

Charitable Strategies: Donating Restricted Stock ©

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As restricted stock becomes a more popular form of executive compensation, financial advisors can tap new giving strategies to help their clients realize their charitable goals. Gifts of restricted stock can provide clients with substantial tax savings, along with the convenience of making a charitable gift without a substantial cash outlay.

The rise of restricted stock is a relatively recent phenomenon. During the economic boom of the late 1990s, stock options were the standard currency of executive compensation. Since then, however, many critics have argued that stock options encourage short-term thinking. Meanwhile, regulatory measures introduced in the wake of numerous corporate scandals have encouraged companies to de-emphasize stock options.

According to The Delaware Employment Law Letter, a recent survey by Mercer Human Resource consulting found that 63 percent of companies surveyed had reduced the number of options granted (or intended to be granted) in 2003. Instead, many companies, including software giant Microsoft, are favoring awards of restricted stock-actual shares that cannot be sold unless an employee stays at a company for a certain amount of time (typically between 3 and 5 years).

As more charitably-minded individuals find themselves with substantial holdings of restricted stock, advisors should consider strategies for incorporating these assets into clients giving plans.

Multiple Benefits

Donating restricted stock can bring many benefits to the charity -and the client. For one thing, clients can make significant contributions but aren't required to tap cash reserves or liquidate other assets. As a result, donors may be able to make a significantly larger contribution to a favored cause than they would otherwise been able to make if the gift was in cash.

"Some donors have most of their wealth tied up in the stock of one company," says Jane Wilton, general counsel, New York Community Trust. If they want to make a substantial charitable gift, restricted stock may be the only asset thats practical to contribute.

Donating restricted stock can also provide donors with an oppportunity to diversify their portfolios. It goes without saying: Having too much wealth tied up in one industry sector or asset class can introduce significant risk into an investment strategy. By simply donating restricted stock, the cash that might otherwise have been given to charity can be used to invest in other, more diversified securities.

In addition, clients can remove valuable assets-as well as any future appreciation-from their taxable estate. "After restricted stock has been held for more than a year, donors may be able to give those shares and take a current income tax deduction for its fair market value," says David Mitchell, an

attorney with the law firm Hoge, Fenton, Jones & Appel, in San Jose, California. Deductions for charitable contributions to public charities, such as community foundations, can be as much as 30% of a donor's adjusted gross income. Excess contributions can be carried over and deducted for another five years."

Issues to Consider

Advisers should make sure that clients take several factors into consideration when donating restricted stock. For example, the income tax benefits may be much greater for a donation to a public charity than to a private foundation. Donors may be able to deduct the fair market value of restricted stock, provided the stock has been held for more than a year. Determining "fair market value" may be difficult, though.

"Some restricted stock has been issued by publicly-traded corporations," says Jill Dodd, an attorney in the law firm Steefel, Levitt & Weiss, San Francisco. "There may be restrictions as to when the shares can be sold by the shareholder. In other cases, shares of a closely-held corporation may not be traded freely because of a shareholder's agreement."

Although circumstances will vary, such "restrictions" will have an effect on the value of restricted stock. Shares of a publicly traded company that can be sold in a few months may have a value near the current trading price; by contrast, shares that can't be sold for a year might have a steeper discount from the trading price.

Getting a Qualified Appraisal

Donations of publicly traded stock, of course, do not require such an appraisal. However, restricted stock may not be freely tradable, so obtaining an appraisal might be the most prudent course of action—even when clients wish to donate restricted stock of a public company.

Donors are required to have an appraisal for any charitable gift of non-publicly-traded stock that exceeds \$10,000, says David Shevlin, senior counsel at the law firm Simpson Thacher & Bartlett, New York. If clients donate restricted stock valued between \$5,000 and \$10,000, no appraisal need be attached to the tax return. Instead, the client must submit IRS Form 8283 with an appraisal summary, signed by the charity, explaining how the valuation was determined.

The appraisal must be made between 60 days before the date of the donation and the due date of the tax return, says Wilton. If a qualified appraisal isn't obtained, the donor may not receive a tax deduction for the stock's fair market value.

Peter Hero, president of the Community Foundation of Silicon Valley in San Jose, California, says that responsibility for the appraisal generally falls to the donor. The appraiser should be a party who is not related to the donor. Donors can go to a CPA or an independent appraisal firm to get a fair assessment of the value of their restricted stock. Appraisal costs can vary widely and may be expensive, so clients

should weigh that cost versus the expected benefits.

Smaller gifts of restricted stock are not covered by the requirements mentioned above. For any gifts of restricted stock, though, clients should be prepared to substantiate such donations with a detailed receipt from the charity as well as records showing when the stock was acquired.

Weighing the Restrictions

Hero says that a charity's decision to accept gifts of restricted stock is not automatic, but depends on the nature of the restrictions involved and the liquidity of the securities in question. That means clients should always discuss restrictions with a favored charity or community foundation before incurring any expenses associated with the gift in particular, the cost of obtaining an appraisal.

In some situations, restrictions may lapse after a charitable donation is completed. In this scenario, the charity may be able to sell the securities, enabling the donor to take a relatively large income tax deduction. In other scenarios, though, achieving the deduction might require a coordinated selling effort between the charity and the client, to assure that no violations of any restrictions occur. Clients can double-check any restrictions by checking with the company's legal counsel before making any commitments.

Charitable gifts, including gifts of restricted stock, are often made at year-end in order to obtain a tax deduction for that year. When it comes to making a gift of restricted stock, however, advisors should counsel clients to begin the process of transferring restricted stock well before late December.

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