American Endowment Foundation

Corporate Inversions

For people who are shareholders of US-based firms that are planning on doing a corporate inversion, they may become the victims of a capital gains tax bomb through no fault of their own. A corporate inversion is a process whereby a company re-incorporates overseas in an effort to lessen its tax burden. The inversion event creates an unintended taxable event for shareholders. A gift to a donor advised fund can offset the tax bite of the inversion.

Companies that earn a sizable portion of their revenue from overseas operations shoulder the burden of having their income taxed twice. Every company pays taxes to the country in which profits are earned. But U.S. companies have the extra burden of also paying the IRS whenever those profits come back from the foreign country into the U.S. The tax bill is the difference between whatever the companies paid overseas and the 35% U.S. rate. An inversion attempts to lessen that burden.

Although an inversion could be considered wise corporate tax planning, an unintended consequence to shareholders is a capital gains tax bill. Although the shares are not actually sold, shareholders are forced into a taxable event. They must pay capital gain taxes on any appreciation in shares they hold in exchanging shares in the "old" firm for shares in the "new" firm.

This tax bomb can be especially painful for those long-time employees and retirees who have accumulated shares over time at low prices. One way to defuse the impending tax bomb is to gift the appreciated shares to a charitable cause. The use of a donor advised fund (DAF) can allow affected shareholders to gift their shares into their own donor advised fund.

This benefits donors in the following ways:

- They receive a deduction for the fair market value of the contributed shares (highest available).
- They avoid any capital gains tax on shares exchanged in the inversion.
- They determine charitable beneficiaries on their own convenient timetable and engage their family in their charitable legacy over successive generations.
- They can recommend their trusted advisor to manage investments in their fund on their familiar platform.
- For this process to work however, the gifting needs to occur prior to the shareholder vote of approval.