

Gifts in Kind: CA Takes Aim, Again

06.26.19 | Linda J. Rosenthal, JD



“Charitable **donations come in different forms**; while cash is king, other types of contributions are useful, too. Among them are ‘gifts in kind,’ sometimes also called ‘in-kind gifts’ or ‘in-kind donations.’” They are a form of charitable giving where the donor doesn’t give money to buy goods and services the recipient needs but, instead, gives the goods and services themselves.

In-kind gifts can be valuable to a charitable organization even though there are more significant (and distinct) record-keeping and reporting duties in connection with these non-cash items. Specifically, there are important issues concerning: (a) the timing of these donations and when the donation is “recognized” for accounting purposes; and (b) how the gifts are recorded, including noting the contribution’s fair market value as contribution revenue in the period received.

The California Attorney General, Xavier Becerra, who succeeded (now) Senator Kamala Harris, has taken particular aim since 2017 at a certain type of in-kind gift that involves distribution by American charities of certain pharmaceuticals to underprivileged nations. He has targeted not only California 501(c)(3)s who take part in this activity, but also out-of-state charities. In 2018, he initiated a high-profile enforcement action against four charities. Just recently, that office has moved against a fifth organization.

On top of that, AG Becerra has sponsored legislation this term that is now sailing easily through the California Legislature. This bill formalizes the Attorney General’s position on this issue despite legitimate criticism from many reputable quarters that his stance is inconsistent with generally accepted accounting principles (GAAP).

Last Year’s Gifts In Kind Actions

In “**CA Issues Cease-and-Desist Orders to Out-of-State Charities**” (May 3, 2018), we told you about the lawsuits that the Attorney General filed in March 2018 against the four *non*-California 501(c)(3) organizations. (The **CA AG’s jurisdiction** reaches not only California charities but out-of-state

501(c)(3)s that solicit donations from California residents. This type of extended jurisdiction is not unusual among American states.)

According to Becerra's Complaints against each group – which we noted at the time were **remarkably clear and free of legalese** – these organizations had “fraudulently solicited funds from California residents.”

The four cases are unrelated except that they involve a similar fact pattern: “Each is part of a chain of distribution of soon-to-be-expired pharmaceutical drugs, donated by the drugmakers, to the developing world. The gist of the AG's claims is that the organizations (1) used an accounting ploy that is, itself, wrongful because it's misleading; and (2) touted these inflated figures to support fundraising appeals in California for additional (and, in at least one case, nonexistent) projects.”

More specifically, “charities may claim only ‘fair market value’ which – for GIKs – is defined as the ‘price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.’” The problem cited in each of these four cases is that organizations “**used the FMV of the medications in the U.S. market instead of the much lower prices** for these drugs in the developing world.” And this isn't exactly chump change; at least 3 of the 4 cited organizations (collectively) **reported revenues of almost \$2 billion**, much of it in the form of non-cash contributions – that is, the pharmaceutical drugs.

There is some controversy over AG Becerra's interpretation of this rule; his position is that these rules follow GAAP while some experts **dispute that assertion**, arguing that the matter is **not as black-and-white** as all that.

New Gifts in Kind Developments

In announcing these enforcement actions last year, the California Attorney General wrote: “Let this **serve as a stern warning** that charities that intentionally mislead the public at the expense of others will be held accountable.”

In late May 2019, the **California Attorney General's Office filed the lawsuit against the fifth charity** on the **same theory of overvaluing donated pharmaceuticals** and making solicitation misrepresentations. This time, though, the target of the probe is a California organization, Santa Rosa-based **Aid For Starving Children**.

In an article in The Nonprofit Times on May 14, 2019, Mark Hrywna writes that three of the four nonprofits that received cease-and-desist orders last year “...have been fighting the litigation for more than a year and the case is expected to **soon be resolved in the charities' favor**, according to sources.” (The fourth organization had quickly settled the case last year, signing a stipulated judgment, and then dissolving.)

Kicking up the controversy several notches this spring, Becerra recently sponsored legislation introduced by Assemblywoman Monique Limón (D-Santa Barbara) on February 21, 2019. **California Assembly Bill 1181** (AB 1181) generally provides for valuation of a non-cash contribution received by a charitable organization that is restricted by the donor from being used domestically **based on its fair market value in the foreign country** where it is ultimately distributed rather than its fair market value in the U.S.

AB 1181 passed the Assembly on May 13 by a vote of 69 to 1 and now goes to the Senate, where it is also likely to easily pass. The measure is currently in the CA Senate Judiciary Committee where a hearing is scheduled for July.

Although Assemblywoman Limon is a vocal advocate for the nonprofit community, this bill has substantial opposition from “nonprofit advocates and accountants [who] believe that the measure would **undermine Generally Accepted Accounting Principles** (GAAP) already being followed across the United States.”

Conclusion

Although this controversial legislation affects only a small number of nonprofits, it will be interesting to follow its implementation, especially given the serious concerns raised by opponents including the California Association of Certified Public Accountants.