

TAX LAW UPDATE

By **David A. Handler**, partner in the Chicago office of Kirkland & Ellis LLP, and **Alison E. Lothes**, partner at Gilmore, Rees & Carlson P.C., in Wellesley, Mass.

• **Cryptocurrency donation needs a qualified appraisal for income tax deduction**—In Chief Counsel Memorandum 202302012, the Internal Revenue Service assessed how Internal Revenue Code Section 170(f)(11)(C) applies to cryptocurrency. That section provides that when a charitable contribution deduction of more than \$5,000 is made, a qualified appraisal is required. There are exceptions for certain kinds of property, including: cash, publicly traded securities and intellectual property inventory.

The taxpayer had purchased cryptocurrency on an exchange and donated it to a charity. The taxpayer prepared her own income tax return and claimed the deduction valued at \$10,000 based on the trading price on the exchange on the date of the donation.

The Chief Counsel explained that cryptocurrency isn't a security under the Treasury regulations and didn't fall into a category that would be excepted from the appraisal requirement. Further, the fact that the cryptocurrency was traded on an exchange didn't provide reasonable cause to omit a qualified appraisal. Therefore, the charitable deduction was denied.

• **Complaint filed for estate tax refund by executors of billionaire's estate**—The executors of the estate of billionaire Richard Mellon Scaife have filed a claim in the U.S. District Court for the Western District of Pennsylvania to recoup an estate tax refund based on a deduction for a liability under an indemnity agreement (*H. Yale Gutnick et al. v. United States*, 2:23-cv-00139). Richard had been a beneficiary of a trust established by his mother in 1935. The trust allowed for discretionary distributions of principal to him; on Richard's death, the remaining trust property would benefit his two children. However, over his lifetime, he had requested and received over \$400 million in principal distributions, which completely exhausted the trust. In exchange for each distribution, he signed an indemnity agreement in which he agreed, on behalf of his heirs and executors, among others,

to indemnify and hold harmless the trustees for any action related to the distribution.

Richard died, survived by his two children whom he completely excluded from his estate plan. The children sued the trustees of the trust for breach of duty, claiming that the distributions made to Richard during his life were improper. They argued that the distributions made to support Richard's newspaper business and for "estate-planning purposes" were a breach of duty. Meanwhile, the estate paid over \$239 million in estate taxes and advised the IRS of the claim and its obligation to defend the trustees and pay its legal and administrative expenses.

After six years of litigation, the trustees and the children signed a settlement agreement in which the estate was obligated to indemnify the trustees for an agreed \$200 million reimbursement to the trust. The estate has filed a claim for a refund of nearly \$70 million in estate taxes, but the IRS hasn't responded with any notice of disallowances, so the estate filed the complaint.

PHILANTHROPY

Dedicating More Of the Great Wealth Transfer to Philanthropy

By **Sandra Swirski**, founder of Integer, based in Washington, D.C., and **Tony Macklin**, founder of Tony Macklin Consulting, based in Pittsburgh

The wealth transfer to younger generations currently underway—and projected to continue for the next 20 years or so—is estimated to top \$84.4 trillion.¹ This is generally described as the "Great Wealth Transfer." Let's focus on two perspectives on that wealth transfer—the role for wealth and philanthropic advisors in guiding the use of that wealth for

philanthropy and Congress' potential role in removing penalties and hurdles these donors face when bringing their philanthropic legacies to fruition.

Who Are the Newly Wealthy?

Based on Cerulli Associates² estimates, Generation X households (born 1965-80) will inherit the most resources (and pass through their peak earning years) in the next two decades. Millennials (born 1981-96) will inherit the most in the long run. At the same time, demographic shifts will lead to 45% of the U.S. population being people of color or multiracial by 2030 and an increase of high-net-worth (HNW) and ultra-high-net worth (UHNW) people of color.

The majority of the newly wealthy will be immigrants to wealth.³ They'll be forming new identities around uses of resources for all aspects of their lives, including philanthropy and social impact. As they do so, these younger and more diverse wealth holders will be:

Separating from their parents' philanthropy. They thank parents and grandparents for instilling philanthropic values in them and frequently are interested in the same causes as previous generations. But they want to carve out their own philanthropic identities, changing how philanthropy works, how quickly it acts and who gets to make decisions.

Redefining philanthropy. They see philanthropy as something much bigger than tax-deductible gifts to charities. It includes giving directly to individuals and entrepreneurs, volunteering, investing for social or environmental impact, building social enterprises, social and political advocacy and other actions. The scale can be as small as supporting family members and neighbors to as big as global climate change.

Enter the Philanthropic Advisor

Those rising generations of wealth holders are increasingly seeking advice from peers and professionals about philanthropy and social impact. In response, advisory firms and organizations like donor-advised fund (DAF) sponsors are hiring dedicated philanthropy advisors. The number and size of firms dedicated to philanthropic consulting is also growing.

"Philanthropic advisor" is an umbrella term for individuals hired to help clients navigate the why, who,

what, where, when and how of using their resources for philanthropy and social impact. This field of advisors has a variety of titles, job descriptions and professional backgrounds. However, each advisor can help a client with one or more of the following goals:

1. Define purpose and legacy. Help clients clarify the motivations, values, principles and priorities that will guide their philanthropy. Help families, boards or groups of employees achieve consensus around shared purpose.

2. Identify resources that could be used for social impact. Use the five capitals framework—human, intellectual, social, spiritual or moral and financial—familiar to many *Trusts & Estates* readers. Or use the "5 Ts"—time, talent, treasure, ties and testimony. Both frameworks help clients name all the ways they can make a difference in the world and plan for how the availability of each resource might evolve as their lives change. Philanthropic advisors who help clients identify resources often also have expertise in charitable gift planning or financial and tax planning.

3. Create and ramp up philanthropic strategies. Help clients more intentionally use their resources to benefit others and create social impact. The philanthropic strategy can be as simple or complex as a client desires. Frameworks for strategies vary widely, but often contain these elements: setting vision and goals; understanding context (for example, trends in data and the ecosystem of organizations working on an issue); defining the roles the client prefers to play within that context; and developing processes for giving or granting. Some philanthropic advisors specialize in certain geographies or issues while others specialize in elements of the strategy such as assessing the effectiveness of social ventures or charities.

4. Choose, create and change social impact vehicles. Guided by the purpose, resources and strategies a client prioritizes, help the client identify the most suitable social impact vehicle(s). Most clients' first vehicle will be charitable, such as a DAF, split-interest gift or private foundation (PF). However, the rising generations of wealth holders are also interested in three other types of vehicles: market-based solutions such as impact investing, creating mission-driven businesses and leading corporate social responsibility programs; public policy vehicles

such as Internal Revenue Code Section 501(c)(4) organizations⁴ and political campaigns; and peer-based vehicles such as crowdfunding platforms, giving circles and social movements.

5. Strengthen governance and family dynamics. Many clients involve others in philanthropic decisions—family members, employees, individuals with expertise in a topic and/or individuals with direct experience in an issue. Develop governance frameworks to determine who makes which decisions and how they should make them. Some advisors also have expertise in improving family dynamics and culture, helping families navigate and re-shape long-standing patterns of relationships and roles. These advisors often work within family offices, family business and family foundation teams.

6. Develop plans for assessment and learning. Inevitably, a client asks questions such as “Am I making a difference?” or “Are we making any progress?” Develop and implement plans to assess the quality, effectiveness and impact of the clients’ philanthropic strategies and of partners such as grantees or coalitions. Or deliver coaching, mentoring and training programs to prepare current and rising generations for new philanthropic roles and responsibilities.

7. Manage operations. Take on the back-office work of administering a social impact vehicle. Like some law offices and wealth management firms, they’ll serve as outsourced grantmaking and operations staff for PFs and charitable trusts. Also, staff projects as varied as non-profit training programs, grassroots advocacy campaigns, donor collaboratives and revolving loan funds.

As you explore clients’ interests in philanthropy and social impact, listen for when they feel curious, stuck or concerned about the seven goals described above. You can use free resources such as “The Stanford PACS Guide to Effective Philanthropy”⁵ and the National Center for Family Philanthropy’s Family Giving Lifecycle Toolkit⁶ to frame the discussions. If you need to search for philanthropic advisors, organizations such as Advisors in Philanthropy, National Network of Consultants to Grantmakers and Purposeful Planning Institute maintain lists of qualified experts. Community foundations and other DAF sponsors also often know qualified advisors.

Whatever roles you and philanthropic advisors choose to play in guiding the great transfer of wealth, you and your clients will face constraints established by politicians and regulators. Those constraints can diminish clients’ creativity and flexibility in using their resources for social impact.

Policymakers’ Role

Social engineering by our federal government using economic incentives and penalties has a long and storied history in the United States. While tax policy, for example, is used to raise revenue for necessary government programs, its system of penalties and benefits is used by policymakers to guide markets toward their goals. In practice, this means directly influencing our behaviors with tax incentives and penalties—embodied in almost 7,000 pages of tax laws and an additional 68,000 pages of regulations.

As we begin to understand the magnitude and timing of the Great Wealth Transfer and what it could mean for philanthropy, charities and communities around the country, we shouldn’t overlook Congress’ role to help, not hinder, the routing of wealth to and through the non-profit sector.

As the old maxim goes, if you want less of something, then tax it. And that goes for philanthropy as well. Back in 2011, the Michigan legislature repealed a tax credit for Michiganders for gifts of up to \$400 to certain charities. That is, they added the tax back on those gifts. What happened? There was a 50% decrease in \$400 charitable donations.⁷

The opposite has been proven true as well, that tax incentives work. In 2020, Congress passed (and then amended) the Coronavirus Aid, Relief, and Economic Security Act, which gave up to a \$600 charitable deduction to most taxpayers for cash gifts. What happened? According to Internal Revenue Service data, 42.2 million households took advantage of the new charitable deduction in 2020, generating \$10.9 billion in charitable giving that year.⁸ Beyond taxes, philanthropy faces myriad regulations and laws that donors and their advisors must navigate or risk penalties, or worse.

This is the conundrum we face, made more acute by the Great Wealth Transfer. Donors who face complex and overly burdensome rules will be less eager to embrace traditional philanthropy, just when they’re deciding how to deploy and invest inherited wealth.

AD PAGE

Policymakers aren't deaf to these concerns. Congress appreciates the important strategic role that philanthropy plays—to pursue risky ideas and solutions to our country's complex problems that the government can't or shouldn't undertake. With our problems seeming to be getting bigger, more complex and more expensive, our government could incentivize more philanthropy if it removed penalties and barriers that current and would-be donors face.

The opportunity that the Great Wealth Transfer presents for philanthropy, coupled with the decade-long slide in individuals giving to charity,⁹ calls for Congress to consider that they're making charitable giving more unappealing because of burdening regulation, onerous hurdles and harsh penalties for honest mistakes.

Excess business holding rules. One good place for Congress to start is by rethinking the excess business holding rules, which penalize philanthropists' PFs that want to invest in low income and distressed communities. The excess business holdings rules were adopted as part of the 1969 Tax Act and were designed to prevent PFs from owning a controlling interest in a corporation. The concern was that those leading the PF might be thinking more about their business than charitable giving.

According to an email Sandra (one of the authors of this column) received from Les Lenkowsky, professor emeritus in Public Affairs and Philanthropic Studies at Indiana University:

[T]hese rationales don't stand up to serious examination. But what they do accomplish is tell a successful entrepreneur that he or she has a choice: Maintain control of your businesses and don't start a foundation or lose control and have a foundation. Although I don't have any evidence, I suspect that a number of people whose assets are in that \$70 trillion are affected by this rule (and opt to delay starting foundations as a result).

Easing these laws to allow PFs to participate in meaningful investments in distressed communities, without heightened penalties and complex regulations, could encourage charitable donors to invest some of the Great Wealth Transfer to transform communities

that are currently bereft of options.

And there's precedent. Congress made a small exception to the excess business holding rules back in 2018 when it permitted a small number of PFs—the most famous of which is Paul Newman's—to own 100% of a company.¹⁰ It may be time to rethink these 40-year-old rules for all PFs.

Arbitrary limits on the charitable deduction. Perhaps a more direct way to unleash charitable giving, while allowing donors to express their values, is to encourage Congress to lift the arbitrary cap—that is, 60% of adjusted gross income (AGI) for cash, and 30% for non-cash gifts—on the amount donors can give and still receive a charitable deduction.¹¹

When the charitable deduction was first enacted in 1917, it included a cap. And since 1917, that cap has changed about eight times, generally increasing to, as noted above, as high as 60% of AGI.¹² But in recent years, Congress has lifted that cap in reaction to certain natural disasters, like Hurricane Katrina, because policymakers believed that would drive more giving to affected areas.¹³

The Great Wealth Transfer presents a compelling opportunity—based on the above precedent—to incentivize those inheriting this largesse to be as generous as they want to be, without the regulatory constraints of a cap on the charitable deduction. Imagine the impact unleashing philanthropy could have on ensuring every child receives an exceptional education, helping our young people thrive in a dynamic workforce, being better stewards of our environment and solving other complex societal problems we face.

Tax on jeopardizing investments. Finally, for those donors considering a PF as their charitable vehicle, Congress should rethink the rules that put a prohibitive excise tax on PFs that want to align their investment strategy with their PFs' mission and values. The basic idea behind these “jeopardizing investments” rules is to keep PF fiduciaries from allocating assets to risky investments that might risk the PF's existence.

According to Alex Reid at Baker Hostetler:

[I]magine sitting down with a potential donor whose basic philanthropic objective is to establish a charity that makes investments

that align with the donor's values. Because the charity has only one donor, it is going to be a private foundation under section 509. As a private foundation, the charity will be subject to the jeopardizing investment rules of section 4944. As a result, the foundation will need to determine on an investment-by-investment basis whether the investment (1) substantially furthers a charitable objective, (2) directly or substantially benefits private parties as compared to the general public, (3) produces income or capital appreciation as a substantial purpose (in which case it isn't a program related investment), (4) is in the form of a written agreement meeting the expenditure responsibility rules which require annual reporting from the investee and includes a reversion to the investor in the event of a breach, among other requirements, (5) complies with the taxable expenditure rules which prohibit lobbying and other uses of funds, and myriad other requirements. This is hard work for even the most sophisticated foundations, requiring highly specialized program staff, and often necessitates a costly legal opinion.¹⁴

And with one important exception, these rules are now largely obsolete as they predate the Universal Prudent Management of Institutional Funds and the invention of modern portfolio theory, which together precisely define and generally prohibit nonprofits from making jeopardizing, imprudent or otherwise foolish investments.

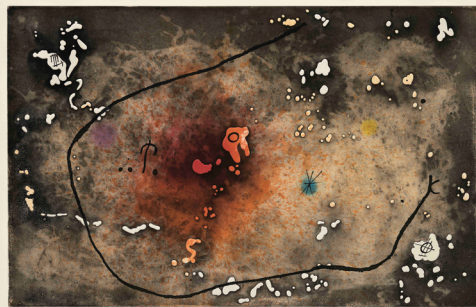
It's time to push Washington to take seriously their role to capture a meaningful portion of the Great Wealth Transfer for philanthropy by rethinking, streamlining and reimagining these rules—and likely others—to make it far easier for wealth to go to, and through, the non-profit sector.

We all have a role to play—you, your clients, philanthropic advisors and our government—if we're going to maximize this historic opportunity to dedicate more wealth to social good.

Endnotes

1. www.cerulli.com/press-releases/cerulli-anticipates-84-trillion-in-wealth-transfers-through-2045.

2. *Ibid.*
3. https://jamesgrubman.com/wp-content/uploads/1620/65/Immigrants_and_Natives_to_Wealth__JFP_July_2007.pdf.
4. For more information, see www.wealthmanagement.com/estate-planning/irc-section-501c4-social-welfare-organizations-ideal-vehicle-grantmaking.
5. <https://pacscenter.stanford.edu/research/effective-philanthropy-learning-initiative/donor-guide/>.
6. www.ncfp.org/family-giving-lifecycle-overview/.
7. "Impact on Giving After the Repeal of the Michigan Community Foundation Tax Credit," Dorothy A. Johnson Center for Philanthropy at Grand Valley State University (February 2013).
8. www.irs.gov/pub/irs-soi/soi-a-inpr-id2201.pdf.
9. <https://philanthropy.iupui.edu/news-events/news-item/latest-data-shows-new-low-in-share-of-americans-who-donated-to-charity.html?id=363>.
10. www.pkfod.com/insights/bipartisan-budget-act-of-2018-excess-business-holdings-newmans-own-exception/.
11. www.fidelitycharitable.org/faqs/all/charitable-deduction-limitations.html.
12. www.everycrsreport.com/files/2020-06-26R46178_86b57054c2b94c47dbddcc1092fb9559c68fe1f.pdf.
13. www.irs.gov/pub/irs-news/ifs-06-12.pdf.
14. www.bakerlaw.com/AlexanderReid.



SPOT LIGHT

Island Hopping

Archipel Sauvage III (Savage Archipelago III) (D. 529) by Joan Miró sold for £10,710 at Phillips Evening & Day Editions Auction on Jan. 18-19, 2023 in London. Miró's personal take on Surrealism has earned him international critical acclaim and even an entire museum dedicated to his work in his native Barcelona. He worked in an array of mediums, including painting, sculpture and ceramics.