

PLANNED GIVING WITH CLOSELY HELD BUSINESS INTERESTS

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Why Use Business Interests in Planned Giving?

- Estate and Income Tax Avoidance**
- Lack of Liquidity**
- Pent up Capital Gain**
- Make a Significant Charitable Impact**



Overview of Estate Tax System

- Unified Credit (exemption equivalent is currently \$5,250,000)**
- Tax Rate is 40%**
- Unlimited Marital Deduction**
- Spousal Portability**
- Unlimited Charitable Deduction**



Overview of Estate Tax System

- **\$14,000 Annual Gift Tax Exclusion**
- **“Step Up” in Basis to FMV**
- **Generation Skipping Transfer Tax**
- **Taxes Due (in full) within 9 Months**



American Taxpayer Relief Act of 2012

- **Impact of increased income tax rates on trusts and estates**
- **Individuals hit maximum 39.6% rate at \$400,000**
- **Trusts and estates hit maximum 39.6% at only \$11,950**



Affordable Care Act Medicare Surtax

- **3.8% Unearned Income Medicare Tax**
- **Includes passive activity income from family businesses**
- **Trusts will pay this tax on undistributed unearned income**
- **CRTs defer recognition of income**



Income Tax Avoidance

- **Generally, no recognition of gain on contribution to charity**
- **Exceptions:**
 - **Bargain Sales**
 - **Prearrangement - Express or implied obligation to sell**



Types of Charitable Entities

- **Public Charity**
- **Private Operating Foundation**
- **Private Foundation (PF)**
- **Donor-Advised Fund (DAF)**
- **Charitable Trusts**
 - **Charitable Remainder Trust (CRT)**
 - **Charitable Lead Trust (CLT)**
 - **Charitable Trust Taxed as PF**



Charitable Remainder Trusts

- **CRATs and CRUTs**
 - **Life or term of years (before charity)**
 - **No additional contributions to CRAT**
 - **5% Minimum – retained payment**
 - **10% Minimum – charitable remainder**
 - **Grantor can retain right to change charities**
 - **NIMCRUTs and FLIPCRUTs**



Charitable Remainder Trusts

- **CRATs and CRUTs**
 - **Generate an immediate income tax deduction (will talk about limitations shortly)**
 - **Estate tax savings**
 - **Income tax deferral (and perhaps avoidance)**
 - **Diversification without triggering immediate gain**
 - **Potential increased cashflow by converting to a portfolio of securities**
 - **Benefit charity**



Charitable Lead Trusts

- **CLATs and CLUTs**
 - ▣ **Life or Term of Years (before family)**
 - ▣ **No minimum payout**
 - ▣ **Grantor v. Non-grantor**
 - ▣ **Not tax-exempt (files 1041); but charitable deduction for payments**
 - ▣ **Because of charitable interest, transfer to family is at a reduced amount**



Charitable Deduction Issues

- Types of Deductions
 - ▣ Basis Deduction
 - ▣ Fair Market Value Deduction
 - Considerations:
 - Shareholder and buy/sell agreements
 - Marketability and control issues
- Deduction Limitations
 - ▣ Limits the percentage a donor may deduct from his or her contribution base (adjusted gross income (AGI))
 - ▣ 2% floor on itemized deductions



Charitable Deduction Issues

- Deduction Limitations for Charitable Contributions
 - ▣ Private Foundation – limited to donor's basis in the stock up to 20% of AGI
 - ▣ Donor-Advised Fund/Public Charity – Limited to FMV of stock, up to 30% of AGI
 - ▣ Supporting Organization -- Limited to FMV of stock, up to 30% of AGI



Charitable Deduction Issues

- Pease Limitation (phase-out of itemized deductions) for 2013
 - Threshold
 - Joint filers - \$300K
 - Head of household - \$275K
 - Single - \$250K
 - Married filing separately - \$150K
 - Itemized deductions reduced by 3% of excess of AGI over threshold amount
 - Reduction of ded's not to exceed 80%



Charitable Deduction Issues

- Substantiation
- Valuation/Qualified Appraisal
- Alternative Minimum Tax (AMT) – itemized deductions



Restrictions on Charitable Entities

- Unrelated Business Taxable Income (UBTI)**
- Excise Taxes**
- Prohibited Transactions**
- Intermediate Sanctions**



Donor's Concerns and Issues

- Tax Avoidance**
- Control Over Amount and Timing of Charitable Distributions**
- Control Over Future Investments**
- Benefit Society**



Charity's Concerns and Issues

- ▣ Transferability – will want an exit strategy
- ▣ Liquidity and Timing – converting to cash
- ▣ Valuation
- ▣ Risk Management – potential liability concerns



Types of Business Entities

- ▣ Sole Proprietorship (SP)
- ▣ Partnership – General (GP) or Limited (LP)
- ▣ Limited Liability Company (LLC)
- ▣ S Corporation
- ▣ C Corporation
- ▣ Professional Practice



Types of Business Entities

- ▣ **Partnerships and LLCs Taxed as Partnerships (pass through)**
 - **Outright Gifts**
 - PF – Self-dealing rules/Excise Taxes/UBTI
 - Public Charity – Intermediate Sanctions/UBTI
 - **CRT –**
 - UBTI causes loss of tax-exempt status
 - Self-dealing rules
 - PLR indicated that a partnership could create a CRT
 - Distribution followed by transfer



Types of Business Entities

- ▣ **Partnerships and LLCs Taxed as Partnerships (pass through)**
 - **CLT -**
 - UBTI
 - Self-dealing
 - Excise Taxes



Types of Business Entities

- **C Corporation (separate taxpayer)**
 - **Outright Gifts**
 - **PF – self-dealing**
 - **Public Charity – intermediate sanctions**
 - **No UBTI**
 - **Corp as donor**



Types of Business Entities

- **C Corporation (separate taxpayer)**
 - **CRT**
 - **No UBTI**
 - **Redemption**
 - **C Corp can establish a CRT**
 - **CLT**
 - **Source of future income necessary**
 - **Consider income tax consequences**
 - **Self-dealing/excise taxes**
 - **Valuation Discounts**



Types of Business Entities

- ▣ **S Corporation (pass through)**
 - SH eligibility – public charity and grantor CLT - OK; CRT - no
 - UBTI on operating income and sale
 - Alternative: S Corp as Donor to CRT
 - PLR says that S corp's deduction for contribution to CRT passes through



Types of Business Entities

- ▣ **S Corporation (pass through)**
 - Grantor CLT – eligible SH; no UBTI
 - Self-dealing/excise taxes



Defined Value Issues

- Defined Value Clause – excess over dollar amount passes to charity or other entity
- IRS public policy argument
- Relevant Decisions
 - Procter, 142 F.2d 824 (4th Circ. 1944)
 - McCord, 120 T.C. 358 (2003)
 - Christiansen, 130 T.C. 1 (2008)
 - Wandry, T.C. Memo 2012-88



Defined Value Issues

- Use of Defined Value Clauses to Reduce Audit Risk
 - Bequest of excess shares over a certain dollar amount to charity or CLT to minimize incentive to audit estate
 - Gift of excess of shares over a certain dollar amount transferred (by gift and/or sale) to Intentionally Defective Grantor Trust (IDGT) to minimize incentive to audit gift

