

CONTRIBUTION OF PRIVATELY HELD C-CORP STOCK



The Situation

Karen, a founder of the Powell Company (“Powell”), a privately-held C-corporation, owns \$10M worth of shares in Powell. She has a zero basis in her shares. Karen informs her advisor that Powell is in discussions with potential buyers for the company and intends to accept an offer shortly. Hearing this news and knowing that Karen is philanthropic, her advisor encourages her to consider donating some of her Powell shares to charity before the sale, in order to further her charitable intentions for now and the future. Karen is intrigued and wants to learn about the potential tax benefits of making such a contribution, and how to choose between making one or more direct gifts to charity, establishing and managing a private foundation, and using a donor-advised fund. She recognizes that her co-founders, other senior-level executives, and investors may also be interested in making charitable contributions.

The Benefits

KAREN DETERMINES SHE WOULD LIKE TO DONATE TO CHARITY.

The potential tax advantages of donating Powell shares to a public charity before a sale triggering capital gains tax include:

- The ability to take an income tax charitable deduction for the fair market value (as determined by a qualified appraisal) of the Powell shares on the date of the contribution;
- Minimizing capital gains tax that would have been incurred on the sale of the donated Powell shares.

OPTION 1: KAREN SELLS ALL \$10M WORTH OF SHARES AS PART OF THE LARGER SALE OF POWELL AND DONATES AFTER-TAX PROCEEDS TO CHARITY.

Capital gains tax (assuming a combined federal and state rate of 20%) = \$2M

With her remaining \$8M, Karen contributes \$2M in cash to her favorite charities.

Karen is left with a net of \$6M after taxes and her charitable contribution. She will be eligible for a \$2M income tax charitable deduction.

OPTION 2: KAREN CONTRIBUTES \$2M WORTH OF POWELL SHARES TO A DONOR-ADVISED FUND (AT A PUBLIC CHARITY) PRIOR TO THE SALE OF POWELL TO A THIRD-PARTY BUYER.

Karen sells her remaining \$8M in shares and pays a capital gains tax of \$1.6M (assuming a combined federal and state rate of 20%).

The charity sells its \$2M in shares but pays no capital gains tax.

Karen is left with a net of \$6.4M after taxes and her charitable contribution. She will be eligible for an income tax charitable deduction of \$1.84M (depending on a qualified appraisal of the stock, assuming some discounting [here 8% is assumed] in valuation due to minority interest). See the following page for more info on qualified appraisals.

The Considerations: Choice of Charitable Solution

Karen is in the early stages of developing her personal charitable mission. While she makes annual donations to a variety of charities, she does not have one or more charities in mind at this time to receive a significant donation. Moreover, creating a charitable legacy for her children is a priority.

As part of the guidance, Karen’s advisor explains the differences between private foundations and public charities, including those that have donor-advised fund programs, highlighting the differential tax treatment for donations of long-term appreciated nonpublicly traded stock—cost basis versus fair market value tax deductions, respectively.

Karen likes the flexibility of the donor-advised fund and appreciates the work that would be required were she to try to involve multiple charities as part of the pre-sale transfer process. She chooses the donor-advised fund option.

ISSUE: IS KAREN'S DONATION AN ANTICIPATORY ASSIGNMENT OF INCOME?

Karen and her advisors must analyze whether at the time of the donation of Powell shares, the sale of Powell has proceeded to the point at which shareholders are considered to be holding the right to receive proceeds from the sale. At that point, the gain has generally attached and shareholders cannot avoid capital gains tax by donating the shares. Generally, if a contribution is made after all the material terms of the sale are agreed upon and there is no material risk that the sale will not close, the IRS may conclude upon audit that the contribution is an "anticipatory assignment of income." In this case, the IRS could require payment of any capital gains tax that otherwise would have been due upon the sale of those shares (plus possible penalties and interest).

Whether or not a contribution will be considered an "anticipatory assignment of income" is dependent on the facts and circumstances.

ISSUE: WHAT TRANSFER RESTRICTIONS APPLY TO KAREN AND TO THE CHARITY?

Powell's governing documents (i.e., shareholders' agreement, etc.) must be reviewed by the recipient charity to understand whether Karen and her transferees, including the recipient charity, are subject to transfer restrictions and, if so, what amendments/approvals/waivers are required to complete the charitable transfer.

Companies commonly include rights of first refusal and corporate redemptions (buybacks), or other provisions.

ISSUE: HOW DOES KAREN SUBSTANTIATE HER CHARITABLE TAX DEDUCTION?

Karen must obtain a qualified appraisal to substantiate the income tax charitable deduction she is claiming for non-publicly traded stock valued at more than \$5,000. The donor reports this value on IRS Form 8283, which is attached to the donor's IRS Form 1040.

The charity must report to the IRS the proceeds received on IRS Form 8282 if the charity sells the asset within three years from the date of the donation.

Appraisals typically reflect lack of marketability and/or minority interest discounts. Discounts are highly dependent on the facts and circumstances existing at the time of the contribution.

Appraisals can be obtained no earlier than 60 days before the date of the donation and no later than the date the donor's tax return for the year of the gift is due with extensions. Appraisers charge a fee for this service.

ISSUE: WHAT RISK DOES THE CHARITY CONSIDER?

As a shareholder in Powell for a period of time, the charity must consider what risk it undertakes as part of that ownership status, including financial risk and other liability. If the charity will participate in the sale of the company, it may be asked to make representations and warranties (and face potential liability) as a selling shareholder. The charity will generally seek to eliminate or minimize any exposure as a selling shareholder, and may seek indemnification from the donor in certain circumstances (e.g., when there is unlimited financial liability post-closing).

Potential donors should consult with their tax advisor about their own tax situation, including the timing of the contribution and their own individual tax reporting requirements.

**For more information, please call a Charitable Planning Specialist at 800.682.4438
or visit [FidelityCharitable.org](https://www.FidelityCharitable.org).**

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In order to claim a deduction for charitable contributions, you must be eligible to itemize your deductions.

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