



RODRIGUEZ,  
HORII, CHOI &  
CAFFERATA LLP

## ANATOMY OF A GIFT AGREEMENT

By Reynolds T. Cafferata

The body of a gift agreement includes many parts including the parties, payment terms, purposes of the gift, provisions for management of the gift, and terms for enforcement of the promised gift. Problems for the donor or the charity can manifest themselves in any part of the agreement. A charitable gift planner needs to be familiar with each part of the anatomy of the gift agreement and the issues that may appear in each part.

### **Parties**

The parties to a gift agreement typically are the donor and the charity. Identifying the donor and the recipient of the gift seems simple in concept, but a number of problems can develop right at the beginning of the gift agreement.

#### Spouses

If donor is an individual, the charity should know whether or not the donor is married. If the donor is married, then both spouses should sign the gift agreement in most circumstances. In many states, if one spouse makes a gift of community property or marital property without the consent of the other spouse, the non-consenting spouse will have a right to either void the entire gift or void one-half of the gift depending on the circumstances.<sup>1</sup> Generally, if the gift is discovered while both spouses are living, the entire gift is subject to being voided. If the gift is discovered after the death of the spouse making the gift, the non-consenting spouse can recover one-half of the value of the gift. If the gift agreement requires payments over time, and the signing spouse dies or becomes incapacitated, the non-signing spouse may not be willing to make the

---

<sup>1</sup> See Uniform Marital Property Act §6.

remaining payments due under the gift agreement. Finally, getting both spouses involved in the gift is a great stewardship opportunity. Often times it is the surviving spouse that makes the most significant charitable gifts, so the charity will want to have a connection with both of the spouses.

There may be some situations where the donor has substantial separate property that is being used to fund the gift and may not wish to involve the non-donor spouse in the process. If the charity has confirmed that the donor is using his or her separate property, then the charity can proceed with only the donor spouse's signature. Even in this case, however, the charity should do what is possible to include the other spouse in the gift.

### Funds and Foundations

Many philanthropists have private foundations, donor advised funds, or other types of charitable funds that they can use to fund a charitable gift. It is important that the donor correctly identify the source of payment of a binding pledge agreement. If the donor is an individual who is personally legally obligated to make payments under the gift agreement, it is a prohibited act of self-dealing for the donor's private foundation to make a payment due under the gift agreement.<sup>2</sup> A donor advised fund may satisfy a donor's legally binding obligation under a gift agreement under certain circumstances.<sup>3</sup> The individual donor and his or her private foundation or donor advised fund generally cannot be jointly legally obligated for the same sums under an enforceable gift agreement. Joint legal obligations between donors and their donor advised funds or private foundations generally result in self-dealing transactions or other prohibited transactions.<sup>4</sup> If the gift agreement is a non-binding letter of intent, then it is generally possible for the donor and a donor-advised fund or private foundation to be parties to the agreement or to make payments on the donor's behalf because the donor is not relieved of a legal obligation when a payment is made to the charity. A charity probably

---

<sup>2</sup> Treasury Reg. § 53.4941(d)-2(f).

<sup>3</sup> Notice 2017-73.

<sup>4</sup> See PLR 201421024.

should have legal counsel review any agreement that has both individuals and related charitable entities as parties to the agreement to be certain it does not create a possible violation of these prohibited transaction rules.

### Businesses and Others

If the gift agreement results in a binding obligation on the donor, if someone other than the donor makes a payment, there may be undesirable tax consequences. As noted above, if a private foundation makes a payment in satisfaction of an enforceable gift agreement of its founder, this is an act of self-dealing. If a corporation makes a payment on an enforceable gift agreement of a shareholder, it could be characterized as a taxable dividend to the shareholder followed by a contribution to the charity. If one individual makes a payment of an enforceable gift agreement of another individual, that is treated as a gift from the individual making the payment to the donor who signed the enforceable gift agreement for gift tax purposes.<sup>5</sup> In this final case, even though it is a gift from the person making the payment to the obligor under the enforceable gift agreement for transfer tax purposes, the person making the payment likely still is entitled to the charitable income tax deduction.<sup>6</sup>

### Authority

If a gift agreement is intended to be a binding obligation, then the person signing the agreement must have authority to enter into the agreement on behalf of the party. An individual generally has authority to enter into an agreement on his or her own behalf if over age of 18 and competent. If the party to the agreement is a corporation, either a for-profit corporation or a private foundation that is incorporated, one or two authorized officers generally need to sign any gift agreement that will be binding on the corporation. If the donor is a trust, one or more of the trustees need to sign the gift agreement. Partnerships generally are bound by the signature of a general partner. A limited

---

<sup>5</sup> Rev.Rul. 81-110, 1981-1 C.B.479.

<sup>6</sup> See Gem 38505.

liability company may be bound by the signature of a manager, an officer, or a member depending upon its structure.

**EXAMPLE:**

This agreement is entered into this \_\_\_\_\_ of 20\_\_\_\_, by and among Jane Smith and Robert Smith (the “Donors”) and The Really Great Charity (the “Charity”).

[BODY OF AGREEMENT]

**Donors:**

\_\_\_\_\_  
Jane Smith

\_\_\_\_\_  
Robert Smith

**Charity:**

The Really Great Charity

By: \_\_\_\_\_

Its: \_\_\_\_\_

**Payments**

A gift agreement should clearly define the amount of the gift and the timing of the payment of the gift. The agreement also should identify the type of property that will be acceptable to satisfy the gift obligation and how gifts other than cash will be valued.

State the gift amount in words and numbers, and double check that words and numbers are consistent.

### Cash Gifts

If the gift will be of a specific dollar amount, the total amount should be set out even if it were paid in installments. If the gift will be made in installments, then the amount of each installment and the date by which it will be paid should be listed in the agreement. Always double check that the total of the listed installments adds up to the total amount of the gift.

### **EXAMPLE:**

The Donors agree to pay Charity One Million Dollars (\$1,000,000.00) as follows:

- Two Hundred Thousand Dollars (\$200,000.00) on or before December 31, 2018;
- Two Hundred Thousand Dollars (\$200,000.00) on or before December 31, 2019;
- Two Hundred Thousand Dollars (\$200,000.00) on or before December 31, 2020;
- Two Hundred Thousand Dollars (\$200,000.00) on or before December 31, 2021; and
- Two Hundred Thousand Dollars (\$200,000.00) on or before December 31, 2022.

### Property Gifts

Many donors will use cash or marketable securities to satisfy the gift agreement. Obviously, it is easy to know the amount to credit for cash payment. With respect to marketable securities, the agreement should provide that the securities will be credited following the IRS deduction valuation rules. Generally that means that a security is valued based on the average of the high and low trading price of the security on the date that it is contributed to the organization. If the payments are to be satisfied only with cash or marketable securities, the gift agreement should include those limitations

so that the donor does not attempt to make the last payment with a prized bobble head collection.

The charity could accept other types of property to satisfy the donor's obligation besides cash and marketable securities. The other types of property that will be acceptable as well as the way that the property will be valued in satisfying the donor's obligation should be spelled out in the agreement. In some instances, the donor and the charity may agree that the obligation is to contribute particular pieces of property to the charity without regard to their value. In that case, the agreement would not state a dollar amount of the gift, but would instead describe the property that is to be given to the charity and the timing of the gift.

If the donor is agreeing to make the gift either in whole or in part upon their death, then the details of the testamentary gift need to be described. The donor may be agreeing that a specific dollar amount will be paid from the estate regardless of its size, or may simply be promising to leave the residue of the estate to the charity, whatever that amount may be. The charity should try to include a time limit for payment of the gifts, such as within six months or nine months of the donor's passing.

If the donor is agreeing to make a testamentary gift to the charity, the charity may want to include language in the document that the donor agrees to give the charity a copy of the will or trust terms setting out the gift. The advantage of this provision is that it gives the charity a basis to follow-up and make sure that the donor has implemented the gift. Even if the donor genuinely desires to make a testamentary gift, the donor can still find lots of reasons to put off meeting with an estate planning attorney. This provision will allow the charity to follow-up with the donor to make sure that the estate plan gets updated to reflect the gift. Some donors, however, may object to the provision. Another problem with the provision is that, if the charity never does obtain the estate planning documents, then the charity is on notice that the donor may not have implemented the gift. If the charity knows that the donor may not have implemented the gift, then the case to enforce the gift agreement based on its reliance on the agreement, discussed below, will be weakened. The court may find that in light

of charity's knowledge that the donor may not have changed the estate plan, it was not reasonable for the charity to rely on the promised gift.

**EXAMPLE:**

Within 90 days after executing this Gift Agreement, Donor will provide to Charity a copy of the page(s) of Donor's estate planning documents that implement the Gift. Should this Gift Agreement not be satisfied in full during Donor's lifetime, Donor's failure to include a specific bequest of the remainder of Gift in Donor's Will or other testamentary documents shall not release Donor's executors, administrators, or other personal representatives from the contractual obligation created by this Gift Agreement.

**Recognition**

If the donor will receive recognition for the gift, the terms of that recognition should be spelled out clearly in the gift agreement. To the extent applicable, the details of signage on buildings, the way the gift will be referred to on websites, and details of public announcements such as press releases should be covered. The agreement should specify the expected duration of the naming, and any circumstances under which the naming would be removed.

Buildings

If the donor is getting recognition on a building, the specific location, type, size and other particulars of the recognition should be described in the gift agreement. To make sure that the donor and the charity are really on the same page with respect to the naming, the charity should attach an exhibit to the gift agreement that is a rendering of how the name will appear on the building in addition to the detailed description in the body of the gift agreement. The gift agreement also should describe other naming rights that will be offered to other donors in the building or space. To avoid any misunderstandings, the description of the other naming opportunities should describe

their relative prominence, and might give the particulars of the location and type size for various levels of naming.

Donors naming physical spaces often want the naming in perpetuity. Perpetuity is a long time, longer than almost anything has existed, and possibly longer than the universe will exist. Accordingly, it is best not to promise donor recognition in perpetuity. Whatever the duration of the recognition, the agreement should address the circumstances that would allow the charity to terminate the recognition early. The first of these is the destruction of the building. How naming is handled in this circumstance may depend in part upon the reason for the destruction and the source of the funds to replace the building. If the building is destroyed by a fire or other catastrophe that is covered by insurance, the charity should be able reconstruct the building with the donor's name going on the replacement building. On the other hand, if the building is demolished because of obsolescence or for other reasons that are not covered by insurance, the charity likely will need to raise donations to replace the building. The donors who fund the new building likely will want to be recognized, and under these circumstances, the charity cannot be obligated to keep the old donor's name on the building.

**EXAMPLE:**

The Donors' generosity will be recognized by Charity by naming the auditorium at Charity's main office the "Jane and Robert Smith Theatre". The naming will be substantially as shown in the rendering attached as Exhibit A. The space will be described as the "Jane and Robert Smith Theatre" on Charity's website and on its publications. Events at the auditorium will be promoted as taking place in the "Jane and Robert Smith Theatre". Other donors' generosity will be recognized on seats, the stage and other parts and equipment of the auditorium. Charity's main office building and other spaces in it will be named for other donors.

If the building on which the recognition resides is destroyed by fire, earthquake, flood, or other casualty, and if Charity is able to rebuild the building with the



proceeds of insurance payments, Donor's name will be placed on the replacement building in substantially the same manner as it appeared in the original building to the extent practicable. On the other hand, if the building is demolished because of obsolescence or other circumstances and is not replaced, or it is not replaced with the proceeds of insurance, Donor's contribution will be acknowledged with a plaque in a prominent location in a replacement building or on the facilities of Charity.

### Programs

Instead of naming a building, the donor may be naming a program or activity of the charity. The duration of the program, possibility of changes or discontinuation of the program, extent to which the name of the program will be reflected in building signage and other material, and any extent to which sub-programs or other activities may be named for other donors all should be addressed in the gift agreement.

### Donor Reputation

A charity may also want to address the charity's right to remove a name if the donor's reputation becomes an embarrassment or inconsistent with the mission of the charity. Enron CEO Ken Lay, and the money manager, Bernie Madoff, both made a number of named gifts to charitable organizations before their unethical business practices came to light. Explaining this provision to a prospective donor may be a bit awkward. Try using a little humor such as "Our lawyers tell us that we have to have the right to take the name down if you end up having to wear an orange jump suit every day." If the donor does not laugh, and starts pushing back on the term, stop the gift negotiations and immediately go sell the stock that you have in whatever company that is run by the donor.

**EXAMPLE:**

Charity reserves the right to remove or modify the recognition of the Donor if necessary to protect the reputation of Charity or to achieve fundraising objectives.

**Fund Restrictions**

If the donor is creating a fund that will be held by the charitable organization, the terms for spending from that fund need to be included in the gift agreement. These terms include whether the fund is endowed and the purposes for which the charity can use the fund.

Endowment

A major term is whether the fund will be an endowed fund, also called a permanently restricted fund. Historically, the charity could spend only the income of an endowed fund which was usually its dividends and interest. Many states have adopted the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”) which allows a charity to spend a prudent amount from an endowed fund each year. A number of factors go into determining what a prudent amount is, but the objective is to draw from the fund annually an amount that supports the charitable program and will preserve the endowed fund in perpetuity to continue supporting the charitable program. There is a presumption that if the charity draws more than 7% of the value of the fund in any one year, the distribution is imprudent. It is important to note that drawing 7% is not presumptively prudent. Many organizations implementing UPMIFA have adopted policies to spend between 3% and 5% of the value of endowed funds. Typically, the value of the fund is determined based on a rolling average of the last three to five years’ values of the fund to smooth out distributions. Under UPMIFA, at times a permanently restricted fund might be drawn down below its contribution amount or historic value. Auditors may view this as invading the endowment unless the gift agreement expressly allows the fund to be drawn below its historic dollar value.

If a fund is to be endowed, the gift agreement should specifically state that the fund is endowed or permanently restricted. The best practices for determining the amount to spend from an endowment have evolved, and likely will continue to evolve. To allow for this evolution over the perpetuity for which the endowed fund is supposed to be held, it is best not to set forth a specific spending rule in the gift agreement. Instead, the gift agreement should state that the fund is an endowed or permanently restricted fund, and that distributions from the fund will be determined in accordance with the endowment spending policy of the charity as it exists from time to time. A charity that drafts its gift agreement in this manner gains two significant advantages. First, the charity will have uniform terms for all of its endowment funds making the investment management of the funds easier. There will not be a series of individual funds all with unique spending rules and unique needs for liquidity. This greatly simplifies the accounting for the funds. In addition, it makes it much easier to pool the funds for investment purposes if they are subject to uniform spending rules. Second, as the organization updates its endowment spending policy based on changing needs and investment conditions, the charity can apply its updated thinking to all of its endowed funds.

**EXAMPLE:**

Charity shall use the Gift to establish the \_\_\_\_\_ Fund ("Fund"), pursuant to the terms of this Agreement and Charity policies adopted and as revised from time to time by the Board of Trustees. The Fund shall be created upon the first transfer of cash or property under this Agreement that Charity receives and accepts from Donor. The Fund shall be classified as a permanently restricted fund, and Charity will spend amounts from the fund in accordance with the endowment spending policy as adopted by Charity from time to time. The balance of the Fund may be reduced below the value of the amounts contributed to the Fund by market losses and by distributions under Charity's spending policy.

### Other Term Restrictions

The donor can create a fund for a particular purpose but not require that it be endowed, allowing the charity to spend any amount of the fund for the specified purpose at any time. Funds for a particular purpose that are not endowed are temporarily restricted funds. If the donor does not want the entire amount of the funds to be spent all at once, but does not want it maintained in perpetuity, then the agreement will need to specifically spell out the amounts charity can spend each year. For example, the charity can spend no more than \$100,000 from the fund each year.

### Purpose Restrictions

When the donor wishes to specify that the fund will be used only for a particular purpose, the charity and the donor should review purpose restrictions carefully to confirm that charity can use the money effectively consistent with the restrictions. Restrictions that will apply to endowed funds must be reviewed in light of the fact that they will in theory apply in perpetuity. Accordingly, use restrictions on endowed funds should be general, flexible and limit the use of the funds to activities that will stay in the core of the organization's mission for a long time period. One way to analyze this is to consider whether if the restricted fund had been created at the inception of the organization it would still be relevant today. For example, an endowed chair for a contracts professor at a law school. If the fund will be endowed or exist for a long period of time, or is restricted to very specific purposes, then the charity should consider and address the possibility that the fund will be too small or too large for the purpose. If a fund is for a very specific project with hard costs such as a construction project, the charity will need to be certain that the gift is sufficient to cover those costs, particularly if the project or at least some aspects of it are being constructed because of donor priorities rather than the charity's priorities. Similarly, if the gift is for very specific project purposes, particularly if they are not of the highest priority for the organization, the charity does not want to find itself forced to spend excessive amounts on non-core activities, particularly if it lacks sufficient funding for core priorities.

Even with the best of planning, specific purposes for a gift may eventually be a problem for a charity. UPMIFA allows the charity to obtain court approval of a change purpose of a fund whose purpose has become unlawful, impracticable, impossible or wasteful. If the donor is still living, the donor can consent to a change in the fund purpose. For maximum flexibility, the charity should include a provision in the gift agreement that allows the governing board to change the purpose of the fund without court approval when necessary.

**EXAMPLE:**

In the event the above purpose of the fund is frustrated, becomes unreasonably burdensome, becomes inconsistent with the charitable objectives of Charity or cannot otherwise be accomplished, the Fund shall be made available as specified by Charity for uses most consistent with the above purpose, and the source of alternative use shall clearly be identified as the “June and Robert Smith Fund”.

**Enforcement**

A basic rule of contract law is that a promise to make a gift is not enforceable.<sup>7</sup> This is true even if the promise is in writing. Some states such as Pennsylvania have enacted statutes to make a written promise to make a gift enforceable.<sup>8</sup> In most jurisdictions, however, a charity will need to add other elements to a gift agreement in order to make it enforceable.

Consideration

The first element that a charity can add to a gift agreement to make it enforceable is a promise by the charity to provide some benefit for the donor. This promise to benefit is called consideration in contract law. The most common form of consideration that a charity provides is naming rights, such as putting the donor’s name

---

<sup>7</sup> Restatement 2d, Contracts § 71.

<sup>8</sup> Penn. Uniform Written Obligations Act.

on a building or program of the charity. The consideration that the charity provides does not need to be of equal economic value to the donor's gift. Contract law uses the term adequate consideration, but largely leaves it up to the parties to determine whether they want to make the exchange described in the contract. Further, even if the consideration does not reduce the donor's deduction under the income tax substantiation rules, it still may be adequate to enforce the contract. The consideration, however, needs to be part of the contract to provide a basis of enforcement. If a charity voluntarily recognizes the donor's generosity after a gift is promised, but the recognition was not part of the agreement to receive the gift, the recognition will not be consideration adequate to enforce the promise to make the gift.

#### Detrimental Reliance

Another circumstance where a promise to make a gift can be enforced is if the person to whom the gift is promised relies on that promise to their detriment.<sup>9</sup> The example in law school contracts class is often that an aunt promises to pay for a Prius for her niece as a graduation gift. She tells the niece to go down to the dealership and purchase the Prius. Relying on the aunt's promise, the niece signs a contract obligating her to pay for the Prius. If the aunt later refuses to make the gift after the niece has relied on the promise to her detriment, the niece can enforce the promised gift. The reliance must be reasonable. So the niece must reasonably believe the aunt has adequate assets to be making a gift of the amount promised, and there must not other factors that would make the reliance on the promise unreasonable such as the aunt having a habit of promising all of her nieces a college graduation car and then reneging on the promise. Finally, the person promising the gift generally needs to be aware that it is likely that the person to whom the gift is promised will rely on it to their detriment. By directing the niece to go down to the car dealership and enter into the contract to buy the car, the aunt should have known that the niece would be legally obligating herself in reliance on the promise.

---

<sup>9</sup> Restatement 2d Contract § 90.

A charitable organization may rely on its donor's promise to make a gift in a manner that will allow the charity to use that reliance to enforce the gift. For example, a donor who makes a promise to make a gift could be obligated to make that gift if the charity proceeds with a construction project in reliance on the promised gift. Other ways that a charity might rely on a donor's promise to its detriment include starting a new program, hiring additional staff, or even naming facilities, precluding putting another name on that facility. The charity's reliance needs to be reasonable, so it cannot be aware of facts that would make it unlikely that the donor would pay, such as the donor not having adequate financial resources to make the gift, or reputation in the community for not following through on charitable gifts. The donor also needs to be aware that the charity will be relying on the pledge. Accordingly, the charity should spell out in the gift agreement what actions it will take in reliance on the donor's promises with as much specificity as possible.

**EXAMPLE:**

Donor acknowledges that Charity is relying upon Donor's promise to make the Gift in planning, scheduling and constructing the East Wing of Charity's administration building.

Some cases also have held that promises by other donors to make gifts that are related to a donor's promise can serve as a basis to enforce a gift.<sup>10</sup> This theory is sometimes combined with other bases for enforcement. For example, the donor is promising to make a gift to campaign to construct a building, and the charity tells the donor that the gift will be announced to other donors to show them how close to the goal that the charity is to induce their gifts to complete reaching the goal.

If the charity wants to be able to enforce the pledge, in addition to the statements regarding consideration, reliance and other donors, the pledge agreement should include language that unequivocally states that it is binding and enforceable against the

---

<sup>10</sup> See "Lack of Consideration as Barring Enforcement of Promise to Make Charitable Contribution of Subscription – Modern Cases" A.L.R. 4<sup>th</sup> 241.

donor. Given the context that the donor is agreeing to transfer something of value to the charity and not receive something of comparable economic value from the charity, it is important to be able to show that the donor was aware in signing the agreement that he or she could be called into court for not honoring the agreement. Such language also will make the decision of the charity to rely on the donor's promise more reasonable. Charities are sometimes reluctant to include this strong language for fear that it will dissuade the donor from signing the agreement. Donor reluctance to sign an enforceable gift agreement is a good reason to consider not using enforceable gift agreement as is discussed below. If the charity wants the gift agreement to be enforceable, however, the gift agreement should clearly state that it is enforceable.

**EXAMPLE:**

This Gift Agreement is irrevocable and shall be enforceable against and be binding upon the Donor, the Donor's estate, the Donor's personal representative, and Donor's heirs, successors and/or assigns.

**Problems with Enforceable Pledges**

The charity should consider whether the benefits of an enforceable pledge outweigh its disadvantages.<sup>11</sup> The benefit of the enforceable gift agreement is that the charity may be able to get a judgement against the donor for the amount due under the gift agreement from a court. There are two contexts in which this may arise. First, the donor refuses to pay the pledge during his or her lifetime and the charity sues the donor. Second, the donor has not included a provision for the pledge in his or her estate plan and dies before all the pledge payments are made, and the charity seeks to enforce the pledge as a debt against the donor's estate.

The value of the ability to sue a living donor depends on the reason for non-payment. If the donor had a significant financial reversal, assets simply may not be available to pay the charity, and the ability of the charity to sue is of no value. If the

---

<sup>11</sup> For an extensive discussion see "Should Pledges Be Enforceable? And other questions to ask about gift agreements" *Journal of Gift Planning* (2011).



donor has had a financial reversal, but still has solvency to pay the pledge, the charity still has to consider the publicity it will receive for suing a donor facing financial challenges as well as the impact that the circumstances may have on the willingness of the court to conclude that the gift agreement is enforceable. Another situation that arises is that the donor has the resources to pay the pledge, but for some reason is no longer happy with the charity or the gift terms, and simply does not want to pay the pledge. If the charity sues this donor, there likely will be allegations of misconduct by the charity in the opposition to the charity's pleading.<sup>12</sup> To the extent that the charity has not acted impeccably with respect to the donor, the charity will need to consider the publicity, and the likelihood that the court would find the agreement enforceable under the circumstances. For these reasons, the charities are often reluctant to sue living donors to enforce pledges.

An advantage of an enforceable gift agreement is that a charity can file a creditor's claim against the donor's estate if the donor dies before satisfying the pledge. If the donor's family is not hostile to the gift agreement, then this filing allows the estate fiduciary to pay the pledge consistent with the fiduciary's duties to the estate beneficiaries. If the beneficiaries strongly oppose payment to the charity, then litigation may be required to collect the pledge.

#### Problems for the Charity

If the charity has an enforceable gift agreement but chooses not to enforce the gift agreement, there can be certain adverse consequences for the charity. First, the enforceable gift agreement likely was booked as revenue for the charity and is an asset on its balance sheet. When the pledge is written off, the charity's assets will be reduced on its financial statements. Since the pledge is an asset of the organization, the officers and directors of the organization need to manage that asset prudently. If the donor has the financial ability to pay the pledge and does not otherwise have defenses to the

---

<sup>12</sup> For an example of how aggressively a sued donor can fight a pledge, see St. John's Health Center Foundation v. Paul Kent Foundation, L.A. Superior Court BC 585670.

enforcement of the gift agreement, it may be imprudent for the officers and directors of the charity not to enforce the gift agreement. Finally, if the donor on the gift agreement is an officer or director of the charity, or otherwise wields influence over the charity, the failure of the charity to enforce the pledge could be an excess benefit transaction under the Internal Revenue Code Section 4958. Section 4958 imposes penalty taxes on insiders of public charities that enter into a transaction with the charity in which the insider receives a greater economic benefit than the charity. When an enforceable gift agreement is written off, the donor arguably receives a benefit equal to the outstanding balance of the pledge, and the charity receives nothing in exchange. The terms of the transaction could be seen as one in which the insider receives a greater economic benefit than the charity.

#### Problems for the Donor

If the gift agreement is enforceable, the donor is constrained with respect to the sources of funds that the donor can use to pay the pledge. If the gift agreement is enforceable against the donor personally, it is an act of self-dealing for the donor to use the donor's private foundation to pay the pledge.<sup>13</sup>

A payment from a donor advised fund can satisfy a donor's pledge if the donor advised fund sponsor does not refer to the pledge when making the grant from the donor advised fund.<sup>14</sup> The donor also must not be receiving any benefits related to the pledge payment that would result in any part of the payment not being deductible if paid by the donor. Finally, the donor cannot claim a deduction for the payment made by the donor advised fund even if the charity erroneously send the donor a substantiation receipt. Matching the donor to the payment may be difficult for the grantee without any direction from the donor advised fund. Further, since the grant from the donor advised fund is unrestricted, there is a question whether it should be the basis of cancelling party of the donor's liability under the pledge. Charities may want to include language in

---

<sup>13</sup> Treas. Reg. § 53.4941(d)-2(f).

<sup>14</sup> Notice 2017-73.

gift agreements that provides that funds from donor advised funds related to the donor will be applied to the obligations under the gift agreement.

The law is unsettled whether a supporting organization can satisfy a the pledge of a disqualified person. A charity should leave that determination to the donor and the donor's advisors.

Finally, if a donor has an enforceable gift agreement and another individual makes a payment on that pledge, for gift tax purposes, the payment is treated as a gift from the person making the payment to the person obligated under the pledge agreement.<sup>15</sup> It appears for income tax purposes, however, that the person making the payment is entitled to the charitable income tax deduction.<sup>16</sup> If the gift agreement is enforceable, the charity will want to include language in the agreement that advises the donor that the donor cannot use a private foundation to satisfy the pledge.

**EXAMPLE:**

Donor acknowledges that this Agreement creates a personal obligation. Satisfaction of Donor's obligations under this Agreement by a private foundation or supporting organization may subject Donor and such organization to excise taxes and penalties. Furthermore, Donor may be required to repay the organization the amount paid in those circumstances. Payments by other persons or entities of this obligation will be a gift to the Donor.

Any payment received from a donor advised fund for which Donor is identified to Charity as the donor by the organization sponsoring the donor advised fund will be applied to Donor's obligations under this Agreement.

If the gift agreement includes obligations on the part of the charity, the agreement should address who can enforce those obligations. The general rule is that individuals,

---

<sup>15</sup> Rev. Rule 81-110, 1981-1 C.B. 479.

<sup>16</sup> G.C.M. 38505.

including donors, cannot file lawsuits to force a charitable organization to carry out its charitable purposes or challenge how a charity is conducting its charitable activities. The attorney general in each state is granted standing to bring court actions to enforce charitable trusts. Where there are specific terms of a written grant agreement, however, courts often find on various grounds that the donor or the donor's family can enforce those terms. In order to minimize ambiguity around this issue, the gift agreement should indicate who has standing to enforce it. Generally this would include the donor, and possibly the donor's children or descendants living at the time the agreement is signed. In order to avoid the possibility of an ever growing class of plaintiffs who have little or no connection to the original donor or gift, the charity will want to limit the group of individuals that can enforce the gift agreement. The charity will not want to have a donor's descendants in perpetuity to have standing to enforce an agreement.

**EXAMPLE:**

Donor alone, and not any other heir, successor or assignee, shall have standing to enforce the terms of this Agreement.

If the donor and charity reside in the same state, the law of that state likely will govern the enforcement of the gift agreement. If they are in different states, however, it may be unclear which state's law governs the enforcement of the gift agreement. In order to avoid confusion over this issue, the gift agreement should include a statement as to what state's law governs the agreement, which typically will be the law of the state in which the charity is located.

**EXAMPLE:**

This Agreement shall be governed by and construed in accordance with the laws of the State of \_\_\_\_\_ without regard to its conflict of law principles.

It is not unusual for gift agreements to get e-mailed around since donors and charities are in different locations, so that the donor and the charity sign different copies of the gift agreement. Furthermore, the charity may never receive the donor's original

signature on the gift agreement. In order to address these situations, the agreement should have what is known as a counterparts clause which states that if the parties sign two different copies of the same documents, that is treated as one document. The agreement also should state that facsimile or scanned signatures are treated the same as original signatures.

**EXAMPLE:**

This Agreement may be executed in multiple counterparts with the same effect as if all parties hereto had signed the same document. All counterparts so executed shall be deemed to be an original, shall be construed together and shall constitute one Agreement. Signatures delivered by facsimile and by email shall be deemed to be an original signature for all purposes, including applicable Rules of Evidence.

Some organizations routinely use alternative dispute resolution in their contracts. Alternative dispute resolution options generally are arbitration and mediation. In an arbitration, the arbitrator has essentially the same powers as a judge and is able to make a decision that is binding on the parties. Normally arbitration clauses include limited appeal rights. In a mediation, the mediator does not have the power to require either of the parties to take any actions. Instead, the mediator works with the parties to help the parties find a resolution that is acceptable to both of them. If the mediator succeeds in bringing the parties together, then the parties sign a new agreement that is generally an enforceable contract between them. Some organizations believe that alternative dispute resolution clauses encourage parties to bring disputes. Accordingly, they disfavor them. This is an issue that should be addressed with the charity's general counsel or outside counsel.

**EXAMPLE:**

Resolution of Disputes

In the event of any controversy or claim arising out of or relating to this Agreement, or the breach thereof, the parties shall first attempt to resolve the dispute by nonbinding mediation. A neutral mediator shall be selected within thirty (30) days of written notice from either party to the dispute. The mediation shall be conducted within sixty (60) days after selection of the mediator. If mediation is unsuccessful, any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in accordance with the Comprehensive Arbitration Rules and Procedures of JAMS, and judgment on the award rendered may be entered in any court having jurisdiction thereof. The parties waive their right to a trial by a jury or court trial. Such arbitration shall be held in \_\_\_\_\_ County, \_\_\_\_\_, and the cost thereof, including reasonable attorneys' fees, expert witness fees, charts, presentations, and any other ancillary costs in the preparation or presentation of the proceeding, shall be borne in such proportions as the arbitrator may decide. The arbitrator shall have no authority to award punitive damages or to add to, modify or refuse to enforce any agreements between the parties. The arbitrator shall make findings of fact and conclusions of law and shall have no authority to make any conclusions of law or award that could not have been made by a court of law. If any party to this Agreement initiates legal proceedings against another party, other than arbitration in accordance with the rules of JAMS as described above, the prevailing party shall be allowed such costs (including without limitation expert witness fees, charts, presentations, and any other ancillary costs in the preparation or presentation of the proceeding) and reasonable attorneys' fees as the court may allow.

### **Designated Funds**

For each charity, there likely will be certain use restrictions that will appeal to many donors. For example, many supporters of a college likely will want to provide funding for scholarships. To simplify administration, a charity will want to create funds for these popular purposes with distribution criteria defined by the organization in

advance. When a donor wishes to support an established program, the charity can direct their funds to the existing fund or reference the existing criteria. This will minimize the number of funds that the charity has to administer for a particular purpose and will provide a uniform set of criteria for distribution those funds. Otherwise, the charity may end up having many different funds with varied distribution criteria all generally for the same purpose.

### **Recognition Standards**

The charity will want to treat donors consistently when recognizing gifts. Also, certain donor restrictions impose administrative burdens on the charitable organization. The charity will want to be certain that the size of the gift is sufficient to compensate for the cost of administering the gift. Finally, some recognition such as naming a building involves opportunity costs since another donor might be willing to give a larger amount for the naming rights. To address these issues, the charity should have naming policies and levels defined in advance. These would include minimum amounts for any kind of named fund that must be accounted for separately. For building naming, each opportunity should have a thought out minimum gift in advance of any solicitations. Certain use restrictions would require a minimum level of funding to ensure the gift is large enough to address that particular purpose. For example, a scholarship fund should generate annually at least \$1,000, if not \$5,000, in order to provide a meaningful scholarship. Something like an endowed professorship will require considerably more money. The charity should have established minimums for these kinds of use restrictions to ensure that the gift will provide meaningful resources for the intended use. If the gift will be testamentary or paid over a lengthy period of time, the charity may need to adjust the minimum in order to ensure that when the gift is funded, accounting for inflation, the gift is still sufficient to meaningfully address the intended use.

### **Negotiating**

Charities want to be grateful for a donor's generosity, and are sometimes reluctant to push too hard for terms in negotiating gift agreements. Gift agreements,

however, will govern the charity's conduct for a very long time, possibly in perpetuity. Gift terms that presently appear to have the potential to be problematic, almost certainly will create problems with the passage of time. Even terms that do not presently appear to present challenges, could prove unworkable for the charity after 25, 50 or 100 years of evolution of society and the charity's mission. The charity should be mindful of these concerns and remind the donor of the enduring nature of the restrictions when negotiating the terms of the gift agreement. Also, when the charity pushes back in the negotiation of the terms of the gift agreement, the charity is saying something very reassuring to the donor. The push back signals to the donor that the charity realizes that it is bound by and will have to follow the gift restrictions. Further, it signals that the charity takes the restrictions seriously enough to push back against ones that it thinks it will have problems fulfilling. In the discussion, the charity should bring the donor back to the goal of advancing the purposes of the organization and working together to create terms that will accomplish that goal now and well into the future.