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Contributing Appreciated non-cash Assets to Charity: Private Equity Fund Interests

by Barbara Benware, Vice President – Investment Oversight and Risk

Private equity funds often incur significant value over time, and may face taxable distribution. For philanthropically minded investors, non-cash assets such as this that have appreciated in value can be among the most tax-advantaged items to contribute to charity, because donors may potentially eliminate capital gains tax liability on the distribution, transfer or sale of the shares and may enjoy a current year tax deduction, if they itemize, while allowing supported charities to receive the most money possible.

It is typically most tax-effective for investors to choose their most highly appreciated, long-held assets to contribute to public charity (including a donor-advised fund account). By donating highly appreciated private equity fund interests, investors can potentially eliminate tax liabililty on fund distribtions and may take a full, fair market value income tax deduction—as determined by a qualified appraisal. Contributions of non-cash assets to a private foundation would generally be deductible, for those who itemize, at the lower of cost basis or market value.

Depending on the size and complexity of the private equity fund, it may be possible to donate a limited partnership interest in the fund directly to a donor-advised fund, yielding maximum benefits to charity. These donations must be approved by the private equity fund's general partner and accepted by the donor-advised fund provider. Upon completion of the gift, donors are eligible for a fair-market-value income tax deduction, if they itemize, as determined by a qualified appraisal.

Considerations include:

- Private equity fund general partners typically oversee transferability of fund shares, and limited partners who wish to donate a portion of their investment to charity can work with the general partner to achieve this goal. In some cases, general partners have established charitable giving programs to enable their investors to achieve their philanthropic goals by permitting charitable transfers of partnership interests or distribution of portfolio company stock prior to a sale. Such programs require the active involvement of the fund's general partner, may be complex, and take time to establish, so initiating discussions well in advance of a liquidity event is critical.
- The charity or donor-advised fund provider will generally not assume liabilities associated with these investments. Individuals should plan to contribute sufficient non-cash assets to cover granting as well as private equity fund open commitments, unrelated business income tax (UBIT) or other liabilities.
- The donor's fair-market-value tax deduction, if the donor itemizes, will be determined by a qualified appraisal of the contributed interest.
- In order to realize the full value of the investment, the charity or donor-advised fund provider must normally be able to hold the private equity interests until the scheduled termination date or liquidity event. Sales of these interests in the secondary marketplace prior to this may be subject to steep discounts.
- If the fund carries debt, the donor may be liable for taxes if the contribution is treated as a bargain sale.

Case Study—Contribution of Seasoned Private Equity Fund Interests

A successful entrepreneur retires from his firm to dedicate himself full time to preserving wild spaces in America. He meets with his advisor to identify portfolio holdings he can tap to fund his philanthropic effort. His advisor suggests donating limited partnership interests in several private equity funds which have completed their investment stage and will soon begin realizing and distributing gains on long-held portfolio companies. By donating these fund interests directly to charity, the entrepreneur can potentially eliminate capital gains tax liability on the distributions, thereby preserving a larger amount for his philanthropy.

	Hold fund and donate after-tax proceeds to charity	Donate limited partnership interest directly to charity
Asset Value	$5,000,000	$5,000,000
Capital Gains (100% Long-Term)	$3,000,000	$3,000,000
Taxes Paid*	$714,000	$ -
Gift to Charity	$4,286,000	$5,000,000
Charitable Deduction†	$4,286,000	$4,500,000
Donor Tax Savings‡	$1,585,820**	$1,665,000

The advisor recommends that he open a donor-advised fund with a provider that is willing and able to accept this type of asset and hold it until fully liquidated. The entrepreneur follows this advice, and his advisor coordinates the transfer of ownership to the donor-advised fund account. The following month, two of the funds make substantial distributions and the entrepreneur begins to recommend grants to charitable environmental programs. He plans to itemize, and is eligible for a fair market value deduction (as determined by a qualified appraisal).

Learn More

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

Gifts of appreciated private equity 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. If you would like to consider a donation, please consult with your tax advisor.

* Hypothetical case study, for illustrative purposes only. Assumes cost basis of $2,000,000, that the investments have been held for more than a year and that all realized gains are subject to the 20% federal long-term capital gains tax rate plus the 3.8% Medicare net investment income surtax. Does not take into account any state or local taxes. Please note that the holding period for carried interest has been increased from 1 year to 3 years under the Tax Cuts and Jobs Act of 2017, and donors should consult with a tax advisor prior to contribution.

† Gifts to charity of private equity fund interests are typically deductible at fair market value, if the donor itemizes, as determined by a qualified appraisal for donated interests with a value exceeding $5,000. Such valuations may be subject to discounts or premia depending on the current market for the interests and projected cash flow. Such discounts/premia vary widely. A 10% discount was assumed for this example. The example assumes there are no liabilities associated with the interests. The example assumes full deductibility (gifts to a public charity [including donor-advised funds] of property held for more than one year are generally limited to 30% of AGI with a 5-year carryover of unused amount).

‡ Assumes donor is subject to the maximum 37% federal tax and does not account for state or local taxes. Certain federal income tax deductions, including the charitable contribution, are available only to taxpayers who itemize deductions, and may be subject to reduction for taxpayers with adjusted gross income (AGI) above certain levels. In addition, deductions for charitable contributions may be limited based on the type of property donated, the type of charity, and the donor's AGI.

** Donor tax savings = value of deduction minus capital gains tax paid.

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