A Gift of Sales Proceeds Is Never Better Than a Gift of Property — OR IS IT?

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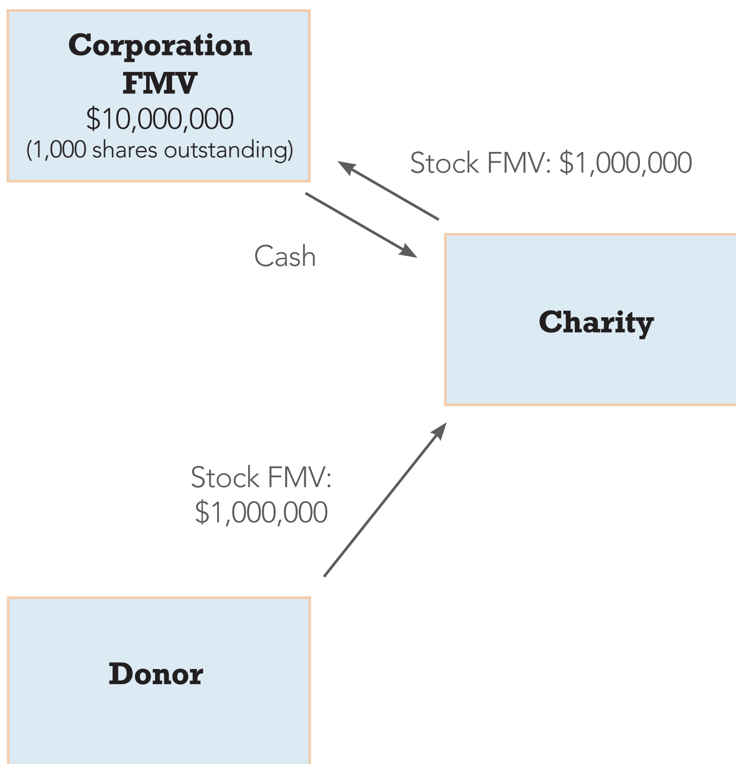
One of the basic principles of gift planning, among the first things the fledgling gift planner learns, is that the donor always comes out ahead donating property to charity before the property is sold. That way, the donor avoids the capital gains tax otherwise due, and still gets a fair market value deduction (which is then available to offset the donor's other taxable income, including any capital gain resulted from the sale of the remainder of the property). And it's all the same to the charity, since it is not subject to tax in any event, right?

This issue is often presented in the context of a donor selling a closely-held business interest. Many a gift planner has been disappointed to receive a call from a donor with whom he or she has been working for some time, saying "Good news! I just closed on the sale of my business and now I'm ready to get moving on that gift proposal we've been discussing." Oh, if only the donor had called earlier, so we could have arranged a gift of stock. Now it's too late to get the best result. People who work in planned giving are, of course, inherently optimistic, so they proceed with the plan, but always have a tinge of regret that they didn't get to do it the right way.

But is that always right? Is a gift of the property always better than a gift of the proceeds? Like virtually all operating assumptions, this one has to be studied in detail for every case the planner deals with. Sometimes, believe it or not, it might be better to wait until the donor's sale of his/her business is over, and make a gift out of the net cash proceeds, than to give the donee an interest in the business (e.g., stock) before the sale occurs.

Abstract: The author compares various options for funding charitable gifts with stock, including shares of S-Corporations and C-Corporations. He considers which options are most beneficial for the donor and for the charity receiving the gift. Syllabus for Gift Planners code: 3.02

Figure 1
Charitable Stock Bailout



Analyzing the Charitable Stock Bailout

The donor, Fergus Family, owns all of the stock of Family Business, Inc. (FBI). For some time now, he has been considering making a substantial contribution to his alma mater, Big University. Fergus has been approached by a potential buyer about selling the business. FBI has 1,000 shares of stock outstanding, and the total value of the company is $10 million, or $10,000 per share. The original plan would have Fergus donate 10 percent of the shares, or 100 shares, worth $1 million, to Big U. The parties contemplate that Big U will thereafter offer the shares to FBI for redemption at their full fair market value of $1 million, in a classic "charitable stock bailout." Figure 1 outlines this transaction. After that transaction has been completed, Fergus will transfer his remaining 900 shares to an independent third-party buyer.

Let's contrast the results to Fergus of two different approaches to this transaction. Either way, he is devoting a 10 percent interest in his company to charity. In Alternative 1, Fergus will contribute 100 shares of stock to Big U and sell the remaining 900 shares to an independent buyer for $9 million in cash. In Alternative 2, Fergus will sell his entire 1,000 shares of stock to an independent buyer for $10 million in cash, then contribute part of his proceeds (either $850,000, which is the net after-tax proceeds from 100 shares, or $1 million, the gross proceeds from 100 shares) to charity.

Alternative 1: Gift of Stock

Assuming that Fergus has a zero basis in the FBI stock, this transaction would produce the following tax results:

Charitable contribution of 100 shares............... $1,000,000

Discount of 30% for minority shares
and lack of marketability....................................... (300,000)

Allowable charitable deduction............................. $700,000

Net tax savings in 35% bracket $245,000

When Fergus sells the remaining 900 shares of FBI to his buyer, the tax results would be as follows:

Gross proceeds from sale of stock.....................$ 9,000,000

Capital gains tax (at 15% rate)..............................(1,350,000)

Net after-tax proceeds.. $ 7,650,000

Plus: tax savings from contribution (above) 245,000

Total after-tax proceeds..................................... $ 7,895,000

Thus, by giving the stock to charity before the sale, Fergus ended up with a total of $7,895,000.

Alternative 2: Gift of Proceeds

Now, let's take a look at the results to Fergus if, rather than contributing the stock to Big U, he contributed the net after-tax proceeds from $1 million of his sales price.

After-sale proceeds to donor
from sale of 100 shares $1,000,000

Capital gains tax (at 15% rate)..................................150,000

Gift to charity of net proceeds $850,000

Net tax savings in 35% tax
bracket (35% of $850,000).................................... $297,500

Less tax savings from gift of stock (see above)....... 245,000

Increased tax savings from gift of proceeds $52,500

Summary — Results to Donor

Benefit to Donor:

Sales proceeds..$10,000,000

Capital gains tax at 15% rate............................... (1,500,000)

Net after-tax proceeds... $8,500,000

Less charitable gift..(850,000)

Plus tax savings 297,500

Total after-tax proceeds..................................... $7,947,500

Compare with net proceeds
from stock transfer approach.............................. $7,895,000

A gift of proceeds, rather than stock, has an advantage of $52,500.

Alternatively, if the donor feels more generous, he may choose to donate $1,000,000 of the proceeds rather than just $850,000. That approach would result in the following:

Gift to charity.. $1,000,000

Net tax savings in 35% tax
bracket (35% of $1,000,000) $350,000

Sales proceeds.. $10,000,000

Less tax savings from gift of stock (see above)...... (350,000)

Sales proceeds..$10,000,000
Capital gains tax at 15% rate.......................... (1,500,000)
Net after-tax proceeds...$8,500,000

Less charitable gift... (1,000,000)
Plus tax savings 350,000

Total after-tax proceeds................................... $7,850,000
After-tax proceeds from $850,000 gift $7,895,000
Difference — reduction of $45,000

Giving the additional $150,000 to Big U cost the donor only $45,000.

Results to Donor

Taking all the figures into account—the cash proceeds received by Fergus, the capital gains tax he must pay and the taxes saved as a result of his contribution deduction—he nets $7,895,000 from the stock contribution and $7,947,500 from a comparable gift of the proceeds.

Of course, this is based upon the assumptions stated above, including the 30 percent discount in the value of the contributed shares, reflecting customary discount for lack of marketability and the fact that the contribution was only a 10 percent interest in the corporation. The results would vary if Fergus was able to deduct the full $1,000,000 value of the shares, but that is not realistic. Even if that were done, his contribution would produce a net tax savings of $350,000 which, added to the $7,650,000 after-tax proceeds from the sale of his remaining 90 percent, would produce after-tax proceeds of $8,000,000 versus $7,850,000 from the gift-on-proceeds alternative—a difference of just $150,000.

Results to Charity

A bigger change occurs on the donee side of the transaction, especially when the nature of the corporation is taken into account. It makes a significant difference to the charitable donee, Big U, whether Family Business Inc. is a C-Corporation or an S-Corporation. Why? Because any proceeds received by a charitable organization from the sale of S-Corporation stock is taxable to the charity as unrelated business taxable income (UBTI), taxable at the regular federal corporate tax rate:

- 15% of the UBTI that does not exceed $50,000,
- 25% of the UBTI that exceeds $50,000 but does not exceed $75,000,
- 34% of the UBTI that exceeds $75,000 but does not exceed $10 million, and
- 35% of the UBTI that exceeds $10 million.

Note: The rates listed above do not reflect an additional tax imposed where UBTI is between $10,000,000 and $18,333,333. In addition, the corporate alternative minimum tax may apply, but that too is not reflected in the

rates listed above. Neither of these factors is taken into account in examples that follow. If the charity is organized as a trust, rather than a Corporation, the unrelated business income tax is imposed at the considerably higher trust income tax rates. Those rates reach a maximum rate of 35% when the UBTI exceeds just $10,450.

Alternative 1: Gift of stock, followed by sale

If FBI is a C-Corporation:

Presale gift of 100 shares to Corporation:

Donor and charity both sell their shares to buyer

Charity receives $1,000,000 and is exempt from tax

Net to charity: $1,000,000, end of story

If FBI is an S-Corporation:

As above, Charity receives $1,000,000, but this time it is subject to the unrelated business income tax.

Proceeds received by charity	$1,000,000
Less tax at corporate rates	328,250
Net to charity	$671,750

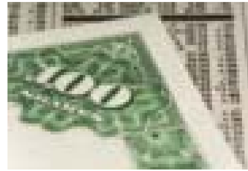
Alternative 2: Post-sale gift to charity of cash proceeds

Gift to charity	$850,000	$1,000,000
Tax to charity	0	0
Net to charity	$850,000	$1,000,000
Advantage over gift of stock	$178,250	$ 328,250

These examples demonstrate that determination of the overall tax impact of a contribution of this sort is a detailed computation with a number of variables. In addition, they demonstrate how the structure used for such a gift can affect the after-tax results to the charitable donee in a much more dramatic fashion than the differences at the donor's level. On the assumptions set forth above, the donor's proceeds were $52,500 greater from a gift of the net cash proceeds ($850,000) rather than the stock. But the net to the charitable donee was $178,250 greater. This is a "win-win" situation.

Summary and Conclusion

Excessive reliance on numerical figures such as those set forth above can have its drawbacks. Over and above the danger of putting the reader to sleep, the bottom line conclusion is affected by so many different factors that the overall effect can easily be overstated or understated with only a few minor changes in the assumptions. The applicable tax rates (both for the donor's individual income taxes and the charity's UBIT), valuation of the donor's contribution for deduction purposes and various aspects of the donor's individual tax position make it hard to draw general conclusions. Then too, the computations set forth above do not take into account the parties' state income tax obligations. As with any numerical examples, these figures are most useful in demonstrating the applicable principles rather than the precise results.



"Good news! I just closed on the sale of my business and now I'm ready to get moving on that gift proposal we've been discussing." Oh, if only the donor had called earlier, so we could have arranged a gift of stock. Now it's too late to get the best result.

However, remember where we started. Most gift planners are accustomed to concluding that a donor benefits more by contributing property rather than selling that property and contributing the proceeds of sale. For many, this is an article of faith and is true in every case, bar none. We've seen, however, that that is not necessarily true.

The example above deals with proposed contribution of S-Corporation stock. Such stock is not unusual, as a number of closely held American businesses are operated in S-Corporation form. So, the facts portrayed above represent at least one common situation where the property-rather-than-cash assumption is misleading, due to the tax treatment of such stock in the hands of the charitable donee.

And it can be more complicated than our example above. Some charitable organizations are set up as trusts rather than nonprofit corporations. This makes a difference when it comes to UBTI, since the unrelated business income tax applies at the rates applicable to either trusts or corporations, depending upon the form of the subject charity. As mentioned above, trusts hit the maximum income tax rate of 35 percent when their taxable income exceeds $10,450, while corporations don't hit their maximum rate of 34 percent until their income reaches $75,000. So trusts are at a disadvantage in this respect. Partly as a result of this, some organizations have resorted to supporting organizations to accept S stock and other problem transfers. On the other hand, trusts are entitled to use the current 15 percent tax rate for capital gains, while corporate capital gains are taxed at the full ordinary income rate. So it's hard to generalize, and the precise results will depend upon all the applicable facts.

Other situations can have a similar effect. For example, if our donor in the preceding examples contributed the stock to charity after he was already obligated to sell it to the independent third-party buyer, the gift-of-stock alternative could be even more expensive. In that situation, the donor would be subject to capital gains tax even though he had already transferred the property. Also, if the property in question has a basis in excess of its value (property that has depreciated rather than appreciated), the donor would normally be well-advised to sell it and contribute all or part of the proceeds. By so doing, the donor's deduction will be the same, but he or she will also realize a potentially deductible capital loss.

There might be other situations as well. The end result is something that should have been obvious to the careful planner in the first place: it is necessary to think through the implications and "run the numbers" in every situation. Gift planning is a complex undertaking, and, while it can be helpful to resort to general principles and assumptions, the actual results will always depend upon all the facts of the specific case.

André R. Donikian, JD, is founder, president and editor in chief of Pentera Inc., a full-service planned-giving firm based in Indianapolis. He has served on the board of NCPG and the Board of Advisors of Union College, and is a founder and former board member of the Planned Giving Group of Indiana. He is the recipient of numerous awards, including the David M. Donaldson Distinguished Service Award from the Planned Giving Group of New England in 1991, and The Spirit of Philanthropy Award from The Center on Philanthropy at Indiana University in 2006. Donikian has published and lectured extensively on philanthropic tax planning, and has developed continuing education programs for state bar associations and accountancy boards.

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