

Internal Revenue Service

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date: January 12, 1999

Legend:

Company =

Foundation =

Date A =

Date B =

Dear Sir or Madam:

This responds to a letter of July 29, 1998, submitted on your behalf by your authorized representatives requesting certain rulings. Requested ruling number 3, which is in our jurisdiction, is that Company will be entitled to a charitable contribution deduction under section 170 of the Internal Revenue Code upon the exercise by an unrelated charity of an option to purchase Company common stock that the charity acquired from Foundation. The other requested rulings were issued by the Exempt Organizations Division in a letter dated November 12, 1998. For ease of discussion, we have divided ruling number 3 into two issues.

ISSUES

(1) If Company, the maker of an option to buy shares of its own common stock, contributes the option to Foundation and Foundation sells it to an unrelated charity described in section 501(c)(3) of the Code, may Company take a charitable contribution deduction under section 170 of the Code upon the exercise of the option by the charity?

(2) If so, what is the amount of Company's charitable contribution deduction?

CONCLUSIONS

(1) Company may take a charitable contribution deduction under section 170 of the Code upon the exercise of the option by the unrelated charity.

(2) The amount of Company's charitable contribution deduction will equal the difference between the fair market value of the stock when the option is exercised and the exercise price.

FACTS

Company is a for-profit organization incorporated under state law. Company's common stock is publicly held and listed on an established securities market. Foundation is a non-profit corporation incorporated under state law. Foundation is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). Foundation has been recognized by the Internal Revenue Service as a private foundation as defined in section 509(a) of the Code.

Company pledged a stock option to Foundation which when exercisable will give Foundation an option to purchase a specified number of shares of Company's common stock at the closing price of the stock on Date A, the date of the pledge agreement.

Under the terms of the pledge agreement, the option will become exercisable only if on or before December 31, 1999, Company receives certain rulings from the Service, including the ruling that is the subject of this request. If Company receives the rulings by that date, the option will be exercisable by Foundation, in whole or in part, at any time during the period commencing on the date Company receives the last of the rulings and ending on Date B.

Foundation may transfer or assign the option or any portion thereof, but only to one or more unrelated charitable organizations described in sections 170(c)(2) and 501(c)(3) of the Code.

It is expected that an unrelated charitable organization described in sections 170(c)(2) and 501(c)(3) of the Code will purchase the option from Foundation for a price equal to the difference between the fair market value of Company common stock subject to the option as of the date of the purchase of the option and the exercise price of the option, less an agreed upon discount.

ANALYSIS

Section 170(a) of the Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 170(b)(2) of the Code provides that the total deduction allowed a corporation under section 170(a) is limited to 10 percent of the corporation's taxable income, computed without regard to certain deductions. Under section 1.170A-1(a) of the Income Tax Regulations, a deduction is allowed to a corporation (with one exception not applicable here) for any charitable contribution actually paid during the taxable year, irrespective of the date on which the contribution is "pledged."

Rev. Rul. 75-348, 1975-2 C.B. 75, holds that a corporation that donates an option to purchase shares of its common stock at a specified price to an educational organization described in section 501(c)(3) of the Code is entitled to a charitable contribution deduction, in the taxable year 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 section 501(c)(3) of the Code is allowed a charitable deduction for the year in which the organization exercises the option, in the manner and to the extent provided by section 170, for the excess of the property's fair market value on the date of exercise over the option's exercise price.

Where a charitable contribution is made in property other than money, section 1.170A-1(c) of the regulations provides, in part, that the amount of the deduction is the fair market value of the contributed property at the time of the contribution. A property's fair market value is the price at which it would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of the relevant facts. Where a property is sold to a charity for less than its fair market value, section 1011(b) of the Code provides for the adjustment of the donor's basis for purposes of computing its gain from portion of the property sold in the bargain sale. See also sections 1.1011-2 and 1.170A-4(c)(2) of the regulations. In addition, section 170(e) of the Code 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 at its fair market value would have resulted in gain. Section 1032 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.

In this case, the bargain sale provisions of section 1011(b) of the Code and sections 1.1011-2 and 1.170A-4(c)(2) of the regulations and the contribution reduction provisions of section 170(e) do not apply. This is because under section 1032 of the Code no gain is recognized by Company on the bargain sale of its stock to the unrelated charity and no gain would be recognized by Company even if it sold its stock to the unrelated charity for its full fair market value.

Under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, we conclude that Company is treated as making a charitable contribution described in section 170 of the Code in the year the option is exercised by an unrelated charity described in section 501(c)(3) of the Code, and the amount of Company's charitable contribution equals the excess of the fair market value of the shares on the date of exercise over the exercise price. In addition, under the reasoning set forth in Rev. Rul. 75-348 and Rev. Rul. 82-197, we conclude that Company will be entitled to a charitable contribution deduction under section 170 of the Code with respect to the charitable contribution in the manner and to the extent provided by section 170.

This letter ruling is directed only to Company. Section 6110(k)(3) of the Code provides that this letter ruling may not be cited or used as precedent.

Company must attach a copy of this letter to any income tax return to which it is relevant. Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter under any provision of the Code other than section 170.

Sincerely,

Assistant Chief Counsel
(Income Tax & Accounting)

By _____
Karin G. Gross
Senior Technician Reviewer, Branch 3

cc: