



Limiting UBIT When Gifting S-Corp Shares

Over the course of 25 years, a business owner built a profitable medical supply business. He was considering retirement, and selling the business, which was organized as an S-corporation. He was the sole owner of the business, and based on a recent appraisal, his shares were worth approximately \$50 million. His cost basis was almost nothing, so he faced a large capital gains tax when he sold his shares.

His accountant knew he wanted to reduce this tax bill and helped him consider the alternatives, including some charitable strategies. The business owner asked about establishing a private foundation, but was disappointed to learn that his charitable deduction would be limited to his cost basis (almost nothing). The accountant explained that a donor advised fund (DAF) is similar to a private foundation, but since it is connected to a public charity it qualifies for a fair market value deduction.

The accountant was also aware about another tax issue that relates to charitable gifts of S-corp shares. When a charity receives and sells appreciated S-corp shares, it owes unrelated business income tax (UBIT) on the capital gain, based on the donor's cost basis. With a tax rate of approximately 35%, would shrink the value of the business owners DAF by quite a bit.

The accountant encouraged the business owner to donate 10% of his ownership towards establishing a DAF, but utilize a special 3rd party trust-form charity to serve as a pass through in order to reduce the UBIT "bite". The business owner followed the advice, and several months later one of his competitors bought his shares as well as ones he had contributed. The business owner was very pleased with the results:

- He took a charitable deduction of \$5,000,000.
- He reduced his estate tax exposure by \$5,000,000.
- He avoided capital gains tax on the shares he contributed (saving \$500,000 MORE than giving CASH POST-SALE).
- A savings of \$1,280,000 in UBIT that would have been paid if the trust-form charitable conduit had not been used, which means that his DAF has more available to give.
- He creates a DAF with cash proceeds of \$4,350,000.

Here is a diagram of the transaction:

