

Internal Revenue Service

Department of the Treasury

Number: **200141018**
Release Date: 10/12/2001
Index Number: 170.01-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:IT&A:2-PLR-104104-01

Date:

July 5, 2001

Legend

X =

Y =

Z =

Year =

Dear

This is in response to a ruling request dated July 17, 2000, and supplemented December 12, 2000. Both the original ruling request and the supplemental information were submitted on your behalf by your authorized representatives. You are seeking rulings on the federal income tax consequences of the proposed transaction described below. You have already received a private letter ruling from Exempt Organizations concerning the proposed transaction. This letter responds to your request for a ruling concerning the charitable contribution deduction.

ISSUE

We are responding to the following ruling that you have requested:

X will be entitled to a charitable contribution deduction under § 170 of the Internal Revenue Code upon the exercise of the Option (whether by Y or by a Permitted Transferee) in an amount equal to the difference between the exercise price and the fair market value of the Common Stock received upon the exercise of the Option, on the date of exercise, subject to the limitations under § 170(b)(2) on the amount of a charitable contribution deduction allowed a corporation.

CONCLUSIONS

1. X will be entitled to a charitable contribution deduction under § 170 of the Internal Revenue Code, on the date the Common Stock is transferred to a Permitted

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Transferee, in an amount equal to the difference between the exercise price and the fair market value of the Common Stock received upon the exercise of the Option, subject to the limitations under § 170(b)(2) on the amount of a charitable contribution deduction allowed a corporation. This ruling is based on the assumption that the Permitted Transferee is described in § 170(c) at the time that the transfer of Common Stock is made by X to the Permitted Transferee.

2. X will be entitled to a charitable contribution deduction under § 170 of the Internal Revenue Code on the date the Common Stock is transferred to Y or a Permitted Transferee pursuant to the Net Exercise procedure described below, in an amount equal to the fair market value of the Common Stock received upon the exercise of the Option, subject to the limitations under § 170(b)(2) on the amount of a charitable contribution deduction allowed a corporation. This ruling is based on the assumption that Y or the Permitted Transferee is described in § 170(c) at the time that the transfer of Common Stock is made by X to Y or to the Permitted Transferee.

FACTS

X is a for-profit corporation.

Y is a non-profit corporation described in § 501(c)(3) of the Code. The Service has recognized Y as a private foundation, as defined in § 509(a) of the Code.

In Year, X pledged to Y an option to acquire Z shares of common stock of X ("Common Stock") at an Option Price, representing the fair market value of the Common Stock as determined by the Board of Directors of X on the date that X pledged the Option.

Y may transfer and assign the Option or any portion thereof only to one or more unrelated charitable organizations described in §§ 170(c)(2) and 501(c)(3) (a "Permitted Transferee"). A Permitted Transferee may not transfer or assign the Option or any portion thereof without the written consent of X.

Generally, the Option is exercisable in whole or in part and from time to time by a written notice of exercise delivered to X. Payment of the purchase price of any shares with respect to which the Option will be exercised generally will be by certified or bank cashier's or teller's check, or wire transfer, and will be delivered with the notice of exercise. Upon exercise of the Option, the certificate or certificates for shares of Common Stock as to which the Option was exercised will be registered in the name of the person or persons exercising the Option.

According to Paragraph 5 of the Option Agreement, the shares that X will transfer to Y or a Permitted Transferee upon exercise of the Option may be subject to restrictions.

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In addition, the Option Agreement provides a cashless procedure (a "Net Exercise"), in which no consideration is paid to X. Under the Net Exercise procedure, Y elects to receive shares of Common Stock equal to the value of the Option. If Y were to elect the Net Exercise procedure, Y would provide X with written notice of Y's election to utilize the Net Exercise procedure, and X would issue to Y the number of shares of the Common Stock computed using a formula specified in the Stock Option Pledge Agreement. These shares would satisfy X's pledge obligation for the shares subject to the Net Exercise.

It is expected that Y will collect the Option in two parts. With respect to a portion of the Option, Y will utilize the Net Exercise procedures described above to effect a transfer of Common Stock from X in satisfaction of its pledge obligation. For the second part, Y will transfer the Option to an unrelated Permitted Transferee, which will pay Y a price for the Option equal to the difference between the fair market value of the Common Stock subject to the Option on the date of the transfer, and the exercise price of the Option, less an agreed upon discount. These terms would be negotiated at arm's-length.

LAW AND ANALYSIS

Section 170(a) of the Code allows as a deduction any charitable contribution (as defined in § 170(c)) payment of which is made within the taxable year.

Section 170(b)(2) provides that, in the case of a corporation, the total deductions under § 170(a) for any taxable year shall not exceed 10 percent of the taxpayer's taxable income, computed with certain adjustments listed in § 170(b)(2). Under § 1.170A-1(a) of the Income Tax Regulations, a deduction generally is allowed to a corporation for any charitable contribution actually paid during the taxable year, irrespective of the method of accounting employed or the date on which the contribution is pledged. In the case of a corporation reporting its taxable income on the accrual basis, § 170(a)(2) provides that, in certain limited cases, a corporation may elect to treat a contribution as paid in the year that it is authorized by the board of directors.

Rev. Rul. 75-348, 1975-2 C.B. 75, holds that a corporation that pledges an option to purchase shares of its common stock at a specified price to an educational organization described in § 170(c) of the Code is entitled to a charitable contribution deduction, in the taxable year that the option is exercised, for the excess of the fair market value on the date of exercise over the exercise price. See also Rev. Rul. 82-197, 1982-2 C.B. 72, holding that an individual who grants an option to purchase real property to a charitable organization described in § 170(c) is allowed a charitable contribution deduction for the year in which the organization exercises the option, in the amount of the excess of the property's fair market value on the date of exercise over the option's exercise price. Rev. Rul. 82-197 states that although the promise to pay may be enforceable, a promise to pay money or sell property in the future is not itself a "payment" for purposes of § 170.

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Where a charitable contribution is made in property other than money, § 1.170A-1(c) of the regulations provides, in part, that the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in § 170(e)(1) and § 1.170A-4(a). Where a property is sold to a charity for less than its fair market value, § 1011(b) of the Code provides for the adjustment of the donor's basis for purposes of computing its gain from the portion of the property sold in the bargain sale. See also §§ 1.1011-2 and 1.170A-4(c)(2) of the regulations. In addition, § 170(e)(1) provides, in certain circumstances, for a reduction in the amount of the charitable contribution if, at the time of the contribution, a sale of the property by the donor at its fair market value would have resulted in gain. Section 1032(a) of the Code provides that no gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.

Since § 1032 provides that a corporation does not recognize gain or loss on the sale of its own stock, the reductions to fair market provided in § 170(e)(1) do not apply when a corporation contributes its own stock to charity. See Rev. Rul. 75-348. For the same reason, the bargain sale provisions of § 1011(b) and §§ 1.1011-2 and 1.170A-4(c)(2) do not apply when a corporation sells its stock to a charity for less than the fair market value of the stock. See Rev. Rul. 75-348.

Section 1.170A-1(h)(2) provides that the charitable contribution deduction under § 170(a) for a payment that a taxpayer makes partly in consideration for goods or services may not exceed the excess of (A) the amount of any cash paid and the fair market value of any property (other than cash) transferred by the taxpayer to an organization described in § 170(c); over (B) the fair market value of the goods or services the organization provides in return.

If the Option is exercised by a Permitted Transferee paying the Option Price for shares of stock, we conclude that, under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, X is treated as making a charitable contribution described in § 170 in the year that the stock is transferred to a charity described in § 170(c), and the amount of X's charitable contribution is the excess of the fair market value of the shares on the date of exercise over the Option Price. Under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, we conclude that X will be entitled to the charitable contribution deduction in the manner and to the extent provided in § 170.

If the Option is exercised by a charity (either Y or a Permitted Transferee) using the "Net Exercise" procedure, which is described above, we conclude that, under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, X is treated as making a charitable contribution described in § 170 in the year that the stock is transferred to a charity described in § 170(c). Because no payment is made by the charity to X under the Net Exercise procedure, the amount of the charitable contribution is the fair market value of the shares (at the time of the contribution) that are paid to the charity. Under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, we conclude that X will be entitled to the charitable contribution deduction in the manner and to the extent provided in § 170.

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Our conclusions are based on the assumption that the charity (either Y or a Permitted Transferee) is described in § 170(c) at the time that the transfer of stock is made by X to that charity. Our ruling is based on the assumption that X will comply with all applicable requirements of § 170 and the regulations under § 170.

If the stock that X transfers to Y or a Permitted Transferee is subject to restrictions, that may materially affect the fair market value of the stock. See § 1.170A-13(c)(7)(xi)(C)(1) of the regulations.

No opinion is expressed about the federal income tax treatment of the transaction under other provisions of the Code.

The above rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that these rulings may not be used or cited as precedent.

Sincerely,
Associate Chief Counsel
(Income Tax & Accounting)
By: Karin G. Gross
Senior Technician Reviewer, Branch 1

Enclosure:
Copy for § 6110 purposes
cc: