

Considerations for Owners of Illiquid Assets

Leonardo da Vinci's *Salvator Mundi*, an oil on canvas from 1500, sold at auction for just over \$450 million.⁽¹⁾ Antilla is the name of a private residence located in Mumbai, India; it is 27-stories tall, six floors of which are a private parking garage, and it is worth \$1 billion.⁽²⁾ Cargill, a food services company in the United States, is the largest privately-owned company in the nation and generates over \$113 billion of revenue annually.⁽³⁾ Bob Dylan recently sold his own song catalogue for more than \$300 million.⁽⁴⁾ If, as an individual, you owned all four of these items, your total wealth would rank higher than the wealth of 53% of the world's sovereign nations.⁽⁵⁾

Clearly, illiquid assets can have an outsized effect on one's personal net worth, and even when more modest in value, these assets can play a significant role in wealth accumulation. They also can present opportunities and challenges for wealth preservation and transfer.

Ownership of illiquid assets often requires careful consideration of:

- The **PURPOSE** of the asset—why do I own it? Does the asset play a role other than strictly financial?
- The **VALUATION** of the asset—what is the method of valuation? Is the valuation volatile? Subjective?
- How to **PLAN** for the asset—are there carrying costs? How is the asset taxed? Can I transfer ownership?

On the following pages, we outline a number of management and planning considerations for four types of illiquid assets:

Real Property

Privately Held Investments

Art & Collectibles

Intellectual & Business Property

- ❖ Residential
- ❖ Commercial
- ❖ Non-Traditional

- ❖ Family-owned Business
- ❖ Direct Investments
- ❖ Private Equity

- ❖ Fine and Decorative Art
- ❖ Watches and Jewelry
- ❖ Collectibles

- ❖ Rights and Royalties
- ❖ Gas, Oil and Mineral Rights

(1) Villa, Angelica. "The Most Expensive Old Masters Artworks Ever Sold at Auction," January 15, 2021, 12:24 PM. *ARTnews*. <https://www.artnews.com/list/art-news/artists/most-expensive-old-masters-works-1234581432/rembrandt-van-rijn-portrait-of-a-man-with-arms-akimbo-1529-30/>

(2) McIntyre, Matt. "The 10 Most Expensive Houses in the World." *Wealth Gorilla*. <https://wealthygorilla.com/most-expensive-houses/>

(3) Statista Research Department. "The 20 largest private U.S. companies, by revenue 2019," January 20, 2021. *Statista*. <https://www.statista.com/statistics/549091/largest-private-us-companies-by-revenue/>

(4) Sisario, Ben. "Bob Dylan Sells His Songwriting Catalog in Blockbuster Deal," December 7, 2020; updated December 9, 2020. *The New York Times*. <https://www.nytimes.com/2020/12/07/arts/music/bob-dylan-universal-music.html>

(5) Credit Suisse, Research Institute. "Global wealth databook 2021," June 2021. <https://www.credit-suisse.com/media/assets/corporate/docs/about-us/>

Real Property

Management Characteristics + Planning Considerations

Real property is perhaps the most commonly owned illiquid asset. For many, it is the single most valuable asset they own. For others, it is a component of their wealth as a means of wealth creation, enjoyment or strategic investment.

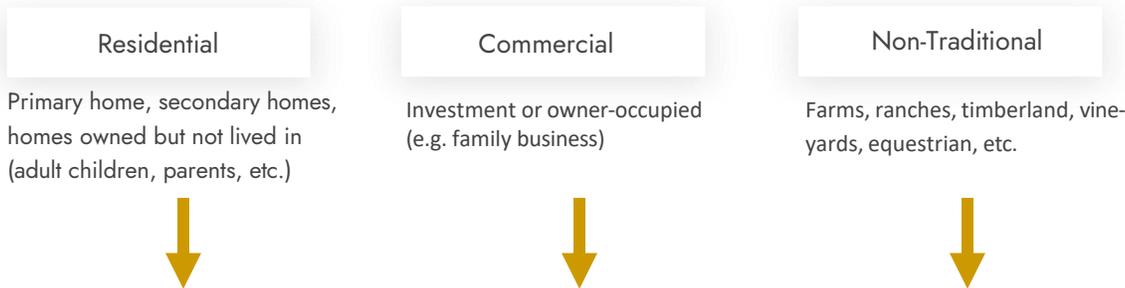
While real properties of all types share certain characteristics, it is important to make distinctions between purposes of the different assets, which then largely will drive present and future planning opportunities.

Investment and Tax Characteristics



Provides Income	Not typically unless from an intra-family loan or short-term leasing.	Current income is typically the main objective though it can be held for capital appreciation.	Via land leases, harvesting, hunting/fishing leases but typically not as robust as traditional Commercial Real Estate (CRE).
Provides Principal Growth	Potentially, though not typically purchased for investment.	Typically, yes, it depends on property type, holding period and geography.	Appreciates typically over a longer-term; can also depend heavily on zoning changes (e.g. from agriculture to industrial).
Principal Preservation	Depends on equity/debt ratio, holding period and market factors.		Often a primary reason for owning these assets; often owned for the purpose of being a net-zero or incomeless asset.
Leverageable	Always full recourse; amounts borrowed can also be used for non-housing purposes (e.g. home equity line of credit); could trigger various fees & taxes (e.g. NY State mortgage recording tax).	Yes, via a variety of sources (CRE bank, conduit, Limited Partnership/ Private Equity, insurance companies, EB-5); can be structured (first, mezz, second, etc.); can be recourse or non-recourse depending on net operating income and borrower goals.	Yes, though can be expensive relative to CRE if current income/ NOI is modest; can be recourse or non-recourse depending on whether the property generates significant income.
Income Tax	Income is currently taxable, if any; potential for 1) an income tax deduction of mortgage interest paid, subject to limitations (that were increased in 2017) and real property taxes and 2) exclusion of some or all realized capital gain upon sale, if primary residence and lived in for 2 of the last 5 years.	Income is currently taxable; can be an advantage if benefiting from Federal subsidies; income is currently taxable and similar in commercial real estate, may be characterized as ordinary income or capital gains. Certain non-traditional property types, such as farms, may carry certain tax benefits that should be explored prior to acquisition	
Estate Tax (When Applicable)	Taxable asset in the estate; can pose issues if unaccounted for in planning.	Generally, unless accounted for in plans or ownership structure; some farms are afforded allowances of time to pay estate tax in certain circumstances.	

Holding and Transfer Characteristics



Valuations	Notoriously a source of debate thanks to online “appraisal” data; value to borrow against is sometimes less than the purchase price.	Valuation depends on usage: land, improvements or business use (NOI calculations); environmental conditions can also affect.	
Insurance	Perhaps the most important asset to insure for most homeowners; also generally tied to “excess liability” policy for additional coverage of domestic employees , etc.	Can be extensive and expensive depending on usage; environmental concerns can also affect dramatically.	
Maintenance	Ongoing, varies based on age of home, location, etc.		Can be minimal or extensive depending on the usage.
Ownership Structure / Fractional Interest	Usually, Joint Tenants With Right of Survivorship (JTWROS), Tenancy in Common (TIC) or Community Property, depending on resident state; can also be held in trust (see below) or other entity.	Usually held in an entity (e.g. LLC) and segregated from other assets for liability protection and/or tax planning purposes.	
Enjoyment / Strife	Potential for both in present use, can also be a point of contention for heirs.	Typically, not held for enjoyment but can cause strife in estates.	Often held for present enjoyment (e.g. family compound / retreat) but can also be a source of strife if operations become unwieldy.
Legacy + Planning Considerations	Can potentially make an effective bequest for estate equalization purposes though can be cumbersome to sell; can be donated to a charity, though check with the Not-for-Profit Organization (NFPO) to confirm acceptability; can be transferred into a Qualified Personal Residence Trust (QPRT) to remove from estate assets.	Can be an excellent means of wealth transfer/estate equalization or a tragic means of incurring unnecessary estate taxes if unaccounted for in planning; can be used creatively for charitable purposes; legal, tax and financial advisors must work together to plan for these assets.	

Privately Held Investments

Management Characteristics + Planning Considerations

Privately Held Investments (PHIs) can be an effective means of wealth creation but can also be a source of significant complexity, both during ownership and in contemplation of transferring the asset to future generations.

Investment and Tax Characteristics	Family-Owned Business	Direct Investments	Private Equity
	As an officer, sole proprietor, beneficial owner, etc.	Investments outside of private equity and perhaps including Board roles.	Capital invested via a structured offering / private equity firm.
Provides Income	Can provide substantial income or be a source of capital expenditure.	Can distribute periodically but more typically via events such as a sale or capital restructuring.	Can provide scheduled distributions or via events typically described in the subscription / offering memorandum.
Provides Principal Growth	Can provide significant capital growth in enterprise value but realization of value can be complicated.	Chiefly the reason for making such investments; principal growth can be magnified for heirs via planning.	Typically, the main objective of the investment and usually over a fixed term.
Principal Preservation	Many business owners cycle profits back into the business, so the “principal” may grow.	A return of investment would be expected; however, downside can be a total loss.	Growth, preservation or losses often not known until event driven reporting; more of a play for long-term growth than preservation.
Leverageable	Yes, via business loans or lines of credit, equipment loans or enterprise- owned CRE debt; can be recourse or non-recourse.	Not typically unless via a promissory note for planning purposes.	Potentially, depending on the subscription agreement and lender guidelines; for PE managers or investors, capital calls can sometimes be leveraged via private credit lines or loans.
Income Tax	The tax nature depends on the income type, i.e. ordinary capital gains or carried interest, potential to deduct losses.	Can be a source of current income but more often a source of capital gains on realization events.	Distributions are taxed as either short or long-term capital gains and not as ordinary income.
Estate Tax (When Applicable)	Generally, unless accounted for in plans or ownership structure; some farms are afforded allowances of time to pay estate tax in certain circumstances.	Generally, yes, unless accounted for in plans or ownership structure	

Holding and Transfer Characteristics

Family-Owned Business

As an officer, sole proprietor, beneficial owner, etc.

Direct Investments

Investments outside of private equity and perhaps including Board roles.

Private Equity

Capital invested via a structured offering / private equity firm.



Valuations	Multiple usually based on EBITA; highly dependent not only on the enterprise but also macro and sector dynamics; valuation process can be lengthy and expensive.	Multiple usually based on EBITA; highly dependent not only on the enterprise but also macro and sector dynamics; cost proportional to investor's share.	Depending on manner of ownership, (e.g. GP, LP or manager) can be a complex process of evaluating enterprise value, book value, and carried interest... among other factors.
Insurance	Can provide significant capital growth in enterprise value but realization of value can be complicated.	Not typically necessary (unless investment includes a Board seat, in which case D&O from the business and/or personal excess liability may be necessary).	
Maintenance	Needed for bricks-and-mortar, administrative, human resources and equipment.	Not typically necessary	
Ownership Structure / Fractional Interest	Can range from sole proprietorship to LP, LLC, S-Corp or C-Corp or be publicly-held with controlling interest held by the family.	Can be held in single, joint or entity name; usually a fairly simple process of share transference (unless as a PE manager then more complex transfer strategies may be necessary).	
Enjoyment / Strife	Can be simultaneously the greatest source of joy and angst in an owner's life.	Not usually a source of emotional reward or stress unless the investment substantially succeeds or fails.	
Legacy + Planning Considerations	Ranging from grantor retained annuity trusts (GRATs) and revocable trusts to employment stock ownership plans (ESOPs) and everything in between; tax, legal and financial advisors must work cooperatively to achieve a successful business transition; accurate and defensible valuation key to initiating the planning process.	Interests can usually be held in an LLC/ FLP/ LP and also transferred to trust (e.g. GRAT); lock-ups may require a continued investment for heirs; PE interests may be difficult to use for charitable purposes (check with the charity first); accurate and defensible valuation key to initiating the planning process.	

Art + Collectibles

Management Characteristics + Planning Considerations

Art and collectibles are frequently acquired for the purpose of enjoyment and later take on qualities of an investment – an “accidental asset” that sometimes presents surprise opportunities or perhaps liabilities for heirs.

**Investment
and Tax
Characteristics**

Fine & Decorative Art

Paintings, prints, photographs, sculpture, decorative pieces, furniture, ethnographic, antiquities.

Watches & Jewelry

Antique/vintage and new watches, new/ estate jewelry and unset gemstones.

Collectibles

Cars, stamps, comic books, coins, memorabilia, wine, spirits, ephemera.



Provides Income	Almost never unless via licensure which is unusual for private collectors; more common for artists or their estates.	Almost never unless considered inventory within an active trade or business (i.e. owner is a dealer).	
Provides Principal Growth	Highly speculative given the inefficiency and opacity of the art market.	Speculative however sometimes more liquid and, to some extent, more efficient and standardized than fine and decorative arts.	
Principal Preservation	Highly speculative given the inefficiency and opacity of the art market.	Somewhat more predictable and transparent than fine and decorative arts, particularly for gemstones with GIA certificates.	Arguably, yes; however highly dependent on asset type and still speculative by nature.
Leverageable	Effective way to make use of unutilized equity; terms vary broadly including rate, term, covenants, personal guarantee—consider loan purpose and align with loan terms.	Potentially via hard money or asset-based lending (ABL) and most banks will lend only against fine art; more available to dealers; be prepared to surrender possession during loan term.	Similar to watches and jewelry; be prepared to surrender possession during the term of the loan.
Income Tax	Realized gains are currently taxed at 28% capital gains rate for collectibles if not a dealer; profits taxed at ordinary income tax rates if a dealer.	Jewelry is usually classified as personal property and are taxed at capital gains rates.	Realized gains are currently taxed at 28% capital gains rate for collectibles if not a dealer; profits taxed at ordinary income tax rates if a dealer.
Estate Tax (When Applicable)	Generally taxable; burden can be reduced through effective planning or ownership structure.		

Holding & Transfer Characteristics

Fine & Decorative Art

Paintings, prints, photographs, sculpture, decorative pieces, furniture, ethnographic, antiquities.



Watches & Jewelry

Antique/vintage and new watches, new/ estate jewelry and unset gemstones.



Collectibles

Cars, stamps, comic books, coins, memorabilia, wine, spirits, ephemera.



Valuations	Highly subjective valuation process and can change significantly over time or not at all, depending on the asset type; valuations are fair market value (FMV), retail replacement or auction estimate depending on appraisal purpose; provenance and condition of the item will impact, as well.	Unset gemstone values are largely standardized whereas subjectivity enters for jewelry and watches, though valuations are a bit more range-bound than fine and decorative arts; provenance, condition and rarity can play a large role in valuations of these assets.	Often requires highly specialized appraiser; some of these asset types carry more standardized valuations (coins, stamps, for example) but as with other art, provenance, condition and rarity can play an outsized role in value.
Insurance	Must be insured; consider itemized versus block; typically, former is more prudent; valuations must be regularly updated for insurance lines, usually annually for most fine art and every 12-24 months for other art and collectibles.		
Maintenance	Can be extensive including restoration, climate, storage, handling and security.	Not as maintenance intensive as "art" but usage/ wear can drive costs for storage, security and additional upkeep.	
Ownership Structure / Fractional Interest	Can be held in single, joint or entity name; usually a fairly simple process of assignment; can be held for business/ investment purposes within business entity; fractional ownership interest in art/ collectibles has fallen out of favor with the IRS and is not typically possible outside of a private placement art investment fund or planning entities; may be more possible when held for business/ investment purposes.		
Enjoyment / Strife	Usually owned for personal enjoyment but can lead to complexities or contention for heirs; also, sometimes falls prey to "secret gifting" to heirs and later becomes a tax issue when a sale or subsequent transfer is attempted— always report gifts per IRS guidelines!		
Legacy + Planning Considerations	Entire collection or individual works usually can be transferred into an entity (e.g. LLC, FP, trusts); can possibly also be transferred into a common charitable lead annuity trust (CLAT) or charitable remainder trust (CRT) to reduce/ eliminate low basis gains; can also be transferred to a private foundation or public NFP (check charity's gift acceptance process first); often imbued with sentimental value and therefore transfers into entities can be complicated for emotional reasons.		

Intellectual & Business Property

Management Characteristics + Planning Considerations

With the advent of digital assets, digital art and the metaverse, intellectual property may be the most quickly evolving type of illiquid asset. That said, commonalities across these asset types typically include contracts and agreements that may drive ownership and transfer characteristics.

Rights & Royalties

Creative property/ copyrights, NFTs/ digital property, patents.

Gas, Oil & Mineral Rights

Below surface resources.

Investment and Tax Characteristics



Provides Income	Typically provides an ongoing, periodic or episodic source of income.	Typically provides an ongoing, periodic or episodic source of income (earning royalties from the resource, vs. leasing of land vs. selling of the rights/land).
Provides Principal Growth	Can grow in value if transferrable (i.e. catalogue of famous pop music), but valuation is often driven by popular trends.	Yes as/when the market for the resource grows; however, if actively mined/ drilled, can actually depreciate as resource is tapped.
Principal Preservation	Rights and property ownership can potentially store value, however also speculative and driven by style/ trends/public taste; royalties may not have a principal value unless transfer permissible.	
Leverageable	Not typically for rights or creative property; royalty advances are possible but depend on the royalty agreement.	Yes, via royalty loans or land loans; while common it is also highly specialized and requires specialized counsel to review contracts.
Income Tax	Generally, royalties are taxed as ordinary income and considered passive if taxpayer is not active in the operation; sales of rights/patents/NFTs are usually considered capital gains unless held & sold by the creator of the property.	Royalties are taxed as ordinary income and considered passive if taxpayer is not active in the operation; sales of rights are usually considered capital gains; leasing of land rights would typically be treated as ordinary income, as with any land lease.
Estate Tax (When Applicable)	Generally taxable; burden can be reduced through effective planning, unless agreement(s) or ownership terminates before death.	Generally taxable, burden can be reduced by effective planning, induced in the estate unless provided for in planning or contracts.

Holding & Transfer Characteristics

Rights & Royalties

Creative property/ copyrights, NFTs/ digital property, patents.

Gas, Oil & Mineral Rights

Below surface resources.



Valuations	Driven by current market for the property as well as potential future income streams; highly specialized appraiser likely required for valuation purposes.	Driven by current market for the resource as well as potential future income streams; can vary depending on zoning/ usage of land; highly specialized appraiser likely required for valuation purposes.
Insurance	Typically, they are not insurable.	They can be extensive and expensive depending on how these assets are owned and used; environmental concerns can also affect dramatically.
Maintenance	Not necessary in the strictest meaning but "profile" maintenance may be necessary in order to maintain popularity and relevance of the property/ creator.	
Ownership Structure/ Fractional Interest	They can be held in single, joint or entity name though usually per contacts/ agreements; if pooled investment, typically easier to transfer interests.	
Enjoyment/ Strife	If self-created it can be a significant source of enjoyment and pride. However, it can also lead to significant emotional/ family strife if not properly counseled at creation; acquisition.	Not usually a source of emotional reward or stress unless the investment substantially succeeds or fails or is a personally-owned enterprise.
Legacy + Planning Considerations	Requires specialized legal counsel to prepare adequately for the efficient transfer of the assets; contracts/ agreements at inception of ownership can have an outsized affect on potential transfer to subsequent generations.	Depending on ownership structure and type of investment (direct or via pool), can require specialized planning and entity formation or can be simple matter of ownership transference via common entities (LLC, FLP, trust).

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