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Starts in less than:5 minutes

Strategically Giving a Business Interest to Charity

March 31, 2022

- It's All About Taxes
- Structures
- Timing
- Valuation
- Tips and Take Aways

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Legal Entities

- Sole Proprietorship
- Partnerships
  - General Partnership
  - Limited Partnership
- Limited Liability Company
- Corporations
  - C Corporations
  - S Corporations
- Public versus Private Charities

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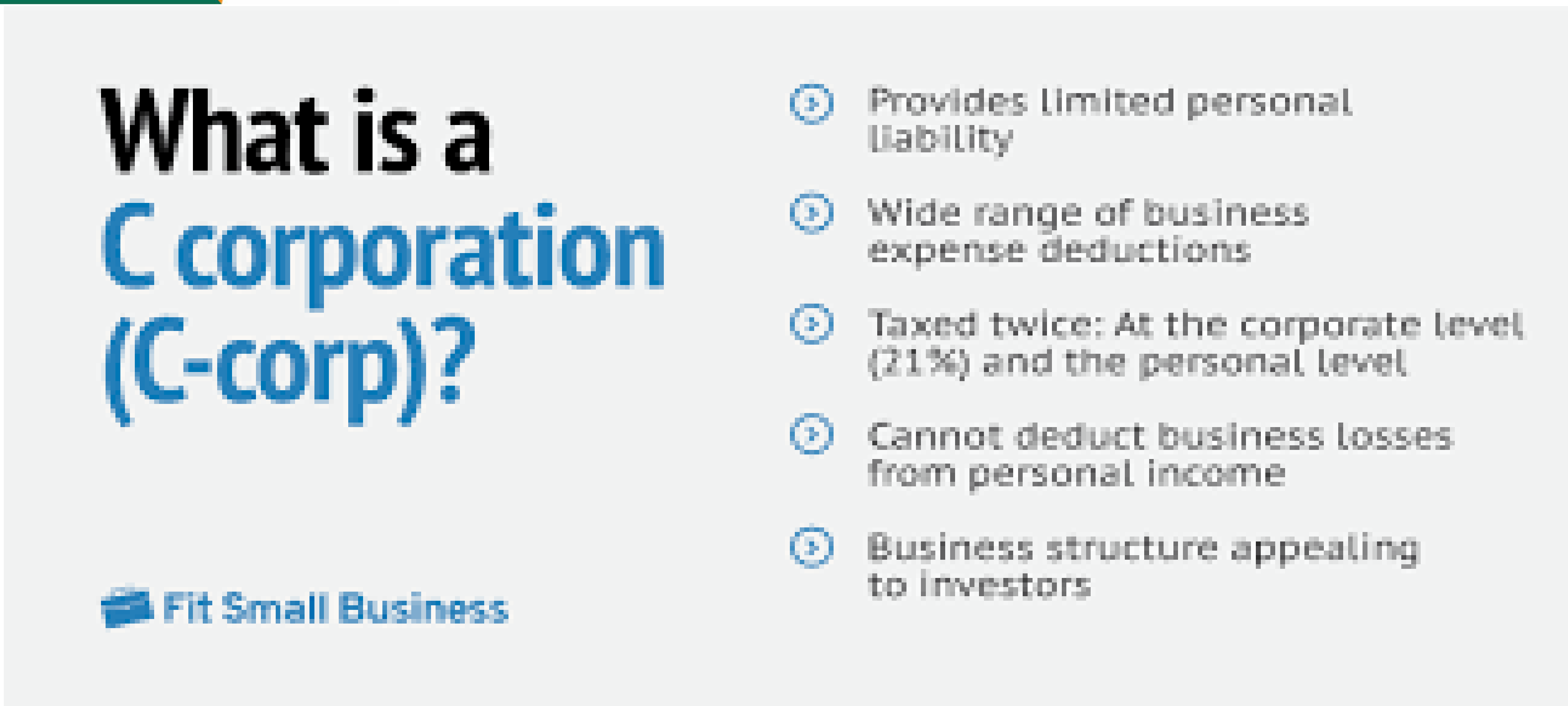
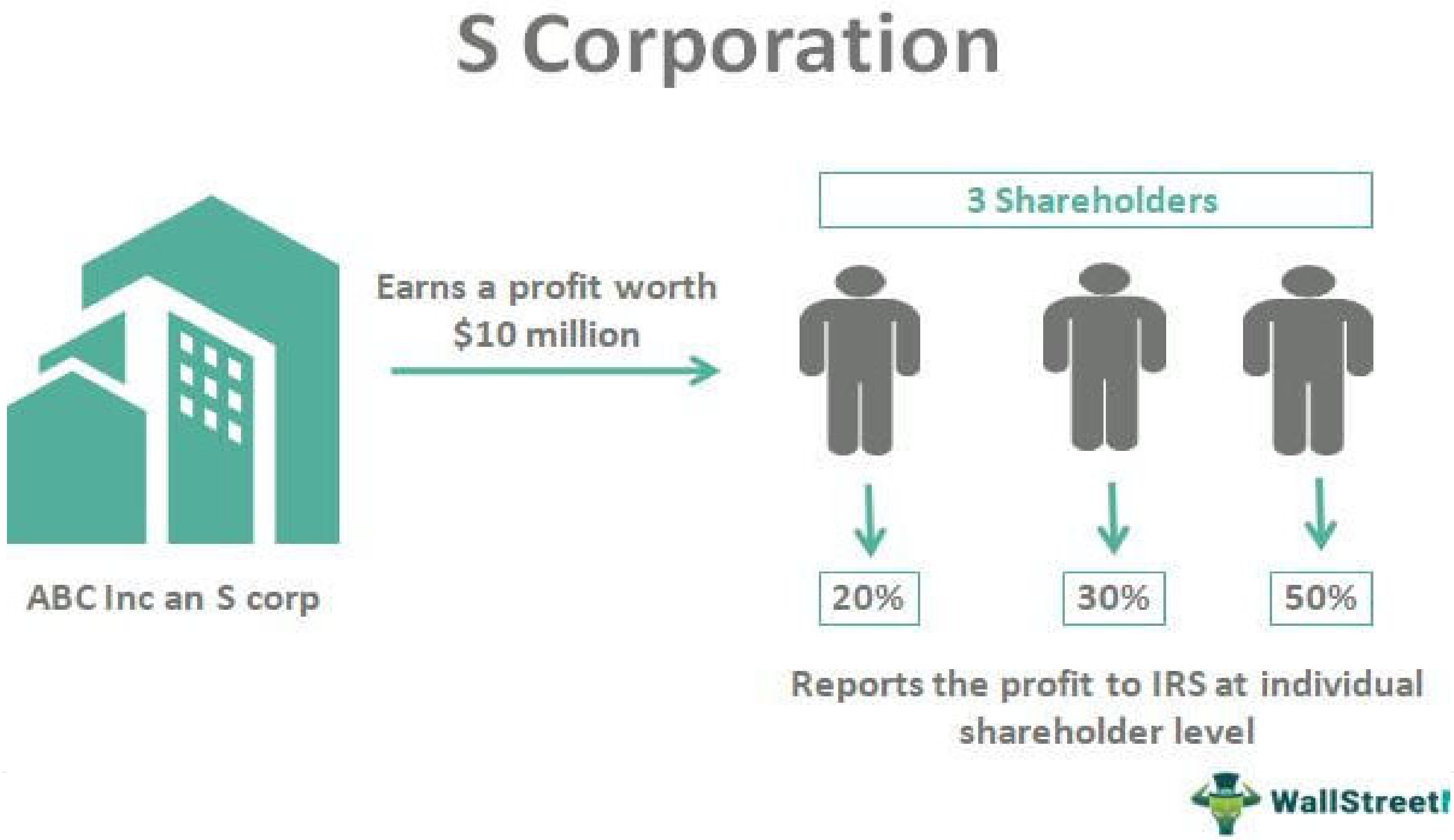
C corporation



S corporation



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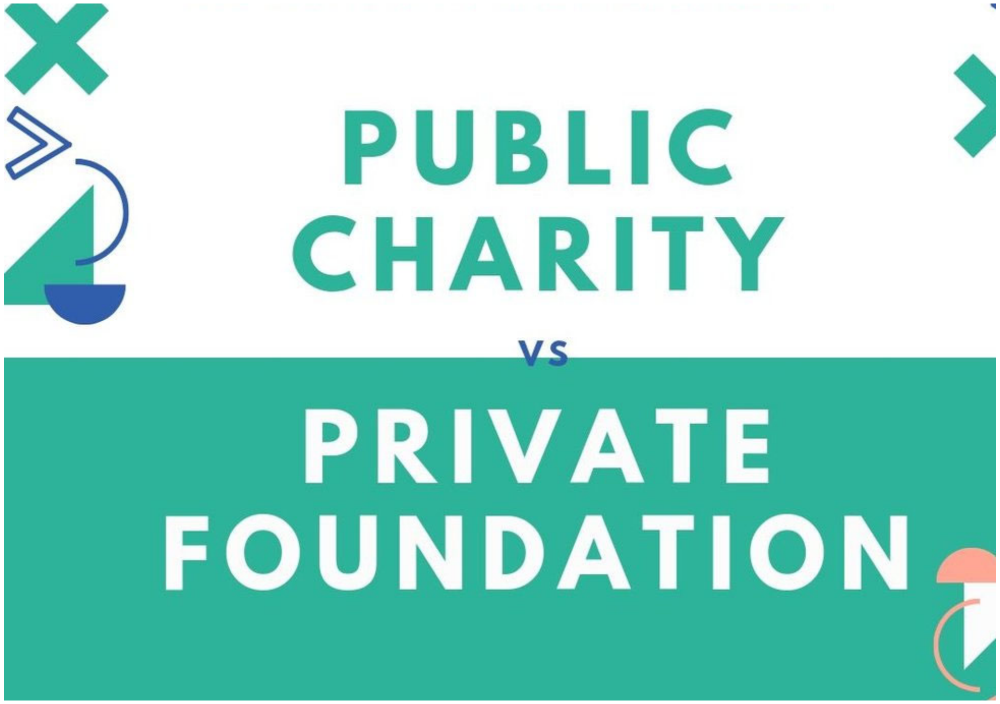
Public Charities vs Private Foundations

- Tax Advantages
  - Donor Advised Funds
  - Capital Gains
  - Income Tax deduction impact
  - 30% versus 20%
- Disqualified Persons
- Public Charities not subject to mandatory grant distributions



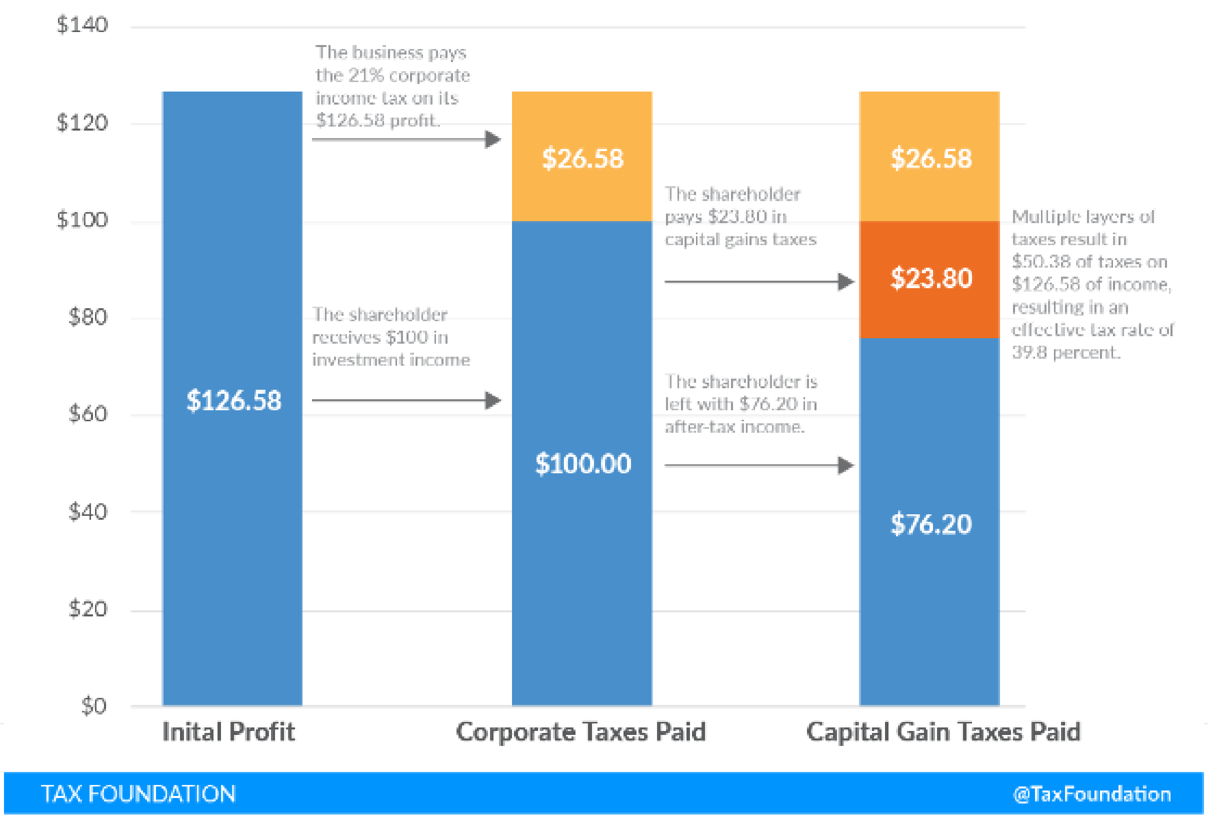
Public Charities vs Private Foundations

- A sale, including a bargain sale, between a private foundation and a disqualified person is a prohibited act of self-dealing subject to unwinding and excise taxes on parties to the transaction. A disqualified person may include a participating "foundation manager" as defined in section 4946(a), e.g., an officer, trustee, or substantial contributor.

- Treasury Regulation sec. 53.4941(d)-2(a)(1) provides that a sale of stock or other securities by a disqualified person to a private foundation in a bargain sale is treated as an act of self-dealing regardless of the amount paid.

Capital Gains Tax

The Capital Gains Tax is a Double Tax on Corporate Income



Capital Gains Tax 26 U.S. Code Subchapter P - Capital Gains and Losses

Short-Term & Long-Term Capital Gains Tax Rates By Income For Singles

Income	Short-Term Capital Gains Tax Rate	Long-Term Capital Gains Tax Rate
Up to $10,275	10%	0%
$10,276 to $41,775	12%	0% up to $41,675
$41,776 to $89,075	22%	15% over $41,675
$89,076 to $170,050	24%	15%
$170,051 to $215,950	32%	15%
$215,951 to $539,900	35%	15% up to $459,750
$539,900+	37%	20% over $459,750

ST capital gains tax is a tax on profits from the sale of an asset held for <1 year

ST capital gains tax rate = federal marginal income tax rate

Source: IRS, FinancialSamurai.com

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Transferability

Operating Agreement

Tag Along Rights

Drag Along Provision

2022-singles-ST-LT-capital-gains-tax-rates.webp

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UNRELATED BUSINESS INCOME TAX

An unrelated business is a trade or business activity regularly carried on for the production of income or loss that is not substantially related to the performance of the exempt purpose or function.
Income from unrelated business (UBI) is taxable.

E	Estimated Tax	Exempt organizations subject to tax on UBI are required to comply with the Code provisions regarding installment payments of estimated income tax by corporations
T	Tax Rate	Unrelated business income (UBI) over $1,000 of a tax-exempt corporation is subject to tax at corporate regular income tax rates.
R	Return Form	An unrelated business income (UBI) tax return (Form 990-T) is required of an exempt organization with at least $1,000 of gross income used in computing the UBI tax for the tax year.

Valuation

- **Donee organization's perspective.** In general, the best practice for an organization that receives a noncash donation is not to participate in, or ratify, the donor's valuation of the property for deduction purposes.
- Provide the required contemporaneous written acknowledgment to the donor *describing* (not valuing) the property.
- Sign Form 8283 as required, which again does not include any ratification of the donor's valuation.
- **Donor's perspective.** A contribution of a partnership or LLC interest for which a section 170 deduction of $5,000 or more is taken must be supported by a *qualified appraisal* of the donated interest, prepared by a *qualified appraiser*. See section 170(f)(11)(C), (E).

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Valuation

Basic Valuation Approaches

- Market Approach
- Income Approach
- Cost Approach

- The nature of the business and the history of the enterprise from its inception;
- The economic outlook and the conditions and outlook of the specific industry in particular;
- The book value of the stock and the financial condition of the business;
- The earning capacity of the business;
- The dividend-paying capacity;
- Whether or not the enterprise had goodwill or other intangible value;
- Prior sales of the stock and the size of the block of stock to be valued; and
- The market price of stocks and the sizes of companies engaged in the same or a similar line of business having their stocks actively traded on an exchange or over-the-counter market

Valuation

- Reg. §§ 25.2512-3(a)- Valuation of interests in business
- Rev. Rul. 59-60, 1959-1 CB 237 – "In valuing the stock of closely-held corporations where market quotations are not available, all other available financial data, as well as all relevant factors affecting the fair market value must be considered for estate tax and gift tax purposes."
- Rev. Rul. 65-193, 1965-2 CB 370 – Separate appraisals needed to value the tangible and

intangible assets of a business

- Rev. Rul. 77-287, 1977-2 CB 319 – Deals with securities that cannot be immediately resold because they are restricted from resale pursuant to Federal securities laws
- Rev. Rul. 80-213, 1980-2 CB 101 – Valuation of stock of a subsidiary corporation that may only be sold with shares of the parent organization (i.e., "paired" stock)
- Rev. Rul. 83-120, 1983-2 CB 170 – Factors to consider in valuing common and preferred stock of a closely-held corporation

Timing

A charitable gift is made when the properly endorsed and transferable stock is deliver to the institution or agent for the institution. If the gifting of the stock is concurrent or in a short time span in relation to the sale of the business, the IRS takes the position that the sale of the property was by the donor, and the gift was one of the proceeds to the charity.

A donor cannot have the requirement that the charity would redeem the interest in a specified amount of time.

The donor should not have a pre-arranged agreement with the charity when there purchase and sale agreement in place.

The charity should determine the liquidity impact before receiving the gift to manage tax impact.

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Tips and Take Aways

- *A tax exempt organization can own S corporation stock since 1998 as a result in the change of law.*
- *The donor's tax deduction is usually less than the appraised value of the stock.*
- *For every day that the charity owns the stock, the charity must report its share of the corporation's income as unrelated business taxable income ("UBTI") and must pay the unrelated business income tax ("UBIT").*
- *Normally a charity does not have UBTI when it sells stock from its investment portfolio for a profit, a sale of appreciated S corporation stock will trigger a UBIT liability.* Sec. 512(e)(1)(B)(ii

Tips and Take Aways

- *Impact on other owners. Comb the organizational documents for tag along and drag along clauses*
- *Non grantor Charitable Lead Trust is permitted to be a shareholder of an S corporation if the trust makes an electing small business trust election.*
- *Transfers of 50 percent or more of a partnership during one year may lead to a technical termination of the partnership. (Sec. 708(b)(1)(B*
- *A donation of debt-financed property may produce UBTI for the recipient charity. Sec. 514(b)*

Questions

Thank you for joining us!!!

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