Five Essential Tips for Donating Your Business Interest Before You Exit

For business owners, retiring and selling a business can be an overwhelming and daunting process. The company may have multiplied in value, and the complexities related to selling business interests can be difficult to navigate. Add to the mix that this is a significant wealth-triggering event—holistic wealth management and legacy planning conversations must be undertaken at the same time. The donation of privately held business interests can be an effective way to achieve tax savings and charitable giving and the legacy-planning goals of the business owner; therefore, charitable planning must be factored into the entire process.

For many founders, the original cost to start the business may have been low or even zero. Upon the sale of this interest, large capital gains taxes may be triggered for the owner. A donation of some of the ownership interest provides a charitable tax deduction for the fair market value of the donated interest and minimizes capital gains exposure for the portion donated to and sold by the charity rather than the business owner.

Since its inception, Fidelity Charitable® has converted $13.2 billion in non-publicly traded assets into dollars for charity.[1] Leveraging this experience, we have compiled five important tips to consider when contemplating contributions of privately held business interests.

What's Inside

[1] *Source: 2024 Giving Report, Fidelity Charitable.*

1. Prepare to Donate Early

Timing is essential. When donating privately held, non-publicly traded assets to charity, planning conversations must start early—with clients, all advisors, and potential charitable recipients. Business exit opportunities can come together very quickly and, therefore, charitable planning conversations may need to be fast-tracked. By working with experts, the legal transfer of business interests to charity can occur without delaying the sale process and all the while maximizing the tax efficiency and philanthropic impact of the transfer.

The Complex Assets Group at Fidelity Charitable® had an opportunity to share this guidance when an advisor inquired about the possibility of donating privately held shares in an advertising agency. The agency and its owner had already entered into a legally binding agreement to sell the business. Consequently, it was too late for the owner to donate the shares in the most tax-efficient manner. Since the owner had already agreed to sell the company, the owner was no longer able to minimize the capital gains tax exposure.

A month later, the advisor contacted Fidelity Charitable again. As the M&A market demonstrates, sale transactions can fall apart for various reasons. The advisor noted that the agreement to sell the advertising agency had fallen through because the buyer failed to get financing to purchase the company. The agency was now back on the market, and the client wanted to revisit the possibility of making a charitable contribution of some of the shares of his business. Working with Fidelity Charitable, the donor was able to legally transfer the shares while the agency was being marketed for sale. Ultimately, the agency, with Fidelity Charitable as a minority shareholder, was sold, and the proceeds funded the exiting business owner's donor-advised fund (DAF) at Fidelity Charitable. Through the DAF, the donor has been able to provide ongoing support to his favorite charities.

2. Ensure Company Documentation Is in Order Ahead of Time

Company governing documents (e.g., shareholders' agreements, membership agreements, limited partnership agreements) should be reviewed to see whether shareholders, members, or partners and the transferees (i.e., the recipient charity) are subject to transfer restrictions. If transfer restrictions exist, the donor will need to investigate what amendments, approvals, or waivers are required to complete the charitable donation of the target interest. Companies commonly require approval from all or a majority of shareholders, members and/or board or managing members, and general partners to allow for a transfer, including a charitable transfer, of ownership interests. Additionally, there may be rights of first refusal in favor of the company or other owners that may need to be waived before the shares can be donated to charity. Still, these restrictions are rarely burdensome enough to be a significant deterrent. Due to the donor's philanthropic intent, these barriers to transfer are typically handled with a simple waiver or consent by the other interest holders. Often, the entity's management is delighted to facilitate the donation so long as the charitable recipient can comply with the governance structure. Many times, other interest holders become interested in donating some of their interest to charity as well, once they learn of the charitable giving strategy.

As an illustration, a consulting company in New York was in the early stages of vetting private equity opportunities with third-party investors. The co-founder was a longtime Fidelity Charitable donor and was familiar with the Complex Assets Group through a previous donation of privately held shares. The governing documents of the company required both board approval and a waiver of a right of first refusal in favor of the company before the shares could be donated. In the process of obtaining approvals from the board and the company, the donor educated his fellow co-founders, management team, and board of directors on his charitable giving strategy. After an introduction from our donor, Fidelity Charitable was able to work with company counsel to obtain all necessary approvals within 24 hours. One prospective contribution turned into five as the four other shareholders established donor-advised funds. Eventually, a sale agreement was reached with a private equity firm, which purchased all the donated shares from Fidelity Charitable. This strategic donation prior to a sale event empowered this group of donors to give 20% to 25% more to their favorite charities. In one instance, that savings efficiency allowed a donor to support not just seed money for an Alzheimer's research project at her alma mater but also a scholarship endowment named in memory of her deceased father, who suffered from the disease.

3. Don't Ignore the Appraisal Requirement, and Don't Procrastinate

While much is made of timing a gift appropriately, it doesn't matter much without a qualified appraisal of the donated asset to substantiate the donor's charitable tax deduction. Generally, for contributions of non-publicly traded securities, donors must obtain a qualified appraisal (an independent, third-party valuation) from a qualified appraiser to support the amount of the charitable tax deduction that the donor is claiming on his or her tax return. Appraisals can be obtained no earlier than 60 days before the date of the donation and no later than the date that the donor's annual tax return (with extensions) is due for the year that the charitable gift is given.

Therefore, while the appraisal does not need to be completed prior to the donation, the donor and his or her advisors should engage with a valuation firm early on in the planning process to confirm both the qualifications and the availability of the appraiser, as well as to set expectations for the overall process. Engaging early allows the appraiser to learn about the company as soon as possible and to share early opinions on estimated value, including potential discounts for lack of marketability and minority interests, as well as price and workload of the appraisal. Taking the first step with the valuation firm before the sale also keeps donors and advisors from scrambling at tax time to reconstruct the history of a company, which is likely in the hands of a new owner.

4. Choose Your Charitable Giving Strategy Carefully

Donors have choices to consider when deciding what type of charitable vehicle to use, including giving directly to an operating charity, a private foundation, or a public charity sponsoring a donor-advised fund (DAF) program. However, many donors and their advisors are unaware of the differences among these options when considering a donation of privately held business interests.

Donating directly to an operating charity

Contributions directly to an operating charity are generally deductible at fair market value (as determined by a qualified appraisal), up to 30% of the business owner's adjusted gross income (AGI). Yet it is important to note that because many charitable organizations are primarily mission- and program-focused, they may not be well-equipped to handle the contribution of non-cash assets quickly and efficiently and may require both board education on the matter and approval prior to the acceptance of the assets. Furthermore, the cost to the charity to outsource the compliance and liquidation work can be considerable.

Donating to a private foundation

Private foundations generally have the expertise to accept business interests. However, the tax benefits are likely lower than those associated with donating directly to a public charity. A contribution to a private foundation is generally deductible to a maximum of 20% of the business owner's AGI at the lower of the original cost basis or fair market value. Also, when giving to a private foundation, it is important to note that the donor cannot give anonymously—something that is important to many donors.

Donating to a public charity with a DAF program

Donating to a charity with a DAF program can be an optimal method for donating business interests when measured by cost, flexibility, simplicity, expertise, and tax benefits to the donor. Similar to an operating charity, contributions of most complex assets to a DAF sponsor, including privately held including privately held business interests, are generally deductible up to 30% of the business owner's AGI at the fair market value (as determined by an independent qualified appraisal). In addition, donating to a DAF sponsor gives you the potential to grow your gift tax-free, thereby maximizing the net proceeds ultimately made available for grants. DAF providers like Fidelity Charitable often have in-house expertise to facilitate the donation of business interests, making this transaction an easy process for the donor. It can also often be more financially and administratively advantageous for the receiving charities. Lastly, a DAF allows you to recommend grants anonymously to many qualified charities over time.

The chart below summarizes aspects of the charitable contribution process and the impact that should be considered when donating these types of non-publicly traded assets to charity.

	Operating Charity	Private Foundation	Donor-Advised Fund (DAF)*
Tax deduction	Fair market value	Cost basis	Fair market value
Expertise handling complex assets	May need to outsource and could reduce net amount	Generally outsource	Internal expertise (some may outsource)
Income tax deduction**	30%	20%	30%
Ability to diversify giving with one asset	100% of asset to one charity	Multiple grants to many charities with one asset	Multiple grants to many charities with one asset
Confidentiality	May generate additional fundraising	Annual tax filings of IRS Form 990-PF is a public record of assets, contributors, and grants	Option to give anonymously
Efficiency	Multiple charities require multiple contacts	One point of contact for transaction	One point of contact for transaction

**A qualified 501(c)(3) charitable organization that administers a donor-advised fund program.*

***Percentage of adjusted gross income (AGI) that a donor may be eligible to receive.*

5. Utilize Experts to Help You Navigate the Process

It is important to leverage the expertise of those familiar with the donation of business interests in order to successfully and efficiently make charitable donations during a business exit.

External advisors

If you have a relationship with an advisor, such as a trusted attorney, accountant, or financial advisor, enlist their support as you move through this process. These advisors have a holistic view of your financial situation and likely understand your future goals. They can help you consider the portfolio implications surrounding the donation of some of your business shares and can help you explore what the tax consequences of the charitable gift might be.

Expertise at the charity

In addition to bringing in trusted advisors to provide the bulk of the planning strategy, a business owner should leverage resources at the recipient charity to fuel his or her philanthropic goals. Until recently, non-publicly traded assets were a largely untapped source of philanthropic funding. Often, donors and their advisors were not aware of this charitable giving option or considered the strategy too complex. To compound the issue, generally, public charities continue to ask donors to donate cash or publicly traded stock, instead of non-publicly traded assets.

Fidelity Charitable has the requisite expertise and dedicated professional resources specifically devoted to converting non-publicly traded assets into charitable dollars, and it has seen substantial growth in these types of contributions in recent years. The Complex Assets Group at Fidelity Charitable is a complimentary team of in-house subject matter experts who work with donors and their advisors quickly and directly to maximize the giving power of these assets. Due to the group's experience and comfort with these types of charitable contributions and subsequent liquidation of the donated assets, acceptance decisions can be made as soon as the necessary information is received; therefore, a business owner can be strategically philanthropic without hindering any larger transaction within the company.

About the Author

Arthur Maginas is director of the Complex Assets Group at Fidelity Charitable, an independent public charity that has helped donors support 382,000 nonprofit organizations with nearly $73 billion in grants.[2] The mission of Fidelity Charitable is to grow the American tradition of philanthropy by providing programs that make charitable giving accessible, simple, and effective. Mr. Maginas assumed his current role in 2018.

In this role, Mr. Maginas works with donors to contribute non-publicly traded assets, such as limited partnership and limited liability corporation interests, private business interests, and restricted stock. Mr. Maginas works closely with donors and their advisors to provide technical expertise and advisory resources before, during, and after the gifting process to ensure that donors achieve more favorable tax treatment while having the greatest charitable impact. He is admitted to practice law in Massachusetts.

Prior to his current role, Mr. Maginas worked in Fidelity Institutional Risk and Compliance as a compliance advisor in the Regulatory Management group. Before that, he held numerous roles supporting multiple Fidelity Charitable service delivery teams, most recently serving as senior complex asset advisor supporting the Complex Assets Group.

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