donation while also eliminating capital gains tax on the sale.<sup>36</sup> If the property is donated to a private foundation, the donor's deduction is limited to the lower of FMV or cost basis, whichever is less.<sup>37</sup>
- b. It can make sense to donate real estate that meets the following criteria:
  - 1) The property has been held for more than a year and has appreciated significantly.
  - 2) The property is marketable and relatively easy and cost-effective to liquidate.
  - 3) The property is generally debt-free. Under the bargain sale rules in Treas. Reg. § 1.1011-2, encumbered real estate donations will be divided between a sale (FMV representing the debt) and the donation (equity of the real estate). If the property is subject to a mortgage, a donor may recognize taxable income for all or a portion of the loan's value. Therefore, it is a good idea for a donor to pay off the mortgage before donating the property.
  - 4) The owner is willing to transfer the property irrevocably to a charity or charitable vehicle, which

<sup>36</sup> IRC § 170(b)(1)(C).

<sup>37</sup> IRC § 170(e)(1)(B)(ii).



will negotiate the sale price and control the sale.

- 5) If a possible sale is already under negotiation with a buyer, the negotiation must not have proceeded to the point at which the IRS would consider it a prearranged sale. That could result in the donor bearing the tax liability for any gain on the sale.
- c. Generally, a donor must transfer his or her entire interest in donated property for the gift to be deductible for income, gift, or estate tax purposes. As with all rules, however, there are exceptions. In certain cases, the donor may irrevocably contribute a remainder interest and retain a life estate in the property. The following may qualify for a deduction if certain requirements are met:
  - 1) Donation of an irrevocable remainder interest in a personal residence (vacation home or primary residence) or a farm;
  - 2) Donation of an undivided fractional interest in the property (an undivided portion of the donor's entire interest) and
  - 3) A qualified conservation easement<sup>38</sup>

#### **10. Collectibles and artwork**

Gifts of collectibles and artwork to charity for non-related use are deductible at the lesser of the donor's cost basis or FMV.<sup>39</sup> Gains on sales of these assets by individuals are currently taxed at a higher rate than other long-term capital gains. Net capital gains from selling collectibles (such as coins or art) are taxed at a maximum 28% rate.<sup>40</sup>

## **IV. Conclusion**

Appreciated assets held longer than one year can be among the most tax-advantaged items to contribute to charity. A donor pays less tax leaving more charitable dollars to fund his/her favorite causes. Understanding how appreciated assets can be a component of a philanthropic wealth management strategy is vital to help clients reach their charitable goals in the most tax-efficient manner possible.

<sup>38</sup> IRC § 170(f)(3)(B)

<sup>39</sup> Treas. Reg. §1.170A-4(b)(3)(i); Reg. §1.170A-4(b)(3)(ii).

<sup>40</sup> IRC § 1(h)(1)(f).

## APPENDIX A: Qualified Appraisals

IRS rules require a “qualified appraisal” completed by a “qualified appraiser” for contributions of property worth more than \$5,000, other than publicly traded securities. The appraisal must be completed no earlier than 60 days before the date of contribution and no later than the due date of the tax return for the year of the gift, including extensions. The qualified appraisal must be arranged for and paid by the donor.<sup>41</sup>

### Summary of Requirements

Value of	Type of Gift	Complete	File
>\$500	Noncash gifts	Form 8283, Section A	Form 8283
>\$ 5,000	All property other than unrestricted publicly traded stock, non-publicly traded stock, artwork, vehicles, intellectual property, or inventory	Form 8283, Section B, Qualified Appraisal	Do not receive charitable income tax deduction during lifetime
	Section B, part III signed by qualified appraiser; Section B, part IV signed by charity	Form 8283	Cannot grant to individuals or to non-operating private foundations
	Unrestricted publicly traded stock/ mutual funds	Form 8283, Section A	Form 8283
	Non-publicly traded stock	Form 8283, Section A	Form 8283
>\$ 10,000	Non-publicly traded stock	Form 8283, Section B Qualified Appraisal	Form 8283 Qualified Appraisal
>\$ 20,000	Artwork	Form 8283, Section B Qualified Appraisal	Form 8283
>\$500,000	All non-cash gifts, excluding unrestricted publicly traded stock	Form 8283, Section B Qualified Appraisal	Form 8283 Qualified Appraisal

### What else must be filed for a donation?

- **Form 8283.** If your client claims a deduction for a contribution of noncash property (exclusive of unrestricted publicly traded stock) worth \$5,000 or less, your client must attach Form 8283 to their tax return and complete Section A. If the claimed deduction for an item of donated property is more than \$5,000, your client must attach Form 8283 to their tax return and complete Section B. If your client does not attach Form 8283 to their return and complete Section B, the IRS may disallow their deduction.
- **Form 8282.** If, within three years of the donation, the recipient charity sells, exchanges, or otherwise disposes of the donated property, the charity must file an information return to the IRS on Form 8282, Donee Information Return, and send the donor a copy of the form.

*The above information is for general educational purposes only and should not be relied upon as legal or tax advice. Donors should consult with their qualified tax advisor for advice particular to their situation.*

<sup>41</sup> Treas. Reg. §1.170A-13(c); For additional information on these requirements, please see IRS Publication 561, Determining the Value of Donated Property

## APPENDIX B: Strategic Gift Planning Overview— Simplified Comparison of Common Contribution Asset Types

Charitable Gift	Deduction/AGI Limitation— Donor-Advised Fund	Deduction/AGI Limitation— Private Foundation	Best use and Potential Benefit to Donor	Limitations
<b>Cash (outright gift)</b>	FMV/50% of AGI with 5 year carryover to a public charity, including a donor-advised fund	FMV/30% of AGI with 5 year carryover	Generally ideal for any type of outright or planned gift.  Income tax deduction; reduce taxable estate	Appreciated non-cash assets may produce greater tax savings for donor
<b>Direct gift from IRA</b>	N/A	N/A	Best if donor doesn't need distribution income, does not itemize, or desires to limit income for tax purposes, and is age 70 ½ or older as of date of distribution; ideal for an outright donation to a public charity (excluding DAF accounts and private foundations under current law)  Excludes the IRA distribution from income, which lowers a taxpayer's AGI	Distribution cannot exceed \$100,000 per year per IRA owner; cannot be made to a private foundation, donor-advised fund, or CRT
<b>Long-term appreciated publicly traded securities (outright gift)</b>	FMV/30% AGI with 5 year carryover	FMV/20% AGI with 5 year carryover	Generally ideal for any type of planned gift  Income tax deduction; potentially eliminate capital gains tax; reduce taxable estate	Additional considerations may apply if stock is restricted; including an effect on deduction if restrictions are material
<b>Restricted stock</b>	FMV determined by a qualified appraisal if contribution > \$10,000 /30% of AGI with 5 year carryover; valuation discounts may apply	Lesser of cost basis or FMV/20% AGI with 5 year carryover	Diversification of concentrated position in company stock	Trading windows and lock up periods may apply as well as other requirements pursuant to Rule 144 or Rule 145
<b>Private C-Corporation shares</b>	FMV/30% of AGI with 5 year carryover; valuation discounts may apply	Lesser of cost basis or FMV/20% AGI with 5 year carryover	Advantageous where donor's shares are highly appreciated and s/he owns concentrated position; most often contributed via a company buy-back program or prior to merger/acquisition	Careful consideration as to timing of contribution in front of a merger or acquisition to avoid pre-arranged sale and assignment of income characterization
<b>Private S-Corporation shares</b>	FMV/30% of AGI with 5 year carryover; valuation discounts may apply	Lesser of cost basis or FMV/20% AGI with 5 year carryover	Generally best for any type of planned gift structured in trust, rather than corporate form; advantageous where donor's shares are highly appreciated and s/he owns concentrated position; most often contributed via a company buy-back program or prior to merger/acquisition	UBIT upon sale by the charity; CRT may not be a shareholder; careful consideration as to timing of contribution in front of a merger or acquisition to avoid pre-arranged sale and assignment of income characterization



Charitable Gift	Deduction/AGI Limitation— Donor-Advised Fund	Deduction/AGI Limitation— Private Foundation	Best use and Potential Benefit to Donor	Limitations
<b>Private partnership or LLC interests</b>	FMV/30% of AGI with 5 year carryover; valuation discounts may apply	Lesser of cost basis or FMV/20% AGI with 5 year carryover	LP and not GP interests are the best for donation purposes.	UBIT; capital calls, debt, recapture issues may apply
<b>Life insurance policy</b>	<p>If not “paid up”: lesser of the interpolated terminal reserve or donor’s adjusted basis/50% of AGI with 5 year carryover</p> <p>If “paid up” the lesser of the adjusted cost basis or policy’s replacement cost/50% of AGI with 5 year carryover</p>	<p>If not “paid up”: lesser of the interpolated terminal reserve or donor’s adjusted basis/30% of AGI with 5 year carryover</p> <p>If “paid up” the lesser of the adjusted cost basis or policy’s replacement cost/30% of AGI with 5 year carryover</p>	Name charity as beneficiary for testamentary gift provides flexibility but no current income tax deduction; or transfer ownership and eligible for charitable income tax deduction	Annuities may trigger gain taxable to donor when transferred; administrative issues if ownership transferred to charity; loans on policy gifts may result in treatment of contribution as part sale/part gift
<b>Gift of irrevocable remainder interest in personal residence, farm, or conserved lands</b>	Net present value of the remainder interest /30% of AGI with 5 year carryover to a public charity, including a donor-advised fund.	Net present value of the remainder interest/20% of AGI with 5 year carryover	Donor allowed to take an immediate charitable income tax deduction; may live in the residence during the life estate term; avoids probate and reduces applicable estate tax	Gift is irrevocable; should have an agreement with the charity as to maintenance and other expenses
<b>Irrevocable gift of real estate</b>	FMV/30% of AGI with 5 year carryover; valuation discounts may apply	Lesser of cost basis or FMV/20% AGI with 5 year carryover	Unencumbered real estate; reduce estate for estate tax purposes while obtaining a current year income tax deduction and potential elimination of capital gains	Carrying costs, depreciation for rental property; potential prearranged sale issues; environmental liability issues for commercial property
<b>Collectibles/ artwork</b>	Lesser of cost basis or FMV (unrelated use) /30% AGI with 5 year carryover	Lesser of cost basis or FMV (unrelated use) /20% AGI with 5 year carryover	If donated to charity that will use as part of exempt purpose; otherwise good as a testamentary gift; reduction of estate tax for high value property; potentially eliminate capital gains at 28% federal maximum rate	Deduction at cost basis for unrelated use. Additional considerations regarding the insuring, shipping, and storage of the property
<b>U.S. savings bonds</b>	N/A	N/A	Testamentary gift – no income realized by the decedent or the estate	Cannot be transferred during lifetime

## APPENDIX C: Strategic Planned Gift Overview – Charitable Vehicles

Planned Giving Vehicle	Deduction/AGI Limitation	Best Use of Vehicle and Potential Benefit to Donor	Limitations
<b>Bequest (through a will)</b>	Estate may be eligible for both an estate tax charitable deduction and an income tax charitable deduction. <sup>42</sup>	Any age over 18 and any income/estate level  Estate income tax deduction; estate tax savings.	Do not receive charitable income tax deduction during lifetime.
<b>Name charity as beneficiary of asset</b>	Estate may be eligible for both an estate tax charitable deduction and an income tax charitable deduction. <sup>43</sup>	Any age over 18 and any income/estate level  Estate income tax deduction; estate tax savings.	Do not receive charitable income tax deduction during lifetime.
<b>Donor-advised fund</b>	50% of AGI for cash  Lesser of FMV or cost basis/50% for short term capital gain property and other non-capital gain property <sup>44</sup>  FMV/30% for long-term <sup>45</sup> capital gain property	Any age over 18 and any income/estate level  Current tax year deduction for contributions allowing donor to grant to favorite causes strategically, over time; protect donor privacy; inexpensive; administrative burden (tax filing, due diligence) born by sponsoring organization; involve family members in philanthropy.	Cannot grant to individuals or to non-operating private foundations.
<b>Charitable gift annuity (CGA)</b>	Value of contribution less the present value of the annuity payments over donor's lifetime.	Fixed lifetime payments (partially tax-exempt); estate and income tax savings. Benefit over a CRAT is that the CGA income stream is guaranteed for life. A CRAT could exhaust under sustained poor market conditions.	Generally, a CGA is a contract with one charity and is irrevocable. <sup>46</sup>
<b>Private foundation</b>	FMV/30% for cash <sup>47</sup>  FMV for publicly traded stock; lesser of FMV or cost basis for other long-term capital gain property, including private stock and real estate/20% <sup>48</sup>	Legitimate and reasonable expenses may be paid from the foundation if incurred in carrying out charitable mission; may directly fund and carry out projects; may grant to individuals; employ family members and other staff in administering philanthropy.	Can be expensive and time consuming to establish; 1% to 2% net investment income tax; not private; must handle all administrative tasks including filing public tax returns, managing assets, charity due diligence; must comply with private foundation rules; requires minimum 5% distribution annually.

<sup>42</sup> IIRC § 642(c)(1).

<sup>43</sup> IRC § 642(c)(1).

<sup>44</sup> IRC § 170(e)(1)(A). A donor may elect to deduct all 30% gifts at cost basis to receive the higher 50% AGI limitation. This may be beneficial where the contributed asset is not highly appreciated or where the donation is too large relative to the donor's income to be able to make full use of the deduction carry over. IRC § 170(b)(1)(C)(iii).

<sup>45</sup> "Long term" means at least 12 months and 1 day. See IRC § 1222(3).

<sup>46</sup> Some charitable gift annuities allow the donor the ability to grant to one or more other charities, including a donor-advised fund at death for legacy planning purposes.

<sup>47</sup> IRC § 170(b)(1)(A) Cash contributions that exceed the 30% limitation may be carried over an additional 5 years. IRC §§ 170(b)(1)(B), 170(b)(1)(C)(iii).

<sup>48</sup> IRC § 170(b)(1)(D)(i). Contributions in excess of the 20% limitation may be carried over for an additional 5 years. IRC § 170(b)(1)(D)(ii).

Planned Giving Vehicle	Deduction/AGI Limitation	Best Use of Vehicle and Potential Benefit to Donor	Limitations
<b>Charitable Remainder Trust</b>	<p>Deduction is the present value of the remainder interest<sup>49</sup></p> <p>AGI Limitation:</p> <p><i>If remainderman is restricted to a public charity:</i></p> <p>50% for a cash contribution passing outright to public charity at the end of the trust term<sup>50</sup></p> <p>30% for a contribution of long-term capital gain property passing outright to public charity at the end of the trust term;<sup>51</sup> or if trust assets are further held in trust for the benefit of a public charity at the end of the non-charitable term<sup>52</sup></p> <p><i>If the trustee, donor or income beneficiary has the power to change the charitable remainder beneficiary, or if the remainder beneficiary is or could be a private foundation<sup>53</sup></i></p> <p>30% for a contribution of cash</p> <p>FMV for publicly traded stock; lesser of FMV or cost basis for other long-term capital gain property, including private stock and real estate/20%</p>	<p>Best assets to fund a CRT include low-basis, highly appreciated assets</p> <p>Benefits include: Fixed (annuity) or fluctuating (unitrust) lifetime income; full value of trust is includible in estate, but the full value of the trust will be deducted from the taxable estate through an estate tax deduction<sup>54</sup></p>	<p>Should not be funded with S-Corp stock, tax-exempt securities, partnership interests that could trigger UBIT, donor's personal residence, encumbered real estate, personal property, or stock options</p>
<b>Charitable Lead Trust</b>	<p>Grantor Lead Trust: Deduction based on the value of income stream that passes to the charity/30% where lead beneficiary is a public charity; 20% if lead beneficiary is a private foundation<sup>55</sup></p> <p>NonGrantor Lead Trust: Donor may not take a charitable income tax deduction</p>	<p>Best in a low interest rate environment and grantor has a high income and large estate with appreciating assets</p> <p>Grantor Lead Trust: Primary motive is to minimize income taxes</p> <p>NonGrantor Lead Trust: Ability to pass property to others with reduced gift and estate taxes. Future appreciation of assets will escape estate and gift taxation</p>	<p>No income tax deduction unless the donor is the "owner" of the charitable lead trust. Trust is irrevocable as is the charity named as the lead beneficiary</p>

<sup>49</sup> For calculating present value of a remainder interest of a CRAT see Reg. § 1.664-2(c); to calculate the value of a remainder interest in a Charitable Remainder Unitrust (CRUT) see Reg. § 1.554-4.

<sup>50</sup> IRC § 170(b)(1)(A); Treas. Reg. § 1.170A-8(a)(2); Rev. Rul. 80-38; PLR 9452026.

<sup>51</sup> IRC § 170(b)(1)(C)(i); Treas. Reg. § 1.170A-8(a)(2).

<sup>52</sup> IRC § 170(b)(1)(B); Treas. Reg. § 1.170A-8(a)(2). If assets held in trust after the non-charitable trust term, IRC § 170(e)(1)(B)(ii) applies as the contribution is "for the use of" the charity.

<sup>53</sup> IRC § 170(e)(1)(B)(iii); PLR 9826021.

<sup>54</sup> IRC § 2055(e)(2).

<sup>55</sup> A contribution to a grantor charitable lead trust is considered a gift "for the use of" charity rather than a gift "to" the charity. Therefore, IRC § 170(e)(1)(B)(ii) applies.





The article addresses gifts of appreciated assets that have been held for more than a year. The tax deduction for non-cash gifts to a public charity or donor-advised fund account may be used to offset up to 30 percent of adjusted gross income and can be carried forward for five years. The donor must file IRS Form 8283 for contributed securities valued at greater than \$500. For gifts other than cash and publicly traded securities in excess of \$5,000 (\$10,000 for closely held stock), the donor must also obtain a qualified appraisal.

Gifts of appreciated property can involve complicated tax analysis and advanced planning. The above article is meant only to be a general overview of some of the considerations and is not intended to provide tax or legal guidance. Please consult with your tax advisor.

A donor's ability to claim itemized deductions is subject to a variety of limitations depending on the donor's specific tax situation.

Contributions of certain real estate, private equity or other illiquid assets are accepted via a charitable intermediary, with proceeds transferred to a donor-advised fund account upon liquidation. This intermediary considers donations on a case-by-case basis, and assets typically must be valued at \$250,000 or more. Call the Fund for more information at 800-746-6216.

A donor's ability to claim itemized deductions is subject to a variety of limitations depending on the donor's specific tax situation. Consult your tax advisor for more information.

Schwab Charitable accepts contributions of certain real estate, private equity or other illiquid assets via a charitable intermediary, with proceeds of your donation transferred to your donor-advised fund account upon liquidation. This intermediary considers donations on a case-by-case basis, and assets typically must be valued at \$250,000 or more. Call the Fund for more information at 800-746-6216.

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