JEWISH COMMUNITY FOUNDATION

Restricted Gifts to Charity – Protecting Donor Intent in Changing Times

APRIL 27 and 28, 2010

RESTRICTED GIFTS

I. INTRODUCTION

A donor who makes a contribution to a charitable organization may impose restrictions on the gift. The restrictions may relate to the purpose for which the gift is to be expended (e.g., to provide scholarships), to timing (i.e., distributions may be expended currently but the principal must be maintained as endowment), or to both purpose and timing (i.e. an endowment to provide scholarships). There could also be other restrictions such as how the gift is to be recognized or invested.

A charitable donee must decide if it can and should accept a gift subject to the restrictions imposed by the donor. There are various reasons why it might not accept a restricted gift such as the donee does not engage in the activity which the donor desires to support, the gift might damage the reputation of the donee, or the donee is not competent to manage the assets that the donor proposes to give to it.

The laws pertinent to restricted gifts have, for the most part been developed by the courts on the basis of trust law, contract law or a combination of both.[1] There are also some relevant

[1] For example, In re Los Angeles County Pioneer Society (1953) 40 C.2d 852, dealt with the issue of how assets held by a charitable corporation which had been received over the years as contributions should be disposed of upon the dissolution of the corporation. In concluding that the assets should be transferred to another similar charitable corporation which conducted similar activities the court stated that the corporation held its assets in trust even though there was no separate trust. See also, Holt v. College of Osteopathic Physicians & Surgeons (1964) 61 C.2d 750, where the court recognized that there is a difference between a trust and a corporation

statutory provisions. Whichever laws apply, it is clear that the restrictions on a gift will be binding on the donee so long as they are mandatory and not merely precatory and are not modified under cy pres or the equivalent. However, as discussed below, there are issues as to who has standing to enforce the restrictions.

A donor may want to take protective measures to prevent a donee from not complying with restrictions imposed by the donor such as providing for a gift over to another charity if the initial donee fails to abide by restrictions.

For various reasons a donor, a donee, or both may desire to modify restrictions on a gift at some time in the future. Under some circumstances this may be done by agreement between the donor and the donee. With court approval a donee may be able to modify the restrictions under Probate Code section 18506 or the judicial principles of equitable deviation or cy pres.

II. CHARITABLE DEDUCTION

There are deductions for contributions made to charitable organizations for purposes of Federal and California income taxes and Federal estate and gift taxes. Herein, only those deduction rules that might come into play because restrictions are placed on a charitable gift will be discussed.

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but states (at 756) that "[r]ules governing charitable trusts ordinarily apply to charitable corporations."

Section 17510.8 of the California Business Code provides that "the acceptance of charitable contributions by a charity . . . establishes a charitable trust and a duty on the part of the charity . . . to use those contributions for the declared purposes . . ."

However, it is important that an independent trust not be created because to be deductible for income tax purposes a transfer to a trust must be to a trust exempt under IRC section 501(c)(3) or to a charitable remainder trust.

It should be kept in mind that gifts to a nonprofit public benefit corporation that, even though they are not restricted by the donor, will be restricted to use for purposes set forth in the corporation's articles of incorporation. Holt v. College of Osteopathic Physicians & Surgeons supra; Queen of Angels Hosp. v. Younger, (1977) 66 Cal.App.3d 359.

A. Benefit To Donor

Deduction may be denied where a donor derives substantial benefit from a gift. Thus, in Ottawa Silica Co. v. N.J, 699 F.2d 1124 (Fed. Cir. 1983), the donor was denied a deduction for land donated for a new high school where the donor knew that the ensuing construction of public access roads would increase the value of its retained property. However the authorities consistently agree that a donor does not derive substantial benefit by name recognition such as where a university agrees to name a building after a donor.

B. Partial Interests

With certain exceptions not relevant here, for income tax purposes a charitable deduction will not be allowed for a gift of a partial interest in property. IRC § 170(f)(3). Thus, when placing restrictions on gifts of property, one must not retain an interest or power that would cause there to be a transfer of less than an entire interest. However, a donor may retain insubstantial interests such as a right to walk his dog over gifted land. Rev. Rul 75-66, 1975-1 CB 85. On the other hand, a retention of the right to vote stock prevented a transfer of the donor's entire interest in the stock. Rev. Rul. 81-282, 1981-CB 78.

C. Failure To Effect A Complete Transfer – Conditions Precedent and Subsequent

Treas. Reg. § 1.170A-1(e) provides:

> (e) *Transfers subject to a condition or power* – If as of the date of a gift a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become

> effective is so remote as to be negligible. If an interest in property passes to, or is vested in, charity on the date of the gift and the interest would be defeated by the subsequent performance of some act or the happening of some event, the possibility of occurrence of which appears on the date of the gift to be so remote as to be negligible, the deduction is allowable. For example, a donor transfers land to a city government for as long as the land is used by the city for a public park. If, on the date of the gift, the city does plan to use the land for a park and the possibility that the city will not use the land for a public park is so remote as to be negligible, the donor is entitled to a deduction under section 170 for a charitable contribution.

Regs. §§ 20.2055-2(b) and 25.2522(a)-2(b) pertaining to deductions for charitable contributions in computing estate and gift taxes, respectively, contain similar language.

In determining when a condition is "so remote as to be negligible" the Tax Court has stated:

> … The phrase "so remote as to be negligible" as it appears in section 20.2055-2(b), Estate Tax Regs., has been defined as "a chance which persons generally would disregard as so highly improbably that it might be ignored with reasonable safety in undertaking a serious business transaction." … It is likewise a chance which every dictate of reason would justify an intelligent

person in disregarding as so highly improbable and remote as to be lacking in reason or substance … (Citations omitted.)

Briggs v. Commissioner, 72 T.C. 646 (1979) at 656-657. Where a gift is conditioned upon acceptance of the gift by the donee, the year of deduction will be the year of acceptance. Linwood A. Gagne v. Commissioner, 16 T.C. 498 (1951). In Rev. Rul. 79-249, 1979-2 CB 104, the IRS took the position that contributions to fund construction of a high school building which would be refunded if sufficient funds were not raised were not deductible until the amount necessary to build this building had been raised.

Perhaps a deduction can be saved by a provision that, if the primary donee fails to satisfy a condition, the gifted property will be transferred to another public charity chosen by the donor or some other person. See Rev. Rul. 76-8, 1976-1 CB 179.

D. Amount Of Contribution

For tax purposes the amount of the contribution is the fair market value of that which is given. This means that, if restrictions will affect that value, they must be taken into consideration. J.T. Fargason, 21 BTA 1032 (1930); Cooley v. Commissioner, 33 T.C. 223 (1959), aff'd 283 F.2d 945 (2nd Cir. 1960); Deukmejian v. Commissioner, 41 TCM (CCH) 738 (1981); Rev. Rul. 85-99, 1985-2 CB 83; Rev. Rul. 2003-28, 2003-1 CB 594.

III. PLEDGES

To be enforceable in California, a pledge agreement must be a valid contract. Section 90(2) of the Restatement of Contracts, one of the leading authorities with respect to contract law, has taken the position since 1979 that no consideration need be furnished by a charitable pledgee to the pledgor in order for a pledge to be an enforceable contract. Some courts have adopted this position. Others have not and continue to hold to the traditional position that a mere promise to

make a charitable gift is unenforceable. While it is possible that, in the future, California courts might follow the Restatement, the California courts have historically required some form of consideration. University of Southern California v. Bryson, (1929) 103 CA 39; Bd. of Home Missions v. Manley, (1933) 129 CA 541; Calvary Presbyterian Church v. Brydon, (1935) 4 CA 2d 676; First Trust & Savings Bank v. Coe College, (1935) 8 CA 2d 195. This means that a pledge agreement must be carefully drafted to establish consideration to ensure that it will be binding on the parties, assuming that both parties want to be bound.

The mere recitation of consideration in a contract that there is good and valuable consideration at best creates a rebuttable presumption that there was in fact sufficient consideration. On the other hand, it is possible that, although there is no written instrument establishing consideration, other evidence would demonstrate that it is present.

Consideration which has been judicially recognized as valid by California courts usually takes one or both of the following forms:

1. The gift is specifically made in consideration of other donors making gifts so that there is mutual consideration flowing between donors. University of Southern California v. Bryson, supra; Calvary Presbyterian Church v. Brydon, supra.

2. The charity unconditionally obligates itself in some manner such as promising to build a building named after the pledgor or to establish a scholarship fund in his or her name. Buchtel College v. Chamberloix, (1906) 3 CA 246, First Trust & Savings Bank v. Coe College, supra.

In some cases, the courts have held that a pledgor is estopped from denying the existence of a contract because the charity has detrimentally relied on the pledgor's promise to make a charitable contribution. In such cases, the charities have been able to demonstrate that they have incurred significant costs or obligations in reliance of the promised gifts such as having begun the construction of a building. University of Southern California v. Bryson, supra.

Should a person making a pledge be concerned about there being consideration? Heirs may seek to thwart a donor's desire to benefit charity by claiming that there is no binding obligation due to lack of consideration. Once the pledge is paid, a donor may seek to enforce restrictions under contract law.

A charitable pledge that is enforceable against the pledgor's estate is deductible as a debt of the estate under section 2053 of the Internal Revenue Code provided that it would have been allowable as a deduction under section 2055 of that Code as a charitable deduction if it had been a bequest. Reg. § 20.2053-5(a). Because of potential claims by heirs, beneficiaries and the IRS, executors and trustees often petition for judicial determinations about whether a pledge is binding.

IV. STANDING

Who has standing to assert that a charitable recipient of a restricted gift has not complied with the restrictions on that gift? Historically, standing had been limited to those persons who have "some interest in the property – he must be a trustee, or a cestui, or have some reversionary interest in the property." Holt v. College of Osteopathic Physicians & Surgeons, supra at 753. It has often been stated by California courts that settlors or donors have no standing to bring a judicial action to enforce a charitable trust. E.g., American Center for Education Inc. v. Cavnar

(1978) 80 Cal.App.3d 476; O'Hara v. Grand Lodge Independent Order of Good Templars of State of California, (1931) 213 Cal. 131.

In San Diego County Council, Boy Scouts of America v. City of Escondido, (1971) 17 Cal.App.3d 189, the court granted standing to the Boy Scouts where the gift it trust was dedicated "for the use, benefit, and enjoyment of the Boy Scouts of Palomar District in San Diego County ..."

In L.B. Research and Education Foundation v. UCLA Foundation (2005) 130 Cal.App.4th 171, a foundation had contributed $1,000,000 to establish an endowed chair at the UCLA School of Medicine. If UCLA failed to comply with certain agreed upon restrictions pertaining to the qualifications of the individual to occupy that chair and/or annual reporting to the foundation, the endowment fund would be transferred to University of California, San Francisco. The donor, contending that UCLA had failed to comply with these restrictions, sued for specific performance, declaratory relief and breach of contract. The lower court dismissed the donor's action on the ground that the gift had created a charitable trust which only the Attorney General had standing to enforce. The Court of Appeals reversed concluding that the transfer was not in trust but was a gift of property subject to a condition in which case the law is that "the transferor or his heir or a third person may enter for breach of the condition." Furthermore, the court held that, even if a trust had been created, the foundation had standing under Holt, supra.

In L.B. Research, the Attorney General took the position that the plaintiff had no standing on the grounds that Corporations Code section 5142 limits those who can bring an action against a nonprofit public benefit corporation for breach of trust and does not include a donor unless the donor has "a reversionary, contractual or property interest in the asset's subject to the charitable trust." The court obviously disagreed with this contention. The Attorney General asked the

California Supreme Court to grant certiorari and to decertify the opinion of the Court of Appeals in L.B. Research. The Supreme Court did neither.

It is noted that the statutory provisions relating to bringing an action against a religious corporation for breach of trust are somewhat different than under section 5142 in that the Attorney General is precluded from doing so, assets of a religious corporation will only be deemed to be impressed with a trust under certain conditions, and a person may only bring an action based on a failure to abide by the restrictions imposed on a gift after giving written notice to the religious corporation. Corp. C §§ 9142 and 9143.

V. CHANGING RESTRICTIONS

A. Provisions In The Instrument Of Transfer

It would seem that, whether trust or contract law applies, a provision in a gift instrument may reserve to the donor or some other person the right to modify or release a restriction. However, any such provision should be carefully drafted to avoid an IRS assertion that there was no completed gift and thus no charitable deduction. Perhaps language such as "in no event may a modification or release allow the gifted property to be used for a purpose other than a charitable purpose of the donee described in section 501(c)(3) of the Internal Revenue Code." Also, it is unlikely that the Attorney General would allow a change in purpose which was not consistent with the purpose or purposes set forth in the articles of incorporation of the donee charity.

B. UPMIFA

Probate Code section 18506 provides that a restriction on an institutional fund may be released or modified in the following circumstances:

1. The donor consents in writing to a release or modification so long as such release or modification does not allow the fund to be used for other than charitable purposes of the institution.
2. A court may modify a restriction regarding management or investment "if the restriction has become impractical or wasteful, if it impairs the management or investment of the fund, or if, because of circumstances not anticipated by the donor, a modification of a restriction will further the purpose of the fund. To the extent practical any modification must be made in accordance with the donor's probable intention.
3. "If a particular charitable purpose or a restriction ... becomes unlawful, impractical, impossible to achieve, or wasteful, [a] court ... may modify the purpose of the fund or the restriction on the use of the fund in a manner consistent with the charitable purposes expressed in the gift instrument ...."
4. An institution may release or modify a restriction on management, investment, or purpose if it determines that such restriction is unlawful, impractical, impossible to achieve, or wasteful and (i) the fund has a total value of less than $100,000, (ii) more than 20 years have elapsed since the fund was established, and (iii) the institution uses the fund in a manner consistent with the charitable purpose expressed in the gift instrument.

The Attorney General must be given notice in situations (2), (3) and (4). An "institutional fund" does not include program related assets. For example, it would not include an auditorium of a university or works of art held by a museum.

C. Deviation

Section 66(1) of the Restatement of Trusts (3rd ed.) provides:

> The court may modify an administrative or distributive provision of a trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor, the modification or deviation will further the purposes of the trust.

This is called an "equitable deviation." It has been applied in California. Stewart v. Towse (1998) 203 Cal.App.3d 425 (changed circumstances unforeseen by settlor justified disregard of provision designating successor trustee). But see Stanton v. Wells Fargo Bank & Union Trust Co. (1957) 150 Cal.App.2d 763, where the court refused to invoke equitable deviation to override a provision by the trustor that all the assets of the trust be invested in a certain type of bonds.

D. Cy Pres

Section 67 of the Restatement of Trusts (3rd ed.) provides:

> Unless the terms of the trust provide otherwise, where property is placed in trust to be applied to a designated charitable purpose and it is or becomes unlawful, impossible, or impractical to carry out that purpose, or to the extent it is or becomes wasteful to apply all the property to the designated purpose, the charitable trust will not fail but the court will direct application of the property or appropriate portions thereof to a charitable purpose that reasonably approximates the designated purpose.

This is a statement of the doctrine of cy pres. Unlike equitable deviation, cy pres only applies to charitable trusts. It applies where the settlor (donor) evidenced a general intent to benefit charity and thus prevents a reversion to the settlor or the settlor's heirs. It has been applied by California courts. E.g., O'Hara v. Grand Lodge Independent Order of Good Templars of California of California, supra. However, prior to 2002, the Restatement rule did not provide that cy pres could be applied when it becomes wasteful to apply the property to a particular purpose, and there is no certainty that California courts will so extend the cy pres doctrine.

Section 9143(b) of the California Corporations Code provides a statutory form of cy pres that is applicable to California nonprofit religious corporations that the directors or members of such a corporation to change the purposes of a gift under certain circumstances including when "the stated purpose for which the property was contributed is no longer in accord with the policies or best interests of the corporation."

VI. RESTRICTIONS IN GIFT INSTRUMENTS

Attorneys for donors and donees should discuss with their clients their particular goals and how these can best be achieved. Attorneys should also consider and discuss the concerns of the other party.

Donors must decide what restrictions, if any, they desire to place on gifts. Donees must decide whether they should accept gifts subject to such restrictions. There may be negotiations between parties about the restrictions. Once the parties have decided on the restrictions, the attorneys must draft agreements to effect these restrictions.

If the donor is to be given recognition for his or her gift, what form will that recognition take? If this is important to the donor, the agreement should set forth the details of the recognition and how that recognition is to compare with recognition of other gifts.

If there is a restriction, how long will it last? For example, if a building is to be named after a donor, what happens if the building is demolished?

If the donor desires to be able to enforce restrictions, a gift instrument should include a gift over and/or a provision granting standing to sue.

From the point of view of the charities, it would be preferable to persuade a donor to include in a gift instrument a provision broader than cy pres but this may be contrary to what the donor desires. Attorneys for donors should be wary of statements in gift agreements such as that gifts will be subject to the gift policies of the donee. Even if present gift policies are acceptable to a donor, the policies could change.

Charities should also consider other provisions to be included in gift policies such as removal of a name where it could cause harm to the charity. (The Madoff School of Business!) Such policies should be incorporated into gift instruments.

Perpetuity is a long time so, even the most focused donor should be encouraged to consider flexibility.

Consideration should be established under California law, and both the gift instrument and the actual facts should recite and support this consideration.

Where a condition (such as name recognition) is important this should not only be detailed, but it should also be stated that it is a sine qua non to the gift to protect against assertions of substantial reliance.

Where the gifted amount could grow in size (e.g. the Buck gift) and the donor desires to restrict the gift regardless of the amount, it should be so stated.

VII. CASES AND CONTROVERSIES OF NOTE

A. Stock v. Augsberg College.

Elroy Stock graduated from Augsberg College and became a frequent contributor to the College. In 1986 he donated $500,000, and the College in return agreed to construct a new wing to an existing building to be named in honor of Stock. In 1988, a news story revealed that for many years Stock had been secretly mailing anonymous letters to families of mixed race and religion denouncing mixed marriages. Promptly following publication of this story the College told Stock that the wing would not be named after him. In 2000, Stock sued the College for breach of contract and misrepresentation. The trial court dismissed the suit because it was filed after the statute of limitations had run on a breach of contract claim and found that there had been no misrepresentations. The Court of Appeals affirmed and gratuitously added that, had the statute not run, the College would either have had to name the wing after Stock or return the $500,000.

B. Confederate Memorial Hall at Vanderbilt University

In 1933, Peabody College, a predecessor-in-interest to Vanderbilt University, agreed that, in return for a gift of $50,000 from the Tennessee United Daughters of the Confederacy ("TUDC"), a dormitory would be built and named "Confederate Memorial Hall." This name was inscribed in stone over the entrance of the building. In 2002, Vanderbilt announced that the inscribed name would be changed to "Memorial Hall." TUDC sued for declaratory judgment, specific performance, and damages. Both parties moved for summary judgment which was granted by the trial court in favor of Vanderbilt on the grounds that it would be "impractical and unduly burdensome for Vanderbilt to continue to perform that part of the contract pertaining to the maintenance of the name 'Confederate' on the building and at the same time pursue its

academic purpose of obtaining a racially diverse faculty and student body." On appeal this decision was reversed.

The court of appeals found that there was a contract between TUDC and Peabody College to maintain the name, that this obligation could be reasonably inferred to be applicable for the life of the building, that maintaining the name for over 70 years was thus not substantial performance, and that the donor's remedy where a donee fails or ceases to comply with the condition of a gift is recovery of the gift. The court concluded that such recovery would be $50,000 adjusted for inflation since 1933 by reference to Department of Labor consumer price index. A significant amount! Vanderbilt did not appeal and did not change the name of the building.

C. Avery Fisher Hall

Avery Fisher had donated funds to construct a hall for concerts by the New York Philharmonic Orchestra which named the concert hall after him. In preparing to build a new concert hall, Lincoln Center's plans to name the new concert hall after a new donor were made known. Members of the Fisher family threatened a lawsuit. The matter was resolved by allowing interior portions to be renamed but the new building had to be named Avery Fisher Hall.

D. Robertson v. Princeton University.

In 1961, the Robertsons contributed $35 million to Princeton University to fund a school of public and international affairs. Subsequently, the Robertson Foundation provided additional funds to support that school. In 2002, heirs of the Robertsons filed suit claiming that Princeton had failed to fulfill the donor's goals. Princeton allegedly incurred $40 million in legal fees in defending the suit and in addition settled the suit by transferring $40 million plus interest to a

Robertson family foundation to cover costs of the lawsuit and $50 million to create a new foundation to fulfill the Robertsons' original purpose.

E. The Buck Trust

Mrs. Beryl Buck died on May 30, 1975 and left the remainder of her estate in trust to be "held and used for exclusively non-profit charitable, religious or educational purposes in providing care for the needy in Maria County, California, and for the non-profit charitable, religious or educational purposes in that county." The San Francisco Foundation was the named trustee of the trust. At the time of her death, Mrs. Buck's estate was worth approximately $12,000,000, but it increased in value to above $400,000,000. In 1984, the Foundation brought an action in cy pres requesting that the court find it "impractical" to continue to limit distributions solely to charitable recipients in Marin County because it was inefficient or ineffective to do so considering the charitable needs and uses in Marin County, one of the most prosperous counties in the United States. However, the Foundation was not able to contend that there were not sufficient charitable needs to absorb the annual income distributions of the Buck Trust. Not surprisingly, the trial court found that, under the circumstances, cy pres was inapplicable. Rather than appeal, the matter was settled by resignation of the San Francisco Foundation in favor of appointment of a newly created Marin County Foundation. In light of the historical application of cy pres in California, the outcome in the Buck litigation was not unexpected. Moreover, even if the California courts had adopted the position of the Third Edition of the Restatement of Trusts that cy pres will apply to prevent wastefulness, it is unlikely that the outcome would have been different.

F. **Barnes Collection.**

This matter has received a great deal of publicity and is the subject of a recent documentary film, The Art of Theft. A collector, Albert Barnes, had created an outstanding and extremely valuable art collection that was housed in a small museum located near Philadelphia, Pennsylvania. The museum and the collection were held by a charitable foundation subject to the condition that no part of the collection be sold, lent or moved from or within its location. The foundation expended all its funds so that it had no money to maintain the collection or operate the museum. Applying the doctrine of cy pres, a court allowed the collection to be moved to a new museum facility in Philadelphia which was funded by the State of Pennsylvania and three local foundations. Could this have been prevented?