

MAXIMIZE TAX EFFICIENCY WITH S CORPORATION STOCK

A Donor Advised Fund incorporated in trust form can reduce tax burdens and preserve more for charitable purposes.

Donating S corporation (S corp) stock before a business sale can be a highly effective way to align financial and charitable goals. When structured appropriately, this approach can significantly reduce tax exposure and maximize the amount available for philanthropy.

The Situation: A donor approached the Community Foundation to explore donating S corp stock before the sale of their business. The Community Foundation partnered with a DAF organization, incorporated in trust form, to accept the gift and maximize tax efficiency.

Challenges with Corporate Form: If the Community Foundation, incorporated in corporate form, had accepted the S corp stock directly, it would have faced tax liabilities on the income and appreciation from the stock. S corp income is treated as unrelated business taxable income (UBTI) for a nonprofit corporate entity, triggering federal income tax on allocated income and post-donation appreciation. Even at a 21% rate, this would have significantly reduced the value available for charitable purposes.

Advantages of Trust Form: By partnering with a DAF organization incorporated in trust form - located in a state without income tax - the outcome was far more tax-efficient. While still subject to UBTI, the trust could offset up to 60% of its adjusted gross income through a charitable contribution back to a DAF at the Community Foundation. This reduced the effective tax rate on the trust's income to approximately 8%.

As a result, roughly 90 cents of every dollar of the S corp stock's value flowed into the donor's DAF. The donor avoided capital gains tax, received a charitable deduction and ensured the proceeds were available to support their philanthropic goals.

Key Takeaways: This case highlights the importance of structuring when accepting complex assets such as S corporation stock. By partnering with a DAF in trust form, the Community Foundation helped preserve more of the gift for charitable use. Early planning and the right structure can materially increase the impact of a client's philanthropy.

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