NAEPC
Journal
of Estate & Tax Planning
Click here to view Issue 35

IRS Loses Tax Court Fight Over Private Stock Donation; Donors and Charities Beware

By: Andrew M. Grumet and Christina N. Cahill

A recent taxpayer victory in the Tax Court in the case of *Jon Dickinson, et ux. v. Commissioner*, TC Memo 2020-128 (Sept. 3, 2020), is an important reminder to donors and potential charitable donees to be well informed of the law when donating, or soliciting donations of, appreciated closely held business interests.

Benefits of Donating Appreciated Interests Ahead of Sales

Wise taxpayers, frequently on the advice of their knowledgeable tax advisors, know that when making a charitable gift, it is typically most beneficial to make a donation to a public charity of an appreciated asset in order to obtain a charitable deduction, rather than donating cash, or even worse, the after-tax proceeds of the sale of the appreciated asset. The benefits, of course, are that the taxpayer will both receive a tax deduction equal to the fair market value of the asset and will not incur tax (i.e., capital gains) on the transaction. This benefit is illustrated in the below example:

	Option 1: Sell stock and donate the net proceeds	Option 2: Donate stock directly to the charity
FMV of stock ($5,000 basis)	$100,000	$100,000
Federal LTCG tax (15%)	$14,250	$0
Amount donated to charity	$85,750	$100,000
Potential personal income tax savings	$27,440	$32,000

Donating appreciated business interests in situations where the business may be sold, or the business owner may otherwise be preparing to divest herself or himself of part of their ownership interest, may be particularly appealing to a philanthropic business owner. As the example illustrates, pre-transaction planning can maximize the amount ultimately available for philanthropic endeavors at the lowest cost to the donor. Savvy gift officers and charities will often suggest this strategy to donors as a way for both the donor and the charity to "win."

Assignment of Income Doctrine

Donors should be cautious about making a gift of an interest in anticipation of a sale or other liquidation event for a variety of reasons. For example, if the expected transaction does not occur, it may not be advisable for the charity to own an interest in the company (and the company may not be too happy about it either). Under those circumstances a charity is not permitted to "re-gift" the interest back to the donor. In even the best of situations, reversing such a transaction would be become complex, and in fact, in most cases it is usually not possible.

Because of the risk associated with a deal not closing, donors often seek to wait until there is some certainty that a transaction will in fact close. However, the longer a donor waits, the greater the risk that the intended result – a donation of property subject to an unrealized gain (i.e., untaxed) – will not be achieved because of the assignment of income doctrine.

The assignment of income doctrine is one of a handful of judicial doctrines developed by United States courts to try to limit tax evasion. A key principal is that a donor cannot avoid taxation on property by merely making a gift of the property. If the substance of the transaction is to avoid income that is otherwise already subject to taxation, such gift may be disregarded.[1] This boils down to a facts-and-circumstances timing question.

Generally, the assignment of income doctrine provides that gain is realized by the owner of property when all events have occurred such that the final resulting transaction is all but assured. In reality, the interest has "ripened" into a fixed right to receive income.[2] Said yet another way, the question is often whether subsequent to the gift there are independent event(s) of significance to conclude that all substantive events related to the transaction have not yet occurred. The charity receiving the donation cannot simply function as a conduit for a transaction that has progressed to the point where it is almost certainly taking place. Whether a particular transaction or series of transactions have, when considering the reality and substance of the circumstances, proceeded to such a point is a fact-specific determination.

[1]See Palmer v. Commissioner, 62 T.C. 684, 692 (1974), affd. on other grounds 523 F.2d 1308 [36 AFTR 2d 75-5942] (8th Cir. 1975), acq. 1978-1 CB 2.
[2]See Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999).

The Tax Court Emphasizes Form of Gift of Appreciated Stock

In the Dickinson case decided earlier this month, Mr. Dickinson had acquired shares over time in a large privately held engineering and consulting firm. He, along with other shareholders, were authorized by the company's Board of Directors to donate shares to Fidelity Investments Charitable Gift Fund, the donor advised fund, in the years 2013 and 2014. Fidelity Charitable's policy, known to the firm and its shareholders, was to immediately liquidate donated stock and it did so with Mr. Dickinson's donated shares by selling them back to the company.

On audit, the IRS determined that Mr. Dickinson did not donate appreciated stock, rather he donated cash because, in substance, the company first redeemed the shares and he then donated the cash to fund a donor advised fund account at Fidelity Charitable. The Tax Court rejected that characterization, however, choosing instead to focus on the form of the transaction, namely that (1) Mr. Dickinson fully transferred his rights to and legal control of the shares to Fidelity Charitable, and (2) he did so before the shares gave rise to income by way of a sale or redemption. Preexisting knowledge of Fidelity Charitable's policy to immediately dispose of donated stock did not, in and of itself, convert the donation of stock into a pre-donation redemption; Fidelity Charitable received the stock and it had the right to do with it what it pleased. At the time of the donation, it could not have been definitively said that a redemption of the shares, regardless of who the owner was, would have occurred.

While the IRS attempted to base its conclusion on the theory that there was a pre-arranged plan for the redemption of the stock, the Tax Court rejected that argument. The Court found that even if that was the case, that does not mean that had the donor retained the stock it would similarly have been redeemed. Citing its 1974 Palmer decision, the Tax Court stated, "[t]he ultimate question, as noted in *Palmer*, is whether the redemption and the shareholder's corresponding right to income had already crystallized at the time of the gift."[3]

Planning Pointers for Donors and Charities

The Dickinson case is a good reminder that the IRS will seek to challenge gifts of appreciated business interests. With such an emphasis by the Tax Court on the proper form of such gifts, donors should be mindful to make the donation sufficiently before the time when the "all events" test has been met, especially in the case of a proposed or impending transaction, or before "the shareholder's corresponding right to income…[has] already crystallized." While the taxpayer succeeded in the Dickinson case, the facts-and-circumstances nature of the assignment of income doctrine can make decision-making tricky when donors hope to make donations of appreciated interests in advance of transactions. Taxpayers should seek legal counsel in such cases.

Charities should also take heed. While many charities have wisely begun to focus on soliciting non-cash charitable gifts, such as appreciated stock, charities should become familiar with the legal principles, such as the assignment of income doctrine, which can impact these gifts. Charities should consider their policies and practices with respect to soliciting and accepting such gifts, both in form and in practice. Not all donors will be fully aware of these principles and may be sorely surprised after making a gift if audited. It may behoove a charity to help educate donors so that a gift is successfully completed. Unhappy donors are not typically repeat donors.

[3]See Palmer v. Commissioner, 62 T.C. at 694-695.

Strategic Nonprofit Solutions Team

Andrew M. Grumet
Shareholder | Practice Chair
agrumet@polsinelli.com

Virginia C. Gross
Shareholder
vgross@polsinelli.com

Christina N. Cahill
Associate
ccahill@polsinelli.com

Douglas K. Anning
Shareholder
danning@polsinelli.com

Thomas J. Schenkelberg
Shareholder
tschenkelberg@polsinelli.com

Nicole P. Ribeiro
Director of Strategic Philanthropy
nribeiro@polsinelli.com

Jonathan S. Blum
Shareholder
jblum@polsinelli.com

Lisa M. Schultes
Senior Partner
lschultes@polsinelli.com

Erica R. Seaborne
Manager of Strategic Philanthropy
eseaborne@polsinelli.com