Fund Your Charitable Giving from Unexpected Sources

Charitable donations of assets such as real estate or privately held stock can help you give more to charity, save cash and lower your taxes, all at the same time.

What's Inside

FIDELITY Charitable℠

Make more of a difference

White Paper

Harnessing the Power of Appreciation

While most charitably minded individuals spend a lot of time choosing the causes they want to support, many overlook basic financial planning fundamentals that could help them give more to these charities. The majority of charitable contributions are made by cash or check. Depending on your particular financial situation, cash can be the least beneficial method of giving – for you, the donor, and for your charitable recipients.
This is true particularly when you have other appreciated assets to choose from. If you were to donate appreciated assets that you've held for more than one year, you could more effectively fund your giving and gain additional tax efficiencies. Appreciated publicly traded securities can certainly be a great asset to donate, yet many people also have non-cash assets in their portfolio with even greater unrecognized appreciation that could be used for charitable purposes.[1]

These seemingly illiquid assets can include real estate, privately held business interests (e.g., C-corp and S-corp shares, and LLC and LP interests) and other capital gain investments. If you were to donate complex assets you have owned for more than one year to a public charity, you are generally entitled to a fair market value (FMV) deduction, and you may be able to eliminate capital gains taxes.[2]
However, giving cash is often reinforced by charities. Beyond cash, some charities ask for publicly traded securities and can facilitate those donations. Rarely, however, do charities ask for non-cash assets such as private business interests. The fact that charities don't ask should not stop you from making the most tax-efficient choice to fuel your philanthropy.

Donating to a charity that has in-house proficiency and experience accepting illiquid assets makes the process significantly easier. Consider working with a charity with this expertise that has a donor-advised fund program (DAF). The DAF provides donors with the opportunity to work with a single charitable organization, make one donation and then recommend grants from the proceeds from the sale of the donated non-cash asset to any number of qualified public charities on the donor's timetable.

[1] Assets held for more than a year are generally deductible at fair market value, up to 30% of adjusted gross income.

[2] Fair market value is determined by an independent qualified appraisal.

Examples of Thinking Differently

Advantages of Donated Securities over Cash Proceeds

When donating appreciated securities you have owned for more than 12 months to charity, rather than selling the securities first and then donating the after-tax proceeds, you will generally be able to take a fair market value tax deduction and eliminate taxes on the capital gains, thereby providing a larger donation to the charities you support.

Outlined below is a hypothetical example showing the advantages of donating a long-term appreciated security as compared to selling the asset and donating the cash proceeds. In this scenario, the donors, Matt and Veronica:

- Are in the 37% federal income tax bracket.
- Have an asset that has an FMV of $450,000 that includes unrealized gains of $150,000, which could be subject to a 20% capital gains and 3.9% Medicare surtax.

Selling Matt and Veronica's Securities vs. Donating

Value of securities[1]

$450,000

Original cost of securities: $300,000[2]
Federal long-term capital gains rate: 23.8%[3]

Sell the securities Donate the proceeds	VS.	Donate the securities
$35,700	Long-term capital gains tax paid	$0
$414,300	Charitable contribution	$450,000

Reduced their tax obligation by: **$13,209**[4]

Additional amount dedicated to charity: **$35,700**

[1] *Amount of the proposed donation is the fair market value of the appreciated securities held more than one year that you are considering to donate.*

[2] *Total Cost Basis of Shares is generally the amount of money you have invested in the shares of a particular fund or individual security. It represents the basic dollar amount that, when compared to the price at which you sell your shares, tells you how much of a capital gain or loss you have realized.*

[3] *This assumes all realized gains are subject to the maximum federal long-term capital gain tax rate of 20% and the Medicare surtax of 3.8%. This does not take into account state or local taxes, if any.*

[4] *Assumes no unrelated business taxable income (UBIT), and top ordinary income tax rate of 37% for valuing charitable deduction. $13,209 reduced tax obligation calculated by comparing the tax benefit of a deduction of $450,000 at 37% versus a deduction of $414,300 at 37%. It does not account for any state and local taxes or alternative minimum tax.*

Donating Real Estate

It is possible to use real estate to fund charitable giving. Let's look at an example with Kimberly, a donor who is planning to sell some undeveloped lots in the Destin area that have appreciated significantly since she acquired them 10 years ago. She does not need income from this sale. Additionally, she would like to donate to a few of her favorite charities, including her alma mater, a local museum, a public charity that provides services for the homeless and an overseas relief organization.

By donating the lots to a public charity with a DAF program, she will benefit from an FMV tax deduction and eliminate capital gains tax on the appreciation of the real estate during her holding period.[1] She can then support her preferred charities over time, through grant recommendations from her DAF.

When evaluating a donation of real estate, the donor/taxpayer and the charity will consider:

1. the marketability of the property
2. the value of the property
3. any debt on the property
4. carrying costs to the charity post-acceptance
5. potential risks to the charity during the holding period and ultimately in the sale process

Before making the donation, the donor must agree to make an irrevocable contribution and to give up all control over the sale of the property, including the price negotiations during the bidding process.

Outlined below is Kimberly's example, showing the advantages of donating the land as compared to selling the land and donating the cash proceeds:

Selling Kimberly's Real Estate vs. Donating

Value of real estate[1]

$1,500,000

Original purchase price: $400,000
Federal long-term capital gains rate: 23.8%[2]

Sell the real estate / Donate the proceeds	vs.	Donate the real estate
$261,800	Long-term capital gains tax paid	$0
$1,238,200[4]	Charitable contribution	$1,500,000[4]

Reduced her tax obligation by: **$96,866**[3]

Additional amount dedicated to charity: **$261,800**

[1] Fair market value is determined by an independent qualified appraisal.

[2] This assumes all realized gains are subject to the maximum federal long-term capital gain tax rate of 20% and the Medicare surtax of 3.8%.

[3] Assumes no unrelated business taxable income (UBIT), and top ordinary income tax rate of 37% for valuing charitable deduction. $96,866 reduced tax obligation reflects the difference between the value of an itemized deduction in the amount of $1,500,000 versus $1,238,200. It does not account for any state and local taxes or alternative minimum tax.

[4] This assumes that the donor has an adjusted gross income of at least $5 million.

Giving in Advance of a Business Sale or Transition

Some donors make charitable donations in conjunction with the sale of a business or another investment. In this case, they gift to a charity that accepts donations of privately held C- and S-corp stock, limited partnership interests, limited liability company interests and publicly traded stock. Consider Michael, a business owner who is contemplating the sale of his private family-owned construction company. He is interested in giving some of the sale proceeds to charity. Michael is the founder, CEO and majority stockholder of the company, which is taxed as a C-corporation.

Michael chooses to donate 10 percent of his ownership interest to a public charity with a DAF program. In this instance, he can potentially maximize his tax benefits by donating shares of the business prior to the sale of the business. By donating the stock prior to the sale, Michael is not subject to capital gains tax on the proceeds received by the charity if the company is eventually sold. If the company does eventually sell and Michael has to pay tax on his remaining ownership interest, he is entitled to a charitable tax deduction equal to the FMV of the shares.[1] This charitable deduction offsets the gain from the sale of his remaining interests. Had Michael gifted his shares to a private foundation, he would have been entitled only to a deduction equal to the lower of the cost basis or the FMV.

If you are considering the sale of a closely held business or a partial sale of your non-cash assets, it's critical to consider your options, discuss strategies with your advisors and in-house experts at a public charity, and be mindful of timing considerations. You will also need to review governing documents to verify transferability; leave time in case documents need to be amended. Finally, consider the need to pay for and obtain an independent valuation to substantiate your tax deduction.

Outlined below is Michael's example, showing the advantages of contributing a portion of his business to a public charity that sponsors a DAF as compared to selling the business and donating the cash proceeds.

Selling Michael's Business vs. Donating

Value of business[1]

$20,000,000

Value of shares donated: $2,000,000
Federal long-term capital gains rate: 23.8%[2]

Sell the business Donate the proceeds	VS.	Donate the business shares
$476,000	Long-term capital gains tax paid	$0
$1,524,000[4]	Charitable contribution	$2,000,000[4]

Reduced his tax obligation by: **$176,120**[3]

Additional amount dedicated to charity: **$476,000**

[1] *As determined by a qualified appraisal.*

[2] *This assumes all realized gains are subject to the maximum federal long-term capital gain tax rate of 20% and the Medicare surtax of 3.8%.*

[3] *Assumes no unrelated business taxable income (UBIT), and top ordinary income tax rate of 37% for valuing charitable deduction. $176,120 represents the difference between the value of the tax deduction for the donation of the shares versus the net proceeds from the sale of the shares. It does not account for any state and local taxes or alternative minimum tax.*

[4] *This example assumes that the donor has an AGI of at least $6.7 million.*

When the Time is Right for You

There are some times when donating non-cash assets may make the most sense. For example, when you are facing a high income tax year, an advisor may recommend donating these non-cash assets to offset a tax burden. Additionally, if you or your partner is experiencing a life-changing event (such as the sale of a business, a transition to a new job or inheriting part of an estate), you may choose to divest yourself of shares of these types of assets. Finally, if you are considering a larger gift or a long-term donation strategy, you may be better able to plan and maximize the amount you contribute to charities over time by donating non-cash assets to charities with a donor-advised fund program.

Events that may provide the opportunity to make a non-cash charitable donation: high income tax year, sale of a business, transition to a new job or inheriting an estate.

Final Thoughts

According to a study of charitable donors, only half of the people surveyed had specifically discussed charitable giving with their advisor.[1] Yet your advisor is a great resource for these conversations and technical considerations. Not only can your advisor help educate you on the tax benefits and implications of donating non-cash assets, but he or she can have this conversation in the context of your overall portfolio—helping you build a smarter, holistic financial plan.

As you consider the opportunity to gift non-cash assets, remember that Fidelity Charitable® is available as a resource. The website (fidelitycharitable.org) has a wealth of information to support donors (and their advisors) in assessing appropriate assets, and developing and executing charitable strategies. In addition, highly experienced staff are available to offer planning advice and guidance in the early stages of a donor's decision making. For those choosing to donate complex assets, the in-house Complex Asset Group can help facilitate illiquid asset contributions. And of course, the team is able to lead the charitable donation process from end to end as needed.

[1] *Fidelity Charitable, "The Giving Gap", April 2016*

About the Author

Nathan Daley is a Vice President in the Complex Assets Group at Fidelity Charitable®, an independent public charity that has helped donors support nearly 255,000 nonprofit organizations with over $29 billion in grants since its inception in 1991. In this role, Nathan works directly with donors, their advisors, and corporate and business lawyers to facilitate the charitable contribution of non-cash assets to achieve the most favorable tax treatment with the greatest charitable impact. Prior to joining Fidelity Charitable, Mr. Daley was a corporate and securities attorney. His practice focused on representing public and private companies, private equity funds and business owners in connection with mergers and acquisitions, public and private offerings of debt and equity securities, entity formation, joint ventures, corporate governance matters, and drafting and negotiating complex commercial agreements. Mr. Daley received a bachelor of business administration degree in finance from the Business Honors Program at the University of Texas at Austin and a juris doctorate, summa cum laude, from Texas Tech University School of Law. Mr. Daley is pursuing his LLM in taxation at Georgetown University.

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