

Privately held business interests



By the Charitable Strategies Group at Schwab Charitable

A tax-smart approach to maximize your philanthropic impact.

If you are a charitably minded executive or entrepreneur, a donation of your privately held business interests may help you achieve maximum impact with your charitable giving. Your interest in a private business—such as a C- or S-Corporation, Limited Partnership (LP), or Limited Liability Company (LLC)—likely has a low cost basis and may have substantial appreciation, resulting in large capital gains taxes when sold.

Donating a percentage of an interest held more than one year can unlock additional funds for charity in two ways.

First, you potentially eliminate the capital gains tax you would incur if you sold the interest yourself and donated the proceeds, which may increase the amount available for charity by up to 20%. Second, you may claim a fair market value charitable deduction for the tax year in which the gift is made and may choose to pass on that savings in the form of more giving.

Donor-advised funds, which are 501(c)(3) public charities, provide an excellent option for donating privately held business interests. The funds allow you to easily convert your appreciated interests into charitable contributions, in particular when a third-party sale or buyback program enables timely liquidation.

Many donor-advised funds also have the resources and expertise for evaluating, receiving, processing, and liquidating this type of gift.

HOW DOES GIFTING PRIVATELY HELD BUSINESS INTERESTS TO A DONOR-ADVISED FUND WORK?



“We have clients who have some private investments that you can’t typically just give to a charity” *- Financial advisor*

Please be aware that gifts of appreciated non-cash assets can involve complicated tax analysis and advanced planning.

This article is only intended to be a general overview of some donation considerations and is not intended to provide tax or legal guidance. In addition, all gifts to donor-advised funds are irrevocable. Please consult with your tax or legal advisor.

Case study: maximizing charitable impact while mitigating tax exposure

Sue, an executive at Corporation XYZ, plans to convert a portion of her concentrated XYZ holdings into cash to fund her philanthropic goals. As there is no easily identifiable market for XYZ stock, Sue's company has a buyback program in place for shares that are donated to charity.

Sue decides to establish a donor-advised fund account as a way to maximize charitable impact while potentially mitigating capital gains tax exposure. Sue works with the donor-advised fund's staff to complete the necessary paperwork for the assignment to the donor-advised fund and transfer back to XYZ through its buyback program.

In Option 1, if Sue transfers \$1 million of shares to XYZ, pays the estimated \$190,000 in federal capital gains taxes, and donates the after-tax proceeds, her tax savings are only \$109,700.

By assigning \$1 million of XYZ directly to charity and utilizing the firm's buyback program, **as shown in Option 2**, Sue potentially eliminates \$190,000 in projected federal capital gains taxes. When combined with her potential income tax deduction, Sue's tax savings is \$370,000.

Cost basis of stock XYZ: \$50,000
Federal long-term capital gains tax rate: 20%



Fair market value of stock XYZ:
\$1,000,000

	Option 1: Sell stock XYZ and then donate the after-tax proceeds	vs	Option 2: Contribute stock XYZ directly to Schwab Charitable	
Long-term capital gains taxes paid	\$190,000		\$0	
Charitable contribution and tax deduction	\$810,000		\$1,000,000	Additional amount available to grant to charities: \$190,000
Tax savings	\$109,700		\$370,000	Additional amount saved on taxes: \$260,300

This hypothetical example is only for illustrative purposes. The example does not take into account any state or local taxes or the Medicare net investment income surtax. The tax savings shown is the tax deduction, multiplied by the donor's income tax rate (37% in this example), minus the long-term capital gains taxes paid.

Additional considerations

In addition to the potential tax benefits described above, the following considerations may apply.

1

Avoid prearranged sales.

If a sale of your privately held business interest is expected, the terms of the sale should still be under negotiation. The documentation must not have proceeded to the point at which the IRS would consider it a prearranged sale. In that unfortunate instance, the IRS may deem your gift an “anticipatory assignment of income” to the charity. As such, you may be required to pay capital gains taxes on the sale by the charity.

2

Business gifts require due diligence by the charity and careful planning by the donor.

Many charities will not accept gifts of privately held business interests due to the complexity involved. Donor-advised funds and other public charities that do accept these gifts likely will do so only after performing substantial due diligence. For example, the company’s governing documents—such as the shareholder agreements, operating agreement, and articles of incorporation—must be reviewed to understand whether there are any transfer restrictions or embedded liabilities, and additionally to assess the time and process to complete the charitable transfer.

There can be complexities on the donor side of the gift as well. For example, donations of indebted interests may trigger negative tax consequences for you and the receiving charity, including tax liability and a reduced charitable deduction, if you itemize. In addition, the deduction for gifts of S-Corp, LP, and LLC interests may be reduced by the amount of ordinary income that would have been realized if you had sold the interest at fair market value on the date contributed.

The above is one example of many possible considerations. Please consult with your tax advisor prior to donating interests in privately held businesses.

3

There are special rules for donations of S-Corp interests to charity.

The donor-advised fund or other public charity will generally be subject to unrelated business income tax (UBIT) on its income from the sale of the S-Corp business. 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’s “look-back” period, during which the IRS can challenge the cost basis of the shares and the taxes paid.

4

Qualified appraisal requirements and annual deduction limits apply.

Overall deductions for donations to donor-advised funds are generally limited to 50% of your adjusted gross income (AGI). The limit increases to 60% of AGI for cash gifts, while the limit on donating appreciated non-cash assets held more than one year is 30% of AGI. The IRS permits a carryover for five tax years, should your charitable deduction exceed AGI limits in a given tax year.

For gifts of privately held business interests in excess of \$5,000, donors must obtain a qualified appraisal by a qualified appraiser to substantiate fair market value for the charitable deduction. Appraisals must be obtained no earlier than 60 days before the date of donation or 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 valuations may be discounted for lack of marketability and/or lack of control.

Interested in learning more?

The Charitable Strategies Group at Schwab Charitable is a team of professionals with specialized knowledge about non-cash asset contributions to charities. Our team stands ready to support you and your advisors, from initial consultation through asset evaluation, receipt, processing, and sale. We strive to provide unbiased guidance and frequent communication at every step of the process to help you and your advisors make informed decisions and stay aware of the time required for your transaction.

For more information about the advantages of contributing appreciated non-cash assets, you can read an [overview article](#) or call us at 800-746-6216.

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with philanthropic planning or
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800-746-6216



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This information is not intended to be a substitute for specific individualized tax, legal, or investment planning advice. A donor's ability to claim itemized deductions is subject to a variety of limitations, depending on the donor's specific tax situation. Where specific advice is necessary or appropriate, Schwab Charitable recommends consultation with a qualified tax advisor, Certified Public Accountant, financial planner, or investment advisor.

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