Gifting Complex Assets

A simple approach to helping clients maximize charitable impact and reduce taxable income.

Randy A. Fox | Aug 22, 2023

A National Philanthropic Trust report on complex assets showed that nearly two-thirds (61%) of contributions to donor-advised funds (DAFs) over the last five years were made with complex assets rather than cash. I suspect that percentage will be even higher this year as we work through economic uncertainty, high inflation and fallout from the bear market in stocks and bonds last year.

What are complex assets? Quite simply, they're assets other than cash or marketable securities. Unlike mainstream Americans, a significant portion of high-net-worth (HNW) families' wealth is composed of complex assets such as shares of privately held companies, private investments such as hedge funds, venture capital and private equity or digital currencies and real estate. For many of the families we work with, the two most common assets they wish to donate are real estate and privately-held business interests.

Easier to Give Than to Receive

Even though complex assets are often better for donors to give than cash, many charities aren't equipped to receive them. They often don't know the right questions to ask, the form in which they should receive complex assets or what to do with those assets once they receive them. And they're often concerned about assuming liabilities associated with those assets, particularly real estate and business interests.

As a result, more HNW families than you think are writing checks to charity out of habit. No one has told them about better alternatives, and both sides lose out. Charities aren't receiving as much as they could under a more enlightened approach, and donors aren't getting as many tax benefits as they could.

Three Steps

You and your clients should first talk to targeted charities to see if they have suggestions for giving complex assets. Also, consider conduit charities, such as DAFs and community foundations. These vehicles often have the resources and expertise for evaluating, receiving, processing and liquidating these types of gifts. They're happy to take the proceeds and give them directly to your targeted charities.

Many HNW families and their advisors make the mistake of selling complex assets before contributing the proceeds to a nonprofit. This can create significant tax liability. If your clients have complex assets that they want to use to fund their charitable goals, consider these three steps:

1. Get on the same page. If a client wants to activate complex assets to support a nonprofit, your client and the nonprofit must be in agreement about what the assets are and if the nonprofit can accept them directly. Make sure you're clear on your client's timeframe, how the transaction will work and what the tax implications will be.

If your client wants to use complex assets to make a gift, it's important to understand the nature of those assets. Are the assets to be sold after donation? What's the cost basis and current FMV (estimated)? Are there any liabilities attached? Is the asset an operating business or a passive investment? Who else is advising your client about the donation? How knowledgeable are both sides about the particular asset and the implications of the gift?

2. Do your due diligence. You'll not only need to understand the complexity and timing of the gift, but also how to liquidate the asset and the tax implications for the donor and the charity, restrictions on the asset and any other legal or tax issues. Does the charity have a gift acceptance policy? What does it say about the asset being donated? Are there hidden tax implications such as unrelated business taxable income that will have a negative effect on the charity? Do any provisions of ownership prohibit transfer to a charity?

3. Ensure smooth acceptance of the asset. If the nonprofit is willing and able to accept your client's asset, donors will complete an agreement that assigns ownership of the asset to the charity and sets forth any necessary terms of the donation. For income tax purposes, the donor is responsible for obtaining an independent qualified appraisal of any asset.

Donating Real Estate

The benefits of giving real estate include:

- **Income tax deduction for the full market value of the real estate.** If your client has owned the real estate for longer than one year (and the property has no mortgage or debt), they qualify for a federal income tax charitable deduction equal to the property's full fair market value (FMV). They receive a charitable tax deduction from income taxes for up to 30% of their annual income, with excess donations carried forward up to five additional years.
- **Avoidance of capital gains taxes** on the appreciation built up in the property.
- **Legacy potential**.

Remember, if the value of the donated property exceeds $5,000, the donor must get a qualified appraisal for contributions of property (other than cash or publicly traded securities), and be willing to sign Form 8283.

When it comes to gifting real estate, make sure the property is held in a limited liability company (LLC) so your client can donate the LLC interests. If your client signs the deed over to the charity, then all of the environmental risk or zoning and building code violations associated with that property go along with it, and the charity will need to conduct a Phase One environmental study. To minimize their liability, some charities require donors to place real estate in an LLC and donate LLC interests. Another option is to donate property to a supporting organization that disposes of real estate on a charity's behalf. Another mistake we see is that someone tries to donate real estate after they've received a binding letter or intent to buy it. That won't fly. Real estate gifts require collaboration between the donor and the charity to find a mutually agreeable transfer strategy. Donors should consult their tax, financial and legal advisors to ensure they're optimizing the tax and financial benefits associated with their gift.

Real World Example

We're working with the founder of a very successful contracting business in California. The business is worth about $30 million with an estimated $10 million of personal goodwill. The client has received a letter of intent that's non-binding. Since his business is an S corporation (S corp), he can't donate the S corp stock since it will cause tax headaches for most charities, but we can peel off his personal goodwill portion. We aren't making an outright gift to charity. Instead, the donation will be made to a split interest trust that will allow our client to receive income for the rest of his life. Because of this, his charitable deduction is based on a number of factors, including his age.

Nonetheless, this will generate a significant income tax deduction, including a 37% savings (23.8% + 13.3%) in California on the $8 million to $10 million of capital gains. This means at the owner's age, he'll get a charitable income tax deduction of about $4 million to $5 million, which will offset some of his ordinary income. Then he'll pay no capital gains tax on the sale of the goodwill (which has zero tax basis). That means we're helping him save tax on the capital gains of $3.5 million. That's a $ 4 million or $5 million swing in his favor. All in, we're talking about a tax savings of $5 million to $7 million.

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