



Whose Money Is It Anyway?

Striking a balance between donor wishes and organizational fiduciary responsibility



Brought to you by:

Robert J. Lane, CPA

**Patricia Entsminger, CPA
(Shareholders)**

**Kerkering, Barberio & Co.
Certified Public Accountants
1990 Main Street, Suite 801
Sarasota, FL 34236
www.kbgrp.com**

Phone:

(941) 365-4617

Emails:

rlane@kbgrp.com

pentsminger@kbgrp.com

Dated:

January 25, 2010

Social investing and social entrepreneurship have dramatically changed the face of philanthropy over the past 10 years. Donors of both extreme and moderate means are no longer content to practice “checkbook” philanthropy. They want to engage in socially responsible philanthropy, donating not only their treasures but also their time, talents and ideas.

Conflict can arise when a donor has different expectations than the organization’s Board and management as to how much involvement is appropriate. The Internal Revenue Code and Treasury Regulations under Section 170 provide some assistance in determining how much donor control is allowable without jeopardizing the donor’s charitable contribution deduction. Section 170 allows a taxpayer to take a deduction for a gift made to a charitable organization described in Section 501(c)(3). Depending upon the level of control over the organization, the donor’s contribution may be limited both as a percentage of Adjusted Gross Income and by the value of the charitable deduction.

Except as provided in Section 170(f)(3), only gifts of a donor’s entire interest in property are deductible. When a donor retains too many incidences of ownership or control over the gifted assets, the IRS may disallow the charitable deduction. It is permissible for donors to place restrictions on how the gift may or may not be used. However, these restrictions should be agreed to prior to completion of the gift. Once the gift is completed the organization is legally obligated to meet the restrictions.

Most organizations have a gift acceptance policy to guide the organization with regard to contributions, including accepting restricted gifts. An organization must balance between satisfying donor’s wishes and fulfilling the organization’s charitable mission. Fiduciary duty is the duty the Board owes to the public to safeguard and use the organization’s assets exclusively for charitable purposes. Although the donor is part of that public, the primary fiduciary duty is not to the individual donor. After the property is transferred, the organization’s management has a primary responsibility to operate exclusively for the charitable purpose for which it was organized and secondarily to fulfill the donor’s restrictions. If there are any restrictions that the organization does not believe it can fulfill and stay within its exempt purpose, it must:

- Refuse/return the gift,
- Persuade the donor to remove restrictions that cannot be met, or
- Change its organizational mission to conform to the gift.

The latter is almost never a viable or wise decision for a charitable organization.

Most states have appointed the Attorney General's office as the "person" with legal standing to enforce the terms of a charitable gift. In recent years donors and their families have attempted to bring suit against charities they feel have failed to meet the terms of gifts in several states with mixed success. The problem with allowing donors to retain the legal right to sue a charity over its use of a charitable gift is that it suggests that the donor has retained enough legal rights over the property to act as a guardian as to its use and could jeopardize the charitable deduction.

New Jersey, for example, allows donors and their families to sue to enforce the terms of a charitable gift. Notably, Princeton University and the Robertson Family settled a bitter dispute over donor intent at the end of 2008. In addition to making concessions including dissolving and establishing a new endowment, Princeton reimbursed the family foundation for legal fees of 40 million dollars. A New York appeals court also ruled in favor of a donor's widow, granting her the legal right to enforce the terms of a 10 million dollar gift. Charities are rightfully very concerned over the potential litigation costs associated with contested gifts or subsequent gift use demands by donors and their families. Putting policies and procedures in place for when the gift is accepted and then following them, will eliminate most misunderstandings between donors and the charities they support.

- Gifts should have all terms and conditions clearly set forth in writing. Either the donor's gift transmittal letter or the donor substantiation receipt should specify what, if any, restrictions are placed on the gift or if there are none, that there are no restrictions.
- The charitable organization can facilitate gift documentation by sending duplicate donor receipts. The donor retains one copy for their income tax records and signs and returns the other copy to confirm the terms of the gift. The charity should follow up and ensure that it receives a signed copy of the donor receipt if the gift is either significant in amount or restrictions. The Internal Revenue Service does not impose any requirement to list restrictions on gifts on the donor receipt. However, adding this information can be of great benefit if a dispute arises in the future.
- Donors should review charitable gift receipts carefully for the description of the property, date of gift, value of any quid pro quo the charity gave in exchange for the charitable gift and any limitations or restrictions on the gift to make sure they are accurate.
- Donors and charities should always use separate counsel in drafting major gift agreements, planned giving documents and bequests. Paying the donor's advisors and appraisal fees is the donor's responsibility and should not be borne by the charitable organization.
- Development directors do well to have a diverse and well developed network of attorneys and accountants specializing in charitable gift planning. The benefits are two-fold. First, having a ready list of independent professionals donors can call on indicates the organization is sophisticated and understands the importance of properly structuring a charitable gift. Second, the network of professionals familiar with the organization, its programs, and the types of gifts accepted may lead to other sources of support for the organization.

It is clear donors must relinquish property ownership to receive an income tax deduction. However, the courts are undecided on whether the donor or the State's Attorney General is best suited to defend the public interest and enforce the terms of a restricted gift. It will likely be some combination of the two and vary from state to state. The Internal Revenue Service will likely continue to favor restriction rather than expansion of donor rights over property contributed to a charity where a charitable deduction is taken. The practical solution is for charities and donors to understand and document the gift terms at the beginning. The better the meeting of the minds, the more likely the donor's, the charitable organization's, and the public's needs will be met to the betterment of all.

###

We would be happy to assist you with any of your questions. Please call us at 941-365-4617 or email Rob Lane at rlane@kbgrp.com or Patricia Entsminger at pentsminger@kbgrp.com.