

A no-nonsense newsletter for estate planners and financial advisors from The Dayton Foundation

Thinking Differently about Charitable Giving Using Closely Held Stock to Make a Charitable Gift

By Sam Warwar, Esq., Tax Partner, Coolidge Wall Co., L.P.A.

“Owners of closely held companies... should consider using stock in their closely held businesses as a means to further their charitable intentions.”

— Sam Warwar

Individuals always are looking for the most advantageous ways to support the charitable causes they believe in. While giving cash is common, there can be significant tax advantages by making gifts of property instead.

Utilizing Appreciated Property vs. Cash

Generally, a charitable contribution of appreciated property allows a donor to deduct the value of property without having to report the appreciation as income. For example, let's say a donor has property he paid \$10 for and now is valued at \$1,000. If gifted to a qualified charity, he would have a \$1,000 deduction and no long-term capital gains tax.

Many donors recognize this tax advantage as a reason to give gifts of appreciated stock to charity. The challenge for owners of closely held businesses is that most of their investment is usually in their businesses, not publicly traded stocks, so most don't have publicly traded stock to give to charity.

Therefore, they think only in terms of giving cash to charity.

Owners of closely held companies, however, should consider using stock in their closely held businesses as a means to further their charitable intentions. This is where an orga-

nization like The Dayton Foundation can be very helpful.

If a donor owns his or her own company, it is typical that the stock is valued substantially higher than the cost. For example, an individual may have a company valued at \$25,000 per share that may have virtually no cost basis (built with “sweat” equity rather than cash infusions). He or she could give one share of stock to a public charity like The Dayton Foundation and deduct the full \$25,000 (assuming he or she held the stock for more than one year). Gifting to a public charity is important here. This is because if the individual made the gift to a private foundation, he or she only could deduct the cost basis, which would be very little.

Valuing Closely Held Stock

In the case of a gift of publicly traded stock, an appraisal to establish the stock's value is not required by the IRS to secure a charitable deduction. However, in the case of a gift of closely held stock, an appraisal is required by the IRS if the deduction claimed exceeds \$10,000. This is true even if a stock is sold shortly after the gift, which common sense would suggest would eliminate the need for an appraisal.

The appraisal must be done within 60 days of the contribution and not later than when the tax return is due and needs to be attached to the tax return that claims the deduction. If the stock is sold within two years of the charitable contribution, the charity has to report that to the IRS.

Considerations for the Advisor to Address

There are many considerations to take into account for both the closely held business owner making the charitable gift of stock in a closely held company and the charity receiving it. One of the main concerns for the business owner is having an “outsider” as a shareholder. On the other hand, the charity has the concern of holding an illiquid investment. The advisor needs to work with the donor and the charity to address these and other considerations to make the gift work the best for all involved.

The typical way to do this is for the company to redeem – or buy back – the stock after the stock gift is made to the charity. In order for that to work for tax purposes, at the time of the gift there cannot be an obligation by the company to buy back or by the charity to sell back the stock to the company. A charitable gift also can be done in anticipation of a sale or merger of the company; however, the gift must be made before any formal decision to sell or merge the company.

If the charity is going to hold on to the stock, a buy-sell agreement should be part of the transaction to control who may be a shareholder in the future and to deal with governance issues.

The aforementioned is how gifts of closely held stock can be made to a charitable organization and still have the owner fulfill his or her charitable obligations and the charity fulfill its charitable mission. The same strategy can be used with a donor-advised or donor-designated endowed fund with an organization like The Dayton Foundation to



SAM WARWAR, ESQ.

Continued...

Using Closely Held Stock to Make a Charitable Gift

Continued from page 1

“There are many considerations... for both the...business owner making the charitable gift of stock in a closely held company and the charity receiving it.”

— Sam Warwar

Futures is made possible by four

I Believe!

Dayton Foundation donor families who have stepped forward to become the 2010-2011 “I Believe!” Partners of The Dayton Foundation. Their commitment underwrites a full year of Dayton Foundation publications, thereby freeing resources for the Foundation’s other community work.

“I Believe!” Partners: Carol & Jack H. Adam, Leona E. & Jane A. Dunwoodie, Janet A. & Donald L. Grieshop, and Marcia L. & Donald J. Schade

Additional support from The Standard Register Company.

receive the gift of closely held stock and thereby perpetuate the donor’s charitable interests over time – today and for generations to come, if the donor so wishes.

S Corporations and LLCs

Many owners are operating as S corporations or LLCs taxed as partnerships now, because those entities do not have double tax like regular corporations; i.e., regular corporations pay one tax on the income of the business and the owners pay a second tax on distributions made to the owners. If the owner has operated his or her business as an S corporation or an LLC taxed as a partnership, the rules for charitable gifts of the stock or LLC become more complex and careful planning needs to be done.

Fortunately, S corporations now are eligible to have charities as shareholders. But in the case of a gift of S corporation stock, there are two differences in the rules described above. First, the amount of the charitable deduction to the donor will have to be reduced by any portion of the value of the stock that is attributable to appreciated assets owned by the S corporation upon sale.

For example, if part of the value of the business is made up of equipment that has been depreciated below its value (assume the value of the equipment is \$1,000,000, but has been depreciated down to \$800,000), the amount of the charitable deduction must be reduced by the stock’s percentage share of the ordinary income that would have been recognized if the corporation sold all the equipment.

Second, under the unrelated trade or business income tax rules, the charity must pay tax on its share of any income that flows through the S corporation to the charity and

Thanks!

On behalf of all of us at The Dayton Foundation, I would like to wish you all a happy and prosperous new year and thank you for your interest in learning more about The Dayton Foundation and some of the many services we can offer your charitable clients.

A total of 44 the 142 endowment and legacy funds and Charitable Checking AccountsSM established at The Dayton Foundation in 2010 came as a result of professional advisor referrals. That’s 31% of all new funds. Clearly we wouldn’t be among the fastest growing community foundations in the country were it not for our partnership with our valued professional advisors. Thank you!

Michael M. Parks
President, The Dayton Foundation

also must pay tax on any income it has upon disposition of the shares.

Gifts of LLC interests have the same reduction of value for the ordinary income-type assets like the S corporation and income tax costs to the charity. In addition, gifts of an LLC interest can result in the part sale/part gift rules applying to the donor if the LLC has any liabilities. When an LLC owner contributes to a charitable organization an interest in the LLC that has liabilities, the transaction is bifurcated into a charitable contribution and a deemed sale. The amount of the charitable contribution is equal to the amount by which the fair market value of the LLC owner’s share of partnership assets exceeds the partner’s share of the LLC’s liabilities. For the deemed sale portion of the transaction, the owner’s percentage share of the LLC’s liabilities on the gifted LLC interest is considered the amount realized on the deemed sale of the LLC interest. The donor’s basis in the LLC interest is prorated between the portion deemed sold and the portion deemed contributed based on the fair market value of each portion. The donor must recognize as gain the spread between the amount realized and the basis prorated to the deemed sale.

The use of S corporation stock or an LLC interest still can have sig-

nificant advantages under the right circumstances, and owners of those interests should be encouraged also to consider gifting those to their charities of choice. However, as indicated above, careful planning and analysis are necessary to make sure there are no surprises if these interests are used for the gift.

I have found the personnel at The Dayton Foundation to be well versed in issues of gifts of interests in closely held businesses and, while they do not give tax advice, their experience and insights are very helpful in structuring the gifts.

Note: Solutions will differ from case to case. The above does not constitute professional financial or tax advice.

Sam Warwar is a Tax Partner at Coolidge Wall Co., L.P.A., has 25+ years’ experience acting as a general counsel to businesses, families and nonprofit organizations and advising and representing clients with business transactions and tax controversies. He recently was recognized as Dayton’s Tax Lawyer of the Year for 2011 by the Best Lawyers publication.

Futures:
Five-time national award-winning publication, Wilmer Shields Rich Awards, Council on Foundations

President: Michael M. Parks. **Governing Board:** Gary L. LeRoy, chair, Craig J. Brown, Ellen S. Ireland, Charles A. Jones, Helen E. Jones-Kelley, Anita J. Moore, James R. Pancoast, Vicki D. Pegg, Colleen M. Ryan, Douglas C. Scholz, Charles G. Schroeder, Jerome F. Tatar, Fred E. Weber. **Financial Managers:** Ameriprise Financial Services, Inc.; Robert W. Baird & Co., Inc.; Behnken and Associates, Inc.; Buckingham Financial Group; C.H. Dean and Associates; Dover Partners; Eaton National Bank; Eubel, Brady & Suttman Asset Management; Fiduciary Trust Company International; Fifth Third Bank; First Alliance Asset Management Access Financial Group; The Huntington; JP Morgan; James Investment Research, Inc.; Johnson Investment Counsel; KeyBank, NA; Liberty Savings Bank, FSB; Linsco/Private Ledger Financial Services; Merrill Lynch and Company; Michael J. Monaghan & Associates; Morgan Stanley Smith Barney; National City Bank; Northwestern Mutual Fund Services; Oxford Financial Advisors Corp.; PNC Bank, Ohio, NA; Parker Carlson & Johnson; Principled Wealth Advisors; Prudential Preferred Financial Services; Transamerica Investment Management, LLC; Truepoint Capital, LLC; UBS Financial Services, Inc.; US Bank; Wachovia Securities. **Investment Consultant:** Fund Evaluation Group, Inc.



We’re here for good.

We help you help others.SM

Meeting All Standards for U.S. Community Foundations.



Follow us on



The Regional Community Foundation