

Dilemma of Contingent Gifts

by Rita A. Fuerst

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The most common and widely used definition of gift is the one used by the Internal Revenue Service. That definition is used because it forms the base on which most contributors and charitable and philanthropic organizations negotiate gift agreements that provide a charitable federal income tax deduction.

The Internal Revenue Service qualifies a payment as a gift based on its *intent, qualified recipient, greater good, and economic return*:

1. *Intent*. The contributor must intend the payment to be a gift. Discussions about determining intent have led to an objective test adopted by the U.S. Supreme Court: "The *sine qua non* of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return." *United States v. American Bar Endowment*.

2. *Qualified recipient*. The recipient organization must be qualified under section 170 to receive contributions.

3. *Greater good*. Any benefit the contributor receives through a gift must be outweighed by the greater good that society receives through the gift. For example, naming a library after the contributor confers special recognition on the contributor, but the contributor may not benefit to a greater extent than the service that the library provides to the community.

4. *Economic return*. Contributors may not receive items of substantial economic value in return for gifts, although the Internal Revenue Service does allow nominal acknowledgment items. Internal Revenue Service Publications 526, *Charitable Contributions*, and 1391, *Deductibility of Payments Made to Charities Conducting Fund-Raising Events*.

Charitable and Philanthropic Gifts

In addition to the Internal Revenue Service definition, there is a basic, legal definition of a gift:



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Inter vivos and causa mortis. A gift must take immediate effect. If given during the lifetime of the contributor, it is called an *inter vivos* gift. If given pursuant to a will or testament, the gift is *causa mortis*.

Provisions set forth in wills are not immediately effective and are not gifts. These provisions are revocable at the discretion of the contributor, and the charitable and philanthropic organization may not take action nor rely upon these provisions as future gifts.

Characteristics

A gift has three legal characteristics: intent, delivery, and acceptance. A transaction must meet all three characteristics to be a gift. Copilevitz, *The Potential Dilemma of Contingent Gifts*.

Intent. This requirement takes several forms. The contributor must have the mental capacity to make a gift. The contributor must be able to understand the nature of the transaction and its effects on the recipient organization as well as its effects on the contributor's financial situation. Minors and people with diminished capacity, by definition, lack the mental capacity to form the requisite intent.

A competent adult also may lack the necessary intent to make a gift if the contributor's free will is overcome through fraud, undue influence, or duress. Fraud is determined on a case-by-case basis; misrepresentation as to purpose or charitable activities of an organization are two examples of *bages of fraud* that could negate a contributor's intent.

Courts have found intent lacking because a recipient organization exerted undue influence over a contributor. In some cases, courts have found that the recipient organization abused a relationship of trust it had with the contributor. Such relationships of trust, or *confidential* relationships, exist in any circumstance when the recipient organization has the power and means to take advantage of the contributor. Attorney-client, priest-penitent, and doctor-patient are three classic examples of confidential relationships. Organization-contributor relationships can have these same characteristics.

In Massachusetts, an heiress contributed more than \$5 million to her church. The court found the church's pastor held such sway over her will that the gift was invalid. She lacked the free will and, thus, the intent to make a gift. *In re: The Bible Speaks*.

The contributor must intend to make a full and complete surrender of title of the property to the recipient organization for no consideration. If the contributor intended to receive an item of value, a consideration, in return, the transaction is not a gift. For example, a person contributes \$15,000 to a college and in return receives a \$10,000 discount on tuition. The full \$15,000 paid is not a gift because of the tuition discount, or quid pro quo, received. Only \$5,000 of the transaction is a gift to the school.

Also, the transaction is not a gift if it is a disguised loan rather than an immediate, irrevocable transfer. *United States v. American Bar Endowment* established a two-part test for payments with such a dual character. First, the payment is deductible as a charitable gift only if and to the extent it exceeds the fair market value of the benefit received. Second, the excess payment must be made with the *intent of making a gift*.

Delivery. The gift, or property of the transaction, must be delivered to the recipient organization. *Delivery* means that everything possible has been done to complete the transfer of property. Such delivery can be actual, constructive, or symbolic. The delivery may even be to a third party whose duty, in turn, is to transfer the property to the recipient organization. *In re: Estate of Wilson*.

An example of a completed gift is a signed check mailed by the contributor to the charitable and philanthropic organization. The contributor intended to make the contribution, nothing remains to be done to transfer the money to the recipient organization, and the post office delivered the check to the recipient organization. This gift is irrevocable. Should the contributor cancel the check, the charitable and philanthropic organization may sue to enforce the contribution.

An example of an unenforceable, uncompleted gift, a *mere promise to pay*, is a pledge to contribute property or a sum of money. The contributor makes a pledge to contribute. This satisfies the intention requirement. The pledge, however, is not a gift because neither of the other two conditions — delivery or acceptance — has been met. The contributor can still have a change of heart and mind.

A majority of states allow charitable and philanthropic organizations to enforce charitable pledges only when they

have shown reliance on the pledges through evidence of some action. This reliance is protected under promissory estoppel and prevents contributors from renegeing. In addition, a minority of states, based on public policy, allows charitable and philanthropic organizations to enforce charitable pledges even absent reliance. *Salsbury v. Northeastern Bell Tel. Co.*; Lord, *Williston on Contracts*.

For example, Richard H. Barclay pledged \$1 million to the University of California at Irvine toward the construction of a theater. The university planned to honor Barclay for this gift by naming the theater for him. Construction began and Barclay paid \$400,000 of his pledge, but he died before the entire pledge was paid.

His widow said her late husband had suffered financial setbacks, and she could afford to pay only \$250,000 of the \$600,000 due. The university sued and won a judgment for the total remaining \$600,000. A lawyer for the Barclay estate stated: "Contributors should treat [charitable pledges] with all the seriousness of a binding contract, realizing that no matter how their circumstances change in the future, the organization will have the right to sue them to collect on the pledge." Murawski, *Cal. Court Rules Contributor's Widow Must Honor \$1-Million Pledge for University Theater*.

Acceptance. The third characteristic of a gift is acceptance by the recipient organization. Acceptance can be expressed through a written acknowledgment taking title, or it can be implied, based on the behavior of the recipient organization.

Conditional Gifts

Contributors often express desires to charitable and philanthropic organizations as to how to spend their gifts. Mere desires are not legally enforceable, but contributors can impose conditions on gifts. A condition on a gift can be expressed or can arise by implication if contributions are solicited for a certain purpose by the recipient organization. (C.J.S. *Gifts* section 36.)

Desire versus Legal Condition

Contributors may impose conditions on valid gifts as long as the conditions maintain the validity of the three gift characteristics. The important question is, When do contributors' desires become conditions?

An enforceable condition must be bargained for and obtained in exchange for the contribution. The language used must reflect this bargaining for the condition to be enforceable.

Emory University differed with a contributor over the issue of desire versus condition. The contributor gave to a scholarship fund intended for graduates of a certain high school who were music or medical majors. Emory gave the scholarships to four different students from the specified high school who had medical majors. The contributor demanded the return of the gift with interest and claimed that the scholarships were not distributed exactly as desired. The court, however, found that the discussions about the distribution of the scholarship fund did not rise to the level of

conditions because there was no indication the contributor bargained to contribute the scholarship fund in return for Emory's promise to act in a certain way. The gift was held to be an unconditional gift. *Hawes v. Emory Univ.*

Yale recently returned a \$20 million contribution because it did not want to satisfy the conditions imposed by the contributor, namely right of approval over the hiring of professors in the new Western Civilization program to be created with the gift. If the case had been litigated, the question would have been whether or not these conditions were bargained for. A university returning a gift of this magnitude is not unprecedented. The University of Utah once returned a \$15 million gift because it did not want to name its medical school for the contributor. Mercer, *The Chronicle of Higher Education*.

In the case of *Frame v. Shreveport Anti-Tuberculosis League*, a contributor gave 55 acres of land to be used for a tuberculosis sanitarium or other equally charitable purpose. The state used the land for the sanitarium for more than 50 years and then converted the sanitarium to a treatment facility for alcoholics after tuberculosis was controlled. The heirs of the contributor sued for the return of the land, claiming (1) the new charitable purpose did not meet the original condition; (2) the alcohol treatment facility occupied only a portion of the land, and the use of the rest of the land did not meet the condition of the gift; and (3) the period of 16 months during which the facility was being converted to the new use was unreasonable and, therefore, caused the property to revert to the heirs. The heirs lost on all three arguments.

The court held that (1) the new purpose did meet the original condition; (2) all the property need not be used for the charitable purpose for the state to retain title; and (3) 16 months was not an unreasonable amount of time for conversion. Courts generally give charitable and philanthropic organizations wide latitude in fulfilling conditions.

Gifts will be regarded as unconditional unless it is clear that the contributor bargained for a certain action by the recipient organization. For example, the contributor may make the contribution only if the funds are to be used for a stated purpose, such as a scholarship fund for music students. Conditions that are clearly bargained for, such as this one, will be enforced.

Permissible Conditions

Conditions consistent with the delivery of title to recipient organizations can be legally enforceable if bargained for. Contributors may impose conditions they desire as long as they do not contain anything contrary to law or good morals.

Two examples of conditions that have been upheld: the recipient organization was required to support the contributor until death and pay for the contributor's burial; in the case of a gift conditioned on other gifts, the recipient organization was required to raise a specified amount of gifts in addition to the contributor's gift. C.J.S. *Gifts* section 36.

The contributor can, as well, transfer fewer than all the ownership rights to a piece of property. In legal terms, all the rights to a piece of property are called a *fee simple*; thus,

contributors may transfer less than a fee simple. Contributors can transfer property and reserve the rights to the property during their lifetimes.

Control of Gifts

By definition, gifts are irrevocable and immediate. A contributor cannot take a gift back; nor can the recipient organization, once it has accepted the gift, decide not to honor a bargained-for condition. In certain circumstances, however, a court will take control of the property and revoke the gift.

Fraud by Recipient Organization

If the recipient organization obtained the gift through fraud, it is revocable. The contributor can seek the return of the gift. The elements of fraud are a representation, its falsity, its materiality, the speaker's knowledge of its falsity, and the hearer's reliance on its truth and consequent damage.

Fraud by Contributor

A 1995 United States appellate opinion arising in Illinois held that some religious organizations had to return more than \$500,000 based on the state's fraudulent conveyance act. *Scholes v. Lehmann*.

Apparently, the gifts these religious organizations accepted were earned through the contributor's fraudulent activities. This decision set a precedent for nonprofit organizations needing to know how the gift contributed was earned. This affects how charitable and philanthropic organizations conduct their charitable solicitation and fundraising. The magnitude of this decision is as yet uncertain.

This decision could be overturned judicially, or the Illinois legislature could amend the fraudulent conveyance act to include an exception for charitable contributions.

Change of Charitable Purpose

Charitable and philanthropic organizations are required to use gifts to further the charitable purposes for which they were organized. Contributions cannot be used for other purposes or for the benefit of directors or trustees, officers, or other private persons. Directors and trustees of charitable and philanthropic organizations face liability if gifts are misused or misapplied.

Circumstances do arise in which it is impossible for a gift to be used to further a particular purpose. The cure of a major disease, for example, could make research into the cause of the disease useless. Yet the charitable and philanthropic organization may not have invested all contributions in the research through which the cure was discovered.

Two legal doctrines protect recipient organizations' actions when circumstances make contributions impossible to use for a particular purpose. They are *cy pres*, Latin for "as nearly as may be," and deviation. *Cy pres* is applied when it has become impossible for the recipient organization to use the contribution beneficially and allows the recipient organization to apply the contribution to a similar purpose. Deviation allows the recipient organization to depart from the terms of a trust when compliance is impossible or illegal

