

LIABILITY:

Random Thoughts On How To Not Get Burned

**Northwest Planned Giving Roundtable
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This session will explore several steps and ideas that you can use to minimize the chances of getting “burned” in a gift acceptance situation. More than just “do your due diligence” – we will discuss using intermediary entities to accept difficult assets, disclaiming gifts/bequests you do not want, entering into a “charitable put” to ensure the prompt sale of a gift asset, and other ideas.

I. MAKE SURE YOU WANT THE ASSET

Due Diligence

The amount and kind of due diligence depends upon the asset in question.

The amount and kind of due diligence may depend upon the charity in question.

See attached *sample* information on real estate gifts.

Gift Acceptance Policy

A charity’s GAP should, among other things, address what kinds of assets and gift vehicles the charity will consider accepting.

The *key* issue – who at the charity makes the final “call”?

II. IF YOU DON’T WANT THE ASSET, DON’T TAKE IT

You don’t have to accept a gift – not only can you decline a gift as it is being offered, but a beneficiary may disclaim any interest, in whole or in part, by filing a disclaimer. The California disclaimer rules are set forth in California Probate Code Section 275 and following; the IRC disclaimer rules are in Section 2518.

General California Rules

The disclaimer must be in writing, identify the creator of the interest, describe the interest being disclaimed, and state the disclaimer.

With whom the disclaimer must be filed depends upon the situation: the Probate Court (for bequests under a will), the trustee of a trust, the person responsible for distributing the interest, the person having possession of the asset, or the creator of the interest.

Note a beneficiary cannot disclaim an interest after he/she/it has accepted the interest.

A disclaimer is effective if it is filed within a “reasonable time” after the beneficiary acquires knowledge of the interest. In the case of certain types of interests, there are special rules that provide when a disclaimer is conclusively presumed to have been filed within a “reasonable time”.

Application to CRTs

Consider a CRT that provides: “at the termination of the trust, the trustee is to distribute the remainder to Charity 1; and if it is not then a qualified charity, the trustee is to distribute the remainder to Charity 2.”

If Charity 1 does not want to accept the trust assets, it should disclaim within nine months after the later of: (1) the time it first acquires knowledge of the interest, (2) the time its interest becomes indefeasibly vested, or (3) when the interest becomes an estate in possession (as the remainder interest is a “future estate”).

If Charity 1 disclaims, Charity 2 should disclaim within nine months the later of: (1) the time of the first disclaimer, (2) the time it first acquires knowledge of the interest, (3) the time the interest becomes indefeasibly vested, or (4) when the interest becomes an estate in possession (as the remainder interest is a “future estate”).

III. IF YOU WANT TO HAVE THE ECONOMIC VALUE OF THE ASSET, BUT NOT THE ASSET

What if you really want the economic value inherent in that run-down toxic waste-laden building?

Short Term CRT

Consider having the donor contribute the asset to a 5% net income CRT with the donor serving as trustee and a 3-year term. The liability remains with the donor (now serving as trustee). The donor hopefully sells the property promptly, and invests the proceeds until the trust termination date.

Donor's deduction is approximately 85% of the building value.

How short a term can you use? IRC section 664(d)(2)(A) refers to payments continuing for “a term of years (not in excess of 20 years).

How do you minimize income back to donor after the property is sold? Use a net income payment form, have the donor invest for growth and not income, and include the charity as an income beneficiary.

An alternative: use a more traditional long-term CRT, and have the donor give his income interest to charity after the asset is sold, and then collapse the trust. See Rev. Rul. 86-60.

Have Donor Give to A Single-Member LLC (Caution - This May Not Work!)

Consider having the charity form a limited liability company (LLC). For state law (e.g., liability) purposes, the LLC should be respected as a separate legal entity unless a litigant can “pierce the corporate veil”. As such, a liability

incurred by the LLC (due to it having accepted toxic real estate) should be limited to the LLC's assets – not the charity's.

For tax purposes, however, a LLC is classified under the so-called “check-the-box” regulations (Treasury Regulation Sections 301.7701-2 and -3). The check-the-box regulations provide, in general, that a single-member LLC may choose to be taxed as a corporation, or as a branch or division of its owner (in which case its separate legal existence is disregarded for federal tax purposes).

Thus, it would appear that a single-member LLC that does not elect to be taxed as a corporation is “disregarded as an entity separate from its owner”. This means that the activities of a disregarded entity “are treated in the same manner as a sole proprietorship, branch, or division of the owner”. These regulations do not limit the scope of the federal tax purposes for which a disregarded entity will be ignored.

However, note that the IRS has been “considering” whether the disregarded treatment applies for purposes of IRC Section 170 for almost 10 years, and has declined to rule on the issue.

Use An Accommodation Charity That Is More Comfortable With “Difficult” Assets.

For example, The Dechomai Foundation, Inc. (full disclosure – Dechomai is a client).

IV. SELL THE GIFT ASSET IMMEDIATELY

What if the donor wants to give you an asset, but you do not want to accept unless you “know” you can sell it promptly. Having the donor identify a buyer and enter into a binding sale agreement with him/her prior to the gift results in the donor being taxed on the gain (see *Palmer v. Comm'r.*, 62 TC 684 (1974), aff'd on other grounds 523 F.2d 1308 (1975), Rev. Rul. 78-197).

Consider having the charity identify a potential buyer prior to the gift, and enter into a “put” agreement with the buyer. Under the “put”, the charity has the right to force the buyer to buy the property at a stated price – but the buyer cannot force the charity to sell. The charity will likely have to pay the buyer some amount before the buyer will agree to be obligated to buy.

At moment of gift, the charity cannot be compelled to sell, as it has power to exercise the put or not. Plus, the donor did not negotiate the put and did not assign “his” income.

This put idea is similar to a gift of property that is subject to a right of first refusal. The IRS issued several PLRs in the early 1990's concluding that such a gift did not violate the rule set forth in *Palmer* and Rev. Rul. 78-197, as the donee charity cannot be compelled to do anything – it is only if donee charity decides to sell that any obligation becomes enforceable.

V. AVOID THE PRUDENT INVESTOR REQUIREMENTS

General Investment Standards Applicable to Charities

California charities are subject to the rules on prudent investments as set forth in both the Corporations Code and UPMIFA (which are not entirely consistent). The California Corporations Code provides that a Board must “avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of funds.” This is an “old fashioned” and fairly conservative statement of the prudent investor rule. UPMIFA articulates a much more “modern” standard of care for investing charitable funds, requiring (among other things) that the Board act in good faith and with the care of an ordinary prudent person.

Exception

So what if a donor wants to give you an asset, and does not want you to sell it immediately? A Board is relieved of the specific fiduciary duties regarding the investment of funds if a donor authorizes a certain investment, and is relieved of both the specific fiduciary duties regarding the investment of funds *and* its general overall standard of care if the donor requires a certain investment (Cal. Corp. Code sec. 5240(c)). The UPMIFA standard of care regarding investments is likewise prefaced with “Subject to the intent of a donor expressed in a gift instrument....”

VI. USE A CAREFULLY DRAFTED GIFT AGREEMENT

If you are going to take the gift, know what the “deal” is and get it documented.

Particularly problematic issues include:

- purpose restrictions, and whether donor has any right to redirect or sue if restrictions are not met
- naming (and un-naming) rights
- confidentiality
- how costs are to be charged

INFORMATION TO OBTAIN PRIOR TO ACCEPTING A GIFT OF REAL ESTATE

(Note: this is a sample only)

BASIC INFORMATION

The donor shall provide basic information including:

- the address and legal description of the property;
- assessor's parcel number;
- a description of any and all improvements on the property and income and expense information;
- a copy of the deed;
- a copy of the current year's tax bill;
- a description of known or suspected environmental contaminants;
- a list of mortgages and other encumbrances on or secured by the property; and
- any other information which would be relevant to Charity, including all information necessary for preparation of IRS Forms 8282 and 8283.

Survey

Charity may request a donor to provide a survey before accepting the property. A survey may be necessary, for example, if survey markers are not visible on undeveloped land or if there are known boundary disputes. It may be necessary to obtain a title policy covering boundary lines in lieu of a survey.

Preliminary Title Report

The donor shall provide Charity with a current preliminary title report on the property, including copies of all documents shown as exceptions to title on the report.

Market Determination

Charity shall consider an appraisal on the property prepared by a qualified real estate appraiser and a Comprehensive Market Analysis (CMA) prepared by a real estate broker qualified for this purpose. If there is significant divergence between the appraisal and the CMA, Charity shall make a further analysis.

CRITERIA FOR DETERMINING WHETHER TO ACCEPT THE REAL ESTATE GIFT

General Criteria

Charity shall consider the cost of acquiring, maintaining, and selling a property before accepting a gift of such property. Factors such as significant environmental hazards, structural defects, ownership disputes, and potential tax liabilities generally reduce the value of an offered gift of property. Charity shall determine whether or not an offered gift of property will be accepted based upon recommendation of the Executive Committee.

On-Site Inspection

One or more representatives, agents, or employees of Charity shall make an on-site inspection of the property prior to acceptance of the gift. Charity may retain a licensed contractor or civil engineer as appropriate to inspect the property and render an opinion as to its condition.

Analysis of Holding Costs and Costs of Sale

Charity shall evaluate the holding costs and prospective sales cost of the offered property on the basis of an analysis of all relevant factors including, but not limited to, the following variables:

- Present market value,
- Future market value (appreciation potential),
- Costs of acquisition,
- Encumbrances,
- Zoning and use restrictions,
- Maintenance and repair expense,
- Loan principal and interest expense,
- Property tax, unrelated business income tax, and other tax expense, and
- Marketing, sales commission and closing costs

Donation Agreement and Grant Deed

To accept the donation, there must be a written donation agreement indicating the donor's irrevocable donation of the gift and its purpose and containing, in the opinion of Charity's legal advisors, appropriate representations, warranties, and releases in favor of Charity. The donor's entire right, title, and interest in the property should be conveyed to Charity by Grant Deed.

Hazardous Materials and Other Environmental Considerations

Prior to acceptance of real estate, Charity shall require an initial environmental review of the property to ensure that the property has no environmental damage. In the event that the initial inspection reveals a potential problem, Charity shall retain a qualified inspection firm to conduct an environmental audit.

The following are examples of some types of prior uses that indicate a need for an environmental study prior to acceptance: underground fuel storage (such as gas station and vehicle fleet servicing); chemical and manufacturing plants; dumps; medical/dentist's facilities; dry cleaners; and agricultural operations.

In addition, in the case of properties with the potential for environmental contamination, Charity shall obtain a Phase I report on the property:

- If such report is clean, the property may be accepted.
- If a Phase I report is not clean, Charity shall obtain a Phase II report. If the Phase II report is clean, the property may be accepted subject to the recommendation of the Executive Committee.
- If the Phase II report is not clean, then Charity may elect to accept the gift if the downside liability risk (and potential remediation costs) is substantially less than the value of the gifted property. Such decision shall be based on the recommendation of the Executive Committee.

ENVIRONMENTAL INSPECTION FORMS

ENVIRONMENTAL INTERVIEW

This interview is designed for use with current and/or prior owners or managers of the property.

Date of Interview _____	Interviewer _____
Person Interviewed _____	Relation to Property _____
Property Description _____	

Type of Property	Agricultural _____	Timber _____
	Commercial _____	Manufacturing _____
	Age of Buildings _____	Undeveloped Land _____
	Residential _____	Other _____

1. Indicate prior uses of property. _____
2. Are you aware of any environmentally sensitive situations on the property?
Describe: _____
3. For uses identified in question 1, has an environmental license or permit ever been issued? _____
No _____ Yes _____
4. Are there any oil, fuel or chemical storage tanks on the property located above or below ground?
_____ No _____ Yes _____
5. Has an environmental assessment been previously conducted? _____ No _____
Yes. If yes, provide a copy of the report.
6. If available, attach maps or surveys that describe the property to this questionnaire. _____ attached
none available
7. If you are unable to furnish the information requested above, please advise us if there is a reliable source that may be able to furnish this information.

PROPERTY INSPECTION CHECKLIST FOR CURRENT ENVIRONMENTAL CONDITIONS

Name of Inspector _____	Date of Inspection _____
Owner of Property _____	Estimated Size _____
Location of Property _____	Current Use _____
Number of years the current use has been in effect _____	
Brief history of property use (list past use and former tenants, and source of information)	
_____ _____ _____	

ENVIRONMENTAL SITE INSPECTION CHECKLIST

- | | | |
|--|------|------|
| I. An on-site inspection revealed the following: | Yes | No |
| A. Stressed or denuded vegetation or unusual barren areas | ____ | ____ |
| B. Discoloration, oil sheens or foul/unusual odors in water | ____ | ____ |
| C. Dump site | ____ | ____ |
| D. Tire/battery/chemical storage or disposal | ____ | ____ |
| E. Storage drums | ____ | ____ |
| F. Above or below ground storage tanks, vent or filler pipes | ____ | ____ |
| G. Evidence of petroleum or oil products | ____ | ____ |
| H. Evidence of PCBs (electrical transformers, capacitors) | ____ | ____ |

- I. Subject or adjoining property used for industrial purposes _____
- J. Existing structures: If yes, indicate if there is:
 1. Evidence of chemical spills/leaks _____
 2. Evidence of asbestos _____
 3. Any source of air emission _____
- K. Does property appear on National/State Hazardous Site list? _____
- L. If "yes" to any of the above, describe: _____

- II. () Based on the evaluation of known, discovered or observed environmental factors, there is no evidence of environmental contamination on this or neighboring properties, and no further action is recommended.
- () Based on the evaluation of known, discovered or observed environmental factors, there is evidence of possible environmental contamination on this or neighboring properties and further investigation is recommended. (*Complete "Evaluation of Known Environmental Factors Form" if this block is checked.*)

Person Completing Form	Title	Date
Acceptance of Form Approved By	Title	Date

EVALUATION OF KNOWN ENVIRONMENTAL FACTORS

Check the appropriate response to each statement based on all sources of information, including the Environmental Site Inspection Checklist.

- | | Yes | No |
|--|-----|----|
| A. This property (or adjacent property) appears on federal, state or other environmental agency list of sites identified for environmental investigation or cleanup. | — | — |
| B. This property is developed and used for an industrial or manufacturing purpose. | — | — |
| C. This property is undeveloped land used for landfill or waste dump purpose. | — | — |
| D. The prior, current or proposed use of this property involves the generation, storage, treatment or disposal of any potentially hazardous materials, oil/petroleum products or other substances regulated by environmental laws and agencies. Specify: _____ | — | — |
| E. Activities on adjacent properties may have contributed to the environmental contamination of the subject property. | — | — |
| F. This property is near a flood plain, wetland or ecologically sensitive area. | — | — |
| G. The Environmental Site Inspection revealed evidence of | — | — |

possible environmental contamination.

- H. The donor has revealed potential sources or causes of environmental contamination. _____
- I. This property is used for agricultural purposes. _____
- () Based on the evaluation of known environmental factors, there is no evidence of possible environmental contamination on this or neighboring properties and no further action is recommended. _____
- () Based on the evaluation of known environmental factors, there is evidence of possible environmental contamination on this or neighboring properties and further investigation is recommended. _____

Recommendations: _____

Person Completing Form _____ Title _____ Date _____

Acceptance of Form Approved By _____ Title _____ Date _____