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FEATURE:
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Charitable Planning With Closely Held Business Interests

Avoid the tax traps that can get in the way of a successful gift

Some things are very difficult to accomplish successfully. Winning a two-front war in Europe, for example (think Napoleon and Hitler). Another is contributing closely held business interests to charity in a tax-efficient manner, particularly during the donor's lifetime. Typically, articles on this topic provide a roadmap for successfully achieving certain estate-planning goals. This article is somewhat different. It begins with a warning—"there lie dragons ahead." Some can be slain by good fact patterns and thoughtful planning. Others not. But, given the vast wealth in this country made up of closely held business interests (whether "mom and pop" shops or hedge or private equity funds), it's inevitable that planners are regularly asked the question: Can I contribute some of my closely held business interests to charity?

The proper answer to that question is that it depends on the nature of the asset (for example, is it a C corporation, S corporation, limited liability company (LLC) or partnership?) and the type of structure you want to use (for example, private foundation (PF), donor advised fund (DAF), charitable lead trust (CLT) or charitable remainder trust (CRT)). The reason for this uncertainty is that there are certain tax traps (the dragons) that can get in the way of a successful gift. We'll identify some of these pitfalls and how they apply to particular closely held assets and particular charitable structures.

Closely Held Business Structures

Closely held businesses (non-sole-proprietorships) are organized as corporations (C corporations or S corporations), partnerships (limited or general) or LLCs. The structure of the business can determine which philanthropic options are better for a given situation.

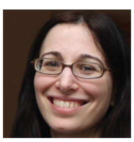
A C corporation is initially taxed at the corporate level, which means that the corporation itself realizes the benefit and burden of any tax characteristics of its specific income and loss. If the corporation pays out dividends to the shareholders, the shareholders are taxed on this amount as a dividend, independent of the tax characteristics of the corporate income.

The other options described above are all "flow-through entities," meaning that income, loss, deductions and credits all pass through to the S corporation shareholders, partners or LLC members. There's no tax at the entity level, and the owners, not the entity, realize the specific tax characteristics.

While flow-through entities are increasingly popular for small businesses, they pose distinct problems in the charitable context. The fact that a C corporation is considered a separate taxpayer makes it the easiest of the closely held structures to give to charity. After all, most publicly traded companies are structured as C corporations, and such securities are favored by the Tax Code, entitling a donor to a full fair market value (FMV) deduction, along with avoidance of the built-in capital gain.

Charitable Recipients

Closely held business owners engaging in philanthropic planning have a range of charitable structures from which to choose. In addition to outright gifts to traditional public charities (like churches, hospitals and universities), alternatives include PFs, DAFs, CLTs and CRTs. A brief description of each option follows. The choice of strategy may be influenced not only by the business structure, but also by the specific advantages and considerations of the potential charitable recipients.

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PFs

A tax-exempt PF is a charitable organization to which a donor can make contributions that qualify for income, gift and estate tax charitable deductions. It can be structured either as a trust or a corporation. A PF commonly receives its funding from one or a few private sources (usually an individual, family or corporation). The principal activity of a PF tends to be making grants to public charities and awarding scholarships to individuals (although some PFs also run charitable programs). A PF must expend 5 percent of its net asset value for charitable and administrative purposes annually.[1] PFs involve a fair amount of administrative complexity and are subject to burdensome rules but offer the greatest amount of donor control of all of the charitable vehicles.[2]

> A non-grantor CLT is, generally, taxed as a complex trust.

If a donor funds a PF with cash or qualified appreciated stock (publicly traded securities), the donor's income tax charitable deduction is based on the full value of the amount contributed, otherwise, the deduction is limited to the lesser of FMV or cost basis.[3] As such, and for other reasons discussed below, lifetime gifts of closely held business interests to a PF aren't particularly attractive. In addition, a donor may deduct cash gifts to a PF only up to 30 percent of his adjusted gross income (AGI) for the year and 20 percent for gifts of long-term capital gain property. Excess deductions for charitable gifts can be carried forward for five years.[4]

DAFs

A DAF is a much simpler philanthropic option in terms of administration when compared to a PF, but the donor loses an element of control. Technically speaking, a donor makes a gift to a sponsoring charitable organization (usually community foundations or commercial DAFs like the Fidelity Charitable Gift Fund), which sets aside the gift in a separate account in the donor's name, from which the donor suggests grants—typically to other public charities in which the donor is involved. The donor doesn't have legal control over grantmaking decisions from the account—the sponsoring organization does—nor does he control how the account is invested, although legitimate grant recommendations by the donor are generally followed by the sponsoring charity. DAFs, at least with respect to the deductibility rules, are more attractive than PFs. Because the organizations sponsoring DAFs are public charities, charitable contributions of closely held business interests held long term qualify for a full fair market charitable deduction. As a result of this tax advantage over PFs, DAFs are increasingly willing to accept contributions of closely held business interests, although because of other reasons discussed below, such gifts may not always be tax efficient, and the sponsoring charity would typically look for a way to liquidate the asset in the short term.

If a donor funds a DAF with cash, the donor may deduct the gift up to 50 percent of his AGI for the year and 30 percent for gifts of long-term capital gain property.[5]

CLT

A CLT[6] is an estate-freeze technique under which a charity receives an income interest for a certain period of time, at the completion of which non-charitable beneficiaries receive the remaining trust principal (if any). The lead interest in a CLT is a charity's right to receive annuity or unitrust payments from the trust for a certain term. An annuity payment is the right to receive a specified amount from the trust each year that doesn't change from year to year. A unitrust payment is the right to receive a specified percentage of the trust assets each year that necessarily will vary as the value of the trust changes from year to year. The remainder interest is the right of the non-charitable remainder beneficiaries to receive the remaining principal of the trust at the expiration of the charitable term. The remainder beneficiaries may be the grantor or other non-charitable beneficiaries (although CLTs aren't attractive vehicles for generation-skipping planning). CLTs may be set up during life or at death.

CLTs may be qualified—meeting various Internal Revenue Code requirements for deductibility of the lead interest for federal estate, gift and/or income tax purposes—or non-qualified. An important distinguisher of a CLT from other charitable options is that a CLT isn't exempt from federal income tax.

The manner in which trust income is taxed depends on whether the CLT is a grantor CLT or a non-grantor CLT:

- The donor is taxed on all of the income of a grantor CLT, regardless of the fact that the income is never distributed to the donor. The donor receives an income tax deduction on trust funding. If the lead interest is held by a public charity and the trust is funded with long-term capital gain property, the income tax deduction, generally, is subject to the 30 percent deductibility ceiling and a 5-year carryforward. If the charitable interest is held by a PF, then the 20 percent deductibility ceiling generally applies. The Internal Revenue Service has ruled in a private letter ruling that the 5-year carryforward isn't available for a CLT benefiting a PF,[7] but leading commentators have criticized this result. Because the donor pays the income taxes during the trust term, grantor CLTs typically aren't attractive vehicles for charitable giving.
- A non-grantor CLT is, generally, taxed as a complex trust. As such, it's taxed on all of its net undistributed income and on all capital gains but receives a deduction for the annuity or unitrust payments made to charity each year (a grantor CLT doesn't). A non-qualified CLT, although rare, generally is taxed as a complex trust for income tax purposes.

CRT

A CRT is an irrevocable trust that provides for the payment of: (1) a specified distribution, at least annually, (2) to one or more beneficiaries, at least one of which isn't a charity, (3) for life or for a term of years (not to exceed 20), and (4) with an irrevocable remainder interest to be held for the benefit of, or paid over to, charity (public charity or PF). The specified distribution to be paid at least annually must be either an annuity or unitrust interest. If a CRT is qualified—with deductions allowable for federal estate, gift and/or income tax purposes—it's exempt from all taxes except to the extent that the trust has unrelated business taxable income (UBTI).[8]

A qualified CRT is a tax-exempt entity. There's typically no capital gain incurred by the grantor on the transfer of appreciated property to a CRT or its subsequent sale by the CRT trustee. It should be noted that if a CRT has any UBTI, as defined in IRC Section 512, it pays a 100 percent excise tax on the UBTI.[9]

The grantor of a CRT is entitled to an income tax charitable deduction equal to the present value of the charitable remainder interest, in some cases limited to cost basis (including transfers of property that's not qualified appreciated stock if a PF can be named as a remainder organization).[10] If the trust instrument provides that only public charities can be named as remainder organizations, the deduction is limited to 30 percent of AGI for gifts of appreciated property held long term and 50 percent of AGI for gifts of cash, with a 5-year carryforward for any unused deduction. Otherwise, the deduction is limited to 20 percent of AGI for gifts of appreciated property held long-term and 30 percent of AGI for gifts of cash, with a 5-year carryforward for any unused deduction.

The Tax Traps

Because of past abuses, there are detailed and highly technical rules around a charitable entity's investments and operations. Many of these rules make various charitable contribution options involving closely held business interests difficult, undesirable or impossible, so it's important to be aware of these rules before attempting a charitable gift. Here are six tax traps in the IRC:

1. Beware of S corporations. Historically, charitable entities couldn't be S corporation shareholders. Transferring S corporation shares to a charity would blow the S election. This changed in 1997, when Congress passed legislation permitting certain charitable entities to be S corporation shareholders. Unfortunately, for reasons set forth below, the legislation did little to encourage charitable gifts of S corporation stock.

When a charity owns shares of an S corporation, all of the charity's share of the S corporation's income and capital gains and the capital gains on the sale of the S corporation stock will be considered UBTI; therefore, they're taxed at regular tax rates.[11]

Other reasons why charitable gifts of S Corporation stock may not work:

- A CRT isn't a valid S corporation shareholder.[12] Therefore, a bequest of S corporation stock to a CRT will void the corporation's S status, causing it

to convert to a C corporation.[13]

- A non-grantor CLT is permitted to be a shareholder of an S corporation if the trust makes an electing small business trust (ESBT) election.[14] This election produces highly undesirable income tax results. As an ESBT, the lead trust will be taxed on S corporation income at the highest marginal rates for trusts,[15] and, worse, the trust will be denied a charitable deduction for the S corporation income the trust distributes to charity.[16]
- Sometimes, when a charitable gift of S corporation stock isn't attractive, it may be possible for the S corporation itself to make a gift of some of its assets to charity, with the charitable deduction flowing through to the shareholders.

2. Onerous PF excise tax rules. Although these rules are referred to as the "private foundation excise tax rules," they actually apply to PFs, CLTs and, to a limited extent, CRTs and DAFs.[17] In general, if one of the excise tax rules is violated, a relatively modest tax is imposed initially, with the tax rate rising substantially if the prohibited act isn't corrected within a certain period of time.[18] The rules are contained in IRC Sections 4940 through 4948. The excise tax rules most relevant to charitable planning with business interests are the prohibitions against excess business holdings and jeopardizing investments (which apply to PFs and some CLTs) and the prohibition against self-dealing (PFs, CRTs and CLTs).[19] The other tax rules are the taxes on failure to make minimum distributions to charity, taxable expenditures and net investment income (NII) of a PF.

UBIT is a particularly significant problem for CRTs.

a. Self-dealing. The basic principle underlying IRC Section 4941 is that all financial transactions between a PF and a disqualified person should be prohibited, whether or not the transaction benefits the PF. Subject to certain exceptions described below, the IRC provides that the term "self-dealing" means any of the following transactions:

- A sale, exchange or leasing of property between a PF and a disqualified person;
- Any lending of money or other extension of credit between a PF and a disqualified person. A disqualified person can make an interest-free loan to a PF if the proceeds are used entirely for its charitable purposes.[20]
- Any furnishing of goods, services or facilities between a PF and a disqualified person. If the PF is on the receiving end, the act doesn't constitute self-dealing if provided without charge and the goods, services or facilities are used exclusively for the PF's charitable purposes;[21] if the disqualified person is the receiver, it's not an act of self-dealing if the furnishing is made on a basis no more favorable than that on which such goods, services or facilities are made available to the general public.[22]
- Any payment of compensation (or payment or reimbursement of expenses) by a PF to a disqualified person, except that payment to a disqualified person for personal services that are reasonable and necessary to carrying out the PF's exempt purposes doesn't constitute self-dealing if such payments aren't excessive.[23]
- Any transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a PF; and
- An agreement by a PF to make any payment of money or other property to a government official.

"Disqualified persons" include:

- Substantial donors (individuals, trusts, estates, partnerships or corporations whose contributions total more than $5,000, if that total exceeds 2 percent of all the contributions received by the PF from its creation through the close of the taxable year in which the donor's contribution is made);[24]
- PF managers, that is, officers, directors, trustees and certain employees of the PF;[25]
- Individuals holding more than a 20 percent interest in corporations, partnerships or trusts that are substantial donors to the PF;[26]
- Family members of any individual described above;[27] and
- Corporations, partnerships and trusts in which individuals described above hold more than a 35 percent interest.[28]

Certain family attribution rules apply for purposes of determining whether a disqualified person holds more than a 20 percent or 35 percent interest in a corporation, partnership or trust.[29]

Note that Section 4941 prohibits both direct and indirect self-dealing. Direct self-dealing involves transactions between a PF and a disqualified person. Indirect self-dealing involves transactions between a disqualified person and an entity that the PF controls. The transactions covered by the term "indirect" self-dealing are those that would have been acts of self-dealing if entered into between the disqualified person and the PF directly.

In addition, any transaction between a PF and a corporation that's a disqualified person, pursuant to any liquidation, merger, redemption, recapitalization or other corporate adjustment, organization or reorganization, isn't an act of self-dealing if all of the securities of the same class as that held by the PF are subject to the same terms, and such terms provide for receipt by the PF of no less than FMV.[30]

Finally, if a disqualified person contributes closely held shares to a PF and retains some shares in his name, every major decision by the company needs to be scrutinized to make sure that it doesn't run afoul of the self-dealing rules. As such, the PF should either sell the shares to a third party shortly after receipt, or the corporation should redeem the shares under the redemption exception to self-dealing to mitigate the self-dealing concerns.

b. Excess business holdings. IRC Section 4943 imposes an excise tax on a PF's excess business holdings. A PF has excess business holdings when its holdings, together with those of disqualified persons, exceed 20 percent of the voting stock, profits or capital interest in a corporation or partnership.[31] Business holdings don't include interests in a business that are substantially related to the PF's exempt purposes or interests in a business at least 95 percent of the gross income of which is derived from passive sources.[32] Permitted aggregate business holdings are increased from 20 percent to 35 percent if it can be established that effective control of the corporation is in one or more persons who aren't disqualified persons with respect to the PF.[33] A PF has five years to dispose of excess business holdings acquired by gift or bequest, and an extension of time can be requested. During this time, the holdings aren't subject to tax.[34] DAFs are also subject to the excise tax on excess business holdings, but practically speaking, DAFs are likely to dispose of closely held stock before the 5-year grace period for gifts to the DAF.[35]

c. Jeopardizing investments. IRC Section 4944 imposes an excise tax on investments that jeopardize the carrying out of a PF's exempt purposes.[36] Section 4944 incorporates a prudent investor standard, involving an analysis of the total portfolio, the risk/return ratio and the use of diversification to lower total portfolio risk, in determining whether a particular investment is a jeopardizing investment. If a PF invests its assets in a balanced, diversified portfolio designed to meet both its current and future needs in carrying out its exempt functions, the Section 4944 excise tax generally shouldn't be a concern.[37] Although Section 4944 applies only to investments made by a PF and not to contributed assets a PF retains, state prudent investor laws generally impose the same investment standards as Section 4944 (for example, total portfolio, risk/return, diversification) and aren't limited to investments made. Under many states' prudent investor laws, a PF generally can ignore the requirement that it diversify its holdings only if it determines that, because of special circumstances, its purposes are better served by retaining a particular asset.

3. Unrelated business income tax (UBIT). Although PFs and CRTs, generally, aren't subject to income tax, an exception applies if the PF or trust has income subject to UBIT.[38] Income is subject to UBIT if it's from an activity that constitutes a trade or business, the trade or business is regularly carried on and the activity isn't substantially related to the tax-exempt entity's exempt purposes.[39] Most passive income, such as rents, royalties, dividends, interest and annuities, isn't subject to UBIT.[40] Passive income will be subject to UBIT to the extent it's derived from debt-financed property.[41]

UBIT is a particularly significant problem for CRTs because, in any year that the trust has unrelated business income, there's a 100 percent excise tax on that income.[42] If a PF has unrelated business income, that income is subject to UBIT at regular corporate or trust income tax rates, depending on how the PF is organized[43] (as compared to the PF's other investment income, which is subject only to a 2 percent

(sometimes 1 percent) excise tax on NII).[44]

For CLTs, UBIT presents much less of a problem because CLTs aren't tax-exempt, as discussed above. A testamentary CLT is taxed as a complex trust, with the trust generally receiving an unlimited income tax deduction under IRC Section 642(c) for the income distributed to charity each year. If the CLT has unrelated business income, its income tax deduction for distributing unrelated business income to charity is subject to the same percentage limitation rules that restrict the amount of income an individual can shelter from income tax each year with a charitable deduction.[45]

Charitable and business planning can go hand-in-hand.

4. Characterization as a pre-arranged sale. In contrast to sales of publicly traded securities, sales of closely held business interests are generally privately negotiated. If a donor enters into an informal agreement or understanding to sell the appreciated property to a buyer prior to transferring it to charity or a CRT, and the property is, ultimately, sold by the trust to that buyer, the IRS may recharacterize the transaction as a sale by the grantor personally rather than a sale by the charity or CRT. This means that not only would the gain be taxable, instead of being a tax-free sale by the charity or CRT, but also that the grantor would have to pay the full capital gains tax out of his own pocket.[46]

5. Minority discounts. These may endanger charitable deductions. Suppose an owner's estate includes his 100 percent interest in the family business, valued at $10 million, and the owner's will bequeaths 25 percent of the stock to a local community foundation and 75 percent to the owner's children. The estate includes the 100 percent interest in the business, but the community foundation receives a minority interest in the business. In a similar context, the Tax Court has ruled that when a decedent's estate includes a controlling interest in a company, but only a minority passes to charity, a minority interest discount should be applied in determining the amount of the charitable deduction.[47] Accordingly, in the example above, it's likely that the amount of the charitable deduction would be less than $2.5 million (25 percent of the value of the business).[48]

6. Donating debt-financed property. Funding CRTs, CLTs, DAFs and PFs with debt-financed property (including any underlying indebtedness of flow-through entities like partnerships and LLCs) is very difficult to accomplish in a tax-efficient manner. Debt-financed property can create a UBTI problem because of the rules in IRC Section 514:

- If the grantor remains liable on the debt, a CRT is treated as a grantor trust for income tax purposes.[49] That means it's not a tax-qualified CRT,[50] and the grantor loses the income and gift tax charitable deductions, plus, the trust loses its tax-exempt status. The grantor will be liable for any capital gains taxes generated when an appreciated trust asset is sold.
- When a donor contributes debt-financed property, the transaction is treated as a bargain sale for income tax purposes under IRC Section 1011(b),[51] that is, the grantor is treated as having sold a portion of the property for consideration equal to the debt on the property and contributed the remainder. This forces the grantor to recognize gain on some portion or all of the outstanding indebtedness on the contributed asset value. The basis of the property is allocated between the two portions on a pro rata basis, based on values in proportion to total property value.[52] This rule applies regardless of whether the underlying debt is recourse or non-recourse and regardless of whether the grantor continues to pay the debt, including a mortgage, after the gift is made.
- A donor is prohibited from transferring a mortgaged asset to fund a CRT if the mortgage was placed on the property within 10 years of the transfer.[53] However, the self-dealing prohibition may not apply to the initial transfer of mortgaged property to a CRT. Treasury Regulations Section 53.4941(d)-1(a) provides that:

> [t]he bargain sale of property to a private foundation is not a direct act of self-dealing if the

> seller becomes a disqualified person only by reason of his becoming a substantial contributor as a result of the bargain element of the sale.

If, however, the loan principal remains outstanding once the donor becomes a disqualified person, the IRS has privately ruled that a new act of self-dealing occurs in each year in which the loan remains uncorrected.[54]

- In general, the sale or exchange of property between a CLT and any disqualified person constitutes a taxable act of self-dealing under IRC Section 4941. When mortgaged property is contributed to a CLT, the transfer will be treated as a sale or exchange for Section 4941 purposes if the CLT assumes the mortgage or if the mortgage was placed on the property within 10 years and the CLT takes its interest subject to the mortgage.[55] This may not be true if the contribution is of a partnership interest with an underlying mortgage.[56]

Success Stories

With the right assets and the right structure, charitable and business planning can go hand-in-hand. Here are two ideas that could provide benefits in both areas.

1. Business succession planning. For a business owner whose business is structured as a C corporation (not an S corporation, LLC or partnership) and has access to ample cash, the general redemption exception to the self-dealing rules can provide a useful planning option. Under this approach, the owner could bequeath an interest in the business to a PF, CRT or CLT (the charitable entity). If the charitable entity is designed properly, the estate would be entitled to an estate tax charitable deduction for the value of the business interest passing to charity. The problems presented by the PF excise tax rules and the UBIT can be avoided by having the business redeem the charity's interest in the business. The PF or charitable split interest trust winds up with cash, while the family ends up in control of the business.

Ordinarily, if an interest in a decedent's corporation is owned by a PF or charitable split interest trust, the corporation is a disqualified person; therefore, a redemption of the foundation's or split interest trust's stock would be a prohibited act of self-dealing under Section 4941. However, even if the corporation is a disqualified person, a redemption won't be self-dealing if all securities of the same class as that held by the charitable entity are subject to the same terms, and those terms provide that the charitable entity shall receive no less than FMV for its stock.[57]

Caveat: The corporation shouldn't fund the redemption with a note. Although the redemption is excepted from the definition of self-dealing, the note may be a separate act of self-dealing under Section 4941(d)(1)(B).

Planning note: If a redemption pursuant to Section 4941(d)(1)(F)'s general redemption exception is contemplated, consider having the corporation issue a separate class of stock prior to the gift to the PF or split interest trust. The grantor can then use that stock as the subject of all gifts to the PF or split interest trust. This will narrow the class of owners of stock subject to the Section 4941(d)(1)(F) general redemption rule.

Also, the prearranged sale issue shouldn't be a problem if the stock is to be redeemed by the corporation rather than purchased by a third party, provided that the PF or trustee of the CLT or CRT is under no binding obligation to offer the stock for redemption after the transfer to the charity or the trust.[58]

This can also be an excellent business succession strategy for closely held C corporations using a lifetime CRT. For the strategy to work best, the children already need to be shareholders in the business, and the business has to have a significant amount of cash on hand (or the ability to borrow from a bank). Mom or Dad would transfer some or all of their C corporation shares to a lifetime CRT for their benefit. Following the exception to the pre-arranged sale rules and the exception to self-dealing for redemptions, the corporation would redeem the shares for cash (a note would be a prohibited act of self-dealing). The corporation would then retire the shares, thereby increasing the ownership interests of the children. Under the right circumstances, a charitable stock bailout is a great strategy for cashing out Mom and Dad and passing the C corporation to the children in a tax-efficient manner. It's important to note that this strategy won't work for S corporations, because a CRT isn't a permitted shareholder of an S corporation.

2. Use testamentary CLTs to solve estate illiquidity. A donor owning stock in a closely held business may be concerned that the business would have to be sold at death to pay estate taxes. One way of significantly reducing the estate tax attributable to the business is for the donor to create a CLT under her will and bequeath a significant portion of stock in the business to the CLT. The donor's estate would receive a charitable deduction for the value of the charity's interest in the trust, thereby reducing the estate tax payable at the donor's death to a more manageable level and possibly avoiding the need for a forced sale of the business. There may be significant disadvantages to placing a business in a CLT, however, including application of onerous PF excise tax provisions, loss of control over the business and cash flow and other issues. Some of the PF excise tax problems, for example, the excess business holdings prohibition, can be addressed by ensuring that the value of charity's interest in the trust doesn't exceed 60 percent.[59]

One way to avoid the business ever making its way to the CLT would be to give family members or an entity they control an option to purchase the business out of the estate for a long-term promissory note. This technique is permissible under the IRC as an exception to the self-dealing rules, and the fact that the note goes into the CLT avoids any excess business holdings concerns. Although this can be an effective freeze strategy for a business that has significant cash flow to satisfy the note payments, the "I"s need to be dotted and the "T"s crossed for the strategy to satisfy the self-dealing rules. Fortunately, the rules are set forth in Treas. Regs. Section 53.4941(d)-1(b)(3), and in two private letter rulings, the IRS approved the use of a note to satisfy a purchase.[60]

Plan Carefully

The twists and turns of gifting closely held business interests to charity aren't for the faint of heart. Unless an advisor specializes in this area, it's best to reach out to someone who does. Even then, based on the specific facts, it may not be possible to structure the gift in a tax-efficient manner. Not reaching out for specialty advice may result in the advisor and the client taking a trip to the land of unforeseen consequences.

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Endnotes

1. Internal Revenue Code Section 4942(e).
2. Certain supporting organizations (SOs) had been marketed as private foundations (PFs) without the headaches, as PFs are subject to strict operational requirements as well as a web of excise taxes that can apply not only to the PF itself, but also to "disqualified persons" with respect to the PF, such as substantial contributors, PF managers and certain family members. An SO is a type of public charity governed by IRC Section 509(a)(3), meaning that it's, among other things, subject to more favorable deduction limitations than PFs. An SO qualifies as a public charity because it supports one or more other public charities. However, recent law changes now limit the benefit of this strategy.
3. IRC Sections 170(e)(1)(B)(ii) and 170(e)(5). Among other requirements, "qualified appreciated stock" must have market quotations readily available on an established securities market.
4. IRC Sections 170(b)(1)(B), 170(b)(1)(D).
5. IRC Sections 170(b)(1)(A), 170(b)(1)(C).
6. The IRC provisions relating to charitable lead trusts are found at Sections 2055(e)(2)(B) (estate tax); 2522(c)(2)(B) (gift tax); 170(f)(2)(B) (income tax); and the Treasury regulations thereunder.
7. Private Letter Ruling 8824039 (March 21, 1988).
8. IRC Section 664.
9. IRC Section 664(c).
10. IRC Section 170(e)(5)(B).
11. IRC Section 512(e).
12. See IRC Sections 1361(c)(2) and (6).
13. IRC Section 1361(a)(2).
14. IRC Section 1361(e).
15. IRC Section 641(c)(2)(A).
16. IRC Section 641(c)(2), flush language; Treasury Regulations Sections 1.641(c)-1(g)(4); 1.641(c)-1(l) Ex. 4.
17. IRC Section 4947(a)(2).
18. *See, e.g.,* IRC Sections 4941(a)(1) and 4943(a) (initial tax of 10 percent) and Sections 4941(b) and 4943(b) (additional tax of 200 percent); Sections 4942(a) (initial tax of 30 percent) and 4942(b) (additional tax of 100 percent); Sections 4944(a) (initial tax of 10 percent) and 4944(b)

(additional tax of 25 percent); Sections 4945(a) (initial tax of 20 percent) and 4945(b) (additional tax of 100 percent).
19. IRC Sections 4947(a)(2) and (b)(3)(A),(b)(3)(B).
20. IRC Section 4941(d)(2)(B).
21. IRC Section 4941(d)(2)(C).
22. IRC Section 4941(d)(2)(D).
23. IRC Section 4941(d)(2)(E).
24. IRC Sections 4946(a)(1)(A); 4946(a)(2); 507(d)(2). An individual's total contributions include those made by his spouse, and substantial donors remain substantial donors for all subsequent periods, unless certain conditions are met.
25. IRC Section 4946(a)(1)(B).
26. IRC Section 4946(a)(1)(C).
27. IRC Sections 4946(a)(1)(D).
28. IRC Section 4946(a)(1)(E), (F), and (G).
29. IRC Section 4946(a)(3) and (4).
30. IRC Section 4941(d)(2)(F).
31. IRC Section 4943(c)(2)(A).
32. IRC Section 4943(d)(3).
33. IRC Sections 4943(c)(2)(B).
34. IRC Sections 4943(c)(6) and (7).
35. IRC Sections 4943(e).
36. IRC Sections 4944 (a) and (b).
37. Treas. Regs. Section 53.4944-1(a)(2).
38. IRC Section 511.
39. IRC Section 512.
40. IRC Sections 511(b)(1), (2) and (3).
41. IRC Section 511(b)(4).
42. IRC Section 664(c).
43. IRC Sections 511(a)(1) and (b)(1).
44. IRC Sections 4940(a) and (e).
45. IRC Sections 681(a) and 512(b)(11).
46. *See Palmer v. Commissioner,* 62 T.C. 684 (1974); Revenue Ruling 78-197; and *Rauenhorst v. Comm'r*, 119 T.C. 157 (2002) for situations favoring the taxpayer. *But see Blake v. Comm'r*, 697 F.2d 473 (2d Cir. 1982) and *Ferguson v. Comm'r,* 174 F.3d 997 (9th Cir. 1999) for cases favoring the Internal Revenue Service.
47. *Ahmansan Foundation v. United States*, 764 F.2d 761 (9th Cir. 1981). *See* Technical Advice Memorandum 9403005; *Chenoweth v. Comm'r*, 88 T.C. 1577 (1987).
48. *See, e.g.,* Private Letter Ruling 9050004 (Aug. 31, 1990) (49 percent interest in closely held corporate stock allocated to marital deduction trust with resulting reduction in marital deduction); PLR 9147065 (July 12, 1991) (marital deduction reduced when decedent's will bequeathed voting stock to decedent's son and nonvoting stock to marital trust); *Disanto v. Comm'r*, T.C. Memo. 1999-421 (marital deduction reduced when surviving spouse disclaimed a portion of closely held stock bequeathed to her, resulting in her receiving only a minority interest). The decedent held a controlling interest in the stock. By reason of the surviving spouse's disclaimer, the surviving spouse received a minority interest in the stock. *Cf. Chenoweth, supra* note 47 (when 51 percent of a closely held corporation was bequeathed to the surviving spouse and 49 percent to the children, control premium accorded to marital share and minority discount accorded to nonmarital share).
49. PLR 9015049 (Jan. 16, 1990).
50. Treas. Regs. Section 1.664-1(a)(4).
51. Treas. Regs. Section 1.1011-2(a)(3).
52. IRC Section 1011(b).
53. IRC Section 4941(d)(2)(A).
54. PLR 9530032 (May 3, 1995) (revoking PLR 9343033 (Aug. 2, 1993)).
55. Treas. Regs. Section 53.4941(d)-2(a).
56. PLR 9402026 (Oct. 19, 1993).
57. IRC Section 4941(d)(2)(F); PLRs 9015055 (Jan. 17, 1990); 9338046 (June 30, 1993); and 9347035 (Aug. 31, 1993).
58. Revenue Ruling 78-197, 1978-1 C.B. 83. *See Rauenhorst, supra* note 46, in which the Tax Court held that IRS couldn't disavow its own favorable-to-taxpayer 1978 ruling on whether stock sale was prearranged. And, the IRS' Chief Counsel (apparently in response to *Rauenhorst*) reminded its attorneys not to take a position inconsistent with published IRS guidelines. IRS Chief Counsel Notice CC-2002-043, 2002 Tax Notes Today 206-13 (Oct. 24, 2002).
59. IRC Section 4947(b)(3)(A).
60. *See* PLRs 200124029 (June 18, 2001) and 200024052 (June 19, 2000).

SPOT LIGHT

Bountiful

"Blueberry Field" (14 in. by 17 in.) by Alex Katz, sold for $3,125 at Doyle's recent Old Master, Modern & Contemporary Prints Sale in New York on April 29, 2014. The Brooklyn-born Katz is best known for his large paintings. Their simplicity and heightened colors are now seen as precursors to Pop Art.