



Defined Value Clauses; S Corp. Distribution of Property; Traps Donating a Business to Charity

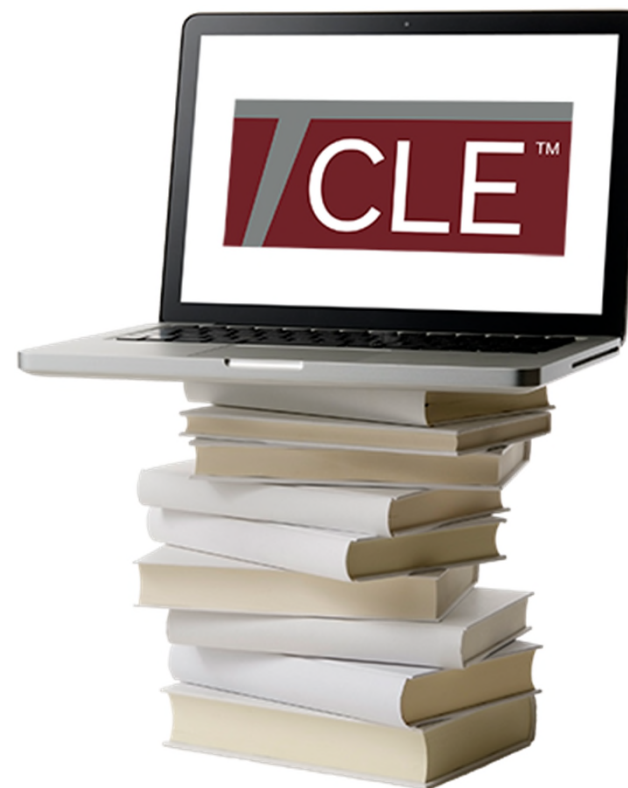
Steve Gorin

sgorin@thompsoncoburn.com

314.552.6151

<http://thompsoncoburn.com/people/steve-gorin>

<http://thompsoncoburn.com/insights/blogs/business-succession-solutions>



KNOWLEDGE WHERE YOU ARE™

WELCOME

Overview

- Defined Value Clauses
- S Corporation Distribution of Property
- Traps Donating a Business to Charity

Defined Value Clauses

- What Is It; When to Use
- Defining How Much Gets Transferred to Whom
- Defining Purchase Price

Note: Supporting materials have the clauses from all of the major cases

Defined Value Clauses

What Is It; When to Use

- Purchase \$5 of Gas or Buy 5 Gallons and Pay Whatever It's Worth (Stephanie)
- Hard-to-Value Asset Transferred by Gift/Bequest, Sale, or Disclaimer
- GRAT vs. Sale to Irrevocable Grantor Trust
- Sales Between Irrevocable Trusts (Hard)

No subsequent adjustment - *Palmolive Building Investors v. Commissioner*, 149 T.C. No. 18 (10/10/2017) (a unanimous reviewed decision) (different issue but reaffirmed position)

Defined Value Clauses

Defining How Much Gets Transferred to Whom

- Excess gift to charity
- Gift to charity and donees; charity and other donees negotiate
- Formula disclaimer, with excess to charity
- Gift based on dollar amount; no gift over

Defined Value Clauses

Defining Purchase Price

- If ready to pay with liquid assets up front, give portion of undiscounted LLC with value equal to value of transferred asset
- If use a note, define the sale price as fair market value, as finally determined for gift tax purposes
- *True v. Commissioner*, Tax Court Docket Nos. 21896-16 and 21897-16 (petitions filed October 11, 2016) – price set by appraiser to be adjusted by audit

Defined Value Clauses

Defining Purchase Price Using Note – See Sample Language in Materials

- Principal = Formula Sale Price
- Allonge to Note to *Estimate* Principal
- Donor Agrees to File Gift Tax Return
- Purchase Price Finalized When Gift Tax Return Statue of Limitations Expires

S Corporation Distribution of Property

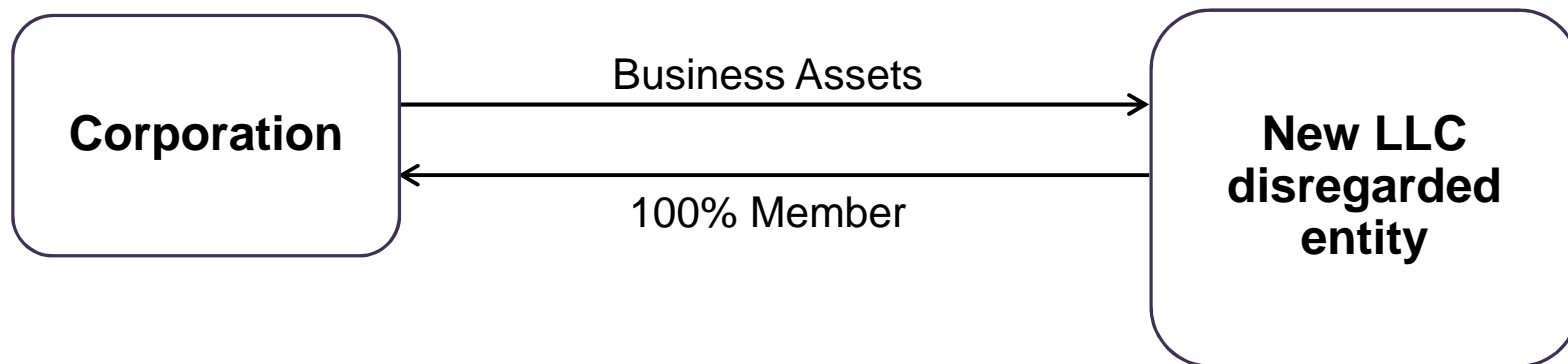
- When a corporation distributes appreciated assets, entire gain (not just depreciation recapture) from the deemed sale of any depreciable or amortizable property may be taxed as ordinary income.
- Applies to distributions, liquidations, or conversions by “unchecking the box”
- Convert future values from corporate solution to a partnership without triggering these issues – next slides are “how to”

Flowcharts: Migrating Existing Corporation into Preferred Structure

Part II.E.5.

Corporation Forms New LLC – Two Options

Direct Formation of LLC (1st option)



Flowcharts: Migrating Existing Corporation into Preferred Structure

Corporation Forms New LLC

Direct Formation of LLC (1st option)

Advantages

- Corporation Can Keep Nonbusiness Assets
- Corporation Can Keep Business Assets That Would Generate Complications if Transferred to the Limited Partnership Structure and Then Had Income Recognition Event
- New LLC Can Stay as a Disregarded Entity for a While as Transition to New Structure and Get Everyone Used to Working in LLC Structure

Flowcharts: Migrating Existing Corporation into Preferred Structure

Corporation Forms New LLC

Direct Formation of LLC (1st option)

Disadvantages

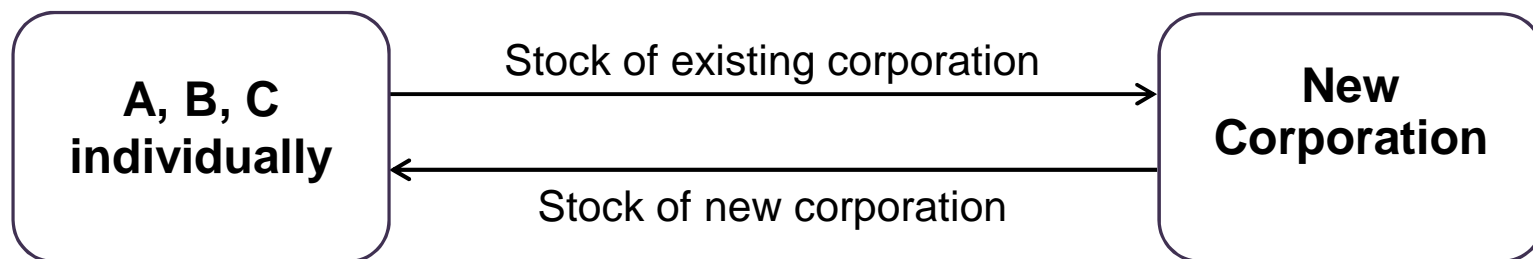
- Piecemeal Transfer of Assets
- Some Assets Not Readily Transferable

Flowcharts: Migrating Existing Corporation into Preferred Structure

Part II.P.3.i.

Corporation Forms New LLC

Use F Reorganization to Form LLC (2nd option)

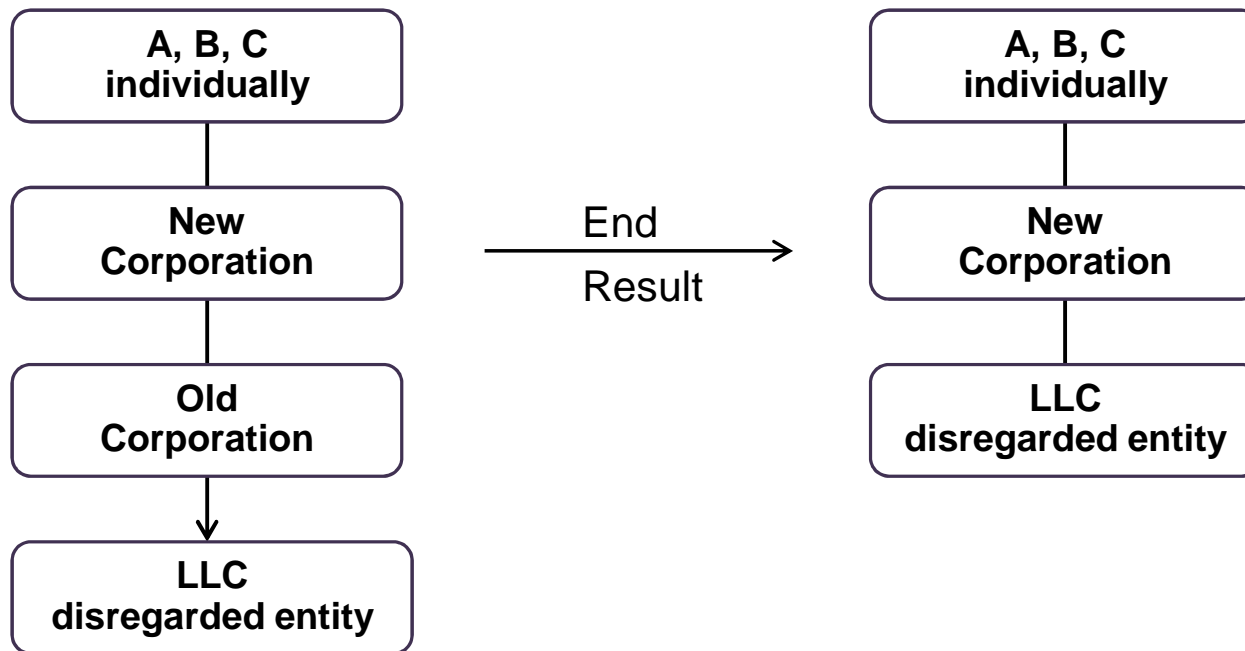


Flowcharts: Migrating Existing Corporation into Preferred Structure

Part II.E.5.c.

Corporation Forms New LLC

Use F Reorganization to Form LLC (2nd option)



Flowcharts: Migrating Existing Corporation into Preferred Structure

Corporation Forms New LLC

Use F Reorganization to Form LLC (2nd option)

Advantage

- Moves all assets in one fell swoop

Flowcharts: Migrating Existing Corporation into Preferred Structure

Corporation Forms New LLC

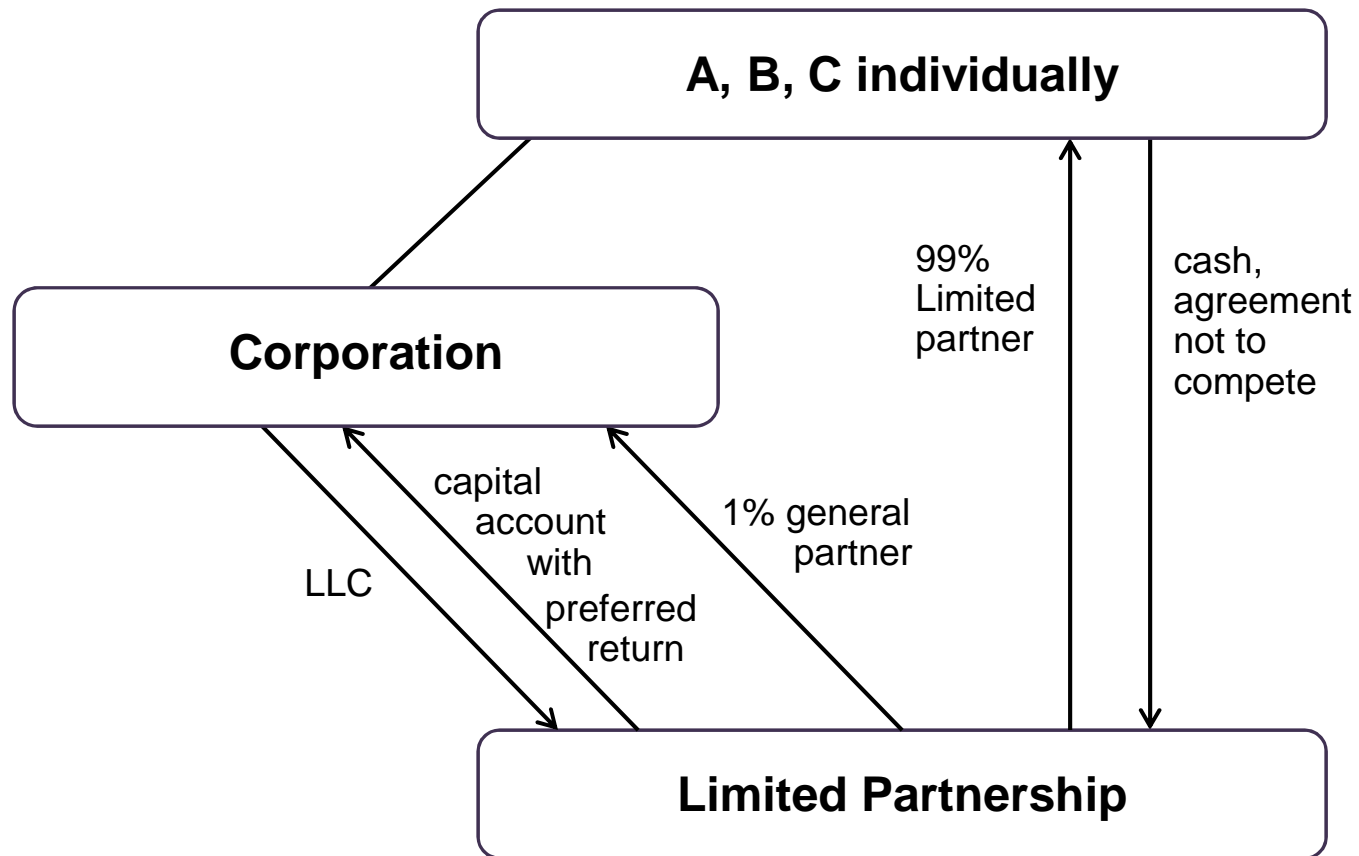
Use F Reorganization to Form LLC (2nd option)

Disadvantages

- No Selectivity of Retained Assets
- Contribution of Stock of Old Corporation to New Corporation and Merger or Conversion of Old Corporation into New Corporation Need to Be Done at the Same Time
- If S Corporation Involved, New Corporation Does New S Election and Old Corporation Does Qualified Subchapter S Subsidiary Election

Flowcharts: Migrating Existing Corporation into Preferred Structure

Migrating LLC to LP: Parts II.E.5., II.Q.7.h.



Traps Donating a Business to Charity

- Contributions to public charities can work well, although any income from an S corporation K-1 or from the sale of S corporation stock constitutes unrelated business income subject to tax (regardless of the nature of the corporation's assets).
- If possible, S corporation should donate assets instead of donor donating stock.

Traps Donating a Business to Charity

- Contributions of closely-held business interests to private foundations can be deducted only to the extent of the contributed property's basis.
- To increase the deduction for C corporation stock, consider contributing it to a charitable remainder unitrust (CRUT), in which the donor's retained interest is worth only the 10% minimum.

Traps Donating a Business to Charity

Contributions of business interests:

- Can cause self-dealing issues (although bequests might be less likely to cause self-dealing issues)
- Might be subject to rules limiting the period in which a charity may own a significant part of a closely-held business.

Traps Donating a Business to Charity

- Transfer of partnership interest that reduces the donor's share of the partnership's liabilities constitutes a bargain sale that may trigger income tax.
- Charitable contribution reduced by the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

Traps Donating a Business to Charity

Charitable Remainder Trust (CRT)

- CRT pays a 100% tax on any unrelated business taxable income generated from any actual or deemed sale of a partnership interest and or from any K-1 it receives from holding a partnership.
- Income taxed (again) to the beneficiary when CRT makes distributions.

Traps Donating a Business to Charity

Unrelated Business Income (UBTI)

- Partnership's business operations
- Income generated by acquisition indebtedness (even if generally excluded).
- Debt may make the entire gain on the sale of the partnership interest be UBTI in ways that may surprise advisors.
- UBTI exclusions in supporting materials.

Traps Donating a Business to Charity

S Corporation – automatically UBTI

- K-1 income, even from items generally excluded
- Gain on sale of stock

If S corporation is in trust where remainder passes to charity, consider converting the corporation to an LLC taxed as an S corporation that “unchecks the box” at death

Traps Donating a Business to Charity

Charitable Deduction against UBTI

- 10% if corporation
- 50% if trust
- Instead of donating business directly to operating charity, pass through a donor-advised fund (or perhaps a supporting organization for the benefit of the charity) taxed as a trust

Traps Donating a Business to Charity

Assignment of Income

- If property is subject to a legally binding obligation to sell before being donated, donor taxed on sale
- Avoid by careful drafting of letter of intent that signed when negotiations open

Traps Donating a Business to Charity

Charitable Split Interest

- Completed Gift Requirement - *Fakiris v. Commissioner*, T.C. Memo. 2017-126
 - Forced Sale to Related Party for Note
 - Charitable Partial Interest Prohibition
 - Split Interest
 - Slicing and Dicing
- Do 51/49 LLC holding company for sale

Conclusion

- January 30 webinar for Fourth Quarter Newsletter
- Additional webinar if tax reform passes
- Blog: [Business Succession Solutions](#)
- Reports on Heckerling:
<http://www.thompsoncoburn.com/forms/gorin-heckerling>