Fairbairn v. Fidelity Investments Charitable Gift Fund: **Managing Contributions of IPO Stock Goes Awry, but Donors have Little Recourse**

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Donors make contributions to donor-advised funds (“DAFs”) for a variety of reasons. One is that DAF rules permit the donor to make the contribution in the current year (which entitles the donor to a deduction in that year), while retaining the ability to give the money to charities in future years. Donors who want to fund a large gift with a complex asset (such as real estate or closely held stock) may also opt to contribute the asset to a DAF, knowing the fund has the expertise to sell the asset, and allowing the proceeds to be divided into smaller gifts to a variety of charities.

As reported in [The Wall Street Journal](https://www.wsj.com/articles/fidelitys-charitable-arm-wins-in-hedge-fund-founders-lawsuit-11614391480), Emily and Malcolm Fairbairn used Fidelity Investments Charitable Gift Fund (“Fidelity Charitable”) to accomplish both objectives, seeking a timely deduction with the additional goal of funding Lyme disease research and other charitable causes. The Fairbairns, who are successful hedge fund managers, needed a tax deduction in 2017 because they expected a large amount of taxable income due to tax law changes. They planned to contribute shares of Energous, a company that had recently IPO’d.

The Fairbairns worked with Fidelity Charitable to make a transfer of nearly two million shares of stock at the end of 2017 (just in time to receive a deduction for that tax year). Energous stock was thinly-traded, and the Fairbairn’s ownership stake was sufficiently substantial that the sale of their stock could depress the price. The Fairbairns and Fidelity Charitable discussed this possibility, although it’s unclear exactly what they agreed to as to the stock sale methodology. The Fairbairns allege that Fidelity Charitable made several promises, including that it would trade the shares in small chunks and that it would employ “sophisticated, state-of-the art” methods for liquidating the stock that would not cause the share price to be depressed. In court, Fidelity Charitable asserted that it had only agreed to limit the sales to 10% of the daily trading volume (which, during the day in question, was around $42 million). This would not have limited Fidelity Charitable from selling the shares upon receipt, which was Fidelity Charitable’s stated policy.

In fact, Fidelity Charitable sold the stock immediately upon receipt, in large blocks, on December 28, 2017. The Fairbains alleged that this depressed the stock price at sale, not only leaving less money for charitable causes, but also decreasing their charitable deduction (because the size of the donor’s deduction 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).[[1]](#footnote-1)

Ultimately the Fairbairns received a $52 million dollar tax deduction and an account at the DAF worth $44 million, values that the Fairbairns alleged were far below what could have been achieved had Fidelity Charitable followed through on what the Fairbairns felt had been promised.

The court’s decision following a bench trial addressed a number of issues, primarily around whether Fidelity Charitable had committed negligence. Although the Fairbairns brought a claim for breach of contract, there was no written agreement regarding the disposition of the stock (likely in order to avoid the argument that the Fairbairns had not given up all of their interests at the time of the transfer and therefore were not entitled to a deduction). The court ultimately ruled in favor of Fidelity Charitable. Applying the prudent investor standard, the court held that Fidelity Charitable was not negligent, because it had acted within its stated policy and had not exceeded its policy of selling up to 10% of the trading volume. The court declined to hold Fidelity Charitable to the requirement that it deviate from its policy of selling shares upon receipt or use more sophisticated means to make stock sales.

One interesting question the court did not reach is whether Fidelity Charitable even had a duty to the Fairbairns. As a recipient of charitable funds, it’s not clear that Fidelity Charitable had any duty to the Fairbairns, although the court seemed inclined to rule that the back and forth planning for the gift did create a duty. That question will have to await another day, however, as the court found it unnecessary to reach it, since it ruled that, in any case, Fidelity Charitable had not been negligent.

**Lessons**

The lessons for donors are clear: if you have expectations as to how a closely-held asset should be disposed of, you should make sure that you’ve discussed this with the DAF organization. This is especially true in a sensitive situation where the method for the disposition of the asset may impact the donor’s charitable income tax deduction. This includes thinly-traded publicly traded stock. But it also includes non-publicly-traded assets in which the DAF will be required to file IRS Form 8282 (the “tattle-tale” form) upon disposition of the asset – with the knowledge that the IRS may compare the donor’s claimed deduction with the amount of proceeds listed on Form 8282.

Donors should be aware that the legal nature of DAFs (accounts owned by a charitable organization over which the donor has only advisory privileges and no legal rights), means that their avenues for legal recourse will be very limited. A donor seeking to sue a DAF for not accomplishing their tax-advantaged gifting strategies will be fighting an uphill battle. A more practical approach would be for a donor to proactively seek out a DAF with existing policies that align with their objectives and approach to disposition.

There are lessons for DAFs, as well. In this case, Fidelity Charitable prevailed, but it did not emerge unscathed. The court’s decision incorporates a number of e-mails between employees of Fidelity Charitable, some of which do not cast a flattering light on the organization. Although a DAF is legally entitled to follow its own policies (and this case reinforces that entitlement), it makes sense from a donor-relations standpoint, and to avoid negative publicity, for the fund to work with the donor as much as is reasonably practical to achieve the donor’s goals. DAFs should be reviewing their policies and making sure that they are up to date, and that the right areas of the organization know about and follow them. The specialists who are talking to the donor should also communicate with the part of the organization charged with liquidating the stock. DAFs should consider evaluating their policies and procedures now, to be ready when the inevitable rush at the end of the year occurs.

1. IRS Publication 561. [↑](#footnote-ref-1)