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Subject: Richard Fox on *Fairbairn v. Fidelity Investments Charitable Gift Fund* - Court Rejects Argument that Requirement of Fidelity Charitable's Exclusive Control Over DAF for Tax Purposes Estops Donors' Claim of False Promises Made Regarding Botched Liquidation of Donated Stock

"This case, which is now headed for trial, raises important issues as to the effect of promises made by a sponsoring organization of a DAF to donors beyond those relating solely to 'advisory privileges' and is a cautionary tale to both sponsors of DAFs and their donors. It also raises significant tax issues regarding the effect of donor conditions placed on assets contributed to a DAF, assuming such conditions are legally enforceable, a determination ultimately to be made by the court in this case. These include the qualification of a DAF under IRC § 4966(d)(2) and its possible reclassification to private foundation status, the availability of a charitable income tax deduction, the valuation of contributed assets for income tax purposes, the ability of a sponsoring organization to provide an IRC § 170(f)(18) acknowledgment, and the need, in the case of a contribution of publicly traded securities, for a qualified appraisal where one might not otherwise be required."

Richard L. Fox provides members with important and timely commentary on *Fairbairn v. Fidelity Investments Charitable Gift Fund*.

Richard L. Fox is an attorney and shareholder at **Buchanan Ingersoll & Rooney** (www.bipc.com). Richard is the author of the treatise, Charitable Giving: Taxation, Planning and Strategies, a Thomson Reuters/Warren, Gorham and Lamont publication, writes a national bulletin on charitable giving, and writes and speaks frequently on issues pertaining to nonprofit organizations, estate planning and philanthropy. Richard is also a Fellow of the American College of Trust and Estate Counsel (ACTEC).

Here is his commentary:

EXECUTIVE SUMMARY:

In *Fairbairn et al. v. Fidelity Investments Charitable Gift Fund*, the donors, Emily and Malcolm Fairbairn, were considering making an approximately $100 million donation though a combination of cash and other assets, including 1.93 million shares of stock of Energous, a publicly traded company, to a donor advised fund ("DAF") maintained at Fidelity Investments Charitable Gift Fund ("Fidelity Charitable"), the largest DAF sponsor in the county. The guidelines of Fidelity Charitable simply stated that it liquidates donated stock "at the earliest possible date," an approach that gave the Fairbairns pause. As investment advisors themselves, they were keenly aware that liquidating a large block of stock can be a delicate process and that "if not executed according to best practices, it can cause the stock's value to crash," thereby significantly reducing the amount of the ultimate sale proceeds funding their DAF. And, if the liquidation occurs on the date of the contribution, the available charitable income tax deduction could be significantly reduced because the value of publicly traded stock on the date of the contribution is the average of the daily high and low price of the stock.

In light of their concerns about the liquidation process, the Fairbairns claimed that Fidelity Charitable made the following legally enforceable promises, albeit not memorialized in writing or any contemporaneous record, as to how it would handle the liquidation of the 1.93 million shares of Energous stock: (1) it would employ sophisticated, state-of-the-art methods for liquidating large blocks of stock; (2) it would not trade more than 10% of the daily trading volume of Energous shares; (3) it would not liquidate any shares until the beginning of 2018; and (4) it would allow the Fairbairns to advise on a price limit.

The Fairbairns asserted that in reliance of these promises, they made their donation of the 1.93 million shares of Energous to Fidelity Charitable, 700,000 shares on December 28, 2017 and the remaining shares on December 29, 2017. Rather than adhering to the promises regarding the liquidation process, however, Fidelity Charitable liquidated the entire block of shares over a three-hour trading window on December 29, 2017, the last business day of the year, causing a more than 30% run-down of the stock value and leaving the Fairbairns with tens of millions of dollars less in their Fidelity Charitable DAF and significantly reducing the amount of their charitable income tax deduction.

The Fairbairns sued Fidelity Charitable based upon the following claims: (1) misrepresentation; (2) breach of contract; (3) estoppel; (4) negligence; and (5) violation of California's Unfair Competition Law, seeking, among other things, to have Fidelity Charitable to restore to the Fairbairns' DAF account the amount of money that a reasonably competent liquidation (adhering to the promises made) would have yielded and to make them whole with respect to their charitable income tax deduction.

In a motion for summary judgment, Fidelity Charitable asserted that as a result of the Fairbairns claiming a charitable income tax deduction on the basis of a tax law requirement that a sponsoring organization of a DAF have exclusive legal control over the donated shares, the Fairbairns were estopped under the "tax estoppel" doctrine from asserting that they were induced to donate their shares through unfulfilled promises as to the liquidation of the donated shares. Thus, Fidelity argued that it could not be bound by any promises it made regarding the contributed shares because, as required for federal tax purposes, it necessarily had exclusive legal control over the donated shares.

The U.S. District Court for the Northern District of California denied the Fidelity Charitable motion for summary judgment, ultimately finding that the tax estoppel doctrine did not apply because the charitable income tax deduction claimed by the Fairbairns was not clearly inconsistent with their assertion that Fidelity Charitable was bound by its alleged promises. The court recognized that although the tax law requires a sponsoring organization of a DAF to have exclusive legal control over donated assets, the parties were still free, albeit at their own peril, to enter into a legally binding agreement that ultimately could cause a purported DAF not to provide the otherwise available tax benefits to the donor.

Indeed, the court stated that "if the Fairbairns prove that Fidelity Charitable made the legally-enforceable promises, and Fidelity Charitable is correct that such legally-enforceable promises disqualify the donation from a charitable tax deduction, the IRS may take action against the Fairbairns to recover any improper deduction. No 'taxpayer estoppel' is needed to prevent any unfairness: Fidelity would be held to its promises, and the Fairbairns would suffer the consequences, if any, of enforcing those promises."

This case, which is now headed for trial, raises important issues as to the effect of promises made by a sponsoring organization of a DAF to donors beyond those relating solely to "advisory privileges" and is a cautionary tale to both sponsors of DAFs and their donors. It also raises significant tax issues regarding the effect of donor conditions placed on assets contributed to a DAF, assuming such conditions are legally enforceable, a determination ultimately to be made by the court in this case. These include the qualification of a DAF under IRC § 4966(d)(2) and its possible reclassification to private foundation status, the availability of a charitable income tax deduction, the valuation of contributed assets for income tax purposes, the ability of a sponsoring organization to provide an IRC § 170(f)(18) acknowledgment, and the need, in the case of a contribution of publicly traded securities, for a qualified appraisal where one might not otherwise be required.

FACTS:

Background

In a complaint (the "Complaint") filed on August 10, 2018 in the U.S. District Court in the Northern District of California against Fidelity Investments Charitable Gift Fund ("Fidelity Charitable"), the donors to a donor advised fund ("DAF"), Emily and Malcolm Fairbairn, accused Fidelity Charitable of "making false promises to secure a $100 million donation … and then outrageously mishandling the donation, costing the Fairbairns millions of dollars and severely impairing their ability to support important charitable causes."

The Fairbairns sought to contribute approximately $100 million to Fidelity Charitable in late December 2017, including 1.93 million shares of stock in a publicly-traded company called Energous, which trades on NASDAQ under the ticker symbol "WATT," to fund a DAF, much of which was to be dedicated to fighting Lyme disease, a disease that had recently stricken their entire family and which has become a silent, rapidly spreading, worldwide disease. The donors were angel investors in Energous and would continue to hold significant shares even after their proposed contribution. The 1.93 million shares represented just under 10% of all the outstanding stock of the company. The share price of Energous had spiked 39% over the course of December 27, 2017 as a result of the Federal Communications Commission approving the core technology behind the company, prompting the donors to seek to make the charitable contribution of Energous stock prior to the end of 2017 in order to offset substantial income they had realized during the year.

According to the Complaint, the donors could have made the donation of the stock to a DAF maintained at JP Morgan, with whom the donors already had an existing relationship and where they had already established a $20 million DAF, and JP Morgan allows donors to"[a]dvise on the timing and rate at which the donated securities are liquidated." Fidelity Charitable had no such policy and its guidelines, contained in the Fidelity Charitable Policy Guidelines: Program Circular," simply stated that it liquidates donated stock "at the earliest possible date." This approach gave the Fairbairns pause because, as investment advisors themselves, they were aware that liquidating a large block of stock can be a delicate process and that "if not executed according to best practices, it can cause the stock's value to crash," thereby substantially reducing the amount of the sale proceeds available to fund their DAF. Given the lack of built-in protections at Fidelity Charitable for circumstances requiring a liquidation strategy more sophisticated than "the earliest date possible," the Fairbairns had three principal concerns about Fidelity Charitable handling the Energous stock liquidation, as set forth in their Complaint as follows:

1. First, a botched liquidation would mean they had less money to direct to the fight against Lyme disease.

2. Second, if the "earliest date possible" for liquidation was the same day the stock was donated, it could significantly reduce the size of the Fairbairns' own charitable income tax deduction. That is because the size of the deduction for donated stocks turns on the stock's fair market value on the day the charitable organization receives it. And fair market value is calculated by averaging the daily high and low prices for the stock. Thus, a botched liquidation that happened on the same day as the donation could have significant negative income tax consequences.

3. Third, as angel investors and continued stakeholders in Energous, the Fairbairns were concerned that a botched liquidation would damage the company going forward.

The Fairbairns' concerns regarding the policy of Fidelity Charitable to liquidate contributed stock "at the earlier possible date" caused the Fairbairns to reconsider making their donation through Fidelity Charitable and instead to strongly consider a JP Morgan DAF. According to the Complaint, to convince the Fairbairns to contribute to a Fidelity Charity

DAF, Fidelity Charitable made the following personalized representations, albeit not memorialized in writing, about how it would handle the liquidation:

1. It would employ sophisticated, state-of-the-art methods for liquidating large blocks of stock;

2. It would not trade more than 10% of the daily trading volume of Energous shares;

3. It would not liquidate any shares until the beginning of 2018; and

4. It would allow the Fairbairns to advise on a price limit (i.e., a point below which it would not sell without first consulting the Fairbairns.

The Fairbairns asserted that in reliance of these promises, they made their donation of the 1.93 million shares of Energous to Fidelity Charitable, 700,000 shares on December 28, 2017 and the remaining 1.2 million shares on December 29, 2017. The Complaint further alleges that following the donation of the shares, Fidelity Charitable violated all of its promises to the Fairbairns by immediately liquidating the donated shares, with the Complaint stating specifically as follows:

> But after the Fairbairns donated the 1.93 million shares, Fidelity Charitable promptly—and egregiously—broke each of its promises. It (1) liquidated the entire block of shares in a three-hour window on December 29, [2017], (2) accounting for 16% of the day's exchange-traded volume and an incredible 35% of the volume over the three-hour trading window, (3) using inappropriate methodologies that caused its own trades to compete against each other and drive the share price down still further, (4) without even telling the Fairbairns it was happening, let alone allowing them to advise on a price limit … **The catastrophic result was a 30% run-down of the stock's value—leaving the Fairbairns with tens of millions less to direct to charitable causes, and reducing the size of their tax deduction by millions more**. (Emphasis added.)

The Fairbairns sued Fidelity Charitable based upon the following claims: (1) misrepresentation; (2) breach of contract; (3) estoppel; (4) negligence, (5) violation of the California's Unfair Competition Law ("UCL"), and were seeking, among other things, to have Fidelity Charitable make them whole with respect to their charitable income tax deduction and to restore to the

Fairbairns’ DAF account the amount of money that a reasonably competent liquidation (adhering to the promises made) would have yielded.

Fidelity Charitable responded to the Complaint by filing a motion to dismiss which asserted that the Fairbairns failed to “state with particularity the circumstances constituting fraud or mistake” as required under Federal Rules of Civil Procedure 9(b), that the first and second promises made by Fidelity did not support a claim for relief, and that the Fairbairns lacked standing because state law vest the state Attorney General with the exclusive authority to bring any claims regarding mismanagement of charitable assets. The court rejected all of Fidelity Charitable’s arguments for dismissal and the motion to dismiss was denied on November 28, 2018.

District Court Denies Motion for Summary Judgement by Fidelity Charitable Ahead of Trial: Rejects Assertion That Requirement of Exclusive Legal Control by Sponsoring Organization Over DAF for Tax Purposes Estops Donors’ Claims of False Promises

Following the denial of its motion to dismiss and ahead of a trial, Fidelity Charitable filed a motion for summary judgment on February 19, 2020 on all of the Fairbairns' claims except for their negligence claim. All of the remaining claims, breach of contract, misrepresentation, estoppel, and violation of the UCL, were premised on the Fairbairns' contention that Fidelity Charitable made the four legally enforceable promises indicated above.

In its motion for summary judgment, Fidelity Charitable asserted that the Fairbairns could not pursue any claims with respect to the first three promises on the basis of the “tax estoppel” doctrine. Under the “tax estoppel” doctrine, a party to a litigation is estopped from taking a position that is clearly inconsistent with a position previously taken by the party for tax purposes. Fidelity Charitable cited, for example, *Carpet Supermarket, Inc. v. Nat'l Fire Ins. Co. of Hartford*, No. CV 09-4951 GAF (CWX), 2009 U.S. Dist. LEXIS 135399, 2009 WL 10675718 (C.D. Cal. Sept. 17, 2009), where the plaintiff was estopped from seeking indemnification under its insurance policy's employee dishonesty endorsement because it previously designated the employee at issue as a non-employee for tax purposes and the definition of employee under the policy was narrower than the tax definition of employee. Similarly, the case of *Marks v. Am. Airlines, Inc.,* 313 Fed. Appx. 933 (9th Cir. 2009) was cited, where the plaintiff was estopped from contending that he was a California resident and therefore able to bring a claim under California law because for years he avoided California income tax by claiming to be a Florida resident, indisputably irreconcilable positions. On the basis of these cases, Fidelity Charitable stated that it is settled law that "[a]n individual is estopped from taking one position on his tax returns, gaining a benefit from that tax return, and then seeking another benefit in court by taking a position incompatible with that taken on the tax return."

In asserting the tax estoppel doctrine, Fidelity Charitable relied upon IRC § 4966(d)(2)(A), under which a DAF must be "owned and controlled by a sponsoring organization," in this case Fidelity Charitable, and with respect to which a donor only has "advisory privileges with respect to the distribution or investment of amounts held in such fund or account." In this context, Fidelity Charitable noted that the Joint Committee on Taxation Technical Explanation of Pension Protection Act of 2006 stated that "[a]lthough sponsoring charities frequently permit donors … to provide nonbinding recommendations concerning the distribution or investment of assets in a donor advised fund, sponsoring charities generally must have legal ownership and control of such assets following the contribution. *If the sponsoring charity does not have such control (or permits a donor to exercise control over amounts contributed), the donor's contributions may not qualify for a charitable deduction*." Also cited by Fidelity Charitable was IRC § 170(f)(18)(B), under which an income tax deduction for any contribution to a DAF shall only be allowed if the taxpayer obtains a contemporaneous written acknowledgment from the sponsoring organization of such DAF "that such organization has exclusive legal control over the assets contributed." In further support of its position under the tax estoppel doctrine, Fidelity Charitable cited a number of tax cases where the courts have held that in order to claim a charitable income tax deduction, a donor must divest himself of control of the subject matter of the gift and must effect the irrevocable transfer of dominion and control of the entire gift to the donee, so that the donor can exercise no further act or dominion or control over it.[i]

Fidelity Charitable then stated that the Fairbairns are "estopped from claiming that they had legally enforceable rights to control the liquidation process because, in taking their tax deduction, the Fairbairns swore that their donation satisfied the Internal Revenue Code requirement that they had ceded to Fidelity Charitable "*exclusive legal control over the assets* *contributed*." 26 U.S.C. § 170(f)(18)(B) (emphasis added). That admission binds them here: If the Fairbairns did not intend to convey and in fact did not convey exclusive control over the donated [Energous] shares to Fidelity Charitable, they were not entitled to the deduction. By taking the deduction, they have attested that they intended to retain only the privilege prescribed by federal tax law—the privilege to advise." Thus, accordingly to Fidelity Charitable, the Fairbairns "[h]aving reaped the consideration benefit of a tax deduction available upon unequivocal surrender of their legal rights to control over those shares" cannot then "seek another benefit in court by taking a position incompatible with that taken on the tax return … namely, by seeking to enforce (through a damages award) supposedly legally enforceable rights to restrict the time, volume and manner of the sale of the stock."

In addition to the tax estoppel argument, Fidelity Charitable argued that the Fairbairn's admissions made during discovery that they lacked "legal control" and retained only "advisory rights" after they made the donation are, as a matter of law, plainly dispositive of the contract claims, stating "If, as the Fairbairns admit, the only rights they retained post-donation are rights to advise, then they have admitted that Fidelity Charitable did *not* convey the right to control [the liquidation process] … Prescribing the time, volume or manner of the liquidation … is fundamentally incompatible with the Fairbairns' admitted retention solely of advisory rights."

In a decision dated March 2, 2020 following an oral argument on February 20, 2020, the court denied Fidelity Charitable's motion for summary judgement, finding that "Fidelity Charitable has not provided that the Fairbairns' representation on their 2017 federal tax return that their donation of Energous stock to Fidelity Charitable is tax deductible clearly contradicts their contention that Fidelity Charitable made the asserted legally-enforceable promises. To put it another way, Fidelity Charitable has not established as a matter of law that the Fairbairns' donation with the alleged conditions means that Fidelity Charitable did not acquire exclusive legal control of the donation as required by the tax code."

The court found that the cases cited by Fidelity Charitable did not establish that if a sponsoring organization promises to handle a future donation in a particular way, that means that the sponsoring organization "does not retain exclusive legal control within the meaning of the tax code." The court particularly noted that in *Fund for Anonymous Gifts v. I.R.S.*,[ii] a case cited by Fidelity Charitable in support of its position, the donee charity, with respect to funds established by donors, “was bound by any enforceable conditions *subsequent* which a donor places on his donation.” That is, the fund was required to honor donor requests made after the donation, such that the donor had continuing control over the fund.[iii] Here, the court emphasized that the “Fairbairns placed the alleged conditions at issue here **prior to or at the time of their donation, not subsequent to their donation**.” (Emphasis added.) The court stated that the agency and legislative authority cited by Fidelity Charitable “likewise do not distinguish between a legally-enforceable promise made at the time of the donation versus a legally-enforceable promise to abide by a donor’s directions given after a donation.”

Fidelity Charitable’s reliance on the Fairbairns' response to a discovery request for admission was also determined not to be persuasive. Fidelity Charitable had asked the Fairbairns to admit that Fidelity Charitable “retained control” of the donated shares. In response, the Fairbairns admitted that they only retained advisory rights and that Fidelity Charitable did, in fact, have legal control. Fidelity Charitable contended that the Fairbairns' admission that Fidelity Charitable had legal control meant they had admitted that Fidelity Charitable could not have induced them to donate their shares through the unfulfilled promises. But, the court noted that “legal control” was not defined at the time of the response by the Fairbairns or Fidelity Charitable.

According to the Fairbairns, legal control in the context of their response meant that “once the donation was made, Fidelity Charitable alone controlled the donation, subject to any promises it made prior to the donation.” In any event, the court noted, requests for admission seeking legal conclusions are generally not permitted. And, to the extent that Fidelity viewed the Fairbairns' response as in some way unclear regarding what “legal control” meant, the court noted that Fidelity Charitable could have “move[d] to determine the sufficiency of an answer or objection,” but it cannot instead hold the Fairbairns to having made an admission regarding their lack of legal control as the term is defined in the tax code when that term was not defined in the request for admission itself or the response.

Based upon the foregoing, the court held that the charitable income tax deduction claimed by the Fairbairns’ on their 2017 income tax return was not clearly inconsistent with their assertion that Fidelity Charitable is bound by its alleged promises and, accordingly, concluded that the doctrine of tax estopped could not be applied to forestall the Fairbairns claims of unfilled promises by Fidelity Charitable. Interestingly, the court noted that the statute of limitations on the Fairbairns' 2017 has not yet run and, in this regard, stated that "if the Fairbairns prove that Fidelity Charitable made the legally-enforceable promises, and Fidelity Charitable is correct that such legally-enforceable promises disqualify the donation from a charitable tax deduction, the IRS may take action against the Fairbairns to recover any improper deduction. No 'taxpayer estoppel' is needed to prevent any unfairness: Fidelity would be held to its promises, and the Fairbairns would suffer the consequences, if any, of enforcing those promises."

The case is now heading to trial, now, however, with Fidelity Charitable having to assert the unenforceability of its alleged promises on grounds other than on the basis of the tax law requirement of a sponsoring organization's exclusive control over assets contributed to a DAF.

COMMENT:

The court in *Fairbairns v. Fidelity Charitable* is not going to make any determination regarding tax consequences, as its charge is to determine whether Fidelity is liable for any purported promises it made to the Fairbairns. The case, does, however raise some important tax issues regarding the effect of the conditions placed by the Fairbairns on their contribution of Energous stock to Fidelity Charitable, ***assuming they are legally enforceable.***

Treatment of Fund Established at Fidelity Charitable as a DAF Under IRC § 4966(d)(2)(A).

As indicated by the court in its decision on the Fidelity Charitable motion for summary judgment, a legally enforceable donor condition imposed at the time of the donation, as opposed to a legally enforceable condition that a charity abide by a donor's continuing directions after a donation, does not necessarily cause the disallowance of a charitable income tax deduction,[iv] although it may affect the value of the contribution.[v] Yet, the fact that the control retained by the Fairbairns with respect to the liquidation of donated stock may not cause the disallowance of a charitable income tax deduction does not mean that such retained control does not disqualify a charitable fund from being treated as a DAF for tax purposes. Indeed, the very premise of a fund being classified as a DAF for tax purposes under IRC § 4966(d)(2)(A), and the attendant tax advantages of a DAF over those of a private foundation, is that the fund be "owned and controlled by a sponsoring organization" and that the donor merely have "advisory privileges," not legally binding control. Similarly, the very premise of a charitable income tax deduction for a contribution to a DAF under IRC § 170(f)(18) is that the sponsoring organization of a DAF have "exclusive legal control over the assets contributed." The legislative history to IRC § 4966(d)(2)(A) clearly indicates that an agreement between a sponsoring organization and a donor that provides enforceable legal rights to a donor with respect to assets contributed to a DAF goes beyond mere "advisory privileges" and will disqualify a fund from being treated as a DAF, stating as follows:[vi]

> Advisory privileges are distinct from a legal right or obligation. For example, **if a donor executes a gift agreement with a sponsoring organization that specifies certain enforceable rights of the donor with respect to a gift, the donor will not be treated as having "advisory privileges" due to such enforceable rights for purposes of the DAF definition**.

The definition of a DAF under IRC § 4966(d)(2)(A) and the requirements for deductibility for contributions to a DAF under IRC § 170(f)(18) squarely align with the treatment of a DAF as a "component part" of the sponsoring organization of the DAF, as opposed to a separate taxable entity. To be treated as a component part of the sponsoring organization of a DAF, such that a contribution to the DAF is treated as contribution to the public charity sponsoring organization and not to a separate taxable entity, the governing body of the sponsoring must have "the ultimate authority and control" over the contributed assets and the income derived therefrom.[vii] Absent a DAF being classified as a component part of the sponsoring organization, it should be treated as a private foundation, not a public charity.[viii] In the *Fairbairn v. Fidelity Charitable* case, assuming that the asserted promises made by Fidelity Charitable are ultimately determined by the court to be legally enforceable, it would therefore appear that the purported DAF created by the Fairbairns at Fidelity Charitable would not be a DAF in the first instance, as it would fail to meet the definition of a DAF under IRC § 4966(d)(2)(A) given the rights retained by the Fairbairns.

Moreover, it would also appear that the Fairbairns' fund at Fidelity Charitable would not be considered a component part of Fidelity Charitable, but would be treated for tax purposes as a separate and distinct private foundation, at least as long as Fidelity Charitable's legally enforceable promises are in force. When the promises by Fidelity Charitable are considered fully satisfied, the fund should then, at that point, be considered a DAF and a component part of Fidelity Charitable, as Fidelity Charitable would then have the ultimate control over the fund, with the Fairbairns then only having advisory privileges.[ix] In substance, the contribution by the Fairbairns would be treated for tax purposes as if the Fairbairn's initially made their contribution of Energous shares to a private foundation and, upon the legally enforceable promises no longer being in place, the private foundation distributes all of its funds to a DAF.

Consideration of Tax Consequences of Private Foundation Classification. If the Fairbairns' are considered to have made their charitable contribution of Energous shares to a private foundation, the tax consequences would include the following:

- ***Amount of Charitable Income Tax Deduction Limited to Tax Basis Because Contributed Stock Does Not Constitute "Qualified Appreciated Stock***." In the case of a contributed of appreciated stock to a private foundation, unless it meets the definition of "qualified appreciated stock," the charitable income tax deduction will be limited to income tax basis, not the greater fair market value. Under IRC § 170(e)(5)(B), "qualified appreciated stock" includes "any stock of a corporation" for which, as of the date of the contribution, market quotations are available on an established securities market and which is held for more than one year." The language of IRC § 170(e)(5) regarding qualified appreciated stock, which requires that market quotations be available on an established securities market, is similar to the language of Reg. § 1.170A-13(c)(7)(xi)(A), which defines "publicly traded securities" as meaning securities "for which (as of the date of the contribution) market quotations are readily available on an established securities market." Under this regulation, however, securities are not considered publicly traded securities if "the securities are subject to any restrictions that materially affect the value of the securities to the donor or prevent the securities from being freely traded. Because of contributed Energous stock could not be freely traded by Fidelity Charitable on account of the restrictions placed by the Fairbairns on the liquidation of the stock, the contributed stock, albeit stock in a publicly traded company, would not likely qualify as "qualified appreciated stock," thereby limiting the income tax deduction to its tax basis.

- ***Reduction of Gross Income Percentage Limitation***. The gross income percentage limitation for contributions of property contributed to a private foundation is 20% of a taxpayer's contributions base (generally equal the adjusted gross income) as opposed to a 30% limitation applied for contributions of to a public charity.

- ***Imposition of Excise Tax on Capital Gain***. IRC § 4940 imposes a 1.39% excise tax on the net investment income, which includes capital gain, of a private foundation, thereby exposing the capital gain realized on the sale of the Energous stock to a 1.39% excise tax.

Other Tax Issues to Consider**.** Normally, in order to claim a charitable income tax deduction for a charitable contribution of stock valued at more than $10,000, a "qualified appraisal is required" and, if the appraised value exceeds $500,000, the appraisal must be attached to the tax return on which the deduction is claimed. An exception to this requirement applies where the contributed stock constitutes a publicly trade security, which means, consistent with IRC § 170(e)(5)(B), a security "for which (as of the date of the contribution) market quotations are readily available on an established securities market." As indicated above, the conditions placed on the liquidation of the Energous stock contributed to Fidelity Charitable make it likely that the exception to the appraisal requirement for a publicly traded security would not apply to the Energous stock. In addition, the conditions placed on the liquidation of the Energous stock would also impact its valuation for purposes of determining the amount of the charitable income tax deduction and raise an issue as to whether Fidelity Charitable could have furnished an IRC § 170(f)(18) acknowledgment that it had "exclusive control over the assets contributed."

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Richard Fox

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Fairbairn v. Fidelity Investments Charitable Fund, Case No: 18-cv-4881-JSC (N.D. Cal March 2, 2020); IRC §§ 170(f)(18); 170(f)(11)(A)(i); 170(e)(5)(B); and IRC 4966(d)(2)(A); *Fund for Anonymous Gifts v. I.R.S.*, No. CIV 95-1629 RCL, 1997 WL 198108 (D.D.C. Apr. 15, 1997), vacated in part, 194 F.3d 173 (D.C. Cir. 1999); Reg. § 1.170A-13(c)(7)(xi)(C)(1).

CITATIONS:

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[i] See, e.g., *Goldstein v. Commissioner*, 89 T.C. 535 (1987); see also *Gookin v. United States*, 707 F. Supp. 1156, (N.D. Cal. 1988); *Pauley v. United States*, 459 F.2d 624 (9th Cir. 1972).

[ii] No. CIV 95-1629 RCL, 1997 WL 198108 (D.D.C. Apr. 15, 1997), vacated in part, 194 F.3d 173 (D.C. Cir. 1999).

[iii] The D.C. Circuit vacated the district court's decision because the Fund was willing "to amend its governing instrument to strike out the provision authorizing conditions subsequent to donations to the Fund."

[iv] The restriction should not, however, prevent the donee organization "from freely and effectively employing the transferred assets, or the income derived therefrom, in furtherance of its exempt purposes." Reg. § 1.507-2(a)(7(i)). In the Fairbairn case, nothing about the conditions imposed by the Fairbairns would prevent Fidelity Charitable from using the contributed assets in furtherance of its exempt purposes.

[v] See, e.g.., Rev. Rul. 2003-28, 2003-1CB 594, where three-year restriction on the transferability of a patent contributed to a university did not cause disallowance of charitable income tax deduction, but "reduces what would otherwise be the fair market value of the patent." See also *Silverman*, TC Memo. 1968-216, where the court held that restrictions on the transferability of artwork contributed to various charities should be taken into account in determining the amount of the available charitable income tax deduction; Rev. Rul. 85-99, 1985-2 CB 2, allowing a charitable income tax deduction for land donated to agricultural college that could only be used for agricultural purposes, but required the land to be valued based upon the restriction placed on its use; Ltr. Rul. 8641017, where the IRS concluded that for purposes of determining the value of land contributed to charity subject to various deed restrictions as to mining and subsurface extraction, the amount of the income tax deduction must be "determined in light of the restriction placed by the donor on the use of the property."

[vi] Technical Explanation of H.R. 4, The "Pension Protection Act of 2006," Joint Committee on Taxation (August 3, 2006).

[vii] See Reg. §§ 1.170A-9(f)(11); 1.507-2(a)(7)(i)(C).

[viii] See Reg. § 1.170A-9(f)(11).

[ix] This treatment is consistent with IRC § 507(b)(1), where the private foundation status of a private foundation is terminated upon its transfer of all of its assets to a public charity.