



# NONPROFIT FINANCE & SUSTAINABILITY CONFERENCE

March 29 & 31 | Virtual





# Playing Your Hand: Managing Restricted and Complex Gifts and Funds

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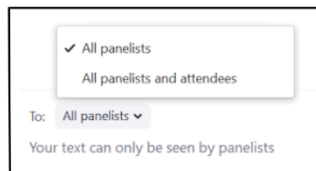
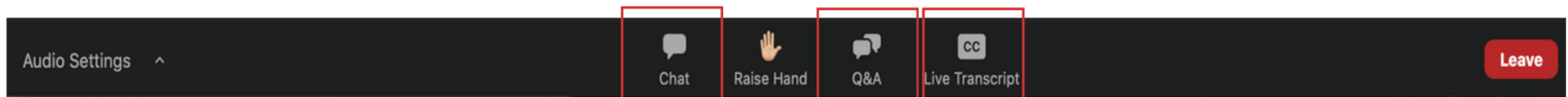


# SESSION ENGAGEMENT

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Remember! Select your Chat Audience as 'All panelists and attendees.'

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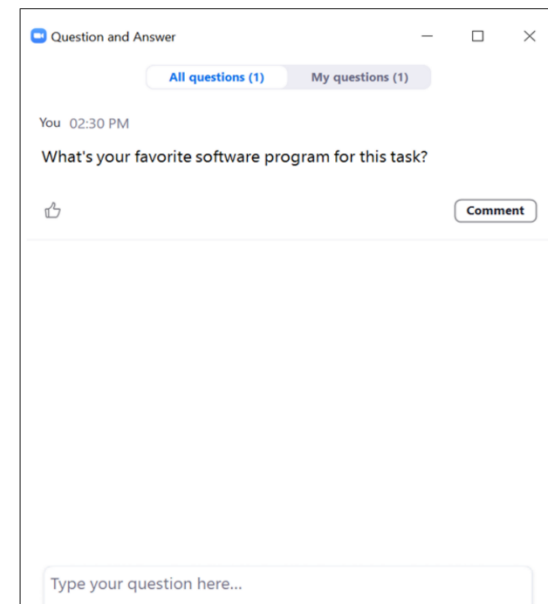
# HOW TO ASK QUESTIONS

Have a question for today's presenters?

**Ask your questions using the Q&A tool.**

You can also give a  to other questions you would like to see answered.

**Please use the Q&A tool for questions, not Chat.**



**2022 NONPROFIT FINANCE & SUSTAINABILITY CONFERENCE**

**CPE CREDIT TRACKING WORD #1**

**Gifts**



Nonprofit Finance & Sustainability Conference

# Playing Your Hand: Managing Restricted and Complex Gifts and Funds

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March 31, 2022



# Presenters



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# Endowment Management

# Defining “Endowment”

The applicable legal definition is found in UPMIFA, which has been adopted in every state, with some slight variations. **“Endowment fund” means a charitable fund that—**

## **under the terms of a gift instrument**

- an endowment fund is a **LEGAL OBLIGATION**

## **is not wholly expendable by the institution on a current basis**

- an endowment fund is **DONOR RESTRICTED**
- concept of “**generational equity**”—must preserve the principal
- some states have adopted a **presumption of imprudence** if the spending from an endowment is an amount **greater than 7% of the principal** in any one year
  - Not in MN
  - The 7% number does **not** create a safe harbor for spending amounts below that level.

# Defining “Endowment”

An endowment is **NOT**—

- A fund without timeline spending restrictions
- A fund with Board-designated timeline spending restrictions

# “Gift Instrument”

- The record of the gift to charity
  - Includes written “agreement” but also other communications recorded with respect to the gift
- UPMIFA rule of interpretation: instructions to use only the “income,” or “interest,” or “to preserve the principal intact” create an endowment subject to UPMIFA’s default rules
- “Gift instrument” not a contract or a trust
  - **Drafting tip:** Be explicit about this in the written document memorializing the gift, and refer to UPMIFA as the law governing the interpretation of the gift instrument

# UPMIFA Prudence Standard for Spending

- Not a bright-line maximum or minimum
- UPMIFA superseded the “historic dollar value” standard
- Nonprofit may spend or accumulate so much of an endowment fund as the nonprofit “*determines is **prudent for the uses, benefits, purposes, and duration** for which the endowment fund is established.*”
- Nonprofit’s determination must be in good faith and with the care of an ordinarily prudent person in a like position.

# Factors for endowment spending rate

- UPMIFA instructs nonprofits to consider the following factors, if relevant:
  - The duration and preservation of the endowment fund
  - The purposes of the nonprofit and the endowment fund
  - General economic conditions
  - The possible effect of inflation or deflation
  - The expected total return from income and the appreciation of investments
  - Other resources of the nonprofit
  - The investment policy of the nonprofit

# But really, how much can we spend?

- UPMIFA's drafters' comments provide guidance
- Presumption that the charity will generally preserve purchasing power of the endowment
- Yet, some spending is permissible even if there is no investment return that year
- Likely permissible to make short term increases due to a crisis, even in a down economy
  - But need to take into account the organization's spending policy



# Evaluating Compliance in Spending

- Reputational risks and donor relations
  - Public criticism can cut both ways, i.e. *“Why aren’t you using this resource”* vs. *“Why are you wasting this resource”*
  - Example of Harvard University (and others) returning and/or declining federal pandemic aid
- Business Judgment Rule
- Attorney General enforcement powers
- Members of the general public and donors generally **do not** have standing to bring a lawsuit
  - BUT this will depend on what law the court applies (UPMIFA vs. general contract law)

# Spending Policies

- Often in notes to audited financial statements
- Often contain an objective:
  - *The nonprofit attempts to provide a predictable stream of funding to programs while seeking to maintain the purchasing power of endowed assets.*
- Often consider UPMIFA factors and come to a conclusion:
  - *The Board of Directors has adopted a policy of appropriating for distribution each year 4.5% of its endowment funds' fair market value as determined quarterly and averaged over the preceding 5 years.*
- Percentage of moving average spending policy (see above) is most common, but not the only model, and not one-size-fits-all
  - Spending policy and investment policy should work hand-in-hand to support the mission and needs of the organization

# Borrowing from Endowments

- UPMIFA does not address this
- A “loan” to the nonprofit itself likely should be viewed as a distribution from the endowment, subject to the same considerations that apply to other distributions—i.e., the notion of borrowing from an endowment does not necessarily provide an organization greater spending leeway
- Still subject to UPMIFA’s prudent spending analysis

# Using Endowments as Collateral

- UPMIFA does not address this, either. Even if permitted, it would be very risky to pledge the “principal” of an endowment as collateral
  - Generally, a nonprofit can only pledge property that the nonprofit has the right to access on a current basis
- Some large foundations are issuing taxable, corporate bonds—these are ***not*** secured by endowment assets

# Purpose Restrictions

# Purpose Restrictions

- “Endowment” is a time restriction
- Gifts also must be used for the specific purposes directed by the donor(s) (if any)
- Restricted purposes must be in writing
  - Can be in a formal gift instrument *or solicitation materials*
- Board-restricted funds are not permanently restricted
- In Minnesota, the AG oversees charities and ensures compliance with donor restrictions
- In Minnesota, the donor generally does not have standing to enforce purpose restrictions

# Best practices for gift instruments and trusts

- Do not undertake programs not already within the organization's charitable mission or goals
- Fully investigate the proposed terms and nature of the gift
- Give the organization as much discretion as possible regarding the operation of the program and the selection of a new purpose if necessary
- Resist donor control
  - Preserves donor's tax deduction
  - Prevents disagreements (e.g., resist giving donors the right to direct charity's activities)
  - Maintains operational flexibility

# Specific terms to include in gift instruments

- Define the purpose broadly
- Include change of circumstances clause:
  - *If [nonprofit] determines, in its sole discretion, that due to a change in circumstances, compliance with a restriction contained in this gift instrument is impracticable, inexpedient, impossible, or not in [nonprofit's] best interest, [nonprofit] may modify the restriction to accomplish, as nearly as possible, the general purposes of this gift instrument and the object and intention of the Donor, without regard to the specific restriction*
  - Backup plan: a stated alternative use
  - CRTs and CLTs cannot use this language
- Expressly state:
  - Gift is irrevocable, unconditional, and not a trust (for an UPMIFA fund)
  - Gift instrument supersedes all other communications and embodies all the terms
  - Deductions may be made to cover costs of investing and managing the fund and making distributions



# Naming Rights

- Naming rights should be granted carefully
  - Time limit
  - Morality clause
  - Future donors with co-naming rights
  - Dollar minimum

# Modifying Restricted Funds under UPMIFA

- Make it fit... or:
- Donor consent in a record
- Court action (*cy pres* doctrine)
  - If “circumstances have so changed... as to render impracticable, inexpedient, or impossible a literal compliance with the terms of the instrument,” the court may modify the fund “in a manner the court determines will, as nearly as possible, accomplish the general purposes of the instrument and the object and intention of the donor.” Minn. Stat. § 501B.31.
- Old, small funds submission to Attorney General and no objection in 60 days
  - Over 20 years and under \$50,000

**2022 NONPROFIT FINANCE & SUSTAINABILITY CONFERENCE**

**CPE CREDIT TRACKING WORD #2**

**Spending**



# Strategies for Gift Development

# IRA Rollover (QCD)

## – Lifetime IRA Rollover

- \$100,000 per year.
- Public charity, not family private foundation, supporting organization, donor advised fund, charitable remainder trust or charitable gift annuity.
- Donor must be age 70 ½ or older.
- Gift must come “directly” from the donor’s IRA.
- Only allowed for IRA not 401k, etc.
- Tax consequences.
  - Excluded from donor’s federal gross income.
  - No income tax charitable deduction.
  - Counts towards donor’s required minimum distribution (RMD) from the IRA for the year (Secure Act changes RMD age to 72 but QCD was unchanged).

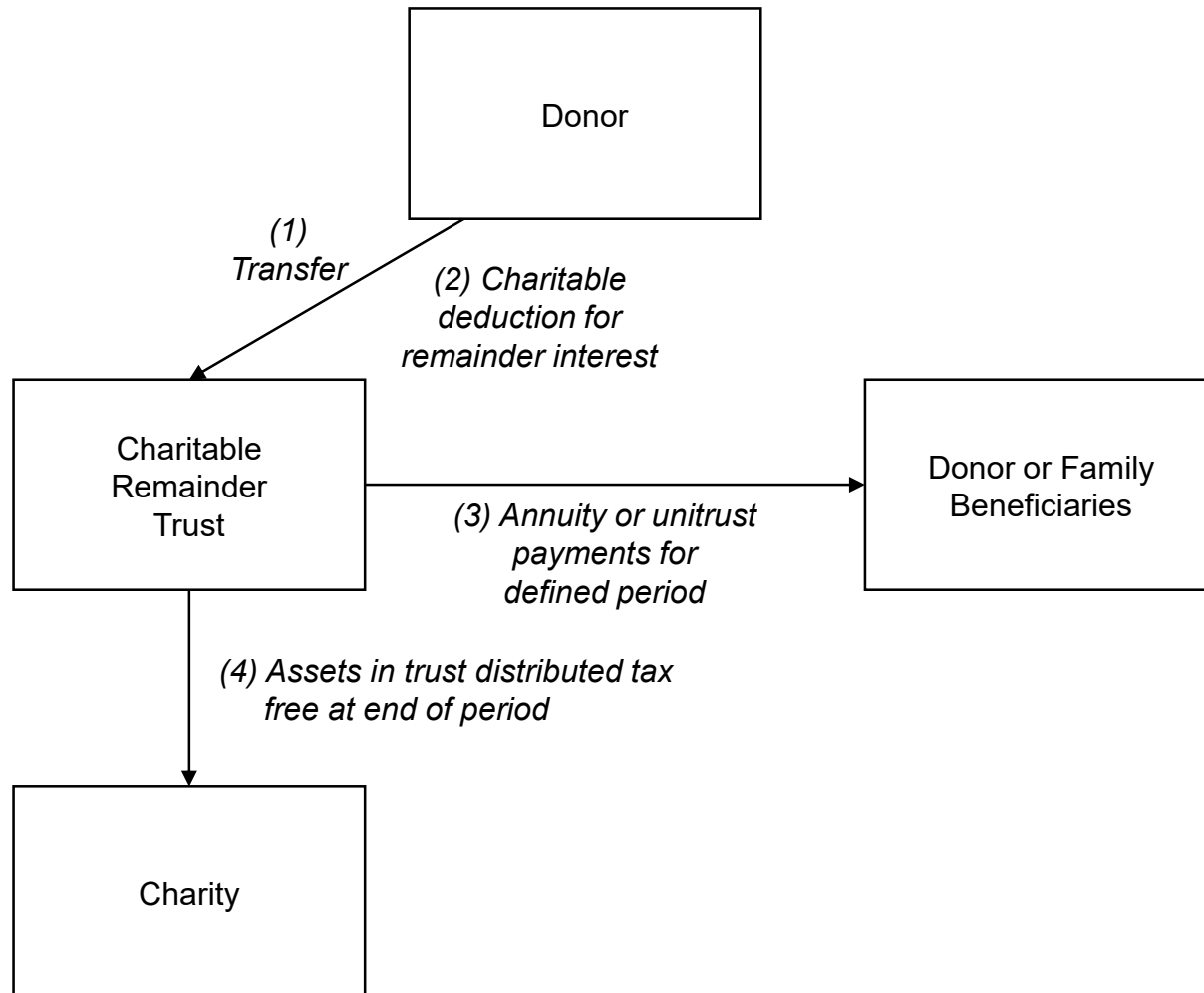
# Testamentary Gifts

- Wills, Revocable Trusts, beneficiary designations of life insurance, beneficiary designations of retirement accounts, beneficiary designations of other assets (POD, TOD, TODD)
  - Make sure acceptable structure, purpose for charity
  - Estate tax deductions for donor
  - Donor retains control during lifetime
- Life Estate / Remainder
  - Only applies to personal residence and farm.
  - Donor retains or gifts a life estate or a term of years for himself or other
  - Income, gift, estate tax charitable deduction for remainder vested in charity
  - When interest rates are low, gift of remainder will be valued higher so charitable deduction will be higher

# Charitable remainder trust (CRT)

- Noncharitable beneficiaries receive defined annual amount for period of time, e.g. lifetime or term of years; at end of period remaining trust property passes to charity
  - Unitrust (redetermined each year based on annual value of assets); annuity (determined at creation and stays the same)
- Can be created during life or at donor's death
- Gift/estate/income tax deduction for value of charity's remainder.
- Almost any type of property
  - Consider liquidity and cash flow to meet annual payment obligation.
  - Avoid UBTI which is taxable at a rate of 100%.
  - Subchapter S termination as nonqualified shareholder and UBTI
  - Appreciated assets to defer capital gains for donor
    - Income recipient reports trust's income up to payment amount
  - Private foundation rules apply: Self-dealing, excess business holdings, jeopardy investments.

# CRT

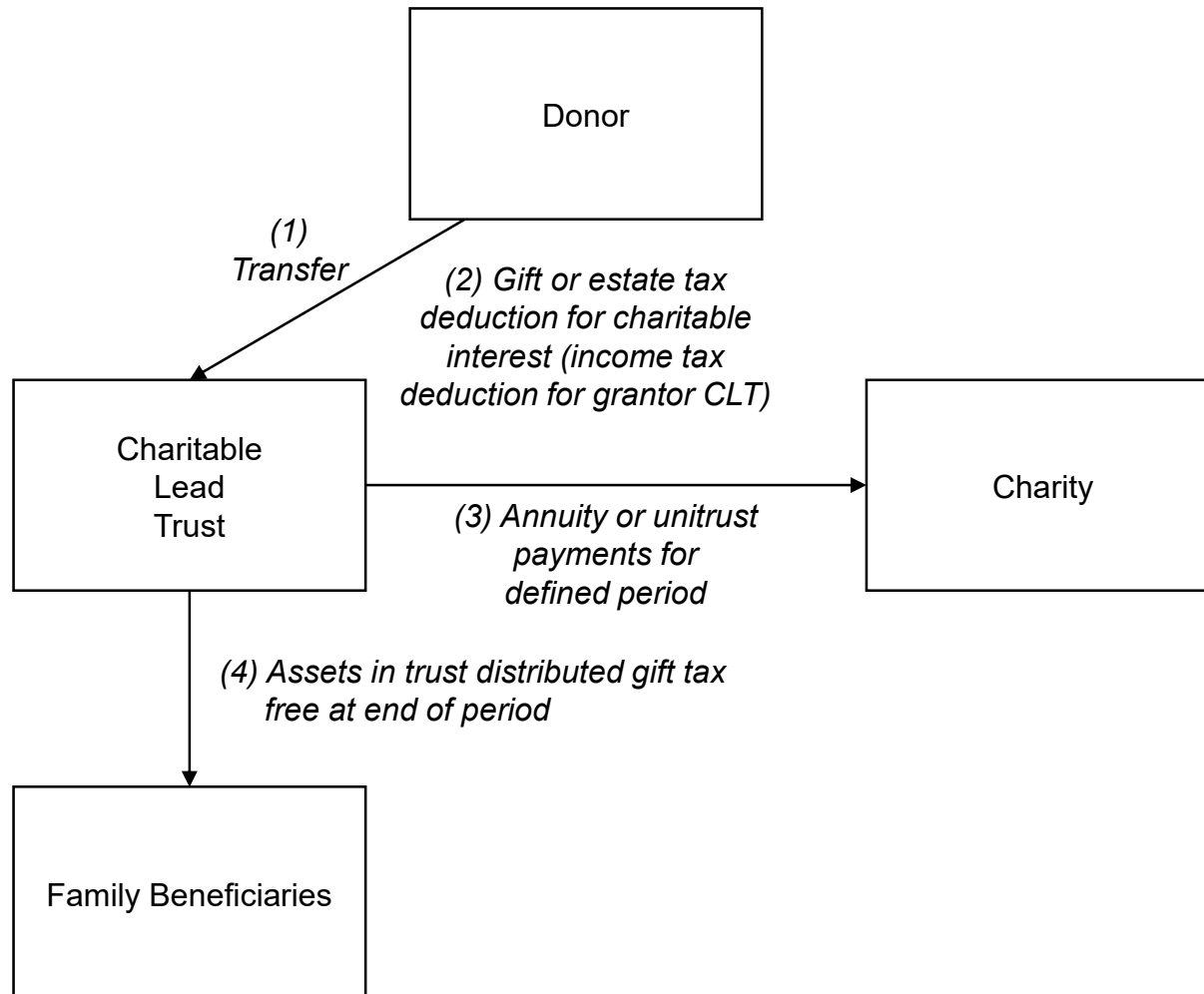




# Charitable lead trust (CLT)

- Irrevocable trust
  - Charitable beneficiaries receive annual amount for a period, e.g. a term of years
  - At end of term, remaining trust property passes to noncharitable beneficiaries
  - Unitrust or annuity trust payment structure allowed
    - In low interest rate times, annuity trusts provide estate tax leverage
- Created during life or at death
- Gift or estate tax deduction available for charity's interest
  - Income tax deduction only for grantor trust
- Almost any type of property
  - Liquidity to satisfy annual payment obligation to the charity.
  - Subchapter S termination unless trust is an ESBT
  - UBTI not available for 642(c) charitable deduction
- Private foundation rules apply

# CLT



# Real Estate

- Donor concerns
  - Partial interests not deductible (time shares, leases)
  - Deductible at fair market value if to public charity or CRT/CLT
  - If no prearranged sale, no capital gain on appreciated property; reduce deduction/recognition of income for ordinary income items, e.g. depreciation, mortgage
  - Qualified appraisal, forms 8282 and 8283
- Charity concerns
  - Environmental issues, ground, asbestos, lead paint, etc.
  - Title issues - Warranty deed, leases, agreements, options, mortgages
  - Valuation and receipt
  - Management and sale – Experts, carrying expenses during possession
  - Tax issues for charity
    - Self-dealing, private benefit
    - Unrelated business taxable income (UBTI) – mortgage, leases

# Farm Tangible Assets (Crops and Machinery)

- Donor concerns
  - No basis in inventory, so ordinary income and only deductible at basis
  - Can retain income and defer recognition of tax
  - No appraisal needed if no income tax deduction
  - Prearranged sale issues
    - Crops to elevator – care required in process of titling, transfer and timing
    - Auction of equipment – care required in contract, timing
- Charity concerns
  - Valuation, title and receipt
    - May not have qualified appraisal so use qualified expert
    - Proper assignment, possession, title documents
  - Management and sale – Experts, carrying expenses/storage
  - Tax issues
    - Self-dealing, sale to family
    - UBTI, multiple sales

# Other Tangible Personal Property (Instruments, Archives, Artwork and more)

- Donor concerns
  - Related use - Deduction at fair market value if to public charity, CRT/CLT
    - If charity sells within 3 years, portion of donor's tax benefit will be recaptured
  - Unrelated use or planned sale
    - Deduction is at lower of donor's basis or FMV
  - Prearranged sale issues
  - Qualified appraisal required
  - Intellectual property issues
- Charity concerns
  - Effective transfer and possession - deed of gift
  - Valuation, title and receipt, intellectual property issues
  - Management and sale – Experts, carrying expenses and storage
  - Tax issues
    - UBTI
    - Self-dealing

# Other Tangible Personal Property (Instruments, Archives, Artwork and more)

- Special issues
  - Coins
    - Currency or collectible
      - Affects donor's deduction and substantiation
      - Bitcoin – currently considered capital gain property not currency
  - Artwork
    - Provenance
      - History, exhibits, owners, sales, etc.
    - Misappropriated artifacts and cultural items with prior rights
    - Protected items – e.g. ivory

# Mineral Interests

- Donor concerns
  - Partial interest versus fractional interest
  - Qualified appraisal
  - Deduct at FMV if to public charity, CRT/CLT; basis if to private foundation
- Charity concerns
  - Nature of interest
    - Producing vs. nonproducing
    - Working (participating) vs. nonworking (nonparticipating)
  - Environmental issues like real estate
  - Valuation – depleting resource
  - Effective transfer of title
  - Management and sale - Experts
  - Tax Issues
    - UBTI if working or participating interest

# Business Interests

- Donor concerns
  - FMV deduction for public charity, CRT/CLT; basis if to private foundation
  - Prearranged sale – facts and circumstances test
  - For pass through entity
    - Deduction is reduced for unrealized receivables, inventory, other ordinary income
    - Bargain sale for mortgage
- Charity concerns
  - Nature and financial condition of business
  - Concerns with other owners of the business
  - Valuation, including discounts
  - Liabilities of owners / partners, including capital calls
  - Tax issues – UBTI at corporate rates including acquisition indebtedness, phantom income
    - Subchapter S always UBTI, LLC/Partnership look through to activities
    - Exceptions - dividends, interest and royalties, rents, capital gain
  - Self-dealing, private benefit
  - Excess business holdings



# APPENDIX

	Bequest	Beneficiary Designation Life Insurance	Beneficiary Designation Retirement Account	POD/TOD	CGA	CRT	CLT	Life Estate Remainder
Donor wants/needs income/asset	X	X	X	X	X – for self	X – for self		
Donor doesn't want or need income/asset		X – or ownership transfer	X – IRA Rollover		X – for another	X – for another	X	X
Cash	X			X	X	X	X	
Publicly Traded Securities	X			X	X	X	X	
Closely Held Business	X – if charity can accept			X – if charity can accept	Probably Not	Depends on factors	Depends on factors	
Real Estate	X – if charity can accept			X – if charity can accept	X – if charity can accept	Depends on factors	Depends on factors	X – home/farm if charity can accept
Tangible Personal Property	X – if charity can accept				X – if charity can accept	X – if charity can accept	X – if charity can accept	
Retirement Assets			X – or Rollover during life			X – at death		
Easy for Donor to Implement	X	X	X	X	X			X
Easy to Administer	X	X	X	X	X			X

*THANK YOU!*

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**2022 NONPROFIT FINANCE & SUSTAINABILITY CONFERENCE**

**CPE CREDIT TRACKING WORD #3**

**Current**



## **WHAT'S NEXT AT THE CONFERENCE...**

**That's a wrap, folks!**

**Thank you for attending the 2022 Nonprofit  
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**2022 NONPROFIT FINANCE & SUSTAINABILITY CONFERENCE**

**ARE YOU PLAYING THE SCAVENGER HUNT?**  
**THIS SESSION'S CODE...**

**Pq#f1**





**THANK  
YOU!**

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