

Analyzing Contributions of Illiquid Assets
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Jeffrey D. Davine, Esq.
Mitchell Silberberg & Knupp LLP
2049 Century Park East, 18th Floor
Los Angeles, CA 90067
Phone: 310-312-3178
Fax: 310-231-8378
jdd@msk.com

I. Gift Acceptance Policies and Procedures. Important to have written gift acceptance policies and gift acceptance procedures to ensure consistency and no overlooked issues.

A. Gift Acceptance Policies.

1. Enacted by the governing board.
2. Provide broad guidance on information to be provided (and not provided) to donors, types of assets that will be accepted, restrictions that can be placed on donations, whether the organization will agree to be a trustee of a trust, and similar considerations.

B. Gift Acceptance Procedures.

1. Generally created by the planned giving department and officers.
2. Provide detailed procedures to be complied with before accepting a gift, such as internal approvals needed, physical inspections (if real or personal property), documents to be reviewed, documentation to be provided to donors, and similar steps.

II. Written Agreements. As a general rule, all gift transactions, other than a simple outright gift of cash, should be set forth in a written document describing the terms, conditions, and restrictions (if any) applicable to the gift.

III. Closely Held Stock.

A. Description. Closely held stock is stock that is not regularly traded on an established national securities exchange. Usually the stock is owned by one person or a small group of people. Often the corporation is a “Subchapter S corporation.”

B. Accepting Gifts of Closely Held Stock. Determining whether to accept a gift of closely held stock should be evaluated on a case-by-case basis. For example, the executive director in consultation with the CFO or the charity’s investment committee (if the charity has an investment committee) should be involved in the decision making process.

C. Minimum Amount. A charity should select a minimum value for closely held stock before considering acceptance. For example, because of the resources needed to evaluate the gift, the charity's policy could be that the estimated value of the stock must be at least \$100,000 before beginning the gift acceptance process.

D. Opportunities For Sale. In determining whether to accept a gift of closely held stock, it is important to evaluate the prospects for the company and if there is an opportunity for the charity to sell or redeem the stock for cash in the foreseeable future. For example, is a sale of the company being planned?

E. Corporation's Activities. In evaluating this type of gift, a complete description of the corporation's activities is necessary. A charity should not accept a gift of closely held stock if it could generate negative or unwanted publicity for the charity either due to the corporation's activities or the identity of the other shareholders.

F. Minority Shareholder Status. It is likely that the charity will be a minority shareholder. As a result, it would be useful to identify the other shareholders and their ownership interests to try to ascertain whether the charity will be treated fairly by the controlling shareholder(s).

G. Shareholder Agreements. A copy of all shareholder agreements in effect (including buy-sell agreements) should be obtained and reviewed to determine if there are any issues, such as restrictions on stock transfer, rights of other shareholders to acquire the stock being contributed, or required capital contributions by shareholders, that require further analysis by the charity planned giving personnel or legal counsel.

H. Financial Information and Tax Returns. Copies of the corporation's balance sheet and tax returns for the last few years should be reviewed to identify potential liabilities.

I. Gift of Subchapter S Corporation Stock. There is an additional issue to consider if the corporation is an "S corporation" - unrelated business taxable income ("UBTI").

1. All income from an S corporation is UBTI.

2. The donor's adjusted tax basis in the stock and its estimated value must be determined so that the amount of taxable gain to the charity can be planned for.

3. If the charity will hold the stock prior to sale, UBTI from the S corporation's operations must be evaluated. The UBTI that will be generated from the sale of the S corporation stock must also be evaluated.

4. The charity should try to secure an agreement from the S corporation to distribute sufficient cash to the charity to allow it to pay its income tax liability (including estimated tax payments) as a result of the UBTI that will be generated by the S corporation's operations.

5. Valuation of the stock for gift acknowledgment purposes should be adjusted to reflect the tax and other liabilities arising from the stock's acquisition and sale.

IV. Interests in Partnerships and Limited Liability Companies.

A. In General. Similar criteria to that described above with respect to gifts of closely held stock applies.

B. Basic Considerations.

1. An LLC is treated as a partnership for federal income tax purposes. As a result, the analysis is the same for both types of entities.

2. The principal factor to be evaluated in determining whether to accept a gift of an interest in a partnership or LLC is whether the charity will incur any liability as a result of acquiring and holding this asset.

3. The partnership agreement (in the case of a partnership) and the operating agreement (in the case of an LLC) must be reviewed (either by someone with the charity who is familiar with these types of documents or by counsel) to determine if contribution or capital call provisions may require the charity to contribute funds to the partnership or LLC.

4. Copies of the partnership or LLC tax returns (IRS Form 1065) for the last two or three years should be obtained. Among other things, the returns can indicate whether the partnership or LLC has debt (discussed below under “unrelated business taxable income”).

5. It is also necessary to confirm that the entity is either a limited partnership or LLC and, if the former, that the interest to be received by the charity is a limited partner interest. A charity should avoid accept gifts of general partner interests.

6. As a general rule, the charity should not accept gifts of partnership or LLC interests that are valued at less than a predetermined amount, e.g. \$100,000.

C. Unrelated Business Taxable Income.

1. UBTI is income from a trade or business that is regularly carried on that is unrelated to the charity’s tax-exempt purposes (other than its need for funds).

2. A partnership and an LLC are conduits, *i.e.* their activities (and their income) is attributed to their partners/members. As a result, a partnership and an LLC can generate UBTI. The income generated by the partnership or LLC retains its character when received by the charity.

3. It will be necessary to determine if the activities carried on by a partnership and an LLC is an unrelated business and will generate UBTI.

a) Example 1. An LLC owns and operates a hardware store and generates income. A charity receives a gift of a 10% interest in the LLC. The charity’s tax-exempt purpose is to assist homeless persons. The business carried on by the LLC is regularly carried on and is unrelated to the charity’s tax-exempt purpose. As a result, any income allocable to the charity is UBTI.

b) Example 2. A partnership invests in securities. All of its income is interest, dividends, and gains from the sale of the securities that it owns. A charity receives a gift of a 10% interest in the partnership. Because the income generated by the partnership retains its character when distributed to the charity, it is not UBTI because interest, dividends, and capital gains are excluded from the definition of UBTI.

4. Debt can also generate UBTI. It is referred to as unrelated debt financed income (“UDFI”).

a) If a charity incurs debt to acquire an interest in a partnership or LLC, the income generated may be UBTI.

b) More commonly, the partnership or LLC incurs debt to acquire assets.

c) UDFI can result if a charity sells an interest in a partnership or LLC at a gain if the partnership or LLC owns property that is subject to debt.

V. Real Property.

A. **Case by Case Analysis.** As is true with respect to the received of stock of a closely held corporation and an interest in a partnership or LLC, each proposed gift of real property must be analyzed separately. Not every gift should be accepted.

B. **Information to be Gathered.** The following information concerning the real estate that is the subject of the proposed gift should be obtained.

1. A copy of the deed conveying the property to the donor.
2. A copy of the current property tax bill.
3. A preliminary title report (from a title insurance company).
4. A copy of each promissory note, mortgage, deed of trust, or other lien/encumbrance affecting the property.
5. A copy of each lease or other contract affecting the property.
6. If the property is income producing, a copy of a profit and loss statement for the last two or three years.
7. A summary of the current insurance coverage for the property.
8. Copies of correspondence with governmental authorities, tenants or prospective purchasers concerning the property.
9. A market analysis of the property to ascertain the property’s value and salability.

C. Fair Market Value Determination. Based upon the information listed above, it should be determined if the value of the property is sufficient to merit further consideration.

D. Physical Inspection. A representative from the charity should conduct a physical inspection of the property.

1. Based upon this physical inspection, if a preliminary determination is made to proceed, an inspection by a professional/certified inspector should be undertaken and a written summary of his/her inspection should be prepared.

2. Depending upon the inspector's report, additional (more detailed) inspections may need to be conducted to ensure that all issues have been addressed/resolved prior to acceptance of the gift.

E. Environmental Review. Based on a physical inspection of the property, a determination as to whether further evaluation of environmental hazards is required.

1. A physical inspection can provide a lot of practical information, such as whether there is likely to be environmental issues.

2. Consideration should be given to the formation of a single member LLC to accept property gifts. See IRS Notice 2012-52 requirements.

F. Donor Representations/Warranties. The donor should provide the charity with certain representations/warranties regarding the property. The representations/warranties should be in writing and signed by the donor.

1. The donor's operation of the property has always complied with all applicable environmental laws, regulations, and court or administrative orders.

2. The donor has no knowledge (except as otherwise disclosed in writing by the donor) of any pending or threatened administrative actions relating to the property, including any actions that may reflect environmental hazards on the property.

3. The donor has no knowledge or suspicion (except as otherwise disclosed in writing by the donor) of any area of the property where hazardous or toxic substances have been released, disposed of, discovered, or exist.

4. The donor agrees to indemnify and defend the charity and hold it harmless from all costs, expenses, and liability arising out of, or in connection with, any claim of environmental impairment of the property, which may have occurred during the period of time in which the donor owned the property up until its contribution to the charity.

G. Title Insurance. Strong consideration should be given to the purchase of a policy of title insurance to guaranty that the charity is receiving marketable title with no encumbrances or exceptions.

H. Consultation With Counsel. If any issues or questions arise, counsel should be consulted.

I. Gifts of Time-Share Units. Some charities will accept gifts of time-share units or similar partial ownership arrangements. These gifts can be risky due to the likelihood of ongoing costs.

J. Remainder in Residence or Farm. A donor can claim a current deduction for contributing a remainder interest in a residence or farm to charity.

1. Structured as a gift of the entire property with the donor retaining a life estate.

2. The retained interest can extend beyond no more than two (2) lives.

3. The gift should be documented with a deed and a co-ownership/co-tenancy agreement that allocates responsibility for expenses of taxes, insurance, maintenance, and other expenses associated with the property.

4. Although the charity should not accept responsibility for contributions for capital improvements such as plumbing or roof repairs, it should retain the right to perform such maintenance/improvements or make required repairs if the charity determines, in its sole discretion, that it is necessary to protect its economic interest in the property.

5. The charity should also be permitted to physically inspect the property (both inside and outside) at least annually and from time to time in the charity's discretion upon reasonable notice to the donor to ensure that the property is not being allowed to deteriorate.

K. Pre-Arranged Sale/Assignment of Income. Important to confirm that the donor hasn't entered into a binding obligation to sell the property prior to conveying title to the charity. This could result in the donor being deemed to have sold the property (and recognized any gain inherent in the property) and then contributed the proceeds of the sale to the charity.