

# Private Letter Ruling 9825031, 6/19/1998, IRC Sec(s). 170

## Full Text:

Date: March 24, 1998

In Reference to: CC:DOM:IT&A:3/PLR-121371-97

### LEGEND:

Corporation/Taxpayer = \*\*\*

Foundation = \*\*\*

Stock = \*\*\*

Dear \*\*\*

This is in response to your letter dated November 5, 1997, as supplemented by Taxpayer's submission of January 9, 1998, and as amended by Taxpayer's letters dated March 6, 1998, and March 17, 1998, in which Taxpayer requests rulings on behalf of Corporation and its corporate members joining in a consolidated return (Contributing Corporations) concerning charitable contributions of certain appreciated stock.

## Rulings Requested

You request the following rulings:

- (1) Shares of stock in domestic corporations that are contributed to Foundation before the expiration of section 170(e)(5) are "qualified appreciated stock" within the meaning of section 179(e)(5)(B);
- (2) Shares of stock in foreign corporations that are contributed to Foundation before the expiration of section 170(e)(5) are "qualified appreciated stock" within the meaning of section 170(e)(5)(B);
- (3) American Depositary Receipts (ADRs) that are contributed to Foundation before the expiration of section 170(e)(5) are "qualified appreciated stock" within the meaning of section 170(e)(5)(B);
- (4) The contributions described in the preceding paragraphs will result in a deduction from the Contributing Corporations' taxable income under section 170 of the Internal Revenue Code, and the amount of the deduction will be equal to the fair market value of the contributed shares on the date of contribution;
- (5) Section 170(e)(1)(B)(ii) of the Code will not apply to the contributions;
- (6) The Contributing Corporations will not be required to recognize gain upon the contributions; and
- (7) To the extent that the aggregate fair market value of all contributions of "qualified appreciated stock" exceeds the amount deductible in the year of the contribution, any excess contributions will be deductible for each of the five succeeding taxable years, as provided in section 170(d)(2), even where such carryovers extend beyond the expiration of section 170(e)(5).

## Facts

Corporation is a holding company that files consolidated returns with its subsidiaries, including the Contributing Corporations. Foundation is a section 501(c)(3) organization and a private foundation within the meaning of section 509(a) other than a private foundation described in section 170(b)(1)(E). Taxpayer and the Contributing Corporations report their taxable income on the accrual basis. One or more of the Contributing Corporations plans to donate shares of currently-held appreciated stock to Foundation in one or more contributions. Taxpayer has provided a list of the companies whose stock is held by the Contributing Corporations and may be contributed to Foundation. It is anticipated that the adjusted basis of the shares to be contributed will be less than their fair market value on the date of the contributions. The shares are not stock in trade, inventory, or held primarily for sale to customers in the ordinary course of the trade or business of the Contributing Corporations. There is no plan for Foundation to sell or otherwise dispose of the shares. The Contributing Corporations will not retain any incidents of ownership over the contributed shares after the contributions.

Some of the contributed shares may be stock in domestic corporations, and some may consist of stock in foreign corporations or of ADRs. An ADR is a negotiable receipt issued in certificate form representing stock in a non-United States company. An ADR certificate is issued by a United States depository bank when the foreign shares are deposited abroad in a custodian bank. The holder of an ADR is entitled to demand delivery of the underlying shares. The American bank converts dividends, interest, and principal from the foreign security into United States dollars. Once issued, an ADR certificate may be freely traded in United States dollars in the United States on the over-the-counter market. If certain SEC filings are made, it may be listed and traded on a national exchange. Taxpayer represents that any shares of domestic or foreign stock and any ADRs contributed are traded on an established securities market either within or without the United States.

The Contributing Corporations represent that, prior to the contribution, they will have held any contributed shares for more than one year from the date of acquisition, and that they will not contribute more than 10% (in value) of the outstanding stock of any corporation. At the time of this ruling, the Contributing Corporations will not have made any prior contribution of shares to Foundation.

Some of the shares that may be contributed are subject to Rule 144 of the rules and regulations of the Securities and Exchange Commission (Rule 144). Rule 144 limits the sale of certain shares of a particular corporation during any three-month period to the greater of:

- (1) 1% of the shares outstanding as shown by the most recent published report;
- or
- (2) the average weekly reported trading volume of the shares of the corporation during the preceding 4 calendar weeks.

As detailed below, Taxpayer has taken steps to ensure that Foundation will be able to sell the contributed shares free of any Rule 144 resale restriction. The Contributing Corporations represent that each contribution will be limited such that the number of any particular corporation's shares contributed to Foundation (including any shares of that corporation already held by Foundation) will be substantially less than 1% of the shares outstanding of that corporation as shown by the most recent report or statement published by that corporation. The Contributing Corporations also represent that, as of the date of the contribution, to the best of their knowledge there will not be any proposed

recapitalization, tender or exchange offer, stock repurchase program or similar plan that would have the effect of substantially reducing the number of outstanding shares of that corporation within the three months following the contribution. By the contribution dates, the Contributing Corporations also will have given to Foundation a statement that they will not dispose of shares of stock in a corporation if the disposition of that stock would restrict Foundation's ability to sell contributed stock under Rule 144. Therefore, the total number of any particular corporation's shares held by Foundation will not exceed the number of that corporation's shares that may be sold by Foundation without restriction under Rule 144.

The contributions will be made at various times, but in no event after the expiration of section 170(e)(5).

## Law and Analysis

### Qualified Appreciated Stock

Ruling requests (1), (2), (3), and (5) pertain to whether the stock in question constitutes "qualified appreciated stock."

Section 170 permits a deduction for any charitable contribution payment of which is made within the taxable year. Section 1.170A-1(c)(1) of the Income Tax Regulations provides 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) of the Code and section 1.170A-4(a) of the Regulations.

Section 170(e)(1)(B)(ii) of the Code provides that in the case of a charitable contribution to or for the use of a private foundation (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 had been sold at its fair market value (determined at the time of the contribution).

Section 170(e)(5) provides an exception to this rule in the case of the contribution of "qualified appreciated stock," which is defined in subparagraph (B) as stock:

- (1) for which (as of the date of the contribution) market quotations are readily available on an established securities market; and
- (2) which is capital gain property (as defined in [section 170] (b)(1)(C)(iv)).

We address the latter requirement first. "Capital gain property" is defined in section 170(b)(1)(C)(iv) as any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain that would have been long-term capital gain. Section 1221 defines a capital asset as property held by the taxpayer, excluding stock in trade, property held primarily for sale to customers in the ordinary course of the trade or business and certain other items not relevant here. Taxpayer represents that the shares to be contributed are not stock in trade, or held primarily for sale, and that they will have been held for more than one year at the time of the contributions. Further, their fair market value at the time of the contributions will exceed their bases. Therefore, the shares constitute capital gain property within the meaning of section 170(b)(1)(C)(iv) and meet the requirement of section 170(e)(5)(B)(ii).

To meet the requirements of section 170(e)(5)(B)(i), a stock must have market quotations readily available on an established securities market. Under an analogous provision in section 1.170A-13(c)(7)(xi)(A)(1) of the Regulations, market quotations are considered to be "readily available on an established securities market" if the securities are:

listed on the New York Stock Exchange, the American Stock Exchange, or any city or regional exchange in which quotations are published on a daily basis, including foreign securities listed on a recognized foreign, national, or regional exchange in which quotations are published on a daily basis.

Taxpayer has represented that market quotations for any shares of stock in domestic or foreign corporations that may be contributed to Foundation will be readily available on an established securities market either within or outside the United States. Therefore, the shares of domestic and foreign stock meet the section 170(e)(5)(B)(i) requirement.

We also conclude that ADRs are "stock" for purposes of section 170(e)(5). An ADR is a certificate representing stock in a non-United States company, designed to be a convenient method of converting dividends, interest and principal from the foreign security into United States dollars. An ADR certificate is traded as stock and represents the underlying foreign shares, which can be obtained upon demand. The Service has interpreted ADRs to be "stock" for various tax purposes, such as the foreign tax credit (Rev. Rul. 65-218, 1965-2 C.B. 566), and the interest equalization tax (Rev. Rul. 72-271, 1972-1 C.B. 369). Taxpayer represents that the ADRs that may be contributed to Foundation are traded on an established securities market either within or outside the United States. Therefore, these ADRs constitute "qualified appreciated stock" for purposes of section 170(e)(5)(B)(i).

Section 170(e)(5)(C)(i) provides that the "qualified appreciated stock" exception shall not apply to stock contributed to the extent that the amount of stock contributed (including the aggregate amount of all prior contributions by the donor of stock in the same corporation) exceeds 10% in value of all of the outstanding stock of the corporation. Taxpayer represents that the Contributing Corporations will not contribute to Foundation more than 10% in value of the outstanding stock of any corporation. The Contributing Corporations have not made any prior contributions of any shares to Foundation. Therefore, the limitation of section 170(e)(5)(C)(i) does not apply.

Because the shares and ADR certificates to be contributed constitute "qualified appreciated stock," section 170(e)(1)(B)(ii) will not apply. Accordingly, ruling requests (1), (2), (3), and (5) are granted.

## **Amount of the Contribution**

In ruling request (4), Taxpayer asks us to rule that the amount of the contributions will be the fair market value of the contributed shares under section 170. Some of the shares that may be contributed are subject to the limitations of Rule 144. In addition to certain other requirements, Rule 144 limits the number of shares of a corporation that may be sold during any 3-month period to the greater of 1% of the shares outstanding or the average weekly reported trading volume of the corporation's shares during the preceding 4 calendar weeks.

The Contributing Corporations represent that the contributed shares will be free from Rule 144 resale restrictions on the date of the contribution. This will be accomplished by limiting the contribution of a particular corporation's shares to substantially less than the

maximum number of shares that may be sold by Foundation under Rule 144 without restriction. The Contributing Corporations also represent that to the best of their knowledge at the time of the contribution of a corporation's stock, there will not be any proposed plan that would have the effect of substantially reducing the number of outstanding shares of that corporation within the three months following the contribution. In addition, the Contributing Corporations agree to limit their stock sales so that Foundation will at all times be able to dispose of its shares free from SEC resale restrictions. Therefore, the shares will be freely transferable in Foundation's hands at the time of the contribution. Accordingly, request (4) is granted.

## Gain Recognitions

In ruling request (6), we are asked to rule that the Contributing Corporations will not have to recognize gain upon making the contributions. Two doctrines under which gain recognition might be required upon the contribution of appreciated property are step transaction and assignment of income. See Rev. Rul. 78-197, 1978-1 C.B. 83; *Ferguson v. Commissioner*, 108 T.C. 244 (1997).

It is represented that there is no plan for Foundation to sell or otherwise dispose of the shares after the contributions and that the Contributing Corporations will not retain any incidents of ownership over the contributed shares after the contributions. Accordingly, there is no reason to apply the step transaction or assignment of income doctrine to this case. Therefore, ruling request (6) is granted.

## Carryovers

In ruling request (7), Taxpayer asks us to rule that, to the extent the aggregate fair market value of all contributions of "qualified appreciated stock" in a taxable year exceeds the limit in section 170(b)(2), any excess contributions will be deductible at fair market value for each of the five succeeding taxable years, as provided in section 170(d)(2), even where the carryovers extend beyond the expiration of section 170(e)(5).

In the case of a corporate donor, section 170(b)(2) provides that the total deductions allowed under section 170(a) shall not exceed 10% of the taxpayer's taxable income. Any contributions in excess of this limitation are deductible under section 170(d)(2) for each of the 5 succeeding taxable years. Section 170(e)(5)(D) provides that the exception for gifts of "qualified appreciated stock" shall not apply to contributions made after June 30, 1998.

In an analogous carryover issue, the Service has ruled that the tax character of the 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 alternative minimum tax, even though the special rule resulting in non-capital gain characterization applies only to contributions made in 1991).

Therefore, in this case, the deductible amount with respect to contributions made before the expiration of the section 170(e)(5) and carried over to succeeding years will be based upon the fair market value of the stock on the contribution dates. As long as a contribution qualifies for "qualified appreciated stock" treatment at the time it is made, excess amounts carried over will be allowed the same treatment. Therefore, request (7) is granted.

## Conclusions

Based upon the facts submitted and representations made in your ruling request, we conclude:

- (1) The shares of stock in domestic and foreign corporations and ADRs to be contributed to Foundation before the expiration of section 170(e)(5) constitute "qualified appreciated stock" within the meaning of that section;
- (2) The proposed contributions will result in a deduction from the Contributing Corporations' taxable income under section 170, and the amount of the deduction will be equal to the fair market value of the contributed shares on the date of contribution;
- (3) Section 170(e)(1)(B)(ii) of the Code will not apply to the proposed contributions;
- (4) The proposed contributions will not result in any gain recognition to Taxpayer or the Contributing Corporations; and
- (5) To the extent that, because of the percentage limitations of section 170(b)(2), the aggregate fair market value of all contributions of "qualified appreciated stock" exceeds the amount deductible in the year of the contribution, any excess amounts will be deductible for each of the five succeeding taxable years, as provided in section 170(d)(2), even where those carryovers extend beyond the date of expiration of section 170(e)(5).

This ruling is addressed solely to the taxpayer that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. No opinion is expressed as to the amount, if any, of Taxpayer's charitable contribution deductions or the federal income tax consequences of the transaction described above under any other provision of the Code.