

# **REPRESENTING CHARITABLE ORGANIZATIONS – A PRIMER IN FUNDAMENTALS**

**by Ronni G. Davidowitz\***

Legal representation of beneficial interests of charities is a specialized field requiring a mixture of sensitivity to public relations and legal knowledge of aspects of not-for-profit law. Counsel for charities must balance the dependence the charities have on maintaining good will to enhance donations against its fiduciary duty to ensure that all benefits accruing to it are collected. Armed with certain fundamentals, counsel may adequately and properly protect the charities' interests while at the same time keeping an eye on its public image.

A charity may acquire a beneficial interest through any variety of instruments, whether testamentary or inter vivos. Notification of such interest is made first to the entity itself. It is important to train the charity's staff in how to deal initially with such notification and how to know when to refer the matter to its counsel. A primary objective of counsel is to overcome any inclination a charity's board or staff might have to sign any form of receipt and release presented to it, under the theory that it shouldn't "look a gift horse in the mouth." Rather, the charity should be encouraged to review the underlying papers presented to it and request supporting documents when such documents have not been presented. This is simply good, prudent business practice. At this juncture, it also may be appropriate to refer the matter to counsel for assistance.

## **Preliminary Considerations**

It is imperative to read thoroughly the entire instrument to ensure that the charity's complete interest is ascertained and understood. For example, a charity may have an up-front cash legacy, but may also be named as a remainderman of a trust. In addition, one should be

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aware of any condition or restriction placed on the gift to charity to make sure that such condition or restriction may be complied with by the charity and that it is not too onerous a burden on the charity. If a demand is made on the charity that simply cannot be fulfilled because it is not practicable or possible to fulfill due to obsolescence, consideration should be given to either a construction proceeding or a *cy pres* proceeding to construe a reasonable alternative that most closely resembles the donor's intent. Alternatively, it may be necessary for the charity to refuse the gift, via a disclaimer under Section 2518 of the Internal Revenue Code of 1986 as amended, (the "IRC"), if the requirements of the gift negate the value of the gift or are wholly unreasonable. This also should be considered in the case of gifts of real property as no charity should blindly accept real property without having done its due diligence to see if, for example, it will become subject to environmental clean-up liabilities by accepting title to land.

A further note on restrictive gifts. Many times a gift to charity takes the form of an endowment gift, with the requirement that the charity hold the funds in a segregated account, in perpetuity. The charity by the terms of the donative instrument may be able to use the income earned by the fund for its general charitable purposes or its use of income may be further limited. In any case, it is up to counsel to alert the charity to strict bookkeeping and reporting requirements as these funds must be separately accounted for to ensure compliance with the terms of the gift. In New York, for example, Section 513 of the New York Not-for-Profit Corporation Law sets forth the reporting obligations and the New York Attorney General's Office has developed forms for not-for-profits to use to trace the historic dollar fund (the initial principal or corpus of the fund), the appreciation or depreciation of the fund and the ordinary income earned. The Attorney General's office is particularly concerned that efforts be made to preserve the historic dollar fund and absent a limitation in the donative instrument as to use of any appreciation, will encourage that a reserve of appreciation be maintained as a hedge against inflation. For general information, log on to the New York Attorney General's website at [www.oag.state.ny.us](http://www.oag.state.ny.us).

Returning to the review of the donative instrument, counsel should read the instrument to see if a testator's charitable intent has been fulfilled by the creation of a charitable remainder trust in strict conformity to Internal Revenue Service Code and Regulations. (See Section 664 of IRC, et seq.) Unhappily, an inexperienced draftsman may not have drafted a trust which meets the requirements for a charitable deduction. However, with timely attention, it may be possible to bring a reformation proceeding to bring the trust into conformity and salvage the charitable deduction.

Counsel must be alert to the presence or absence of an estate tax clause. Absent language directing to whom estate taxes must be apportioned against, estate taxes are apportioned against each beneficiary's interest in proportion to the estate taxes generated by the property gifted to the beneficiary. See, for example, Section 2-1.8 of the New York Estates, Powers & Trusts Law. In such an instance, no estate taxes should be charged against the interests of the charitable organization. To the extent the charity has a residual (or remainder) interest in an estate, it will be entitled to receive an accounting summarizing all of the transactions which have occurred in the administration of the estate since the death of the decedent and counsel should pay particular attention to the allocation of estate taxes reported in the accounting.

#### Reviewing An Accounting

In reviewing an accounting on behalf of charity, counsel must give consideration to the same issues as when representing a non-charitable beneficiary. Specifically, counsel should compare the principal on hand to the income collected to be certain all monies have been accounted for, that the fiduciary took prudent steps, in the case of an estate, to preserve the estate assets, and in the case of a trust, to grow the trust assets. Did the fiduciary take control of the assets by getting, if necessary, preliminary letters and did the fiduciary act to stem losses? Were the assets sufficiently diversified? Were the disbursements made proper charges against an

estate or trust, are the legal and accounting fees reasonable, are commissions properly calculated and is the proposed schedule of distribution properly determined?

With respect to fiduciary income taxes, as a general rule, no charitable share should be diminished by payment of fiduciary taxes. If there are charitable and non-charitable residuary beneficiaries, any fiduciary incomes taxes paid should be allocated against the non-charitable beneficiaries. Pursuant to Section 642 (c) of the IRC, the estate is entitled (and should have taken) a full charitable deduction on its fiduciary income tax returns for income distributed or deemed set aside for charity. Such charitable deduction inures to the benefit of charity.

Counsel must be knowledgeable about applicable statutory rules concerning the computation of commissions to ensure that commissions have been determined correctly. For example, under Section 2309(5) of the New York Surrogate's Court Procedure Act, in the case of a trust created wholly for charitable purposes, the trustee is not entitled to commissions against principal, but rather, is entitled in such circumstance, to commissions from income in an amount equal to six percent of income collected in each year.

In determining whether to recommend approval of an accounting, counsel for charity must be grounded in law and in common sense. With regard to the law, counsel must protect charity by being aware of the rules affecting all beneficiaries and charities, in particular. With regard to common sense, counsel must be sensitive to public relations aspects as too vigorous a defense may result in attorneys and corporate entities discouraging a donor from making a gift to charity. Care must be taken to use appropriate judgment in protecting the interests of the beneficiary while not antagonizing the estate or trust administrator with points that, although technically correct, are of a minor nature in substance and volume. If, for example, legal fees appear higher than normal and you are unable to ascertain any unusual circumstances justifying the higher fees, look to see what your charity's interest is and to what degree it would receive additional funds should you prevail.

Experience has shown that where individuals leave sizeable gifts to charity, they tend to benefit multiple charities, often times charities with common goals and objectives. It is good practice to communicate with counsel for the other charitable beneficiaries. Therefore, to the extent that circumstances permit, avoid having your charity be the lone voice and rather join forces with your co-beneficiaries to argue any problems with an accounting. Also, where possible, encourage the attorney general's attorneys and staff to help you out as the representative of ultimate charitable beneficiaries.

In summary, counsel should be well versed in the law to maximize the benefits accruing to its charitable clients, should operate with sensitivity to charity's role and yet not abdicate fiduciary responsibility and good advocacy.