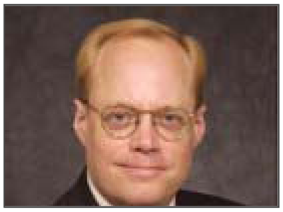

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Taxing Two Thanksgiving Gentlemen

A central theme of the Bible is that it is better to give than to receive, even when you give up a great deal. "Two Thanksgiving Gentlemen," a short story masterpiece by O. Henry, gives this theme a twist. A vagabond—today we would call him homeless—is feted each Thanksgiving Day to a grand dinner in a posh New York eatery by a successful businessman. But on this Thanksgiving Day, each man hides his true circumstances.

The businessman is down on his luck so starves for two days in order not to disappoint the vagabond. Ironically, the vagabond is flush, his stomach bursting from *two other* holiday meals from other well-wishers. Forcing down each bite, he plays along knowing how important this ritual is to his kindly rich benefactor. Only O. Henry could make us feel what each feels as we smile ruefully at the comedy playing out.

In this crowdfunding era, individual acts of kindness still count, even if they don't produce a tax break. That's right, the charity the two Thanksgiving gentlemen exchange isn't tax deductible, since you can't give directly and get a deduction.

These days when you give you want to deduct it, and you can't deduct the value of your time or your services. This is so even if you usually bill by the hour and donate many hours of otherwise billable time to charity. And you can't deduct gifts made directly to the needy even if you're trying to get your money where it will do some good.

That leaves charities, but even if you've checked the credentials and IRS tax exemption of an organization, how do you know how much goes to overhead and what your money really supports? Public charities and churches are supposed to benefit the general public, not private individuals. Some charities pay executive salaries and other perks that can make you squirm. As the Tea Party scandal underscored, there are many different kinds of nonprofits.

Many types funnel money to charities of the full 501(c)(3) variety, making contributions to those charities tax deductible by donors. The stakes are large, and nonprofits often face scrutiny from the IRS. Lavish spending and private inurement are classic problems in some non-profits. Penalties can be assessed, and in extreme cases, the government can threaten to revoke a tax exemption. Big payments for goods or services don't necessarily violate the law, but there is IRS scrutiny to be sure there's no private inurement.

The usual key to such arrangements is whether the terms and conditions are at arm's length—the kind of deal unrelated parties strike. When the LA Times reported the IRS investigation of Los Angeles' Kabbalah Centre, the questions were whether funds inured to the Berg family that controlled the Kabbalah Centre for decades.

If a tax exempt church or charity pays a founder or someone else more money than is fair for goods or services, it can jeopardize the tax-exempt status of the organization. There's a particularly big risk if it looks like the charity is the founder's own private fiefdom. How does the IRS find out? Although tax-exempt, these charities must file tax returns on IRS Form 990.

The moral? When it comes to giving don't be controlled solely by taxes, like the Thanksgiving gentlemen. Alternatively, get some tax advice before you act. Incidentally, make sure your donee can use what you give too. In O. Henry's "The Gift of the Magi," a struggling young couple wants to exchange something special for Christmas. Della cuts off her flowing hair and sells it to a wig maker to buy a platinum chain for her husband Jim's heirloom pocket watch. You guessed it, Jim sells his prized watch to buy combs for Della's hair.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.