Philanthropic strategies with concentrated portfolios

Giving stock through community foundations

When an executive at a publicly held company *decided she wanted to make a charitable contribution to her local community foundation, Chris Nicholson saw a great estate planning opportunity. Nicholson, the vice president of development at the East Bay Community Foundation in Oakland, California, recommended that the executive donate a portion of the employer stock she held.*

"Most of the executive's net worth was tied up in that company's stock," says Nicholson. "We helped her realize her philanthropic goals by donating a portion of that position." The gift allowed the donor to set up a planned giving strategy while reducing the investment risk to her portfolio.

Helping a client realize a charitable goal while also diversifying a concentrated position provides many benefits for both the charity and the donor.

Across the country, many advisors regularly deal with similar clients: those whose wealth is concentrated largely in one stock or the stocks of a few companies. Holding concentrated stock, of course, is perilous during periods of heightened volatility or a market downturn.

"Declines can be steep and fast," says Gregory V. Aloia, an attorney and wealth advisor with Abacus Wealth Partners, LLC, Philadelphia. "Even before the recent bursting of the tech-stock bubble, we've seen highly regarded stocks go from \$140 to under \$20 in a year." Even wealthy clients may face financial distress if this happens to a key holding.

Philanthropy can provide a solution. Donating shares from a concentrated portfolio can allow donors to fulfill charitable commitments without having to tap cash reserves. Donors can also reduce market risk, defer capital gains tax, and diversify their holdings. As long as those assets have been held more than a year, donors enjoy a tax deduction on the full value of the donated asset and steer clear of capital gains taxes.

Planned giving

While many clients' goals may be attained by outright donations of concentrated stock, some clients may prefer to use a charitable remainder trust (CRT) to immediately reduce the risks of a concentrated portfolio while providing income from a diversified portfolio.

The strategy is slightly more complex. After the shares held in a concentrated position are donated to a CRT, they may be sold with no tax obligation. Then the full proceeds can be invested in a diversified portfolio and designed to pay income to the donor and perhaps a surviving spouse.

CRTs come in a variety of flavors. “Older clients may prefer the simplicity and predictability of an annuity trust, which will pay out a fixed amount each year,” says Laura Peebles, a director in the Washington, D.C., office of Deloitte & Touche LLC. “Younger donors might choose a unitrust, which pays a fixed percentage of trust assets and possibly can provide increasing income over the years.”

For people who are not yet ready to retire, a NIMCRUT, or net income with makeup charitable remainder unitrust, might be used. A NIMCRUT can be designed to pay out little now but more later, perhaps after the donor retires.

Peebles says that a concentrated portfolio also may be used to fund a charitable gift annuity. Again, the donor can receive an immediate tax deduction, lock in a lifelong income, and avoid the risks of holding a portfolio composed of a single stock or just a few stocks. “Especially for relatively small donations, clients might like a gift annuity’s lack of complexity,” says Peebles. “The main drawback to a gift annuity is that the annuitant is a general creditor of the charity. That risk can be alleviated by contributing to an established community foundation that is financially sound.”

Timing and appraisal

For planned giving strategies as well as outright contributions, an independent appraisal may be necessary. “Donations of shares in a thinly traded public company or shares donated by an insider of a widely traded corporation may require an appraisal,” says Peebles. An appraisal also will be required if the concentrated position consists of shares of a closely held company.

When it comes to concentrated positions of closely held shares, Peebles says that charitable donations often occur when the company is sold. She recalls a situation in which the seller wanted to donate a substantial portion of his shares to a charitable remainder trust. As part of the transaction, the buyer would purchase the shares from the trust, which would then provide income to the seller.

Peebles told the client that this transaction likely would be permissible because no binding contract was in place. “If the agreement had been enforceable, there probably would be adverse tax consequences for the seller.” This is an issue an advisor should evaluate when a large block of stock in a closely held corporation is donated to a charitable remainder trust.

Such financial considerations are important, according to Abacus Wealth Partners’ Aloia, but they are not the only concerns. “An advisor’s primary focus should be on a process that also helps a client establish an emotional connection to giving,” he says. “Such an approach can remove any personal obstacles that might arise while providing a result that is ultimately more rewarding and meaningful to the client.”

There is so much more we'd like you to know. Your local community foundation can help you help your clients achieve their charitable giving goals. To locate the community foundation near you, visit www.communityfoundationsnc.org.

community foundations
SERVING NORTH CAROLINA