Why It Might Make Sense to Donate Your Best Investments Instead of Cash

Appreciated Assets Can Be Among the Most Tax-Advantaged Items to Contribute to Charity

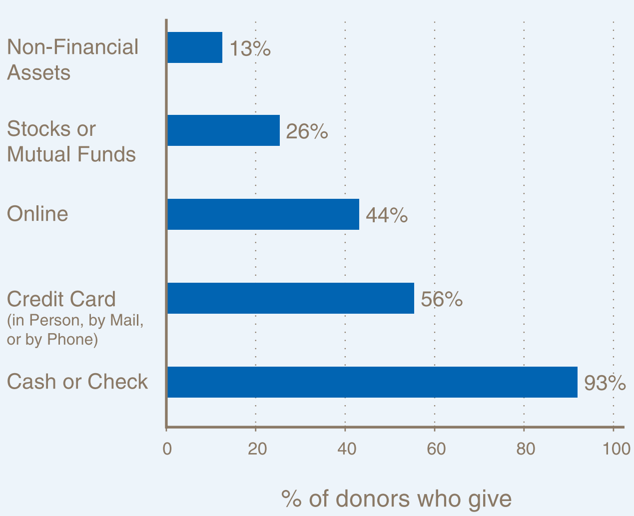
by Barbara Benware, Vice President – Investment Oversight and Risk

What might your best stock holding, a piece of real estate, shares in a privately held company, interests in private equity, venture or hedge funds, and fine art or collectibles have in common? Whether you purchased them for love or investment purposes, they could be among the best items to give to your favorite charities to realize maximum tax benefits.

Before you sell them, it's vital to understand how appreciated assets can be an important part of a philanthropic wealth management strategy. Assets that have appreciated in value can be among the most tax-advantaged items to contribute to charity because you can enjoy a current year tax deduction and potentially eliminate capital gains tax liability on their sale. This allows you to pay lower taxes and also allows the charities you support to receive the most money possible.

Yet most Americans are not aware of the benefits of contributing these types of assets. Only 26% of high net worth households give appreciated investments to charity, while 93% make donations using cash or checks.*

DONORS ARE UNDERUTILIZING APPRECIATED ASSETS



Source: The 2012 Bank of America Study of High Net Worth Philanthropy

Unfortunately, not all charities have the resources or capabilities to accept gifts of appreciated investments directly. That's where donor-advised fund accounts can come in handy. These charitable accounts, offered by many financial institutions and community foundations, allow you to more easily convert appreciated investments into tax-effective charitable contributions. This is because the sponsoring charity may have more experience with these types of gifts and can be in a better position to evaluate prospective contributions of appreciated property and liquidate the property once it is donated. Simply transfer the investment to the donor-advised fund account and qualify for a fair market value tax deduction on the date of transfer†. You pay no capital gains tax when the investment is liquidated, and the cash proceeds can then be invested and you can recommend grants to your favorite charities immediately or over time at your convenience.

Here is some important information to keep in mind when donating appreciated assets to a charity or donor-advised fund account:

Publicly Traded Securities

Restricted Stock

Real Estate

Privately Held Stock (C-Corp and S-Corp)

Limited Partnerships or Limited Liability Corporations

Private Equity, Venture Fund, and Hedge Fund Investments

Collectibles and Artwork

DEDUCTIBILITY LIMITS FOR DONATIONS OF NON-PUBLICLY TRADED SECURITIES TO A:

	Charity or Donor-Advised Fund Account	Private Foundation
Generally Deductible at:	Fair Market Value	Lesser of Cost Basis or Fair Market Value
Deductibility Limits	30% of AGI 5 year carry forward	20% of AGI 5 year carry forward

Publicly Traded Securities

Shares of appreciated publicly traded securities, such as stocks and mutual funds, are generally straightforward assets to donate. For maximum tax efficiency, shares must be held for more than one year. You must transfer the shares directly to the charity or donor-advised fund account and should not sell the stock. Selling the appreciated asset first will trigger capital gains tax liability. Appreciated securities held for more than one year and donated directly to a public charity or a donor-advised fund account are generally deductible at fair market value without recognizing any capital gain.

Donated publicly traded partnerships—in particular master limited partnerships ("MLPs")—are an important exception to the typical fair market value deduction for long-term gain securities, as the charitable deduction must be reduced by the amount of ordinary income that would have been realized if the property had been sold at fair market value on the date contributed. For MLPs with substantial accumulated depreciation, this can greatly reduce the charitable deduction. Additionally, if the partnership carries debt (often the case with MLPs), the donor may be liable for taxes.

Restricted Stock

Executives with concentrated and restricted positions in a public company stock may think about donating shares to help reduce tax exposure in their portfolios. Considerations include:

- 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.
- Contributions of restricted stock to a public charity or donor-advised fund account are generally deductible at fair market value on the date of contribution, but may be subject to discount based on the specific restrictions. By contrast, if donated to a private foundation, contributions of restricted stock are generally deductible at the lower of cost basis or market value. A qualified appraisal is generally required to substantiate fair market value.

Real Estate

If you contribute highly appreciated real estate to a public charity or donor-advised fund account, you may be entitled to a full, fair-market-value tax deduction for the donation while also eliminating capital gains tax on the sale. It can make sense to donate real estate that meets the following criteria:

- The property has been held for more than a year and has appreciated significantly.

- The property is marketable and relatively easy and cost-effective to liquidate.
- The property is generally debt-free.
- The owner is willing to transfer the property irrevocably to the donor-advised fund, which will negotiate the sale price and control the sale, often using an experienced intermediary.
- 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

These criteria most often apply to donations of a primary or secondary home or other residential property held for some time. Commercial real estate may also be donated under certain circumstances. Such gifts involve additional legal and tax considerations.

Contributions of real estate to a public charity or donor-advised fund account are generally deductible at fair market value—as determined by an independent qualified appraisal—on the date of contribution, whereas contributions of real estate to a private foundation are generally deductible at the lower of cost basis or market value.

Privately Held Stock (C-Corp and S-Corp)

If you are considering selling shares in a privately held company, you may find that donating a portion of the shares to a charity or donor-advised fund account before the sale can help to reduce your tax burden and enable you to give generously to charity†. Considerations include:

- 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.
- Contributions of privately held stock to a public charity or donor-advised fund account are generally deductible at fair market value on the date of contribution—as determined by a qualified appraisal—whereas such contributions to a private foundation are generally deductible at the lower of cost basis or market value.
- The company's shareholder agreements and other governing documents must be reviewed to understand transfer restrictions, timing, and process to complete the charitable transfer.
- You must obtain a qualified appraisal of the shares to substantiate the charitable deduction claimed. Appraisals must be obtained no earlier than 60 days before the date of donation and no later than the due date of the donor's tax return (including extensions) for the year of the gift. Appraisals depend on the facts and circumstances at the time of contribution and may be discounted for lack of marketability and/or presence of a minority interest.
- Once contributed, the charity or donor-advised fund account controls the contributed shares.
- Gifts of indebted interests may trigger negative tax consequences for donors and recipients.

Additional considerations for S-Corp stock:

- The charity or donor-advised fund account 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. The charity or donor-advised fund provider 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.

Limited Partnerships or Limited Liability Corporations (LLCs)

Deductibility rules, holding-period considerations, and adjusted-gross-income 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 donor-advised fund provider will negotiate the sale price and control the sale, typically using an experienced intermediary. 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 donor-advised fund account may be subject to UBIT on its share of the entity's income. Gifts of indebted interests may trigger negative tax consequences for donors and recipients. 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 fair market value on the date contributed. Please consult with a tax advisor prior to donating interests in flow-through entities.

Private Equity, Venture, and Hedge Fund Investments

By donating highly appreciated alternative investments to a public charity or donor-advised fund account, you can take a full, fair-market-value tax deduction—as determined by a qualified appraisal—for the donation while also eliminating capital gains tax on the sale. Contributions of similar assets to a private foundation would generally be deductible at the lower of cost basis or market value. Considerations include:

- The charity or donor-advised fund provider should be able to redeem or sell the interest. Most hedge fund interests can be redeemed periodically at net asset value. Minority limited partnership interests in private equity funds are highly illiquid until fully realized and 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 full value of the investment.
- The charity or donor-advised fund provider will generally not assume liabilities associated with these investments. Individuals should plan to contribute sufficient liquid assets to cover granting as well as private equity fund open commitments, UBIT, or other liabilities.

Collectibles and Artwork

Gifts of collectibles and artwork to charity or donor-advised fund accounts for non-related use are deductible at the lesser of the donor's cost basis or fair market value. Gains on sales of these assets by individuals are currently taxed at a higher rate than other long-term capital gains. A donation can help you eliminate this tax liability.

Knowing the benefits of donating various appreciated assets is an important component of an overall tax-smart financial plan. And using a donor-advised fund may provide even greater tax deductions relative to other vehicles, and thus enabling you to give even more to charity.

Learn More

For more information about the advantages of contributing appreciated assets and for a detailed consultation about your specific situation, please call us at 800-746-6216 or visit us at www.schwabcharitable.org.

* The 2012 Bank of America Study of High Net Worth Philanthropy: Issues driving charitable activities among wealthy households, Bank of America and The Center on Philanthropy at Indiana University, November 2012.

† 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.

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 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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