

Private Letter Ruling 9734034, 5/22/1997, IRC Sec(s). 170(e)(5)

Full Text:

Date: May 22, 1997

Refer Reply to: CC:IT&A:03/PLR-105674-97

LEGEND:

Taxpayer = ***

Foundation = ***

Company = ***

State = ***

x = ***

y = ***

z = ***

Dear ***

This is in response to your private letter ruling request on behalf of Taxpayer dated March 20, 1997 and supplemented by a letter dated April 14, 1997. Taxpayer requests rulings on the proper federal income tax treatment under section 170 of the Internal Revenue Code of a contribution of shares of Company common stock to Foundation.

RULINGS REQUESTED

Taxpayer requests the following rulings:

1. The shares contributed by Taxpayer to Foundation on December 23, 1996 constitute "qualified appreciated stock" within the meaning of section 170(e)(5)(B) of the Code.
2. Company shares that Taxpayer may subsequently contribute to Foundation on or before May 31, 1997 will constitute "qualified appreciated stock" within the meaning of section 170(e)(5)(B) of the Code.
3. The shares contributed by Taxpayer to Foundation on December 23, 1996 and any subsequent contributions of Company shares by Taxpayer to Foundation on or before May 31, 1997 will result in a deduction from Taxpayer's taxable income under section 170 of the Code, and the amount of such deduction will be equal to the fair market value of the Company shares contributed, valued as of the date of the contribution.
4. Any excess contributions of qualified appreciated stock attributable to the shares contributed by Taxpayer on or before May 31, 1997 may be carried over to succeeding taxable years pursuant to section 170(b)(1)(D)(ii) of the Code.

FACTS

1. Initial Contribution

On December 23, 1996, Taxpayer contributed x shares of Company common stock (shares) to Foundation. Company is a corporation. Foundation was organized on December 16, 1996 as a State not-for-profit corporation. It is anticipated that upon submission of its application for recognition of tax exempt status, Foundation will be classified by the Service as a private foundation within the meaning of section 509(a) of the Code and will not be considered a private foundation described in section 170(b)(1)(E). Taxpayer will timely file the application for recognition of Foundation's tax exempt status and thus the classification of Foundation as a private foundation will relate back to December 16, 1996, the date of organization.

Prior to contributing the shares to Foundation, Taxpayer owned y shares. All of the shares held by Taxpayer were acquired in a transaction that did not involve a public offering. Prior to the time Taxpayer contributed any shares to Foundation, Taxpayer held the shares for more than two years. At the time of contribution, Taxpayer had an adjusted basis in the shares that was less than their fair market value. The remaining shares held by Taxpayer have been held for more than two years and Taxpayer has an adjusted basis in the shares that is less than their fair market value. Taxpayer held the shares contributed and holds the remaining shares as investment assets and, as such, the shares in the hands of Taxpayer are not assets described in section 1221(1), (2), or (3) of the Code.

The shares are listed on the Nasdaq National Market. On the date Taxpayer contributed the shares to Foundation, Company had approximately z shares outstanding. Because Taxpayer acquired the y shares in a transaction that did not involve a public offering, Taxpayer is prohibited under the Securities Act of 1933 (the "1933 Act") from selling the shares unless they are offered pursuant to an effective registration statement or sold in an exempt transaction.

Under Rule 144 of the General Rules and Regulations promulgated under the 1933 Act ("Rule 144"), the shares can be sold by Taxpayer free of any restrictions imposed by the 1933 Act (i.e. without compliance with the registration requirements of the 1933 Act) provided that, under section (e)(1) of Rule 144 (the "Rule 144 volume limitation"), the amount of shares sold by Taxpayer during any three-month period does not exceed the greater of (i) one percent of the shares outstanding as shown by the then most recent report or statement published by the Company, or (ii) the average weekly trading volume of the shares during the preceding four calendar weeks. The other requirements under Rule 144 are (i) the availability of "adequate current public information" with respect to the issuer of the securities, (ii) a two-year holding period between the date of acquisition of the securities from the issuer and the date of any resale of the securities by the acquirer in reliance on Rule 144, (iii) that the securities be sold in a brokers' transaction or in a transaction directly with a market maker, and (iv) that Form 144 be filed with both the SEC and any national securities exchange on which the securities are traded.

Pursuant to Rule 144(d)(v), Foundation, as the charitable recipient of the shares, is able to tack the holding period of Taxpayer onto the period it holds the shares. Foundation is entitled to rely upon Rule 144 as an exemption under which it may sell the shares provided the public information, holding period, Rule 144 volume limitation, manner of sale, and notice requirements of Rule 144 are satisfied. Taxpayer represents that at the time he contributed the shares to Foundation he was able, pursuant to the exemption under Rule 144, to sell the shares free of any restrictions, provided that the number of

shares sold during any three-month period does not exceed the Rule 144 volume limitation. Taxpayer also represents that the shares in the hands of Foundation are free of resale restrictions imposed by the 1933 Act, provided that the total number of Company shares sold by Taxpayer and Foundation during any three-month period, in the aggregate, does not exceed the Rule 144 volume limitation.

To ensure that the Rule 144 volume limitation is not exceeded, Taxpayer and Foundation have entered into an agreement that restricts Taxpayer's ability to dispose of the shares. Under the terms of the agreement, Taxpayer "agrees (1) that he will not sell or otherwise dispose of any other shares of [Company] stock owned by him to the extent that such sale or other disposition would restrict the ability of the Foundation to sell the [x] shares of [Company] stock transferred to it by him pursuant to this agreement and (2) that if at any time the Foundation should decide to sell all or part of the shares of [Company] stock so transferred to it by [Taxpayer], he will take any and all actions reasonably necessary to confirm the Foundation's right to sell said shares in compliance with the provisions of Rule 144."

Taxpayer (including any contributions by members of his family as described in section 170(e)(5)(C)) did not contribute shares to the extent that the amount of stock of Company contributed to private foundations (when increased by the aggregate amount of all prior contributions by Taxpayer of stock in Company to private foundations) exceeds 10 percent (in value) of all of the outstanding stock of Company.

2. Subsequent Contributions

In addition to the contribution of the shares to Foundation on December 23, 1996, Taxpayer plans to make one or more contributions of shares to Foundation on or before the date on which section 170(e)(5) of the Code expires, which is May 31, 1997. The maximum number of shares that will be contributed by Taxpayer in each subsequent contribution will be limited such that (i) the number of shares contributed by Taxpayer will not exceed the number of shares that may be sold by Taxpayer under Rule 144 on the date of the contribution, and (ii) the total number of shares held by Foundation at any time as a result of the December 23, 1996 contribution and any subsequent contribution will not exceed the number of Company shares that may be sold by Foundation under Rule 144.

Taxpayer and Foundation will enter into additional agreements that restrict Taxpayer's ability to dispose of shares. Under the terms of the proposed agreements for subsequent contributions, Taxpayer "agrees (1) that he will not sell or otherwise dispose of any other shares of [Company] stock owned by him to the extent that such sale or other disposition would restrict the ability of the Foundation to sell the *** shares of [Company] stock transferred to it by him pursuant to this agreement, (2) that he will not contribute shares of [Company] stock to the Foundation in an amount which would cause the Foundation to possess more shares of [Company] stock than could be sold pursuant to the volume limitation of section (e)(1)(i) of Rule 144 and (3) that if at any time the Foundation should decide to sell all or part of the shares of [Company] stock transferred to it by [Taxpayer], he will take any and all actions reasonably necessary to confirm the Foundation's right to sell said shares in compliance with the provisions of Rule 144."

Taxpayer (including members of his family as described in section 170(e)(5)(C)) will not contribute shares to the extent that the amount of stock of Company contributed to private foundations (when increased by the aggregate amount of all prior contributions by Taxpayer of stock in Company to private foundations) exceeds 10 percent (in value) of all of the outstanding stock of Company.

LAW

Section 170(a) of the Code allows a deduction for any charitable contribution (as defined in section 170(c)) payment of which is made within the taxable year.

Section 1.170A-1(c)(1) of the Income Tax Regulations states that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value, of the property at the time of the contribution reduced as provided in section 170(e)(1) and paragraph (a) of section 1.170A-4.

Section 170(e)(1)(B)(ii) of the Code provides that in the case of charitable contributions to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in section 170(b)(1)(E), the amount of the charitable contribution of property otherwise taken into account under section 170 is reduced by the amount of gain that would 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 the contribution).

Section 170(e)(5)(A) of the Code states that section 170(e)(1)(B)(ii) does not apply to any contributions of "qualified appreciated stock."

Section 170(e)(5)(B) of the Code defines "qualified appreciated stock," except as provided in section 170(e)(5)(C), to mean any stock of a corporation (i) for which (as of the date of the contribution) market quotations are readily available on an established securities market, and (ii) which is capital gain property (as defined in section 170(b)(1)(C)(iv)).

Section 170(e)(5)(C)(i) of the Code provides that, in the case of any donor, the term "qualified appreciated stock" shall not include any stock of a corporation contributed by the donor in a contribution to which section 170(e)(1)(B)(ii) applies (determined without regard to section 170(e)(5)) to the extent that the amount of the stock so contributed (when increased by the aggregate amount of all prior such contributions by the donor of stock in such corporation) exceeds 10 percent (in value) of all of the outstanding stock of such corporation. For purposes of section 170(e)(5)(C)(i), an individual shall be treated as making all contributions made by any member of his family (as defined in section 267(c)(4)). Section 170(e)(5)(C)(ii).

Under section 170(e)(5)(D) of the Code, section 170(e)(5) does not apply to contributions made (i) after December 31, 1994, and before July 1, 1996, or (ii) after May 31, 1997.

Section 170(b)(1)(C)(iv) of the Code defines the term "capital gain property" to mean, with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain.

Section 1222(3) of the Code defines "long-term capital gain" to mean gain from the sale or exchange of a capital asset held for more than one year, if and to the extent the gain is taken into account in computing gross income.

Section 1221 of the Code defines the term "capital asset" to mean property held by the taxpayer (whether or not connected with his trade or business) but does not include (1) stock in trade; (2) certain property used in a trade or business; (3) certain property that

is the product of the taxpayer's personal efforts; (4) accounts or notes receivable; and (5) certain publications of the United States government.

In the case of charitable contributions of capital gain property by an individual donor to a charitable organization not described in section 170(b)(1)(A) of the Code, section 170(b)(1)(D)(i) limits the total amount of such contributions taken into account under section 170(a) for any taxable year to the lesser of (i) 20 percent of the taxpayer's contribution base (as defined in section 170(b)(1)(F)) for the taxable year, or (ii) the excess of 30 percent of the taxpayer's contribution base (as defined in section 170(b)(1)(F)) for the taxable year over the amount of the contributions of capital gain property to which section 170(b)(1)(C) applies. Contributions made by an individual in a taxable year in excess of such percentage limitations are carried over to each of the five succeeding taxable years under section 170(b)(1)(D)(ii).

In an analogous carryover issue, the Service has ruled that the tax character of contributed property under the alternative minimum tax is determined at the time of the contribution. See Rev. Rul. 90-111, 1990-2 C.B. 30 (excess contribution carryovers for non-capital gain property from 1991 are treated as non-capital gain property for 1992 and subsequent years under the alternative minimum tax, though the special rule resulting in non-capital gain characterization applies only to contributions made in 1991).

ANALYSIS

1. Initial Contribution

For stock to be "qualified appreciated stock," it must meet the requirements of section 170(e)(5)(B) of the Code. Section 170(e)(5)(B)(i) requires that market quotations for the stock be readily available on an established securities market as of the date of the contribution. On December 23, 1996, the date of the initial contribution, the shares were listed on the Nasdaq National Market and, under the facts of this case, there were no SEC restrictions on Foundation's ability to sell the shares. Accordingly, the shares meet the requirements of section 170(e)(5)(B)(i).

To meet the requirements of section 170(e)(5)(B)(ii) of the Code, the shares must be capital gain property within the meaning of section 170(b)(1)(C)(iv), which means that the shares would have to result in long-term capital gain if sold at their fair market value. Under section 1222(3), long-term capital gain results from the sale of a capital asset held for more than 1 year. In the present case, the shares represent a capital asset, since the shares were held for investment and do not meet any of the exceptions to the definition of capital asset set forth in section 1221(1) through (5). Since it has been represented that the fair market value of the shares on the date of the initial contribution was more than the adjusted basis of the shares, we also find that if the shares were sold, the sale would result in a gain.

In regard to the one-year holding requirement, Taxpayer represents that he had held the shares for more than two years. Based upon Taxpayer's representations, we conclude that the shares represent long-term capital gain property within the meaning of section 170(b)(1)(C)(iv), and Taxpayer's contribution of the shares meets the requirements of section 170(e)(5)(B)(ii).

Since clauses (i) and (ii) of section 170(e)(5)(B) of the Code are met, and Taxpayer will not have contributed more than 10 percent (within the meaning of section 170(e)(5)(C)) of all outstanding stock to Foundation, we conclude that the shares that Taxpayer

contributed to Foundation on December 23, 1996 are "qualified appreciated stock" within the meaning of section 170(e)(5)(B).

2. Subsequent Contributions

On or before May 31, 1997, Taxpayer plans to make one or more contributions of shares to Foundation. Taxpayer will not contribute shares to Foundation in an amount that would cause Foundation to possess more shares of stock than could be sold pursuant to the volume limitation of section (e)(1)(i) of Rule 144. In the agreements between Taxpayer and Foundation for contributions after December 23, 1996, Taxpayer will promise that he will not sell or otherwise dispose of any other shares owned by him to the extent that such sale or other disposition would restrict the ability of Foundation to sell the additional shares transferred to it by hi pursuant the agreements. Thus, the shares that Foundation receives in any contribution will be freely transferable immediately upon receipt by Foundation. Also, Taxpayer (including any contributions by members of his family as described in section 170(e)(5)(C)) will not contribute shares to the extent that the amount of stock of Company contributed to private foundations (when increased by the aggregate amount of all prior contributions by Taxpayer of stock in Company to private foundations) exceeds 10 percent (in value) of all of the outstanding stock of Company.

Since clauses (i) and (ii) of section 170(e)(5)(B) of the Code will be met in each subsequent contribution, and Taxpayer will not have contributed more than 10 percent (within the meaning of section 170(e)(5)(C)) of all outstanding stock to donee private foundations, we conclude that the shares that Taxpayer contributes to Foundation in subsequent contributions will be "qualified appreciated stock" within the meaning of section 170(e)(5)(B).

3. Carryover to period after May 31, 1997

Under section 170(e)(5)(D), section 170(e)(5) treatment does not apply to contributions made (i) after December 31, 1994 and before July 1, 1996, or (ii) after May 31, 1997. Thus so long as Taxpayer contributes all of the "qualified appreciated stock" to Foundation on or before May 31, 1997, Taxpayer will be allowed to value the contribution without regard to section 170(e)(1)(B)(ii).

The Service position in Rev. Rul. 90-111 suggests that, in determining the tax character for carryovers of deductions under section 170, the focus is on the tax character of the contributed property when the contribution is made. Thus, so long as Taxpayer's contribution qualifies for "qualified appreciated stock" treatment at the time that it is made, the carryover will be given the same treatment.

RULINGS

Based on the facts stated above, we conclude as follows:

1. The shares contributed by Taxpayer to Foundation on December 23, 1996 constitute "qualified appreciated stock" within the meaning of section 170(e)(5) of the Code.
2. The shares that Taxpayer may subsequently contribute to Foundation on or before May 31, 1997 will constitute "qualified appreciated stock" within the meaning of section 170(e)(5) of the Code.
3. Section 170(e)(1)(B)(ii) will not apply to Taxpayer's contributions of shares, contributed on or after on December 23, 1996 and on or before May 31, 1997.

4. Any excess contributions of qualified appreciated stock attributable to the shares contributed on or after December 23, 1996 and on or before May 31, 1997 may be carried over to succeeding taxable years pursuant to section 170(b)(1)(D)(ii) of the Code.

Our response is based on the assumption that Foundation's application for recognition of exemption will be approved and that Foundation will be recognized as an organization that is eligible to receive contributions that are deductible under section 170 of the Code.

No opinion is expressed concerning the deductibility of the contributions or the federal tax consequences of the proposed transaction under any other provisions of the Code.

A copy of this ruling should be attached to Taxpayer's federal income tax returns for the tax years affected.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Assistant Chief Counsel

(Income Tax & Accounting)

By: Karin G. Gross

Senior Technician Reviewer,

Branch 3

Enclosure:

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