Benefits of Donating Equity Compensation Awards to Charity

A tax-smart approach to maximize your philanthropic impact

by the Charitable Strategies Group at Schwab Charitable

For charitably minded executives, certain equity compensation awards (or, more accurately, the stock acquired upon award exercising or vesting) can make excellent gifts to charity because of the potential tax benefits. These investments often have a low cost basis and may have a significant current market value, resulting in a large capital gains tax bill when sold.

If you itemize deductions on your tax return instead of taking the standard deduction, donating these awards can unlock additional funds for charity in two ways. First, you potentially eliminate the capital gains tax you would incur if you sold the stock yourself and donated the proceeds, which may increase the amount available for charity by up to 20%. Second, you may claim a fair market value charitable deduction for the tax year in which the gift is made and may choose to pass on that savings in the form of more giving.

Donor-advised funds, which are 501(c)(3) public charities, provide an excellent gifting option for donations of equity compensation awards, as the funds typically have the resources and expertise for evaluating, receiving, processing, and liquidating the assets. How does gifting appreciated awards to a donor-advised fund work?

Donor

Donate vested or exercised awards held over one year

- Potentially eliminate capital gains tax on appreciation
- Claim current year, fair market value income tax deduction

Donor-Advised Fund

Recommend grants from your account immediately or over time

- Invest account assets for tax-free potential growth

Charities

Please be aware that gifts of appreciated non-cash assets can involve complicated tax analysis and advanced planning. This article is only intended to be a general overview of some donation considerations and is not intended to provide tax or legal guidance. In addition, all gifts to donor-advised funds are irrevocable. Please consult with your tax or legal advisor.

Equity compensation award types

The most common forms of equity compensation awards are nonqualified stock options (NSOs), incentive stock options (ISOs), restricted stock units (RSUs), and restricted stock awards (RSAs). The awards themselves generally are not transferable and therefore cannot be given to charity. However, once these awards are vested and/or exercised—and the underlying stock is held for more than one year—they make tax-smart charitable gift options.

Under federal securities law, the underlying stock held after an award is vested or exercised is generally restricted by legend if the company is private and/or the shares have not been registered with the Securities and Exchange Commission under the Securities Act of 1933. This stock is referred to as restricted stock. If the company is public and the shares have been registered but are held by somebody considered an “Affiliate,”[*] the stock is not restricted but the person is restricted and the stock is referred to as “Control Stock.” Stock restricted by legend and Control Stock are referred together as “Restricted Stock.” When donated, restricted stock must be sold in accordance with Rule 144 resale restrictions,[†] which require the charity to work with the company’s general counsel to remove the restrictive legend or clear the restricted person, and the process may require certain paperwork and filings.

To learn more about donations of restricted stock, click here.

What award types are ideal for donating to charity?

Not all equity compensation awards are treated the same for purposes of the charitable income tax deduction. As illustrated below, ideal gift options meet the IRS’s holding period requirements of at least more than one year and have high appreciation with a low cost basis. These gifts allow you to potentially eliminate capital gain recognition on the difference between fair market value on the date donated and fair market value when vested or exercised.

Equity Compensation Awards	Tax Treatment Upon Vesting or Exercise	Your Charitable Gift Option	Your Potential Tax Benefits	Gift Rating
Vested Restricted Stock Units (RSUs) and Restricted Stock Awards (RSAs) held >1 year from vesting	Ordinary income tax on difference between fair market value (FMV) at vesting and amount paid for your stock	Eliminate capital gain recognition on difference between FMV at exercise and FMV at gift date	Deduction at FMV, up to 30% of your adjusted gross income (AGI), with 5-year carryover	**Ideal Gifts**
Exercised Nonqualified Stock Options (NSOs) held >1 year from exercise	Ordinary income tax on difference between exercise price and your stock’s FMV at exercise	Eliminate capital gain recognition on difference between FMV at exercise and FMV at gift date	Deduction at FMV, up to 30% of your AGI, with 5-year carryover	
Stock received upon Incentive Stock Option (ISO) exercise held >1 year from exercise and 2+ years from grant[§]	No ordinary income, although you may lose Alternative Minimum Tax (AMT) preference item in AMT calculation[**]	Eliminate capital gain recognition on difference between FMV at exercise and FMV at gift date[**]	Deduction at FMV, up to 30% of your AGI, with 5-year carryover	**Good Gifts**
Vested RSUs and RSAs held <1 year	Ordinary income tax on difference between FMV at vesting and amount paid for your stock	No advantage to selling your stock and donating cash proceeds[††]	Deduction at lesser of cost basis and FMV, up to 50% of your AGI, with 5-year carryover	
Exercised NSOs held <1 year	Ordinary income tax on difference between exercise price and your stock’s FMV at exercise	No advantage to selling your stock and donating cash proceeds[††]	Deduction at lesser of cost basis and FMV, up to 50% of your AGI, with 5-year carryover	
Unvested RSUs and unexercised ISOs	Not transferrable to charity			**Unacceptable Gifts**
Unexercised NSOs		Generally, not transferrable; exercise by charity may result in ordinary income tax to you	Deduction at lesser of cost basis and FMV, up to 50% of your AGI, with 5-year carryover	

* This generally is senior officers, directors, and shareholders with greater than 10% equity.

† Rule 144 is a regulation enforced by the U.S. Securities and Exchange Commission. The regulation provides an exemption that allows the public resale of restricted, unregistered, and control securities if a number of conditions are met. This includes how long the securities are held, the way in which the securities are sold, and the amount of securities that can be sold at a certain time.

§ Tax treatment of ISO stock transferred to charity before holding period requirements are met is not included. Please consult with appropriate tax or legal advisor on specifics.

** Difference between FMV at exercise and exercise price is an AMT preference item included in your AMT calculation. You may lose AMT preference item on contribution.

†† 60% of AGI deduction limit with a five-year carryover is permitted for charitable contributions of cash. Note: any short-term capital gains tax paid reduces value of gift to charity.

Case study: charitable tax planning opportunity

Cheryl is a founder and senior executive of a technology company, TechCo, that recently went public. She has accumulated a significant amount of restricted stock from the vesting of RSUs that she has held for more than one year. As Cheryl will have unusually high income this year because of the stock's initial public offering (IPO) and additional RSUs vesting, she would like to minimize her tax exposure. Cheryl is eager to plan for her family's future and diversify their concentration of wealth, but she is also concerned about the public perception of selling a large number of shares so quickly after the IPO.

Cheryl's family has always been charitably minded and would like to continue their support of charities and causes important to them. After speaking with her financial advisor, she learns about the tax benefits of donating appreciated assets instead of cash to charity. She also learns how, with a donor-advised fund, she can easily pre-fund a charitable account with multiple years of gifts, invest the account's assets for tax-free potential growth, and recommend grants from the account to charities of her family's choice over time.

Cheryl decides to open a donor-advised fund account with $1 million in restricted stock and receives her employer's approval to donate a portion of her TechCo restricted shares. The cost basis of the shares she donates is $50,000. The donor-advised fund works with the company's general counsel to satisfy the requirements of Rule 144 to remove the restrictive legend or Affiliate status prior to contribution. Cheryl is able to claim a $1 million current year income tax deduction to offset some of the income realized from vesting of her RSUs and also does not owe capital gains taxes on the $950,000 appreciation. In addition, because she donated the shares to a charity, she is not subject to any public filing requirements for company stock sales in the current year.

Cost basis of TechCo stock: **$50,000**

Federal long-term capital gains tax rate: **20%**

Fair market value of TechCo stock:
$1,000,000

	Option 1: Sell TechCo stock and then donate the after-tax proceeds		**Option 2:** Contribute TechCo stock directly to Schwab Charitable	
Long-term capital gains taxes paid	$190,000		$0	
Charitable contribution and tax deduction	$810,000	vs.	$1,000,000	Additional amount available to grant to charities: **$190,000**
Tax savings	$109,700		$370,000	Additional amount saved on taxes: **$260,300**

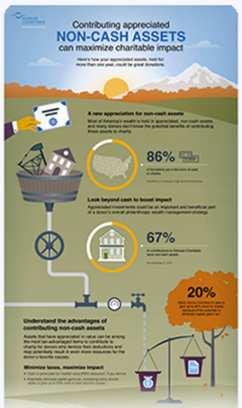
By donating $1 million of TechCo stock directly to charity after restrictions are lifted, as shown in Option 2, Cheryl potentially eliminates $190,000 in projected federal capital gains taxes and thereby has an additional $190,000 for a tax deduction and available to grant to charities. She also has an additional $260,300 in tax savings.

This hypothetical example is only for illustrative purposes. The example does not take into account any state or local taxes or the Medicare net investment income surtax. The tax savings shown is the tax deduction, multiplied by the donor's income tax rate (37% in this example), minus the long-term capital gains taxes paid.

Gifts of restricted stock to charity are typically deductible, for those who itemize, at fair market value. Values may be subject to discount based on the specific restrictions if the restrictions are not cleared prior to contribution. In the above hypothetical case study, the restriction was cleared prior to contribution. For gifts of more than $5,000, the donor must obtain a qualified appraisal if the restrictions are not cleared prior to contribution. Such valuations vary wildly, depending on the nature of the specific restrictions. No discount was applied in this example because the restriction on the gift was cleared prior to contribution. The example assumes full deductibility (gifts to public charities, including donor-advised funds, of property held longer than one year are generally limited to 30% of AGI with a five-year carryover of any unused amount).

Planning for an IPO?

Under Section 83(b) of the Internal Revenue Code, an employee can accelerate tax treatment of his or her RSUs or RSAs to the grant date, even if the stock is unvested and subject to a substantial risk of forfeiture.[§§] The employee would pay ordinary income tax on the fair market value of the restricted stock reduced by the amount of the exercise price (normally zero for RSUs and RSAs). This strategy is most commonly used with early stage, non-publicly traded companies if the employee expects the stock to appreciate, as any future appreciation would be taxed at the lower capital gains tax rate and would receive long-term capital gains tax treatment if held for more than one year after the 83(b) election is made. An important note of risk: if the stock declines or if the shares are forfeited because the vesting requirements were not met, the employee would have paid taxes and cannot take a loss.



Interested in learning more?

The Charitable Strategies Group at Schwab Charitable is a team of professionals with specialized knowledge about non-cash asset contributions to charities. Our team stands ready to support you and your advisors, from initial consultation through asset evaluation, receipt, processing, and sale. We strive to provide unbiased guidance and frequent communication at every step of the process to help you and your advisors make informed decisions and stay aware of the time required for your transaction.

For more information about the advantages of contributing appreciated non-cash assets, you can review our infographic, read an overview article, or call us at 800-746-6216.

If you would like to learn more about Schwab Charitable donor-advised fund accounts, click here.

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Giving wisely
is great.

For questions or assistance with philanthropic planning or charitable giving:	Visit www.schwabcharitable.org Call Schwab Charitable at 800-746-6216 Contact your advisor	Follow Schwab Charitable

§§ An 83(b) election must be made within 30 days of the grant of the RSA and RSU and is generally irrevocable. The election must be made in writing and filed with the IRS office where the employee regularly files tax returns. The employee must also send a copy of the election to the employer. Consult a tax advisor for specifics.

This information is not intended to be a substitute for specific individualized tax, legal, or investment planning advice. A donor's ability to claim itemized deductions is subject to a variety of limitations, depending on the donor's specific tax situation. Where specific advice is necessary or appropriate, Schwab Charitable recommends consultation with a qualified tax advisor, Certified Public Accountant, financial planner, or investment advisor.

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