

Encourage S Corporation Gifts to Charity

An Important Tax Incentive for Conservation Needs to be Renewed

In 2006, Congress enacted a revision to the law to allow S corporation stockholders to deduct the fair market value of property they donated to a charity. Under prior law, S corporation stockholders could not take a deduction larger than their basis in their stock.

This has turned out to be a significant incentive for conservation. We know of at least 40,000 acres that were protected with conservation easements in 2007 and 2008 using this provision. Unfortunately, the 2006 provision expired on December 31, 2009.

We know of a number of pending donations that will not proceed without Congress renewing the provision. One would protect 1,000 acres of big game habitat in Wyoming. Another would protect land worth tens of millions of dollars immediately adjacent to a national park in California.

If a landowner holds appreciated property inside a partnership, the partnership basis adjustment rules allow for the full deduction to flow through. The 2006 S-corp fix simply made this same treatment available to S-corporations. Without it, the landowner who holds appreciated property in an S corporation and is considering donating it to a charity cannot take a deduction larger than their basis in their S corporation stock. In addition, they may be taxed on the appreciation of the property if the corporation is dissolved – despite the fact that they have donated it!

These limitations apply to all charitable donations from an S corporation.

How the Incentive Works (From JCT)

This provision provides that the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation will be equal to the shareholder's pro rata share of the adjusted basis of the contributed property.¹

Thus, for example, assume an S corporation with one individual shareholder makes a charitable contribution of stock with a basis of \$200 and a fair market value of \$500. The shareholder will be treated as having made a \$500 charitable contribution (or a lesser amount if the special rules of section 170(e) apply), and will reduce the basis of the S corporation stock by \$200.²

¹ See Rev. Rul. 96-11 (1996-1 C.B. 140) for a rule reaching a similar result in the case of charitable contributions made by a partnership.

² This example assumes that basis of the S corporation stock (before reduction) is at least \$200.

This provision was originally passed in 2006 as section 1203 of the Pension Protection Act:

SEC. 1203. BASIS ADJUSTMENT TO STOCK OF S CORPORATION CONTRIBUTING PROPERTY.

(a) IN GENERAL.—Paragraph (2) of section 1367(a) (relating to adjustments to basis of stock of shareholders, etc.) is amended by adding at the end the following new flush sentence: "The decrease under subparagraph (B) by reason of a charitable contribution (as defined in section 170(c)) of property shall be the amount equal to the shareholder's pro rata share of the adjusted basis of such property. The preceding sentence shall not apply to contributions made in taxable years beginning after December 31, 2007."

http://www.irs.gov/irb/2008-11_IRB/ar09.html is an IRS bulletin explaining the 2006 change in the law. Congress extended this provision through 2009, and both the House and Senate have voted to extend it through 2010.

In JCX-59-09, the Joint Committee on taxation scored a one-year extension of this provision as costing \$27 million over 5 years and \$37 million over ten years.

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