

## RULES FOR DESIGNATED GIFTS

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Considerable confusion exists in the church world regarding designated gifts. Some take a very restrictive view, claiming that the church may not accept any gift that is designated for a specific purpose or person. Others take a very expansive view, claiming that the church should assist donors in accomplishing the donor's charitable and religious goals. The truth is somewhere between these two extremes. This article spells out some of the rules governing designated gifts.

### STATE LAW RULES

Churches are permitted to do many things under state law, but they create problems under federal tax law. Assuming the donor does not want a tax deduction for the gift, the church is governed solely by state law.

Under state law, one must first determine whether the church, or the donor, imposed the designation. The church may only remove designations in three ways: (1) with the written permission of the donor(s), (2) by court order, or (3) with the permission of the state Attorney General. If the designation is imposed by the church on itself, then it is bound to that designation. The church may remove that designation only by utilizing one of the three methods from the preceding sentence. For example, assume the church conducted a capital gifts campaign to build a new family life center. The church designated that all gifts to the campaign would be utilized solely in building the family life center. The capital gifts campaign was so successful it has \$100,000 left over after completing the building. To be able to use the \$100,000, it must secure written permission from all donors (to the capital gifts campaign) to spend the money otherwise. If this is impossible, the church must either file a lawsuit to request permission from the court to remove the designation or secure permission from the state attorney general.

If the church spends the money in violation of the above rules, then any donor to the designated fund may bring a lawsuit against the church for misrepresentation or a deceptive trade practice. If the church is found liable under the state deceptive trade practices law, the church usually must pay punitive damages to the donor, plus the donors' attorney's fees.

For this reason, many churches adopt a designated gifts policy. This policy states that the board of the church may remove any restrictions on gifts when it is in the best interest of the church to do so. This policy is included in all giving documents. It is also usually printed on all gift receipts. In all fundraising materials, it restates the policy. Continuing the example above, the fundraising materials for the family life center states the church board reserves the right to spend the funds received in accordance with its designated gifts policy. The fundraising materials then restate the policy. The adoption of this policy and the accompanying publicizing of the policy will avoid the problems created when a designated gift fund is overfunded. As a result, the church board may spend the \$100,000 of overfunding on any project it chooses without notifying donors, filing a lawsuit, or notifying the state attorney general.

If the donor imposes the designation, then the church should determine whether to accept the donor's designation. If the designation fits within the church's exempt purposes, then it may accept the designation. If the designation does not fit within the church's exempt purposes, the church should not accept the gift. For example, assume the donor requests that her gift will be used to purchase a new piano. If the church finds that it needs a new piano, then it may accept the gift and use it solely to purchase the piano. Another example: the donor requests that her gift be used to help the Smith family. If the church determines that the Smith family needs benevolent assistance, under state law, it may accept the gift with the designation. (But see FEDERAL TAX LAW discussion below.)

If the donor imposes the designation and the church fails to follow the donor's designation, the donor may sue if he or she can prove a written or oral agreement with the church existed concerning the designation. In many states, the donor may sue under the state deceptive trade practices law to enforce their designated gifts.

### FEDERAL TAX LAW

General tax rules: If the donor wants the gift to be tax deductible, then the donor must transfer control over the gift to the church. Gifts that are designated for the benefit of an individual are not tax-deductible.

The church must be cautious in soliciting designated gifts. If the church creates the designation, then the gift is tax-deductible though the ultimate beneficiary of the gift is an individual. If the amount of the gift exceeds the designated purpose, then two problems may be created. The state law problem of overfunding is discussed above. If the beneficiary of the gift is an individual and the church gives the entire amount to that individual, it may give the IRS a basis for revoking the church's tax exempt status. If the beneficiary of the designated gift is a church officer or pastor and that gift causes that individual's compensation to exceed a reasonable amount, then the church has allowed unlawful inurement to occur. If the beneficiary is a benevolent needs family, then it may have allowed that family to be unjustly enriched and thereby causing an unlawful private benefit to occur. Either of inurement or private benefit may cause the loss of tax exempt status.

The gift to an individual must be distinguished from a gift to the ministry of an individual. For example, the donor wants to support missionary Smith and designates their gift for the benefit of missionary Smith. Assuming the church agrees to support missionary Smith and pays the money to the mission agency that is sponsoring missionary Smith, the amount donated is fully deductible because the entire amount will go to support the ministry of missionary Smith. On the other hand, if the church pays the money directly to missionary Smith without requiring any accountability for the use of the funds, then the church might have conferred a private benefit on missionary Smith or it may have paid compensation for services rendered to missionary Smith, triggering IRS reporting requirements.

## CONCLUSION

All churches should adopt a written policy governing designated or restricted gifts. The policy should have two components: one governing church created designations or restrictions and one governing donor created designations or restrictions. The church should have a procedure for approving all designated gifts that are created by the church before any funds are solicited. All churches should require a very high level of approval on restricted gifts that are not within previously approved ministries of the church. All churches should also adopt a written policy governing donor designated or restricted gifts. The policy should require a very high-level approval on all donor designations and restrictions. The church should encourage the use of suggested donations instead of legally binding designations or restrictions.