When to Say No (or Yes!) to a Gift

Date: February 7, 2019

Time: 1:00 – 2:30 Eastern

Presenter: Jeff Lydenberg
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Agenda

- Basic considerations in accepting complex assets
- Danger signals of bad gifts
- Drafting acceptance policies to stay out of trouble
- Due diligence guidelines
- Risk control strategies
- When to say yes or no to particular assets

Basic Considerations

- Assets that are hard to value, hard to liquidate
- Size matters
  - ✓ Larger the gift, likely greater the risk
  - ✓ Charities large and small must follow same process
  - ✓ Is the gift worth the resources/risk?
- Charity's reputation at risk
- Use risk control strategies to facilitate complex gifts

Danger Signals of Bad Gifts

- Unknown prospect
  - ✓ Charitable gifts express donor emotions, values and, life story
  - ✓ Is prospect known to charity or in community?

- Any connection to your organization?
  - ✓ Best indicator of interest in <u>your</u> charity is history of giving
  - ✓ Alumni? Volunteer? Member? Subscriber?
  - ✓ Part of your natural constituency?

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Danger Signals of Bad Gifts

- Too good to be true
  - ✓ Six and seven figure gifts
  - ✓ Complex terms
  - ✓ “Legal” opinions
  - ✓ Obligations on the part of charity
  - ✓ Charity will benefit “eventually”
  - ✓ Could you explain the gift to your grandmother?

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Danger Signals of Bad Gifts

- Trust your instincts
- Have you or colleagues heard of the gift plan before?
- Post a question to CGP-Link
- Do terms of the “great” gift violate basic tax rules as you understand them?
- Engage professionals to evaluate a too good to be true gift

Danger Signals of Bad Gifts

- Charity/Gift shopping
  - ✓ "I tried to sell this asset without success."
  - ✓ "Another charity passed on this gift as well."

- American Council on Gift Annuities (ACGA)
  - ✓ Sets standard sustainable gift annuity rates
  - ✓ Sets a level playing field for charity
  - ✓ Higher gift amount <u>does not</u> justify higher rate
    - o Larger the gift, greater the risk

Drafting Good Gift Acceptance Policies

- Drafting gift acceptance policies
  - ✓ Collaborative effort development, finance, general counsel
- Initial considerations
  - ✓ Rules of the road as to acceptable assets and vehicles
  - ✓ Framework for evaluating risk and reward
  - ✓ CGAs, CRTs, CLTs, retained life estates, oil and gas interests

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Drafting Good Gift Acceptance Policies

- Donor advised funds
  - ✓ No more than incidental benefit from DAF
  - ✓ Bifurcated gifts prohibited
  - ✓ Can satisfy legally enforceable pledge (Notice 2017-73)

- Restricted gifts
  - ✓ Restrictions must be within charity's mission and for purposes likely to exist in the future
  - ✓ Include variance clause for changed circumstances

Drafting Good Gift Acceptance Policies

- Appraisals
  - ✓ Assets valued in excess of $5,000 require qualified, independent appraisal
  - ✓ Appraiser must sign a Form 8283 for countersignature by charity accepting asset
  - ✓ If property disposed of within 3 years, charity files 8282
- Yes Virginia, the donor should pay for the appraisal!
  - ✓ If charity pays for appraisal, donor should reduce deduction by amount of appraisal

Drafting Good Gift Acceptance Policies

- Donor advisors
  - ✓ Encourage donor’s independent counsel
- Counting and crediting
  - ✓ Uniform policies with room for exceptions
- Stewardship
  - ✓ Describe giving societies, amounts, who is in and out
  - ✓ How to steward is a matter of procedure, no policy
- Pledges
  - ✓ Uniform policies with room for exceptions
  - ✓ Consider terms of pledges backed with estate gift

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Drafting Good Gift Acceptance Policies

- The gift acceptance committee
  - ✓ The critical component to make informed decisions
  - ✓ Ad hoc group charged with evaluating risky and complex gifts
- Composition of committee will change depending on particular gift
  - ✓ Core members: chief development officer, CEO, CFO
  - ✓ Other members may be invited based on their expertise
  - ✓ Committee may engage legal, accounting, or other experts to evaluate different situations

Due Diligence

- Process is not just evaluation of financial and legal risk
  - ✓ Consider reputational risk
  - ✓ Would you be happy to see this on front page of your local paper?
- Don't get carried away!
  - ✓ People get excited by big numbers
- Due diligence is equal opportunity process
  - ✓ Insiders not exempt from close scrutiny
  - ✓ There will be (not maybe) donor relations issues

Your Charity

Name Here

Risk Control Strategies-Single Member LLC

- **Single member limited liability company** (LLC)
  - ✓ IRS notice 2012-52
  - ✓ Gifts to charity owned LLC tax deductible as if made to parent charity

- LLC owned by single charity disregarded entity for tax purposes
  - ✓ Activities of the LLC treated as if by parent charity
  - ✓ Liability of LLC limited to assets of LLC

Risk Control Strategies-Single Member LLC

- Charity not in chain of title or ownership of LLC assets
  - ✓ LLC liable for title defects, premises liability, environmental contamination and other risks of real estate ownership
  - ✓ Consider LLC for many risky assets
- Parent charity responsible for taxable activities of LLC
  - ✓ LLC must only furthers tax-exempt purposes
  - ✓ LLC earning income on S corporation stock or capital gain on sale of S stock generates Unrelated Business Income (UBI)
  - ✓ UBI earned by LLC reported on tax return of parent charity

Risk Control Strategies-Donor Advised Funds

- Most DAFs equipped to accept risky, hard to value, hard to sell assets
- DAF may be captive arm of financial services firm or community foundation

FIDELITY Charitable[SM]

- DAFs minimums funded with complex assets subject to higher minimums
  - ✓ Vanguard: $25,000 to open DAF with cash or securities
  - ✓ Vanguard: $750,000 minimum to accept gifts of closely held assets, hedge funds, or other private equity assets

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Risk Control Strategies - Donor Advised Funds

- How can a DAF help with difficult assets?
  - ✓ DAF accepts asset
  - ✓ Manages acceptance, fronts carrying costs (taxes, maintenance, attorney's fees, due diligence experts)
  - ✓ DAF converts to cash
  - ✓ DAF reimburses itself from proceeds of sale
- Where's the gift?
  - ✓ Net proceeds of asset fund donor's DAF
  - ✓ Donor could immediately grant entire account to charity after sale
  - ✓ Or not! Charity may lose control of donor

Cash and Publicly Traded Securities

When to say yes? Almost always

When to say no? Well…

- What/who is the source of the gift?
- Is there a reputational risk?
- Will the gift run afoul of foreign currency restrictions?
- China limits conversion of Renminbi (RMB) to foreign currency to the equivalent of $50,000 U.S.

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Gifts of Real Estate

- Two primary concerns:
  - ✓ Liabilities: environmental, carrying costs, premises liability
  - ✓ How to convert property to cash
- Phase I environmental audit, title search, liens, lawsuits, marketability study
- Charity appraisal
- Engage professionals to assist

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Gifts of Real Estate

When to say yes? It depends

- Could property advance charitable mission?
- Are donor and property known to charity?
- Does property pass due diligence tests?

When to say no?

- If the value of the property not worth the cost of evaluation
- If the property is unmarketable and overvalued
- If donor wants charity to assume a mortgage
- If the gift would be a pre-arranged sale

Closely-Held Business Assets

When to say yes?

- **C corporation's** easiest business asset with least risk
  - ✓ What is plan to convert to cash? Stock redemption?
- **S corporations**
  - ✓ Single largest source of wealth in U.S.
  - ✓ Consider gift of corporate assets instead
- **Pass-through entities**
  - ✓ Greatest flexibility in how to structure
  - ✓ Not subject to UBI as a passive investment

Closely-Held Business Assets

When to say no?

- **C corporation** gifts to private foundations and CRTs
- Subject to private foundation rules
  - ✓ Considered self-dealing if stock sold to disqualified persons
- Charity liable for tax on income and capital gain from **S corporation** as UBI - Deal breaker!
- **Passthroughs** difficult to market
  - ✓ Partnerships may require charity to give cash
  - ✓ LLC liability generally limited to initial investment

Gifts of Life Insurance

When to say yes?

- Transfer Ownership of Paid-Up Policy
  - ✓ Could be cashed in immediately
  - ✓ Could be carried as an investment
- Name Charity as Beneficiary of Donor's Policy
  - ✓ Charity not liable for premium payments
  - ✓ Donor could change their mind, but not a net loss

Gifts of Life Insurance

When to say no? (Probably)

- **Gift of Policy with Premiums Due**
  - ✓ Donor could make annual tax deductible gift of premium
  - ✓ What if donor loses interest or fails to pay premiums?
  - ✓ Present value of premiums higher than death benefit
- **Purchase New Policy, Name Charity as Owner**
  - ✓ Commissions are economically inefficient to charity
  - ✓ See points above

Oil and Gas Interests

When to say yes?

- Fee and Royalty interests, Non-operating Interests
  - ✓ Engage oil and gas professionals working for charity
  - ✓ Potential liability, but assets can be quite valuable

When to say no?

- Working Interests
  - ✓ All liability, environment, compliance, safety on the owner of the working interest
  - ✓ Not your core business, stay away

Tangible Personal Property

When to say yes?

- **When property can be put to a related use**
  - ✓ Related use if of type normally used in mission and charity intends to use property in its mission
  - ✓ Donor entitled to a fair market value deduction
  - ✓ Form 8283 and qualified, independent appraisal required if value over $5,000
  - ✓ Form 8282 (Tattletale form!) if sold within 3 years

Tangible Personal Property

When to say no?

- Property unrelated to charitable mission
  - ✓ Donor's deduction limited to cost basis
  - ✓ Donor relations issues
- Disposition and carrying costs are prohibitive
  - ✓ Moving
  - ✓ Storage
  - ✓ Insurance
  - ✓ Fragile property

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Gifts from IRAs

When to say yes?

- **Charitable IRA rollover** (qualified charitable distribution)
  - ✓ When it is 100% deductible (no bifurcation!)
- **Beneficiary of IRA at death**
  - ✓ Almost always say yes!
  - ✓ But see next slide

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Gifts from IRAs

When to say no?

- **Charitable IRA rollover** (qualified charitable distribution)
  - ✓ Can't be used for tickets, auction items, or if more than minimal quid pro quo benefits
  - ✓ Can't be made to DAF, supporting org, or private foundation
- **Beneficiary of IRA at death**
  - ✓ Get ready, process is complex, intrusive, and lengthy
  - ✓ Consider advising donor to make DAF beneficiary of IRA

Cryptocurrency

- Educate your self
- Bitcoin is only one of hundreds of virtual currencies, but most popular
- Unresolved legal, tax, and regulatory issues
- Treated as gift of property
  - ✓ Appraisal required if claimed value over $5,000
  - ✓ Short term v. long term

Cryptocurrency

When to say yes or no?

- Don't say yes or no until infrastructure in place to accept (or not!)
  - ✓ See paper for resources
  - ✓ Risk is fluctuation in value, sell immediately like stock
- Consider reputational risk
  - ✓ Know your donor
  - ✓ How and why are they trading in virtual currency
  - ✓ Associated with illegal activity

Timeshares

- Timeshare ownership interests take several forms
  - ✓ Shared deeded interest
  - ✓ Shared leased ownership
  - ✓ Timeshare owner (even charity) liable for portion of annual expenses
  - ✓ Resale market is glutted and sale price can exceed annual maintenance fees
- When to say yes? Almost never
- When to say no? Almost always

Questions?

Still Have a Question?

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