Merger & Acquisition Activity Drives Time-Sensitive Charitable Opportunities

Learn how M&A activity can turn into a win for charitable giving

Publicly traded company transactions, including inversions, are often in the headlines. This trend is expected to continue as the number of announced M&A deals is on the rise globally.[1] Although these transactions are generally favored by shareholders because they can create additional income, they can also produce additional tax liabilities due to the forced recognition of capital gains. Transactions that have already closed and those that may still close this year should trigger end-of-year tax planning conversations for advisors and their clients. There are a variety of planning strategies that can help mitigate tax liabilities. With a view toward philanthropy, several of these strategies can provide both high-impact charitable giving opportunities and a positive impact on finances.

What's Inside

[1] Intralinks Deal Flow Predictor for Q1 2017

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White Paper

M&A Scenarios

If you are invested in a company that has corporate M&A transaction in play, you, as a shareholder, are subject to capital gains tax and may also be subject to Medicare surtax of 3.8% on those appreciated securities. In some cases, shareholders fail to understand the impact of this situation until they prepare their tax returns and see they have experienced a substantial liquidity event. While this event created a positive return on their investment, it also triggered the recognition of the capital gain and the expensive capital gains tax.

Charitable giving is an excellent strategy that you can leverage to not only support a favorite charitable cause, but also potentially reduce your tax liability. The tax benefits differ depending on the timing of the M&A transaction. The two scenarios that should be considered are:

- Announced M&A Transaction
- Completed M&A Transaction

In either scenario, whether the investor learns of the transaction when it is announced or after it has been completed, there is an opportunity to positively impact his or her tax situation with a philanthropic strategy, as long as the charitable contribution is made before December 31.

Announced M&A Transaction Scenario Planning

Transaction has been announced, but not yet finalized: If a shareholder learns of the transaction when it is announced but not yet completed, he or she has the option to donate the stock subject to the transaction to a charity. By donating the stock, the investor may be eligible for a fair market value tax deduction and will generally not be subject to the capital gains tax. It is important to note that to use this charitable giving strategy, timing of the donation is critical. It is very important to consult your tax advisor before employing this tactic.

Completed M&A Transaction Scenario Planning

Transaction has been finalized and is pending closing or has already closed: If the shareholder learns of the transaction after it is complete, he or she has the option to offset the tax consequences by making a charitable donation with cash or an asset from his or her financial portfolio by December 31. Turn to the *What to Donate* section for tips on identifying the best asset for charitable giving.

Charitable Opportunity

Giving directly to an operating public charity is a frequent choice when making a philanthropic donation. However, during a high-income year, a compelling alternative may be to select a charitable planning vehicle for smarter giving or to allow for more time to select the charitable cause they wish to support. Charitable vehicles can often handle more sophisticated donations (such as appreciated stock), more easily facilitate support to a variety of charities and provide for greater long-term giving with the potential for investment growth.

One such vehicle is a **donor-advised fund** (DAF). A DAF is a program sponsored by a public charity that allows a donor to make an irrevocable charitable contribution and take advantage of an immediate tax benefit with an income tax deduction generally equal to the fair market value of the donation. The donor can then easily recommend grants to qualified charities over time. The donor can also recommend how the remaining contribution is invested to potentially grow the donation tax-free to increase future charitable giving.

Similarly, a **private foundation** permits tax-deductible contributions and can allow for grantmaking to a number of charities over time. Private foundations can also sometimes enable greater investment flexibility for potential growth of the donation.

Due to different tax status, however, the tax benefits of donating to a public charity, including a DAF sponsor, can be more beneficial than a private foundation. A contribution of cash to a public charity allows for a charitable deduction of up to 50% of a donor's adjusted gross income (AGI), while a contribution of cash to a private foundation allows for a charitable deduction of up to 30% of a donor's AGI. A contribution of long-term publicly traded securities or non-publicly traded assets to a public charity allows for a charitable deduction of up to 30% of a donor's AGI while a similar contribution to a private foundation allows for a charitable deduction of up to 20% of a donor's AGI.

What to donate?

As noted in the "Announced M&A Transaction" scenario, if you donate appreciated long-term securities, which are the subject of a corporate transaction pending finalization of material terms, tax law allows for a fair market value income tax deduction. When the charity sells the stock, neither the charity nor the donating taxpayer generally incurs capital gains tax, thus allowing more to go to the charity.

However, even in the "Completed M&A Transaction" scenario, it can still be advantageous to make a charitable donation to help offset recognized capital gains on the securities associated with the merger/acquisition transaction. An important first consideration is to identify the best asset to be used to accomplish the charitable contribution. Many donors, and some advisors, instinctively think charitable contributions are generally cash. While cash may make sense in light of a capital gain that has already been incurred from the merger/acquisition transaction, for many clients who have additional long-term appreciated securities in their portfolio, donating one of these assets may be the better choice. Donating an appreciated long-term security such as a publicly traded stock or mutual fund allows for a fair market value income tax deduction, and when the charity sells the stock, it generally does not incur capital gains, thus allowing more to go to the charity.

For some donors, it may be even more tax efficient to contribute non-publicly traded assets, such as private company stock, real estate or LLC interests, to offset a recognized gain elsewhere in the portfolio. Such contributions to a public charity will also typically entitle you to a full fair market value deduction,[2] but if these assets are contributed to a private foundation, a deduction of tax basis is generally appropriate. When a public charity liquidates or receives distributions from the contributed non-publicly traded asset, the charity typically will not experience capital gains, so considerable tax efficiencies may be possible.

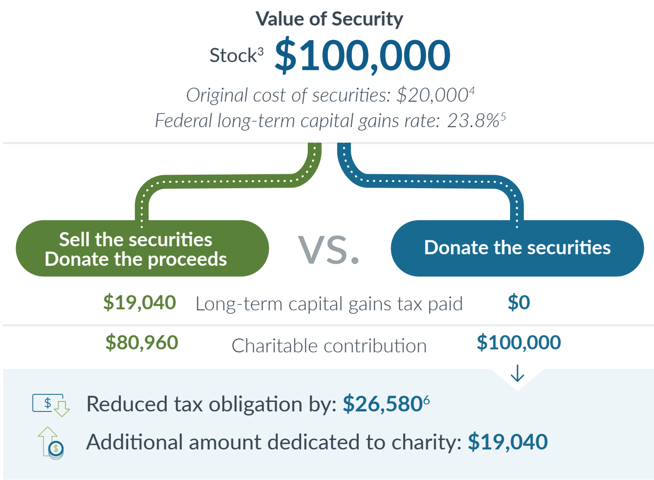
There are a number of legal and technical elements that need to be considered as part of any contribution of non-publicly traded assets to charity. You will want to be sure to coordinate the planning with their tax advisor and with the charity to be sure all critical elements are considered.

Outlined below is a hypothetical example showing the advantages of donating a long-term appreciated security as compared to selling the asset and donating the net cash proceeds.

In this scenario, the donor:

- Is in the 39.6% federal income tax bracket
- Has an asset that has an FMV of $100,000 that includes unrealized gains of $80,000 subject to a 20% capital gains and 3.8% Medicare surtax

With this example, donors would be able to eliminate capital gains tax and therefore donate an additional $19,040 to charity as well as take a larger income tax deduction:



[2] In addition to the capital gains tax, shareholders are also subject to the Medicare surtax of 3.8%

[3] Amount of the proposed donation is the fair market value of the appreciated securities held more than one year that the donor is considering to donate.

[4] Total Cost Basis of Shares is generally the amount of money the donor has invested in the shares of a particular fund or individual security. It represents the basic dollar amount that, when compared to the price at which the donor sells their shares, tells them how much of a capital gain or loss they have realized.

[5] This assumes all realized gains are subject to the maximum federal long-term capital gains tax rate of 20% and the Medicare surtax of 3.8%. This does not take into account state or local taxes, if any.

[6] Assumes no unrelated business taxable income (UBTI) and top ordinary income tax rate of 39.6% for valuing charitable deduction. $26,580 reduced tax obligation calculated by adding the savings from not having to pay capital gains tax of $19,040, plus the improved income tax deduction of $7,540 based off assets valued at $100,000 x 39.6% yielding $7,540 lower income tax than does $80,960 x 39.6%. It does not account for any state and local taxes, alternative minimum tax, or limitations to itemized deductions that may be applicable to taxpayers in higher federal income tax brackets.

Final Thoughts

Corporate mergers and acquisitions are usually favored by shareholders because of the additional gains they create. However, this activity can also result in an increased tax liability. Strategically leveraging additional income resulting from a merger or acquisition can give you a unique opportunity to achieve your philanthropic goals.

Donating to a public charity, like Fidelity Charitable®, during a high-income year can be an effective strategy for you to support the charitable causes you care about as well as reduce your tax obligations. An investor who is impacted by either M&A scenario will want to be sure to coordinate planning with their tax advisor and with the charity to ensure that all critical elements are considered. A tax advisor can often provide more detail about the charitable offset and model the impact depending on the totality of the client's portfolio, including public and private stock and cash.

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