

TAXWISE GIVING

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DONOR MANAGED INVESTMENT ACCOUNTsm—EXCITING NEW KID ON THE BLOCK

A just-issued private letter ruling (not yet published by IRS) approves an innovative program that enables donors to manage the investment of their contributions after making a gift to a charity. The Donor Managed Investment Accountsm Program allows donors or their financial advisors to share their investment success—tax-free—with the nonprofits they support, while receiving an immediate income tax charitable deduction.

The DMI Program was developed by Winklevoss Consultants, Greenwich, Connecticut. It allows donors to exercise greater influence over the management of funds they contribute to charities. Unlike a donor-advised fund that limits investment selections to a few pre-selected alternatives, the DMI Account Program allows donors to follow their own preferred investment strategies, choosing from many investments including equities, fixed income, mutual funds, and alternative investments.

Boola, boola, moola, moola. Perhaps you read about the 40 Yale alumni who pooled \$75,000 as a 25th reunion gift, but kept it invested in a separate fund. On the 30th reunion, 31 alums added \$300,000 to the fund. Flash forward to the 50th reunion a few months ago. The fund performed mightily and they gave Yale a \$90 million gift.

The DMI Account Program appears to give all donors a way of potentially increasing their charitable gifts. (Keep in mind that the charitable deduction is for the original contribution, not the larger amount the charity receives down the road.)

"The DMI Account Program has great appeal to individuals who want to 'make a difference' rather than just provide one-time support for a given charity," according to Dr. Paul Schervish, Director of the Center on Wealth and Philanthropy at Boston College and co-developer of the program. "A classic example is a wealthy donor who fully intends to support a university at some future point, but wants to grow his or her net worth until some milestone, such as retirement, before making the gift," says Dr. Schervish. "The DMI Account methodology encourages gifts to be contributed earlier, and then grown in the tax-free environment of the nonprofit that owns the funds. To my knowledge, it is the first new vehicle for organized giving by individuals directly to a charity since the Tax Reform Act of 1969."

"Take a hedge fund manager, for example," said Howard Winklevoss, CEO of Winklevoss Consultants, "who is able to earn a 15 percent return every year. These professionals are often exposed to a 30-40 percent tax rate, depending on their investment strategy. While growing money at 9 percent after-tax is great, growing money at a tax-free rate of 15 percent is spectacular. A \$5 million gift becomes a \$10 million gift after just 5 years under these assumptions. And those who are successful managing their own money, or like the investment strategies of their investment advisor, can exercise greater control over their philanthropy without the need to establish and run a private foundation, and at a higher level of deductibility."

"The DMI Account is a three-way win," according to Dr. Schervish. "Qualified nonprofits will receive more funds from proactive donors, investment managers will be retained to manage these gifts for a longer period of time, and participating donors will realize a more significant impact from their gifts."

Winklevoss Consultants says that it provides a turnkey service to qualifying nonprofit organizations for the complete set-up, implementation, marketing, and administration of the DMI Account Program. Winklevoss has filed a patent application for its DMI Program. For additional information, contact: Mark Rakov, (203) 861-5565, Mrakov@winklevoss.com

Taxwise Giving is not endorsing the DMI Program. It is, however, a major new development and thus I am passing it on to my readers.

Facts in letter ruling (as soon as published by IRS, *Taxwise Giving* will report the letter ruling number). Donor 1, an individual, and Donor 2, a limited liability company, propose to make donations of cash and traded securities to College.

At the time of the donation, Donor 1 and Donor 2 will each enter into a separate Agreement with College. The Agreements are identical except for the identity of each Donor and description of the contributed assets. Under the Agreement, any donation made to College is to be placed in an investment or brokerage account (Account) established in the name of College exclusively for its own benefit. Each donation will be unconditional and irrevocable. Donor 1 and Donor 2 will surrender all rights to retain or reclaim ownership, possession or a beneficial interest in any donation, and Donor 1 and Donor 2 may not divert the assets held in Account to any person. Under each Agreement, Donor 1 or Donor 2, or Donor's investment manager, is permitted to manage the investments in Account under a limited power of attorney. Each Donor is prohibited from engaging in any act of self-dealing regarding the assets in Account.

The Agreement imposes investment restrictions on a Donor's management of Account:

Account will hold or invest only in U.S. equities, U.S. open-end mutual funds, U.S. closed-end mutual funds, U.S. fixed income securities (including, but not limited to mortgage-backed, asset-backed and high-yield securities), offshore/onshore hedge funds, REITS, and private placements; no investment may be made in companies in which Donor owns, directly or indirectly, more than 5 percent of the outstanding shares of stock; assets in Account may not be pledged or encumbered by Donor or advisor, or used to satisfy any debt or liability of Donor; Donor has no right to vote any stock or other securities held in Account; and Donor may not commingle assets in Account with any assets outside Account.

Donor's power to manage investments terminates 10 years from the date of the donation (unless sooner terminated as described below); and Donor may not invest in short sales, forward settling transactions, derivatives, or any borrowing.

Agreement also provides that College has the right at any time or for any purpose and in its sole discretion to withdraw any or all of the assets held in Account or to terminate the limited power of attorney and Agreement.

Finally, Agreement will terminate automatically in severe loss cases, as determined by College in its sole discretion. Agreement may also be terminated at any time by either party upon written notice to the other.

Ruling one—Contributions by Donor 1 and Donor 2 meet the requirements for the income tax charitable deduction.

IRS's analysis: To be deductible under IRC §170, a contribution must qualify as a gift in the common law sense of being a voluntary transfer without consideration. *Pettit v. Commissioner*, 61 T.C. 634, 639 (1974). See also *Hansen v. Commissioner*, 820 F.2d 1464, 1468 (9th Cir. 1987) (the term "charitable contribution" is synonymous with the term "gift"); *Elrod v. Commissioner*, 87 T.C. 1046, 1075 (1986). If the donor receives, or can reasonably expect to receive, an economic benefit commensurate with the money or property transferred, no deduction under IRC §170 is allowable. Rev. Rul. 76-185, 1976-1 C.B. 60.

IRC §170(f)(3) denies taxpayers a charitable contribution deduction for certain contributions of partial interests in property. Section 170(f)(3)(A) provides, in part, that in the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed only to the extent that the value of the interest contributed would be allowable as a deduction under IRC §170 if such interest had been transferred in trust. For purposes of IRC §170(f)(3)(A), a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in the property. A donor is not entitled to a charitable contribution deduction if the donor has retained

substantial rights in the contributed property. See *Stark v. Commissioner*, 86 T.C. 243, 251-252 (1986).

If, however, the rights in the contributed property retained by the donor are so insubstantial that he has, in substance, transferred his entire interest in the property, the partial interest limitations of IRC §170(f)(3) don't apply, Reg. §1.170A-7(b)(1)(i) is satisfied, and a deduction is allowed. See also Rev. Rul. 76-331, 1976-2 C.B. 52; Rev. Rul. 75-66, 1975-1 C.B. 85. [emphasis supplied]

In Rev. Rul. 81-282, 1981-2 C.B. 78, the taxpayer contributed shares of voting stock to a charitable organization, but retained the right to vote the contributed stock. The ruling concludes the right to vote the stock is a substantial right inherent in the ownership of common stock. Accordingly, the ruling holds that the taxpayer is not entitled to a deduction under IRC §170 since the taxpayer did not transfer all substantial rights in the stock to the donee, but only a partial interest under IRC §170(f)(3), and the contributed interest was not an undivided portion.

In Rev. Rul. 75-66, 1975-1 C.B. 85, the taxpayer donated his entire interest in 800 acres of real property to the United States but retained the right during his life to train his personal hunting dog on trails extending over the entire property, and to maintain paths and lanes relating to this reserved use. The ruling holds that the contribution satisfied Reg. §1.170A-7(b)(1)(i) since the rights retained by the taxpayer were not substantial enough to affect the deductibility of the property contributed, and the taxpayer was thus entitled to a charitable contribution deduction under IRC §170.

In this case, the retention of investment management control by Donor subject to the restrictions contained in the Agreements, isn't substantial enough to affect deductibility and doesn't constitute the retention of a prohibited partial interest under IRC §170(f)(3). [emphasis supplied]

Ruling two—contributions made by Donor 1 and Donor 2 meet the requirements for the gift tax charitable deduction.

IRS analysis: Reg. §25.2511-2(b) provides that as to any property, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, depending upon all the facts in the particular case. Accordingly, in every transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. Reg. §25.2511-1(h)(1) provides that a transfer of property by a corporation to B is a gift to B from the stockholders of the corporation.

IRC §2522(a) provides that in computing taxable gifts, a deduction is allowed for the amount of all gifts to or for the use of a corporation or trust organized and operated exclusively for religious, charitable, etc., purposes.

Reg. §25.2522(c)-3(b)(1) provides that if, as of the date of the gift, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

In this case, Donor 1 and Donor 2 propose to make gifts to College. After making a contribution to College, the assets contributed will be held in respective Accounts in the name of College. Donor 1 and Donor 2, or their investment managers, may manage the investments in the respective Donor's account for a period of 10 years. However, under the Agreement each Donor is subject to restrictions discussed above, and College may terminate the arrangement at any time and College has the right at any time or for any purpose and in its sole discretion to withdraw any or all of the assets held in Account.

Under the facts presented, IRS concludes that the power retained by Donor 1 and Donor 2 to manage the investment of the assets contributed by each Donor, does not constitute the retention of an interest in the property for purposes of IRC §2522(c)(2) and Reg. §25.2522(c)-3(c)(1). Further, the retained power to manage investments of an Account does not cause the charitable gifts to be subject to a condition or power under Reg. §25.2522(c)-3(b). Accordingly, IRS concludes that a gift tax charitable deduction will be allowable under IRC §2522 to Donor 1 and to the appropriate individual with respect to the gift by Donor 2.

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