Donating Appreciated Business Interests

Tax Advantages of Donating Appreciated Business Interests

- Charitable Contribution Deduction of the FMV of the Business Interests Donated
- Avoidance of Long-Term Capital Gain Tax
- Reduction of AGI which can benefit
    - Qualified Business Income Deduction - SSTBs and Wages Limitations
    - Taxable Social Security Income
    - Child Tax Credits
    - Retirement Plan Contributions
    - Many other tax rules dependent on AGI and taxable income

Example of Donating Appreciated C Corp Stock

Facts:

# of Shares of Apple	1,000
Date of Purchase	11/25/2005
Basis Per Share	$2.48
FMV Per Share	$119.21
Total Basis	$2,480
Total FMV	$119,210
Total Unrealized Gain	$116,730
Long-Term Capital Gain Rate	20%
NII Tax Rate	3.80%
Utah State Tax Rate	4.95%
Active K-1 Ordinary Income	$440,000

Example of Donating Appreciated C Corp Stock

<u>Donation after Sale of Stock</u>

Ordinary Income	$440,000
LTCG - Stock Sale	<u>$116,730</u>
Adjusted Gross Income	$556,730
QBID	$0
Itemized Deductions	<u>$129,210</u>
Taxable Income	$427,520
Fed Tax	$84,805
State Tax	<u>$27,263</u>
Total Tax	**$112,068**

Example of Donating Appreciated C Corp Stock

Donation after Sale of Stock		Donation Prior to Sale of Stock	
Ordinary Income	$440,000	Ordinary Income	$440,000
LTCG - Stock Sale	$116,730	LTCG - Stock Sale	$0
Adjusted Gross Income	$556,730	Adjusted Gross Income	$440,000
QBID	$0	QBID	$62,158
Itemized Deductions	$129,210	Itemized Deductions	$129,210
Taxable Income	$427,520	Taxable Income	$248,632
Fed Tax	$84,805	Fed Tax	$48,021
State Tax	$27,263	State Tax	$19,967
Total Tax	**$112,068**	Total Tax	**$67,988**
		Tax Savings	**$44,080**

This Strategy Applies to Privately Held and Pass Through Businesses As Well

Example of Donating Appreciated S Corp Stock

Same as C Corp Except the Charity will pay UBIT Tax

UBIT Tax Rate (Nonprofit Corporation): 21% Fed. + 4.95% UT = 25.95%

Realized Gain $116,730

UBIT Tax $29,124 (close to donor tax savings ignoring AGI effects)

+ UBIT on any income earned by S-Corp during Charity’s holding period

Donating Appreciated Partnership Interests

- Partnership Interests are not automatically subject to UBIT like S-Corps, but can be depending on the facts.

- Restructuring an S-Corp through a Type F Reorganization can be a good way to avoid the UBIT tax. The detailed specifics are beyond the scope of this discussion.

- After reorganization, S-Corp would hold a partnership and donate partnership interests to Charity; deduction would flow to owners

Donating Appreciated Partnership Interests: Donors

- Section 751: gain attributable to “Hot Assets” and recapture is ordinary gain
- Charitable deduction decreased by amount that would be ordinary gain
- Rev. Rul. 75-194: if partnership interest includes an allocation of partnership liabilities, charity is treated as having purchased partnership interest in return for assuming the liability amount.
- The transfer to Charity is treated as a bargain sale.
- Donor realizes a portion of the gain in the same proportion that the debt bears to the value of the gift.

Donating Appreciated Partnership Interests: Charity

- Section 751: gain attributable to “Hot Assets” and recapture subject to UBIT
- Section 514: Income normally tax-free for charities is subject to tax if the income-producing assets are debt-financed. Taxable portion is determined by determining debt to basis ratio.
- Where the partnership has indebtedness, IRS position is that **gifted interest is debt financed**, because charity took on indebtedness to receive it.
- Upon sale, **debt-basis ratio determines what portion of the gain will be taxable**.

Example of Donating Appreciated Partnership Interest

Cash sale price/FMV:	$950,000
Allocable debt (also basis)	$50,000
Total amount realized	$1,000,000
Other basis besides debt	$50,000
Total basis	$100,000
Total gain	$900,000
Hot assets/recapture price	$200,000
Hot assets/recapture basis	$20,000

<u>Donation after Sale of Interest</u>

LTCG - Stock Sale	$720,000
Hot assets gain (ordinary)	$180,000
Charitable Deduction:	($950,000)
Net Income	**($50,000)**

<u>Donation Prior to Sale of Stock</u>

Sale portion = $50K/$1M = 5%	
Gain = $50K - 5% of $100K basis =	$45,000
(LTCG: $36,000; Ordinary: $9,000)	
170(e) limit: $950K - $95K * 20% =	$171,000
170 Deduction = $950K - $171K =	($779,000)
Net Donor Income:	**($734,000)**
Charity Basis = $50K + 95K =	$145,000
Hot Asset UBTI = $200K - $29K basis	$171,000
Remaining gain = $800K - $116K =	$684,000
Debt/basis percentage	x 50%
Debt-financed income UBTI	$342,000
Total Charity UBTI	**$513,000**
Net Combined Taxable Income	**($221,000)**

When is an in-kind gift less advantageous?

- Interests held less than a year (deduction limited to basis)
- Gifts to private non-operating foundations (deduction limited to basis for most closely held assets)
- S-Corp Gifts
- Partnership gifts where partnership has significant leverage relative to basis

Reducing UBIT: Gift to Charitable Trust Intermediary

- Donation goes to public charity sponsoring DAF
- DAF incurs UBIT
- DAF transfers funds to other charities in year of sale
- DAF can claim a second charitable deduction for cash gifts to charities
- Because charitable intermediary is a trust, deduction is up to 60% of its AGI
- This results in a 60% reduction of UBIT
- NOTE: This year only, CARES Act may allow a 100% deduction
- Good option for gifts of S-Corps and other UBIT-inefficient gifts

Opportunities and Risks for Donor

Opportunities

- Significant Tax Benefits

Risks

- The business sale falls through. Now you have the Charity as your business partner.
- Valuation / documentation disputes

Pre-Gift Issues

- Charity may have a gift review process--leave time for its due diligence
  - Review Tax returns and financial statements to identify potential UBIT and other liabilities
  - Confirm Donor’s power to transfer and iChariy’s power to sell if it wishes (check bylaws, shareholder agreement, and SEC rules); obtain any necessary consents
  - Discuss likely scope of representations and indemnification required if there is a sale
  - Check conditions for effective transfers. (Do share certificates need to be issued?)
- Donation agreement
  - Charity may seek indemnification from Donor for damages resulting from acceptance of gift
- Avoid committing Charity’s shares to be sold.

Post Gift Process

- Must get qualified appraisal--depending on value, it may need to be attached to return. Note new 2019 rules for qualified appraisals.
- Must have acknowledgment letter from donee meeting certain requirements such as identifying property donated and the value of anything provided in return.
- Get appraiser and charity to sign Form 8283, and submit it with tax return.
- Charity will file Form 8282 reporting gain on disposition of the interest.
- Make sure accountants provide necessary information to charity and know to include charity as an owner when taxes are filed the following year.

Checklists for Advisors /Core Takeaways

- Identify this opportunity months in advance of a client's sale so you have time to prepare. These gifts can take several weeks to complete. Waiting to long to start the process can cause you to miss this opportunity.
- Expect to educate the buyer's legal counsel and accountants. Outside of Utah this is fairly uncommon practice. However, this has never been a deal killer for any of my clients yet.
- Be aware of the assignment of income doctrine. The assignment (gift) must be made before a signed agreement with the seller is consummated. The more time between the assignment and the signing of the sales contract the better--especially if charity can't unilaterally choose not to proceed.

Checklists for Advisors /Core Takeaways

- Don’t assume your deal is too small to benefit from this strategy. Even a gift of $50,000 can cause net tax savings even after paying the legal and accounting bills.

Questions and Answers