Your charitable intentions can work in tandem with your business succession planning objectives. Here are a few of the strategies you can employ:

Outright Gift: An outright gift of business ownership interests can be made to a charity. This strategy is the most straight-forward, and best used when the business has excess cash on hand or more than adequate cash flow. The transfer to the charity will allow the owner an income tax deduction and prevent recognition of gain on the sale of the business interest.

After the gift has been made to charity, the charity will usually sell the interests back to the business or to other owners. The charity will receive cash and, as a charity, will not recognize gain on the sale. As a result of the sale, the remaining business owners will now have control of the corporation. This same strategy can also be employed with a third party purchasing the interests from charity.

Charitable Remainder Trust: An owner can also transfer his or her interests to a charitable remainder trust. A charitable remainder trust has two life cycles. During the first life cycle, the trust makes fixed annuity or percentage payments every year for the life of the designated beneficiaries of the trust. The designated beneficiary is usually the owner, or if not the owner, the beneficiaries are usually from among his or her family. Afterwards, the remaining trust assets are provided outright to a charity—thus the name.

After making the transfer to the charitable remainder trust, the owner can take an income tax deduction for the actuarial value of the remainder interest in the trust – the value of the piece of the trust that actually goes to charities and not the first group of beneficiaries. The deduction is subject to some limitations. The owner also avoids recognition of capital gains on the interests. The owner is allowed to be one of the beneficiaries of the trust. This means the trust can provide a steady stream of income to the owner during his or her retirement years.

Afterwards, the business interest can then be sold by either the trust or the charity. Much like an outright gift above, this gives the charity ready cash and allows the business to be passed on to the successor party, which may be family, employees, other owners, or a third-party.

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TLC tip

Charitable Lead Trust: The charitable lead trust is the reverse of the charitable remainder trust. In this instance, the charity is the first beneficiary and after a period of time (usually measured by a fixed number of years or the life of a specific individual) the trust assets are paid over to non-charitable beneficiaries. Usually, the remainder beneficiaries are family members from the next generation. This strategy is employed to rather aggressively minimize transfer taxes while keeping control of the business in the owner's family.

The above is a general summary of charitable transfer techniques. There are attendant risks with each of these transfers:

Unrelated Business Taxable Income: Also known as UBTI, this is essentially income from a business that is owned or carried on by a charity but not substantially related to the function that gives the charity its charitable exempt status. The tax consequences of UBTI are quite severe. A charity with UBTI must pay a tax on all UBIT received. A charitable remainder trust has its UBTI confiscated through a 100% excise tax. Charitable lead trusts lose the income tax deduction allowed them when making distributions to a beneficiary-charity. Practitioners and owners should be wary of transferring debt-encumbered property and LLC interests federally taxed as partnerships as they will almost certainly trigger UBTI.

Pre-Arranged Sales: The IRS will collapse several predetermined transactions into a single transaction if they believe it more reflective of the situation. This is applicable where an owner makes a gift of a business to a charity and another party purchases that interest from the charity. If the IRS finds that the charity or charitable trust was obligated to sell the asset, it will re-characterize the entire transaction as a sale by the owner to this other party. In this instance, that would mean the owner will have to recognize any gain on the sale.

S-Corporation Stock to Charity: A great deal of thought should be given to transferring S-Corp. stock to a charity. A charitable remainder trust cannot hold S-Corp. stock without voiding S-Corp. election. Furthermore, any charity that owns the S Corp. stock will be taxed on its UBTI and will recognize gain on the sale of the stock. In these instances, it is perhaps better to gift select assets from an S-Corporation rather than an interest in the business.