CASE STUDY

Fueling Philanthropy with Appreciated Private Equity Interests

FIDELITY Charitable®
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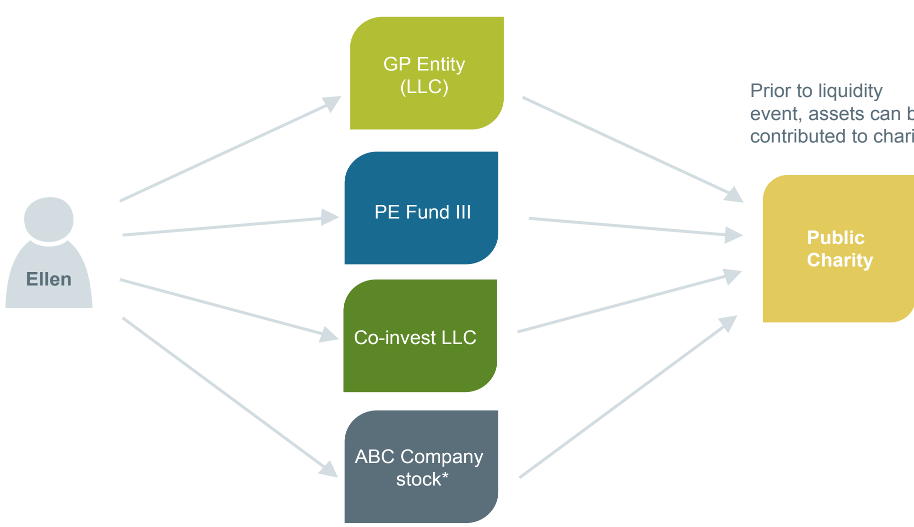
OVERVIEW

Ellen is a managing director at a private equity firm (Ellen's Firm), and serves as the general partner (GP) for several PE funds. Ellen owns interests in the GP entity (formed as an LLC), a co-invest vehicle (Co-invest LLC) that is invested in ABC Company (a portfolio investment company that is also partially owned by one of the firm's PE funds (PE Fund III). Elllen also owns LP interests in PE Fund III.

SITUATION

- The charitable contribution of non-publicly traded assets to a public charity generally offers two significant tax efficiencies. First, when these assets are contributed to a public charity, the donor is generally entitled to a fair market value tax deduction[1] (based on qualified appraisal). Second, the public charity generally does not pay tax on the sale of the asset.[2]
- Ellen's Firm is preparing to exit ABC Company.
- Ellen is very philanthropic and is interested in maximizing her charitable giving with donations of appreciated assets. She owns four distinct non-publicly traded assets that may be candidates for charitable giving:
  1. GP interest (entity formed as an LLC): Giving this interest can effectively allow Ellen to transfer her carried interest.
  2. LP interest in PE Fund III: Giving this interest will allow the anticipated distributions to flow to the charity
  3. Co-invest LLC interest: Giving this interest will also allow the anticipated distributions to flow to the charity.
  4. Shares in ABC Company: Some PE firms are structured such that it is possible for the firm to distribute portfolio company stock to the managing directors in advance of a possible liquidity event. Ellen could then contribute that stock to charity.



* ABC Company is a privately held C Corporation

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CONSIDERATIONS

Ellen's Firm and Ellen must evaluate the potential impact of the charitable contribution of each particular asset. Further, Fidelity Charitable® must perform its due diligence to be sure the assets are acceptable for contribution.

ARE THE INTERESTS/SHARES TRANSFERABLE?

The entity or Company's governing documents (e.g., shareholders' agreement, etc.) must be reviewed to understand transfer restrictions and amendments, approval, or waivers that may be required to complete the necessary transfers. This includes transfers from the partnership (GP or LP) to the managing directors (MDs) and from the MDs to the charity.[3]

DOES ANTICIPATORY ASSIGNMENT OF INCOME APPLY?

Since the Fund is considering exiting ABC Company, Ellen and her advisors must determine if her donation of LP interests, LLC interests, or ABC Company stock prior to an exit constitutes an anticipatory assignment of income. Critical to the analysis is whether the exit negotiations have ripened to the point where what Ellen is donating to charity is effectively the right to receive cash. Determinations are highly dependent on the facts and circumstances. A key question is whether the charity can be compelled to sell the stock/interests. If Ellen or the charity can be compelled to sell the stock, then the anticipatory assignment of income doctrine may apply. If, on IRS audit, it is determined that there was an anticipatory assignment of income, Ellen will have to pay the capital gains tax that otherwise would have been due (plus interest and possible penalties).

HOW DOES ELLEN SUBSTANTIATE HER CHARITABLE TAX DEDUCTION?

When Ellen donates privately held long term assets to charity, her charitable tax deduction is generally equal to the fair market value on the date of the gift. Fair market value is determined by a qualified independent appraiser. The appraiser attests to the valuation on IRS Form 8283. Appraisals for complex assets typically reflect lack of marketability and/or minority interest discounts. Appraisals can be obtained no earlier than 60 days before the date of donation, and no later than the date the donor's tax return for the year of the gift is due with extensions. Appraisers charge a fee.

WHAT ARE THE ACCEPTANCE GUIDELINES FOR COMPLEX ASSETS AT THE SELECTED CHARITY?

Charities have differing guidelines and criteria for the acceptance of complex assets. Charities typically (i) require an understanding of the potential exit strategies and the timing of such exits; (ii) seek to understand the risk they undertake as asset owners, including financial risk and other liability; (iii) seek to eliminate or minimize any exposure during the holding period and as a selling owner in transaction documents; and (iv) may seek indemnification in certain circumstances (e.g., where there is a potential for financial or other liability during the holding period or post-closing).

IS THE DISTRIBUTION OF ABC COMPANY STOCK RECOGNITION OF A GAIN EVENT TO ELLEN?

Regardless of whether ABC Company is a public company or privately held at the time of the distribution, there is generally no recognition of gain to Ellen. If it is a public company, under an exception to IRC Section 731, a distribution of marketable securities does not result in recognition where the partnership is an "investment partnership" and the partners are "eligible partners."[4] If it is a private company, then the distribution of its private stock is not "money" under Section 731, and the general rule does not apply. As a result, there is no recognition of gain.

For more information, please call a Charitable Planning Specialist at 800.682.4438 or visit FidelityCharitable.org.

[1] If the distributed stock is non-publicly traded securities, a qualified appraisal is required.

[2] For some assets, the public charity will experience unrelated business taxable income (UBTI) during its holding period or through its sale of the asset.

[3] If an LP interest is the asset to be transferred, the Limited Partnership Agreement must be reviewed.

[4] An "investment partnership" is a partnership (i) that has never engaged in a trade or business, and (ii) where substantially all assets of the partnership consist of money, stock in corporations, or certain other investment-type assets (collectively, "investment-type assets"). Regulations under IRC Section 731 generally exclude from activities that would constitute a trade or business those in which a PE Firm would typically engage (e.g., management services, including receipt of fees for such service), consulting services and service on Boards of Directors of portfolio companies. "Eligible Partner" is any partner who, before date of distribution, did not contribute to the partnership any property other than investment-type assets.

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