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Some Restrictions Apply: Donating Restricted Stock

Congratulations! Your startup is finally going public/being acquired/experiencing some other “liquidity event,” and those shares you have been earning are actually going to be worth something! Your taxable income is probably going to spike this year, and you may be thinking about offsetting it with a large donation to your favorite public charity. Your most valuable asset is your stock in the company, so the obvious thing to do is transfer some of it to charity, right?

Not so fast!

Even if the company is publicly-traded, your stock may be restricted under the securities laws and/or the terms of one or more shareholder agreements or lock-up agreements. If so, a host of issues may arise:

- › Before you try to give the stock to the charity, you need to confirm that you have the right to transfer the stock at all. If a shareholders’ agreement is the only thing preventing transfer, you may be able to have the agreement amended or an exception made, depending on your position with the company and your “pull” with the other shareholders. If the restriction is based on securities laws or a lock-up agreement, you may be out of luck.
- › You normally don’t recognize gain when donating appreciated stock to a public charity. But if the charity will be obligated to sell the stock as soon as the charity receives it – for example, if you already committed the stock to a buyer, and the charity will only hold it pending completion of the sale – the IRS will treat you as though you sold the stock yourself and then donated the cash to charity. That means you will pay tax on the gain from the sale, probably wiping out your tax benefit from the donation. This “pre-arranged sale” rule can also be an issue if you contribute your stock after a tender offer or redemption has been announced, even if you have not entered into any agreement yourself.
- › If you have held the stock for one year or less (i.e., its sale would not generate long-term capital gain), your deduction will be limited to your cost basis – probably zero or close to it – making the stock a poor choice for your contribution. If you earned the stock as compensation and did not make a “Section 83(b)” election at the time you received it, the one-year clock did not start ticking until the stock vested.
- › Unless the stock is completely unrestricted (i.e., there are “market quotations readily available on an established securities market”), you will probably need an IRS-

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qualified appraisal before you take your deduction. Qualified appraisals of nonpublic stock can be costly and difficult to obtain.

- If you are donating stock in a company you founded, maintaining control of the company is probably important to you. Talk to your tax counsel about this issue – simply donating the stock while retaining the right to vote the shares can kill your deduction, because the IRS may treat it as a donation of less than your entire interest in the stock.
- The charitable deduction is available in the tax year that the contribution is “actually paid.” If the stock transfer is conducted through the issuing corporation, the donation is not complete until the corporation enters the transfer on its books – not when you authorize the transfer. This distinction can be crucial if the transfer will be completed near the end of the year. Transfers of restricted stock can be complex and may involve approval from multiple parties, often taking longer than donors anticipate.
- There may be implications for your other holdings of the same security. For example, if you are subject to a volume limitation on sales under securities laws or a shareholders’ agreement, you may be required to aggregate sales by the charity with your own sales.

If you have stock options rather than actual stock, things are more complicated. See Erik Dryburgh’s excellent article on this topic [here](#).

And if all you have are “restricted stock units” (RSUs), well, forget it – you can’t transfer them at all. RSUs are not really an asset that you own; they are more like a bonus that you may receive at some point in the future. Once your RSUs vest and you receive actual stock, you may be able to donate that, depending on what restrictions apply to it.