Pescosolido v. Commissioner, 91 T. C. 52 (1988)

Charitable contributions of section 306 stock are limited to the donor's cost basis if not proven to be free from a tax avoidance plan.

Summary

Carl Pescosolido, Sr. , donated section 306 stock to Harvard and Deerfield Academy, claiming a fair market value deduction. The IRS challenged this, arguing the stock's disposition was part of a tax avoidance plan. The Tax Court ruled against Pescosolido, limiting the deduction to cost basis due to his inability to disprove tax avoidance intent, given his control over the corporation and the tax benefits of the contributions. This decision emphasizes the scrutiny applied to controlling shareholders' dispositions of section 306 stock and the burden of proving non-tax-avoidance motives.

Facts

Carl A. Pescosolido, Sr. , a successful businessman, consolidated his oil companies into Lido Corp. of New England, Inc. , in a tax-free reorganization. He received voting and nonvoting preferred stock, classified as section 306 stock. Pescosolido, a graduate of Deerfield Academy and Harvard College, donated this stock to both institutions in 1978 and 1979. He claimed charitable deductions based on the stock's fair market value. The IRS challenged these deductions, arguing that the stock's disposition was part of a tax avoidance plan due to Pescosolido's control over Lido and the tax benefits of the contributions.

Procedural History

Pescosolido and his wife filed a petition in the U. S. Tax Court after the IRS issued a notice of deficiency disallowing their charitable contribution deductions. The IRS later conceded that the deductions should be allowed at cost basis rather than disallowed entirely. The Tax Court heard the case and ruled on July 18, 1988, as amended on July 26, 1988.

Issue(s)

1. Whether Pescosolido's charitable contributions of section 306 stock to Harvard and Deerfield Academy should be deductible at fair market value or limited to his cost basis under section 170(e)(1)(A).

Holding

1. No, because Pescosolido failed to establish that the disposition of the stock was not part of a plan having as one of its principal purposes the avoidance of federal income tax, as required by section 306(b)(4). Therefore, his charitable contribution deductions are limited to the cost basis of the stock under section 170(e)(1)(A).

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Court’s Reasoning

The court applied section 306, designed to prevent shareholders from extracting corporate earnings as capital gains, and section 170(e)(1)(A), which limits deductions for contributions of section 306 stock to cost basis unless the disposition is not part of a tax avoidance plan. Pescosolido, as a controlling shareholder, bore a heavy burden to prove no tax avoidance intent. The court was not persuaded by his evidence of charitable intent alone, especially given his control over Lido and the substantial tax benefits of the stock’s disposition. The court inferred tax avoidance from the unity of purpose between Pescosolido and Lido and the potential for tax savings. It also noted Pescosolido’s awareness of the stock’s tax status, as evidenced by his tax return filings and the IRS ruling he received during the reorganization.

Practical Implications

This decision impacts how contributions of section 306 stock by controlling shareholders are treated for tax purposes. It emphasizes the need for clear evidence negating tax avoidance motives when such shareholders donate section 306 stock. Practitioners should advise clients to document non-tax motives for stock dispositions thoroughly. The ruling may deter controlling shareholders from using section 306 stock for charitable contributions due to the limited deduction to cost basis. Subsequent cases, like Bialo v. Commissioner, have continued to apply this principle, reinforcing the scrutiny applied to dispositions of section 306 stock by those in control of the issuing corporation.

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