SHIFTING THE CONVERSATION FROM CASH TO ASSETS

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Presented by:

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I. Introduction

Most gifts are funded with cash or publicly traded securities. Why? Because these assets are easy to transfer, easy to value, and charities are happy to accept them. The reality, however, is that your most generous donors hold most of their wealth in real estate, tangible personal property, and closely held assets.

This session will cover how to structure gifts that include illiquid assets, such as these. It will also suggest ways you can encourage a donor to talk about these sorts of assets, as well as practical solutions to the typical objections raised by a charity's general counsel and business office to accepting gifts funded with property other than cash or publicly traded securities.

Cash and publicly traded securities are the assets of choice for most charitable giving. When solicited for a gift, donors balance their passion for the cause and how much they can "afford." The donor mindset is to make a gift with the most liquid and easy to transfer resources at their disposal. Charities love cash and marketable securities as well because these assets are easy to transfer, easy to value, and charities are happy to accept them.

As a donor's net worth increases, the amount of their wealth that is illiquid also increases. Illiquid property is not easily converted to cash but can represent the majority of a donor's assets. The table below shows statistics from Edward Wolff at New York University showing the distribution of asset types as net worth increases. Wealth among those of modest means is concentrated in retirement accounts and personal residences. Not only is this property illiquid, the donor can't part with those assets during life. They need retirement savings and a place to live.

At a glance it is obvious that wealth is more concentrated in illiquid assets such as investment real estate and private equity interests as net worth increases. The takeaway from this information is straightforward. When asking for cash or cash equivalents, you are asking small. When asking for assets, you are asking big. Shift the conversation from cash to assets to increase fundraising results.

To put the chart below into perspective, a net worth of $169,551 in 2017 (the most recent year for which we have data) represents 60% of the total 126 million U.S. households. A net worth of $10,374,030 or more in 2017 put a household in the top 1% of household net worth. The top 1% is roughly the wealthiest 1,259,817 households in America. To reach the 1% in terms of annual income in 2017, an American household would have to earn $434,455. The data support the reality that the majority of wealth (and charitable gifts) come from a tiny minority of households.

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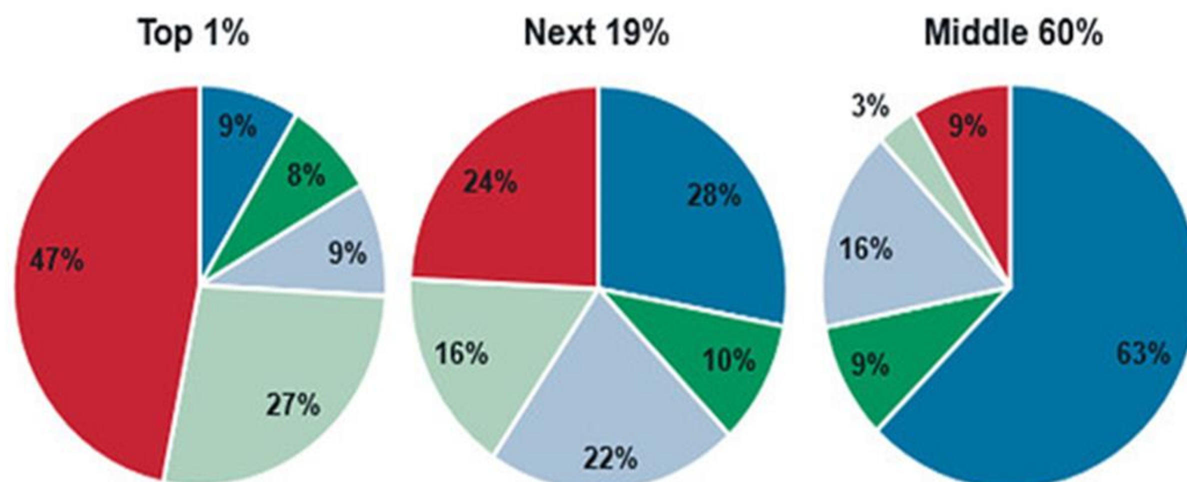

II. Correlation of Asset Gifts to Overall Giving

Dr. Russell James, Professor of Personal Finance at Texas Tech University has conducted research on the impact of non-cash gifts on a charity's overall fundraising performance. **Cash is not king for fundraising: Gifts of noncash assets predict contributions growth** (working paper - posted 2/20/18, Russell N. James III, Professor & Director of Graduate Studies in Charitable Financial Planning Department of Personal Financial Planning, Texas Tech University, Lubbock, TX).

He concluded that non-cash gifts predict long-term fundraising growth. His research shows that, nonprofits raising over $1 million in 2010 that reported only cash gifts on e-filed nonprofit tax returns in 2010 and 2015 experienced an average increase in gifts over the 5-year period of 11%. Charities reporting any noncash gifts for that same period increased total giving of 50%. Therefore, charities consistently receiving gifts of stocks or bonds grew their contributions six times faster than those receiving only cash.

What accounts for this effect? Dr. James concludes that there are subjective and objective variables may make those making gifts of assets to make larger gifts. Academic research proves that the strongest predictor of charitable giving is not the objective adequacy of one's wealth, but rather one's subjective feelings about the adequacy of the wealth. "Shifting the Conversation" to assets influences these subjective perceptions that are most influential in getting a gift and increasing the size of a donor's gift.

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Subjective Variables

1. **A sudden windfall**
   If you are experienced in planned or major gift fundraising, you likely have worked with a donor that came into money they weren't expecting. For example, a bequest from a wealthy parent that is larger than anticipated. Sometimes it's a bonus or commission that was unexpected. These sudden unearned dollars aren't considered regular income and may increase receptiveness to a large gift.

2. **Giving things other than money.**
   Cash is fungible. A dollar bill in your wallet is not any different than another dollar bill. Cash or cash equivalents represent the donor's ability to meet their daily obligations and support their lifestyle.

   Assets, even publicly traded securities, are not necessarily fungible. One share of Coca-Cola should be the same as another share of Coke. What if the donor inherited a stock from a parent or what if the donor made a smart decision and bought a stock before the company hit it big? Such an asset evokes an emotional connection to the property donated.

3. **Talking about wealth instead of income**
   Most charitable giving is via cash, checks, credit card, or other electronic means such as electronic recurring gifts. These vehicles generally come from the donor's income and savings. Their perception of their wealth, particularly what they can "afford", is driven in large measure by the amount of money available to them in these most common ways of giving.

   For wealthy donors, only a small portion of their wealth is in the form of cash and cash equivalents. Shifting the discussion to gifts of assets draws the donor's attention to their wealth and away from their disposable income.

Tapping into these subjective considerations turns the discussion to the donor's wealth. For the wealthy, liquid, disposable income is small relative to their total wealth. When a donor considers their wealth, the universe of charitable possibilities increases exponentially.

Objective Variables

Capital Gain Tax Savings

The leading objective reason for making gifts of assets rather than cash is tax savings. A gift of appreciated property completely avoids capital gain tax that would otherwise be due if the property were sold. There is a double tax benefit of an income tax charitable deduction for the fair market value of the property if the donor has held a capital asset for at least a year.

Sale of assets held for investment generates taxable capital gain income. Just like the income tax, the capital gain tax rate is progressive. The higher the donor's income, the higher the tax rate on capital gain. For example, a married couple earning $78,750 or less is not subject to capital gain tax on the sale of capital gain property. As the table above demonstrates, those in the bottom of the income scale are not as likely to own securities, non-residential real estate, or business interests.

A married couple filing jointly with taxable income of $488,850 or more is subject to a capital gain tax rate of 20%. These wealthiest Americans also owe a 3.8% tax on net investment income in addition to

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the capital gain tax. Therefore, the top income earners in the United States pay a combined tax of 23.8% on the sale of capital assets.

What happens if a donor subject to the 23.8% capital gain tax owns a capital asset worth $100,000 for which they paid $20,000? The donor would realize $80,000 of capital gain income. The capital gain tax due would be $19,040 leaving the donor with only $80,960 net proceeds from the sale.
What if the donor instead donates that same asset to charity? The donor is relieved of the $19,040 capital gain tax completely. In addition, if the donor has held the asset for at least one year, the gift generates an income tax charitable deduction of $100,000. Assuming an income tax rate of 37% and no deduction limitations, the deduction saves the donor $37,000 in income tax. The combined tax savings is $56,040. The gift worth $100,000 to the charity only cost the donor $43,960.

Taxation of Private Equity and Hedge Funds
The table above shows that 47% of the wealth of the top 1% is held in business equity and real estate. Much of the business interests refer to private equity investments and hedge funds. Private equity is an alternative investment class and consists of capital that is not listed on a public exchange. Private equity is composed of funds and investors that directly invest in private companies. Hedge funds are alternative investments that earn active return for their investors. Hedge funds may be aggressively managed and make use of derivatives (a security whose value is derived from underlying assets) and leverage (borrowing) with the goal of generating high returns.

Private equity and hedge funds are usually structured as limited partnerships. The main tax advantage of a limited partnership is that it is a flow-through entity, all profits and losses flow directly to the individual limited partners. The distributions from the partnership may be taxed as ordinary income or capital gain, or even a tax-free return of principal. The tax advantage of the partnership is that its income is considered passive income. Instead of making distributions to its investors taxed as ordinary income, these funds pay a “management fee” and then classify that as a non-taxable business expense. The net effect is that private equity and hedge funds generate very little tax to the owner.

So why would private equity and hedge funds make a good gift to charity? While the regulation and taxation of private equity and hedge funds is highly favorable to investors, these assets are illiquid. While there is a growing secondary market for buying and selling private equity and hedge funds, sale of alternative assets is considered a sale of the underlying assets of the funds. Therefore, the distributions could be taxed as ordinary income, or long or short-term capital gain. A gift of these assets to charity avoids or reduces gain taxes and generates an income tax charitable deduction. A gift of an interest in a hedge fund or private equity raises the specter of unrelated business taxable income for the charity (UBTI). Since these investments often raise money through borrowing (the leveraging mentioned above), careful tax planning is required to avoid UBTI income to an otherwise tax-exempt charity.

III. Raising the Subject of Wealth and Assets

Wealth screening services can give some clues as to a prospect’s wealth and capacity to make a gift. Screening information may not present a complete picture of the prospect’s wealth since assets and wealth are not always publicly available

Before even raising the subject of wealth and assets, the development officer will have probably been cultivating the relationship in preparation for a solicitation. If there are twenty steps leading to a gift decision, the discussion of how the gift is funded is probably step eight or nine. The gift is the thing.

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The discussion that follows assumes a prospect has been properly cultivated, the solicitation may have been made, and negotiations of the particulars of the gift have occurred.

Even among those of modest means, how much someone makes, how much they have saved, how much wealth they own is an intensely personal subject. In American society one's wealth is a barometer of one's success, prestige, happiness, and, power. While hesitant to share the specifics of one's wealth, lifestyle is a potential indicator of wealth. Nonetheless, a high wage-earning doctor or lawyer who spends a lot could mean that while there is a high income, they may have low wealth. The membership, slip fees, and maintenance of a yacht at the Naples Yacht Club or the annual ski vacation to Aspen don't come cheap.

Since lifestyle can be misleading, one of the simplest ways to determine those with high incomes from those with high wealth, is a simple question. Ask your prospect, "Do you have an estate tax problem?" A yes to that question means that (in 2019) the prospect has a net worth in excess of $11,400,000 if the prospect is single. That amount is doubled to $22,800,000 for a married couple. Use discretion and timing to decide when or if to ask that question. An answer to the estate tax question can quickly guide the gift officer as to the type and size of the most appropriate gift.

IV. My Donor is Rich. Now What?

Whether through the estate tax question or through other sources, after establishing a prospect has significant assets, how do you get that wealth on the table?

A common response to a solicitation or even a discussion of giving levels is, "I wish I could make such a gift, but I'm not in a position to do so." There are many variations on this "I wish I could do more…" response. It's time to discern the true objection to the gift. The prospect may say they need their income to maintain their lifestyle or that their assets are tied up in their business interests or real estate.

Assuming the donor is committed to making the gift, these objections suggest that the prospect is thinking about wealth as liquid assets and disposable income. It's time to shift the conversation. Phrases like the following can help kick off the asset discussion:

1. "It sounds like you have multiple financial obligations and objectives. Let me tell you about potential charitable solutions that can help you meet multiple objectives?"
2. "You mentioned your need for income. There are gift plans that could potentially increase your income and reduce capital gain taxes. Can I tell you more about those ideas?"
3. "None of us can predict the future and I appreciate your concern about outliving your resources. Let me tell you about ways to make a gift and not part with assets currently."
4. "You can make a gift of just a portion of your business interests/private equity and still maintain control of the majority of your wealth."
5. "There are gifts that can support our mission and supplement your retirement income in addition to your traditional retirement plans."

Overcoming Objections or Stalling

Donors may be sophisticated investors and money managers with excellent professional advisers. Nonetheless, these donors and their advisers may have modest experience with charitable techniques to reduce tax on illiquid and sophisticated assets. In addition, real estate, private equity, hedge funds and

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other business assets are a buy and hold asset. Because of the potential taxation upon disposition of these assets, the donor is going to be hesitant to think of them as a source of charitable gifts.

This is the time to begin to shift the conversation. Here are some ways to respond to some possible objections to a solicitation incorporating the subjective and objective ways that donors think of their wealth.

1. (Objection: "That's a lot of money.") "You have been successful in building your wealth. Your assets and investments are probably complex and difficult to access. Am I correct? Our organization can work with you to tap into your wealth without disrupting your business or lifestyle."

2. (Objection: "We're over committed.") "Many of our supporters feel overwhelmed by multiple personal, financial and, charitable obligations. There are a variety of planning techniques that could help you balance these obligations without feeling overwhelmed. Let me describe what some of our other supporters have done."

3. (Objection: "We rely on the income from our investments to maintain our lifestyle.") "You want to make a gift, but you don't want to make decisions that would put your financial stability at risk? Have I captured your concern? Let me tell you about ways you can enjoy tax savings from a charitable gift and receive income for the rest of your life."

4. (Objection: Concerns about uncertain economy, tariffs and, a possible recession) "There are charitable gift options that can make fixed, guaranteed payments for life. Such a gift would take the uncertainty of the market off your mind."

5. (Stalling tactic: "Let me think about it and I'll get back to you.") "Based on our conversation today, what are your concerns that you want to think about?"

6. (Stalling tactic: "I'll need to talk to my advisor/spouse about this.") "What are some of the questions you have for your advisor/spouse? Perhaps I could provide more information that they would find helpful in making your decision."

V. What to Do When the Donor Says Yes!

You've solicited a prospect for a seven-figure gift. You've overcome their objections, motivated them to take action, and helped them understand the advantages of a gift of assets rather than disposable income.

Is your organization prepared to accept real estate, cryptocurrency, foreign assets, private equity, or hedge funds? The answer, even in sophisticated charities, is most often not a chance. The risk (real or perceived) of these assets and the due diligence and resources required to accept these gifts may outweigh the benefits of even substantial gifts.

Strong, comprehensive gift acceptance policies create a road map of what assets can be accepted with little internal approvals. There are few assets that a charity should, as a matter of policy, refuse to accept under any circumstances (except perhaps timeshares!). The answer to a gift of any asset of value should always be yes, however the answer is more precisely "Yes, but…"

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The qualification on saying yes is that charity must conduct due diligence and risk control strategies before accepting gifts of certain assets. Don't immediately assume that one's own general counsel, development staff, and business office will manage the process of accepting complex assets. In most cases a charity can hire its own advisers and managers to handle acceptance of complex assets. Real estate management firms can handle all of the logistics of accepting, maintaining, and selling real property, obviously for a fee. The charity's financial services provider is likely to have a private client group experienced in disposition of business interests, private equity, and hedge funds. There will be fees to manage these sales, but a significant gift can be well worth the fees to accept the assets.

VI. Donor Advised Funds to Accept Complex Assets

It would be an understatement to say that the relationship of many non-profits with donor advised funds (DAFs) is tense. Charity argues that donations that were made directly to the charitable sector now sit on the sidelines in DAFs. DAF supporters argue that the DAF is a good vehicle for the thoughtful distribution of charitable gifts and can be a critically important resource when a donor has a cash event such as the sale of a business. DAF advocates also tout the ability of the funds to teach inter-generational philanthropy.

Love or hate the DAF, they do offer unique resources when gifts of complex and risky assets are on the table. Large nationally known DAFs and many community foundations will accept gifts of non-publicly traded stock, LLC or LLP interests, private equity, hedge funds, restricted stock, insurance, and real estate to establish a DAF. The costs of converting these assets to cash are deducted from the proceeds on the sale of the donated asset including any unrelated business income (UBI).

DAFs establish minimum gift values for complex assets that are typically much higher than for DAF accounts established with cash and publicly traded securities. For example, the minimum amount to establish a DAF with Vanguard Charitable is $25,000. However, the minimum value to fund a DAF account with closely held companies, hedge funds and other private equity assets at Vanguard Charitable is $750,000.

The DAF invests the proceeds of the sale of complex assets and manages the grant making process. A donor could contribute a valuable and risky interest to a DAF and the donor could immediately make a grant of some or all those assets to one or many charities they choose to support.

The downside to charity of using a DAF to accept complex assets is the potential loss of the relationship and communication with the donor. The DAF will be working exclusively with the donor throughout the process of liquidating the donated asset. The charity has no input on the terms or values of the sale of these assets. Once the DAF account is funded, there is no guarantee that there will be the grant anticipated or any grant at all from the DAF. Charity should continuously steward DAF donors and family to ensure the donors wishes are carried out.

VII. Single-Member LLC to Accept Complex Assets

Another solution to protecting charity when accepting complex assets is to use a single-member limited liability company (LLC). In Notice 2012-52 the IRS ruled that charitable donations made to a charity owned LLC qualify for an income tax charitable deduction as if the gift were made to the parent charity

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An LLC created by a 501(c)(3) charity offers the charity protection from the LLCs legal risks. If properly structured with the non-profit as the only member of the LLC and with the proper tax status, the LLC is disregarded for federal income tax purposes. Since the LLC is a disregarded entity, like the parent charity, the LLC is exempt from the income, capital gain, and other taxes. The LLC does not need to separately apply for tax-exempt status or file a separate Form 990.

The net result is that charity should consider establishing a single member LLC for the purpose of holding and liquidating real estate and other complex assets. The LLC would be treated as a disregarded entity and income and expenses would flow through to charity. The selling point is that liability for property owned by the LLC is limited to the LLC's assets. Charity's deep pockets are not available for legal claims against the LLC.

VIII. Completing Gifts of Complex Assets

A. Cash and securities from non-U.S. persons

Gifts from non-U.S. sources, even in the form of cash and publicly traded securities can raise legal concerns. The currency laws of some countries limit or even prohibit the transfer of assets out of the country without the approval and oversight of governmental regulation. Googling "currency restrictions china" as of the time of writing this paper reveals that the conversion of Chinese RMB (Renminbi) into foreign currencies is restricted to US $50,000 equivalent per person per year. Employ an expert in international banking and finance if there is concern about currency fraud or violation of international banking regulations.

B. Real Estate

Real estate held for investment purposes is rarely held in the name of a natural person. For liability and tax reasons, it is common to hold real estate in a business entity such as a C corporation, an S corporation, a partnership, or even in private equity or hedge funds. These business structures can present complications when making a charitable gift.

Unless the property is going to be used in the charity's mission, the charity wants to convert the property to cash as quickly as possible. There might be co-owners who don't want to sell the property or don't want to buy the interest donated to charity. Management agreements can limit who can sell the real estate, who can buy the property, and when. These considerations could require negotiation and trade-offs. Also, most charities don't want to be partners or shareholders of the donor's business. When accepting real estate, the strategy should be to sell the property

C. Closely Held Business Assets

A closely held business is an entity that is not publicly traded and could be in the form of a C or S corporation, limited liability company (LLC), or limited partnership (LP). As with real estate, the gift acceptancy policy should describe a due diligence process to determine the value of the business, its marketability, and potential liability. Acceptance of a closely held business will require approval of the Gift Acceptance Committee and most likely outside legal counsel.

An ownership interest in a closely held business may be subject to restrictions on its transfer. Such a restriction could mean that the security is not marketable or subject to conditions that make the security

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essentially unmarketable or not readily convertible to cash. The gift acceptance policy should address the charity's willingness to accept restricted assets.

There may be undesirable tax consequences to charities that accept closely held businesses. For example, S corporation stock generates unrelated business taxable income to the charity. These negative tax consequences do not necessarily mean the gift is not viable. If the value of the asset is great enough, many charities will be willing to pay the tax in order to take the gift. Nonetheless, the gift acceptance policy and the Gift Acceptance Committee should assess the potential negative tax consequences of these gifts.

C Corporations

A gift of a closely held C corporation is the easiest of all non-publicly traded securities to transfer and entails the least risk. A critical consideration when holding securities that are not traded on a public exchange is how is the stock going to be converted to cash? A C corporation may be able to buy back the donated stock from the charity quickly and easily. C corporation stock can be used in life income arrangements such as a FLIP CRUT as well as for outright gifts. A charity holding C corporation stock is insulated from liability for actions by the C corporation.

The private foundation rules apply to private foundations and charitable remainder trusts. These rules restrict certain types of transactions that would not be a problem for a public charity. One of the private foundation rules prohibits self-dealing. Self-dealing prevents a "disqualified person" from engaging in almost any business or financial transactions between a private foundation or CRT. For example, C corporation stock given to fund a CRT cannot be sold by the CRT to the donor's children. The children are disqualified persons. The C corporation could redeem the stock from the CRT. Pay careful attention to these rules when discussing potential gifts to a CRT.

S Corporations

Charity might say yes to a donation of S corporation because the S corporation form is more common than all publicly and privately held C corporations and LLCs combined. Therefore, willingness to consider gifts of S corporation stock could tap into one of the single largest sources of wealth in the United States. Since an S corporation is a flow through entity for tax purposes, a gift of S stock will generate an income tax charitable deduction proportional to the percentage interests of all owners of the corporation.

While charities are eligible to own S corporation shares, there are multiple taxes and other barriers that make a gift of S corporation stock unattractive. A charity is subject to unrelated business income tax ("UBIT") on its portion of the S Corporation's accounting income. Also, the gain from the sale of S Corporation stock will be subject to UBIT. When a charity owns S Corporation stock, income generated from dividends, interest, and rents is taxable, and even gain on the sale of the S corporation stock is taxable. A gift of the assets (real estate, equipment) of an S corporation may be a more attractive option.

LLCs, LLPs, and Partnerships

Gifts of interests in limited liability companies, limited liability partnerships, or other partnerships offer great flexibility in achieving donor and charity goals. These business organizations are called pass-through entities because the income, losses, and tax liability flow through to the owners pro-rata according to their ownership interests. Since the income distributed by a pass-through business is considered a passive investment, charity is not subject to UBIT.

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Some flow-through business interests generate positive cash flow, have good appreciation potential, and may be marketable. They can be valuable gifts to the charity. Others are virtually worthless and may saddle the charity with liabilities. In the case of partnerships, determine if charity owners are subject to potential liability such as cash calls. In the case of a limited partnership or LLC, the liability is generally limited to the initial investment. Depending on the assets the entity owns and its cash flow, there could be a limited market to convert the ownership interests to cash.

D. Private Equity and Hedge Funds

A donor may own a private equity interest in a company nearing a liquidity event (sale of the business for example) or a fund currently winding down. This situation is a good time to consider a charitable gift of a portion of those interests to charity. The donor will get an income tax charitable deduction for the fair market value of the interest (supported by a qualified, independent appraisal, and the tax savings allows the donor to make a larger gift.

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 charity or a donor-advised fund. The fund's general partner will probably need to approve a charitable gift of the partnership units.

To minimize risk to the charity or donor-advised fund, the gift should avoid transferring liabilities associated with the funds. 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 a scheduled termination date or liquidity event. Sales of these interests in the secondary marketplace prior to this may be subject to steep discounts.

E. Retirement Plan Assets

Donors may wish to use traditional Individual Retirement Accounts, Roth IRAs, 401(k)s, 403(b)s or other qualified retirement plans to make gifts. These gifts may be made during life, but it may be generally preferable for the donor to donate these assets at death.

Current outright gifts of assets withdrawn from retirement plans are treated as a cash gift deductible at fair market value. The gift policy should encourage the donor to seek tax advice to ensure that the tax implications of such a gift are fully understood by, and acceptable to, the donor.

Since 2013, the charitable IRA rollover (known as a Qualified Charitable Distribution, QCD, to tax professionals) is permanent law. To avoid subjecting gifts intended as IRA rollovers to negative tax consequences, gift policies should require that the donor meet the requirements of the law in making such a gift. The donor must be over 70 ½, the maximum rollover is limited to $100,000, the source of the rollover must be a traditional or Roth IRA, and the transfer of the rollover must come directly to the charity from the IRA administrator. A policy that requires adherence to the law is beneficial to the donor and the charity.

Gift policies should allow the charity to accept retirement plan assets upon the death of the donor in nearly every case. The acceptance of testamentary gifts of qualified plans present few issues of risk or liability so wouldn't routinely require review by the gift acceptance committee. Unfortunately, the administrative and regulatory rules applicable to qualified plans can be cumbersome. That process, however, should be outlined in the charity's procedures, not in a gift acceptance policy.

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Qualified Charitable Distributions
A QCD must be otherwise 100% deductible. Therefore, QCDs can't be used to fund gift annuities, charitable remainder trusts and other split interest or life income gifts. Likewise, donors may not receive quid pro quo benefits. If the donor receives any benefits that would typically reduce his or her charitable deduction, such as football tickets, the IRA distribution will be taxable income to the donor.

QCDs may not be made to private foundations, donor-advised funds and supporting organizations. Many charitable foundations are organized as supporting organizations (defined in IRC section 509(a)(3)) are explicitly excluded from the new tax benefits.

Naming Charity as the Beneficiary of an IRA
The simplicity of adding charity as the death beneficiary of an IRA has made it an increasingly attractive asset with which to make charitable estate gifts. The donor does not have to consult a lawyer to change their will or trust to change their beneficiary designation. The donor can divide up interests in the IRA among charitable beneficiaries and heirs. The IRA beneficiary designation gift is one of the most tax-efficient testamentary gifts available.

F. Cryptocurrency

Cryptocurrency, also known as virtual currencies, like Bitcoin, are an increasing source of discussion in the philanthropic community. What is cryptocurrency? How is it transferred? Does this asset present potential liability issues for charity? What is the mechanism for accepting cryptocurrency?

While Bitcoin is considered the original cryptocurrency, there are many other currencies. These include Litecoin, Ethereum, Ripple, and thousands of others. This list includes 894 virtual currencies in circulation traded on hundreds of virtual exchanges.

There are unresolved legal, tax, and regulatory issues regarding cryptocurrency. Nonetheless, virtual currency offers the opportunity to accept assets of significant value. Gifts from non-U.S. citizens can run afoul of complex currency regulations and expensive exchange fees. Foreign donors may be able to make gifts to U.S. charities more easily and quickly using cryptocurrency.

These virtual currencies work like cash in that they have a value that can be exchanged for goods and services. There is no centralized authority that issues and regulates these currencies in the same way as cash. The distinguishing feature of virtual currency is that it can be exchanged anonymously without comprehensive regulation. The IRS has ruled that virtual currency is to be treated as property and therefore the rules governing tax treatment of gain or loss applicable to noncash gifts. The long and short-term holding period rules applicable to the tax treatment of gifts of other property apply to virtual currency. To take an income tax charitable deduction in excess of $5,000 for a gift of cryptocurrency the donor will need a qualified independent appraisal.

Other than the risk of fluctuation in value, gifts of these currencies don't present a financial liability to charity. (Electronic accounts are subject to the risk of hacking.) Since cryptocurrency is anonymous, it has been associated with illegal activity such as the purchase of illicit drugs. As such, there is a reputational risk to a charity accepting Bitcoin for example. Refer to the earlier discussion of warning signs of potentially risky gifts. A donor with a history of giving and volunteer service with a well-known public reputation is unlikely to attract publicity.

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The mechanics of accepting a gift of virtual currency is deceptively simple for individuals as compared to accounts for organizations. For individuals, to start trading in cryptocurrency the first step is to create a wallet. The wallet can be a paper wallet like a gift card or a hardware wallet that is like an electronic mobile bank account. These wallets are quick and easy for individuals to establish. Unfortunately, the process of establishing a wallet for charity can be time consuming and intrusive. Therefore, don't wait until a prospect is offering a gift of virtual currency to prepare to complete the process to accept such currency. The volatility of the currency and pressure to complete a year end transaction can create a very frustrated donor.

Finally, you will need a processor to accept and process gifts of cryptocurrency. BitPay and Coinbase are the two most popular processors, CoinGate is another vendor to consider. Each of these processors can exchange most of the common forms of cryptocurrency such as Bitcoin and Ethereum. The processor can quickly liquidate the gift into currency, deposit it into the charity account and if necessary, handle conversion into U.S. dollars. Fees for these accounts are typically lower than credit card processing fees.

IX. Planned Gift Vehicles Appropriate for Complex Assets

The tax savings from gifts of highly valuable assets discussed above generally favor outright gifts of these assets. Traditional planned gifts that generate income such as gift annuities, charitable remainder trusts, and pooled funds may not be appropriate to fund with illiquid assets. Plus, high net worth donors want to reduce their income to reduce taxes.

It is generally disfavored to fund a non-grantor charitable lead trust with highly appreciated illiquid assets. Intuitively it might seem that a lead trust that passes significant wealth to the donor's heirs at reduced transfer tax cost would be the perfect choice for these illiquid, complex assets. There is a nuance to the lead trust that makes such a trust not an ideal choice. The lead trust is a fully taxable trust. If a non-grantor lead trust liquidates a highly appreciated asset, the trust pays capital gain tax, depleting the principal left for heirs. The donor to a grantor lead trust pays the capital gain tax when the trust sells an appreciated asset, reducing the tax efficiency of such a solution.

Charitable Remainder Unitrust with a Flip Provision

The vehicle of choice with any illiquid asset is the charitable remainder unitrust with a flip provision. Once again, the flip unitrust is appropriate for those seeking an income tax charitable deduction, capital gain tax reduction and a stream of income.

Upon funding, the flip unitrust pays the lesser of its net income or the unitrust amount. If the asset funding the flip unitrust does not produce income, then the beneficiaries receive no income. If the funding asset produces income, the trust will pay its income (net of any trust expenses). The trust "flips" or converts to a regular unitrust after the occurrence of a trigger event described in the trust agreement. Allowable triggering events are 1) a specific date, 2) the sale of specific unmarketable securities, or 3) the occurrence of an event outside the control of the trustee and anyone else, including the birth, death, marriage, or divorce of a specific person.

A flip unitrust funded with an illiquid asset typically converts to a straight unitrust payment upon the sale of the illiquid asset. The trust "flips" or converts to a straight payout unitrust in the year following the year of the flip triggering event.

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The advantages of the flip unitrust are such that it is appropriate for gifts of real estate, closely held business interests, private equity, and hedge fund units.

Retained Life Estate

A retained life estate is a gift plan that allows the donor to deed a personal residence or farm to charity. The donor retains the right to occupy and otherwise use the property for life or a term of years. Upon the death of the donor (known as the life tenant) or expiration of the term of years, the charity owns the entire property and can sell it to convert the property to cash.

We know that personal residences make up a small portion of the wealth of the top 1%. Why would a donor consider making such a gift? It is common for high net worth donors to own multiple residences. While they may compose a small part of the donor's wealth, any one of these residencies could easily be worth millions of dollars. The life tenant (the donor) continues to live in and maintain the property. At the end of the life tenancy charity can realize a significant gift.

A "personal residence" eligible for a retained life estate gift includes any property used by the donor as his or her home and is not limited to the donor's principal residence. The donor with the New York condo, the house in Palm Beach, and the ski lodge in Aspen could use any one of these properties to make a gift of a retained life estate.

Why would a wealthy donor make such a gift? The retained life estate (particularly in a low discount rate environment) can generate a significant income tax charitable deduction. For example, assuming a couple, ages 78 and 75, and a 2.8% discount rate, 60% of their retained life estate gift is deductible. If the donor is anticipating a cash event, needs a large deduction and owns a multi-million-dollar property, the retained life estate could be the perfect gift.

Bargain Sale

A bargain sale appeals to a donor who would like to make a gift to charity but would like to minimize the tax consequences of a sale of appreciated property and realize some cash on the sale. Real estate is the most common asset for the bargain sale but some of the other complex assets discussed earlier could be used in a bargain sale.

The donor sells the asset to the charity at a "bargain" price, i.e., something less than the asset's appraised fair market value. The gift documentation should substantiate the fact that the price paid by the charity is intentionally less than fair market value because the donor is intending to make a charitable gift of the difference.

Whatever the price paid by the charity, the donor receives a charitable deduction for the difference between the sales price and the appraised fair market value of the property. The cost basis of the property is prorated between the sale and the gift in proportion to the price paid. This means that the donor will recognize some, but not all, of the capital gain.

The bargain sale can be a powerful tool to generate a tax-free solution for a highly appreciated asset.

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Consider a zero tax-free solution:
The donor owns real estate worth $5,000,000 for which he paid $750,000. Sale of the property would generate $4,250,000 in capital gain income if sold. The donor would owe over $1 million in capital gain taxes leaving them with a net of $4 million.

What if the donor sold the property to charity for $3,232,570? Assume the donor's Federal marginal income tax rate is 40.8%, the tax rate on the income tax savings is 37%, and the capital gains tax rate is 23.8%. This example does not account for state and local taxes that may also be triggered.

The income tax charitable deduction would be $1,767,430. Assuming a 37% tax rate for the tax savings, the donor would save $653,949 in income taxes. Assuming a capital gain tax rate of 23.8%, the capital gain tax due on the $2,747,685 would also be $653,949. Therefore, the net tax due on a payment of over $3.2 million would be zero.

A Bargain Sale in Installments
Sometimes, a donor will want the charity to make the payments over the course of several years. With an installment bargain sale, the tax deduction is available in the year of the gift, but the capital gain is spread over the number of years in which the payments are made. Also, if the parties agree, the total amount paid can fluctuate from year to year. A portion of each year's payment will be taxed as capital gain and a portion as ordinary income (due to interest determined in light of I.R.C. § 483), with a third component being tax-free return of capital. The precise amount of each component will vary from year to year depending on the amortization, and payments received by the donor will cease with the last installment (or perhaps sooner, if the donor dies before the last installment is made and has either provided for someone else to receive the remaining payments or has arranged to have them payable to his or her estate, with a third option of having the donor's will provide that any amount still owing by the charity upon death is forgiven).

X. Conclusion

Shifting the gift conversation from cash and disposable income to assets puts all of the donor's wealth on the table. The higher a donor's net worth, the more of his or her wealth is tied up in business interests and real estate, not cash, cash equivalents or publicly traded securities. Consider the objective and subjective variables in raising the subject of making a gift of illiquid and more complex assets instead of cash. Overcoming objections, demonstrating flexibility in working with assets, and a basic fluency in the language of the types of property owned by the wealthy can raise more gifts for your charity.

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