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**FEDERAL AND STATE QUID PRO
QUO AND SUBSTANTIATION RULES**

Jim Rourke

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jrouke@nexsenpruet.com



FEDERAL CHARITABLE CONTRIBUTION RULES

Best Resources (besides *South Carolina Nonprofit Corporate Practice Manual*)

- IRS Pub. 1771 – Donee’s perspective
- IRS Pub. 526 – Donor’s perspective
- <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations>
- IRC §§ 170 and 6115 (and accompanying regulations)



CHARITABLE CONTRIBUTIONS AND *QUID PRO QUO*



FEDERAL CHARITABLE CONTRIBUTION RULES

Elements of a Deductible Charitable Contribution:

- Transfer
- Of money or property
- To a permissible donee
- **That is both voluntary and without receipt of economic consideration or benefit; and**
- That is in the proper form



FEDERAL CHARITABLE CONTRIBUTION RULES

The burden is on a taxpayer claiming a charitable contributions deduction to show that all or part of a payment constitutes a contribution or gift.

A charitable contribution must be made voluntarily and not under compulsion.



FEDERAL *QUID PRO QUO* RULE

A transfer to a permissible donee is deductible as a charitable contribution under IRC § 170 if:

- the taxpayer transfers to charity money or property that exceeds the value of any return benefit to the taxpayer; and
- the taxpayer intends to make a gift of the excess.

The two-part test is known by various names, including the *quid pro quo* rule.



FEDERAL QUID PRO QUO RULE

"A donor may only take a contribution deduction to the extent that his/her contribution exceeds the fair market value of the goods or services the donor receives in return for the contribution; therefore, donors need to know the value of the goods or services. An organization must provide a written disclosure statement to a donor who makes a payment exceeding \$75 partly as a contribution and partly for goods and services provided by the organization. A contribution made by a donor in exchange for goods or services is known as a *quid pro quo* contribution."



TIMING OF WRITTEN DISCLOSURE

"An organization must furnish a disclosure statement in connection with either the ***solicitation*** or the ***receipt*** of the quid pro quo contribution. The statement must be in writing and must be made in a manner that is likely to come to the attention of the donor. For example, a disclosure in small print within a larger document might not meet this requirement."



FEDERAL *QUID PRO QUO* RULE

"Example of a *quid pro quo* contribution: A donor gives a charitable organization \$100 in exchange for a concert ticket with a fair market value of \$40. In this example, the donor's tax deduction may not exceed \$60. Because the donor's payment (*quid pro quo* contribution) exceeds \$75, the charitable organization must furnish a disclosure statement to the donor, even though the deductible amount does not exceed \$75."



FEDERAL QUID PRO QUO RULE - WRITTEN STATEMENT

Using E-mail for Disclosures

- Not recommended, but appears acceptable (see IRS Announcement 2000-84 and Info Letter 2000-0070)
- Should make note for donor to print e-mail and keep in records



NATURE OF A *QUID PRO QUO*

A *quid pro quo* is easiest to identify when a taxpayer receives money, property, services, or privileges in return for a transfer to an eligible donee.

Examples include:

- a cash payment;
- religious instruction;
- secondary school education.



NATURE OF A *QUID PRO QUO*

More difficult examples:

- Services rendered (*Rolfs v. Comm'r*; *Arceneaux v. Comm'r*)
- Products purchased (*Werbianskyj v. Comm'r*)
- Real property and cancellation of indebtedness (*Signom v. Comm'r*)
- Rights to admission or other privileges (Rev. Rul. 72-506)
- Required approval for design, construction, or development of property (*Pollard v. Comm'r*)
- Benefits from Third Parties (CCA 200238041)



FEDERAL *QUID PRO QUO* RULES

FUTURE BENEFITS

Expectation of Future Benefits

An expectation of receiving a benefit in the future can constitute a *quid pro quo* under § 170.

E.g., Rev. Rule. 58-264, 1958-1 C.B. 144 payments by clergymen required to be made to pension fund for the benefit of them, their widows, and dependent children were nondeductible personal expenses and not deductible charitable contributions; the right to benefits from the fund constituted adequate compensation for the payments.



FEDERAL QUID PRO QUO RULES

FUTURE BENEFITS

Expectation of Future Benefits (cont'd)

- *Viralam v. Comm'r* (2011)- Foundation designed for doctors and medical professionals to “[e]stablish a Foundation account for charitable giving, income tax reduction planning, estate tax reduction, educational funding, and future retirement planning.” Foundation also offered a student loan program whereby Foundation account funds could be disbursed as loans for college and graduate school tuition and related expenses. The program's terms further provided that the loans could be repaid (with interest) either through repayments generally commencing 5 years after graduation or by the recipient's providing charitable services for designated periods.
- Court was satisfied that the provision of student loans to family members fell within the definition of “goods and services” received in return for the contribution. The outlays for petitioner's son's student loans constituted more than 80 percent of the distributions from petitioner's Foundation account (exclusive of distributions to pay the Foundation's management fees) in the first 5 years after its creation, until respondent began an examination of petitioners' 1998 return and the loans were repaid (with interest forgiven) in 2003. Thus, under the regulations, *petitioner's expectation in 1998 that the Foundation would provide student loans to his children in subsequent years means that the Foundation is deemed to have provided goods or services in consideration for the original donation.*



VALUATION OF QUID PRO QUO

- FMV of return benefit is determined under same valuation rules used to determine FMV of a contribution
 - FMV = price at which property would change hands between willing buyer and seller, neither being under compulsion to buy/sell and both having reasonable knowledge of the facts
- Examples
 - FMV of a privilege = amount a member of the public would have to pay to obtain the privilege
 - FMV of services rendered = amount that his general changed for same or similar services
 - FMV of future benefit – much more difficult/few authorities



GOOD-FAITH ESTIMATE OF FMV EXAMPLES

- Treas. Reg. § 1.6115-1(a)(3), *Ex. 1*
 - Art museum allows donors to hold private events at Gallery, which holds a unique art collection (located in the museum), for a \$50,000 donation. No other events may be held at the Museum. The community in which the museum is located has 4 hotels, 2 of which offer ballrooms with similar amenities and atmosphere of the Gallery, but lack the unique art collection. One of the ballrooms rents for \$2,500. For purposes of good faith estimate, those two ballrooms are considered similar or comparable facilities.



GOOD-FAITH ESTIMATE OF FMV EXAMPLES

- Treas. Reg. § 1.6115-1(a)(3), *Ex. 3*
 - Charitable organization offers a dinner for two followed by an evening tour of Museum conducted by a painter whose works are on display at the Museum. The Museum does not normally provide tours on a commercial basis, and instead offers them without cost. Because tours are typically free to the public, a good-faith estimate of the value of the evening tour is \$0. So the fact that the tour is conducted by the painter rather than the Museum's regular tour guides does not render the tours dissimilar or incomparable.



GOOD-FAITH ESTIMATE OF FMV EXAMPLES

- IRC § 170(l) – Payments to a College or University for the right to purchase tickets to athletic events
 - State University announces that a contribution of \$1,000 or more to its athletic scholarship program entitles the contributor to purchase season tickets for home basketball games. Tickets are in great demand and usually unavailable without making the contribution. Donor sends check for \$1,300, consisting of \$1,000 contribution and \$300 for two season tickets. The \$1,000 contribution is subject to IRC § 170(l). The right to purchase the tickets constitutes goods and services provided to the donee, having a fair market value equal to 20% of the payment – so donor can deduct \$800, or 80% of his contribution.



WRITTEN DISCLOSURE

Exception

"A written disclosure statement is not required:

- where the goods or services given to a donor meet the 'token exception,' the 'membership benefits exception,' or the 'intangible religious benefits exception'
- where there is no donative element involved in a particular transaction, such as in a typical museum gift shop sale"



WRITTEN DISCLOSURE

Token Exception

- Insubstantial goods or services a charitable organization provides in exchange for contributions
- Rev. Proc. 90-12 – 3 requirements
 - Contribution must occur in the context of a fundraising campaign in which the charitable recipient advises donors how much of their payments is a deductible contribution
 - FMV of all the benefits received in connection with the contribution does not exceed lesser of 2% of contribution or \$105 for 2015 (indexed for inflation); or contribution is \$52.50 (for 2015) or more and the only benefits received in connection with contribution are token items bearing donee's logo or name
 - Cost to charity cannot exceed the low-cost article limit of \$10.50 in 2015



WRITTEN DISCLOSURE

Membership Benefits Exception

- Annual membership benefit is considered to be insubstantial if it is provided in exchange for annual payment of \$75 or less and consists of annual recurring rights/privileges like:
 - Free/discounted admissions to charitable org's facilities or events
 - Discounts on purchases from the org's gift shop
 - Free or discounted parking
 - Free or discounted admission to member-only events sponsored by an org, where the per-person cost (not including overhead) is within the low-cost articles limits of \$10.50



WRITTEN DISCLOSURE

Membership Benefits Exception (cont'd)

Examples from Treas. Reg. § 1.170A-1(h)(5), *Ex. 1 + 2*

- **Treas. Reg. § 1.170A-1(h)(5), Ex. 1** - Payment of \$105 to org in return for family membership. Membership entitles family to free admission, discounts on merchandise from gift shop, and invitations to member-only events. Special events will have a cost to the org (excluding overhead) of \$10.50 or less per attendee. Benefits are considered membership benefits and can be disregarded—can treat full amount as deductible.
- **Treas. Reg. § 1.170A-13(f)(8)(1), Ex. 1** - Member pays \$75 for 12-month membership package including right to purchase tickets before they go on sale to general public, free parking, and 10% discount on merchandise in gift shop. All benefits can be disregarded in applying the quid pro quo rule, and donee can deduct entire charitable contribution



WRITTEN DISCLOSURE

Intangible Religious Benefits Exception

- If a religious org provides only “intangible religious benefits” to a contributor, the acknowledgment does not need to describe or value those benefits.
- But – written disclosure should state that the organization provided intangible religious benefits
- What are “intangible religious benefits”?
 - Benefits provided by a tax-exempt org operated exclusively for religious purposes, and are not usually sold in commercial transactions outside a donative context
 - Examples include admission to a religious ceremony and *de minimis* tangible benefit, like wine used in a religious ceremony
 - Do NOT include education leading to a recognized degree, travel, and consumer goods.



STATE *QUID PRO QUO* RULES

Section 12-6-1130 provides:

(12) The deduction for charitable contributions allowed by Section 170 of the Internal Revenue Code is determined in the same manner as provided in Section 170 of the code except that no deduction is allowed unless, in addition to the requirements of Section 170 of the Internal Revenue Code, the contribution also meets the requirements of Section 12-6-5590.



STATE *QUID PRO QUO* RULES

Section 12-6-5590 provides:

(A) No credit under Section 12-6-3515 or deduction under Section 170 of the Internal Revenue Code and Section 12-6-1130(12) shall be allowed for a contribution unless the donor has the donative intent required by Section 170 of the Internal Revenue Code and the regulations and cases interpreting Section 170 of the Internal Revenue Code.



STATE *QUID PRO QUO* RULES

Section 12-6-5590 continued:

(B) In addition to the donative intent required by Section 170 of the Internal Revenue Code, no credit under Section 12-6-3515 or deduction under Section 170 of the Internal Revenue Code and Section 12-6-1130(12) shall be allowed for any noncash charitable contribution in the claimed amount of \$100,000.00 or more unless the donor has the requisite donative intent required by this section.



STATE *QUID PRO QUO* RULES

Section 12-6-5590 continued:

(C) The requisite donative intent includes the requirement that the donor be motivated by detached and disinterested generosity benefiting a charitable purpose rather than expected economic benefit.



STATE *QUID PRO QUO* RULES

Section 12-6-5590 continued:

(D) A noncash charitable contribution by a donor given to comply with any state or federal environmental or other regulatory requirement; for the purpose of obtaining road, water, or sewer services; or in conjunction with obtaining a grant, subdivision, building, zoning, environmental, mitigation, or similar permit or approval from any government, shall be deemed not to have the requisite donative intent absent extraordinary circumstances.



STATE QUID PRO QUO RULES

Section 12-6-5590 continued:

(E) The department shall examine the substance, rather than merely the form, of the contribution and related and surrounding transactions, and may use the step transaction, economic reality, quid pro quo, personal benefit, and other judicially developed doctrines in determining whether the requisite donative intent is present.



STATE *QUID PRO QUO* RULES

QUID PRO QUO AND SFO'S

Proviso 1.80 of the 2014-15 General Appropriation Act

(B) A person is entitled to a tax credit against income taxes imposed pursuant to Chapter 6, Title 12 or bank taxes imposed pursuant to Chapter 11, Title 12 for the amount of money the person contributes to a nonprofit scholarship funding organization up to the limits of this proviso if:

(1) the contribution is used to provide grants for tuition, transportation, or textbook expenses or any combination thereof to exceptional needs children enrolled in eligible schools who qualify for these grants under the provisions of this proviso; and

(2) the person does not designate a specific child or school as the beneficiary of the contribution.



STATE *QUID PRO QUO* RULES

QUID PRO QUO AND SFO'S

- More tangible state tax benefit (i.e., state tax credit) raises significant issues of *Quid Pro Quo*
 - But see CCA 200238041 (discussing treatment of a state tax credit as a *quid pro quo*)
 - Also practical analysis – deduction would have to be reduced by the amount of tax savings (immediate reduction in deduction)



TAX SAVINGS FROM CHARITABLE CONTRIBUTIONS DEDUCTION ARE NOT *QUID PRO QUO*

When a donor makes a charitable contribution, the donor is entitled to an income tax deduction under § 170 in the year of the contribution. The deduction reduces the donor's taxable income, which in turn reduces the donor's income tax liability.



TAX SAVINGS FROM CHARITABLE CONTRIBUTIONS DEDUCTION ARE NOT *QUID PRO QUO*

The reduction in federal and state income taxes in return for a charitable contribution is a financial benefit received by a donor in return for a contribution to charity. The financial benefit is equal to the amount of the tax savings. Notwithstanding the financial benefit, the reduction in a donor's income taxes attributable to a charitable contributions deduction are not considered a *quid pro quo* received by the donor in exchange for the contribution.



TAX SAVINGS FROM CHARITABLE CONTRIBUTIONS DEDUCTIONS ARE NOT A *QUID PRO QUO*

In CCA 200238041, which discussed the treatment of a state tax credit as a *quid pro quo*, the IRS stated that the tax benefit of a federal or state charitable contributions deduction is not viewed as a return benefit that eliminates or reduces a deduction under § 170 or that vitiates charitable intent.



FAILURE TO PROVIDE WRITTEN DISCLOSURE

Penalty

A penalty is imposed on charities that do not meet the written disclosure requirement. The penalty is \$10 per contribution, not to exceed \$5,000 per fundraising event or mailing. An organization may avoid the penalty if it can show that failure to meet the requirements was due to reasonable cause.



CHARITABLE CONTRIBUTIONS AND THE SUBSTANTIATION REQUIREMENT



SUBSTANTIATION

- The Substantiation Rules provide a method for the IRS to discover—and value—*Quid Pro Quo*.
- For all contributions – donor cannot claim a deduction unless the donor maintains a record of the contribution
- For contributions greater than \$250 – Tax Code places burden on charitable organization to provide disclosure statement



CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

- For Contributions less than \$250 – Donor must maintain “reliable written records, showing the name of the donee, the date of the contribution, and the amount of the contribution” (Treas. Reg. 1.170A-13(a)(1)(iii))
- Reliability of written records - determined on the basis of all of the facts and circumstances of a particular case.
- Factors demonstrating reliability:
 - The **contemporaneous** nature of the writing evidencing the contribution.
 - The **regularity** of the taxpayer's recordkeeping procedures. For example, a contemporaneous diary entry stating the amount and date of the donation and the name of the donee charitable organization made by a taxpayer who regularly makes such diary entries would generally be considered reliable.
- Reliable records can include canceled checks, receipts, diary entries, and bank statements



CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

- Special rules for deductions over \$250 from perspective of donor
- IRC § 170(f)(8) – Taxpayer making contribution is required to obtain a contemporaneous written acknowledgment from the donee with respect to the contribution
- Determined on a contribution-by-contribution basis
 - Separate contributions of less than \$250 – will not be aggregated (think weekly offerings to donor’s church)
 - Separate contributions of more than \$250 – must either (1) provide acknowledgment for each contribution over \$250 or (2) provide an annual summary substantiating several single contributions of \$250 or more
 - IRS anti-abuse rules are expected (and have been since 1993)



CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

The acknowledgement must include the following information:

- Name of the organization
- Amount of cash contribution
- Description (but not the value) of non-cash contribution
- Whether the donee organization provided any goods or services in consideration, in whole or in part, for any cash or other property contributed
- Good faith estimate of the value of goods and services, if any, that the organization provide in return for the contribution



CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

A required written acknowledgment must:

- inform a donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of money (and the fair market value of property other than money) contributed by the donor over the value of goods or services provided by the organization
- provide a donor with a good-faith estimate of the fair market value of the goods or services



ELEMENTS OF A CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

Regs. § 170A-13(f) does not require any particular format for a contemporaneous written acknowledgment. According to the legislative history, the acknowledgment may be made by letter, postcard, or computer-generated forms. An acknowledgment can be provided in paper form or electronically, including an e-mail addressed to the donor.



ELEMENTS OF A CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

Rules for Contributions via Payroll Deduction

- Donor usually uses pledge card prepared by or at the direction of the charitable org, along with:
 - Pay stub
 - Form W-2
 - Other employer-furnished document that shows the amount withheld and paid to a charitable org
- If donor makes single contribution of \$250 or more by payroll deduction – pledge card from org must also include the statement
- Each payroll deduction amount of \$250 or more is treated as a separate contribution for purposes of the requirement for written acknowledgments



ELEMENTS OF A CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

EXAMPLES

IRS Pub. 1771, *Charitable Contributions: Substantiation and Disclosure Requirements*, provides the following examples of contemporaneous written acknowledgments that satisfy the requirements of § 170(f)(8):

- Thank you for your cash contribution of \$300 that (organization's name) received on December 12, 2007. No goods or services were provided in exchange for your contribution.



ELEMENTS OF A CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

- Thank you for your cash contribution of \$350 that (organization's name) received on May 6, 2007. In exchange for your contribution, we gave you a cookbook with an estimated fair market value of \$60.



SUBSTANTIATION

The donor may also lose the charitable deduction if the written acknowledgement is not given.

There have been a very large number of cases in the past five years on this issue. For example, many land Trusts were experts on the tax issues involving conservation easements—but not on the law of charitable giving—and they failed to provide the proper written acknowledgment.



CONTACT ME



Jim Rourke
Associate

Columbia, SC
803.540.2030
Jrourke@nexsenpruet.com