FEATURE:
PHILANTHROPY

By **Conrad Teitell, Rachel B.G. Sherman** & **Katherine C. Gent**

# Quid Pro Quo and Fundraising Events

Not following the charitable gift QPQ rules means trouble for charities and donors

Last month, we discussed various quid pro quo (QPQ) charitable gifts. Now, we'll focus on the QPQ rules applicable to charitable fundraising events and other QPQ concerns, including how charities and donors can benefit and avoid the Internal Revenue Service's ire.

In advising clients, consider this from Clifford W. Ashley's 619-page book, *The Ashley Book of Knots.* What Ashley says about knots applies to this article's topic:

> A knot is never 'nearly right'; it is either exactly right or it is hopelessly wrong, one or the other; there is nothing in between. This is not the impossibly high standard of the idealist, it is a mere fact for the realist to face.[1]

**Lesson:** Follow the Internal Revenue Code, IRS regulations and other requirements to the letter. Close isn't good enough for QPQ charitable gifts. The IRS and the courts don't ignore foot faults. And, there aren't mulligans[2]—second chances. See "It Adds Up," p. 15.

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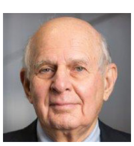
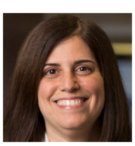
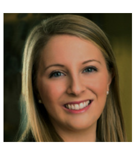

## A Persistent Problem

Advisors who ignore tax history are bound to consult their malpractice carrier. The IRS has been concerned about QPQ gifts for years. The IRS' guidelines in Revenue Ruling 67-246 on the deductibility of admission payments for fundraising events (such as charity balls, bazaars, banquets, shows and athletic events) still apply today. In that ruling, the IRS stated that guidelines were needed because "the public has been erroneously advised in advertisements or solicitations by sponsors that the entire amounts paid for tickets or other privileges in connection with fund-raising affairs for charity are deductible." Donors were also "misled by questionable solicitation practices which make it appear from the wording of the solicitation that taxpayer's payment is a 'contribution,' whereas the payment solicited is simply the purchase price of an item offered for sale by the organization."[3]

Legislation in 1987 further cracked down on misleading and erroneous solicitations by charities. That legislation required exempt organizations that weren't qualified to receive deductible contributions, for example, social welfare organizations, labor unions, trade associations, social clubs and the like, to disclose that fact in fundraising solicitations.[4]

The IRS' Special Emphasis Program asked charities for help in informing contributors more accurately about the deductibility of contributions made in connection with fundraising events.[5] Phase I was strictly educational: a rehash of Rev. Rul. 67-246, a Fundraising Hotline to help charities place a value on donor incentives and safe harbor guidelines for donor incentives. The IRS entered the second phase of its Special Emphasis Program in 1990: a long, hard look at charities' fundraising practices.

Under Phase II, charities faced examination by the IRS. Its questionnaire (Form 9215) didn't inquire



solely into an organization's raffles, auctions and concerts, but instead, was a roadmap to practically every hot topic affecting tax-exempt organizations. Questions delved into a charity's dealings with professional fundraisers, explored bingo and other games of chance, travel tour arrangements, thrift shops and goods and services given to donors in exchange for charitable contributions. The questionnaire also inquired about procedures for property gifts. The form left room for the IRS agent to assess penalties against the organization being examined.

Donors needn't reduce their charitable deductions when they receive small items or benefits of "insubstantial value."

Phase II included the Charitable Solicitations Compliance Improvement (CSCI) study. That study, in addition to gauging the accuracy of information provided to donors, was designed to determine how much revenue Uncle Sam was losing due to erroneous charitable deductions. An *IRS Manual Supplement* described the CSCI study. After choosing 21 charities or private foundations for scrutiny, the IRS screened their donors. Those whose deductions exceeded an unspecified dollar amount and who received goods or services in return would be minutely examined. Despite the CSCI's avowed purpose, any other irregularities that were uncovered were fair game.

**Appeals court affirms the IRS' hard line.** In 1982, a U.S. circuit court forced a charity to comply with a "John Doe" summons ordering it to produce the names and addresses of its donors.[6] Because 162 out of 162 audited returns showed excessive deductions for property gifts to the charity, the court held that the IRS had a reasonable basis to believe that some of the remaining property donors might also have overvalued their gifts.

**Penalties against charities using false or misleading information when soliciting donations.** Penalties are specified in: IRC Section 6701 (aiding and abetting the understatement of any individual's tax liability); IRC Section 6700 (promoting abusive tax shelters); IRC Section 7206 and IRC Section 7207 (criminal fraud). The cumulative effect of repeated violations could lead the IRS to conclude the organization wasn't operated exclusively for charitable purposes.

## Key Deductibility Rules

Here are some key bullet points:[7]

- Unless an exception applies, a donor can't receive anything of value.
- If a donor gets something in return, the IRS presumes her payment is the purchase price, and no charitable gift was made.
- To get a charitable deduction, it's the donor's burden to establish: (1) the amount paid exceeds the value of the benefits received; and (2) she intended to make a charitable gift of the excess.
- A donor's intention to make a gift sometimes may be inferred from the surrounding circumstances; proof isn't always required.
- But, proof of donative intent may be important when it's unclear whether a payment was made as a purchase or a gift.
- When a charity tells the value of a premium beforehand, the donor can then show she intentionally made a gift by knowingly paying more than fair market value (FMV).
- Bottom line:[8] Only the amount of the payment exceeding FMV of what the donor receives is a charitable gift.

## Determining FMV

To determine the FMV for goods or services generally available in a commercial transaction, the charity must estimate the FMV in good faith using a reasonable methodology. If the estimate isn't made in good faith, it fails to meet the QPQ contribution disclosure requirements.[9]

To determine FMV for goods or services not generally available in a commercial transaction, a charity may make a good faith estimate of value by reference to the FMV of similar or comparable goods or services. Goods or services may be comparable even though they don't have the unique qualities of the goods or services being valued.[10]



## It **Adds** Up

*Why strict rules are needed*

We're not talking chopped liver.[1] In their most recent fiscal years, the 100 largest U.S. charities raised a combined $51.5 billion from private donations.[2] That increased by 5% from last year's statistics and accounts for roughly 12% of the $427.7 billion in total donations received by all of the U.S. charities in 2018.[3] No wonder the Internal Revenue Service and Congress impose strict rules for deducting charitable gifts.

**Endnotes**

1. A common explanation of this expression: Chopped liver was traditionally served as a side dish, not the main course.
2. *www.forbes.com/lists/top-charities/#65e31bfd5f50.*
3. *Ibid.*

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## Procedures to Charities

To help assure donors' contribution deductions, a charity must clearly state: (1) that the charity requests a gift as part of the payment for a fundraising event; (2) the amount of the gift requested—determined in advance the amount attributable to the purchase of admission or other benefits; (3) the amount in the solicitation (and on any ticket, receipt); and (4) that the deductible gift is the donor's payment less the FMV of what the donor receives. If the payment equals the FMV of what a donor receives, it's not deductible regardless of intention. The fact that the entire amount paid by the donor is used by the organization exclusively for philanthropic purposes isn't relevant to the amount of the donor's deduction.[11]

## Token Benefits

Donors needn't reduce their charitable deductions when they receive small items or benefits of "insubstantial value."[12] The IRS' guidelines and examples create a safe harbor for charities that acknowledge contributions with token items.[13]

Generally, charitable contributions of $250 or more must be substantiated by a written acknowledgment to be deductible.[14] The acknowledgment must include: (1) the amount of any cash contributions or, for non-cash contributions, a description of the property; and (2) a statement of whether the charity provided any goods or services to the donor in return for the gift.

If a charity gives a donor a low cost article within the meaning of IRC Section 513(h)(2) (which states the item can't cost the charity more than $11.20 in 2020) or a "token" item (such as a bookmark, calendar, key chain, mug, T-shirt or poster), the charity's receipt needn't mention the item.[15] For example, a donor contributes $300 to charity and receives a T-shirt worth $5 with the charity's logo. Because the T-shirt is a token item and may be ignored for substantiation purposes, the receipt needn't mention the T-shirt, but it must say that the charity gave the donor nothing in return for the contribution.

A charity can tell a donor that her gift is fully deductible if: (1) the donor's payment is made in response to a "qualified fundraising campaign" in which the charity tells donors how much they can deduct; and (2) the donor receives benefits having an FMV of $112 or 2% of her payment, whichever is less, or the donor gives the charity at least $56 and receives a token item.[16] The token must bear the charity's name or logo and must cost the charity no more than $11.20. These amounts are indexed annually for inflation.

An exception long buried in Revenue Procedure 90-12 bears highlighting: "These guidelines describe a safe harbor; depending on the facts in each case, benefits received in connection with contributions may be 'insubstantial' even if they do not meet these guidelines."

Thus, a donor who gives $1 million and receives an item worth $200 might still be able to deduct the entire payment—even though the IRS' safe harbor test isn't met.

Suppose the token items were donated to the charity and thus cost the charity nothing. The charity must make a reasonable estimate of what the items would have cost had they been purchased. That goes for donated services too.

**Unsolicited freebies are safe too.** Donors who receive unsolicited free items needn't reduce their deductions when they receive unsolicited free, low cost articles as part of a charity's fundraising efforts.[17]

How can an item be both free and low cost? It's free to the donor and low cost to the charity.

**Other exclusions.** Fundraising campaigns must meet two requirements. First, the charity mails or otherwise distributes free, unordered items to patrons.



To meet this requirement, any item received by a patron mustn't have been distributed at the patron's request or with the patron's express consent. Any item distributed must be accompanied by a request for a charitable contribution and by a statement that the patron may retain the item whether or not she makes a contribution. Second, the cost (as opposed to the FMV) of all the items, in the aggregate, distributed by or on behalf of the organization to a single patron in a calendar year is within the limits established for "low cost articles" in Section 513(h)(2).[18]

Even when an excess payment is made, it isn't deductible if the donor only realized that fact after making the payment.

## Avoid Tax Trap

*IRS Publication 526* provides guidance with regard to charitable contributions and deductions on personal income tax returns. The IRS will disallow a charitable deduction for donors who receive a chance to win something as a QPQ. The instructions aren't the law—only the IRS' interpretation of the law, but that's enough to scare us.

**Here's the tax trap.** A donor pays $500 to attend a fundraising banquet. The value of the dinner and entertainment is $100. In that case, the donor may only deduct $400 (the $500 payment minus the $100 QPQ). But, suppose in addition to the meal and the entertainment, a ticket to the event entitles the donor to a chance of winning a car. The IRS has instructed its agents that the donor's charitable deduction would be zero because the purchaser acquires something of value as the result of her purchase—the opportunity to win a prize in addition to the value of the dinner and the entertainment. The IRS doesn't allow a taxpayer to make a computation of her probability of winning a raffle to value her gift to a charitable organization and report such value as an income tax deduction, because there's no statutory or judicial authority that would allow the taxpayer to do so.[19] Thus, it's immaterial how much, if anything, in excess of the value of the meal and entertainment may have been paid. The purchaser may not deduct any part of the purchase price.

**Comment.** A charity planning a raffle or door prize as part of a fundraising banquet should give donors an option to decline participating. That should preserve the charitable deduction for the amount given by the donor minus the value of the meal and the entertainment.

Payments to a charity for raffle tickets aren't deductible as charitable contributions because the donor-purchaser is deemed to have received full consideration by receiving a chance to win a valuable prize.[20]

The test of deductibility isn't whether the right to admission is exercised, but whether the taxpayer accepts or rejects the right.[21] Donors wishing to refuse benefits offered by a charity need affirmatively to refuse to accept rather than simply not use tickets to an event. Checking a box on a charity-provided form is one way to reject a benefit offered by a charity. A donor properly rejecting a charity-offered benefit may claim a deduction for the full amount of the gift, and the charity's acknowledgment needn't reflect the value of the rejected benefit.[22]

## Dual Character Payment

When a donor receives a benefit from a charity, but the amount of the donor's payment is out of proportion to the benefit, the payment has a "dual character." This means that it's part a non-deductible purchase and part a deductible contribution.[23]

**Two-part test for deductibility.** A dual character payment is deductible: (1) to the extent it exceeds the FMV of the benefit received; and (2) if the donor intends the excess payment to be a gift.

Even when an excess payment is made, it isn't deductible if the donor only realized that fact after making the payment. When a donor receives a privilege or benefit in return for her payment, the presumption is the payment isn't a gift. The burden is on the donor to prove the contribution isn't the purchase price of the benefit and that part of the payment does, in fact, qualify as a contribution.[24] None of the payment is deductible unless the donor can overcome the presumption that it doesn't exceed the value of the benefits she expects in



return. The donor must also show that she intended to make a gift of any excess when she made the payment. The 2-part test for deductibility comes into play in several of the cases relating to a founder's or sustainer's gift to a non-profit retirement housing community.

**Fundraising by non-profit retirement housing communities.** The IRS routinely denies charitable deductions for transfers to retirement homes and communities, often called "founders' gifts" or "sustainers' gifts," when the donations are made at or near the time of entry.[25]

Rev. Rul. 72-506 illustrates the IRS' unwillingness to allow a deduction for sustainers' gifts. In that ruling, each applicant to the retirement home was asked to make a gift. The size depended on the apartment the applicant wanted to occupy. The IRS ruled a deductible charitable gift must be a voluntary transfer with no expectation of securing a commensurate benefit in return. If the QPQ benefits the donor can reasonably expect to obtain are sufficiently substantial to provide a QPQ, no charitable deduction is allowable. Similarly, the IRS doesn't allow taxpayers to deduct founders' gifts made to retirement homes if those payments are made with the expectation of a return benefit, such as admission to the retirement home.[26]

**But, here's a rare exception.** In *Dowell v. United States,* the donor and her husband were accepted as residents of a retirement home affiliated with the Oral Roberts Evangelistic Association. Two weeks later, the donor gave a $22,500 check to the Association, and the couple claimed a $22,500 charitable deduction, which the IRS disallowed. At trial, the donor testified that she didn't promise to make a sponsorship gift, nor was the gift made to induce the home to admit the couple as residents. The home's representative testified that: (1) when the donor applied for admission, the home didn't have a policy of advising applicants that a sponsorship gift was necessary; and (2) when applications were considered, the admissions committee didn't know whether a sponsorship gift had been made. The district court held that the couple's deduction was proper.[27]

**Caution.** It's a question of fact as to whether an individual's payment to a retirement home is a charitable gift made out of "detached and disinterested generosity" or a QPQ for admission. A donor seeking to deduct payments to a retirement home (or its affiliate) at or close to admission surely faces litigation with the IRS. But, she's entitled to her decade in court.

## Fundraising by Religious Institutions

For many years, the IRS allowed deductions for fixed donations made in relation to religious services: bequests for saying masses, pew rents, building fund assessments and periodic dues.[28] The IRS viewed the donor as merely an incidental beneficiary; the primary beneficiaries were members of the faith and the general public.

But, in 1989, the U.S. Supreme Court in *Hernandez v. Commissioner* held that fees paid to the Church of Scientology were nondeductible QPQ payments, not charitable contributions.[29] Although the payments were made for religious benefits, the Court's decision involved issues of broad interest to all charities that offer benefits—no matter how intangible—to donors. A subsequent suit, *George H. Powell v. United States*, threatened to make the IRS re-examine its disparate treatment of Scientology and more traditional religions.

> The IRS and the courts can go either way on the slippery issue of a donor's subjective motivation.

In *Powell*, a Scientologist claimed that the IRS had unconstitutionally singled out his church for discrimination, alleging that members of other churches were allowed to deduct similar payments.[30] The district court dismissed his case, but the U.S. Court of Appeals for the Eleventh Circuit reinstated the suit. The plaintiff wasn't trying to establish that his transfers were charitable gifts. Rather, he claimed a refund because the IRS let members of other religions deduct fixed QPQ payments. The case was remanded to the district court based on the fact that administrative inconsistency is a valid claim on which relief can be granted.[31]

Meanwhile, in 1991, two IRS Technical Advice Memoranda reaffirmed Rev. Rul. 78-366 regarding deductions for fixed donations made in relation to religious services, stating that a bequest was deductible even though it required the donee church



to say masses for the donor's family. In TAM 9119006 (May 10, 1991) and TAM 9145005 (Nov. 11, 1991), the IRS noted that the donee church had a policy of honoring all requests to say masses for the deceased, stipend or no. The bequest becomes part of the church's general funds, rather than going to any individual member of the religious order. As far as the IRS was concerned, it was an outright charitable bequest.

The QPQ rules on religious benefits apparently are an attempt to forestall denial of charitable deductions for QPQ religious gifts by providing that there isn't a QPQ.

## Earmarked Gifts

The QPQ rules also apply when a donor expects that benefits made to a charitable organization will flow to any third party in whom she has a significant personal interest. The IRS and the courts can go either way on the slippery issue of a donor's subjective motivation. Does she intend to benefit an individual or the charitable organization?

The IRS won't allow a deduction for gifts earmarked for the benefit of a specific individual. For instance, if an individual chooses to sponsor a student at a religious school and makes tuition payments to the school designed to benefit a particular student, the gift won't be deductible. In Rev. Rul. 79-81, the IRS said the taxpayer wasn't allowed a deduction for such payments, even though the payments were to be used at the school's discretion. The IRS denied deductions because each sponsor intended to benefit a particular individual and not the school as a whole.

In Rev. Rul. 68-484, the IRS permitted deductions for corporate scholarship grants to colleges from which the donor recruited many of its employees. The colleges selected the scholarship recipients, and neither the donor nor the recipients made employment commitments. The IRS found that the corporation intended to benefit the charitable organization, not the individual recipients.

**University scholarship fund.** In Private Letter Ruling 9338014 (Sept. 24, 1993), the donor established a university scholarship fund to honor his relatives. Needy students had preference to receive aid, but recipients could include the donor's family. A scholarship committee had the power to select recipients. The IRS ruled that the donor's contributions qualified for income and estate tax charitable deductions. Although the class of permissible recipients may include the donor's family, the selection committee wasn't required to give them preference. The IRS conditioned its ruling on the absence of an understanding between the parties that the donor's relatives would be given preference in the selection of scholarship recipients.[32] But, note that PLRs aren't authority—except for the recipient.

**Gift tax consequences.** If a gift is held to be earmarked for an individual, not only does the donor lose the income tax charitable deduction but also could be subject to federal (and possibly state) gift tax on a transfer to that individual (assuming it exceeds the $15,000 per donee annual exclusion). Not a worry for most taxpayers, except those who are concerned about diminishing their over $11.58 million gift and estate tax exemption. But, don't overlook any state transfer taxes.

The words of Justice Oliver Wendell Holmes, Jr., in *United States v. Wurzbach*,[33] are instructive in concluding this article:

> Whenever the law draws a line there will be cases very near each other on opposite sides. The precise course of the line may be uncertain, but no one can come near it without knowing that he does so, if he thinks.

## Endnotes

1. *See* Clifford W. Ashley, *The Ashley Book of Knots* (1993), at p. 18. Some say knots predate fire and the wheel. Without knots and rope, work cloth couldn't have been woven nor could early bridges have been built (some are still built with rope and knots). Although knots are mainly associated with boats and ships, today, knots are also used by surgeons (for humans and trees) and climbers—to name just a few.
2. One etymological source has the term named after Canadian-born golf amateur David Bernard Mulligan. Another source has it named after John A. "Buddy" Mulligan, a locker room attendant in the 1930s at the Essex Falls Country Club in New Jersey. We hope we've gotten the derivation right. If not, we'll do it over again.
3. Revenue Ruling 67-246.
4. Internal Revenue Code Section 6113.
5. *www.irs.gov/pub/irs-tege/eotopicm89.pdf.*
6. *United States v. Brigham Young University*, 679 F.2d 1345 (10th Cir. 1982).
7. A Google search for the origin and then prevalence of the term "bulletpoints" proves unhelpful. But, here's the best we found on English Language &

Usage: "For cryin' out loud. You have a list. It's a little sloppy so you can't tell where each item in the list begins, so you add a dash or a dot in front of each item. Centuries later (after bullets are invented) someone decides to call the dash/dot a 'bullet.' A century or two after, the department of redundancy adds 'point.'" *See english.stackexchange.com/questions/214741/what-is-the-origin-of-the-phrase-bullet-points.*

8. Originally (and to this day) used in the bottom line of all the figures in a financial statement to show profit or loss. Today, it also means the final result of anything—financial or not.
9. Treasury Regulations Section 1.6115-1(a)(1).
10. Treas. Regs. Section 1.6115-1 (a)(2)
11. *See supra* note 3.
12. Revenue Procedure 90-12.
13. *See also IRS Publication 1771*, "Charitable Contributions—Substantiation and Disclosure Requirements," *www.irs.gov/pub/irs-pdf/p1771.pdf.*
14. IRC Section 170(f)(8).
15. Treas. Regs. Section 1.170A-13(f)(8)(i)(a).
16. Rev. Proc. 2019-44.
17. Treas. Regs. Section 1.170A-13(f)(8)(i)(A).
18. *See supra* note 3.
19. Conrad Teitell, *Teitell's Outright Charitable Gifts*, at p. 78.
20. *See Goldman v. Commissioner*, 46 T.C. 136 (1966), *aff'g* 388 F.2d 476 (6th Cir. 1967).
21. *See supra* note 3.
22. *Ibid.*
23. *United States v. American Bar Endowment*, 477 U.S. 105 (1986).
24. *See supra* note 3.
25. *See* Private Letter Ruling 7929042 (April 18, 1979); PLR 7939125 (June 29, 1979); PLR 8034090 (May 29, 1980); PLR 8038064 (June 25, 1980); PLR 8051100 (Sept. 25, 1980).
26. *See Sedam v. United States*, 518 F.2d 242 (7th Cir. 1975).
27. *Dowell v. United States*, 553 F.2d 1233 (1977).
28. Rev. Rul. 70-47; Rev. Rul. 78-366.
29. *Hernandez v. Comm'r, consolidated with Graham*, 490 U.S. 680 (1989).
30. *George H. Powell v. United States*, 1990 WL 279509 (S.D. Fla 1990).
31. *George H. Powell v. United States*, 945 F.2d 374 (11th Cir. 1991).
32. PLR 9631004 (Aug. 2, 1996).
33. *United States v. Wurzbach*, 280 U.S. 396, 399 (1930).