Gifts of Restricted Stock, Options, and Closely Held Interests

Clients who own illiquid securities such as closely held stock, restricted stock and stock options can use them to make meaningful gifts to charity. They can also generate significant tax deductions to offset income or capital gains. Community foundations are well-suited to help with gifts of illiquid securities.

Clients may consider it a mixed blessing to own an equity interest in a private business, restricted stock, or stock options. The assets may be valuable, but the value can't be unlocked without triggering a significant tax event.

"Many people assume because a stock is restricted that they are stuck with it and can't do anything with it," says Vaughan Henry of Henry & Associates, a Springfield, Ill. consultancy specializing in gifting and estate planning. But donating such assets can generate exceptional tax benefits while serving charitable intent. Some people may mistakenly believe that only the ultra-affluent can donate restricted or privately held stock. But the Silicon Valley Community Foundation, like many community foundations, administers donor advised funds with assets starting at just $10,000, as well as larger sums, according to Jennifer Rowe, director of planned giving.

Strategies for Asset Types

Gifts of illiquid securities carry different tax advantages depending on the type of security and the manner in which it is gifted. The following are some of the key considerations for each of these assets.

Restricted Stock: Often it's donated ahead of a change in a company, such as its sale, an initial public offering, or a merger. The donation provides significant tax deductions that can be applied to the taxable gains the donor will soon realize. However, the IRS requires an appraisal of any donated property, other than publicly traded stock, valued over $5,000. Rule changes in 2006 tightened the parameters, meaning in practice that appraisal costs may run as high as $20,000. As a result, the donations should be sizable to be worth everyone's time and effort. Even if the restricted stock is publicly traded, the gift will require a qualified appraisal that takes into account the nature and duration of the restrictions. This can be avoided only if the transaction can be structured such that the restrictions do not apply to the amount of stock given to the charity.

For those in need of income, a charitable remainder trust (CRT) is a good option, according to Henry. CRTs allow a large deduction upfront equal to as much as 30% of adjusted gross income, with excess carried ahead for up to five years. The donor collects income from the CRT for a set period of time. After the term is complete, the charity acquires the remainder value of the asset. "It is an excellent planning tool for an appreciable asset that you intend to market," Henry says.

Closely Held Stock: Even if there is no plan to market the stock of a private company, the asset can still be gifted for its full, appreciated value. As with restricted stocks, gifts of closely held stock require a qualified appraisal.

Most charities will try to liquidate concentrated stock positions as soon as possible. The charity will want to know the world of potential buyers for the stock and under what conditions it can be sold. Tightened regulations also mean charities must ensure they can sell the asset for what the donor valued it at. While this can be a complex process, Rowe says that community foundations are experienced with such transactions and often can get approvals within a few days.

Stock Options: Incentive stock options cannot be donated while a donor is alive, but, if the plan permits, can be given as part of a bequest, generating a charitable deduction for the estate. Nonqualified stock options can be donated while living, but the donor is responsible for the tax bill when the charity exercises them. As such, it is better for the donor to exercise the options first and then donate the proceeds to charity.

Benefits of Community Foundations

Community foundations are an ideal resource when it comes to donating illiquid assets. Here are some of the advantages of working with community foundations on these types of donations.

- **Experience handling illiquid assets**: Community foundations have the experience and willingness to work with illiquid assets, says Erik Dryburgh, Principal at Silk, Adler & Colvin, a San Francisco law firm with a specialty in giving and estate planning. “There are a lot of charities out there that know nothing beyond raising cash, as they are so program-driven,” Dryburgh says. “Community foundations are as much donation-focused as they are about raising money and granting it out.”

- **Full tax benefits for donors**: “There are substantial problems in giving any of these [asset types] to private foundations,” says Stephen Maislin, President of the Greater Houston Community Foundation. “For example, if you give closely-held stock to a private foundation you can only deduct your cost basis—what you paid for it—as opposed to appreciated value.” When giving to a community foundation, however, the full appreciated value of the stock can be deducted with no capital gains exposure, providing significant federal and state tax benefits.

- **Donors can direct the giving**: Clients find immense satisfaction through the ability to give to causes of their choosing through a community foundation. “We invest the money, and they have the advisory power,” Maislin says. “The donor keeps the recognition and we essentially provide the administrative platform.”

Meeting Client Wishes and Tax Needs

Donors of illiquid assets can support beloved causes while taking the most tax-advantaged route with assets they may have thought were locked away. For example, one recent donor of restricted stock to the Greater Houston Community Foundation has recommended grants to local high schools and churches as well as national charities. At the other end of the spectrum, community foundations possess the expertise to take general donations and distribute grants according to the needs they identify.

By donating to a community foundation, clients can use the assets efficiently. Administrative costs are low and there is no need to make numerous individual donations. “It is all about flexibility,” Rowe says. “It‘s an opportunity to use their interest in a company to do good.”

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