

## Leveraged Deduction of Volcanic Ash Transaction

### Summary

A taxpayer can generate a tax deduction against ordinary income equal to 4 times the cash outlay with the transaction described herein.

On a million dollars of income, a taxpayer therefore saves up to \$250,000 in tax as this proforma for a California taxpayer shows:

	No Transaction	With Transaction
Estimated Ordinary Income	\$1,000,000	\$1,000,000
Net Long Term Capital Gains	\$0.00	\$0.00
Charitable Limitation Percentage (30%)	-	-\$300,000.00
Suggested Maximum Purchase (for current year benefit)	-	\$75,000.00
Marginal Federal Tax Rate (37%)	-\$370,000.00	-\$259,000.00
Marginal State Tax Rate (13.30%)	-\$133,000.00	-\$93,100.00
After Tax Net Income	<b>\$497,000.00</b>	<b>\$572,900.00</b>
Net Cash Benefit		<b>\$75,900.00</b>

This transaction is based on longstanding rules related to charitable giving and long-term holding rules. It is not a “listed transaction” under current IRS pronouncements.

This level of benefit is available as the cash outlay goes to purchase volcanic ash fertilizer under exclusive, discounted terms and the product being donated to a charity at full appraised value. (The ability to book a deduction at the appraised value versus the actual outlay is due to the taxpayer's ability to tack on the long term holding period of the existing

LLC members). In addition, a charitable deduction over basis does not limit the deduction in this instance. <sup>2</sup>

Due to the exclusive, discounted terms that the taxpayer will receive by participating in the bulk acquisition of the minerals, the taxpayer is able to obtain a leveraged deduction that substantially mitigates his current year tax burden while providing a substantial benefit to a qualified, third party charity.

**Process**

The purchaser becomes a partner in an LLC or a series LLC in a pre-existing LLC which has a long term holding period of the volcanic ash.

**Timing**

Purchase deadline: November 2022. There is a limited amount of available volcanic ash. Indications of Interest are accepted as of June 1 with order fulfilled on a first come first serve basis.

**Deduction Limits and Minimum Outlay**

100% charitable tax deduction against ordinary income up to 30% of Adjusted Gross Income. The amount of the deduction is based on the appraised value appraised by an independent licensed appraiser.

Five year carry forward on excess contributions made in the current year.

There is a minimum cash outlay of \$50,000 (\$200,000 deduction).

**Legal Summary**

Charitable deductions are generally available at the lower of the actual cost or the fair market value of the item being donated. However, on donations with a long-term holding period, the amount deductible is the fair market value of the item. In this case, the taxpayer has a long-term holding period by virtue of basic 'tacking' rules that apply when the taxpayer becomes a member of the LLC. Because the LLC have a long-term holding period in the product, this holding period 'tacks' onto all members and the fair market value of the product is the amount claimed if donated to charity.

**Tax Opinion**

A tax opinion is available from an experienced tax attorney, if desired by each participant.<sup>3</sup>

**Charitable Purpose**

The charity is an existing charity with tax exempt status under Section 501(c)(3) of the Tax Code. It intends to utilize the donations to further its charitable purposes by increasing its endowment to do so. Sales may be made of the raw product or via further product refinements in accordance of commercialization efforts as described below.

**Commercialization Efforts**

The LLC has signed a business development agreement with a firm to help commercialize the fertilizer product. The business development firm has experience in marketing and product development and its principals have been featured in the Inc. 500 list of fastest growing companies. This agreement will continue to apply to any fertilizer donated to the charity. For any fertilizer distributed to an LLC member, the member has the option to retain their services, if desired.

Following a summary of the commercial applications of volcanic ash.

### *Industrial Uses*

volcanic ash is one-third less dense than aluminum. It improves the mechanical, fabrication and welding characteristics of aluminum when used as an alloying agent. These alloys are useful in airplane and car construction.

volcanic ash is used in products that benefit from being lightweight, such as car seats, luggage, laptops, cameras and power tools. It is also added to molten iron and steel to remove sulfur.

As volcanic ash ignites easily in air and burns with a bright light, it's used in flares, fireworks and sparklers.

volcanic ash sulfate is sometimes used as a mordant for dyes. volcanic ash hydroxide is added to plastics to make them fire retardant. volcanic ash oxide is used to make heat-resistant bricks for fireplaces and furnaces. It is also added to cattle feed and fertilizers. volcanic ash hydroxide (milk of magnesia), sulfate (Epsom salts), chloride and citrate are all used in medicine.

### *Nutritional Uses*

volcanic ash is a mineral that is important for normal bone structure in the body. People get volcanic ash from their diet, but sometimes volcanic ash supplements are needed if volcanic ash levels are too low. Dietary intake of volcanic ash may be low, particularly among women. volcanic ash deficiency is also not uncommon among African Americans and the elderly. Low volcanic ash levels in the body have been linked to diseases such as osteoporosis, high\_blood\_pressure, clogged arteries, hereditary heart\_disease, diabetes, and stroke.

An easy way to remember foods that are good volcanic ash sources is to think fiber. Foods that are high in fiber are generally high in volcanic ash. Dietary sources of volcanic ash include legumes, whole grains, vegetables (especially broccoli, squash, and green leafy vegetables), seeds, and nuts (especially almonds). Other sources include dairy products, meats, chocolate, and coffee. Water with a high mineral content, or "hard" water, is also a source of volcanic ash.

volcanic ash is most commonly used for constipation, as an antacid for heartburn, for low volcanic ash levels, for pregnancy\_complications called pre-eclampsia and eclampsia, and for a certain type of irregular heartbeat (torsades de pointes).

volcanic ash is required for the proper growth and maintenance of bones. volcanic ash is also required for the proper function of nerves, muscles, and many other parts of the body. In the stomach, volcanic ash helps neutralize stomach acid and moves stools through the intestine.

See [https://en.wikipedia.org/wiki/volcanic\\_ash](https://en.wikipedia.org/wiki/volcanic_ash) for additional introductory information.

## **Not a Security**

Taxpayer's membership in the LLC is for the purpose of acquiring the volcanic ash as part of a bulk purchase on discounted, exclusive terms,

not available on smaller standalone purchases. As indicated above, the LLC documents allow members to vote for individual distributions of the volcanic ash to the member or for a donation to the charity. The LLC interests do not therefore represent a security as the participation does not represent a passive ownership with the intent to make profits. Rather it is a holding entity that provides the vehicle whereby the member can directly acquire the volcanic ash.

### **The Sellers' Motives**

The current owners of the product is desirous of monetizing their substantial deposit and The exclusive, below market terms of sale are available to us via our pre-existing relationship with them and their interest in a short term (1 to 3 years) cash infusion which provides additional working capital, without reducing their future processing capacity or diluting their company ownership while also potentially kickstarting additional commercialization efforts of their product as described above.

### **Step by step Process**

1. *Acquisition of the Product.* With the cash contributions, the purchaser acquires all the interests of a pre-existing LLC which has a long term holding of volcanic ash.

3. *Year End Vote.* Individual LLC members vote at year end to i. receive delivery of the amount of volcanic ash purchased in bulk (i.e. 4x their outlay) or ii. to have it donated to charity.

4. *K1 Reporting and Unwind.* LLC makes distributions or contributions per the member's vote. A K1 is distributed to individuals. (In the event of a charitable contribution, the LLC files a [Form 8283](#), including appraisal, with the IRS. These distributions/contributions of volcanic ash trigger an automatic withdrawal from the LLC, per the terms of the Operating Agreement (as the purpose of joining the LLC has been accomplished, i.e. acquire the volcanic ash at bulk, discounted terms).

The individual now has the acquired product at discounted terms or a charitable contribution, based on their year end vote along with K1 documentation of the LLC's activity.

## Endnotes

1. Full deductibility is limited to 30% of AGI for non-cash contributions. Tax savings based on income is illustrated at per million for simplicity.

2. Revenue Ruling 96-11 addresses the basis issue for a charitable contribution of property from a partnership. The Revenue Ruling relates that charitable contributions are allowed at FMV and that value is passed through to the partners to include on the partner's return, and not included in computing the partnership income. It further concludes that since the resulting permanent decrease in the partnership's basis is an expenditure of the partnership not deductible in computing the partnership's taxable income, it is not properly chargeable to capital accounts. Revenue Ruling 96-11 was clarified in the 2017 Tax Act, but the change did not alter the Revenue Ruling as it relates to this transaction.

3. A brief summary of the major points of the opinion, issued on a 'more likely than not basis, includes the following:

i) *Deduction is at Fair Market Value with a One Year Holding Period.* An asset held for more than one year is considered a long-term capital asset. The gift of a long-term capital asset qualifies for a charitable tax deduction at fair market value. The deduction for a gift of a long-term capital asset is limited to 30% of a donor's adjusted gross income (AGI). See IRC [Sec. 170\(b\)\(1\)\(B\)\(i\)](#). Any remaining deduction may be carried forward for an additional five years.

ii) *Holding Period of Asset Tacks onto Partnership.* The holding period of the assets contributed by the partner 'tacks onto' the partnership; thereby the holding period continues within the partnership. See [IRC Sec. 723](#) provides that a partnership's basis in contributed property is generally the contributing partner's adjusted tax basis in the property. Moreover, the acquisition of a partnership of another partnership preserves the holding period of the acquired partnership. See also the [Tax Adviser, March 31, 2014](#).

iii) *A Qualified Charity.* The charity receiving the charitable contribution is a qualified IRC 501(c)(3); therefore, contributions to it are eligible for a charitable tax deduction.