DAFs: An Option for Donations of Non-Qualified Appreciated Stock

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If shares of stock contributed to a private foundation do not meet the definition of "qualified appreciated stock," the taxpayer's income tax charitable deduction generally will be limited to his or her basis in the property (rather than the fair market value of the property). Two situations in which taxpayers may have difficulty navigating this requirement are where the equity interest at issue is publicly traded but the entity is not a corporation (such as a publicly-traded partnership or a partnership interest in an UP-C structure) and where the stock at issue is subject to Securities and Exchange Commission Rule 144 volume limitations. In both of these situations, taxpayers may wish to consider a donation to a donor-advised fund.

For a taxpayer's donation of stock to his or her private foundation to be eligible for a fair market value income tax charitable deduction, in general, the stock must constitute "qualified appreciated stock." Qualified appreciated stock is "any stock of a corporation for which (as of the date of the contribution) market quotations are readily available on an established securities market and which is capital gain property" (meaning that the taxpayer has held it for more than one year). Therefore, there are two requirements: the entity must be a corporation and the value of the stock must be determined by reference to market quotations on an established market.

Publicly-traded partnerships are not corporations. Further, founders of companies structured as partnerships for tax purposes, when pursuing an initial public offering, often implement an UP-C structure, where the existing partnership owners in an operating company form a C corporation, organized as a holding company owning equity interests in the partnership. The founders continue to own partnership interests, which may be exchanged for stock of the publicly traded corporation. In both cases, these partnership interests, even if the value is determined by reference to the public market, fall outside the definition of qualified appreciated stock, as the definition specifically references only stock of a *corporation*. For taxpayers holding property of this type, a donation to a DAF may be an attractive alternative.

Even if the entity is a corporation the stock of which is publicly traded, there may be restrictions on the ability to sell the stock. These restrictions, in turn, may materially affect the value of the securities, in which case the value of the stock is deemed not to be determined by reference to market quotations (a critical element of qualified appreciated stock). While comprehensive treatment of SEC Rule 144 is outside the scope of this brief article, for purposes of this discussion, it suffices to note that Rule 144 may subject a prospective transferor or transferee to volume limitations on trading. A series of Private Letter Rulings provides that the relevant inquiry in determining whether stock subject to Rule 144 limitations constitutes qualified appreciated stock is whether the donee-charity is unrestricted in its ability to sell the shares when it receives them. However, a Private Letter Ruling, while indicative of the Internal Revenue Service's view on a particular subject, is binding only on the taxpayer who requested it, and cannot be definitively relied on by other taxpayers. If a taxpayer does not wish to request a Private Letter Ruling or rely on another person's Private Letter Ruling as probative of the IRS's treatment of his or her situation, he or she may consider a donation to a DAF instead; in that case, the taxpayer would receive a deduction for the fair market value of the stock even if it does not constitute qualified appreciated stock.