Making Planned Giving Work for Business Owners

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I. Privately-Held Business Entities

a. C Corporation

i. Character - The C corporation is a creature of state law and is formed by the filing of Articles of Incorporation with the proper state agency. By-Laws should be adopted which determine with greater detail the governance of the corporation. The shareholder(s) (either one or more) are the equity owners of the corporation. The Board of Directors is the policy making body for the corporation, while the officers are its daily operational leaders. The corporation will ordinarily issue stock certificates to the shareholder(s), as evidence of their ownership interest. The stock is a separate asset that may be transferred. In many instances, however, the shareholders enter into a buy-sell agreement restricting, among other things, the transfer of that stock and establishing certain rights upon the sale or other transfer of that stock. The shareholders, directors and officers are generally not legally liable for the acts and debts of the corporation.

ii. Taxation – A corporation which is taxable as a "C corporation" is governed by Subchapter C of the Internal Revenue Code of 1986, as amended ("Code", and reference to Section shall mean a Section of the Code, unless otherwise referenced). In general, the corporation itself is a separate taxable entity. Taxable income or gain which it earns or incurs is taxable at the corporate level. The corporation's owners (shareholders), however, may also be subject to income tax on their receipt of distributions from the corporation. Thus, the oft-stated phrase that the C corporation is subject to a double level tax – once at the corporate level and again at the shareholder level. For example, if a C corporation earns $1 Million of net income at an assumed corporate tax rate of 50%, the corporation will pay $500,000 in taxes. If the corporation then makes a dividend distribution of $500,000 to the shareholders, the shareholders will pay tax of $250,000 at an assumed tax rate of 50%. Thus, the net after tax proceeds would be $250,000. *This oversimplified example is for conceptual purposes only, as many exceptions and reduced rates do apply under both the C and S corporate tax rules.*

b. S Corporation

i. Character - Like a C corporation, the S corporation is a creature of state law and is formed by the filing of Articles of Incorporation with the proper state agency. By-Laws should be adopted which determine with greater detail the governance of the corporation. The shareholder(s) (either one or more) are the equity owners of the corporation. The Board of Directors is the policy making body for the corporation, while the officers are its daily operational leaders. The corporation will ordinarily issue stock certificates to the shareholder(s), as evidence of their ownership interest. The stock is a separate asset that may be transferred. In many instances, however, the shareholders enter into a buy-sell agreement restricting, among other things, the transfer of that stock and establishing certain rights upon the sale or other transfer of that stock. The shareholders, directors and officers are generally not legally liable for the acts and debts of the corporation.

ii. Taxation – Unlike a C corporation, the taxation of the S corporation and its shareholders is governed under Subchapter S of the Code. In general, the S corporation is not treated as a separate taxpaying entity and the taxable income and gain passes through to its shareholders. Thus, the S corporation is coined as a "conduit" entity. In the example described above in I.a.i., the tax consequences would be as follows: S Corporation would have no taxable income and the shareholders in the aggregate would be subject to income tax equal to $500,000. Thus, the net after tax proceeds would be $500,000, or $250,000 greater than the C corporation.

c. Partnerships

i. Character – A partnership is a business entity with two or more individuals acting together for a joint purpose, in which the profits and expenses are shared in furtherance of that purpose. In general, there are three types of partnerships – general, limited and a limited liability partnership. A general partnership does not need to file any document with any state agency to be formed. In fact, a general partnership does not need any formal writing or agreement. All general partners are legally liable for the acts and debts of the partnership. A limited partnership, however, is generally created by the filing of a Certificate of Limited Partnership with the proper state agency. A limited partnership has two types of partners – general and limited. The general partner ordinarily controls and manages the activities of the partnership and is legally liable for its acts and debts. The limited partner is not ordinarily legally liable for the acts and debts of the partnership and can only have limited involvement with the operation of the partnership to retain the limited liability stature. In a limited liability partnership, the partners are not ordinarily liable for the acts and debts of the partnership and a managing person is chosen. Ordinarily, partners are not given any specific evidence of ownership, like in a corporation. The partner's interest in the partnership is nevertheless a separate asset and can be transferred. In many instances, however, the partners enter into a partnership agreement restricting, among other things, the transfer of their partnership interest and establishing certain rights and duties of the partners. A partnership owned by family members is referred to as a family limited partnership or FLP.

ii. Taxation – Any type of partnership is also a "conduit" entity, as described generally above under I.b.i. The partnership itself is not a taxpaying entity and the partners in the aggregate share the taxable income and gain which is passed through the partnership to them. The taxation of a partnership is governed under Subchapter K of the Code. Treas. Reg. Section 301.7701-2(a) now permits an entity with two or more members to be classified as a partnership for federal tax purposes by simply "checking the box" to be so treated. Prior to this simplified procedure a complex array of tests (under the Kintner Regs) had to be met in order to assure the conduit treatment for tax purposes. Under the old regime, certainty of tax status could often be questioned.

d. Limited Liability Company (LLC)

i. Character - Like a C corporation, an S corporation, a limited partnership and a limited liability partnership, an LLC is a creature of state law and is formed by the filing of Articles of Organization with the proper state agency. An LLC may have one or more members in most states. The members are the equity owners of the LLC and the LLC is operated either by a majority vote of the members or by an appointed managing member. Ordinarily, members are not given any special evidence of ownership, like in a corporation. A membership interest in an LLC is nevertheless a separate asset and can be transferred. In many instances, however, the members enter into an operating agreement restricting, among other things, the transfer of their membership interest and establishing certain rights and duties of the members. The members are not legally liable for the acts and debts of the LLC.

ii. Taxation – An LLC with more than one member (a multi-member LLC) is generally taxed as a partnership (as described generally above at I.c.i.), unless it elects to be taxed as a corporation (then likely, as described generally above at I.a.i.). An LLC with only one member (a single member LLC or SMLLC) is either taxed as a corporation or is totally disregarded for tax purposes, a "tax nothing", so to speak.

e. Sole Proprietorship – A sole proprietorship is truly a tax nothing. The business does not have a separate entity for state law purposes and all tax items are reflected on Schedule C of the owner's personal income tax return. Simplicity is the hallmark of the sole proprietorship, but so is liability. The owner is legally liable for all acts and debts of the sole proprietorship. Only the assets of the sole proprietorship can be transferred.

II. Planned Giving Vehicles of Interest to Business Owners

a. Charitable Remainder Trusts (CRT)

i. NIMCRUT

1. Character of Income Stream - A net income with makeup charitable remainder unitrust ("NIMCRUT") pays the unitrust amount from the lesser of (i) the net fiduciary income earned by the trust's assets or (ii) a percentage of the net fair market value of the trust's assets (determined annually). A deficiency account may accrue, which may be "made up" in subsequent years when and if the net fiduciary income of the trust for that year exceeds the stated percentage payout rate.
2. Use as a Flexible Tool for Special Needs - The definition of "fiduciary income" is one of the components in calculating the unitrust amount. If the unitrust amount generates no fiduciary income, no payment will be made to the income beneficiary of the trust. Fiduciary income is a term of art and is defined by the terms of the trust agreement and state principal and income laws. Although state law trends have been significantly changing, interest income and dividends are generally allocable to fiduciary income, and capital gains are not allocable to fiduciary income. However, the IRS permits the allocation of post-contribution gain to fiduciary income. For instance, upon the sale of privately-held C corporation stock by a CRT soon after its contribution, no fiduciary income will likely be incurred, because capital gains on the stock relate to gain accruing prior to the contribution to the trust (pre-contribution gain). However, if the CRT holds the stock and its goes up in value, then the appreciation accrued after the date the stock is contributed to the trust (post-contribution gain) will constitute fiduciary income when the stock is ultimately sold and the cash proceeds are generated. Upon the trust's receipt of fiduciary income, the cash must be distributed to the income beneficiary in accordance with the definition of the unitrust amount. If a donor/income beneficiary desires to use the trust as a supplemental device for retirement planning, for instance, the trust should contain language which affirms that use in the definition of fiduciary income and state law should be reviewed. On the other hand, an appreciating diversified portfolio of marketable securities will likely generate fiduciary income each year, because these investments will be more readily traded. Likewise, the annual distributions from a mutual fund will constitute fiduciary income, if the fund has appreciated in value. As you know and bucking recent trends, individual stocks or mutual funds may not always go up in value. If the assets of the trust fail to appreciate in value, the unitrust amount payout is directly affected. For instance, if the trust acquires only IBM stock and it goes down in value, no fiduciary income will be produced upon its sale, because the IBM stock did not appreciate in value. Concomitantly, no payment of the unitrust amount will be made to the income beneficiary. If the intended use of the trust is for a particular financial planning purpose, special consideration must be given prior to the execution of the trust and implementation of such purpose. For instance, some donors desire to use a NIMCRUT as a supplement to their retirement planning. In that event, the mix of investments will dictate the ability to control the timing of the receipt of fiduciary income, and therefore, the timing of the receipt of the unitrust amount. If an annuity contract or an investment partnership or LLC is being considered for reinvestment of the trust's assets, special care must be exercised. It should also be noted that the IRS is unwilling to render a private letter ruling to determine whether such an investment structure disqualifies a CRT.

ii. FlipCrut - The final Regulations adopted in 1997 permit a "one-time" flip of the character of the unitrust amount to be received by the income beneficiary from a NIMCRUT interest to a standard CRT interest. The "triggering event" which causes the change in unitrust method must (i) be stated in the governing instrument, and (ii) arise (A) on a specific date or (B) by a single event whose occurrence is not discretionary with, or within the control of, the trustees or any other person. However, the initial unitrust method can only be an income exception method which flips into a standard unitrust interest, and the flip to the standard interest must take effect at the beginning of the taxable year following the year in which the triggering event occurs. As a consequence of the flip, any NIMCRUT make-up account will be forfeited. The final Regulations provide ten examples of permissible and impermissible triggering events. The permissible triggering events are generally those events that are outside of the control of any person. For instance, the IRS has stated that the sale of an unmarketable asset as defined in Treas. Reg. Section 1.664-1(a)(7)(ii), such as the donor's former personal residence, is a permissible triggering event. In addition, if an unregistered security for which there is no available exemption permitting public sale is used to fund a FlipCrut, a permissible triggering event is the earlier to occur of the date when the stock is sold or the time the restrictions on its public sale lapse or are otherwise lifted. The IRS also provides the following permissible triggering events: when the income beneficiary reaches a certain age, when the donor gets married, when the donor divorces, when the income beneficiary's first child is born, and when the income beneficiary's father dies. It does not appear that these safe harbors are exclusionary in nature. As should be expected, the impermissible events relate to occurrences, which are within the discretion of some person. For instance, the sale of publicly traded stock is not a permissible triggering event, because that decision is within the discretion of the trustee. In addition, a request by the income beneficiary or his or her financial advisor will likewise not be permissible events.

b. Charitable Lead Trusts (CLT)
    i. Character – As it relates to the payout, a charitable lead trust works in an inverse fashion as the charitable remainder trust. For instance and in general, a CLT pays the lead interest to charity for a period of years or the life of an individual with the remainder either reverting back to the donor or to or for the benefit of another private individual. A CLT can be created during life or at death and the lead payout can either be in the form of a unitrust amount or an annuity amount.
    ii. Types
        1. Non-Grantor - In a non-grantor CLT, the donor is not subject to income tax on the income and gain incurred by the CLT. Correspondingly, the donor is not entitled to an income tax deduction. The trust is a taxpaying entity, but receives a charitable income tax deduction for the lead payments to charity. The present value of the remainder interest in the CLT is treated as a gift for gift tax purposes.
        2. Grantor - In a grantor CLT, the donor is subject to income tax on all income and gain incurred by the CLT. Correspondingly, the donor is entitled to a charitable income tax deduction. The present value of the lead charitable interest is the amount the donor will be entitled to as a charitable income tax deduction. This deduction, however, will have to be recaptured for income tax purposes on a pro rata basis if the donor dies during the term of a term-of-years CLT. The trust is a tax nothing and does not receive a charitable income tax deduction for the lead payments to charity.
        3. Super-Grantor – The super-grantor CLT is a hybrid and special creature. It is essentially a defective grantor trust for income and estate and gift tax purposes. In other words, the donor is subject to all of the income and gain incurred by the trust (a grantor trust for income tax purposes), but the CLT assets are not includable in the gross estate of the donor. Thus, the donor can implement income and estate tax planning into his or her philanthropic planning.

c. Private Foundation v Donor Advised Fund v Supporting Organization
  i. Definitions
    1. Private Foundation – a private foundation is a charitable organization defined under Section 501(c)(3). The major distinction between a private foundation and a public charity is that the sources of funding for the private foundation are normally limited to a family or small group of individuals or a corporation. The creator may have total control over the investment and distribution of the private foundation's assets and its administration.
    2. Public Charity – a public charity is a charitable organization defined under Sections 501(c)(3) and 170(b)(1)(A)(i)-(vi) and generally include a church, a school, a hospital, a governmental unit, a charitable organization supported by the public at large, an organization that is supported by receipts from its charitable operations and a supporting organization, as described further below.
    3. Supporting Organization – a supporting organization is a public charity under Section 509(a)(3) which supports other public charities. In general, there are three types of supporting organizations: Type-1, in which a public charity legally controls the supporting organization (i.e., a parent-subsidiary relationship); a Type -2, in which a public charity legally operates or supervises the supporting organization (i.e., a brother-sister relationship); and a Type-3, in which a public charity oversees the operations of the supporting organization.
    4. Donor Advised Fund - A donor advised fund ("DAF") is a component fund of a community trust described in Treas. Reg. Section 1.170A-9(e)(11)(ii). A community trust is any organization that meets the requirements of Treas. Reg. Section 1.170-9(e)(11)(iii)-(vi) and is treated as a single entity rather than an aggregation of separate funds. DAFs have historically been most commonly used by traditional community foundations. A DAF is, in its simplest form, a contract with a charity in which a donor contributes assets to a public charity, and the charity holds those assets in a fund from which the donor (and his or her family) may advise the charity as to annual distributions to make to the sponsoring charity or to another public charity.
  ii. Benefits of Public Charity Status
    1. More Favorable Income Tax Deductions – Donors to a public charity receives favorable income tax deduction treatment as compared to the treatment given donors to private foundations. For instance, cash contributions are deductible up to 50% of adjusted gross income and gifts of long-term capital gain property are deductible up to 30%. Cash contributions to private foundations are limited to 30% of adjusted gross income and 20% in the case of gifts of long-term capital gain property. Gifts of long-term capital gain property to a public charity are deductible to the extent of the fair market value of the contributed asset, whereas gifts of this type of property (except marketable securities) to a private foundation are limited to the donor's adjusted tax basis in the asset.
    2. Exemption from the Prohibited Transaction Rules Applicable to Private Foundations - Private foundations are subject to extensive regulation and specifically are subject to an excise tax regime covering the private foundation's administration, investments, distributions and business transactions under Sections 4940 through and including 4945. These rules effectively prohibit a donor from contributing a privately-held business interest to a private foundation. However, control is absolute with the private foundation - the donor (and his or her family) may maintain absolute control over the administration of the private foundation, investment of its assets and the amount, character and timing of its distributions.

III. Technical Issues & Solutions

a. Unrelated Business Income Tax ("UBIT")

i. Character of Tax - A public charity is generally not subject to income tax, See, Section 501(a). Likewise, a CRT is generally not subject to income tax, See, Section 664(c). However, a substantial exception to this "tax-exempt" status applies to both a charity and a CRT (and in effect, a CLT) where such entity has unrelated business income. UBIT will apply to the activities of a public charity if three (3) factors are present: (i) income is derived from a trade or business, (ii) which is regularly carried on by the charity and (iii) the conduct of which is not substantially related to the charity's performance of its tax-exempt function, See, Section 512(a) and Treas. Reg. Section 1.513-1(a). Section 513 specifically addresses unrelated trade or business activity and defines it as, "any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501..." There are a variety of activities which can be conducted by a charity and not rise to the level of an "unrelated trade or business", such as where the charity's activity is "primarily for the convenience of its members, students, patients, officers, or employees....", See, Section 513 (*i.e.*, college cafeteria and book shop). Under Section 511(a), the amount of income subject to UBIT (which includes debt-financed income, as discussed below) will be taxed under the corporate rates under Section 11.

ii. Applications of Tax - It should be noted that the impact is different if a charity, a CRT or a CLT incurs UBIT. For instance, a charity will pay tax only on its unrelated business income, and the incurrence of UBIT will generally not otherwise adversely affect the charity. However, a charity may lose its tax-exempt status if the revenue generated from "unrelated" sources is substantial (one-half of the charity's annual revenues, See, GCM 39108) or if the operation of the unrelated trade or business is not in furtherance of its tax-exempt purposes and the charity is operated for the primary purpose of carrying on a trade or business. Whereas a CRT will lose its tax-exempt status for all purposes in any taxable year in which it incurs UBIT, See, Sections 511 and 664(c). A non-grantor CLT loses, on a dollar for dollar basis, its charitable income tax deduction under Sections 642(c) and 681. A charity, CRT or CLT may incur UBIT even if it indirectly owns a business activity. For instance, a limited partner, member of an LLC, or member of another non-corporate entity will have attributed to it UBTI of the enterprise as if it were a direct recipient of its share of the entity's income which would be UBTI if it were itself carrying on the business of the entity, See, Section 512(c), Revenue Ruling 79-222, 1979-2 C.B. 236 and *Service Nut & Bolt Co. Profit Sharing Trust v. Commissioner,* 724 F.2d 519 (6th Cir. 1983). In addition, applying the aggregate view of partnerships, the IRS National Office in TAM 9651001 advised that an interest in a partnership that holds debt financed property is effectively an interest in the partnership's underlying assets and liabilities. Thus, the charity received debt financed income from the sale of its partnership interests, But See, PLR 9414002 where the charity's sale of stock in a subsidiary corporation whose real estate was leveraged did not incur debt financed income as a corporation was a separate taxpaying entity. The incurrence of any debt by a CRT or CLT generally is dangerous. For instance, no investments (even marketable securities) should be acquired through the incurrence of "margin" debt.

iii. Debt Financed Income - Unrelated business income is not restricted to income from operations but also applies to gains from the disposition of debt financed property. Notwithstanding the exclusions for rent, capital gains and interest from UBTI discussed below, UBIT applies if debt financed income is generated. Under Section 514, certain income that would otherwise be excluded from the scope of UBIT must be included in UBIT because such income is incurred with respect to debt financed property. Section 514(b) defines "debt-financed property" as any property which is held to produce income and with respect to which there is "acquisition indebtedness" at any time during the year. Property held to produce a capital gain upon disposition, as well as property which produces a recurring income stream, is "held to produce income" for purposes of this definition, See, Treas. Reg. Section 1.514(c)-1(a)(1). The gain from the sale of such property is also subject to tax as UBIT. Keep in mind also that the sale of debt financed property within twelve (12) months of mortgage satisfaction will trigger this tax, See, Treas. Reg. Section 1.514(b)-1(a). In order to have a DFP, the property must be subject to "acquisition indebtedness". As stated in Treas. Reg. Section 1.514(a)-1(a)(1)(v), "acquisition indebtedness" means the outstanding amount of -- (i) the principal indebtedness incurred by the organization in acquiring or improving such property; (ii) the principal indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and (iii) the principal indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement. Treas. Reg. Section 1.514(a)-1(a)(1)(v) describes the method to calculate the taxable portion of the gain generated upon the sale of DFP, as follows: If debt-financed property is otherwise sold or disposed of, there shall be included in computing unrelated business taxable income an amount with respect to such gain (or loss) derived from such sale or other disposition as - (a) the highest acquisition indebtedness with respect to such property during the 12 month period, preceding the date of disposition, is of (b) the average adjusted basis of such property.

iv. Exceptions to Tax - Aside from the type of activities excepted from UBIT, Congress has recognized that the nature of the income arising from certain activities should be considered in determining whether the income should be treated as unrelated business income and taxable.

1. 512(b) exceptions - For instance, dividends and interest (Section 512(b)(1)), royalties (Section 512(b)(2)) and certain rents from real property (Section 512(b)(3)) are all excepted from UBIT, because such income is passive in nature. However, great care must be exercised in considering these technical qualifications of each exception. For instance, "rents from real property" is a term of art and generally requires that the rental of real property be fixed in amount and on a triple net basis and the landlord is prohibited from providing substantial services (as is more explicitly described under the real estate investment trust rules). Another significant exception to UBIT is gains on the sale of property (Section 512(b)(5)), unless such property is "inventory" (as discussed below in III.f. under "Dealer Issues") or is "debt-financed property" (as discussed above).
2. Holding Rule DFP Exception - An exception to the DFP rule is provided under Section 514(c)(2)(B) where, among other things, the encumbrance is placed on the property more than 5 years before the date of the gift.
3. Special School DFP Exception for Real Property - A substantial exception to the DFP acquisition indebtedness rules is described in Section 514(c)(9). Debt which is incurred in the acquisition of property by certain "qualified organizations" will not be treated as acquisition indebtedness, so long as such organizations do not violate certain statutory prohibitions. This exception applies only to schools (and their affiliated supporting organizations) and Section 501(c)(25) organizations.

b. Excess Business Holdings Tax

i. Character of Tax – In order to discourage private foundations from holding investments in business enterprises, Congress enacted Section 4943, which basically subjects a private foundation to a two-tier excise tax for its "excess business holdings". In enacting this Section, Congress was concerned that private foundation managers would focus their attention on the success of a business enterprise and away from the charitable purposes for which the private foundation was created. In addition, such enterprise, as owned by a tax-exempt entity, could unfairly compete with another similarly situated enterprise which was owned by a taxable entity. The excise tax imposed under Section 4943 is 5% of the highest value of the holdings in a business enterprise in excess of the "permitted holdings". A harsh second-tier excise tax equal to 200% of such excess business holdings may apply if (i) the 5% tax is imposed and (ii) the private foundation still has excess business holdings at the close of the earlier to occur of (A) the date of mailing of a notice of deficiency by the IRS relating to such holdings or (B) the date on which the 5% tax is assessed by the IRS, See, Sections 4943(b) and (d)(2), Also See, Section 6684 for a possible third-tier tax. "Permitted holdings" means 20% of the voting stock in an incorporated business enterprise, or 20% of the profits or beneficial interest in a non–incorporated enterprise, reduced by the percentage such interests owned by all disqualified persons (as defined in Section 4946(a)) ("Disqualified Persons", who are generally substantial contributors to, and trustees of, the private foundation, and any person related by family to such individuals and entities significantly owned by such individuals), See, Section 4943(a)(1) and (2). Once the permitted holdings have been determined, the permitted holdings are subtracted from the percentage held by the foundation to determine the amount of "excess business holdings", See, Treas. Reg. Section 53.4943-3(d). The net effect of these formulas is to assure that the combined holdings of all Disqualified Persons and the private foundation in a business enterprise are not more than 20%. Any readjustment of the assets (*e.g.*, a recapitalization, redemption, merger) may also impact the excess business holdings rules, See, Treas. Reg. Section 53.4943-7(d).

ii. Exceptions to Tax - If the excess business holdings tax applies, there are several methods by which the private foundation can limit the impact of, or altogether avoid, such tax.

   1. Five-year period - The private foundation is given a five-year period beyond the date of the gift to dispose of the business holdings in excess of the combined 20% permitted holdings, See, Section 4943(c)(6). The law treats the business holdings as being held by Disqualified Persons for such five-year period. Thus, the private foundation is not deemed to own any business holdings for such period. There are, however, exceptions to this favorable rule. These exceptions basically attempt to prohibit an end run around this rule, *i.e.*, transfer from the private foundation to another commonly controlled or related private foundation, a purchase by an entity effectively controlled by a Disqualified Person or the private foundation or a Disqualified Person's plan to purchase during the five-year period additional holdings in the same business enterprise held by the private foundation, See, Treas. Reg. Section 53.5953-6(c).
   2. Effective control exception - Under certain circumstances, the permitted holdings may be increased from 20% to 35%, See, Section 4943(c)(2)(B). Such an increase is permitted if (i) persons other than the private foundation and Disqualified Persons have "effective control" of the enterprise and (ii) the private foundation establishes to the satisfaction of the Commissioner that effective control is in one or more persons (other than the private foundation itself) who are not Disqualified Persons. Effective control means the power to direct or cause the direction of the management and policies of a business enterprise, whether through the ownership of voting stock, the use of voting trusts, or contractual arrangements, or otherwise. For example, the effective control test is met if individuals holding a minority interest, none of whom is a Disqualified Person, have historically elected a minority of the corporation's directors. The key is to prove that another person or group of persons do control the company, not that the Disqualified Persons don't control the company, See, Revenue Ruling 81-111, 81-1 CB 509.
   3. Passive source exception - The third possible method of avoiding the Section 4943 tax is the passive source exception. The definition of a "business enterprise" includes the active conduct of a trade or business, including any activity which is regularly carried on for the production of income from the sale of goods or the performance of services, See, Section 4943(d)(3)(B). If 95% or more of the gross income of a business enterprise is "passive", the entity will not

be deemed to be a business enterprise. The definition of what is passive is a term of art and basically includes dividends, interest, payments with respect to securities loans, annuities, royalties measured by production of income from the property, rents from real property (unless taxable as unrelated business income) and gains or losses on sales and exchanges of property (other than inventory and property held for the sale to customers), See, Section 4943(d)(3). This concept is consistent with the Congressional intent in attempting to discourage foundation managers from spending too much time on the business enterprise, See, PLR 9211067. If the activity is passive, by definition, the managers would not be spending time on the business enterprise.

4. Extension of initial five-year period - The IRS has the statutory power to extend the initial five-year period (discussed in (i) above), for unusually large gifts or bequests of diverse holdings or holdings with complex corporate structures, for up to an additional five years, Section 4943(c)(7). The private foundation must prove to the Secretary of the Treasury that it has made diligent efforts to dispose of such holdings during the initial period, and a disposition of such holdings within the initial period has not been possible (except at a price substantially below fair market value) due to the size and complexity or diversity of such holdings. The private foundation must submit a plan with the Secretary and the state official having the authority over the foundation's affairs (usually the Attorney General's Office) for disposing of the excess during the extended period. This plan may be accepted by the Secretary if it can be reasonably expected to be carried out during the extension period.
5. De minimis rule - A de minimis rule is provided in which Disqualified Persons may retain any percentage of holdings, so long as the private foundation holds no more than 2% of the voting stock (or profits or beneficial interest) or 2% by value of all outstanding shares, See, Section 4943(c)(2)(C).
6. 90-day grace period - A private foundation will have at least 90 days from the date of the gift to dispose of the excess business holdings without incurring this excise tax, See, Treas. Reg. Section 53.4943-2(a)(1)(ii). This 90-day period is extended to include the period during which a private foundation is prevented by federal or state securities laws from disposing of such excess business holdings, See, Treas. Reg. Section 53.4943-2(a)(1)(iii).

iii. Applications of Tax – Although Sections 4941 and 4945 generally apply to a CRT, Section 4943 applies to a CRT in only very limited circumstances, See, Section 4947(b)(3)(B). Although Section 4943 deals with a private foundation and not a CLT, Section 4947(a)(2) and (b)(3)(A) cause the excess business holdings tax to apply to a CLT where the aggregate value of the charitable lead interest exceeds 60% of the fair market value of the property contributed to such trust.

c. Jeopardy Investment Tax

i. Character of Tax - Section 4944 subjects a private foundation and a manager of the private foundation (*i.e.*, a trustee) to a two-tier excise tax for *making investments* in such a manner as to jeopardize the carrying out of the private foundation's exempt purposes. If such a jeopardizing investment is made, Section 4944(a)(1) imposes on the private foundation a tax of 5% of the amount of the investment for each year or part thereof in the "taxable period" (defined below), and Section 4944(a)(2) imposes a similar 5% tax on any foundation manager who knowingly and willfully participated in making such investment. However, the tax on the foundation manager is limited to $5,000 per investment. The second tier tax of 25% of the investment is imposed whenever (i) an initial tax is imposed pursuant to Section 4944(a)(1) on the making of a jeopardy investment and (ii) the investment is not removed from jeopardy within the "taxable period", Section 4944(b)(1). The "taxable period" is the earlier to occur of (A) the date of mailing of the deficiency notice by the IRS, (B) the date on which the 4944(a)(1) tax is imposed or (C) the date on which the amount so invested is removed from jeopardy, Section 4944(e)(1). A foundation manager is liable for an additional tax equal to 5% of the amount invested, only if an additional tax has been imposed on the foundation and the manager has refused to agree to part or all of the removal from jeopardy of such investment. This second-tier tax on the foundation manager is likewise limited to $10,000 per investment (Also See, Section 6684 for a possible "third-tier" tax where the private foundation or manager had been liable for the Section 4944 tax in a prior year and became liable for the same tax in a subsequent year or where the act or failure to act giving rise to the excise tax is both willful and flagrant).

ii. Exception to Tax

    1. Gratuitous Transfer - The tax under Section 4944(a)(1) is imposed on the private foundation if it "invests" any amount in such a manner as to jeopardize its tax-exempt purpose, See, Treas. Reg. Section 53.4944-1(a). Although neither the Code nor the legislative history address the application of this tax to gifted property, Treas. Reg. Section 53.4944-1(a)(2)(ii)(a) provides that Section 4944 shall not apply to an investment made by any person which is later gratuitously transferred to a private foundation. This Regulation Section further provides that, if such foundation furnishes any consideration to such person upon the transfer, the foundation shall be treated as having made an "investment" in the amount of such consideration. One commentator describes this Regulation Section as follows, "Property received as a gift or bequest is not a jeopardizing investment regardless of how imprudent it might be if purchased by the foundation", Bittker & Lokken, *Federal Taxation of Income Estates and Gifts*, Second Edition, 1993, ¶101.7.3, p.101-111. Thus, it appears clear that the *receipt* by way of gift of a speculative asset by a private foundation cannot be described as an "investment", causing the private foundation to be subject to the tax under Section 4944. However, what is less clear is the ability of the foundation to *retain* such asset without incurring the jeopardy investment tax. In fact, another commentator has indicated that an implied duty to dispose of highly speculative property, even if acquired by gift, can arguably be read into Section 4944, See, Chiechi and Maloy, 338-3rd T.M., *Private Foundations - Section 4940 and Section 4944*, p. A-17 ("Chiechi"). However, two private letter rulings which relate directly to CLTs, and as recognized by Chiechi, indicate a contrary and favorable taxpayer result, See, PLRs 8125038 and 8038180, Also See, PLR 8135040 and 9320052. The IRS, however, adds the following qualification to that conclusion: the trust does not change the form or terms of such investment. Treas. Reg. Section 53.4944-1(a)(2)(iii) provides in effect that if a private foundation changes the form or terms of an investment (including property gratuitously transferred to a private foundation), the trust will be considered to have entered into a new investment which will be judged at the time of such change as to whether that investment carries out the organization's exempt purposes. Thus, a change in the form or terms of an investment triggers a reapplication of the jeopardy investment standard.

iii. Applications of Tax – Although Sections 4941 and 4945 generally apply to a CRT, Section 4944 applies to a CRT in only very limited circumstances, See, Section 4947(b)(3)(B). Although Section 4944 deals with a private foundation and not a CLT, Section 4947(a)(2) and (b)(3)(A) cause the excess business holdings tax to apply to a CLT where the aggregate value of the charitable lead interest exceeds 60% of the fair market value of the property contributed to such trust.

iv. Jeopardy Investment Defined - Treas. Reg. Section 1.4944-1(a) states the general trustee standard to be applied in determining when an investment is a "jeopardy investment" under Section 4944, as follows: when the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investments, in providing for the long- and short-term financial needs of the foundation to carry out its exempt purposes. This standard as established in the legislative history has been described as a "prudent trustee" approach, See, S. Rep. No. 91-552, 91st Cong., 1st Sess. 45 (1969), 1969-3 C.B. 423, 453, and reaffirmed as such by the IRS in Revenue Ruling 74-316, 1974-2 C.B. 389.

As provided in Treas. Reg. Section 53.4944-1(a), the managers may, in the exercise of the requisite standard of care and prudence, take into account the expected return (including both the income and appreciation of capital), the risks of rising and falling price levels, and the need for diversification within the investment portfolio (for example, with respect to type of security, type of industry, maturity of company, degree of risk and potential for return). In addition, the determination whether the investment of a particular amount jeopardizes the carrying out of the exempt purposes of the foundation shall be made on an investment by investment basis, in each case taking into account the foundation's portfolio as a whole. Such Regulation Section also provides that no category of investments shall be treated as a *per se* violation of Section 4944. However, this Regulation does cite certain investments which will be closely scrutinized, as follows: trading on margin, trading in commodity futures, investments in working interests in oil and gas wells, purchase of puts, calls and straddles, purchase of warrants and selling short. The determination whether the investment of any amount jeopardizes the carrying out of a foundation's exempt purposes is to be made as of the time that the foundation makes the investment and not subsequently on the basis of hindsight. Therefore, once it has been ascertained that an investment does not jeopardize the carrying out of such purposes, the investment shall never be considered to jeopardize the carrying out of such purposes, even though as a result of such investment, the foundation subsequently realizes a loss, See, Treas. Reg. Section 53.4944-1(a)(2).

d. Self-Dealing Tax

i. Character of Tax - Section 4941 imposes an excise tax (from 5% to 200%) on a private foundation for direct or indirect acts of "self-dealing" between a private foundation and a Disqualified Person, including any direct or indirect: sale or exchange, or leasing, of property; and lending of money or other extension of credit; and furnishing of goods, services, or facilities; and payment of compensation (or reimbursement of expenses); and transfer to, or use by or for the benefit of, a Disqualified Person of the income or assets of a private foundation. Note that the definition of a Disqualified Person does not include a charity defined under Section 509(a)(1), (2) or (3).

ii. Application of Tax - There are two persons upon whom the Section 4941 self-dealing excise tax can be imposed, the Disqualified Person and the foundation manager (*i.e.*, Trustee). The self-dealing excise tax has two tiers, the (a)(1) and (2) tier and the (b)(1) and (2) tier. Each tier's tax is imposed during the taxable period, See Sections 4941(a) and (b). The taxable period begins upon the act of self-dealing and ends upon the earlier of (i) the date of the mailing of the notice of deficiency, (ii) the date on which the tax imposed under (a)(1) is assessed, or (iii) the date on which the correction of the act of self-dealing is completed, See, Section 4941(e)(1). The taxable period may otherwise close on any particular act of self-dealing if the statute of limitations for the assessment of the excise tax arising thereunder expires. These self-dealing rules apply to both a CRT and a CLT as if such trust was a private foundation, See, Section 4947(a)(2), Also See, Section 6884 for a possible third tier tax.

iii. Exceptions to Tax - Even if a transaction would constitute self-dealing, no excise tax will be imposed if the transaction satisfies one of the following overall exceptions.

1. Furnishing of Goods, Services or Facilities on Same Basis as to Public - The furnishing of goods, services, or facilities by a private foundation to a Disqualified Person where such goods, services, or facilities are made available to the general public on at least as favorable a basis as they are made available to the Disqualified Person is exempt from the self-dealing tax, Section 4941(d)(2)(D).
2. Compensation for Certain Personal Services - The payment of compensation (or the payment or reimbursement of expenses) by a private foundation to a Disqualified Person (other than a government official) for the performance of personal services which are reasonable and necessary to carry out the exempt purposes of the private foundation is not self-dealing, as long as such

compensation (or payment or reimbursement) is not excessive, Section 4941(d)(2)(E).

3. Corporate Transactions - A transaction between a private foundation and a corporation which is a disqualified person and which is pursuant to a liquidation, merger, redemption, recapitalization, or other corporate adjustment, organization, or reorganization is not self-dealing so long as all of the securities of the same class as that held (prior to such transaction) by the foundation are subject to the same terms and such terms provide that the foundation will receive no less than fair market value, See, Treas. Reg. Section 4941(d)(2)(F).
4. Self-Dealing Corrective Act - The correction of a previous act of self-dealing is not self-dealing, See, Treas. Reg. Section 53.4941(e)-1(c)(1).
5. Initiation of Disqualified Person Status - A transaction between a private foundation and Disqualified Person where the Disqualified Person's status arises only as a result of the transaction at issue is not self-dealing, See, Treas. Reg. Section 53.4941(d)-1(a).
6. Certain Indirect Transactions - Certain specific transactions, not directly involving a private foundation as a party but involving an organization, estate, or trust in which the private foundation owns an interest are excluded from self-dealing. For example, indirect self-dealing does not include certain transactions with respect to a foundation's interest or expectancy in property held by an estate (or revocable trust) where the transaction is approved by the probate court having jurisdiction over the estate or trust, See, Treas. Reg. Section 53.4941(d)-1(b)(3). The IRS has approved the use of this exception to self-dealing in several instances, including a disqualified person's purchase of a private foundation's interest in corporate stock (PLR 8901039), a private foundation's interest in a deed of trust and the related note receivable (PLR 9127052) and a private foundation's remainder interest in nonresidential real property (PLR 9112012).

e. Imputation of Gain to Donor – Assignment of Income & Step Transaction Doctrines - There are many cases and IRS rulings that involve the imputation of gain to the donor on the sale of an appreciated asset by a donee. However, there are several overriding principles and cases which must be analyzed in this regard. In *Palmer v. Commissioner,* 62 T.C. 684 (1974), the court held that the gain on the sale of the stock of a closely-held company by a charity would not be imputed back to the donor on the corporate redemption of the stock. In *Palmer*, the donor controlled both the company and the charitable foundation and donated appreciated stock in the company to the foundation. The court found that, in light of the presence of an actual, valid gift and because the foundation was not a sham, the gift of stock was not a gift of the proceeds of redemption. One day after the gift, the corporation redeemed its stock from the foundation. The IRS acquiesced to the decision in *Palmer,* See, Revenue Ruling 78-197, 1978-1 C.B. 83. In this Revenue Ruling the Service specifically acknowledged that the taxpayer in *Palmer* had voting control of both the corporation and a tax-exempt private foundation and that the gift, followed by the redemption, was pursuant to a single plan. Nonetheless, the Service will treat the proceeds of a stock redemption under facts similar to those in Palmer as income to the donor only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption. Subsequent to *Palmer*, the court in *Blake v. Commissioner,* 697 F. 2d 473 (2d Cir., 1982), aff'g 42 TCM 1336 (1981), held that the mere prearrangement of the sale caused an imputation of gain to the donor. Many in the planned giving community believe that this case is a good example of the maxim, "bad facts make bad law." In *Blake*, the donor gifted $700,000 of marketable securities to a charity "to purchase the yacht AMERICA". The charity accepted the gift and sold the stock. The charity then purchased from the donor the yacht for $675,000, in a so-called "quid pro quo" transaction. However, the charity sold the yacht 3 - 4 months thereafter for only $200,000. On the basis of the Tax Court's factual findings, the Second Circuit had little trouble concluding that Blake had expected the charity to purchase his vessel and that he had an enforceable cause of action under a promissory estoppel theory, as a matter of law, if the charity refused. The court treated the transaction as a "unitary one", where the appreciated stock was used for the purpose of purchasing another asset of the donor. Thus, the donor was taxable on the sale by the charity of the $700,000 of marketable securities. Despite the apparent inconsistencies between *Palmer*, Revenue Ruling 78-197 and *Blake*, there are logical interpretations of these and other relevant cases and rulings. In effect, *Blake* dealt solely with a situation in which there was a gift of an appreciated asset to charity, so that the charity in turn could purchase an asset from the donor. In effect, there was a donor-required "quid pro quo", in order to consummate the gift. There are many other relevant cases that should be considered in analyzing the imputation of gain issue, such as *Greene v. United States*, 13 F.3d 577 (1994), aff'g, 806 F.Supp. 1165 (1992), in which gain was not imputed to the donor where the donor contributed futures contracts to a private operating foundation with no strings attached or prearrangement for resale by the charity, and *Ferguson v. Commissioner*, U.S. Court of Appeals, 9th Circuit, 98-70095, 4/7/99, aff'g 108 T.C. 244 (1997), where, in the context of a tender offer, gain was imputed to the donor where at the time of contribution of the corporate stock, it was practically certain that the tender offer and merger would be completed successfully. The most recent case in this arena is *Rauenhorst v Commissioner*, 119 T.C., No. 9 (2002), in which the IRS asserted that the taxpayer should be subject to the imputation of gain on the sale of stock by a charity after a charitable gift. In *Rauenhorst*, WGP, a corporation, sent the management of NMG (another corporation) a letter stating its intention to purchase all of the stock of NMG. Several officers of NMG accepted this letter of intent. Management of NMG accepted the offer and on October 22, 1993, the Board of Directors of WGP adopted a resolution authorizing management to proceeds with the purchase. On November 9, 1993, Rauenhorst contributed stock warrants (representing approximately 18% of the stock) to 4 charities on November 9, 1993, and the transfer was reflected on the corporation's books 3 days later. On November 22, the NMG shareholders (including the charities) entered into a purchase agreement and sold the shares on December 22 at a price of $7,598 per share. Each charity filed Form 8282 reporting the sale of the NMG stock. On audit, the IRS claimed that the almost $5 Million capital gain on the sale of this NMG stock was taxable to the Rauenhorsts, on the grounds that the gain had already accrued when they transferred the warrants to charity. On partial summary judgment, the Tax Court rejected the IRS argument and required the IRS to accept the holding of its own ruling (Revenue Ruling 78-197). Capital gain will only be imputed back to the donor in a corporate redemption if at the time of the gift, the charity was legally bound, or could be compelled, to sell the shares. The Tax Court again thankfully relies on the legally binding standard and distinguishes this valuable new decision from the *Ferguson* decision. *Also See,* in the U. S. Fourth Circuit Court of Appeals (which includes the State of Maryland), *Martin v Machiz*, 251 F. Supp 381 (MD District, 1961).

f. "Dealer" Issues – Dealer status usually produces unfavorable income tax consequences. For instance, an asset that would normally produce capital gain on sale will produce ordinary income to a dealer of that asset. In addition, contributions of dealer property will limit the charitable income tax deduction in accordance with the ordinary income reduction rule under Section 170(e)(1). Lastly, if a CRT or CLT is deemed a dealer itself in assets which it holds, UBIT will be generated on its receipt of operating income or on sale and the exception under 512(b)(5) will not apply. The litmus test for a dealer is represented by frequent, regular and continuous development or sales of property, See Also, Section 1237 and the regulations thereunder for a statutory exception to dealer status for the limited subdivision and sale of real property. In *Adam v. Commissioner*, 60 T.C. 996 (1973), acq., 1974-1 C.B. 1, six factors were relevant in determining whether the sale of land had been carried out in the ordinary course of business, as follows: (i) the purpose for which the asset was acquired, (ii) the frequency, continuity and size of the sales, (iii) the activities of the owner in improving and disposing of the property, (iv) the extent of improvements made to the property, (v) the proximity of purchase and sale, and (vi) the purposes for which the property was held. In *Adam* and subsequent cases, the Tax Court found that no one of these factors is controlling but all are relevant facts to consider in what is basically a facts and circumstances test, See, *Houston Endowment, Inc. v. United States*, 606 F. 2d 77 (5th Cir. 1979), *Biedenharn Realty Co. v. United States*, 526 F. 2d 409 (5th Cir. 1976) and *Buono v. Commissioner*, 74 T.C. 187 (1980). Dealer status has been similaraly applied under the UBIT rules. Whether a particular activity engaged in by a charity is unrelated within the meaning of Section 513(a) and therefore subject to the tax imposed by Section 511, depends in each case on the particular facts and circumstances present, See, PLR 8734005. In *Malat v. Riddell*, 383 U.S. 569 (1966), the Supreme Court interpreted the meaning of the phrase "held primarily for sale to customers in the ordinary course of the trade or business" under Section 1221(1). The Court interpreted the word "primarily" to mean "of first importance" or "principally". By this standard, ordinary income would not result unless a sales purpose is dominant. The Service has often applied the principles derived under Section 1221 to rulings interpreting the language of Section 512(b)(5).

g. Valuation Issues –

   i. Generally - Fair market value is generally determined under the definition found in Treas. Reg. Sections 25.2512-2(b)(1) and 20.2031-2(b)(1) – "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." In Revenue Ruling 77-287, 1977-2 C.B. 319, the IRS has provided factors to analyze in determining value of corporate stock that is privately-owned: (i) the nature of the business and the history of the enterprise from its inception; (ii) the economic outlook in general and the condition and outlook of the specific industry in particular; (iii) the book value of the stock and the financial condition of the business; (iv) the earning capacity of the company; (v) the dividend-paying capacity; (vi) whether or not the enterprise has goodwill or other intangible value; (vii) sales of the stock and the size of the block of stock to be valued; (viii) the market price of stock of corporations engaged in the same or similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter. Treas. Reg. Sections 20.2031-3(c) and 25.2512-3(a)(3) indicate that many of these factors also apply in valuing other business interests, such a partnership or LLC interests.

   ii. Special CRT Rules – Treas. Reg. Section 1.664-1(a)(7) provides rules for valuing unmarketable assets that are transferred to or held by a CRT. A CRT holding unmarketable assets will be disqualified unless any required valuations are (i) performed exclusively by an independent trustee or (ii) determined by a current qualified appraisal as defined under Treas. Reg. Section 1.170A-13(c)(3). An independent trustee is defined as a person who is not a grantor or a noncharitable beneficiary of the CRT and is not a related or subordinate party (under Section 672 and the regulations thereunder) to a grantor, a grantor's spouse or a noncharitable beneficiary of the CRT. Unmarketable assets are defined in Treas. Reg. Section 1.664-1(a)(7)(ii) as assets that are not cash, cash equivalents or other assets that can be readily sold or exchanged for cash or cash equivalents and include real property, closely-held stock and unregistered securities with no available exemption permitting public sale.

   iii. Charitable Contribution Deduction – A donor who claims a charitable contribution deduction in excess of $5,000 for the contribution of property, other than certain publicly traded securities, must among other things satisfy the requirements of Treas. Reg. Section 1.170A013(c): (i) the donor must obtain a qualified appraisal to determine the property's fair market value; (ii) the donor must attach a fully completed appraisal summary (Form 8283) to the tax return on which the deduction is first claimed; and (iii) the donor must maintain certain records. In addition, if a donor was required to file Form 8283 in order to claim a charitable deduction, the donee recipient must also file an informational return (Form 8282) if the donee sells, exchanges or disposes of the property within 2 years of its receipt. Form 8282 may bring to light facts that would indicate that the donor overvalued the property. A donee recipient would also include a CRT or a CLT.

IV. Examples

Example #1:

a. Fred owns 100% of a business that has been in his family for ages – the Bedrock Quarry Company. Fred's daughter, Pebbles, has no interest in the Company after marrying Moonrock. Fred is ready to sell his stock interest to a willing buyer. Mr. Slate, the planned giving officer at the Bedrock Foundation, suggests that he consider contributing his stock to a charitable remainder trust and then have the trust sell the stock interest. Fred is attracted to the idea, but wants to know the tax and financial ramifications of such a gift.

b. Let's assume the following: The fair market value of the Company stock is $5 Million; Fred has a zero basis in the Company stock; Fred is subject to a 20% (federal and state) capital gains tax rate and a 45% (federal and state) income tax rate; 7% is the growth rate of investments; the Company stock is Fred (age 68) and Wilma's (age 65) sole asset.

c. If Fred sells the stock he will incur a $1 Million capital gains tax, leaving him and Wilma with $4 Million to reinvest. Thus, they will accrue $280,000 of income (before tax) for the rest of their lives. At death, their estates will be subject to estate tax depending upon the value of the investments at that time and the applicable exclusion amount. Foundation will not receive any benefit from this plan.

d. If however, Fred contributes the stock to a charitable remainder trust, he will be entitled to an income tax deduction in the year of the gift equal to approximately $1.2 Million, which saves in real dollars approximately $540,000. Fred and Wilma also increase their income (before tax) to $350,000 per year. At death, the value of the tax savings and net income not spent will grow for the benefit of Pebbles and may be subject to an estate tax; however, the value of Fred's estate does not effectively include the value of the charitable remainder trust at his death, as his estate will be entitled to a charitable and/or marital estate tax deduction. Of course, Pebbles will not receive any benefit from the principal of the trust, as the principal is irrevocably designated for the benefit of the charity chosen by Fred and Wilma to receive the remainder of the trust.

Example #2:

a. Pebbles became involved in the family business, and after ten years, Fred owned 51% of the Company stock and Pebbles owned a 49% interest. Fred generally liked the idea of a CRT and now contemplated contributing his 51% interest to a CRT and having the Company redeem it from the CRT. In that event, Pebbles would end up with 100% of the Company stock. Fred's advisor suggests that self-dealing is implicated and maybe we shouldn't run any risks in making this gift.

b. STEPS: (i) Fred creates and funds the charitable remainder trust with the 51% stock interest in the Company; (ii) the Company redeems such stock interest from the CRT for cash; (iii) the CRT reinvests the entire net proceeds from the sale into a diversified portfolio of investments; (iv) Pebbles becomes the 100% owner of the Company stock; (v) the CRT pays income to Fred and Wilma for their lives; and (vi) upon the death of Fred and Wilma, the assets of the CRT will be distributed to the Bedrock Foundation.

c. If the Company redeems the 51% interest pursuant to a plan of redemption in which the same offer for redemption is made to all shareholders for cash at a purchase price no less than the fair market value of the Company stock, the self-dealing rules are not violated (Code Section 4941(d)(2)(F)).

Example #3:

a. Fred also owns most of the bank stock in two closely-held companies. He created a revocable trust which will become irrevocable upon his death, and his private foundation will be entitled to all of the corpus and undistributed income in the trust. At such time, the private foundation will not want to retain this stock, as it is not income producing, and will offer the stock for sale to disqualified persons.

b. The sale by the trust of the bank stock will not constitute self-dealing if the requirements of Treasury Regulation Section 53.4941(d)-1(b)(3)(i)(a) are met, including but not limited to, the transaction is approved by the local probate court, the trustee possesses a power of sale with respect to the property, the foundation receives at least fair market value at the time of the transaction and the foundation receives an interest at least as liquid as the one it gave up.

Example #4:

a. Fred also owns a small percentage of a highly speculative stock that is currently worth $1 Million. The stock could either explode in value or be rendered worthless. Fred contributes the stock to a charitable lead trust. Fred's advisor is concerned that the jeopardy investment rules will be violated and Fred should not make the contribution.

b. Generally, an investment made by any person which is later gratuitously transferred to a charitable lead trust should not trigger the jeopardy investment tax (Treasury Regulation Section 53.4944-1(a)(2)(ii)(a)).

Example #5:

a. Wilma, Fred's wife, owns a parcel of income producing real estate and contributes the real estate to a charitable lead trust. Wilma's advisor is concerned that unrelated business income may adversely affect the benefits from the charitable lead trust.

b. If the income constitutes "rents from real property" under Code Section 512(b)(3), no UBI will be generated and will not adversely affect the trust. In general, so long as the rental for real property is fixed and triple net, and no substantial services are provided by the landlord, UBI should not be an issue of concern. Can you revise the terms of the lease prior to the transfer into the trust to comply with 512(b)(3)? What if Wilma contributes the real estate along with marketable securities into a family limited partnership – same result? What if the real estate was debt encumbered?

Example #6:

a. Fred also has many parcels of real property that he buys and sells on a regular basis. He wants to contribute some or all of these properties to a charitable remainder trust. Fred's advisor does not want him to do so, because Fred is a "dealer" and the sale by the trust will constitute UBI.

b. The donor's status as a dealer should not taint the trust's sale. What is the benefit of this result? What might change this result? What if the property is debt encumbered?

Example #7:

a. The Bedrock Quarry Company was operated in an S corporation. Fred's advisor suggested that he contribute his 51% stock interest into a charitable remainder trust and conduct the redemption plan in accordance with the self-dealing exception. Mr. Slate, the planned giving officer for the Bedrock Foundation advised Fred that there may be some issues to consider further.

b. The S corporation may convert into a C corporation and Fred can then contribute his stock into the charitable remainder trust. In addition, the S corporation could use a valuable asset (like, a big crane) and contribute that asset to the charitable remainder trust for no more than 20 years with income paid to the S Corporation.

Example #8:

a. The Bedrock Quarry Company did convert into a C corporation. The Company had already entered into a plan of redemption which had been approved by its shareholders. Fred then took the advise of Mr. Slate and contributed his stock interest into the charitable remainder trust. What if the Company was engaged in the first ever tender offer of its stock to the conglomerate, Dino Dynasty, and then contributed the stock to the charitable remainder trust. Will Fred incur gain on the sale of the stock by the charitable remainder trust? What would happen if the Company Board had already accepted a nonbinding letter of intent to authorize the sale of Company stock?

Example #9:

a. Fred altogether abandoned the idea of contributing the stock, but Slate recognized in the process of strengthening the relationship with Fred that Fred also owned the underlying real estate in a separate entity, which Fred had already listed with a real estate agent, Century 00. Fred was very interested in contributing the real estate to a charitable remainder trust but forgot to tell Slate that he had already entered into a contract on the property. Will Fred incur gain on the sale of the real estate by the charitable remainder trust?

Example #10:

a. Wilma created a family limited partnership which holds marketable securities and income producing real estate and wants to contribute her limited partnership interest to a charitable lead trust. Wilma's advisor warns Wilma that a partnership interest can constitute a business enterprise for purposes of the excess business holdings excise tax.

b. So long as 95% of the income is passive in nature, the partnership interest will not constitute a business enterprise (Code Section 4943(d)(3)(B)).

c. The excess business holdings tax will not apply if the value of the lead interest is 60% or less of the value of the property contributed to the trust. What if EBH does apply? The trust could hold the gifted stock for 5 years without the imposition of this tax and possibly extend that time for an additional 5 years (Code Sections 4943(c)(6) and (7)).

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