consequence, a shareholder in a corporation which has substantial undistributed earnings can, without tax, receive a dividend of re-redeemable preferred stock, secure a deduction for the full value of the stock by contributing it to a private foundation, and, if no prearranged plan for redemption exists, experience no tax consequences when the corporation redeems the stock from the foundation. The corporate profits have thus traveled a route leading from the corporation, through the shareholder, to the foundation; but the shareholder has never been taxed on them, and he has been able to reduce his taxable income by the entire amount of their value.

Indeed, if the stockholder is in a relatively high income tax bracket, he may well find significantly more cash in his pocket after the donation of section 306 stock to a foundation than he would be able to retain if he sold the stock for its full value. If, for example, a taxpayer in the 60 percent bracket sold section 306 stock for $20,000, he would pay a tax of $12,000 on the proceeds and be able to retain a net profit of $8,000.[3] If, on the other hand, he were to donate his stock to a foundation, his $20,000 deduction would diminish the tax which he would otherwise have to pay by $12,000. He would, then, be $4,000 richer if he gave the stock to a foundation than if he sold it.

The bailout potentialities of charitable contributions of section 306 stock have not escaped the notice of tax planners and advisers. A recent article in Taxes magazine describes the advantages to be derived from such contributions with clinical particularity. Rabinowitz and Dick, "Charitable Contributions of Section 306 Stock," Taxes, April 1964, page 220. Other articles describing the device are abundant.[4]

The Treasury Department's recent survey of private foundations suggests that a substantial number of taxpayers have made practical use of the often-repeated advice that the antibailout statute can be circumvented by giving section 306 stock to charity. Among the approximately 180 surveyed foundations which own 10 percent or more of at least 1 class of stock in a corporation, there are 74 separate holdings of what, from the reported information, appears to be section 306 stock.

The continued availability of the bailout device in the charitable contribution area has evoked criticism from a number of independent commentators. See Bittker, "Federal Income Taxation of Corporations and Shareholders" (1959 ed., p. 251). In its revised report of December 11, 1958, the House Ways and Means Committee Advisory Group on Subchapter C of the Internal Revenue Code of 1954 described the disposition of section 306 stock by donation to charity as an "abuse," and recommended that the problem be dealt with by reducing the donor's allowable charitable deduction by the amount which, under section 306, would have been taxed as ordinary income if the donor had sold the stock for fair market value. The working view developed on this subject by the American Law Institute Tax Project was to the same effect. 14 Tax Law Review 1, 5 (1958).

[3] This example assumes that the stock's ratable share of the earnings and profits of the corporation at the time of distribution was at least equal to the proceeds of the sale.

[4] Cutler, "Various Aspects of Contributions to Charity," 17 New York University Annual Institute on Federal Taxation 1117, 1136 (1959); Lowndes, "Tax Advantages of Charitable Gifts," 46 Virginia Law Review 394, 413 (1960); Merritt, "The Tax Incentives for Lifetime Gifts to Charity," 39 Taxes—The Tax Magazine 104, 118 (1961); Quiggle and Myers, "Tax Aspects of Charitable Contributions by Individuals," 28 Fordham Law Review 579, 604–605 (1960); Ray and Oliver, "How to Choose Right Property and Method of Giving to Benefit from Gifts to Charity," 10 Journal of Taxation 118 (1959); Rudick and Gray, "Bounty Twice Blessed: Tax Consequences of Gifts of Property to or in Trust for Charity," 16 Tax Law Review 273, 280 (1961); Sugarman, "Charitable Giving Development in Tax Planning," 39 Taxes 1027, 1029 (1961); "Estate Planners Note: Contributions of Section 306 Stock Not Taxable," 7 Journal of Taxation 133 (1957).