Who Can Make a Pledge – And Who Can Pay It Off?
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The following information is provided as a guide. **The ultimate determination regarding appropriate actions within an institution always rests with the lawyer and auditor tasked with ensuring compliance with legal and financial regulations for that institution.**

A pledge, for purposes of this paper, is an obligation by a donor to a donee. The pledge must meet the criteria for "contributions" in the form of **unconditional promises to give** as outlined by the Financial Accounting Standards Board (FASB, who first established the standard – the Government Accounting Standards Board, or GASB, has followed with similar criteria).

The definition of a promise to give, as outlined on page 30 of FASB Statement of Financial Accounting Standards No. 116, is "a written or oral agreement to contribute cash or other assets to another entity. **A promise carries rights and obligations** – the recipient of a promise to give has a right to expect that the promised assets will be transferred in the future, and **the maker has a social and moral obligation, and generally a legal obligation, to make a promised transfer**." [emphasis added] Once such a promise is made, to the extent it may be recorded as an asset by the nonprofit, the maker of the promise assumes an offsetting liability. Page 31 of the above document – quoting from Concept Statement 6 – states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events."

Thus, a recordable/enforceable pledge or promise to give may only be made by the entity assuming liability and responsibility for satisfaction of that commitment. The maker has no authority to so obligate another entity over whom they have no legal or financial control. They assume full and total responsibility for satisfaction of the obligation.

Amplifying this, 4th edition of the CASE Guidelines states: "A pledge can be made only by the entity exercising legal control over the assets to be given. Therefore, an individual cannot make a pledge that includes anticipated matching contributions from an employer or some other source. Nor can an individual commit funds that may be applied for through a donor-advised fund or community foundation . . . An enforceable, countable pledge includes only those funds that will be given by that legal entity."

Regarding the above FASB quote pertaining to "a written or oral agreement," there are wide interpretations among auditing firms stipulating to the form of documentation necessary to consider the pledge "enforceable." Therefore your own auditor typically makes this determination for each individual institution. As stated in the 4th edition of the CASE Guidelines:

> "Pledges of a donor's assets should be documented, committing to a specific dollar amount that will be paid according to a fixed time schedule. . . Your institution's auditing firm will suggest what form the written commitment take for booking purposes, including whether email is an acceptable format. It is advisable that the donor stipulate to the amount, purpose, and payment period in a written document to the nonprofit organization. Some auditors, however, will acknowledge a letter from the institution to

> the donor, outlining the same details based on a conversation held with the donor, as a bona-fide commitment from the donor. It is advisable, however, that such a letter require the signature of the donor with a copy returned to the institution. Again, seek guidance from your auditor."

So an entity may make a binding pledge, or promise to give, only if they are willing to assume full personal responsibility and liability for the entire amount. They generally cannot encumber another entity – they are literally "on the hook" for the entire amount. But does this mean that another entity cannot assist the maker of the pledge or promise towards satisfaction of that commitment? Much depends on the relationship between maker and payer – and much also rests on the legal nature (tax classification) of the entity rendering a payment.

Clearly it is not legally possible for certain categories of foundations or charities (specifically private foundations), frequently referred to as "family foundations," to satisfy another entity's pledge or promise to give. In IRS-speak, this would be considered self-dealing. A Council on Foundations article from 2003 explains further (only the portion of the article pertaining to pledges and fundraising activities are included in this quote):

"The main prohibition for family foundations is "self-dealing." Simply stated, a family foundation can not enter into any financial transaction with certain related parties, defined in the law as "disqualified persons." A disqualified person is any officer, director, trustee or employee with the authority to act on behalf of the foundation and substantial contributors.

"The list of prohibited transactions between a private foundation and a disqualified person includes:

- Satisfying the enforceable pledge (such as a donation) of a disqualified person"

"Some specific examples of self-dealing are:

- Personal family pledges- A legally binding pledge (personal pledge to charity, etc) is a personal debt, and if a disqualified person makes such a pledge, its an act of self-dealing for a foundation to pay that debt.

- Attending fundraisers - If the foundation buys a ticket to a fundraising event, and the ticket price includes payment for goods and services (dinner and entertainment) the ticket cannot be used by a disqualified person."

The IRS previously prohibited the use of a gift from a donor-advised fund (DAF) from satisfying a personal pledge. However, the IRS modified that stance on December 5, 2017 in IRS Notice 2017-73 allowing treatment of DAF gifts as pledge payments provided:

1. The DAF sponsoring organization makes no reference to the existence of any charitable pledge when making the distribution from the donor's DAF (references to the name of the person who advised on the distribution are permitted);

2. No Donor/Advisor receives, directly or indirectly, any other benefit that is more than incidental on account of the DAF distribution (such as those described below or set forth in future guidance); and

3. The Donor/Advisor does not claim a charitable contribution deduction for the DAF distribution, even if the charity receiving the distribution mistakenly sends the Donor/Advisor a tax acknowledgement.

On a separate note, the preponderance of corporations offering employee matching gift programs clearly state in their guidelines, and frequently in the match application form, that **their** contribution may not be used to satisfy a personal obligation of their employee. In fact, many such programs require that **their** contribution go towards a specific fund or program and not necessarily where their employee made the original gift.

There are some instances, however, where someone other than the maker can make a payment toward another entity's pledge. A common example is a spouse and other family member. There may also be times when the individual owns a business or is one of its principals and causes a gift to be made toward that pledge. However, given some of the potential tax issues revolving around these situations, it is **always** best to have it stated clearly in writing by the payer that the payment may indeed be applied to that other entity's pledge.

<u>Bifurcated Payment</u>

While not directly related to the issue of who can make a pledge and who can pay it off, it is important to note the IRS concern regarding the delivery of benefits to donors because of gifts made by either DAFs or private foundations. In both cases no tangible benefit can be given in exchange for gifts made through these sources. This includes invitations to special recognition events or galas. These donors simply cannot be invited to these events if they have a fair market value benefit.

Some have questioned whether these rules can be circumvented by allowing the individual to pay a fee equal to the fair market value to attend. The short answer is "No." In a discussion pertaining to private foundations on this topic, the *Tax Economics of Charitable Giving* states:

"If a private foundation purchases tickets to charitable fundraising events, care must be exercised to be certain that no self dealing results. The IRS held there was self dealing where the chairman of a corporate donor, who was not an officer or director of the foundation, used tickets purchased by the company's private foundation. The IRS has also ruled that bifurcation of the purchase costs of attending a fundraising event between a disqualified person (who pays for the quid pro quo portion) and a private foundation (which pays for the charitable portion of the ticket) would result in self dealing."

Along the same lines, the IRS reinforced its prohibition of delivery of benefits to donor in exchange for DAF gifts in Notice 2017-73. Quoting from a summary provided by Ropes & Gray, LLC:

"**Charity Events and Membership Fees:** Grants from a DAF that enable a Donor/Advisor to attend or participate in a charity-sponsored event would result in a more than incidental benefit, even if the Donor/Advisor pays the non-deductible portion of the cost of the ticket. This would result in a penalty excise tax on any Donor/Advisor who advises as to the distribution or who received the benefit of the payment from the DAF. The IRS has previously indicated informally that it views grants that enable a Donor/Advisor to attend an event as a violation of the rule prohibiting more than incidental benefits from DAFs. Similarly, a grant from a DAF to pay on behalf of a Donor/Advisor the deductible portion of a charity membership fee that has deductible and non-deductible portions would also result in a more than incidental benefit and penalty excise tax."