Negotiating charitable gifts

A thoroughly negotiated and well-drafted gift agreement can lead to a mutually beneficial donation and fulfilling charitable experience for all.

In today's world, pursuing your life's goals is being challenged in new ways. Which makes now the perfect time to review your goals in terms of "Advice. Beyond investing." Because when we collaborate on what matters most to you, we can create a plan tailored for you.

Issues to consider	**2**
Pledge agreements	**3**
Other ways to make a pledge	**4**
Gift agreement	**4**
Tax consequences of gifts	**5**
Conclusion	**6**
Cents and Sensibility Negotiating Major Gift Agreements with Art Museums	**8**

When contemplating a large gift to charity, donors often want to be certain that the donated assets will be used by the charity as they intend. While charities strive to accommodate and properly recognize their donors, their ability to honor the donor's request or intent may be limited by federal or state law or the charities' internal governance documents. Ideally, a donor and charity will openly discuss their objectives and priorities in order to understand the parameters and expectations surrounding the gift and come up with a mutually satisfactory gift agreement. Without this dialogue, even the most carefully drafted gift agreement can lead to hard feelings—or even litigation.

One of the most well-known cases involving a conflict arising from a charity's inability to carry out the donor's intent centered around the Barnes Foundation (the "Foundation") in Pennsylvania. In 1922, Dr. Albert Barnes donated his significant art collection to the Foundation with specific instructions in the Foundation bylaws that the collection must remain in his home and hung exactly as he had done during his lifetime. Many years later, the board of directors of the Foundation petitioned a court to amend the Foundation's bylaws to allow them to move the collection to a new building in Philadelphia. A court granted the request to move the collection, after protracted litigation and objections by many in the art world.

Issues to consider

Restricted vs. unrestricted gifts. Charities love unrestricted gifts. "Unrestricted" means that the board has the sole discretion to decide how to use the funds—e.g., to pay salaries, fund research or pay bills. Restricted gifts, on the other hand, are designated for a specific purpose or project of the charity. Because of their nature, restricted gifts are often discussed and negotiated at length and memorialized in a gift agreement. Donors should be educated about the negotiation process and be clear about their goals and the charity's limitations before starting discussions with a charity about a significant gift.

Types of donated assets. In addition to the possible restrictions on the charity's use of the funds, the property donated to a charity may raise issues if it is anything other than cash or marketable securities. Some charities will happily accept gifts of closely held stock or real estate and have the infrastructure and staff to accommodate and administer those types of assets. Other charities may not be equipped to receive—or may not want—anything other than publicly traded stock or cash. For example, a gift of real estate can carry with it taxes, maintenance costs, insurance and potential liability. For that reason, charities that accept real estate will often require it to be held in a limited liability company or other type of corporate structure. The charity may also ask that the donor contribute liquid funds for the maintenance and upkeep of the gifted property. Other illiquid assets that are not in line with a charity's purpose may be too burdensome for the charity to hold, administer and sell and may create unfavorable income tax consequences for the donor (see discussion below regarding tax consequences).

Naming rights. Some charities will recognize donor gifts by naming a building, program or professorship after the donor. Charities generally have guidelines or requirements that gifts must satisfy before any naming rights will be approved. For example, Stanford University publishes general guidelines for minimum levels to fund endowed gifts, ranging from $250,000 for a needs-based undergraduate scholarship to $4 million for an endowed professorship.[1]

Charities generally have guidelines or requirements that gifts must satisfy before any naming rights will be approved.

Some charities may solicit gifts and grant naming rights as part of a fundraising campaign and may even design spaces to maximize opportunities for naming rights. Interested donors should ask the charity if it has a gift acceptance policy that outlines what minimum threshold requirements must be met for securing naming rights.

From the charity's perspective. When a charity receives a gift or an enforceable pledge to make a gift, it will reflect those assets on its financial statements and may count the pledged gifts toward a campaign goal. Some charities will also recognize donors who have committed to provide for the charity at death, even though a bequest could be revoked. Charities often appreciate the opportunity to recognize and thank their donors and also may wish to publicize the gifts in order to encourage other donors to make gifts or bequests.

Pledge agreements

Donors may have various reasons for wanting to make a charitable gift over a period of years, such as a desire to maximize income tax deductions and coordinate cash flow needs. Some donors also want to monitor the charity's use of the gifted funds and make sure that the charity complies with the donor's stated goals before making the next contribution. Donors who commit to making a sizeable gift over a period of years will often be asked to sign a pledge agreement. Donors with outstanding pledge agreements should understand whether the pledge to the charity is binding and enforceable; those who are considering making a pledge should consider whether they want their pledge to be binding. A pledge may be enforceable either (i) by its terms or (ii) if the charity has relied upon the donor's stated promise to make the gift (i.e., if the charity breaks ground and begins construction of a building in reliance on the donor's pledge to fund the building).

Donors who commit to making a sizeable gift over a period of years will often be asked to sign a pledge agreement.

Donors should be aware that they may not satisfy personal enforceable pledges with assets of their private foundation. Doing so would be considered an impermissible act of self-dealing that could generate penalties and excise taxes for the donor.[2] Similarly, a donor may not use assets from his or her donor-advised fund to satisfy a personal pledge, because it would be considered an "excess benefit transaction" that could result in penalties.[3] To navigate around this, the private foundation can be the obligated party under a pledge agreement. For donor-advised funds, the donor may (i) sign a nonbinding multi-year gift intention, which simply states that the donor intends to recommend grants to the charity from his or her donor advised fund account, or (ii) may recommend that the donor-advised fund's charitable sponsor enter into a gift agreement with the charity.

Charities sometimes find themselves in the position of deciding whether to enforce a pledge. The charity's board of directors has to balance its duty to preserve assets of the charity with the costs of seeking to enforce compliance and the potential unfavorable publicity associated with suing a donor. A charity may also file a claim against a donor's estate if the donor dies without having satisfied the pledge. In 2016, Duke University filed a $10 million claim against the estate of Aubrey McClendon, the former CEO of Chesapeake Energy Corp., to enforce an outstanding pledge. Duke received a lot of publicity after filing the claim and subsequently chose to withdraw it stating that the claim "was misperceived as adversarial to the McClendon family, which was never the intention."[4]

Gift acceptance policies define the types of assets a charity will and will not accept and set forth guidelines for recognition and administration of the gifted funds.

Other ways to make a pledge

If the donor does not want a pledge to be binding but wants the charity to know about his or her intent to make a gift, there are a couple of alternatives to an enforceable pledge.

Statement of intent to make a gift. While this isn't something that the charity can rely on (and therefore won't be able to take action or start a new program or project in reliance on the gift), it can provide other benefits. The donor will have flexibility to back out of the gift if circumstances change and the charity will be able to thank the donor. They can agree that if the intended gift is paid in full, then the donor will receive certain recognition for the gift.

Revocable enforceable pledge. A donor can agree to make certain payments to a charity and retain the right to revoke the pledge during his or her lifetime. However, the pledge would be enforceable upon the donor's death (assuming it wasn't revoked) so the charity can then file a claim against the donor's estate if the estate does not satisfy the pledge. This may be a good option for donors who want to retain flexibility during their lifetimes, negotiate the terms of a restricted gift and be sure that the charity receives the assets at death. The charity may also be able to count the expected gift toward their fund-raising goals.

Gift agreement

Often a donor works with a member of the charity's board of directors or a member of the development staff to negotiate the terms of the gift. Significant gifts will generally be memorialized in a gift agreement, the terms of which may be incorporated into a pledge agreement. Many charities have standard gift agreements that outline the respective obligations, expectations and rights of the donor and the charity. Depending on the size of the gift, the donor may have leverage to negotiate the terms of the gift agreement.

Prior to negotiating the terms of a gift agreement, donors should ask the charity if it has a gift acceptance policy. These policies define the types of assets the charity will and will not accept and also set forth guidelines for recognition and administration of the gifted funds. The development staff of a charity may be excited by the prospect of a large gift. Especially with gifts of complex assets, like closely held stock or real estate, a gift acceptance policy may help the parties navigate all of the issues without insulting the donor by rejecting a proposed gift. For example, if a donor wants to give a piece of real estate, the charity may not be able or willing to absorb the associated costs and expenses or to take on the potential liability. If the charity has a gift acceptance policy, the donor could be made aware of the charity's inability to accept the donation without actually having to reject the donor's gift.

Gift agreements should incorporate the goals and objectives of the donor and the charity and build in flexibility to account for unforeseen circumstances. The gift agreement can address the following:

- the charity's use of the gifted assets
- recognition for the donor and/or the donor's family (i.e., naming rights, publicity)
- terms and circumstances under which the charity may sell the gifted assets
- provisions for any maintenance, expenses and insurance associated with the gifted asset
- provisions regarding the investment of funds received by the donor

– expectations if the charity receives closely held business stock (although donors must be careful to avoid mandating a redemption of the stock in writing)
– permitted participation or monitoring by the donor of the use of the funds. For example, if a donor is endowing a professorship, it is unlikely that the donor will have any role in selecting the professor. In the case of a scholarship, the donor may be able to serve as part of a selection committee or have some say in the recipients of the scholarship.
– ongoing reporting obligations of the charity to the donor
– measurements for success for the donor's goal (incorporating realistic short-term and long-term benchmarks)
– mechanisms to modify the agreement by the parties
– alternative plans and procedures if the original purpose of the gift becomes impractical or impossible to sustain
– parties with whom the charity can consult if gift restrictions must be modified after the donor's death (e.g., donor's spouse or descendants)
– continued recognition if a building or structure named after the donor is demolished or no longer used or owned by charity
– circumstances under which naming rights might be changed (i.e., if the donor receives negative publicity)

Donors should be aware that they will not necessarily have standing to bring a lawsuit against the charity to enforce the terms of a gift agreement. Courts have long held that only states attorneys general have standing to sue a charity for an impermissible use of a gift. However, there have been some cases in which courts have permitted the descendants of a donor to bring a lawsuit to enforce the terms of a charitable gift. Donors may want to incorporate provisions into the gift agreements that explicitly give the donor and the donor's family standing to enforce the agreement.

Tax consequences of gifts

Donors will receive a charitable income tax deduction for the year in which a gift is made, not when a pledge is made.

Donors will receive a charitable income tax deduction for the year in which a gift is made, not when a pledge is made. For gifts of cash or long-term capital gain property, a donor will receive a charitable income tax deduction for the property's fair market value, subject to limitations based on the donor's adjusted gross income (AGI) and whether the gift is made to a public charity or a private foundation. With respect to gifts of any other asset (i.e., art, real estate, collectibles, short-term gain property), the income tax deduction will depend on whether the charity's use of the gift is deemed "related" or "unrelated" to its charitable purpose. If the use of the gift is related, the donor is entitled to a deduction for the fair market value of the property (limited to 30% of AGI). If the use of the gift is unrelated to the charity's charitable purpose, the donor is only entitled to a deduction equal to his or her tax basis in the property (limited to 50% of AGI).

Donors should confirm what the charity intends to do with the gifted property before it is offered.

The following chart illustrates the AGI limitations for charitable gifts. Note that any unused deduction in the year of the gift may be carried forward for five years.

Charitable recipient	Cash	Long-term gain property—Related Use *Deduction valued at fair market value*	Long-term gain property—Unrelated Use *Deduction valued at cost Basis*	Short-term gain property *Deduction valued at cost basis*
Public charity (includes donor-advised funds)	50%	30%	50%	50%
Private foundation	30%	20%	30%	30%

For example, if a donor makes a gift of a piece of art to an art museum that puts it on display, the museum's use would be considered related to its charitable purpose. Accordingly, the donor would receive an income tax deduction based on the fair market value of the artwork. If, however, a donor gives the piece of art to a hospital (that does not have an art collection), the hospital will most likely not use the artwork to further its charitable purpose. The hospital will likely sell the artwork and use the proceeds for its mission and projects, and therefore the donor would only receive an income tax deduction equal to his or her basis. The deduction for a charitable contribution of artwork will also be limited to the donor's basis if it is considered ordinary income property, which generally applies to artwork 1) created by the donor, 2) received by the donor as a gift from the artist, 3) held as inventory by a dealer, or 4) owned for less than one year prior to the gift.[5]

Misunderstandings between the donor and the charity can lead to adverse tax consequences to the donor because of the related use rules, so donors should confirm what the charity intends to do with the gifted property before it is offered. Even if a donor gives an asset that could be used to support the charitable purpose of the organization, but the charity actually ends up selling the asset within three years of receipt, the donor's gift may not qualify as a related use.[6] Donors may wish to incorporate into the gift agreement a representation by the charity that the gifted item will be put to a related use for at least three years.

Conclusion

In light of the complexity and nuance surrounding large charitable gifts, donors should consult with legal counsel to help navigate the process and negotiate the gift agreement. A thoroughly negotiated and well drafted gift agreement can lead to a mutually beneficial donation and fulfilling charitable experience for all.

–*Ann Bjerke*, Senior Wealth Strategist

The **Advanced Planning Group** of UBS provides comprehensive planning, advice, and education to ultra high net worth individuals and families. The team consists of professionals with advanced degrees, extensive planning experience, and various areas of expertise. Through our publications, the Advanced Planning Group features the intellectual capital of UBS in wealth planning, estate tax, and philanthropy and evaluates how changes in the legislative and tax landscape might impact our clients' planning.

[1] http://giving.stanford.edu/questions-comments/frequently-asked-questions#minimumgiftlevels
[2] Internal Revenue Code (IRC) Section 4941(d)(1)(E); Regs. 53.4941(d)-2(f)(1)
[3] IRC Section 4958(c)(2)
[4] Duke Withdraws its Claim Against Aubrey McClendon's Estate, Wall Street Journal, August 29, 2016.
[5] Regs. 1.170A-4(b)(1)
[6] IRC Section 170(e)(7)

Collectors and museums may have different views on which works are important to scholars and museum audiences.

Cents and Sensibility

Negotiating Major Gift Agreements with Art Museums

by

Doug Woodham

If you are considering making a major gift to an art museum, then it is important to understand how museum development staff can collaborate with you to design a mutually beneficial gift agreement. The first important question is whether you want to donate cash, art or some combination of the two. Donating art is generally much more complicated because the needs and interests of the museum and collector are more likely to diverge.

Collectors and museums both love art and objects, but they may have different views on which works are important to scholars and museum audiences. Moreover, because most museums can only show a fraction of their collection at any one time (generally 5% or less of the total object count), they are loath to enlarge their collections with material that will spend most of its time in costly storage facilities. One of the biggest planning mistakes collectors make is to assume that art museums will be excited to accept works from their collection.

Collectors should start the donation process by creating a short list of museums where they would like to see the work(s) go. The more important the museum, the more important the work needs to be. To avoid disappointment, it is best to have different levels of museums on the list. If you know with certainty that you will donate the work after finding a suitable home for it, then there is less of a need to get an appraisal before contacting museums. But if the value of the object will influence whether or how you donate it, then first get an appraisal from a qualified professional.

Assuming a suitable museum is interested in the work(s), there are three basic donation deal structures: donate the work now; make a promised bequest; or donate a fractional interest, perhaps 25%, with the balance donated later. There is one additional deal structure, called a bargain sale, but it is rarely used. This occurs when the museum is offered the opportunity to buy the work for less than its fair market value. The collector gets a charitable donation equal to the difference between fair market value and the sale price, along with sale proceeds. These deal structures have very different financial planning, tax and operational implications. As a result, collectors need to be acutely aware of the differences so they can make an informed decision on whether and how to proceed.

Case study: donating a major collection

Sally and John, collectors who want to remain anonymous, have a wonderful collection of drawings, paintings and sculptures by leading American and European post-war and contemporary artists. Because their children will inherit a great deal of wealth, and none are interested in living with the collection, the couple decided to pursue donating their collection to a major institution. After selecting three museums, they negotiated simultaneously with all of them to get the best possible promised gift deal. Because of the quality of the collection and their willingness to work creatively with the institution around the deal structure, they inked an agreement with the following terms:

- *Timing.* Title to the collection will go to the museum after both Sally and John have passed away. Until then, the collection will remain in their homes for them to enjoy.
- *Museum obligations.* The museum will publish an illustrated catalogue on the collection, including essays by leading scholars, within four years of signing the promised gift agreement. The museum will also mount a show of important work from the collection, coupled with an education and outreach program evangelizing the significance of the gift to the museum, to coincide with the publication of the catalogue.
- *Optionality.* Due to the size of the collection and the long-term costs the museum will incur for preservation, restoration, storage and display, Sally and John gave the museum the right to sell noncore elements, subject to certain timing restrictions. In return, the museum committed to keep core elements of the collection (which was a defined term in the promised gift agreement) in perpetuity and to show these works at least once every five years, either individually or in groups.
- *Annual contributions.* The couple agreed to make substantial unrestricted annual contributions in each of the next five years to support museum programming, acquisitions and research.
- *Donor recognition.* While the museum wanted to announce the promised gift when the agreement was signed, the couple instead elected for the announcement to occur when the collection show opens at the museum. They also elected to have their annual unrestricted contributions be noted in all museum publications as "anonymous" so as to minimize unsolicited requests for funding from other philanthropic organizations.

Doug Woodham is the Managing Partner of Art Fiduciary Advisors, an advisory practice based in New York City that helps collectors and artists create legacy plans. Earlier in his career, he was President of Christie's for the Americas and a Partner with McKinsey & Company. Doug is also the author of the best-selling book *Art Collecting Today: Market Insights for Everyone Passionate About Art* (2017).

See important notes and disclosures on the next page

This report is provided for informational and educational purposes only. Providing you with this information is not to be considered a solicitation on our part with respect to the purchase or sale of any securities, investments, strategies or products that may be mentioned. In addition, the information is current as of the date indicated and is subject to change without notice.

Neither UBS Financial Services nor its employees (including its Financial Advisors) provide tax or legal advice. You should consult with your legal counsel and/or your accountant or tax professional regarding the legal or tax implications of a particular suggestion, strategy or investment, including any estate planning strategies, before you invest or implement.

Important information about Advisory & Brokerage Services
As a firm providing wealth management services to clients, UBS Financial Services Inc. offers both investment advisory services and brokerage services. Investment advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate arrangements. It is important that clients understand the ways in which we conduct business and that they carefully read the agreements and disclosures that we provide to them about the products or services we offer. For more information visit our website at **ubs.com/workingwithus.** 171030-2998_S

© UBS 2017. All rights reserved. The key symbol and UBS are among the registered and unregistered trademarks of UBS. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.