



**Charitable Options for  
Business Sales**

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**Overview**

- § **80% of America's 32,000,000 businesses are sole proprietorships**
- § **Succession planning is a top priority of most businesses**
- § *Family Business Institute* reports a disconnect between the optimistic belief of today's family business owners and the reality of the massive failure of family companies to survive through the generations.
  - Only 30% survive into the second generation, 12% into the third generation and 3% to the fourth generation
  - **80 questions every business owner should answer**

**2011 Income and Estate Tax Law**

- § **Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, effective Jan 1, 2011**
- § **Senate 81-19, House 277-148**
- § **Extends the Bush Tax cuts and provides temporary estate tax reform for two years**
- § **\$5 million exemption for individuals**
- § **35% rate**

**2011 Income and Estate Tax Law**

- § **Sunsets on 12-31-2012 if Congress does not act**
  - **2013 \$1million exemption and 55% rate**
- § **IRA rollover option extended to 2012 for individuals 70 ½ or older**
  - **\$100,000 limit to qualified charities**
- § **Exemption indexed for inflation after 2012**

**2011 Income and Estate Tax Law**

§ **Portability of exemption**

- After death of first spouse any unused portion of the spouse's \$5 exemption may go to the surviving spouse's future estate
- § Must file IRS 709 and **make the election**, regardless of whether the estate of the predeceased spouse otherwise is required to file an estate tax return.

§ **Step-up in basis of asset on death**

**2011 Income and Estate Tax Law**

§ **Unification of estate, gift and generation-skipping tax with one \$5 million per-individual exemption**

- No sunset on gift and GST
- Example: taxpayer makes a \$3 million taxable gift during life to a child or "skipped individual" then \$2 million could be sheltered in estate

**2011 Income and Estate Tax Law**

§ **Unification of estate, gift and generation-skipping tax**

- May simplify succession planning for family businesses and other matters
- No portability of generation-skipping taxes
  - At Mary's death, her estate uses \$2 million of her \$5 million exemption, the other \$3 million carries over to her surviving husband, John. He can shelter \$8 million for estate taxes but only \$5 million for generation-skipping taxes



**2011 Income and Estate Tax Law**

§ **Family-owned business deduction adjustment in value**

- Qualified family-owned business may deduct up to \$675,000
  - § Participated in business for five of eight years preceding death
  - § One heir is required to materially participate in trade or business for a least 10 years following decedent's death.



## Business Forms



§ Sole Proprietor

§ Partnership

§ Limited Liability Company (LLCs)

§ Sub Chapter "S" Corporation

§ "C" Corporation

## Outright Gifts - Charity

§ Charity has no motivation to keep stock in closely held corporations

- Limited market
- Does not usually conform to charity investment policies

§ Charity can sell back to corporation at fair market value

§ Charity can sell to other shareholders at fair market value, step up in basis

§ Charity reports sale on IRS form 8282




**8282** Donee Information Return (Sale, Exchange, or Other Disposition of Donated Property) - See instructions on back.

Form 8282 (Rev. 03-08)

## Donor - Current Gifts Checklist

- § Save income taxes
- § Save income and capital gains tax
- § Save gift and estate tax
- § Transfer a family business
- § Provide for a magnificent gift
- § Appraisal value filed on IRS form 8283



## Outright Gifts - Donor

§ Closely held stock may be contributed to a charitable organization

- Charity made eligible shareholders of S corp transfers in 1998

§ Appraisal of stock required to substantiate current income tax charitable deduction

- 30% deduction for appreciated asset gifts
- Qualified appraiser
- 60 days limit on appraisal, or by filed tax return
- Marketability discount, minority interest discount

IRS form 8283 filed

## Corporation Giving Matrix

Gift Options	Outright Gift	Outright Redemption or Transfer
<b>Corp Types</b>		
Sole Proprietor	Asset	Yes
Partnership	Interest	Yes
Limited Liability Company (LLCs)	Asset	Yes
Sub "S" Corporation	Asset	Yes
"C" Corporation	Asset	Yes
	Stock	Yes
	Stock	Yes

### Deferred Gift or Life Income Checklist

§ Provide increased spendable income	§ Protect retirement plan from confiscatory tax
§ Provide guaranteed secure income	§ Allow lifetime use of gift property
§ Save current income and capital gains tax	§ Protect family business for estate tax
§ Eventually save estate tax	



### What is a Charitable Trust?

§ Individually designed tax-exempt trust agreement	§ Payments are not guaranteed
§ Assets are irrevocably transferred	§ Payments depend on rate selected with a minimum of 5% payout (IRS regulation)
§ Donor(s) or Beneficiaries receives <u>fixed or variable</u> payments for life or term of years	§ Payments depend upon type of trust selected
	§ Part Gift --- Part Investment

### Types of Charitable Trusts

§ <i>Total return or standard payment CRT</i> <ul style="list-style-type: none"> <li>- Beneficiary receives X% (minimum 5%) of the annual fair market value of the trust assets</li> <li>- As the value of the assets increase or decrease the beneficiary payment increases or decreases</li> </ul>	§ <i>Income only CRT</i> <ul style="list-style-type: none"> <li>- beneficiary receives only the ordinary income (interest and dividends) generated by the trust investments</li> <li>- payments change as the income generated by the trust investments change</li> <li>- May include a makeup provision when income would exceed the payout rate in future years</li> </ul>
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### Types of Charitable Trusts

§ <i>FLIP Charitable Remainder Trust</i> <ul style="list-style-type: none"> <li>- established first as an <b>income only</b> CRT which changes or FLIP's to a standard payment or <b>total return</b> CRT upon the occurrence of a stated trigger event</li> </ul>	§ The trigger event may be a set date (age 65?), an event (death of spouse), or a combination of a date or event (age 65 or my remarriage which ever occurs first)
	§ Normally sale of asset



### Types of Charitable Trusts

§ *FLIP Charitable Remainder Trust*

- Ideal for hard to value assets and real estate




### Types of Charitable Trusts

§ *Charitable Remainder Annuity Trust*

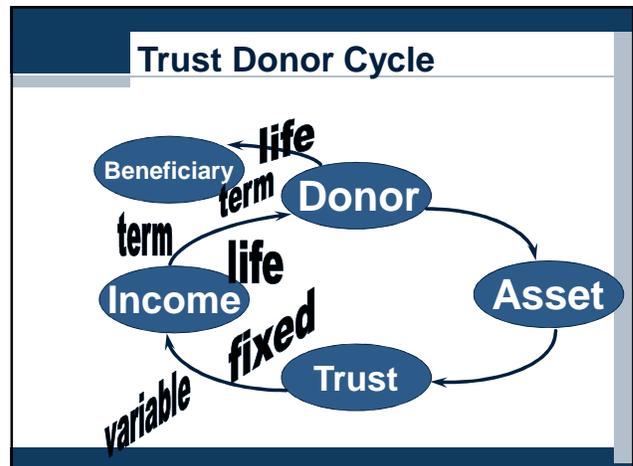
- beneficiary receives a fixed percentage or a set dollar amount of the initial trust assets (minimum 5%)
- **no additions** to the trust allowed



### Trust and Investments

§ In a standard or income only CRT the risk is to the **beneficiary** thru the investment performance

§ In an annuity trust the risk is to the **charity** from the ultimate residuum as a direct result of the withdrawals and investment results

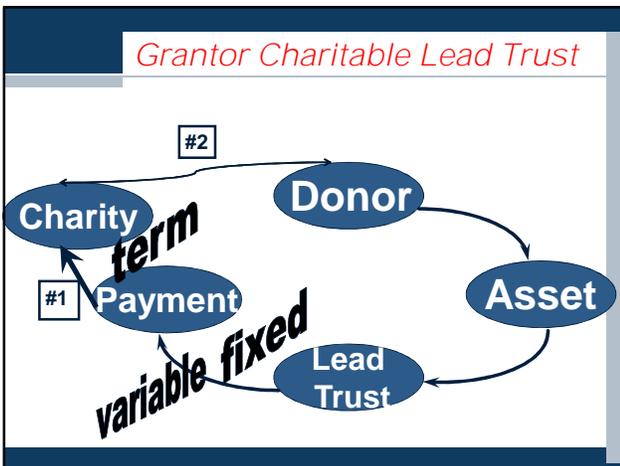


### Corporation Giving Matrix

Gift Options		Gift Annuity	Charitable Remainder Unitrust
<b>Corp Types</b>			
Sole Proprietor	Asset	Yes	Yes
Partnership	Interest	No	No
	Asset	Yes	Yes
Limited Liability Company (LLCs)	Interest	No	Yes
	Asset	No	Yes
Sub "S" Corporation	Asset	Yes	Yes
	Stock	Yes	No
"C" Corporation	Asset	Yes	Yes
	Stock	Yes	Yes

### Corporation Giving Matrix

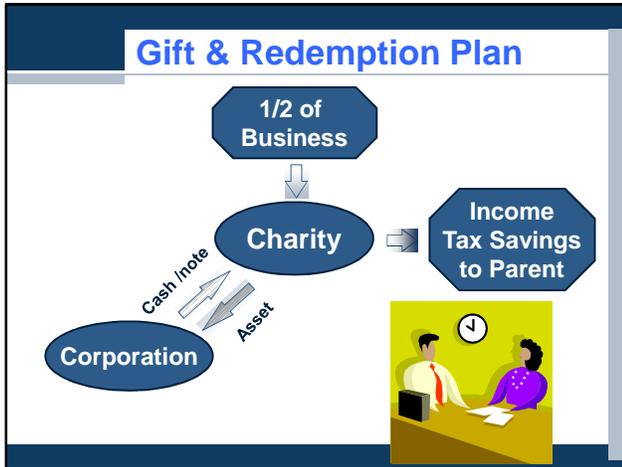
Gift Options		Grantor Charitable Lead Trust
<b>Corp Types</b>		
Sole Proprietor	Asset	Yes
Partnership	Interest	No
	Asset	Yes
Limited Liability Company (LLCs)	Interest	Yes
	Asset	Yes
Sub "S" Corporation	Asset	Yes
	Stock	Yes
"C" Corporation	Asset	Yes
	Stock	Yes



### Outright Gifts - Charity

- § Example: Mr. and Mrs. Scott own all 500 share in ABC corporation.
- § Each share is worth \$10,000.
- § They donate 10 shares to charity and receive a fair market value deduction of \$100,000, 30% deduction.

- § The charity sells the shares back to ABC corporation which pays for them using a portion of the \$300,000 in accumulated earnings.



### Outright Gifts - Charity

§ Example: Mr. and Mrs. Wilson own 300 share in XYZ corporation and wish to establish a family endowment. At the same time they would like to increase their daughter's ownership stake in the family business.

- They have made annual and lifetime gifts of stock to daughter resulting in the daughter owning 200 shares.
- Over the years the stock has increased in value and the remaining shares will trigger a heavy estate tax.

### Outright Gifts - Charity

§ Example: Mr. and Mrs. Wilson

§ Gift 100 shares to charity

§ Charity sells stock back to corporation, absorbing them as treasury stock

§ Remaining ownership with no gift or estate tax

- 200 shares for Wilson's, 50% ownership
- 200 share for daughter, 50% ownership

**We appreciate  
YOUR BUSINESS!**

### Transfer to Family

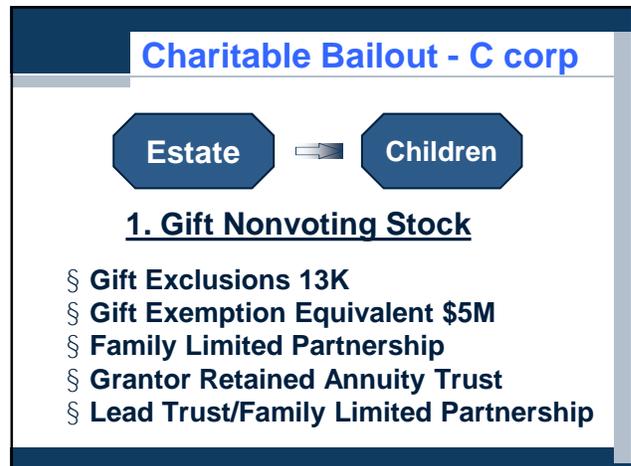
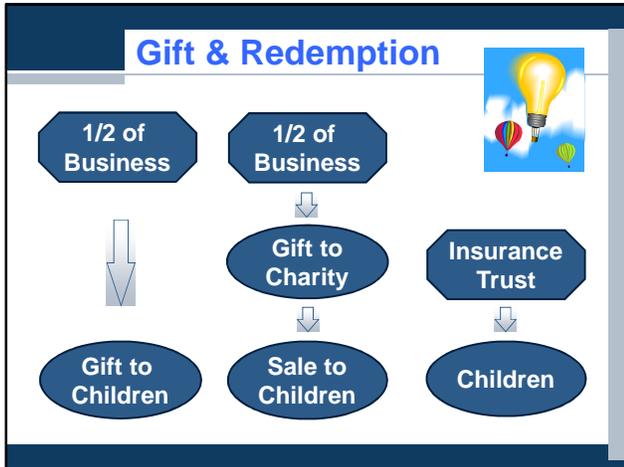


§ Part Gift

§ Part Sale

- Gift Annuity
- Unitrust
- Gift and Redemption

§ Insurance Trust



### Charitable Bailout – C Corp



**Estate**



**Unitrust  
\$2,000,000**



**2. Gift & Redemption**

- § NV Stock to Unitrust
- § No Binding Obligation
- § Stock to Corporation
- § Cash to Trust/FMV



**Corporation  
NV Stock**

### Sole Proprietor



- § Personal Ownership, no legal existence apart from the owner
- § Personal Liability
- § Income and capital gains reported on 1040
- § Entering retirement an important stage to convert value of assets into income stream

### Sole Proprietorship

- § **Capital gain assets**
  - Held long term
    - § Land, buildings, good will
  - Taxed at 15% plus state tax rate
- § **Ordinary income assets**
  - Inventory, operating assets, receivables, depreciated machinery and equipment



### Proprietorship Asset Sale

- § **Sell in Unitrust**
  - Real estate
  - Tangible Personal Property
  - Equipment
  - Goodwill
- § **Sold For Cash**
  - Operating Assets



### Sole Proprietorship Asset Sale

§ Charitable Remainder Trust challenges

- May not hold an ongoing business
- Subject to Unrelated Business Income tax (UBIT), Sec. 513(a)
  - § A few exceptions such as a **short term lease**
  - § Operate the business before sale
- Debt on property when sold produces UBIT on sale
  - § Exception: Non-recourse debt held for five years
  - § Debt relief strategies

### Debt relief strategies

- § Small debt – Pay off
- § Release
- § Bridge loan
- § Part sale to charity
- § Personal guarantee



### Sole Proprietorship Asset Sale

§ Charitable Remainder Trust challenges

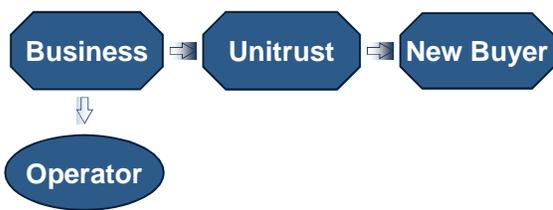
- Self-dealing rules (Sec. 4947(a)(2))
- Family members are disqualified persons for the sale of charitable trust assets

§ Pre-arrange sale

- No binding legal agreement



### Active Business to Unitrust



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    graph LR
      Business[Business] --> Unitrust[Unitrust]
      Unitrust --> NewBuyer[New Buyer]
      Operator((Operator)) --- Business
  
```

1. **Short Term** Cash Lease to Operator, passive income
2. Gift Business to Unitrust Valuation issues
3. UT Sells to New Buyer

### Partnership

- § Partnership has title to assets
- § Partnership return
- § Informational return on IRS form 1065
- § K -1's to partners – pass through taxation
- § General partner – liability
- § Limited partner – no liability, except amount invested
- § Business owner charitable receptivity



### The Limited Liability Corp.

- § Personal assets protected from claims, bad debt
- § Pass through taxation and deductions
- § Single or multiple members
  - File IRS 1065, informational return
- § Inside and Outside basis in assets



### The Limited Liability Corp.

- § Charitable remainder trust challenges similar to Sole Proprietorship operating business
  - UBTI issues
  - Debt issues
  - Self-dealing issues
- § Charity can hold/sell shares

### Business Forms

- § Sole Proprietor
- § Partnership
- § Limited Liability Company (LLCs)
- § *Sub Chapter "S" Corporation*
- § "C" Corporation



### Subchapter "S" Corporation

- § **Maximum 100 Shareholders**
- § **After 1998 -- Charitable Shareholders permitted**
- § **One Class of Stock**
- § **Pass Through Taxation Form 1120S**
- § **Charitable Deduction < Basis**
  - Inside basis – S Corp basis in asset
  - Outside basis – shareholder basis

### Sub Chapter "S" Assets

- § **May be gifted outright to charity**
  - Deduction may be limited to cost basis plus long term capital gain in S corp stock
  - If stock has ordinary income assets, i.e. depreciation recapture, unrealized receivables or appreciated inventory then under Sec. 1245 deduction is reduced to cost basis
  - **Assume: shareholder makes a gift of stock appraised for \$100,000 and S corp holds \$5,000 in ordinary income assets then CCD will be \$95,000**
  - Appraisal required, Minority interest discount
    - § Appraiser may/ apply discount to S corp stock

### Prearranged Sale

- § **No binding agreement for charity repurchase, Rev. Rul. 78-197**
- § **Prospective buyers in the wings**
- § **No signed or oral binding agreement**
- § **If binding agreement then capital gains tax due**

### Sub Chapter "S" Assets

- § **Charity tax on unrelated business taxable income (UBIT), Sec 521(e)**
  - Dividends and all other distributions
- § **Charity sells stock it is taxed on the gain on sale at corporate rate, Sec 512(e)(B)(ii)**
- § **Limited market, identify buyer before sale**

**Sub Chapter "S" Assets**

§ A Charitable Remainder Unitrust is not a permissible owner of Sub "S" corp stock

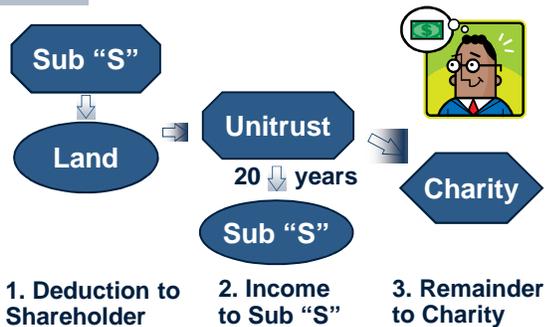
- If stock is transferred to CRUT S corp loses the S corp election and is taxable at the corporate level and shareholder level

**Sub Chapter "S" Assets**

§ It is permissible for the S corp to establish a CRUT

- Must be for term of years
- Income tax deduction flows through to shareholders
- Income payments flows through to S corp and then distributed to shareholders

**Subchapter "S" Unitrust**



**Ely Motors – "S corp"**

- § Tommy Ely, 58, sole shareholder
- § Operates 8 car dealerships
- § \$250 million in sales
- § Pledges \$1,000,000 to public charity
- § Strategy: outright gift



### Ely Motors – Outright gift S stock

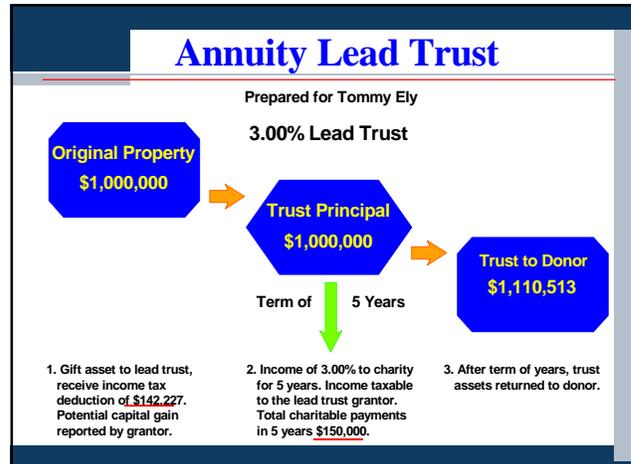
- § Result: **\$1,000,000** income tax deduction for Tommy (assume no ordinary income assets)
- § Charity pays UBIT on dividends during holding period, and corporate tax on gain upon sale
  - Net charity receives less than \$1,000,000
- § Charity sells stock to new business partner or corporation redeems shares
  - Program or project funded
- § Tax liability of charity could be more than donor

### Grantor Charitable Lead Trust

- § GCLT is a permissible shareholder for S corp stock
  - Transfer will not effect S corp tax status
- § Assets returned to Grantor upon end of term
- § Variable term and payout amount
  - Income taxed to grantor yearly
- § Immediate upfront 30% of AIG income tax deduction, for the use of not “to charity”
- § Tax-free bond alternative

### Ely Motors – Grantor CLT

- § Result: Income tax deduction (30% limit) for Tommy
- § CLT is a permitted owner of S corp stock
- § Charity receives annual distributions from S corp dividends
- § Trust term and payout set by S corp owner
- § S corp reverts back to grantor at end of term
- § Yearly distribution taxable to S corp owner



### Gift Annuity



- § Gift Annuity provides life income to donor
- § May or may not use ACGA rates
- § Buyer in the wings important to produce cash for reinvestment
- § Tax considerations on sale important

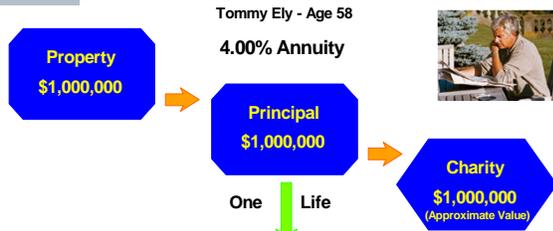
### Ely Motors – CGA for Tommy

- § Tommy uses \$1,000,000 in S corp stock to establish a Charitable Gift Annuity
- § Tommy accepts a 4% payout
  - \$40,000 annual payment, taxed at ordinary income, capital gains and tax-free
- § Receives a \$319,216 charitable deduction
- § Partial bypass of \$900,000 in capital gains



### Charitable Gift Annuity

Tommy Ely - Age 58  
4.00% Annuity



1. Gift property to charity. Partial bypass \$900,000 gain may save \$43,094. Income tax deduction of \$319,216 may save \$111,726.
2. Annuity of \$40,000.00 for one life. Tax-free amount \$2,651.72. Estimated one life payout of \$1,080,000. Effective payout rate 5.5%.
3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.



### Ely Motors – CGA for Ben

- § Tommy wants to benefit Ben his longtime mentor with a lifetime income
- § Ben is age 81
- § Tommy contributes \$1,000,000 to establish a CGA for Ben
- § Corporation redeems shares using retained earnings.



### Ely Motors – CGA for Ben

- § Tommy receives charitable income tax deduction for gift annuity
- § Charity pays tax on gain, dividends, receives less than \$1,000,000 for annuity
- § Charity reduces contract value with ACGA payout rate reduction to Ben to compensate for reduced proceeds
- § Tommy files gift tax return for current gift to Ben
- § Tommy realizes immediate capital gain on S corp stock sale

### Charitable Gift Annuity

Property  
\$1,000,000

→

Principal  
\$1,000,000

→

Charity  
\$500,000  
(Approximate Value)

Ben Jones - Age 81  
5.00% Annuity

One ↓ Life

\$312,656 capital gain taxable  
IRS 709 gift value \$347,395

1. Gift property to charity. Partial bypass \$900,000 gain may save \$88,102. Income tax deduction of \$652,605 may save \$228,412.

2. Annuity of \$50,000.00 for one life. Tax-free amount \$39,500.00. Estimated one life payout of \$485,000. Effective payout rate 9.2%.

3. Quarterly payments for one life. Property passes to charity with no probate fees. There are also no estate taxes.



### Convert S corp to C corp

- § Bill and Amy are age 64, own an ABC Corp an “S Corp.”
- § Major corporation is interested in purchasing their corporation
- § Longtime active members of community and committed to giving back



### Convert S corp to C corp

- § Bill and Amy are age 64, own an ABC Corp an “S Corp.”
- § Objectives:
  - Pay no capital gains tax on sale
  - Reduce current and future taxes income taxes
  - Cash to travel around the world

**Solution: Convert S corp to C corp**

§ **The account recommends S corp to convert to C corp and complete a tax-free sale with CRT and outright sale.**

§ **70% of stock goes into CRT**

§ **30% of stock sold outright**

§ **Result: tax-free sale**



*Charitable options  
for business sales*

