Steve Leimberg's Charitable Planning
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Subject: Richard Fox on *Dickinson v. Commissioner* - Tax Court Respects Form of Donation of Privately Held Stock to Fidelity Charitable Donor Advised Fund and Rejects IRS Asserted Recharacterization of Donation as Redemption of Stock by Donor Followed by Cash Contribution of Redemption Proceeds

"As in the Dickinson case, most charities receiving donated shares of stock, particularly privately held stock, want an exit strategy in place at the time of the donation so that the stock can be liquidated. Indeed, in the case of privately held stock, a charity, and particularly a donor advised fund, will require that some form of exit strategy be in place. In these cases, the donor seeks to deduct the fair market value of the donated stock and does not want to recognize any taxable gain on the appreciation, the normal result in the case of a contribution of appreciated stock.

However, as indicated in Dickinson, in the case where a redemption or other disposition of donated stock is anticipated or prearranged, the IRS may seek to recharacterize the contribution of stock as a contribution of the sale proceeds by the donor and seek to impose tax on gain realized by the donor on the sale. In these cases, an IRS challenge should be anticipated, so that, as was done in the Dickinson case, it is of great importance to document that the charity receiving the property is under no legal obligation to sell the stock after the donation and that the donor has no rights to receive sale proceeds at the time of the donation."

Richard L. Fox provides members with commentary on *Dickinson v. Commissioner*.

Richard L. Fox is an attorney and shareholder at **Buchanan Ingersoll & Rooney** (www.bipc.com). Richard is the author of the treatise, Charitable Giving: Taxation, Planning and Strategies, a Thomson Reuters/Warren, Gorham and Lamont publication, writes a national bulletin on charitable giving, and writes and speaks frequently on issues pertaining to nonprofit organizations, estate planning and philanthropy. Richard is also a Fellow of the American College of Trust and Estate Counsel (ACTEC).

Here is his commentary:

EXECUTIVE SUMMARY:

In *Dickinson*, the taxpayer contributed stock in a privately held company to a donor advised fund at Fidelity Investments Charitable Gift Fund ("Fidelity Charitable"). Shortly after the donation, the shares were redeemed by the company, which was anticipated to occur at the time of the contribution, although upon its receipt of the donated shares, Fidelity Charitable was not legally obligated to sell the stock in a redemption transaction. The IRS asserted, however, that each donation of the shares, followed by Fidelity's redemption, should be treated in substance as a redemption of the shares for cash by the taxpayer, followed by the taxpayer's donation of the cash proceeds to Fidelity Charitable. In taking this position, the IRS treated the taxpayer as having realized a taxable gain on the redemption of the stock and asserted that the taxpayer was liable for income tax on the redemption. The Tax Court rejected the position of the IRS on the basis that at the time of the donation, the taxpayer had no rights to any redemption proceeds and Fidelity Charitable was not legally obligated to sell the stock, notwithstanding that the parties may have prearranged for Fidelity Charitable to sell the donated stock pursuant to a redemption transaction. Therefore, the court held that the taxpayer could deduct the full fair market value of the donated stock without recognizing any taxable gain.

As in the *Dickinson* case, most charities receiving donated shares of stock, particularly privately held stock, want an exit strategy in place at the time of the donation so that the donated stock can be liquidated. Indeed, in the case of privately held stock, a charity, and particularly a donor advised fund, will require that some form of exit strategy be in place. In these cases, the donor seeks to deduct the fair market value of the donated stock and does not want to recognize any taxable gain on the appreciation, the normal result in the case of a contribution of appreciated stock. Indeed, in its decision, the court specifically noted that donating appreciated property to a charity allows the taxpayer to avoid paying tax that would arise if the taxpayer instead sold the property and donated the cash proceeds. However, as indicated in *Dickinson,* in the case where a redemption or other disposition of donated stock is anticipated or prearranged, the IRS may seek to recharacterize the contribution of stock as a contribution of the sale proceeds by the donor and seek to impose tax on gain realized by the donor on the sale. In these cases, an IRS challenge should be anticipated so that, as was done in the *Dickinson* case, it is of great importance to document that the charity receiving the donated stock is under no legal obligation to sell the stock after the donation and that the donor has no rights to receive sale proceeds at the time of the donation.

FACTS:

Background

In *Dickinson*, T.C. Memo. 2020-128, the taxpayer was the chief financial officer and a shareholder of Geosyntec Consultants, Inc. ("GCI"), a privately held company, during the tax years at issue in this case. The GCI board of directors authorized shareholders to donate GCI shares to Fidelity Investments Charitable Gift Fund ("Fidelity Charitable") through written consent actions in 2013 and 2014. In both consent actions, the board stated that Fidelity Charitable **"has a donor advised fund program which incorporates procedures requiring [Fidelity Charitable] to immediately liquidate the donated stock" and "seeks an imminent exit strategy and, therefore, promptly tenders the donated stock to the issuer for cash."** (Emphasis added.) The GCI board approved a third round of donations at a board meeting by unanimous vote in 2015 and the Board members signed the written minutes of the meeting. After each board authorization, the taxpayer donated appreciated GCI shares to Fidelity Charitable to be credited to his donor advised fund.

After the donation, GCI confirmed in letters to Fidelity that its books and records reflected Fidelity Charitable as the new owner of the shares that the taxpayer had donated. For each stock donation, the taxpayer signed a letter of understanding ("LOU") to Fidelity Charitable, indicating that the transferred stock was "exclusively owned and controlled by Fidelity," and that Fidelity "maintains full discretion over all conditions of any subsequent sale" of the stock and "is not and will not be under any obligation to redeem, sell, or otherwise transfer" the stock. That taxpayer received confirmation letters from Fidelity that explained that Fidelity Charitable had "exclusive legal control over the contributed asset." Shortly after each donation, Fidelity Charitable redeemed the GCI shares, whereby GCI distributed redemption proceeds to Fidelity Charitable that were credited to the taxpayer's donor advised fund.

The taxpayer claimed a charitable income tax deduction for each taxable year that shares of GCI stock were donated to Fidelity Charitable. The IRS asserted, however, that each donation of the GCI shares, followed by Fidelity's redemption of the shares, should be treated in substance as a redemption of the shares for cash by the taxpayer, followed by the taxpayer's donation of the cash redemption proceeds to Fidelity Charitable. In taking such position, the IRS treated the taxpayer as having realized a taxable gain on the redemption of the GCI stock and asserted that the taxpayer was liable for income tax on the redemption, as well as a corresponding penalty under IRC § 6662(a) for each tax year at issue.

Analysis and Holding of Tax Court

The Tax Court first recognized the tax advantage the taxpayer sought to achieve in this case, noting that a taxpayer may deduct under IRC § 170 the fair market value of appreciated property donated to a qualified charitable organization without recognizing any capital gain on the appreciation, stating as follows:

> Donating appreciated property to a charity allows the taxpayer to avoid paying tax that would arise if the taxpayer instead sold the property and donated the cash proceeds. See sec. 61(a)(3); Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates & Gifts … ("[T]he shrewd strategy with appreciated assets is to contribute the property in kind, allowing the charity to sell if it prefers cash."). Petitioners sought the tax advantages of donating appreciated property rather than cash proceeds.

In reliance on *Humacid v. Com'r*, 42 T.C. 894 (1964), the Tax Court stated that "we respect the form of this kind of transaction if the donor (1) gives the property away absolutely and parts with the title thereto and (2) before the property gives rise to income by way of a sale," which the court referred to as the two prongs required to be met under *Humacid.*

The court, in addressing the first *Humacid* prong, stated that GCI's letters to Fidelity Charitable confirming ownership transfer, Fidelity Charitable's letters to petitioners explaining that Fidelity Charitable had "exclusive legal control" over the donated stock, and the LOUs to the same effect all support the taxpayer's claim that he transferred all of his rights in the GCI stock to Fidelity Charitable. In support of its position, the IRS asserted that the fact that "Fidelity [Charitable] regularly redeemed the GCI shares shortly after each donation, according to what the Board understood to be Fidelity's internal procedures" suggest that the taxpayer, CGI and Fidelity Charitable "could have arranged the redemptions in advance of the gifts." In rejecting the IRS position, the court stated that a preexisting understanding among the parties that the donee would redeem donated stock does not convert a post-donation redemption into a pre-donation redemption and, moreover, that "neither a pattern of stock donations followed by donee redemptions, a stock donation closely followed by a donee redemption, nor selection of a donee on the basis of the donee's internal policy of redeeming donated stock suggests that the donor failed to transfer all his rights in the donated stock." Accordingly, the court held that the taxpayer's contemporaneous documentary evidence of an absolute gift satisfied the first prong requirement of *Humacid*.

In addressing the second *Humacid* prong requirement, that the taxpayer make the donation before the stock gives rise to income by way of sale, the court, citing *Helvering v. Horst,* 311 U.S. 112 (1940), noted that this requirement implements the assignment of income doctrine, such that "a taxpayer who has earned income cannot escape taxation by assigning his right to receive payment" so as to ensure "that if stock is about to be acquired by the issuing corporation via redemption, the shareholder cannot avoid tax on the transaction by donating the stock before he receives the proceeds."

The court then addressed the assignment of income doctrine specifically in the context of a charity redeeming donated shares of stock shortly after it receives the donation. In this context, the court stated that where a donee charity redeems donated shares shortly after a donation, the assignment of income doctrine applies "only if the redemption was practically certain to occur at the time of the gift, and would have occurred whether the shareholder made the gift or not." The court noted, for example, *Ferguson v. Com'r*, 174 F.3d 997 (9th Cir. 1999), aff'g 108 T.C. 244 (1997), where a shareholder recognized income on shares donated to a charity where under a merger agreement, the purchase of such donated shares from the donee charity by a third-party was “practically certain to occur (i.e., whether the right basically had become a fixed right)” at the time of the contribution, rather than the subject of “a mere anticipation or expectation” when the shareholder donated the stock. Also cited by the court was *Hudspeth v. U.S.*, 471 F.2d 275 (8th Cir. 1972), where the court in that case recast a stock donation as a taxable stock sale and donation of the sale proceeds where the taxpayer donated stock after the issuing corporation's directors and shareholders had adopted a plan of complete liquidation, where at the time of the contribution, the only remaining step to complete the liquidation was the mere ministerial act of filing documents with the state necessary to complete the liquidation under state law. Therefore, the court held that the taxpayer “had made contributions not of stock, but of proceeds of the liquidation, and he is properly taxable on gain arising therefrom.”

In contrast to the aforementioned cases, the court noted that there was no assignment of income in *Palmer v. Com’r*, 62 T.C. 684 (1974). In that case, a donor, who was a shareholder in control of a corporation transferred shares of stock of the corporation to a private foundation, which the donor also controlled. Subsequent to the transfer and pursuant to a prearranged plan, the shareholder caused the corporation to redeem the transferred shares from the foundation the very next day. In its analysis, court in Palmer stated: “there were two paths which the [donor shareholder] could have taken — he could have had the stock redeemed and then made a contribution of the [proceeds], or he could have contributed the stock and let the donee arrange for the redemption. The tax consequences to the donor turn on which path he chooses, and so long as there is substance to what he does, there is no requirement that he choose the more expensive way.” The court in *Palmer* found that the gift of stock had in fact been made to the foundation, “no vote for redemption had yet been taken” when the shareholder donated that stock, and the foundation was not legally obligated to redeem the stock at the time it received title to the shares, thereby supporting a conclusion by the court that the substance of the transaction was indeed a donation of shares, not of redemption proceeds. As such, the court respected the form of the transaction and did not recharacterize the transaction as a redemption of the stock by the donor shareholder followed by a gift of the redemption proceeds to the private foundation, notwithstanding that all “parties were related and anticipated the redemption before the donation.”

The Tax Court in Dickinson then stated that as in *Palmer*, "the redemption in this case was not a fait accompli at the time of the gift" and that even if "the parties may have prearranged for Fidelity to redeem the stock … it would not affect the analysis under the second *Humacid* requirement. Rather, we respect the form of the transaction because the taxpayer did not avoid receipt of redemption proceeds by donating the GCI shares." In its holding, the court noted that the IRS "argues that the parties may have prearranged for Fidelity to redeem the stock." The court stated, however, that "[e]ven if that was the case, it would not affect the analysis under the second *Humacid* requirement. Rather, we respect the form of the transaction because [the taxpayer] did not avoid receipt of redemption proceeds by donating the GCI shares."

Interestingly, the Tax Court in *Dickinson* noted that the IRS pointed to Rev. Rul. 78-197, 1978-1 C.B. 83, a "bright-line" rule that the IRS applies in cases like *Palmer*, which focuses on the donee's control over the disposition of the appreciated property. In that ruling, the IRS concluded that the IRS "will treat the proceeds of a redemption of stock under facts similar to those in *Palmer* as income to the donor only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption." The court then noted, however, that "This Court has not adopted Rev. Rul. 78-197, *supra*, as the test for resolving anticipatory assignment of income issues, see *Rauenhorst v. Com'r*, 119 T.C. at 166, and does not do so today. The 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." Regardless of whether Fidelity Charitable's obligation to redeem the stock may suggest the donor had a fixed right to redemption income at the time of the donation, the court stated that the IRS did not allege that the taxpayer had any such right in this case.

COMMENT:

The IRS and the courts have often considered whether the gain on stock donated to charity shortly before a merger, liquidation, or redemption transaction is taxable to the donor, notwithstanding that the stock in the transaction is actually disposed of by the charity, not the donor taxpayer. When the gain has been determined to be taxable to the donor, the decision has generally rested on an anticipatory assignment of income theory. That is, the right to the proceeds from the disposition of the shares was found to be so firmly fixed prior to the gift that the donor was, in effect, transferring the sale proceeds, not the stock, even where the sale by the donee charity stock is anticipated or prearranged before the stock is donated. And, in the redemption context, the IRS has applied Rev. Rul. 78-197, whereby the redemption proceeds will be taxed to the donor where the donee charity, following the receipt of the donation, is legally bound or can be compelled to surrender the shares to the corporation for redemption.

Whether or not a charity receiving a donation of property is considered to be legally bound to sell donated property is dependent on the facts and circumstances of each case and the controlling state law. *In Blake v. Com'r*, 697 F2d 473 (2d Cir. 1982), for example, the charity was considered to be legally obligated to sell stock contributed by a donor, the proceeds of which were then used to purchase a yacht owned by the donor. The court found, on the basis of the particular facts of the case, which were clearly egregious, the existence of a legal obligation to sell the stock on the part of the charity under the doctrine of promissory estoppel under applicable state law. The transaction was recast as a sale of stock by the donor and a contribution by the donor of the yacht to the charity. The more egregious the facts, the more likely it is that the IRS will assert that there is a legal obligation imposed on the charity to sell. In Blake, it was clear that the transaction was, in essence, a sham. The taxpayer contributed publicly traded stock, with the understanding and knowledge that the donee charity would, in fact, sell the stock and use the cash proceeds to purchase his yacht. Under these facts, the state law principle of promissory estoppel applied, such that the court found that the charity was under a legal obligation under state law to sell the contributed stock and use the proceeds to purchase the donor's yacht. In *Chrem*, TC Memo. 2018-164, the Tax Court, citing relevant authority, summarized its view of the assignment of income doctrine as applied to charitable contributions as follows:

> In the typical scenario, the taxpayer donates to a charity stock that is about to be acquired by the issuing corporation via redemption, or by another corporation via merger or acquisition. In determining whether the taxpayer has assigned income in these circumstances, one relevant question is whether the prospective acquisition is a mere expectation or a virtual certainty. "More than expectation or anticipation of income is required before the assignment of income

> doctrine applies." Greene v. United States, 13 F.3d 577, 582 [73 AFTR2d 94-746] (2d Cir. 1994). Another relevant question is whether the charity is obligated, or can be compelled by one of the parties to the transaction, to surrender the donated shares to the acquirer. Rev. Rul. 78-197, 1978-1 C.B. 83 (1978); see Rauenhorst v. Commissioner, 119 T.C. 157, 166 (2002) (finding "the donee's control to be an important factor"). The existence of an "understanding" among the parties, or the fact that transactions occur simultaneously or according to prearranged steps, may be relevant in answering that question. See, e.g., Blake v. Commissioner, 697 F.2d 473, 480 [51 AFTR2d 83-445] (2d Cir. 1982) (stating that an "understanding" among the parties need not be "legally enforceable under state law"), aff'g T.C. Memo. 1981-579 [¶ 81,579 PH Memo TC]; Ferguson v. Commissioner, 108 T.C. 244 (1997) (finding assignment of income with respect to proceeds of merger that occurred contemporaneously with charitable contribution), aff'd, 174 F.3d 997 [83 AFTR2d 99-1775] (9th Cir. 1999).

As in the *Dickinson* case, most charities receiving donated shares of stock, particularly privately held stock, want an exit strategy in place at the time of the donation so that the stock can be liquidated. Indeed, in the case of privately held stock, a charity, and particularly a donor advised fund, will require that some form of exit strategy be in place. In these cases, the donor seeks to deduct the fair market value of the donated stock and does not want to recognize any taxable gain on the appreciation, the normal result in the case of a contribution of appreciated stock. However, as indicated in *Dickinson*, in the case where a redemption or other disposition of donated stock is anticipated or prearranged, the IRS may seek to recharacterize the contribution of stock as a contribution of the sale proceeds by the donor and seek to impose tax on gain realized by the donor on the sale. In these cases, an IRS challenge should be anticipated, so that, as was done in the *Dickinson* case, it is of great importance to document that the charity receiving the donated property is under no legal obligation to sell the stock after the donation and that the donor has no rights to receive sale proceeds at the time of the donation.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Richard Fox

CITE AS:

CITES:

Dickinson, TC Memo. 2020-128; *Humacid v. Com'r*, 42 T.C. 894 (1964); *Blake v. Com'r*, 697 F2d 473 (2d Cir. 1982); Rev. Rul. 78-197, 1978-1 C.B. 83; *Ferguson v. Com'r*, 174 F.3d 997 (9th Cir. 1999), aff'g 108 T.C. 244 (1997); *Helvering v. Horst*, 311 U.S. 112 (1940); *Chrem*, TC Memo. 2018-164.