

Tax Break for Donation of Closely Held Stock

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Julian Block

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Charity begins at home for people who own shares of closely held companies — legal-speak for shares not publicly traded on the New York Stock Exchange or other securities markets.

Give a Little, Get a Little

If you own shares of such a company — as is the case with many entrepreneurs — you can realize big tax savings by contributing some of those shares to religious groups, schools and other philanthropic organizations.

Done correctly, contribution-redemptions allow you to withdraw sizable amounts from your company without being taxed and without giving up any ownership interest in your business. To qualify a withdrawal as tax free, make a charitable contribution of your stock, which, *without any prearrangement*, is then sold by the charity to your company.

How It Works

Della Jerome owns all 1,000 shares of her company, Lady Godiva Accessories (LGA). Her shares originally cost \$1,000 and now are worth \$100,000. Suppose Della wants to donate \$15,000 to Roosevelt University. But instead of writing a check, she donates 150 shares.

Roosevelt is free to do what it pleases with those 150 shares. LGA then offers to redeem the shares for the fair market value of \$15,000. Because Roosevelt has no other practical way to turn the shares into cash, it accepts LGA's offer.

Win-win: Della gets a charitable deduction of \$15,000, the value of her contributed stock, without laying out a penny of her own cash — and she escapes taxation on the appreciation of the donated shares. Roosevelt University ends up with a cash contribution. And LGA has, in effect, paid out funds on behalf of Della, who once again owns all the stock. The redeemed shares are simply carried at cost as treasury stock on LGA's books.

Show Me the Money

What does this accomplish? Della avoids the dividend income of \$15,000

that she would have realized had she directly bought the stock from LGA, *then* contributed the proceeds to Roosevelt.

Caution: The Internal Revenue Service can still spoil the fun if Roosevelt University is legally bound or can be compelled by LGA to surrender the shares for redemption. In that event, warns an IRS ruling, the agency will treat the contribution redemption as a dividend to Della (Rev. Rule 78-197).

No IRS Worries

But there really is no need for any prior agreement requiring the recipient to sell stock back to the donor. After all, what else is Roosevelt University going to do with 150 shares of LGA?

Ordinarily, it makes sense for Roosevelt University to convert the shares into cash by selling them, and the most logical buyer is LGA itself, which is more than happy to liquidate a potentially bothersome minority interest.

Note: IRS approval of the contribution-redemption device does not bar it from trying to reduce the amount of Della's charitable deduction. It can do so by valuing the shares of LGA lower than the \$15,000 that she claimed.

Writer: Julian Block is a tax attorney in Larchmont, N.Y., and author of "Julian Block's Tax Avoidance Secrets," an annual guide now in its 13th edition.

About This Item

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The Edward Lowe Foundation was created by Ed and Darlene Lowe in 1985 to "champion the entrepreneurial spirit." Headquartered near Cassopolis, Michigan, the foundation works with entrepreneur support organizations nationwide to encourage peer learning among second-stage business owners. Before his death in 1995, Ed Lowe, the creator of Kitty Litter, had become an advocate for entrepreneurship as the key to the success of the free-enterprise system.

Contact: 800-232-LOWE(5693) or edwardlowe.org

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