



## Beware of “Quid Pro Quo”

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Charitable gift planners take note: BEWARE OF QUID PRO QUO! Events in Washington these last few weeks have brought the term “quid pro quo” into the national conversation. However, the IRS has long recognized that there can be a quid pro quo in exchange for a charitable gift. There are strict regulations that govern situations where the donor receives a benefit (quid pro quo) in exchange for their charitable gift. The IRS can impose penalties against charities for violations of quid pro quo regulations and donors can find their charitable deduction in jeopardy- or worse in some instances. Donors should be made aware of these regulations to avoid donor relations issues when their gift substantiation receipt is not what they anticipated.

### What Is “Quid Pro Quo?”

In philanthropy, a quid pro quo is a favor or advantage granted or expected in return for a charitable contribution. The classic charitable quid pro quo scenario is when a donor makes a gift that is partly as a charitable contribution and partly for goods or services. Such situations are common when in exchange for a contribution the donor receives tickets for a gala, concert, athletic competitions or similar events. For example, the donor might contribute \$1,000 and in exchange receive gala tickets that include food, entertainment, and other benefits valued at \$250. The donor can only deduct \$750 (\$1,000 - \$250), as the charitable contribution part of the payment is \$750. IRC§170(f)(8) requires the substantiation letter to state whether the charity provided any goods or services in consideration for a taxpayer's contribution. In situations where there is a return benefit to the donor, the phrase “no goods or services were received in exchange for this gift” will not be applicable for the full amount of the payment to the charity.

### Disclosure Statement from the Charity

The IRS requires charity to provide a donor a written disclosure if the payment to the charity (not just the value of the quid pro quo) is more than \$75 and the quid pro quo will be provided. For example, if a donor gives a charity \$100 and receives a concert ticket in exchange valued

at \$40, even though the quid pro quo portion is \$40, the charity must provide a written disclosure because the donor's payment exceeded \$75. The disclosure must provide a good faith estimate of the fair market value of the goods or services to be received by the donor. The disclosure can be provided either when the gift is solicited or in the substantiation receipt provided to the donor. Even if the disclosure was provided when the gift was solicited, it is good practice to also include the good faith estimate of the fair market value of the quid pro quo in the substantiation receipt.

## **Insubstantial Value and Annual Memberships**

Charitable gifts where the donor will receive benefits are fully deductible and no disclosure is required if: (1) the goods or services have "insubstantial" value as determined by the IRS<sup>[1]</sup>; or (2) the donor makes a payment of \$75 or less per year and receives only annual membership benefits that the individual can exercise often during the membership period such as free or discounted admissions (common with museums).

## **Qualified Charitable Distributions (QCDs) and Quid Pro Quo**

A qualified charitable distribution (QCD), better known in the charitable community as the IRA charitable rollover, must be entirely tax deductible under Section 170 of the Internal Revenue Code. If the QCD donor receives any benefit (i.e. quid pro quo) that does not qualify as "insubstantial value" as defined by the IRS<sup>[1]</sup>, then the QCD is disqualified and the donor must report the QCD distribution as taxable income. If the donor itemizes and is not subject to the AGI limitations, they can take a corresponding income tax charitable deduction for the charitable portion of the payment. The IRS does not allow the donor to allocate the QCD between the charitable and non-charitable portions of a gift with an associated quid pro quo benefit— it's all or nothing!

## **Donor Advised Funds (DAFs) and Quid Pro Quo**

A grant from a donor advised fund cannot result in a donor, advisor, or any related party receiving more than an incidental benefit<sup>1</sup>. If the goods or services are more than a de minimis value, it violates IRS regulations and subjects the donor to a 125% excise tax. Material quid pro quo benefits are prohibited. A DAF is prohibited from making payments for meals, gala tickets, preferential seating or parking at athletic events. For example, a donor may make a DAF grant for the charitable portion of a fundraising event and make a personal payment for the value of the quid pro quo benefit the events, a practice known as "bifurcation." The Service offered guidance in IRS Notice 2017-73 that a grant from a DAF for the deductible portion and a personal gift for the non-deductible portion would result in a more than incidental benefit and trigger the penalty excise tax. For example, if the ticket breaks out the cost for the dinner and the gift to the charity, the donor must pay from sources other than her DAF for the full value of the ticket (charitable and non-charitable) and not just for the non-charitable amount.

## Penalty for Failure to Disclose

A penalty is imposed on a charity that does not make the required disclosure of a quid pro quo contribution of more than \$75. The penalty is \$10 per contribution, not to exceed \$5,000 per fundraising event or mailing. The charity can avoid the penalty if it can show that the failure was due to reasonable cause.

Educating donors as to the IRS quid pro quo regulations can be a challenging task. Another challenge is when some charities look the other way at such regulations, creating a donor relations dilemma for the “observant” organization. Quid pro quo may soon fade from the national headlines, but it will be ever present for gifts to charity. Beware!

[1] Insubstantial benefits - Goods or services deemed to have insubstantial value require no disclosure by the charity and gifts made by the donor in exchange for such goods or services are fully deductible. Under IRS §170 and subsequent revenue procedures providing for annual indexing, in 2019 these “low cost articles” are where the fair market value is not more than two percent of the donor’s payment or \$111.00, whichever is less; or when the donor’s payment is at least \$55.50 and token items such as bookmarks, calendars, key chains, mugs etc. bearing the organization’s name or logo are the only benefit the donor receives. If the cost to the charity of such items does not exceed \$11.10 in the aggregate for all items received by the donor that year, then such items are considered “low cost articles.”