Donor-Advised Funds: Gifts of Complicated Assets

No doubt, you've heard the expression, "Money isn't everything." This is especially true when it comes to contributing to a donor advised fund ("DAF").

SOME BACKGROUND FIRST: A DAF is an account established with a qualified charity (known as the DAF's sponsoring organization) that provides the advisor (typically, the donor or other persons designated by the donor) the right to make nonbinding recommendations to the charity with respect to the fund's administration.

The advisor may recommend grants to specific charities, subject to approval by the DAF's sponsoring organization. A DAF's sponsoring organization is classified as a public charity for income tax purposes, and contributions to it are eligible for an income tax charitable deduction. Morgan Stanley Global Impact Funding Trust ("MS GIFT") is a public charity that serves as a sponsoring organization for DAFs.

Most gifts to a DAF consist of cash or marketable securities. However, MS GIFT may, in appropriate circumstances, accept gifts of other forms of property, such as real estate, artwork or other collectibles, private company stock, restricted stock, limited liability and limited partnership interests, life insurance and other miscellaneous assets.

A gift by a donor of a "complicated" asset can be an especially effective way for the donor to fulfill his or her charitable goals. Not only can the donor make a sizable gift to charity, but the donor also may do so using an asset that may have formerly been illiquid, may not have produced income for the donor, or may even have required expensive upkeep to maintain.

For purposes of the federal estate and gift tax charitable deductions, most complex assets are valued at their fair market value and are deductible in full rather than being subject to a percentage limitation.

MS GIFT will work with you personally to determine the viability of making a gift of any specific asset, but following are some basic considerations pertaining to a variety of complicated assets and an explanation of what may happen after such assets are donated and then sold.

Gifts of Other Forms of Property

LIFE INSURANCE

Q. What are the tax consequences for a donation of a life insurance policy to a DAF?

A donor who wishes to make **a current charitable gift of a life insurance policy** to a DAF should do so by irrevocably naming the DAF as both the policy's owner and beneficiary. Simply naming the DAF as a beneficiary in a revocable beneficiary designation will not by itself make a donor eligible for an income tax charitable deduction.

A donor may make **a gift of a policy's death benefit** to a DAF simply by naming the DAF as the beneficiary of the policy. The donor may retain the right to change the beneficiary in the future. The donor will not receive an income tax charitable deduction because there is no completed charitable gift. However, the donor's estate should receive an estate tax charitable deduction for the death benefit paid to the DAF and will not need to pay estate taxes on the death benefit.

Q. How is the policy valued?

A. For income tax purposes, a gift of a life insurance policy is equal to the policy's value or the donor's basis in the policy, whichever is less.

The policy's value, however, depends upon the situation involved. The value of a paid-up policy is generally the cost that particular donor would have to pay to replace the policy at the time of the gift. The value of a policy that is not fully paid-up is roughly equal to the policy's cash value (known as the "interpolated terminal reserve"). This value may be obtained from the insurance company.

CLOSELY HELD BUSINESSES

Donations of interests in closely held businesses, such as S corporations, limited partnerships and limited liability companies, typically must be appraised by a qualified appraiser who will determine their fair market value at the time of the donation. The qualified appraisal will take certain factors into account: net worth, prospective earning power, dividend-paying capacity, goodwill, etc.

Any restrictions on transferring a closely held business interest also are considered in the appraisal. As long as the donor has held the interest for at least one year, then the value for charitable deduction purposes is based upon the interest's fair market value as determined by appraisal. MS GIFT typically will sell the interests promptly after the gift is made, and the sales price will be relevant for purposes of determining the gift value. Gifts of business interests held for more than a year are deductible up to 30% of the donor's adjusted gross income ("AGI").

Special rules apply for gifts of pass-through entities that hold ordinary income property.

ARTWORK AND OTHER COLLECTIBLES

Like other assets discussed, personal property, such as artwork, must be appraised by a qualified appraiser who will determine the property's value at the time of its donation. The appraisal can consider a wide variety of factors, including the item's age, condition, rarity, who created it and the demand for similar items in the marketplace.

Artwork and other collectibles contributed to a DAF normally will be liquidated after the gift is made rather than being held and used in furtherance of the DAF's exempt purposes. Because of this, the value of the gift for tax purposes normally is the lesser of the donor's basis in the property or its fair market value, and the donor's deduction is limited to 50% of his or her AGI.

REAL ESTATE

The value of real estate must be established by a qualified appraisal prepared by a qualified appraiser hired by the donor. The appraisal may not precede the gift of the real estate by more than 60 days and must be delivered to the donor by the due date (including extensions) of the tax return for the year of the gift.

Generally, a donor who contributes real estate held for at least one year may take a charitable deduction based on the full fair market value of the property as determined by the appraiser. However, as with other complex assets, real estate will typically be sold promptly by MS GIFT, and the sale price will be relevant for determining the value of the gift. Federal tax law limits an individual's charitable deduction for gifts of long-term capital gain property, such as real estate, to 30% of the donor's AGI.

The unique characteristics of real estate create potential liability for its owners, and MS GIFT will need to evaluate any gift of real estate for specific risks before agreeing to accept it.

After the DAF Sells the Property

- Complicated assets given to a DAF will typically be sold soon after contribution. However, even if those assets are highly appreciated at the time of contribution, the donor will generally avoid any recognition of gain, and will not have to pay any associated taxes, upon their sale by the DAF.
- The donor's DAF account will be credited with the net sale proceeds of the donated property. This amount may be different from the value of the property for tax deduction purposes, both because of the costs involved with the sale and because values may fluctuate between the date of the gift and the date of sale.
- The donor's account will be reduced by any special charges or taxes associated with the property, such as unrelated business income taxes from the gifts of closely held business interests.