

1031 Exchange: Donating Real Estate into a Donor Advised Fund



Real estate investors have been using 1031 exchanges for decades. A 1031 exchange is a transaction in which you can sell your investment property and defer all of the tax that would otherwise be due on the sale, including the capital gains tax, depreciation recapture tax, and state income tax by reinvesting those proceeds into a new property. Because the exchange into replacement property needs to be of equal or greater value than the relinquished property, it can typically increase investors' purchasing power for their next investment. However, the more this process is done, the more it becomes a runaway train that is hard to exit due to the accumulation of deferred taxes with each exchange.



Many people enjoy supporting the charitable causes that are important to them. However, they often do it with direct cash payments on an after-tax basis. A better, tax-efficient alternative for many may be to leverage the value of an illiquid asset like real estate to support a good cause.

The owner of the 1031 real estate should consider the following questions:

- Are the 1031 properties held in a business entity such as a Limited Liability Company or Limited Partnership?
- Have they been enjoying the benefits of 1031 exchanges, but now want to move on to other investment opportunities?
- Would a large capital gains tax be due if they sold this property?

If the answer is “yes” to any combination of these questions, the entity holding these 1031 properties may be a good candidate for gifting.

Donating 1031 Real Estate Through A Donor Advised Fund

A donor advised fund (DAF) is a charitable giving vehicle that is established by a sponsoring public charity, which make grants to other charitable organizations based upon recommendations from the donor. By donating appreciated real estate to a donor advised fund, the owner can earn generous tax benefits, support their favorite causes, and free up time for other pursuits.

American Endowment Foundation (AEF) is a public charity that enables donors to create a donor advised fund. AEF administers the fund on behalf of the donor and the donor can then recommend grants to qualified nonprofit organizations on their own schedule. The donor's financial advisor can remain involved in managing the investment dollars that reside in the DAF account.

How It Works

Any gift of real estate is subject to the review and approval of the AEF Gifting Committee and requires a minimum appraised value of \$1,000,000. AEF strongly prefers that any gift involving real estate is an interest in an entity that directly or indirectly owns the real estate (e.g., stock in a corporation or interests in a partnership, trust, limited liability company or other entity) rather than the property itself.

At AEF, after a donor establishes a donor advised fund with AEF, the donor irrevocably transfers title of no more than 90% of the entity to the fund. The donor may be eligible for an immediate federal tax deduction equal to the Fair Market Value (FMV) of the entity donated, up to 30% of the adjusted gross income (AGI). If the FMV of the donation is greater than 30% of AGI, the excess can be carried forward for five years.

This compares very favorably to similar donations made to a private foundation, which are generally deductible at cost basis. After ownership of the entity has been transferred to the fund, AEF will work with the donor and their financial advisor to sell the property. The donor will then be responsible for the dissolution of the entity (if not sold with the real estate) with their legal and tax advisors in accordance with the Secretary of State where the entity is domiciled. Once this process has been completed, the cash proceeds will be available for the donor to donate through their DAF.

By choosing this route, the donor utilizes a tax-smart tool to support the good causes important to them and implement donations on a timetable that fits their schedule and interests.

