TWENTIETH CONFERENCE ON GIFT ANNUITIES

WISE PUBLIC GIVING SERIES, NO. 59

1989

TWENTIETH CONFERENCE ON GIFT ANNUITIES

PAPERS PRESENTED AT THE
TWENTIETH CONFERENCE ON GIFT ANNUITIES
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COMMITTEE ON GIFT ANNUITIES

COMMITTEE ON GIFT ANNUITIES
1865 Broadway New York, NY 10023

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OPENING REMARKS

Dr. Darold H. Morgan
Chairman, Committee on Gift Annuities

It is my good pleasure to welcome you to the 20th Conference on Gift Annuities. There are lots of firsts for us in this meeting. It is the first time the Conference has been held outside the United States. It is the first time—with 741 representatives in attendance—that the Conference has exceeded 650 in enrollment. It is the first time the Conference has been held in early April. It is not the first time, however, that we have a program geared to meet the ever-changing needs of the charitable giving world.

We have an excellent Program Committee, chaired by Jane Stuber, Vice Chairman of the Committee on Gift Annuities and Director of the Deferred Giving Program at Smith College. Her efforts in planning and executing these plans have been nothing short of herculean. An equally excellent Arrangements Committee, chaired by Tal Roberts, Vice Chairman of the Committee on Gift Annuities and Executive Vice President, Baptist Foundation of Texas, has done yeoman's work for us all. Most of you know something of the immense amount of detailed work involved in these responsibilities. We are grateful to both committees. However, the real heroine of the 20th Conference on Gift Annuities is Mary Lou Ruegg, of the American Bible Society, whose organizational and administrative skills are simply unparalleled. She assumed responsibility for the arrival of workshop materials, printing, invitations, and endless details too numerous to mention, combined with a dedication par excellence.

Most of you are aware that in 1986, Uncle Sam in his feverish quest for income decided to tax gift annuities. Thanks to Tal Roberts, Conrad Teitell, Terry Simmons, and a long list of other concerned and knowledgeable individuals—and with assistance from our friends in the Church Alliance Pension Group—the situation was resolved by The Technical Corrections Act. Without the generous support of sponsoring organizations who made special contributions for this purpose, the Committee would have been unable to represent your interests in this vital matter. Your special gifts and letters of support were greatly appreciated. But it is necessary to remind you that the battle is not yet over. We will continue to keep you posted in the developments in the legislative arena.

A helpful practice we have followed at previous conferences has been the appointment of a Resolutions Committee to propose Conference actions. If you will allow a continuance of this practice, I would suggest the following persons serve the 20th Conference on Gift Annuities in that capacity:

Chairman: MR. CHARLES N. O'DATA, Vice President of Development, Geneva College

MR. ROGER K. PAROLINI, Director of Endowment, Aurora University

MR. JOHN SOUTH, Director of Development, Father Flanagan's Boys' Home

DR. CHARLES W. BAAS, Committee on Gift Annuities Secretary

MR. MICHAEL MUDRY, Committee on Gift Annuities Actuary

DR. JOHN D. ORDWAY, Committee on Gift Annuities Member

MR. EUGENE L. WILSON, Committee on Gift Annuities Member

And your Chairman, as an Ex-Officio member.

Again, welcome to Toronto and to the 20th Conference on Gift Annuities.

ECONOMIC & FINANCIAL OUTLOOK

Mr. Cyrus P. Durgin
Vice President, Constitution Capital Management

Before we address the main subject of what seems to lie ahead for the U.S. economy, I'd like to take a quick look with you at a business in which everyone in this room is deeply interested: raising funds for nonprofit organizations. My reason for doing this is simple. While fund raising and charitable giving are not commonly thought of as a business, it is a fact that this area is one of our economy's most consistent (and consistently unrecognized) growth sectors. Total charitable giving in the U.S and giving by individuals have both increased in every year going back at least as far as 1955 (when adequate national records began to be kept). I'm not sure that any of our well known growth industries can make the same claim of completely uninterrupted growth over a period of nearly three and a half decades.

Even if we adjust the annual giving numbers for inflation, the record is a very impressive one. So-called real giving has increased in all but 4 of the past 33 years. The exceptions (1970, 1974, 1980, and 1982) were all years in which the economy was in recession, with real (inflation-adjusted) gross national product lower than in the previous year. In addition, they were all years in which the rate of inflation was relatively high. It's interesting to note that real giving rose slightly in 1958, which was also a recession year. The 1958 recession was a good bit more severe than that of 1970, but 1958 was a year of fairly low inflation.

Another way of looking at this is to relate charitable giving to the level of national income. Here again, the record is impressive. Since 1955, total charitable giving has ranged between 2.6% and 2.1% of national income, a remarkably narrow band. However, there has been a distinct and probably instructive pattern in the way this percentage has fluctuated. Prior to 1965, giving held in the area of 2.4% to 2.6% of income. Then it declined rather steadily for a decade, reaching its low of just under 2.1% of income in 1975. It recovered a little during the next seven years but was still under 2.2% in 1982. Since then, however, giving has risen more sharply to 2.4% of income. It is surely no coincidence that the years of decline, 1965 to 1975, were the period during which inflation emerged as a serious ongoing economic problem and that the recovery years since 1982 have seen the lowest average level of inflation since the early 1960's.

It seems, then, that the lesson to be drawn from this is that, while general economic conditions—whether the real economy is growing or contracting—certainly are relevant to the behavior of charitable giving, inflation is at least as important a factor, particularly over fairly long time periods. And for you here today, inflation is doubly important, since it is now generally agreed that inflation, particularly expected inflation, has a potent influence on the level of intermediate and long term interest rates. So before moving on to the current economic scene, let's consider what makes inflation rise and fall.

Speaking very broadly, there are two schools of thought on this. One school argues that inflation is the result of overworking our economic resources. After a fairly long period of economic growth, we are apt to be making full use of our resources of manufacturing capacity, labor, and raw materials. To obtain the additional resources necessary for further growth, we must employ less efficient resources and increase what we pay for the use of those resources. This creates rising cost pressures which translate into accelerating economy-wide price increases.

This view is quite plausible, but history doesn't support it. Let's look at the trends of inflation and resource utilization, measured as 4-year averages. Output growth, capacity utilization, and employment of the labor force were all at post-WWII peaks in the mid-1960's as inflation began to pick up. However, resource utilization dropped sharply over the following 15 or so years while inflation continued to build. For instance, the 4-year average of manufacturing capacity usage was nearly 89% in 1968, fell to 78% in 1977, rose to 82% in 1980, and dropped again to 75% in 1983. But the average level of inflation rose from under 2% in 1975 to over 7% in 1977, was 8% in 1980, and peaked at almost 10% in 1983. After 1983, the average level of inflation dropped to about 3½% in 1988, while capacity utilization recovered to 82%. This pattern is just the reverse of what one would expect.

The other school of thought on inflation sees money as the culprit. One doesn't have to be a strict monetarist to believe that excessive money growth is the essential factor which makes inflation possible. By definition, the rate of inflation is a direct function of (1) money growth relative to real economic growth and (2) the rate of turnover of the money supply. The latter varies a lot during economic cycles, but its trend has been consistently down for about thirty years. *So it has been the rate of money growth relative to economic growth which has largely determined our inflation* *experience,* and the 4-year average growth of this variable over the past 20-plus years has been remarkably close to the average inflation rate. So history does support this view. It is not surprising to find that there is also a reasonably close fit between this variable's trend and that of interest rates.

So, looking at the current situation and ahead to the next few years, how do things look? The short answer is: pretty good. Right now, however, that's a fairly controversial position, so let me try to justify my view. Currently there is considerable anxiety that inflation must rise appreciably in the next couple of years because the current economic expansion is over 6 years old and our resource utilization is becoming too high. As noted earlier, history does not warrant fear of a serious inflationary break-out on this count. Cost pressures are building, and this has produced an upward drift in inflation over the past couple of years. But the operative word here is 'drift'. Anxiety is also high because the value of the dollar has fallen 40% or so relative to other major currencies in the past 4 years, and this has an inflationary impact. Yes, this does put upward pressure on import prices, but this is a relatively minor factor. Actually, the lower dollar helps to make our manufactured goods much more competitive here and abroad, giving our industrial sector a 'second wind'. This bears on the key issue: *the downward trend in money growth relative to economic growth which has been evident since 1983-84 is still in place,* and the stimulative effects of the lower dollar make it easier to keep money growth appropriately low. Simply put, *an inflationary spiral just doesn't seem possible within the next few years;* the excess money to fuel it doesn't exist.

Is a recession likely? A recession will almost certainly occur sometime in the next 3 years or so, but the sorts of economic imbalance which typically lead to recession simply aren't evident now. Therefore a recession appears quite unlikely during the next 12 to 15 months.

What about interest rates? Relative to the current level of inflation, long term rates are high. Therefore, since I believe that inflation will not be a major problem in the next few years we must expect long term rates to decline at least moderately, perhaps by about a point over the next 12 months.

In summary, I see no reason for serious concern about inflation or economic growth, and interest rates seem more likely to decline than rise.

ACTUARIAL BASIS FOR IMMEDIATE & DEFERRED GIFT ANNUITY RATES

Mr. Michael Mudry
Senior Vice President
Hay/Huggins Company, Inc.

My remarks today have three main purposes. I will first explain the areas where assumptions are made in connection with the calculation of rates of immediate and deferred gift annuities. Secondly, I will comment on the analysis made of the assumptions used in developing the present maximum rates. Third, I will present for your consideration the recommendations of the Committee on Gift Annuities relating to the maximum annual rates to be used for immediate and deferred gift annuity rates for the period until the next Conference on Gift Annuities.

To avoid confusion, I shall at the start define two words which I will use. First, I will define the original amount paid to a charitable organization for a gift annuity as the "gift" paid for the annuity, because this appears to be the common usage, even though it can be argued that only a portion of the payment represents a true gift to the organization because the rest is really needed to pay the annuity to the annuitant. Thus, under this definition, if $10,000 is paid for a gift annuity, such $10,000 is the gift. Such amount has been referred to also by some people as the principal or the amount transferred or by some other term, but I will refer to it as the gift in this paper.

The second definition is of the word "rate". In the gift annuity field, the word "rate" represents the percentage that is multiplied by the gift in order to arrive at the annual annuity payable to the annuitant. Recommended maximum percentages, or rates, are adopted by the Conference on Gift Annuities. The rates for immediate gift annuities are listed according to the annuitant ages in the table of uniform gift annuity rates published by the Committee on Gift Annuities for single-life annuities and for annuities for two lives. For example, the present table shows the maximum recommended rate for a single-life immediate gift annuity to be 7.8% at age 70. This meaning of the word "rate" is different from that usually used in insurance circles, where "rate" is frequently considered to mean the premium rate that is charged by an insurance company for the coverage being purchased. Of course, when I refer later in my remarks to mortality rates or interest rates, the difference in usage of the word "rates" should be obvious.

Based on the above two definitions, the dollar amount of annuity actually paid to an annuitant is equal to the gift times the rate. Therefore, a person of age 70 who pays a gift of $10,000 to a charitable organization for an immediate single-life gift annuity for himself or herself would be entitled to an annual gift annuity payment for life of the $10,000 gift times a rate of 7.8%, or $780, under the maximum recommended rates.

Let us now review the areas where assumptions are made for the purposes of calculating gift annuity rates. Although many of you who have attended prior Conferences on Gift Annuities may be fairly familiar with my comments concerning the types of assumptions used, I will still take a few minutes to go over them again since there are a number of persons here today who are attending their first Conference on Gift Annuities.

Assumptions are made relating to the following five areas in connection with the development of gift annuity rates:

(1) the mortality rates in future years,
(2) the investment yield rate or, as more commonly called, the interest rate to be earned on the gift paid for the annuity,
(3) the portion of the gift to be used to meet future administrative expenses,
(4) the frequency of the annuity payments, and
(5) the residuum available to the organization at the death of the last annuitant.

The assumptions made in these five areas in connection with the present applicable maximum rates of gift annuity have been in effect since they were adopted at the 1983 Conference six years ago. A brief explanation of each of these areas follows.

Mortality rates (which are also referred to as rates of death) are presently assumed for immediate annuities and for the annuity payment period of deferred annuities in accordance with what is called the 1983 Table a for female lives, with ages set back one year. Instead of trying to explain the meaning of this technical jargon, I will simply mention a sample of the assumed rates of mortality at some ages under this assumption. For example, the mortality rate is about two-thirds of 1% at age 65, 1.065% at age 70, 1.79% at age 75 and 3.23% at age 80. Each of these rates represents the percentage assumed to die within one year among a group of persons of a given age. Thus, in a group of 70-year-olds, it is being assumed that 1.065% will die in a year. Different percentages normally apply at each age, with the rates increasing as age advances, except at very young ages. You may have noticed that I had indicated that the death rates presently being assumed are those that were developed from experience among female lives. The resulting annuity rates are applied regardless of the sex of the individual. Annuities derived from such rates are frequently called unisex annuities because they do not differ on the basis of sex. This approach of providing the same annuity rate at a given age for members of both sexes has been in effect in connection with maximum recommended gift annuity rates since the first Conference on Gift Annuities held in 1927. This practice differs from that followed by insurance companies, which still normally provide different amounts of annuity at a given age for males and females from a given amount of premium, except to the extent they are prohibited from doing so by law.

The second area of assumptions made relating to gift annuities is in connection with the interest rates assumed to be earned in the future. For present *immediate* gift annuity rates, the assumed interest rate is 6.5%. For present *deferred* gift annuity rates, this same 6.5% interest assumption basically applies during the period annuities are being paid, but during the deferred period between the date of issue of a deferred annuity and the date the payments become effective, interest is assumed at an annual rate of 4.5% during each of the first ten years of such deferred period, 4% for each of the second ten years, 3.5% for each of the third ten years, and 3% for each year of deferral in excess of thirty. Combining the 6.5% interest rate assumed during the payment period and the interest rates grading from 4.5% to 3% during the deferred period produces effective overall assumed interest rates for deferred gift annuities that are close to 6.5% when the deferred period is short. As the deferred period increases, the effective interest rates decrease. This result is appropriate because the longer the deferred period, the greater the risk that experience will be unfavorable, so the greater the degree of conservatism that is necessary.

Under the third area of assumptions applicable for gift annuities, it is assumed in effect that 5% of the gift needs to be set aside initially on average in order that such 5%, together with interest earnings thereon, will be able to cover expenses. Such expenses include promotional expenses, writing the agreement, and future expenses for items such as accounting, paying annuity checks, filing reports with state insurance departments, etc.

The fourth area of assumptions involved in the development of gift annuity rates concerns the frequency of payment of the annuity. It has always been assumed since the first Conference on Gift Annuities in 1927 that gift annuities would be paid in semi-annual installments with the first payment due at the end of six months except, of course, in connection with deferred annuities, where the first payment is deferred to a later date. However, once the deferred annuity commences, it is assumed that payments will be made semi-annually. Actual gift annuity payments are frequently made at different intervals, such as monthly or quarterly, in which case it would theoretically be necessary to modify the annuity rate somewhat. However, most organizations use the same rate at a given age regardless of the frequency of payment, even though it has a small impact on the amount of residuum.

Under the fifth and last area of assumptions made pertaining to gift annuity rates, it is presently being assumed that the residuum at the death of the last annuitant will amount to 50% of the gift. A 50% residuum would remain to be distributed at the termination of the gift annuity agreement to the organization that issues the annuity if all assumptions were realized exactly. If it were desired to release a 50% residuum at the last death under each annuity agreement, it would be necessary to retain funds that would exceed a 50% residuum in the case of early deaths in order to be able to also provide a 50% residuum for those who outlive their life expectancies. Alternatively, some organizations maintain individual accounts for each agreement, and release the larger remaining residuum than 50% that arises at early deaths, with the recognition that a diminishing residuum will arise the longer an agreement is in force if experience equals the assumptions.

Instead of waiting until an agreement terminates before making use of a residuum, some organizations withdraw some or all of the present value of the residuum up front. This can be accomplished either by insuring the annuity (at least if double reserves are not required as they may be for organizations subject to the New York Insurance Law) or by setting aside on a self-administered basis a sufficient reserve on the books of the organization to cover the annuity payments to be made. An earlier release of a residuum would mean that the amount released would be less than the expected residuum at the termination of the agreement because interest would not be earned on the released amount between the date of release and the date the agreement is terminated. In recent years, it has frequently been possible to release up front an amount in excess of required reserves that can come close to or exceed 50% of the gift—mainly because of the ability to invest funds at an interest rate that exceeds the 6.5% assumed interest rate. Of course, if the released amount had been retained until the death of the annuitants, it would have increased significantly over the years for the same reason and have amounted to substantially more than 50% of the original gift.

Once a decision has been made concerning the assumptions to be used, the actual process of calculating immediate gift annuity rates is a mechanical matter utilizing the following four steps:

(1) From each $100 of gift, 5% (or $5) is subtracted for expenses,
(2) From the remaining $95 there is subtracted the single premium needed to provide a 50% (or $50) residuum at the termination of the agreement,
(3) The remainder from (2) is divided by the single premium needed to provide an annuity of $1 per annum payable in installments of $.50 each at the end of each six months, and
(4) The result from (3) is divided by the $100 gift and rounded to the nearest one decimal point to obtain the immediate gift annuity rate.

For example, the rate at age 70 for a single-life gift annuity is derived by first subtracting the 5% expense loading, or $5, from a gift of $100, which leaves a remainder of $95. From this $95 amount there is then subtracted a single premium of $17.15 needed to provide a $50 residuum. When the remaining $77.85 is divided by the single permium of $10.02 needed to provide an annual annuity of $1, payable in semi-annual installments of $.50 each, the result is $7.77, or 7.8% of the $100 gift.

This might be the appropriate point to mention that, after the calculation of rates has been completed, it has usually been decided to reduce the resulting rates at the very low ages and to follow the practice used in the insurance field of capping the rate at some age such as 85 or 90. The reduction at the very young ages is made in recognition of the fact that annuities issued at such ages are likely to be paid for a period of many years into the future during which substantial changes in interest rates may occur. Thus, additional conservatism is deemed advisable.

Now that I've provided the background to the present rates, let us turn to a consideration of the elements that were considered in deciding the rates being recommended to this Conference by the Committee of Gift Annuities. Actually, it is usual that attention is given only to the mortality and interest assumptions, since it is generally considered that the other three assumptions concerning the 5% expense load, the semi-annual frequency of payment, and the 50% residuum should be continued. Therefore, let us consider the two remaining assumptions relating to mortality and interest, starting with the former.

The present mortality assumptions were adopted in 1983 as being an appropriate prediction of death rates to be experienced among annuitants under gift annuity agreements entered into from 1983 through the next Conference on Gift Annuities. It is recognized that continuing improvements since then in areas such as life styles and health care have served to reduce mortality rates (and hence increase life expectancies). Accordingly, it would be appropriate at this time to base gift annuity rates to be adopted at this Conferance on updated lower mortality rates which would serve to reduce gift annuity rates in the absence of any other change in assumptions.

Now let us consider the interest rate assumption. As I had indicated earlier, the interest rate that has been assumed for maximum gift annuity rates since 1983 is 6.5% during the annuity payment period and a graded scale ranging from 4.5% for the first ten years of deferral for deferred gift annuities to 3% for the years of the deferred period in excess of thirty. Let us concentrate first on the 6.5% interest rate during the annuity payment period. A review of prevailing interest rates on long-term bonds being issued at the time of the 1983 Conference (when the current assumed interest rates were adopted), the 1986 Conference, and those being issued currently, shows the following:

	Interest Rates on Long-Term Bonds	
Conference	Aa Utility	U.S. Treasury
1983	12.25%	10.62%
1986	8.88	7.45
1989	10.30	9.43

The prevailing interest rates in 1983 of 12.25% on long-term Aa utility bonds and 10.62% on U.S. Treasury bonds were significantly higher than the 6.5% interest rate adopted at that time to be assumed for the annuity payment period. The conservative 6.5% assumption was recommended by the Committee on Gift Annuities because actual interest rates on new issues were falling at the time and could be expected to continue to fall further since they were still substantially higher than normal as the result of high rates of inflation.

At the time of the 1986 Conference, the interest rates on long-term bonds of 8.88% on Aa utilities and 7.45% on U.S. Treasuries were a bit higher than 6.5%, but were sufficiently close to that level that the Committee recommended continuation of the 6.5% assumption. Taken into account in this decision was the fact that some of this excess was offset by the decision not to adjust the mortality assumption in recognition of decreases in mortality rates between 1983 and 1986.

The interest rates on long-term bonds currently being issued of 10.30% on Aa utilities and 9.43% on U.S. Treasury bonds fall roughly midway between 1983 and 1986 actual rates and are approximately 3 to 4 percentage points above the current 6.5% assumptions. However, many economists predict that, although long-term interest rates may continue to increase further for the near term, they are expected to decline below present levels in the not too distant future.

Taking into account all of the above information, the Committee on Gift Annuities is recommending to this Conference that the assumptions relating to immediate gift annuities remain unchanged and, hence, that the present maximum immediate gift annuity rates be continued until the next Conference. As for interest rates for deferred gift annuities, the Committee recommends that each of the annual rates of interest assumed during the deferred period be increased by one-half percentage point, but with the assumption during the annuity payment period remaining at the 6.5% rate applicable for immediate gift annuities. Thus, the assumed interest rate would increase from 4.5% to a 5% level for each of the first ten years of the deferred period, from 4% to 4.5% for each of the second ten years, from 3.5% to 4% for each of the third ten years, and from 3% to 3.5% for each year in excess of thirty. The impact of these changes in assumed interest rates during the deferred period can be illustrated by the following data, which shows the interest factors applicable for the deferred period and the resulting single-life annuity rates for sample ages for individuals to whom deferred gift annuities are issued for payments beginning at age 65.

Annuity Rates for Selected Deferred Periods for Annuities Beginning at Age 65

Exact Age At Date Of Issue	Full Years in Deferred Period	Interest Factors		Annuity Rates at Age 65– Interest Factor Times 7.3%		
		Present	Proposed	Present	Proposed	% Increase
34	30	3.243	3.744	23.7%	27.3%	15%
39	25	2.730	3.078	19.9	22.5	13
44	20	2.299	2.530	16.8	18.5	10
49	15	1.889	2.030	13.8	14.8	7
54	10	1.553	1.629	11.3	11.9	5
59	5	1.246	1.276	9.1	9.3	2

From the above illustration it can be seen that the proposed deferred annuity rates payable beginning at age 65 range from 27.3% of the gift for issues at age 34 to 9.3% for issues at age 59 and are from 15% to 2% higher for the comparable ages than present rates. Needless to say, the greater the deferred period, the greater the percentage increase in the deferred gift annuity rate.

An approximate rule-of-thumb that can be used is that the maximum deferred gift annuity rates under the proposed interest factors would be higher than the comparable present maximum rates by about .5% times the number of full years in the period from the date the deferred gift annuity agreement is issued to the date six months before the annuity payments begin. For example, in the above illustration, the deferred annuity rate for a 20-year deferral would increase from 16.8% to 18.5%, or about 10%. For a 10-year deferral the increase in the rate would be about 5%.

There are several reasons why it is being proposed that the interest rates be increased for the deferred period, but not for the annuity payment period. Because the introduction of a deferred period usually produces longer periods during which the issuing organization is at risk for the investment of the funds it receives for a gift annuity, it is considered advisable to adopt more conservative interest assumptions for deferred annuities than for immediate annuities. However, in light of the actual interest rates available, the Committee decided there was too great a degree of conservatism in the assumed interest rates during the deferred period. Furthermore, in order to keep the annuity rate tables as simple as possible, no mortality discount is taken into account during the deferred period, nor is any interest credit given for a fraction of a year of a deferred period, both of which provide additional conservatism.

For my next remarks, let us turn our attention again to immediate gift annuities which, after all, represent the overwhelming majority of gift annuities issued, since relatively few deferred gift annuities are written. Although the Committee has recommended no change in the 6.5% assumed interest rate for immediate gift annuities in recognition of potential decreases in interest rates, it is aware that, under the current economic climate, yields from new investments of funds paid for annuities currently being issued are usually higher than 6.5%. This situation may be temporary, but while it lasts it will generally enable a charitable organization to receive a residuum higher than the assumed 50%. To illustrate this point, I have calculated the amount of residuum under single-life immediate gift annuities at sample ages of 65, 70 and 75 if actual interest rates earned during the existence of the annuity contract were the presently assumed 6.5% and also 5%, 8% or 10%. It is further assumed that experience would equal the assumptions in the other three areas where assumptions are made, which are mortality rates, a 5% expense loading and a semi-annual frequency of payment. The results are as follows:

Age at	Residuum As a Percent of Gift Under a Single-Life Gift Annuity if Actual Interest Earnings Are			
Issue	5%	6.5%	8%	10%
65	4%	50%	108%	206%
70	16	50	89	154
75	26	50	78	120

As would be expected, the above results show that the residuum is below 50% of the gift when only 5% is earned instead of 6.5%, but exceeds 50% when more than 6.5% is earned, and to a greater extent the greater the excess earnings over 6.5%. The deviation from a 50% residuum is greatest at the youngest ages because any earnings over or under 6.5% have a longer period to work their impact. It should be recognized that, for example, the residuum of 206% of the gift if 10% is earned in connection with a single-life annuity issued at age 65 would tend to have somewhat reduced purchasing power when it arises at the death of the annuitant because of the probable inflation that would have occurred while 10% yield rates are available.

Obviously the resulting residuum would change if experience relating to the other assumptions were to differ from assumptions. The extent of the change would depend on the degree by which the experience and assumptions differ.

In conclusion, I would like to state again that the Committee on Gift Annuities recommends the following action for the Conference to take tomorrow morning:

(1) that the present maximum annual immediate gift annuity rates be continued until the next Conference and

(2) that the present maximum annual interest rates applicable during the deferred period for deferred gift annuities each be increased by one-half percentage point, so as to become 5% for each of the first ten years of the deferred period, 4.5% for each of the second ten years, 4% for each of the third ten years, and 3.5% for each year in excess of thirty.

In conjunction with this action, though, the Committee also is recommending that the maximum rates under both immediate and deferred gift annuities be decreased to the extent necessary whenever the new variable interest rate of 120% of the applicable federal mid-term rate which becomes effective on May 1, 1989 would result in a situation where no charitable contribution deduction could be claimed by the donor. This would occur if such federal rate decreased sufficiently to reduce the otherwise deductible amount to 10% or less of the original gift, since federal law in effect requires that the deductible amount exceed 10% of the gift in order that deductibility can be claimed. It thus becomes extremely important that organizations issuing gift annuities closely monitor the annuity rates provided so as to insure that deductibility by the donor is preserved.

REPORT ON STATE REGULATION

Tal Roberts, Esq.
Executive Vice President
Baptist Foundation of Texas

For the benefit of those who have not attended a Conference on Gift Annuities before, let me give you some background on the Subcommittee on State Regulation. It was formed about twelve years ago when it was obvious that activity at the state level regarding the regulation of gift annuities and, to a lesser extent, pooled income funds was here to stay. There was, however,—and still is—a concern on the part of members of the Committee on Gift Annuities that the purpose and scope of the subcommittee's work would be misunderstood or misinterpreted. Simply stated, the work of the Subcommittee on State Regulation is to gather information as we can, and disseminate it to you. We are not in the business of giving legal advice. We are a group of volunteers who, with your help, are trying to monitor the regulatory activities at the state level.

Let me take a moment and introduce to you the other members of the subcommittee. They are Richard James, Loma Linda University, California; James Marshall, Meriter Foundation, Wisconsin; James Potter, American Lung Association, New York; and finally, Roland Matthies, retired Vice President and Treasurer, Wittenberg University, Ohio, who served as the first and only chairman of the subcommittee for the first ten years of its existence, and to whom we owe a great debt for his many efforts in this area.

As you can see, the subcommittee has a certain geographical balance to it. As you may have read in the program, I am from Texas and try to monitor the Southwestern states. We don't have much to worry about in the area of state regulation of gift annuities in our part of the country right now—all our regulators are busy with other matters . . . like banks, savings & loans and insurance companies.

One matter that is of interest to all of us which is getting increased attention right now is the matter of state and local regulation of charitable solicitation. Although this is an area that falls outside the scope of our subcommittee, it is one that we want you to be aware of and the best way we know how to do that is to refer you to our friends at the American Association of Fund-Raising Council in New York. The entire January-February 1989 issue of their newsletter entitled "Giving USA Update" is devoted to a summary of state laws regulating charitable solicitation.

This year's summary is especially timely in light of the recent U.S. Supreme Court case involving the National Federation of the Blind of North Carolina in which certain portions of the North Carolina charitable solicitation statute were struck down as being in violation of First Amendment/free speech rights. As a result of this decision, which was handed down last June, many state legislatures (perhaps as many as 15 or 20) are trying to bring their laws into compliance this session.

For a copy of the January-February "Giving USA Update," send $10 to American Association of Fund-Raising Council, 25 West 43rd Street, New York, NY 10036, or call (212) 354-5799.

Now let's talk about gift annuities. A charitable gift annuity, of course, is a contract which is entered into between the organization you represent and your donor. Because it is a contract and not a trust, and because it has characteristics similar to those of certain financial-services products available in the commercial marketplace, some states have attempted to regulate the promotion, issuance or investment of gift annuities, under the jurisdiction of either the state insurance board or the state securities commission. At the present time, based on information available to the subcommittee, those states are as follows:

California, Florida, Illinois, Maryland, Minnesota, New Jersey, New York, Oregon, Utah (as of July 1, 1986), Washington, and Wisconsin.

To those of you who live and work in these states, this is old news to you. You have adapted your gift annuity programs to meet the appropriate statutory and/or regulatory requirements. To those of us outside these eleven states, we are on notice that in order to operate a gift annuity program within these states, we must be prepared to comply with the requirements of registration, fees, reserves and the like.

The question is often raised, "What if I don't plan to do business on a regular basis in a regulated state? What if I just have one donor living there? Do I have to register or be licensed? Is an occasional mailing to a select list of prospects, or an ad in my national periodical, or an agreement signed in my home office, or regular visits by staff to interested prospects, or having a nonpaid volunteer call on prospects enough to require registration in those states?" I do not have the answers to those questions. The term "doing business" in another state is subject to wide interpretation. We are aware that many institutions take the position that if the money is received by mail and the annuity contract is written in the state where their institution is incorporated, then the laws of the home state would prevail, and there would be no need for registering in the state where the annuitant resides. You should know that that is not the position of the Committee on Gift Annuities, and we would strongly urge you to obtain the advice of your legal counsel before pursuing such a course of action.

If your state is not included in this list of eleven, can you assume that it does not regulate gift annuities? *Probably*. If you're not sure, or if your president or board chairman want "proof" that you're not subject to regulation, should you go to the insurance commissioner or the securities commissioner and ask them? *Probably not*. Most of them do not know what a gift annuity is, but when presented with the question, "Do you regulate gift annuities?" or "Do gift annuities come within your jurisdiction?" they are duty-bound by the "bureaucrat's code" to answer in the affirmative.

My advice to you is to contact other planned giving officers in your state, call your attorney or call us at the Committee. I'm simply talking about networking. Have a network of colleagues with whom you can share ideas and ask questions. I was pleased to learn just last week that in a state where the issue of regulation raised its head a couple of years ago, three people who previously did not know each other and who, independently of each other contacted us about the matter and were put in touch with each other, have now formed their own local planned-giving group that meets regularly for the purpose of sharing ideas and information with each other. What am I saying? I'm saying that if you really want to know who comprises the Subcommittee on State Regulation, look to your left and look to your right. **You** are the committee.

Of course, the most significant regulatory matter in the three years since our last conference was at the federal level rather than the state level and that was the matter of Code Sec. 501(m) and its potential applicability to gift annuities. Hanging over all of us was the threat that gift annuities would be regulated, if you please, as commerical insurance. But thanks to all of you—and I do mean all of you—the Code now contains language to the effect that gift annuities are **not** commercial insurance if they produce an income or estate tax charitable deduction **and** meet the tests of Sec. 514(c)(5).

While the resolution of this issue at the federal level obviously would have no legal force or effect at the state level, it does provide a strong basis for arguing against regulation, as insurance at least, in those states not now regulated. I, for one, would certainly argue the point.

Now for a brief word about pooled income funds. The subcommittee is not aware of any significant statutory or regulatory activity concerning pooled income funds at the state level in recent months. In Vol. I of his publication, "Deferred Giving," Conrad Teitell, after reminding us to check state law for any applicable requirements, advises that many states have recently adopted some version of the Uniform Securities Act, which exempts pooled fund units from registration and advertising review procedure requirements when the units are issued by a "not for private profit" entity, as defined by the Act. Some states' versions of the Act also exempt the issuer from "agent registration requirement," says Mr. Teitell.

At the federal level the SEC several years ago issued its well publicized "no action letter" with the net effect being that as long as the SEC believes we're acting in good faith and making the proper disclosure to our prospects there will not be a federal registration required of pooled income funds.

Apparently the only significant development in the area of pooled income funds in recent months has been the issuance of model agreements by the Internal Revenue Service. These agreements have received widespread exposure and have been subject to some criticism in the charitable community. They constitute a safe harbor for planners and draftsmen, in that documents which faithfully follow the IRS forms will qualify for the desired tax treatment. However, the existence of this "safe harbor" means that the IRS will no longer issue private letter rulings approving pooled income fund documents in those situations that are the same as or similar to those contemplated by the model documents. It is not known what variations from the model documents would be so substantive, in the opinion of the IRS, as to warrant a letter ruling.

This topic will no doubt be discussed in the pooled income fund workshops and in Mr. Teitell's presentation.

Before I ask Jim Potter to bring us up to date on a very significant matter that's been brewing in the State of New York, I want to close my part of the report with a few parting shots. You might call them, "Tips on keeping the camel out of the tent":

1. In the promotion of gift annuities, avoid the use of sales-oriented language. Remember, we don't "sell" gift annuities, we **issue** them; and gift annuities are not "investments," they're **gifts**.
2. Follow the gift annuity rates set by the Conference. Our watchword should be "cooperate, don't deviate." Don't bid up the rates: it's a no-win situation. In the short-run, you and your organization lose—sooner or later, we all lose.
3. Getting back to nomenclature, remember that the payments we make to our annuitants are **annuity payments**, not interest payments. (When in doubt on the use of any terminology, consult your Green Book or call the Committee.)
4. Have access to competent counsel, and finally,
5. Think twice before inquiring of state officials as to what regulations need to be met.

By way of added emphasis, let me say that while some of these tips regarding nomenclature may seem obvious or trivial or unnecessary, let me assure you they represent very real concerns. And they became more real than ever to those of us who worked closely on the 501(m) matter the last couple of years. The terminology we use, if it is not accurate, can come back to haunt us. I assure you that the people at Treasury and at the congressional staff level look very closely for any evidence that we are not what we claim to be, and they will use our words against us. So please take care.

REPORT ON NEW YORK STATE REGULATION

Mr. James B. Potter
Director of Planned Giving
American Lung Association

Over the past two years, several members of the Committee on Gift Annuities and the officers and staffs of several charities have had several meetings with various staff of the New York State Insurance Commissioner's office regarding the latter's interpretation of the New York State Insurance Law.

The subject in question is reinsurance of gift annuity obligations by a charity. The Insurance Commissioner's office interprets the word "reinsurance" in the law as meaning that the charity will negotiate a "treaty" agreement with a commercial insurance company licensed to do business in New York State. The purchase of a commercial annuity contract by the charity, such as those offered to the general public is not a "treaty" agreement and such commerical annuity policies are not recognized by the Insurance Commissioner as "reinsurance" of the annuity obligation.

To this date, only one commercial insurance company licensed in New York offers a treaty agreement to charities for this purpose. That company is Canada Life of New York. It is presumed that other companies will soon offer such contracts.

The Canada Life Agreement specifies that the charity will reinsure all its gift annuity agreements with the company at the standard rates in effect at the time. The rates are not specified. The Committee on Gift Annuities does not recommend that charities reinsure its annuity obligations under this particular agreement.

The Insurance Commissioner's office will not recognize previously purchased commercial annuity policies as either reinsurance or as assets appropriately held in the charity's Gift Annuity Fund. Since the single premium charged by the insurance companies for reinsuring the annuity is in the neighborhood of 65% of the face value of the annuity gift, and since the legal reserve to be held in the charity's Annuity Fund to guarantee future payments may be of the same magnitude, charities that have previously purchased commercial annuity policies from licensed insurance companies have a problem in making sure that sufficient assets for such gifts remain in their Annuity Fund. The immediate result is that reinsurance using regular commercial annuity policies has ceased in New York State.

The New York State Insurance Law also specifies that a charity must maintain a Segregated Annuity Fund of identifiable assets of the amount computed as the required legal reserve of at least $80,000 or $100,000 whichever is greater. Reserves above this amount may be reinsured with licensed insurance companies as long as a treaty agreement is used. In that event, the required legal reserve (above the $100,000 amount) may be subtracted from the Segregated Annuity Fund.

This means that the charity must invest the first $80,000 to $100,000 of required legal reserve to guarantee the annuity payments to the annuitants, and may reinsure only those gifts above that amount. In short, every charity operating in New York State must maintain its own invested Segregated Annuity Fund of at least $100,000. Charities trying to avoid maintaining their own Segregated Annuity Fund cannot do so through reinsurance. Since the initial $100,000 fund must be maintained, it becomes questionable whether reinsurance is a viable goal since an annuity fund with annual reporting must be maintained in any event.

While the Insurance Commissioner's office has stated that it would be issuing clarifications of their interpretations, none have been forthcoming in the last 24 months. It would seem they are satisfied that they have stopped the use of commercial annuity policies as a means of reinsurance and they expect more out of state (foreign) charities to come forward to apply for permits to write additional gift annuity agreements to New York resident donors, or from charities that are domiciled in New York.

While these issues are a matter of interpretation of the New York Insurance Law, it is now clear how the Insurance Commissioner's office interprets this legislation. Charities that were interpreting these matters differently are advised to take note. Charities writing gift annuity agreements in New York State are advised to follow the advice of their own legal counsel in these and all such legal matters.

While I have your attention, let me make some additional suggestions regardless of what state your charity is domiciled or your annuitants live. If you have reinsured any annuity agreements in the past, have the insurance company send your charity the periodic annuity checks. Cash those checks and issue your own annuity check on your organization's check form.

Also, recognize that the W2-P form the insurance company sends each annuitant that they pay directly does not contain the same data that you shared with the donor at the time of the gift.

Your data is probably correct. The insurance company's data is not, since it is based on commerical annuity data, not gift annuity data. In fact you need to write each insurance company and explain that these are charitable gift annuities and that they should cancel such form reporting and let you handle it. Your organization should send the appropriate W2-P form to each annuitant annually. Make sure each insurance company corresponds with you, not the annuitant directly. Even if you set it up differently, make the change. As the purchaser of the annuity contract with the company, you have the right to change the contact point and to whom the payments are made.

Do not save time and work by having the insurance company send the annuity payments directly to your annuitants. Your annuitant made the gift to you. Don't give up the ability to have a contact with that annuitant by having an impersonal insurance company make the payments. Covet the chance to send each check with your own letter of transmittal. Tie that donor closer to you with each contact you make.

Good gift administration is good gift development. The most likely planned gift donors you have are your past donors, if you understand about the care and feeding of them. Development Officers, don't leave it to the business office of your institution. It is your development responsibility to see to the continuing contact with your planned gift donors.

Making income and annuity payments to your income beneficiaries should be one of the most important and pleasant tasks with which you are involved. Don't delegate it to others who don't understand the importance of that periodic contact.

If you want to improve your track record of subsequent gifts from past life income donors, begin to increase your contacts with them by managing the responsibility of sending the income payments to each one. Use merge print letters of transmittal with your checks that are tailored to each group. There is no more meaningful or pleasant contact you can make with any annuitant than sending them their annuity check. Take advantage of that opportunity for another development contact.

PROFESSIONAL ETHICS OF PLANNED GIVING

Winton C. Smith, Jr., J.D.
Memphis, Tennessee

The Planned Giving profession requires special expertise and a special relationship with those who support charitable organizations. The profession requires the highest standard of practice in every respect.

CANON

ONE: PLANNED GIVING PROFESSIONALS SHALL ACQUIRE AND MAINTAIN THE HIGHEST PROFESSIONAL SKILLS AND KNOWLEDGE.

Comments

- Planned giving expertise is essential to properly serve those who give to charitable institutions.
- Planned giving professionals shall always present accurately the level of their expertise.

TWO: PLANNED GIVING PROFESSIONALS SHALL ALWAYS PLACE THE INTERESTS OF PROSPECTIVE CONTRIBUTORS ABOVE THOSE OF THE CHARITABLE INSTITUTION.

Comments

- Planned giving professionals shall always seek to help the donor accomplish his objectives. This is particularly important where the donor's objectives conflict with the institution's short term interests.
- Planned giving professionals shall always serve the donor's interests first.
- Planned giving professionals shall always encourage donors to consult with family members and other interested parties prior to the completion of a major gift.
- Planned giving professionals shall always encourage donors to consult independent counsel prior to the completion of a major gift.
- Planned giving professionals shall always encourage donors to consult independent legal counsel regarding all legal implications prior to the completion of a major gift.

THREE: PLANNED GIVING PROFESSIONALS SHALL ALWAYS MAINTAIN THE HIGHEST STANDARD OF INTEGRITY, TRUTH, AND ACCURACY IN THEIR WORK.

Comments

- This profession exists to help contributors accomplish their objectives. This is particularly important when the contributor's objectives conflict with the short term interests of the institution.
- Planned giving professionals shall always consider the contributor's primary objective and shall encourage a planned gift only when the contributor's primary objective is to make a charitable gift.
- Planned giving professionals shall insist that all proposals, publications, and other materials shall be truthful and nondeceptive.

FOUR: PLANNED GIVING PROFESSIONALS SHALL ALWAYS ENCOURAGE CONTRIBUTORS TO SEEK INDEPENDENT COUNSEL AS THEY MAKE A PLANNED GIFT.

Comments

- Planned giving professionals shall encourage contributors to consider our professional role as a representative of the charitable organization.
- Planned giving professionals shall always encourage contributors to consult independent counsel prior to the completion of a major gift.
- Planned giving professionals shall always encourage contributors to consult family members and other interested parties prior to the completion of a major gift.

FIVE: PLANNED GIVING PROFESSIONALS SHALL ALWAYS ENCOURAGE CONTRIBUTORS TO SEEK INDEPENDENT LEGAL COUNSEL PRIOR TO THE COMPLETION OF A PLANNED GIFT.

Comments

- Planned gifts frequently require legal expertise. Planned giving professionals do not practice law, and therefore they always encourage donors to seek independent legal counsel prior to completing a planned gift.

- Sample language:

  This letter explains the tax savings associated with this type of gift. Each person's situation is unique. Moreover, state laws differ. It is important therefore that you consult your own advisors regarding the application of this gift to your particular situation.

SIX: PLANNED GIVING PROFESSIONALS SHALL ALWAYS PRESERVE THE CONFIDENTIALITY OF CONVERSATIONS IF REQUESTED TO DO SO.

Comments

- Planned giving professionals never disclose confidential information.
- Planned giving professionals recognize that confidentiality is often absolutely essential to success in this work.

SEVEN: PLANNED GIVING PROFESSIONALS SHALL ENCOURAGE CONTRIBUTORS TO MAKE INDEPENDENT AND FULLY INFORMED DECISIONS IN EVERY RESPECT.

Comments

- Planned giving professionals shall always encourage contributors to consider their gift with other independent advisors.
- Planned giving professionals shall always encourage contributors to discuss their gifts with family members and others affected by the gift.
- Planned giving professionals shall always encourage the use of independent legal counsel in view of the legal implications of many planned gifts.

EIGHT: PLANNED GIVING PROFESSIONALS SHALL ALWAYS PLACE THE INTERESTS OF CONTRIBUTORS ABOVE THOSE OF THE CHARITABLE INSTITUTION IN THE MANAGEMENT OF PLANNED GIFTS.

Comments

- Planned giving professionals shall counsel contributors regarding the management of planned gifts and shall always encourage the management vehicle which serves the contributors' interests first.

NINE: PLANNED GIVING PROFESSIONALS SHALL ALWAYS REPORT ACCURATELY THE RESULTS OF THEIR WORK.

Comments

- Planned giving results shall always be reported according to the type of gift and the eventual return for the charitable institution.

TEN: PLANNED GIVING PROFESSIONALS SHALL RECEIVE COMPENSATION COMMENSURATE WITH THE PROFESSIONALISM OF THEIR WORK.

Comments

- Planned giving professionals shall always insist on compensation commensurate with the quality of their work.
- Planned giving professionals shall receive a salary, retainer, or fee, not a commission.

CANADIAN GIFT ANNUITIES

Mr. James A. Chisholm
Director of Development
Vancouver School of Theology

Life in the Canadian planned giving field is quite uncomplicated when compared to the variety of vehicles available south of the border. There are few tax advantages to be realized by the average Canadian considering a planned gift. Perhaps the best motivation then for giving is simply the need to give. What then motivates gifts through planned giving vehicles? The charitable organization and the donor relationship to it are of significant importance in finalizing such a gift. The need to give to the charity is generally the sole motivating factor.

There are three primary vehicles for a planned gift:

1. Bequests through a donor's last will and testament represent the largest number of planned gifts received by charities in Canada. The relative simplicity with which this can be arranged makes this an attractive form of gift. There are no succession duties or estate taxes in Canada, therefore there are no tax advantages in making this form of gift.
2. Charitable Gift Annuities are the next most significant form of planned gift, although few charities in Canada are currently involved in a significant marketing program. Notable exceptions would be religious charities. There are significant tax advantages to the donor in this form of gift. The regulations governing charitable gift annuities are federal statutes. In order to be an eligible issuer of charitable gift annuities, a charity must hold a valid Revenue Canada registration number. A note of caution—Canadian charitable foundations are not permitted to assume a liability under federal government regulations, therefore they are ineligible to enter into gift annuity contracts with donors. At the present time the provincial superintendents of insurance in all ten provinces have the power to, but do not, regulate the issuance of charitable gift annuities.
3. Life insurance as a gift has not been a major item in Canada although it would be the third largest form of planned gift. There has been an increasing interest in this form of gift in recent years among religious and educa-

tional charities. There are major tax advantages in this form of gift as the policy premiums can be used as a tax credit as can the cash surrender value of an existing policy. Tax credits accumulated through a life insurance gift are subject to a 20% limitation of annual net income.

Other forms of planned gifts may include gifts of property which, for the average Canadian, will offer little tax advantage for the donor due to the laws and exemptions governing capital gains taxes. Irrevocable and revocable trust agreements can be beneficial in certain cases for both the donor and the charity. These must be dealt with on an individual basis and are managed by a third party as trustee.

Gift Annuity Specifics

A charitable gift annuity is a contract under which an individual donor makes an irrevocable contribution of capital to a charity in exchange for guaranteed periodic income payments for life at a specified rate. The contract may also be written on the joint lives of spouses or siblings in order that the guaranteed income payments are paid until the death of the survivor. The rate of income for single life annuities can be found at the end of this article.

Revenue Canada provides an interpretation bulletin (IT 111R) which is, in essence, the guideline for determining life expectancy in calculating the amount of periodic payments that are exempt from income tax. When the total receipts anticipated from the annuity contract are less than the cost of purchasing the annuity, the shortfall is considered to be a gift and the donor receives a charitable gift receipt for this amount at the time of entering into the gift annuity contract.

That portion of the periodic income payments that is deemed to be a return of capital is exempt from taxation and is not considered as income when reporting periodic payments to Revenue Canada and the donor. In making this calculation the following steps are taken:

a. Multiply the life expectancy (refer IT 111R) by the annual annuity payment to arrive at the total payments over the span of life expectancy.
b. Divide the amount paid for the annuity by the total return. If the result is 1.0 or greater, the entire periodic payment is non-taxable. No further calculation is necessary.

c. Multiply the fraction obtained in b. by the total of annual annuity payments. This yields the non-taxable portion.
d. Subtract the non-taxable portion from the total annual annuity payment to obtain the taxable portion.

The Effects of Tax Reform in Canada

Tax reform has brought major changes to charitable giving in Canada. In its effort to encourage the work of charities, the government of Canada is giving greater incentives for charitable donations by many Canadians. Through tax reform, most people will receive a larger refund through tax credits in 1989 than in previous years. Because of the introduction of tax credits for charitable donations, a donor can actually give more to charities while actual out-of-pocket expense remains the same.

For example, a single taxpayer with a gross income of $30,000 making a gift of $3,000 could increase their charitable gift by 11.6% and have the same out-of-pocket expense as they did prior to tax reform.

The new combined federal and provincial income tax rates are as follows. They will vary from province to province and thus these are approximate:

On the first $27,500 of taxable income	26%
On the next $27,500 of taxable income	39%
On the remaining taxable income	44%

The federal tax credit for charitable giving is 17% of the first $250.00 and 29% on the remainder up to the allowable 20% maximum of income.

CANADIAN ANNUITY RATES
SINGLE LIFE ANNUITY—Effective April 15, 1986

Age	Rates
60	8.3
61	8.4
62	8.4
63	8.5
64	8.6
65	8.7
66	8.8
67	8.9
68	9.0
69	9.2
70	9.3
71	9.5
72	9.6
73	9.8
74	10.0
75	10.2
76	10.4
77	10.7
78	10.9
79	11.2
80	11.5
81	11.9
82	12.2
83	12.6
84	13.0
85	13.0

Actuarial Basis

1. One-half of the gift (50%) is applied to a single or joint life annuity.
2. Female Ultimate Tables a (55)—British with age rated down three years.
3. No allowance for expenses. All expenses are assumed to be net from interest margins.
4. Interest rate projections are determined by the issuer.
5. The number of yearly payments is based on Revenue Canada's Interpretation Bulletin IIIR.

Rationale for Setting Gift Annuity Rates

1. Those entering into a Gift Annuity Agreement are donors and not investors.
2. Rates should not be so low (or high) as to impede sales.
3. Rates should be comparable to and guided by the generally prevailing rates for five year Guaranteed Investment Certificates and Canada Savings Bonds.

CHARITABLE CONTRIBUTION TAX BENEFITS IN A NUTSHELL
. . . you could look it up

Conrad Teitell, Esq.
Prerau & Teitell
White Plains, New York

This article tells about the tax benefits of charitable contributions by those who itemize their deductions, and gives the relevant Internal Revenue Code sections, Treasury regulations and other citations. But first, an aside:

Daniel M'Naghten, suffering from delusions of persecution, had a fancied grievance against Prime Minister Robert Peel. He went to London to assassinate him. M'Naghten fired into the Prime Minister's carriage, killing Sir Robert's secretary, Drummond. The Prime Minister was riding in Queen Victoria's carriage at the time.

M'Naghten was found not guilty by reason of insanity. As Lord Chief Justice Tindal put it: ". . . the party accused was laboring under such a defect of reason, from disease of the mind, as not to know the nature or quality of the act he was doing; or, if he did know it, that he was not aware he was doing what was wrong."

Thus the birth of the M'Naghten rule (variously spelled M'Naghten, M'Naughten, McNaghten) in England which is followed in a number of our states. An increasing number of states are abandoning the M'Naghten rule for the irresistible impulse rule—an individual is not criminally responsible if he cannot control his conduct in committing a crime even though he knows it to be wrong. This rule was given national attention in the book and film, "Anatomy of a Murder."

A number of years ago the Times of London ran a series of articles on the M'Naghten rule. United States Supreme Court Justice Felix Frankfurter complimented the London Times on the articles, having only one criticism. They mispelled M'Naghten's name, spelling it M'Naughten instead of M'Naghten.

The Times answered: "We have an old letter in our files signed by M'Naughten himself and he spelled his name exactly as we have in our newspaper."

Justice Frankfurter responded: "I question whether a lunatic is authority for anything, even the spelling of his own name."

Now, the subject at hand. The federal government encourages gifts to schools, churches, hospitals and other public charities by allowing charitable deductions for a variety of gifts. But don't rely on my statements as authority. Here are citations to the Internal Revenue Code, Treasury regulations, revenue rulings and court cases. I have an irresistible impulse to tell you about them.

Unless otherwise stated, it is assumed that the gift is made by an individual to a public charity (e.g., school, church, hospital) or a private operating foundation (e.g., museum, library). Abbreviations used: IRC = Internal Revenue Code of 1986; Reg. = U.S. Treasury Regulation; Rev. Rul. = Revenue Ruling; Rev. Proc. = Revenue Procedure; T.D. = Treasury Decision.

CITATIONS OF AUTHORITY

Gifts of money. Deductible up to 50% of donor's adjusted gross income. IRC §170(b)(1)(A); Reg. §1.170A-8(b). Five-year carryover allowed for any "excess." IRC §170(d)(1); Reg. §1.170A-10(b).

Gifts of securities and real estate held long-term. Deductible at the full present fair market value, with no tax on the appreciation. *Campbell*, 209 F.2d 331 (CA-5, 1954). (When a donor claims an income tax charitable deduction for a gift of capital gain property, the appreciation on the gift is an alternative minimum tax (AMT) preference. IRC §57(a)(6). The AMT is discussed later.)

Deductible up to 30% of adjusted gross income. IRC §170(b)(1)(C)(i); Reg. §1.170A-8(d)(1). Five-year carryover allowed for any "excess." IRC §170(b)(1)(C)(ii).

Under an election, a donor can increase the ceiling to 50% of adjusted gross income (with a five-year carryover for any "excess") by making the same gift, but—

(1) reducing the amount deemed contributed for all long-term property gifts during the year by 100% of the appreciation and

(2) similarly reducing the deemed contribution for long-term property gifts being carried over from earlier years. IRC §170(b)(1)(C)(iii); IRC §170(e)(1); Reg. §1.170A-8(d)(2).

Gifts of securities and real estate held short-term. Deduction is for cost basis. IRC §170(e)(1)(A); Reg. §1.170A-4(a)(1).

Deductible up to 50% of adjusted gross income. IRC §170(b)(1)(A). Five-year carryover for any "excess." IRC §170(d)(1); Reg. §1.170A-10.

Ordinary income property (sale would result in ordinary income). Reg. §1.170A-4(b)(1). For gifts of inventory, Section 306 stock, collapsible corporation stock, crops, art works created by the donor (and other "ordinary income" property gifts), deduction allowed for property's cost basis. IRC §170(e)(1)(A); Reg. §1.170A-4(a)(1). Deductible up to 50% of adjusted gross income. IRC §170(b)(1)(A). Five-year carryover allowed for any "excess." IRC §170(d)(1); Reg. §1.170A-10(b).

Tangible personal property (e.g., works of art, antiques, books) held long-term. Reg. §1.170A-4.

Related gifts. Deduction is full present fair market value, with no tax on the appreciation (see discussion of AMT, below), if use of the property is related to donee's exempt function (e.g., gift of painting to art museum or to school for its art gallery). Deductible up to 30% of adjusted gross income. IRC §170(b)(1)(C)(i). Five-year carryover allowed for any "excess." IRC §170(b)(1)(C)(ii). Deductible up to 50% of adjusted gross income (with five-year carryover for any "excess") if same election made as for gift of long-term securities or real estate, above.

Unrelated gifts. Reg. §1.170A-4(b)(3). If gift is unrelated to donee's exempt function, deduction is for the cost basis. IRC §170(e)(1)(B)(i). Deductible up to 50% of adjusted gross income. IRC §170(b)(1)(A). Five-year carryover allowed for any "excess." IRC §170(d)(1).

Gift of work of art without the copyright. Gift or bequest of work of art qualifies for gift and estate tax charitable deductions (but not income tax deduction) even though copyright itself isn't transferred to charity, when (1) the donee is a public charity described in IRC §501(c)(3) that is not a private foundation (under IRC §509) and (2) the use is related to the donee's charitable purpose. IRC §2055(e)(4); Reg. §20.2055-2(e)(1)(ii); IRC §2522(c)(3); Reg. §25.2522(c)-3(c)(1)(ii).

Gifts of tangible personal property held short-term. Same as gifts of short-term securities and real estate, above.

Bargain sales. Charitable contribution is the difference between fair market value and sale price of long-term securities and real estate. IRC §170(e)(2); *Magnolia Dev. Corp.*, 19 TCM 934; *Waller*, 39 TC 665 (Acq.); *Gladstein*, (DC) 68-1 USTC Para. 9197; *Gamble*, (DC) 68-1 USTC Para. 9393.

Capital gain implications. Cost basis of property must be allocated between portion of property "sold" and portion of property "given" to charity, based on fair market value of each. Appreciation allocable to sale is subject to capital gain tax; appreciation allocable to gift is not. (See discussion of AMT, below.) IRC §1011(b); Reg. §§1.1011-2 and 1.170A-4(c)(2).

Caveat. Outright gift of mortgaged property is considered a bargain sale. Reg. §1.1011-2(a)(3); *Guest,* 77 TC 9 (1981).

Partnership gifts. Contributions not deductible on partnership return, but deductible by individual partners. IRC §702(a)(4); Reg. §1.170A-1(h)(7).

Corporate gifts. Ceiling on deductibility is 10% of taxable income. IRC §170(b)(2). Five-year carryover for any "excess." IRC §170(d)(2). Corporation on accrual basis may elect to deduct a gift on this year's tax return even though payment made in next tax year if gift authorized by board this tax year and payment made within two and one half months of the close of this tax year. IRC §170(a)(2); Reg. §1.170A-11(b). Corporations meeting certain tests get enhanced deductions for gifts of inventory (used by charity for the ill, needy or minors) or scientific equipment (used by colleges, universities or qualified scientific research organizations for research, experimentation or research training). Deduction is for (1) the property's basis plus half of the appreciation or (2) twice the property's basis, whichever is lower. IRC §170(e)(3) and (4); Reg. §1.170A-4A.

Private foundations (other than private operating foundations). Appreciated securities, real estate and tangible personal property held long-term. Deduction is for cost basis. IRC §170(e)(1)(B)(ii).

Exception for "pass-through" foundations: Deduction allowed for full present market value where private foundation within two and one half months following the year of receipt gives an amount equal to all such gifts to public charities (schools, churches, etc.) or private operating foundations. IRC §170(b)(1)(A)(vii), (E)(ii) and (iii); Reg. §1.170A-9(g)(2)(iv). *Note.* Unless tangible personal property is put to a "related" use, deduction is nevertheless limited to cost basis. IRC §170(e)(1)(B)(i).

Long-term appreciated marketable securities—special rule for gifts before 1995. A deduction at full fair market value is allowable for contributions of up to 10 percent of the stock in a corporation for which (as of the contribution date) market quotations are readily available on an established securities market. IRC §170(e)(5).

Ordinary-income and short-term property gifts. Deduction is for cost basis. IRC §170(e)(1)(A).

Ceilings on deductibility. Thirty percent of adjusted gross income for cash and ordinary-income property. IRC §170(b)(1)(B). Twenty percent of adjusted gross income for gifts of capital-gain property. IRC §170(b)(1)(D)(i). *Exception for "pass-through" foundations:* If certain distribution requirements are met, ceiling may be 30% or 50% of adjusted gross income, with five-year carryover for any "excess." IRC §170(b)(1)(A)(vii), (C)(iii).

Carryover. Five-year carryover for "excess" gifts. IRC §170(b)(1)(B).

Delivery date determines valuation and year of deduction. Reg. §1.170A-1(b). Here are the rules.

Gifts of securities. If mailed, date of mailing is delivery date; if hand delivered to charity, date received by charity is delivery date. If securities delivered to donor's bank or broker (as donor'agent) or to the issuing corporation (or its agent) instructing corporation to reissue in charity's name, delivery date is date securities transferred to charity on corporation's books (date on new stock certificate having charity's name).

Gifts by check. If mailed, date of mailing is delivery date; if hand delivered to charity, date received by charity is delivery date.

Gifts of art works and other tangible personal property. Date property received by charity is delivery date.

Real estate gifts. Date charity receives properly executed deed is delivery date (unless state law requires deed to be recorded for title to pass).

Pledges. Deductible in year fulfilled—not when made. IRC §170(a)(1). Satisfying pledge with property does not give rise to taxable gain or deductible loss. Rev. Rul. 55-410, 1955-1 CB 297.

Determining fair market value for gifts of securities.

When there is a market for securities on a stock exchange or over the counter. Fair market value is mean between high and low on date of delivery (bid and asked prices on date of delivery if quoted selling prices not available). Reg. §20.2031-2. Same rule for closed-end investment company shares.

Valuation of mutual fund shares (open-end investment companies). Fair market value is redemption price ("bid"). *Cartwright,* 411 U.S. 546 (1973).

Determining fair market value of real estate, works of art and other property not traded on an exchange or over the counter. Fair market value is price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Reg. §1.170A-1(c)(2). Valuation is substantiated by expert appraisals. (See below.) Cost of appraisal is an IRC §212(3) deduction (subject to 2% floor on miscellaneous deductions). Percent of adjusted gross income ceiling on charitable contributions is inapplicable. Rev. Rul. 67-461, 1967-2 CB 125. For guidelines to be used in making appraisals, see Rev. Proc. 66-49, 1966-2 CB 1257, and Reg. §1.170A-13(c).

Substantiating charitable deductions. Strict appraisal, appraisal summary and information reporting requirements are imposed when property gifts (other than marketable securities) are claimed as income tax charitable deductions. The rules apply to property contributions claimed at over $5,000 per item or group of similar items, whether or not donated to the same charity ($10,000 for closely held stock, but appraisal summary is required if claimed value is over $5,000).

Easier (but still detailed) reporting rules apply for property gifts valued at $5,000 or under. See Form 8283. Reg. §1.170A-13.

Reporting by donees. A charity disposing of donated property (subject to the appraisal requirements) within two years of receiving the gift must report its disposition to IRS and the donor. IRC §6050L. Penalties imposed for failure to comply. IRC §§6721, 6722, 6723.

Penalties. Civil and criminal penalties imposed for negligence, fraud and valuation overstatements. IRC §§6653, 6659, 7206 and 7207. Higher interest rate may apply as well. IRC §§6601 and 6621.

Services. No charitable deduction for value of personal services rendered free for charity. Reg. §1.170A-1(g); Rev. Rul. 162, 1953-2 CB 127; Rev. Rul. 67-236, 1967-2 CB 103.

Unreimbursed volunteer expenses. Deductible when incurred in rendering services for charity. Rev. Rul. 55-4, 1955-1 CB 291. Optional standard mileage rate of 12¢ per mile for unreimbursed automobile expenses. IRC §170(j). Ceiling is 50% of adjusted gross income, with a five-year carryover. *Rockefeller,* 76 TC 178, *aff'd,* 676 F.2d 35 (CA-2, 1982); Rev. Rul. 84-61, 1984-1 CB 39.

No deduction allowed for charitable travel expenses if "there is a significant element of personal pleasure, recreation or vacation" in travel. IRC §170(k).

Unreimbursed babysitting expenses incurred to render volunteer services are not deductible. Rev. Rul. 73-597, 1973-2 CB 69.

Patron's gifts. Contribution is amount transferred by donor minus value of theatre ticket, meal or other privilege donor receives. Rev. Rul. 67-246, 1967-2 CB 104; Rev. Rul. 86-63, 1986-1 CB 88.

Installment obligation—caveat. Gift of installment obligation (gain reported under IRC §453) accelerates remaining deferred gain in year of gift. Rev. Rul. 55-157, 1955-1 CB 293.

Charitable loans. No income, gift or estate tax deductions for interest-free loan or rent-free use of property. IRC §170(f)(3)(A); Reg. §1.170A-7(a); IRC §§2522(c)(2) and 2055(e)(2). *Exceptions:* Although uncharged interest is generally imputed to lender of interest-free loan, regulations exempt charitable loans up to $250,000 per charity. Temp. Reg. §1.7872-5T(b)(9). Rent-free loan of artwork to public charity for a related use is exempt from gift tax. IRC §2503(f).

Depreciable property. Deduction reduced by what would have been taxed as ordinary income (under IRC §1245 or IRC §1250) if property had been sold. IRC §170(e)(1)(A).

Life insurance gifts. Donor names charity beneficiary and irrevocably assigns incidents of ownership to it.

Gift of policy on which premiums remain to be paid. Income tax deduction is slightly above cash surrender value. Reg. §25.2512-6(a). However, if that amount exceeds policy's cost basis, deduction is for cost basis. IRC §170(e)(1)(A). Continued payment of premiums gives donor deduction for annual premiums. *Awrey,* 25 TC 643 (1955).

Gift of fully paid-up policy. Income tax deduction is generally replacement cost. Reg. §25.2512-6(a). However, if that amount exceeds policy's cost basis, deduction is for cost basis. IRC §170(e)(1)(A).

Endowment policy. Charitable deduction for value minus amount that would be taxed as ordinary income on a sale. IRC §170(e)(1)(A). But see Reg. §1.170A-4(a). **Caveat**. Donor has ordinary income of difference between cost and maturity value in year charity receives proceeds. Rev. Rul. 69-102, 1969-1 CB 32; *Friedman,* 41 TC 428, *aff'd,* 346 F.2d 506 (CA-6, 1965).

CHARITABLE REMAINDER TRUSTS

Charitable remainder unitrust—description. Specifies that the income beneficiary is to receive annual payments determined by multiplying a fixed percentage (at least 5%) by the net fair market value of the trust assets, as determined each year. On the death of the beneficiary (or survivor beneficiary, if there is more than one), charity gets the remainder. IRC §664(d)(2).

A variation calls for the trustee to pay only trust income if actual income is less than stated percentage. Deficiencies in distributions (i.e., where trust income is less than stated percentage) are made up in later years if trust income exceeds the stated percentage.

Under another variation, deficiencies are not made up. IRC §664(d)(3); Reg. §1.664-3(a)(1)(i)(b).

Charitable remainder annuity trust—description. Specifies a fixed dollar amount (at least 5% of the initial net fair market value of transferred property) paid annually to the income beneficiary for life. On the death of the beneficiary (or survivor beneficiary, if there is more than one), charity gets the remainder. IRC §664(d)(1).

How payments taxed to recipient. For unitrusts and annuity trusts, amounts paid to the recipient retain the character they had in trust. Each payment is treated as follows: **first**, as ordinary income to the extent of the trust's ordinary income for the year and undistributed ordinary income for prior years; **second**, as capital gain to the extent of the trust's capital gain for the year and undistributed capital gain for prior years (which can be offset by any capital losses the beneficiary may have from other investments); **third**, as tax-exempt income to the extent of the trust's exempt income for the year and undistributed exempt income for prior years; **fourth**, as a tax-free distribution of principal. IRC §664(b); Reg. §1.664-1(d).

Unitrusts and annuity trusts are exempt from taxation. But a trust is not exempt in any year it has income that would be taxable unrelated business income if the trust were an exempt organization, IRC §664(c), and must make quarterly estimated payments of unrelated business income tax. IRC §§6154(h), 6654(k). Payments to income beneficiary still taxed as described above.

Governing instrument requirements. To assure charitable deductions and avoid adverse tax consequences, governing instrument must contain specific provisions. See Reg. §§1.664-1 through 1.664-3; IRC §508(e); IRC §4947(a)(2); Rev. Rul.

72-395, 1972-2 CB 340; Rev. Rul. 82-128, 1982-2 CB 71; Rev. Rul. 82-165, 1982-2 CB 117; Rev. Rul. 88-81, 1988-39 IRB 4.

Income tax. Contribution deduction allowed for value of remainder interest—computed using Treasury tables. *Unitrusts*—IRC §170(f)(2); Reg. §§1.664-3(d) and -4; IRS Pub. 723C. *Annuity trusts*—IRC §170(f)(2); Reg. §§1.664-2(c) and 20.2031-7; IRS Pub. 723E. Treasury tables change May, 1989. See discussion of new Treasury tables, below.

Caveat. Annuity trust must meet "5% probability test" of Rev. Rul. 77-374, 1977-2 CB 329. But see *Moor*, 43 TCM 1530 (1982).

Capital gain. No capital gain incurred on transfer of unmortgaged appreciated assets to trust. (Gain attributable to charitable remainder is AMT preference; see discussion of AMT, below.) Rev. Rul. 55-275, 1955-1 CB 295; Rev. Rul. 60-370, 1960-2 CB 203. Nor is there capital gain to donor on a sale by trust (except as taxable under four-tier system, above). *Exception:* gain taxable to donor if trust assets sold and invested in tax-exempt securities pursuant to agreement between donor and trustee. Rev. Rul. 60-370, 1960-2 CB 203.

Estate tax. IRC §2055(e)(2)(A).

One-life (donor is beneficiary). Fair market value of trust principal at death included in gross estate and then deductible as charitable contribution—resulting in a washout.

Two-life (funded with donor's separate property, donor is first beneficiary and another is to be survivor beneficiary). The fair market value of trust principal at donor's death is included in his or her gross estate, but is then fully deductible as charitable contribution if second beneficiary does not survive. If second beneficiary survives, charitable remainder (based on the survivor's age at the donor's death) is deductible charitable contribution.

Amount includable in gross estate may be less than entire trust principal if entire trust corpus not needed to generate income sufficient to pay unitrust or annuity trust amount. Rev. Rul. 82-105, 1982-1 CB 133; Rev. Rul. 76-273, 1976-2 CB 268.

Gift tax. IRC §2522(c)(2)(A). Value of the charitable remainder is fully deductible, so charitable gift is immune from gift tax. Where there is a life interest other than donor's, there is a gift by donor to non-charity beneficiary of value of beneficiary's life interest. Value of that gift depends on type of property ownership and when other beneficiary's payments are to begin. It is often possible for donor to avoid gift tax (when donor is one of the beneficiaries) by reserving right to revoke life beneficiary's interest *by will only*. Reg. §1.664-3(a)(4); Rev. Rul. 74-149, 1974-1 CB 157.

Gift and estate tax marital deductions. When donor's spouse is the only other beneficiary, a marital deduction is allowed for the spouse's life interest. IRC §§2056(b)(8) and 2523(g). And a charitable deduction is allowed for the remainder interest. IRC §§2055(e)(2) and 2522(c)(2). Thus, no transfer tax.

POOLED INCOME FUNDS

Description. Donor tansfers money or securities to public charity (only charities described in IRC §170(b)(1)A)(i), (ii), (iii), (iv), (v) or (vi) can have pooled income funds). Charity adds donor's gift to its separately maintained pooled income fund, where it is invested together with similar gifts of other donors.

Each donor gets his or her pro rata share of pooled income fund earnings each year for life. Income the beneficiary receives is taxed as ordinary income. On the income beneficiary's death, the charitable organization removes assets from the fund equal to his or her share and uses them for its charitable purposes.

Donor's pooled fund gift can also provide life income for a survivor (e.g., spouse). IRC §642(c)(3), (4), (5); Reg. §§1.642(c)-5 and -6.

Governing instrument requirements. To assure charitable deduction and avoid adverse tax consequences, governing instrument must contain specific provisions. See Reg. §§1.642(c)-5 and -6; IRC §§508(e) and 947(a)(2); Rev. Rul. 82-38, 1982-1 CB 96; Rev. Proc. 88-53, 1988-48 IRB 13.

Income tax. Charitable deduction allowed for the value of the remainder interest, determined using Treasury tables. IRC §170(f)(2)(A); Reg. §1.642(c)-6(d); IRS Pub. 723D. See discussion of new Treasury tables below.

Capital gain. No capital gain incurred on transferring unmortgaged appreciated assets to pooled income fund. (See discussion of AMT, below.) Fund takes over donor's basis and holding period in assets. Reg. §1.642(c)-5(a)(3). No capital gain to donor or fund if fund sells long-term assets. IRC §642(c)(3). Gain on sale of short-term assets is taxable to fund.

Estate tax. IRC §2055(e)(2)(A).

One-life plan (donor is beneficiary). Value of donor's share in fund at death includable in gross estate, but then fully deductible as charitable contribution—resulting in washout.

Two-life plan (funded with donor's separate property, donor is first beneficiary and another is to be survivor beneficiary). Value of donor's share in fund at death includable in his or her gross estate, but then fully deductible as charitable contribution if second beneficiary does not survive. If second beneficiary survives, charitable deduction for remainder interest, based on survivor's age at donor's death.

Marital deduction. The general rules of IRC §§2056(b)(7) and 2523(f) apply (terminable interests qualifying for the marital deduction). Thus, the donor's units in the pooled income fund, pursuant to Q-TIP election, are eligible for the marital deduction. The property will be included in the spouse's estate at spouse's death but, because the spouse's life estate ends and the property passes outright to the charitable remainderman, an estate tax charitable deduction is allowed to the surviving spouse's estate. See Proposed Reg. §§20.2056(b)-7(e), Example 15 and 25.2523(f)-1(f), Example 9.

Gift tax. IRC §2522(c)(2)(A). Value of the charitable remainder is fully deductible, and thus charitable gift is immune from gift tax. Where there is life interest other than donor's, there is gift by donor to non-charity beneficiary of value of beneficiary's life interest. Value of the gift depends on type of property ownership and when other beneficiary's payments are to begin.

It is often possible to draw contract so that gift is not deemed made to non-charity beneficiary by reserving right to revoke life beneficiary's interest *by will only*. Reg. §1.642(c)-5(b)(2). Use this method when a donor's spouse is the second beneficiary in a two-life inter vivos pooled fund gift because the surviving spouse's future interest does not qualify for Q-TIP gift tax election.

CHARITABLE GIFT ANNUITIES

Description. Donor transfers money or property to charity in exchange for its promise to pay fixed amount annually to donor (and a survivor, if desired) for life. Transfer is part gift and part purchase of an annuity.

Income tax. Charitable deduction computed using Treasury tables. Rev. Rul. 84-162, 1984-2 CB 200. See below for discussion of new Treasury tables.

How beneficiary taxed. Annuitant's return is part capital and part interest; only the interest portion is taxable.

Determining amount received tax-free—the exclusion ratio. The exclusion ratio is a fraction—numerator is the value of the annuity (determined under Rev. Rul. 84-162, supra); denominator is expected return (determined using tables in Reg. §1.72-9).

Entire annuity payment becomes taxable if annuitant outlives his/her life expectancy. IRC §72(b)(2). If annuitant dies before reaching life expectancy, unrecovered investment in the annuity is an itemized deduction on last income tax return. IRC §72(b)(3); see IRC §67(b)(11). Effective for annuities with starting dates after 1986.

Capital gain implications when appreciated property used to fund gift annuity. There is capital gain when gift annuity is funded with appreciated property. Amount of gain is smaller, however, than would be on sale (see discussion of AMT, below).

Further, gain is not all reportable in year of transfer—as it would be on a sale of property. Gain is reported ratably over annuitant's life expectancy when annuity is nonassignable and donor is an annuitant. Reg. §1.1011-2(a)(4) and (c), Example 8.

Estate tax. IRC §2039.

One-life (donor is annuitant). No estate tax.

Two lives (funded with donor's separate property; donor is first annuitant and second individual is to be survivor annuitant). If second annuitant doesn't survive donor, no estate tax. If second annuitant survives, included in donor's gross estate is value of annuity (at survivor's age on donor's death). Any estate tax paid by donor's estate attributable to annuity is deductible by survivor over his or her life expectancy. Reg. §1.691(d)-1(c).

Gift tax. IRC §2522(c)(2)(A).

One-life (donor is annuitant). No gift tax.

Two-life (funded with donor's separate property; donor is first annuitant and another is to be survivor annuitant). Gift to survivor of future and terminable interest; hence no annual exclusion or marital deduction.

Suggestion. Gift tax on survivor's interest can be avoided if donor reserves right to revoke survivor's annuity. Reg. §25.2511-2(c).

Marital deduction. One-life gift annuity for spouse qualifies for unlimited gift and estate tax marital deductions. Two-life spousal joint and survivor annuity qualifies for marital deduction as Q-TIP. IRC §§2056(b)(7)(C) and 2523(f)(6).

Deferred payment annuity (payments begin more than one year after gift). Income tax charitable deduction. Rev. Rul. 84-162, 1984-2 CB 200. (See discussion of new Treasury tables, below.) Exclusion ratio not determined until payments begin; estate and gift tax implications same as above for "immediate" annuities.

CHARITABLE LEAD TRUSTS

Description. Trust makes payments to designated charity for term of years, with reversion to donor (or spouse) at end of term. To avoid income tax to donor on trust income, reversionary interest must be worth less than 5% of trust corpus. IRC §673(a).

Instead of reversion to donor or spouse, lead trust can provide payments to charity for a number of years with remainder to family members—reducing (and sometimes eliminating) gift and estate taxes on passing property "down the line." Be sure to take the generation-skipping transfer tax into account.

Income tax. Income tax charitable deduction only if (1) income paid to charity is taxed to the donor; and (2) charity's interest is a guaranteed annuity or unitrust interest. IRC §170(f)(2)(B); Reg. §1.170A-6(c)(2).

Ceiling on deduction is 30% of adjusted gross income, with a five-year carryover for any "excess." IRC §170(b)(1)(B). Different rules may apply if the beneficiary of the lead interest is a non-operating private foundation. IRC §170(b)(1)(D).

Caution. The deduction is "recaptured" if donor ceases to be treated as owner before trust terminates (e.g., donor dies). IRC §170(f)(2)(B).

Gift and estate tax. To avoid gift and estate tax implications on charity's income interest, the interest should be a guaranteed annuity or unitrust interest. IRC §§2522(c)(2)(B) and 2055(e)(2)(B); Reg. §§25.2522(c)-3(c)(2) and 20.2055-2(e)(2); Rev. Rul. 77-300, 1977-2 CB 352.

Computing value of charity's lead unitrust and lead annuity trust interests. See discussion of charitable remainder trusts, above, for citations to tables for computing value of charitable remainder interests; use those tables to calculate value of lead interests.

Caution. Rev. Rul. 82-128, 1982-2 CB 71, dealing with charitable remainder trusts, could apply to charitable lead trusts.

Capital gain. If donor has reversionary interest, donor is taxed on gain in year realized by trust. (See discussion of AMT, below.) If no reversionary interest, capital gain taxable to trust. If someone other than donor is to get assets at trust's termination and there is sale within two years of trust's creation, any "built-in" gain is taxed to trust at donor's tax rates. IRC §644.

GIFT OF FUTURE INTEREST IN REAL PROPERTY WITH RETAINED LIFE ESTATE

If property is a personal residence or farm, income tax deduction allowed for value of remainder interest, taking straight-line depreciation or cost depletion into account, discounted at 10% per annum. Need not take depreciation or depletion into account in computing estate and gift tax deductions, but still discount at 10% per annum. IRC §170(f)(3)(B)(i); Reg. §1.170A-7(b)(3) and (4); Reg. §1.170A-12(a); IRC §2522(c); Reg. §25.2522(c)-3(c)(2)(ii) and (iii); IRC §2055(e)(2); Reg. §20.2055-2(e)(2)(ii) and (iii); Rev. Rul. 76-473, 1976-2 CB 306.

GIFT OF FUTURE INTEREST IN TANGIBLE PERSONAL PROPERTY WITH RETAINED LIFE ESTATE

No federal income, gift or estate tax charitable deduction for gift of tangible personal property (e.g., work of art, furniture, antiques) when donor or close family member retains life estate. IRC §§170(a)(3) and 2522(c)(2); Reg. §25.2522(c)-3(c)(1)(i); IRC §2055(e)(2); Reg. §20.2055-2(e)(1)(i).

QUALIFYING DEFECTIVE SPLIT-INTEREST CHARITABLE GIFTS FOR TAX BENEFITS

A permanent rule now permits reformation to qualify for tax benefits if certain requirements are satisfied. IRC §2055(e)(3).

ALTERNATIVE MINIMUM TAX

In general. When a donor claims an income tax charitable deduction for a gift of capital gain property, appreciation on the property is an Alternative Minimum Tax (AMT) preference. IRC §57(a)(6). In effect, the charitable deduction is for the property's cost basis. Most taxpayers aren't subject to the AMT, but it's important to determine whether there will be AMT consequences to avoid unpleasant surprises.

AMT and "excess" gifts. If the donor's capital gain property gift exceeds the deductibility ceiling, and thus is carried over to a future year, the gift's basis is deducted first; appreciation on the gift isn't a preference until basis is fully deducted. Joint Committee on Taxation's *General Explanation of TRA '86* (JCS-10-87), page 444. But gifts before August 16, 1986 aren't subject to the AMT even if carried over to future years. P.L. 99-514 §701(f)(4).

AMT and charitable remainder gifts. Only gain attributable to charity's remainder interest is AMT preference. JCS-10-87, page 444.

AMT and charitable gift annuities. Gain on "gift" portion is AMT preference; gain on value of annuity is not.

AMT and charitable lead trusts. Gain attributable to lead interest is AMT preference only if donor is taxed on trust income and claims income tax charitable deduction.

New Treasury tables. Effective May, 1989, charitable deduction tables no longer assume a 10% interest rate; instead, interest assumption is pegged to Federal mid-term interest rate based on average market yield of U.S. obligations. IRC §7520. "Applicable Federal rate" changes monthly; thus, donor's deduction for deferred (split-interest) gift depends on rate in month transfer is made.

Two-month lookback. Donor has option to use rate for current month or either of two previous months.

WORKSHOP SESSION—CHARITABLE GIFT ANNUITIES—BASIC

Miss M. Elizabeth Brothers
Associate Vice President for Development and College Relations, Rollins College

A charitable gift annuity consists of two parts: a guaranteed fixed income stream to the donor or other beneficiaries and a charitable contribution to an eleemosynary organization. It is not a trust, but a contract in which the charity commits itself to make payments, even if the underlying assets become depleted.

In order to prevent that happening, the Committee on Gift Annuities, which as you know is a voluntary association of 25 members representing over 1400 gift-annuity-issuing agencies, has recommended Uniform Gift Annuity Rates. These have been computed so as to produce, on the average, a "residuum" or gift to the organization of approximately 50% of the amount originally turned over under the agreement. This is the reason that the rates are not as high as those offered by an insurance company, where there is no gift involved. The Committee on Gift Annuity rates are based on actuarial studies or mortality experience among gift annuitant lives and careful consideration of the rate of income to be earned on invested reserve funds. Some states have enacted legislation to help assure the proper annuity gift rates and program administration. Any competitive raising of gift annuity rates serves to jeopardize the gift that will be ultimately available to the issuing organization.

A gift annuity may be purchased with either cash or other property, usually long-term, appreciated securities. If the contribution is made in cash or ordinary income property to a 50% charity (for example, a hospital, church, college or university), the donor's contribution will be subject to the 50% of adjusted gross income limitation and the five-year carryover rules. If the property in question is "30% capital gain property", the donor's contribution will be subject to the 30% limitation on deductibility.

When a donor transfers property for a gift annuity, he or she and the issuing organization are really entering into a contract. The organization's promise to pay the annuity is not tied to a specific fund, but rather the charity's promise is backed by its entire assets. In other words, if the assets donated become exhausted, other assets belonging to the charity must be used to continue the payments as long as the beneficiary lives.

Some charities "reinsure" gift annuities with commercial insurance companies, which means that the commercial insurer undertakes to pay the annuitant the contractual amount. While this arrangement offers a sense of security to the charity, and perhaps to the donor, the charity still would be liable if the commercial insurer for some reason stopped making payments. When reinsuring an annuity, it is important to select an insurance company with a Best's high rating.

It is prudent for all charities that issue gift annuities to create a fund (perhaps fifty percent of all such assets contributed), which can be used to meet obligations. In over 20 states, gift annuities are subject to regulation by the state insurance department; a few states consider the issuance of gift annuities to be within the regulatory jurisdiction of their state securities agency. Self-regulation as well as state regulation is important, so we can assure prospective donors of the safety of a gift annuity.

In order to process and calculate the tax and income implications of a gift annuity we need to obtain the following information: the full name and birthdate of all donors and beneficiaries and the full addresses and social security numbers of these persons; the amount and kind of assets to be used to fund the gift (if cash is not used, we need to know the date of purchase of the property and its value at the time of purchase and at present), the frequency of payments desired and the date assets will be delivered to fund the annuity. Remember when doing the calculation, if the beneficiary is less than six months from his or her next birthday, he or she is considered to be that older age.

A deferred payment gift annuity is an annuity that is to commence more than one year from the date of purchase. You will not only need all of the above information, but will require the due date of the first annuity payment. This is important because the first step in determining the present value of such an annuity is to obtain an annuity rate based on the annuitant or annuitants ages (to the nearest whole year) at that date. As in the case of an immediate payment gift annuity, it is necessary to adjust the annuity rate so obtained to reflect the payment sequence. The deferred payment gift annuity is a good alternative for a younger donor, who can afford to wait several years before payments start. The donor's charitable deduction is the amount of cash or the fair market value of other property given *less* the value of the annuity.

When a second beneficiary is included, both the amount of income paid out and the income tax deduction are reduced, but there are often offsetting considerations. While some organizations accept as little as $1,000 for a gift annuity, many require a $5,000 minimum for one life and $10,000 when two lives are covered.

Charities that issue charitable gift annuities must file reports of payments with the IRS and the annuitants. Payments to the annuitant must be reported on Form W-2P. The Social Security Administration gets Copy A and the annuitant, copies B and C. The deadline is February 28, but your donors will love you if you send the information out before the end of January. Retirees like to do their taxes early. Form W-2P contains blocks for gross annuity paid and taxable amount; the annuitant includes these amounts on the portion of Form 1040 dealing with "other pensions and annuities". At the time the gift is made, you should have annuitants complete Form W-4P, which pertains to back-up withholding.

Three elements determine the taxation of gift annuity payments. The investment in the contract is the present value of the annuity; it is not the amount transferred by the donor in exchange for the annuity. The present value of an immediate gift annuity is determined as of the date of purchase, but the present value of a deferred gift annuity is determined as of the starting anniversary.

The second element is the expected return or the amount that will be paid to the purchaser if he or she lives exactly for the period predicted in the "life expectancy" table. There are separate tables for one and two life expectancies. Two people have a longer life expectancy than one, hence the lower income tax deduction for two than one.

The third element, the exclusion ratio, is equal to the donor's investment in the contract divided by the expected return. The exclusion ratio multiplied by the amount of each annual payment determines how much of the payment is tax free to the donor. The balance is taxed as ordinary income. Previously, this tax-free portion remained constant for the entire lifetime of the beneficiaries, no matter how long they lived. Under present legislation, the tax-free payments continue only during the "life expectancy" given on the tables. Thereafter, the entire payment is taxable.

Various tax services provide suggested annuity contracts for one and two lives with wording for cash contributions and other kinds of funding. Some contracts are only signed by the issuing organization, others have the signatures of both the charity and the donor, plus witnesses. Whatever type of agreement you wish to use should be reviewed by a qualified attorney in the jurisdiction in which your charity is located.

Since we cannot predict what tax rules or life expectancy tables will be in force when a donor starts receiving payments from a deferred annuity at some point in the future, it makes sense to calculate the exclusion ratio for a deferred payment gift annuity in the same manner as an immediate payment annuity. You should explain that the tax treatment of the donor's annuity may have to be recalculated if there are law changes between now and the date the donor starts receiving payments. You will notice that the exclusion ratio, or tax-free portion, is less than it would be for an immediate payment gift annuity. The reason for this is the interest accumulates during the term of the deferred annuity and is taxed as regular income. Since most people are in a lower income tax bracket after retirement than when they are working, this may not be an important consideration for the donor.

The easiest way to fund a gift annuity is to use cash. Most donors do exactly that, but a significant number use long-term appreciated securities. For long-term treatment, securities acquired after December 31, 1987 should have been held for at least 12 months and a day. If the donor is the income recipient or one of the recipients, and the annuity is nonassignable or is assignable only to the issuing organization, he may report his gain in equal installments over his life expectancy, as determined by IRS tables.

Any gain unreported at the death of the purchaser annuitant will escape federal income taxation. This is also the case in a two-life annuity where the purchaser-annuitant is not survived by a survivor-annuitant. However, when the donor-annuitant is survived by a survivor-annuitant, the survivor is required to report any remaining payments still due at the time of the first annuitant's death. Gain may be spread in this way only if the purchaser of the annuity or the purchaser and one or more survivor annuitants are the only annuitants; and as said previously, only if the annuity is either nonassignable or is assignable to the issuing organization.

The regulations are silent as to how the gain is to be spread in the case of a deferred payment gift annuity. Presumably, no gain is to be reported until the annuity payments begin. The regulations also are silent as to whether any short-term capital gain or ordinary income realized on the purchase of a gift annuity may be spread over the donor's expected lifetime. Normally, it is better to encourage donors to fund their gifts in long-term property and avoid this problem.

We need to be careful about accepting mortgaged property in exchange for a gift annuity and should avoid it if possible. A discussion of this matter belongs in an advanced course, not in a basic one.

An annuity may also be funded with tangible personal property by a donor who wishes to transform the property into a source of income. With such gifts, the donor should obtain an expert appraisal as close to the time of the gift as possible. If the property is put to an "unrelated use" (that is, being sold by the exempt organization), the donor's contribution will be reduced. The amount of the reduction will be equal to 100% of the long-term capital gain allocated under the bargain sale rules to the contributed portion of the property.

Sometimes older persons exchange their residences for gift annuities. The 1981 Tax Reform Act increased the capital gains exclusion to $125,000 (from $100,000) for the sale of their principal residence by persons 55 or older. The increase could be helpful here, permitting most donors to totally avoid capital gains taxes on their annuities.

Some charities are issuing immediate payment gift annuities in exchange for gifts of remainder interests in homes and farms where donors remain on the property for life. Such charities must have reservoirs of cash available to make annuity payments because they receive nothing from the donors until the last income beneficiary dies.

Since the Tax Reform Act of 1986 eliminated the 60% deduction for the reportable portion of long-term capital gains, individuals are now subject to tax on 100% of the capital gain they report each year, even if they bought the annuity before the 1986 Tax Reform Act was passed. These donors may benefit in the future if favorable tax treatment is restored to long-term capital gains. Their gains are fully deductible, of course, against any capital losses.

When an individual obtains a gift annuity for his life only, he makes a single gift—a charitable contribution to the issuing organization. The gift qualifies for the gift tax charitable deduction to the extent it exceeds the $10,000 annual exclusion. A gift tax return must be filed to claim the deduction.

If the donor purchases an annuity for the life of another individual, he is deemed to make a gift to the annuitant in an amount equal to the present value of the annuity, determined as of the date of purchase. If it is an immediate payment annuity, the gift is of a present interest and qualifies for the $10,000 annual exclusion; if the annuity is deferred, the gift is of a future interest and does not qualify for the $10,000 exclusion. If the annuitant is the donor's spouse, the gift qualifies for the gift tax marital deduction.

An individual who obtains a gift annuity for another can largely avoid making a taxable gift by retaining the power to revoke the interest of the annuitant. By doing so, the donor prevents the gift of the annuity being complete for gift tax purposes. Completed gifts occur only as payments are actually received by the annuitant during the donor's life. These then become gifts of present interests, and can be offset with the $10,000 annual exclusion.

The estate tax consequences of a gift annuity mainly depend on who is the annuitant or annuitants and whether the annuity is for one or more lives. If a donor obtains a gift annuity for his or her own life, the only items with respect to the annuity that are includable in his gross estate are payments due but not received before his death.

If the donor procures a gift annuity for another, the date-of-gift value of the annuity is includable in his adjusted taxable gifts, assuming the donor did not retain the power to revoke the annuitant's interest. If he did retain such power, the transfer of the annuitant's interest becomes complete only upon the donor's death, assuming the annuitant survives the donor, and therefore the value of the annuity at that time is includable in the donor's gross estate. If the annuitant is the donor's spouse and the value of the annuity is includable in the donor's gross estate, it qualifies for the estate tax marital deduction. In addition, to the extent the annuity payments received by the annuitant during the donor's life constituted taxable gifts, they will be included in the donor's adjusted taxable gifts.

The IRS has approved an estate tax charitable deduction for a donor who bequeaths a portion of his estate to a qualified charity on the condition that the charity provide a gift annuity for a relative or friend. The value of the property must exceed the value of the annuity payable to the beneficiaries. To assure the availability of the estate tax charitable deduction for a gift annuity established by will, the donor's will must direct that a set dollar amount or percentage of the estate be transferred to a particular charity, conditioned on the charity's agreement to pay a specific annuity amount to a named beneficiary or beneficiaries. The difference between the present value of the annuity and the amount transferred to the charity is the charitable contribution as with a lifetime annuity. The annuity payout must be ascertainable. The donor should also provide against the contingency that the charity may be unable or unwilling to accept the annuity, by naming an alternative organization or dividing the bequest to include outright legacies for the individual and the charity. Donors who set up gift annuities by will should include contingency clauses covering the possibility that the beneficiary of the annuity may predecease them—either naming an alternate beneficiary or leaving an amount outright to the charity.

The 1986 Act eliminated the charitable deduction for nonitemizers and also increased the standard deductions. Many annuity purchasers do not itemize and now may get little or no deduction benefit from gift annuities of $1,000–$5,000 or even larger. Lower tax rates reduce tax savings from all deductions, including charitable deductions for gift annuities. Donors who give long-term, capital gain property in exchange for a gift annuity could face alternative minimum tax (AMT) on the "appreciation element" of their contribution deduction, although this will be a problem for few donors. On the other hand, any capital gain reportable under the bargain sale rules no longer is an item of tax preference for the AMT. However, donors no longer can take advantage of the 60% deduction for the reportable portion of their capital gain.

Starting on May 1, 1989 the fixed IRS valuation tables that have been used to compute deferred gift deductions for the last five years will be modified. The tables in effect since December 1, 1983 were based on 10% interest/discount assumptions. (The 10% figure represents the amount of interest or income that a trust or charity could be expected to earn on contributed funds—not the payout to an income beneficiary.)

The new tables reflect an interest/discount rate equal to 120% of the federal mid-term interest rate, as revised monthly, which is based on the average market yield of obligations of the United States. The result is that deductions will vary from month to month, beginning in May.

The IRS publishes the federal mid-term interest rates—"Applicable Federal Rates (AFR)"—on or about the 20th of every month and apply for the forthcoming month. The rate tables generally appear in *The Wall Street Journal*—toward the back of Section C ("Money & Investing" section), in the Internal Revenue Bulletin and in the weekly tax materials of such publishers as Commerce Clearing House and Prentice Hall.

Starting May 1, you would refer to the monthly rate (rounded off to the nearest two-tenths of one percent) to find the deduction factors for all deferred gift computations—this means gift annuities, charitable remainder trusts, charitable lead trusts and gifts of remainder interests in homes and farms. Pooled income fund contributions apparently will be calculated as before, although we have yet to hear whether IRS plans to change the assumed rate of return to be used by funds in their first, second or third taxable years. That assumed rate is currently nine percent.

Annuity gifts made in May can be valued according to the May, April or March mid-term rates, under the rules that allow charitable donors to look back two months and choose the best rate out of three months. There will be new IRS tables and formulas for calculating deductions pegged to the federal mid-term rate and also new mortality tables.

An important question we need to answer is how to deal with these changes in talking with donors and writing our promotional literature after May 1, without causing unnecessary confusion.

In direct conversation or correspondence with donors, we simply explain that deductions will fluctuate from month to month—and then choosing, on the date of the gift, the best rate available from the three-month time frame. For example, you could compute the deduction for a charitable gift annuity in May and tell the donor that his or her deduction will be at least that high if the gift is arranged in May, June or July. This could help avoid the procrastination many of us encounter in our donors, and help to create a sense of urgency. If the donor still does not complete the gift, you would have a good excuse to get back in touch every three months to provide updated deduction figures.

Promotional literature presents a greater problem. You could continue to use deduction tables in force for the last five years, but with a *caveat*, stating that they were only approximate because deductions now fluctuate from month to month. Readers should be invited to call your office to obtain precise figures based on current conditions.

Rather than throwing away old brochures you can enclose an update sheet, a sticker or stamped imprint, noting that deductions now fluctuate every month and that readers should contact you for exact figures. The advantage of the new regulations is that they encourage prospective donors to get in touch with you.

Under the new regulations, gift annuity deductions fluctuate and exclusion ratios also change. There is more tax-free income at lower interest rates, although the deductions are lower. Older people who purchase gift annuities may be more interested in tax-free income than they are in large charitable deductions. Many of them are not able to itemize their deductions and may get little or no tax benefit from a charitable contribution deduction especially for charitable gift annuities of modest size. Everyone can benefit from tax-free income.

There are many advantages to the gift annuity, either immediate or deferred. The concept is simple and easily explained to donors. It is predictable because they know exactly how much income they will receive. It is suitable for the small donor as well as the more affluent one. The non-taxable income is welcome, since there are so few tax shelters left. For retired persons, this can reduce the amount of Social Security income taxed. (Unlike tax-exempt income from municipal bonds, non-taxable interest from a gift annuity does not have to be included in the income base.) A gift annuity can help to reduce the surtax on the Catastrophic Protection Act, since it will be based on the amount of income tax paid. The income is safe because it is backed by the charity's assets and may also be reinsured by a sound insurance company. The income tax deduction is attractive to many donors.

The deferred payment gift annuity is a valuable means of involving younger donors, often during their top earning years, in our planned giving programs. Perhaps the most popular use for a deferred gift annuity is as a retirement income device. It is ideal for a donor who has reached the limit of allowable contributions to a Keogh plan, qualified pension or profit sharing plan or who is unable to deduct payments to an IRA. Rollins and some other charities are calling this plan the "Charitable IRA", because it is easier for donors to relate to this familiar concept than to a deferred payment gift annuity. They like the immediate tax deduction to be claimed in the high income years and the promise to future income after retirement at a substantial rate of interest.

We will learn to live with the three-month lookback which becomes effective on May 1 and the change may actually help us to establish closer relationships with our donors.

Note: Much of the technical information for this workshop was drawn from the tax service published by R & R Newkirk-Longman Group USA.

WORKSHOP SESSION—CHARITABLE GIFT ANNUITIES—BASIC

Dr. Robert B. Gronlund
President, Gronlund, Sayther & Associates

The Gift Annuity Agreement, outside of the charitable bequest, is the oldest of the methods we will discuss and a program of offering Gift Annuities is really the forerunner to our modern deferred giving programs. A survey taken in 1931 revealed that the American Bible Society was already writing Gift Annuities in 1821 and that the American Baptist Home Mission Society had been engaged in such a program since 1840. Other programs have been in existence from sixty to one hundred years, so we are hardly talking about anything new.

Definition

What do we mean by a Gift Annuity Agreement? *A Gift Annuity Agreement is a giving plan or method whereby a gift of a principal sum or a piece of property or a block of securities is made to your charity in exchange for an agreement by which the donor receives a fixed annual sum for life.* In other words, John Donor gives to your organization $10,000 and you agree to provide him, based on his age at the time of the gift, and let's say he is 78, 9.1% or $910 every year for as long as he lives. And while Mr. Donor has completely and irrevocably transferred the $10,000 to you and cannot receive it back, you in turn have committed yourself to paying him $910 per year even though he might live to be 103 and even if interest rates or the economy collapses. It is the guaranteed or fixed nature of the income that characterizes the Gift Annuity Agreement. You will recognize this method as similar to an insurance or pension annuity or the agreement children occasionally make with their parents, when they agree to pay them so much a month for life in exchange for the family farm or business which has been the parents' main asset and source of income up to that time.

However, there's more to it than simply this, as you might guess, and particularly because we are concerned about *Charitable Gift Annuities.* We are involved not only with an annual payment for life, which is the annuity, but also with a charitable contribution. And a way to get at this might be to ask a question which should be in your mind. *"How is the annual rate determined, what factors affect it?"*

Calculation of the Gift Annuity Rate

There are four primary questions to be answered in the calculations of a gift annuity rate. These are: 1) How long do you expect your annuitant to live? 2) What rate of interest do you expect to earn on your invested Gift Annuity reserve funds? 3) What do you expect your administrative costs to be? 4) What portion of the principal received is to constitute a gift to your charity?

Let me make a few comments about this gift portion which is termed the *residuum*, the part you expect to have remaining for your charitable purposes after you have paid John Donor his $910 for each year that he lives. The use of the term *residuum* should indicate to us that the principal sum in a Gift Annuity is expected to erode. We do not anticipate after taking out administrative costs that we can earn 9.1% on the funds we have received from Mr. Donor but that we must each year take a portion of the original principal in order to pay the annuity. This erosion, of course, accelerates through the years as an increasingly smaller principal earns less interest and necessitates an ever greater portion of the principal to be utilized in meeting payments.

Three of these four questions I raised do not present any problem. Expected administrative costs can be determined and the Conference on Gift Annuities uses 5%. Rate of interest earned on invested funds is also easily ascertained and the Conference employs 6.5%. You may say, as many do, we can earn more than that on our invested funds, but you have to remember that we are concerned and involved in Gift Annuity rates, not just with this year or next, but in many cases with the next ten, twenty and even thirty or forty years. Hence, we strive for a conservative average of expected investment return over the years ahead. Residuum can also be established and the Conference uses 50%, *i.e.*, after all the other factors are applied and the rates set, 50% would be expected to be retained as a gift by the institution. Or, to return to our example, of the $10,000 John Donor gave us, after administrative costs and after paying out the annuity over his life expectancy, $5,000 would remain.

But that life expectancy presents some problems. Which of many expectancy tables should we follow? To answer this will require an actuary and you can hire one and have him advise you, do all the complicated computations and set your rates. But there is an easier and less expensive and, frankly, more consistent way and that is to follow the rates set by the Conference on Gift

Annuities and thus to receive the equivalent of several thousand dollars of actuarial services free. Approximately 90% of the Gift Annuity issuing organizations in America follow the rates as established by the Conference. This provides for uniformity, consistency, stability and surety in approaching both prospective donors and in dealing with the Internal Revenue Service. It avoids unseemly competition and prohibits "shopping around" on the part of donors. He will make the gift because he believes in what your organization is doing and not because you have higher rates than someone else. It keeps the Gift Annuity Agreement within the safe confines of a true gift and avoids approaching commercial annuity rates or competing with insurance firms and inviting further regulation and restriction by IRS.

But to proceed with our computation of Gift Annuity rates and the answers to our four questions. As you know, this Twentieth Conference on Gift Annuities passed the following resolution: "BE IT RESOLVED that the present immediate gift annuity rates, as adopted by the Eighteenth Conference on Gift Annuities on May 5, 1983 and reaffirmed by the Nineteenth Conference on Gift Annuities on May 1, 1986, be continued as the Uniform Gift Annuity Rates recommended by the Twentieth Conference on Gift Annuities."

The Eighteenth Conference action was as follows: "BE IT RESOLVED that gift annuity rates based on the 1983 Table A-Female Maturity Assumptions—with ages rated one year younger, interest assumption at 6½%, 50% residuum, expense loading at 5%, with tabular rates modified at younger ages, extending to age 90 and above at 14%, be adopted by the Eighteenth Conference on Gift Annuities as the maximum uniform rates."

In outline those are the factors and the solutions reached. The decisions made by the Conference regarding the assumptions that affect the rates are conservative as they should be. For we are eleemosynary institutions issuing Gift Annuity Agreements behind which we place the total assets and lives of our institutions. Above all, we are concerned about a gift that will further the charitable purposes of our institutions and not about simply providing as high an annuity payment as possible.

This is not to say that the rates as established by the Conference on Gift Annuities are low. They are not as you who have examined them know. Rates are 6% per annum at age 35 and move up from that each year to 6.4% at age 45, 7% at age 60, 7.8%

at age 70 and to 14% at age 90. Because the question always comes up (and frequently from prospective donors), might I say that the rate remains stable for life as established at the time the agreement is written. Rate of payment does not change as the person becomes older for annuities already issued. Also, the rates quoted are for Single Life Gift Annuity Agreements. Two-Life Agreements can also be written and, because another factor is involved, that of a second life over which the annuity payment must be extended, the rate is lower than that of a Single-Life Gift Annuity. For example, the Single-Life Gift Annuity rate at age 78 is 9.1% but for two persons each aged 78, it is 8%. Gift Annuity Agreements are not written on more than two lives.

Before we leave the discussion of rate setting, allow me to point out that rates are subject to regular review by the Committee on Gift Annuities together with its actuary. The Committee of a maximum of twenty-five members meets periodically to consider a number of matters relating to the promotion, regulation, and taxation of Gift Annuities, as well as to consider terminology and rate changes and to arrange for Conference meetings. The Committee, which provides a continuing advisory service in the field of Gift Annuities, came into existence in March 1927. After years as a subcommittee of the Federal Council of the Churches of Christ, the Committee became an independent agency in October 1955, by vote of the Ninth Conference on Gift Annuities. Two main factors influencing the initiation of rate change consideration on the part of the committee are the investment outlook as it affects interest rates and the mortality experience among annuitant lives.

Let me also say that the 50% residuum of which we spoke is simply an average expected to be achieved. Residuum on individual Agreements will vary markedly as will general experience. Every issuing organization has a classic example of the annuitant that lived to be 103 and ended as a net liability to the institution drawing an annual payment long after the original principal had been completely eroded! But, on the whole, experience has been most favorable. Many report an average residuum of 80% or more and The American Lutheran Church Foundation, which I formerly served as Executive Director, actually was experiencing a 100% residuum on many Gift Annuities. These annuities had been issued during the thirties at rates of payment of 2% and 3% and the improved economy of the forties and fifties had made possible a higher return on the investment of the Gift Annuity Fund.

So far, then, we have discussed two motives or factors which lead many to make a gift utilizing the Gift Annuity Agreement. We have talked about the desire to assist your charity and we also discussed rates, for the amount of annual income, sure, fixed and guaranteed, that a Gift Annuity can provide influences many. Now, let's turn to a third appealing feature of the Gift Annuity Agreement and that is its tax aspects. This, too, you must understand if you are going to issue Gift Annuities and answer the questions your prospects will raise.

Tax Aspects of a Gift Annuity Agreement

We have already spoken of a Gift Annuity consisting of a purchase of an annuity and a gift to your institution. The first we term the actuarial value; the second the gift value. The actuarial value approximates the amount required on the commercial market to purchase an annual annuity in the amount indicated by the age of the donor. In other words, an annuity of $910 per year could be purchased by our Mr. Donor for less than the $10,000 he is giving to us—in fact, for about $4,386. The remaining portion of $5,614 is the gift value. It is this gift value and not the entire $10,000 that is deductible by Mr. Donor as a charitable contribution deduction on his income tax. Such a deduction is limited, of course, together with his other charitable giving, to a maximum in any one tax year of 50% of his adjusted gross income, (30% for gifts of appreciated property) but any excess may be carried over for five tax years.

But, let's move on. Because an annuity is expected to erode, *i.e.*, the principal generally must be invaded to make the annual payments, part of the annuity payment is tax-free to the annuitant because it is a return of his or her own money and not actual income earned. This varies with the age of the donor at the time the Agreement is written, but to return once more to our Mr. Donor who took out a $10,000 Gift Annuity at age 78 and who receives $910 per year, 46.34% of this annual income is tax excludable. He needs to pay tax on only $488.31 out of the $910 he receives each year. This tax feature, added to the charitable contribution deduction available, makes the Gift Annuity appealing tax-wise to many donors.

All of this should lead you to realize that you have some computing to do so that you can give both prospects and donors the necessary tax information they seek and require. We employ the nearest birthday for ascertaining the donor's age and the frequency of payment affects the tax computation. Annuity payments can be made monthly, quarterly, semiannually or annually or on any other schedule that the donor may desire. However, you will save yourself expense and time by insisting that all small annuities be made on an annual or semiannual basis. Annual payments are usually made on the anniversary date of the Agreement.

While there are basically two types of Gift Annuities, Single Life and Two Life, alternatives are available beyond this simple division. For example, the annuity may be written for the donor only as a Single-Life Agreement; or it may be written for the benefit of an individual named by the donor called the Income Beneficiary. The Two-Life Agreement also offers several options. Payments may be made jointly to both persons so long as both live and thereafter to the survivor for the remainder of his or her life. This is a Joint and Survivor Gift Annuity. Or payments may be made to the donor only but upon his death to a survivor named in the original agreement for the remainder of the survivor's life. This would be a Single and Survivor Gift Annuity.

Gift Annuity Fund Management

Thus far we have covered fairly thoroughly three of the four factors that interest people in Gift Annuities, namely, a desire to make a gift to your charity, a desire, often a necessity, for regular, assured income, and an interest in reducing taxes. There is yet a fourth factor in my experience and that is the desire to be free of investment worries. This can be a convincing argument particularly for the widow not accustomed to handling investments or for the couple who, in growing old, find it more and more difficult and irksome to keep abreast of economic developments. All this implies that your organization in freeing donors from investment concerns, adopts these responsibilities itself and this is correct. Unless you are willing to follow sound and prudent investment policies, you have no business issuing Gift Annuities. You enter into an agreement to pay the annuitant an income for life and adequate reserves must ethically be maintained to provide that income. I say ethically because, except for several states, there are no legal reserve requirements or any regulation of the writing of Gift Annuities. This imposes a moral obligation upon all institutions to maintain sound reserves and to follow ethical practices. Most go the second mile by investing and retaining the entire annuity principal, for example, the $10,000 donated by our Mr.

Donor, and not using any portion for institutional purposes until after Mr. Donor's death when the balance remaining is determinable. This policy and procedure I recommend to you especially when you only have a few Gift Annuities. It is safe and sure and above reproach. Also to provide the liquidity and the safeguards you may need, it is not recommended that you invest annuity funds in your operation.

Some Additional Warnings

While we are at it, allow me to provide some additional cautions. Watch your promotional terminology. Avoid terms like "investment," "interest," "purchase," "sale," "generous return," "higher return than banks pay," etc. Avoid anything and everything that sounds like you are in the commercial annuity business. Highlight at all times that a gift is involved and that your charity is to be benefitted. While tax considerations are important, do not make them foremost. Do not enter into deals that involve hiking the rates or taking property of questionable value. A few will shop from agency to agency and you may find, as I did after traveling 2000 miles to California to see what was supposedly a large prospective donor, that an even dozen agencies had already turned him down. Be above reproach at all times. Practice the highest form of ethics. Say "no" when some dear soul who has only $20,000 to her name and social security of only a few hundred dollars per month wants to put the entire $20,000 into a Gift Annuity. Explain to her that she must keep a reserve fund for emergencies and that she will probably have to use her $20,000 to supplement her Social Security. And again I urge—don't go beyond the published rates. If you think it is a brilliant move by doing so to take a gift away from another agency, just wait until your other annuitants and prospects find out and then see what kind of a merry-go-round you are on. Also, be sure you keep abreast of the latest developments in the field, particularly in the area of taxation. Things can change suddenly. Read and study and attend the Conference on Gift Annuities, as well as workshops and special sessions.

Some Variations

Let gifts of appreciated securities be a red flag warning to you in dealing with the Gift Annuity. IRS has ruled that the bargain sale rules apply in such a gift. You will find an excellent explanation of this whole matter plus a computation formula in your green manual. In essence it says that there is some capital gains tax implication in exchanging appreciated securities for a charitable Gift Annuity. That's the bad news. The good news is that this gain is reported over the life expectancy of the donor and should he or she die earlier the remaining gain is forgiven.

As you have already heard in this conference, there is also a Deferred Gift Annuity. You can pay now and enjoy the income later. The Deferred Gift Annuity can be used in retirement planning and is an excellent substitute for the IRA if your donor is no longer eligible for a tax-deductible IRA. For example, a male at age 55 could either make a $55,000 lump sum gift to your charitable organization or gifts of $5000 per year for eleven years. At age 65 he would receive an annuity for life of $4790. In addition, there would be a charitable deduction available of $35,000 and tax savings of probably $9800 or more. In effect, your donor has received a 10.7% return on the gift but above all he has helped your charity.

I mentioned earlier that it is important to keep up and to be aware of changes in rates, rulings, valuation tables, etc. One great value of membership in the Conference is that it does alert you to these changes. As you have already heard, in the Technical Corrections Act it was decided that new mortality tables and a new projected rate of return on invested annuity funds must be utilized. Previously a 10% projected rate of return was utilized but now a new floating rate must be used equal to 120% of the federal midterm rate of US obligations adjusted to the nearest 2/10 of 1%.

The federal rates are issued about the 20th of each month. The donor has the option of using the current months rate or the two previous months rates. An excellent explanation of this whole matter is the article by Marc Carmichael "Marketing Deferred Gifts After TAMRA" which appeared in the February, 1989 issue of *Fund Raising Management*.

To continue with variations on a basic Gift Annuity Agreement, in a two-life agreement there could be gift tax implications. You should check with tax counsel. For gift tax purposes the actuarial value of the annuity is used.

Similarly there could be estate tax implications if a testmentary Charitable Gift Annuity is involved. Again check with tax counsel.

Some Hints on Building a Successful Gift Annuity Program

There are but two basic ingredients in a successful Gift Annuity program that will produce millions of dollars for your organization: patience and hard work. Both are absolute necessities, but the first is probably the more difficult. The pressure is always on to produce the immediate dollar. Despite our adoption as professionals of the development concept which is the establishment of long-range, continuing programs that will provide needed support, our boards and executives are often oriented to fund-raising per se and tend to stress the short-term approach and the immediate dollar. Gift Annuities is a long-range program by which you can assure the future of your charity. It won't produce well for ten to twenty years and in some cases even longer. But imagine if someone had only started such a program for you twenty years ago! Because there is this time lag, many, unless the donor otherwise insists, designate Gift Annuities for an Endowment Fund. That helps take the pressure off and also keeps you from becoming morbid about the health of your annuitants, who I will tell you right now will become some of your very good friends.

The growing number of senior citizens in our society makes such patience, as well as the hard work, worthwhile. More and more prospects are available for every institution as the numbers of older people increase. The average annuitant, our studies tell us, is apt to be in her seventies, a woman, either widowed or never married and the average annuity will be less than $2,000. But, moreover, these same studies indicate that she and all other annuitants of whatever age or sex will be likely to take out more than one annuity with you, will often support your current program to some extent, occasionally by returning the annuity check, and are more than likely to include your institution in their will. Because of the repeat factor among annuitants, many institutions have found it helpful to write annuities in $1,000 minimums. In this case, the annual income is inconsequential enough so that you may wonder why the donor does not make an outright gift. But the acquisitive instinct is strong as is the desire to make a good bargain and frequently they are simply trying you out to see if you do keep your word on making the payments. Here, too, patience is the prime virtue and often a thick file of correspondence and call reports will accumulate and a year or more go by before the gift is made.

Annuitants on the whole are not sophisticated, experienced investors. They are often simple people with a deep desire to help your cause. The KISS technique is essential. For those to whom this technique is new, the letters stand for Keep It Simple Stupid! It should also be noted that prospective annuitants are usually found among those who fear depression more than inflation and who prefer a fixed, sure income to a fluctuating one even though the latter may provide more income over the long run. Annuitants are also frequently hardened advocates of the "never spend the principal" school and the fact a life income is assured through the gift appeals to them.

The most frequent objections you are likely to run into in a program of Gift Annuities is the observation that higher rates can be obtained elsewhere, generally from an insurance firm. Here your skill as a development person can be put to good use as you extol the advantages and necessity of charitable giving. Another objection is the fear that undue medical or other expenses might make the availability of major funds a necessity. This can be effectively countered by suggesting a portion of the Gift Annuity be revocable should such occasion arise, but remember there is then no charitable contribution deduction for this revocable portion.

Personal calling is without equal in writing Gift Annuities. But a surprising amount of Gift Annuities can be promoted and the agreements completed simply through the mails. Advertising and articles in newsletters, magazines and other publications have also proved productive for many.

Whatever you use I am sure you will find a program of Gift Annuities worthwhile for it is an intriguing gift method that provides a benefit not only to your charity, but also to the donor. It places you and him or her and his family in a close relationship that is both rewarding and satisfying. Out of this relationship frequently comes the large annuity or the large other deferred gift that your cause so desperately needs and above all from it comes a good friend—for your organization and for you personally.

WORKSHOP SESSION—CHARITABLE GIFT ANNUITIES—ADVANCED

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I. Bargain Sales—Basic Rules

A. Donative interest must be present

1. If donor expects benefit in exchange for his gift, he may not obtain any deduction for gift.
2. See *Singer Co. v. U.S.*, 449 F.2d 413 (Ct. Cls. 1971); Rev. Rul. 76-756, 76-2 C.B. 51; *Stark* 86 T.C. 243 (1986) where taxpayers expected some business benefit for transfer.
3. §162 business expense deduction may be available if §170 deduction not available. No percentage limitation imposed on business expense deduction.
4. If a bargain sale is planned, state the intention to make a charitable contribution in the contract in order to avoid any questions about deductibility.

B. Basis

1. Since a bargain sale is part gift-part sale, basis must be allocated between the gift portion and the sale portion.
2. Dottie Donor, in 33% income tax bracket, sells securities having fair market value of \$10,000 to charity for \$4,000. Her basis is \$2,000 and she has held securities for more than 1 year. She has made a gift of \$6,000 and a sale of \$4,000. The portion of the basis allocated to the sale is determined by the ratio of sale price to fair market value (4,000/10,000) x \$2,000 = \$800. DD has recognized long term capital gain of \$3,200 (\$4,000 − \$800) on bargain sale. In her 33% bracket, the sale will generate a tax of \$1,056 and the gift will generate a tax savings of \$1,980. See Reg. §1.1011-2(a)(1) and Reg. §1.170A-4(c)(2). For purposes of the alternative minimum tax, the basis allocated to the gift portion

[1] I am deeply indebted to my partner, Carolyn Osteen, who prepared the major portion of this outline in connection with a Massachusetts Continuing Legal Education Program. I did not see any benefit to be had by reinventing the wheel myself.

is determined by the ratio of the gift amount to the total fair market value (6,000/10,000) x \$2,000 = \$1,200, thus the preference item for AMT is 6,000 – 1,200 or \$4,800. See §57(a)(6).

3. DD is better off under bargain sale rules than if she were to sell securities at fair market value incurring tax of \$2,640. If she then contributed \$6,000 of sale proceeds, deduction would save \$1,980 in tax. Net tax cost of gift would be \$660. With bargain sale, tax on gain of \$1,056 is more than offset by tax savings of \$1,980. Net tax savings is \$924.
4. Character of gain realized on bargain sale transaction, whether capital gain or ordinary income, is determined by whether property is capital asset or ordinary income asset.

C. Gift of mortgaged property is bargain sale

1. When donor gives mortgaged property to charity, Reg. §1.1011-2(a)(1) says donor is treated as having sold property to charity for amount of mortgage even if charity does not assume or agree to pay debt.
2. Bargain sale arises even if the indebtedness is nonrecourse to the donor; *Guest,* 77 TC 9 (1981).
3. If mortgage terms permit transfer of property subject to mortgage and charity is not required to assume or to pay mortgage, and donor undertakes to hold charity harmless under the mortgage and pay off mortgage as it falls due, no bargain sale to donor, because the donor is not relieved of any liability.
4. If donor does not undertake to pay mortgage as it comes due and charity must pay off mortgage, income from property including rent, interest, capital gain may be taxable to charity as debt-financed income. See §514 and Reg. §1.514.

D. Gift of limited partnership interest is bargain sale

1. Rev. Rul. 75-194, 75-1 C.B. 80 says when partnership property is subject to debt, even though limited partner is not personally liable, each partner's interest is treated as subject to his allocable share of debt and that debt share is treated as amount realized even though donee does not assume or agree to pay.

2. It is this rule which torpedoes most gifts of tax shelters; most donors don't realize that they will recognize gain to the extent of their share of the partnership indebtedness.

E. **Deduction reduction and recapture rules—interaction with bargain sale rules**

1. If the contributed property is ordinary income property, tangible personal property given to a public charity for an unrelated use, or appreciated property given to private foundation it is subject to reduction rules of §170(e), causing deduction to be limited to basis; Reg. §1.1011-2(a)(1) provides that no deduction is allowable unless contribution portion of bargain sale exceeds the reduction amount applicable to entire property, not just contributed portion. In *Estate of Bullard,* 87 T.C. 261 (1986), the Tax Court invalidated that portion of Regs. because of inconsistency with general basis allocation rules.
2. If no charitable deduction is available because recaptured income is inherent in contributed property and contribution reduction rules apply, no bargain sale is made. All basis may be allocated to sale portion of property. See Reg. §1.1011-2(a)(1) and Rev. Rul. 76-253, 76-2 C.B. 51.
3. Reduction rules of §170(e) applicable to certain gifts of tangible personal property, gifts to private foundations and gifts of ordinary income property causes deduction reduction.
4. Dottie Donor gives building with fair market value of $100,000, and basis of $40,000, mortgage of $55,000 and depreciation recapture of $60,000. DD has made contribution of $45,000 but this is less than amount of depreciation recapture. Under §170(e) the charitable deduction will be eliminated by the depreciation recapture. However, DD is entitled to allocate all basis ($40,000) to amount deemed received as sale proceeds ($55,000) so that taxable gain would only be $15,000.
5. Dottie Donor gives building worth $100,000 subject to $25,000 mortgage and basis of $40,000, and $30,000 of depreciation recapture if property were sold. She has made a gift of $75,000, but she will not

be entitled to a deduction for the full amount because of the depreciation recapture. She has also made a sale for \$25,000, the amount of the mortgage. The basis must be allocated between sale portion and gift portion. (25,000/100,000 x 40,000 = \$10,000 = basis allocable to sale portion). Sale results in taxable gain of \$15,000 (\$25,000 − \$10,000 = \$15,000). Balance of basis (\$40,000 − \$10,000 = \$30,000) is allocable to gift. Recaptured depreciation is allocated between sale and gift portions of property. Sale portion is \$7,500 (\$25,000/100,000 x 30,000) which is taxed as ordinary income. Sale proceeds of \$7,500 is treated as capital gain. Balance of recapture of \$22,500 (\$30,000 − \$7,500) is allocated to gift and reduces deduction for gift. Deductible gift is \$52,500 (\$75,000 less \$22,500, representing amount of recapture allocable to gift).

F. **Installment and deferred bargain sales**

1. Payment for bargain sale (or straight sale) may be deferred or made in installments. Imputed interest rules require donee to pay interest at applicable federal rate or interest will be deemed paid under §7872. Reg. §1.7872-5T(b) (9) contains exception for loans to charitable organizations if total loans outstanding during the year to the charity do not exceed \$250,000.
2. If state law imposes burdensome insurance regulations on gift annuities (not a problem in Massachusetts where M.G.L. 175, §118 expressly exempts charitable gift annuities from all state regulation) or charity is unwilling to assume actuarial risk of gift annuity, deferred or installment payment sale may be alternative to gift annuity.
3. Charity may have debt-financed income taxable as unrelated business taxable income ("UBTI") on acquisition of property subject to installment or deferred payment contract so that income or gain may be taxed to charity under §§511-514. Gift annuity is exempted from UBTI. See §514(b).
4. If charity which receives installment or deferred payment obligation is treated as a related party and

resells property before obligation is paid in full, donor-seller may have acceleration of gain. See §§453 and 267(b).

II. Gift Annuities—A Bargain Sale in Disguise

A. Gift annuity is nothing more than a special form of bargain sale where the consideration is paid in the form of an annuity. Donor makes present gift, reserving right to annuity. Amount of annuity varies depending on annuitant's age.

1. Reg. §§1.170A-1(d) and 1.1011-2(a) sanction deduction for bargain element of gift annuity and spell out treatment of income and gain with respect to the annuity payments.
2. Like straight bargain sale, gift element in gift annuity is deductible as charitable gift. The value of the gift is simply the value of the cash or property contributed less the present value of the annuity. The value of the annuity is now determined by the same tables used to value remainder interests in charitable remainder annuity trusts. See Rev. Rul. 84-162, 84-2, C.B. 200 and Reg. §20.2031-7.
3. The amount of the annuity depends on annuitant's age and is usually derived from tables provided by Committee on Gift Annuities, 1865 Broadway, New York, New York, 10023, tel 212-408-1322.

B. TAMRA 88 has turned the tables

1. *New Interest Rates.* §5031(a) of the Technical and Miscellaneous Revenue Act of 1988 adds a new §7520 to the Code which requires that for all purposes of the Code the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest shall be valued under tables prescribed by the IRS using an interest rate (rounded to the nearest 2/10ths of 1 percent) equal to 120 percent of the midterm Applicable Federal Rate in effect under section 1274(d) (1) for the month in which the valuation date falls.
   a. Welcome to the Table of the Month Club.
   b. The IRS has been publishing monthly tables of Applicable Federal Rates under section 1274 for several years in order to deal with no interest loans, original issue discount, etc.

c. AFRs are based on rates paid on U.S. debt instruments for short term (up to 3 years), mid term (3-9 years) and long term instruments.
d. Annual mid-term AFR for March 1989 is 9.30%; 120% of that rate is 11.22%, which would be rounded to 11.2%; for April of 1989 the annual mid term AFR is 9.60% and 120% of that rate is 11.58% which would be rounded to 11.6%.
e. For charitable transfers, the donor or his estate is entitled to use the AFR for the month of the gift or the AFR for either of the two months preceding the gift.
   (1) provision intended to respond to charities complaints that monthly changes were too frequent.
   (2) since tables are published about the 20th of the preceding month, if the gift decision is being made late in the month and the donor can delay the gift, one can choose between 4 rates (the two preceding months, the current month and, by delaying the gift until the next month, the next month). But in December, the delay will also delay the deduction for a year.
f. New interest rate tables scheduled to go into effect as of May 1, 1989.
g. As interest rates rise, the value of an annuity falls, which means that if 120% of the mid-term AFR stays higher than 10%, the new rates will make gift annuities more attractive after they go into effect, except for the countervailing effect of the new actuarial tables with updated mortality assumptions.

2. *New Actuarial Tables.* In addition to new interest assumptions §7520(c)(3) now requires Treasury to revise the actuarial tables every 10 years in order to ensure that they reflect the most recent mortality experience.
   a. Initial actuarial tables required "no later than" December 31, 1989, but since the new tables must be used for all gifts after May 1, 1989, a new table LN is rumored to be currently available and

should be published with the new interest tables due by May 1, 1989.

b. The revised tables are reputed to have lives which are approximately 3 years longer than the current life expectancies.

   (1) Longer life expectancies will increase the value of the annuity and thus decrease the value of the charitable gift.

   (2) Increase in life expectancies may therefore cancel the effect of higher interest rate assumptions.

3. *Notice* 89-24, I.R.B. 1989-10, 1, was published by the IRS on February 17, 1989 to provide transition guidance for using the new tables, which have yet to be published.

   a. The notice implies that the new actuarial tables will in fact be published by May 1, 1989.

   b. For a charitable gift made in May 1989 a donor may elect to use 120% of the AFR rates for March or April of 1989 (if the gift is made in June the donor may elect the April AFR) but if either election is made, the donor will use the actuarial tables currently in effect; in other words, the donor cannot use the new actuarial rates which will be effective after April 30, 1989 if he elects to use the interest rates for March or April 1989.

   c. This may actually prove to be a benefit for gift annuities entered into in May or June of 1989 (a "window of opportunity"):

      (1) since 120% of the April AFR is higher than 10%, the donor may elect to use the higher rate to depress the value of the annuity

      (2) if he makes this election he is required to use the current actuarial assumptions, which will be to his advantage, since the new assumptions will have longer lives.

C. **Gift annuity is not a deferred gift**

1. Because gift annuity is not a deferred gift, no trust is created, simplifying administration and reporting requirements (W-2P).

2. Gift annuity is not subject to private foundation rules to which charitable remainder trusts and

pooled income funds are subject. See §4947(a)(2)(B). Example: Dottie Donor gives closely held stock to Public Charity (PC) subject to gift annuity. PC may resell stock immediately to DD or stock may be redeemed by issuing company without violation of self-dealing rules. If gift were made instead to charitable remainder trust or pooled income fund, §4941 might have imposed penalty taxes on DD and company for self-dealing transaction.

3. Because the gift element is a present gift, the gift annuity may be the only way to make a "deferred gift" with tangible personal property.
    a. If a charitable remainder trust is funded with tangible personal property (e.g., a work of art or gold coins) §170(a)(3) will defer any deduction for the remainder interest until all of the intervening interests (i.e., the interests of the life beneficiaries) have expired or are held by persons other than the donor and/or his relatives. (Query what happens if the trust sells the property—that should terminate the interest of the donor and any other life beneficiary).
    b. This problem is avoided if the tangible personal property is exchanged for a gift annuity because that exchange will terminate the interest of the donor in the tangible personal property.
    c. Some states (e.g. New York) have statutes which prohibit charities from accepting tangible personal property for a gift annuity.

D. Estate and gift tax

1. If donor is only annuitant, annuity is extinguished at death and excluded from his estate. If spouse has survivorship interest, spouse's interest may qualify as QTIP for estate tax marital deduction under §2056(b)(7).
2. When donor designates another person as the annuitant, the donor makes taxable gift of the present value of the annuity to designated beneficiary. The value of the annuity should qualify for the $10,000 gift tax exclusion for present interests under §2503(b) exclusion.

3. If donor is first annuitant the interest of the survivor annuitant will not qualify for the $10,000 exclusion because it is a future interest. Donor may avoid taxable intervivos gift to survivor by reserving right to revoke survivor's interest. At donor's death the value of the survivor's annuity interest will be taxable to the donor's estate.
4. If donor's spouse is recipient of gift annuity, spousal gift qualifies as QTIP gift when spouse has vested interest and no other beneficiary has an interest following spouse. If spouse must survive donor to receive annuity, annuity does not qualify as QTIP interest until vested. See Reg. §25.2523(b)-1(c). Right to revoke spouse's interest must be reserved until interest vests.
5. Beware an annuity funded with joint property.
   a. There is no problem if the annuity is joint and survivor, for then the annuity interests follow the original interests in the property and there should be no gift, but each donor should reserve the right to revoke the survivorship interest of the other.
   b. If joint property is used to fund an annuity for W with a survivorship annuitant to H, H has made a gift of his joint interest to W and W has made a gift to H her survivorship interest in the property, a gift which will not qualify for the marital deduction. Cured by reserving the power to revoke.

E. Taxation of charity
1. Since contributed property becomes part of general assets of charity and is subject to obligation to pay annuity, property is debt-financed and may give rise to UBTI to charity unless all of the following requirements of §514(c)(5) are met:
   a. Value of annuity must be less than 90% of contributed property and no other consideration may be advanced by charity.
   b. Annuity must be payable for life or lives of one or two individuals in being at time of gift—i.e., not for term of years.
   c. No minimum or maximum number of payments may be specified.

d. Annuity may not provide for adjustment in annuity amount to reflect income earned by contributed property or other property.

2. If annuity does not satisfy a-d above, it should be funded with property which will produce no income such as painting or real estate to be used by charity in exempt functions or cash which may be traced immediately into exempt function expense.

F. Section 501(m)—Sloppy drafting creates a tempest in a teapot

1. 1986 Act added §501(m) to deprive charity exempt under §501(c)(3) or (c)(4) of exemption if substantial part of activities consists of providing commercial-type insurance. If providing commercial-type insurance is insubstantial activity, income derived therefrom is taxable as UBTI.
2. Certain insurance activities of charitable organizations were specifically exempted, including providing insurance at less than cost to class of charitable recipients and certain HMO activities, but §501(m) originally provided no exemption for gift annuities.
3. Since §514(c)(5) contains conditions which if satisfied, protects charity from UBTI on income from property contributed to fund gift annuity, §501(m) should be inapplicable to gift annuities.
4. TAMRA-88 corrected problem by adding §501(m)(3)(E) to exclude charitable gift annuities from definition of commercial-type insurance.
   a. "Charitable gift annuity" is defined by §501(m)(5) as including any annuity if a portion of the amount paid is allowable as a charitable deduction and the requirements of §514(c)(5) are satisfied.
   b. §501(m)(5) now has the effect of reinforcing conditions of §514(c)(5); failure to satisfy §514(c)(5) now has a double whammy:
      (1) any property received will be considered debt financed unless used for exempt purposes
      (2) "profit" from the insurance transaction will be UBTI and taxed under the insurance company provisions in the Code (Subchapter L); query how the gift element will be treated—it should not constitute income.

G. Income taxation of beneficiary

1. §§72 and 1011 govern tax treatment: a portion of each annuity payment is ordinary income, a portion is capital gain if appreciated capital gain property is used to fund gift *and the donor is the annuitant,* and a portion may be tax-free return of capital. Reg. §1.72-4 determines exclusion ratio: investment in contract (annuity value) divided by the expected return (annuity amount x annuitant's life expectancy). Life expectancy does not include life expectancy of survivor beneficiary unless survivor was also donor; e.g., jointly held property.
2. Example: Dottie Donor, aged 72 with life expectancy of 14.6 years, gives $50,000 to charity and receives annuity of $4,000 per year paid quarterly in arrears (first payment due in 2 months). She will receive deduction of $26,253. Value of annuity is $23,747 and expected return is $4,000 x 14.6 or $58,400. Exclusion ratio = 23,747/58,400 or 40.66%. DD is entitled to exclude $1,678 as tax-free return of capital and is taxed on ordinary income annually of $2,372.
3. If annuity commences after 12/31/86, §72(b)(2) '86 TRA, requires that excludable annuity payment is limited to investment in contract. Once annuitant has survived his life expectancy, he must treat entire annuity amount as taxable income. If annuitant dies prior to life expectancy, his estate (or surviving annuitant if any) has income tax deduction (§72(b)(3) which is deductible "below-the-line" i.e. from adjusted gross income but which is not subject to 2% floor applicable to miscellaneous deductions. §§62 and 67(b)(11).
4. If long-term capital gain property is used to fund annuity and the donor is the annuitant, a portion of each annuity payment is taxable as long-term capital gain spread over donor's life expectancy, *provided donor is only or first annuitant and annuity is non-assignable except to charity.*
   a. In example given above, Dottie Donor contributed $50,000 of appreciated securities having basis of $10,000 and basis is allocated in accor-

dance with bargain sale rules 23,747/50,000 x 10,000 = gain of $18,998 is spread over her life expectancy or $1,301 per year. Annuity of $4,000 per year consists of $2,372, $1,301 capital gain and $327 of tax-free return of basis until expiration of Dottie's life expectancy of 14.6 years after which entire annuity is taxable as ordinary income.

b. Note that under Reg. §1.1011-2(a)(4), the gain is recognized only over the life of the donor; it cannot be spread over the life of the donor and the survivor annuitant.
   (1) This means that where there is a survivor annuitant, the period over which the capital gain is recognized (the life expectancy of the donor) will be different from the period over which the investment in the contract is recovered (the joint life expectancies of the donor and the survivor).
      (a) This creates a potential problem for the allocable portion of the gain could be higher than the allocable portion of the investment in the contract.
      (b) The Regulations do not deal with this problem; Example (8) of Reg. §1.1011-2(c) states that gain is to be recovered "only from that portion of the annual payments which is a return of his investment in the contract . . ."
      (c) Rationale for this position is that the balance of the payment is interest, taxable as ordinary income.
      (d) Application of the language in the regulations would push some of the gain on to the survivor.
   (2) If the donor dies before the gain is recovered and there is no surviving annuitant, the balance of the gain goes tax free.
   (3) Similarly, where the annuity is assigned to the charity which issued it any gain unrecognized is tax free.
   (4) However, if there is a surviving annuitant

and the donor dies before the gain has been fully taxed, the survivor will be taxed on the balance of the gain over the donor's life expectancy as though the donor had lived.

   c. If the property is owned jointly, and the annuity is a joint and survivor annuity, the gain should be recovered and taxed over the joint lives of the donors, but the Regulations do not deal with this issue.

5. If capital gain property is used and the donor is not the first annuitant (or is not an annuitant at all) or if the annuity is assignable, the donor will recognize the gain immediately and the amount to be recovered tax free by the beneficiary(ies) will be the gain recognized by the donor and the basis allocated to the gain portion.
   a. This rule creates a potential trap where one spouse uses appreciated property to create an annuity for the other; this will result in the immediate taxation of the gain.
   b. The problem can be solved by having the first spouse give the property to the second spouse and then have the second spouse use the property to create the annuity.
6. If a gift annuity is funded with mortgaged property there is a question as to whether the gain resulting from the mortgage can be spread over the donor's life expectancy. Although Reg. §1.1011-2(a)(4)(ii) can be read to support the spread, it really doesn't deal with the issue. Since the rationale for the spread is that the donor is receiving his cash payment in installments, the rationale does not apply to the indebtedness which, at least in theory, represents money which the donor has already put in his pocket. Thus the better view is that the gain on the indebtedness is immediately taxable.

H. **Deferred gift annuities**

1. If the commencement of the annuity payments of annuity is deferred the value of the annuity will be reduced, which means that the value of the deductible gift is increased.
2. Deferred gift annuity may function as a retirement

vehicle. Example: Dottie Donor, aged 45, earns $85,000 per year and is a participant in her employer's qualified pension plan. Prior to 1987 she had been contributing $2,000 per year to her IRA. After 1986 she loses the IRA deduction but replaces that with a contribution to a charitable deferred gift annuity commencing payment when she reaches age 70. If she contributes $2,000 to such an annuity, under deferred gift annuity tables provided by Committee on Gift Annuities, the amount of annuity payment beginning at age 70 would be $410, and charitable deduction would be $1,833. If deferred gift annuity is continued in succeeding years, the annuity amount would increase annually as the deduction diminishes because the period of deferral would be growing shorter.

3. An income only unitrust is sometimes recommended as a similar retirement vehicle.
   a. Trust invests in growth stocks with low or no dividend until beneficiary retires
   b. On retirement of beneficiary, the investment of the trust is switched into stable high yield securities to produce stable retirement income
   c. Problems:
      (1) trustee has to distinguish growth stock from shrink stock
      (2) donor's charitable deduction does not reflect the deferral of the income
   d. Deferred gift annuity can avoid both of these problems because it can be "funded" with assets which are guaranteed to grow, e.g., zero coupon bonds and the deduction reflects the deferral.
4. If a deferred gift annuity is funded with capital gain property, the recognition of gain should be deferred until the payments begin as long as the donor is the annuitant and the annuity is non-assignable, but the regulations do not deal with this issue. (There is a 1973 unpublished private ruling which so holds.)

I. Variable payment annuity

1. Gift annuity amount may escalate annually so long as the amount payable is ascertainable with certainty. See PLR 8322068 and Reg. §1.72-5(a)(5).

2. Escalation must be fixed and cannot be tied to income from the property without creating problems under section 514(c)(5).

J. **Reinsurance of annuity obligation by charity**
   1. Charitable organization has no obligation to hold gift annuity amount in trust or to reinsure its obligation.
   2. Rev. Rul. 62-137, 62-2 C.B. 28 states that the deduction for a gift annuity will not be affected by the fact that the gift annuity contract is reinsured or coinsured with a commercial insurance company unless the agreement provides that all or a designated portion of the annuity obligation must be reinsured by a designated commercial insurer.
   3. In PLR 8322068 the donor required the charity to reinsure the escalating annuity obligation by purchasing a single premium annuity.
      a. The reinsurance obligation did not prevent an income tax or a gift tax deduction for the gift to the charity,
      b. The deduction was measured by the difference between the value of the property transferred and the premium which the charity had to pay to reinsure its obligation.

K. **The donor must not retain an interest in the property transferred to fund the gift annuity**
   1. In PLR 8851030 the donor purchased a gift annuity from a charity pursuant to an agreement which obligated the charity to use the funds transferred to purchase U.S. Treasury Bonds and to pay the annuity out of the interest payments on those bonds.
   2. IRS held that this arrangement constituted the retention of an interest in the property within the meaning of §2522(c)(2) so that no gift tax deduction was allowed for the gift to the charity.
   3. PLR did not deal with the income tax consequences of this arrangement but if this is a retention of an interest it would also disqualify the income tax deduction see §170(f)(3).

4. Query whether the investment requirement represents a retained interest in the property transferred—this is a fairly expansive reading of the statute. Compare PLR 8322068 in which the IRS ignored a requirement that the annuity obligation be reinsured.
5. In any event IRS cushioned the blow by permitting the donor to recover the deduction by amending the agreement to provide that the annuity obligation is to be paid out of the general funds of the charity.

WORKSHOP SESSION—CHARITABLE GIFT ANNUITIES—ADVANCED: POP QUIZ

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Baptist Foundation of Texas

Fact Situation Number One:

Lois Lane, now 60, owns the complete collection of all the Superman comics ever published. She has been told that the collection is worth $500,000, although her basis in the collection is $10,000. Lois is very interested in, and is a supporter of, the Journalism Department at Metropolis University. Accordingly, she visits her old friend, Jimmy Olson, currently the Director of Development at Metropolis University. She tells him about her collection and, in response to his questions, says that she has a $2,000 per month pension, $300,000 in certificates of deposit, $50,000 in a short-term money account, and her home which is worth approximately $100,000. Lois has never married, and has no children or others who depend upon her for support. Jimmy prescribes a gift annuity with the Superman comics, utilizing the CGA recommended rate and payable monthly at the end of the period.

(1) Is there a potential problem at this point?

(2) Assume that everything is as described above, except that the annuity, by the terms of the agreement, may be assigned to Lois' sister. Are there any problems?

(3) Assume that everything is the same as in the original example except that the agreement was entered into on December 31, 1986. Does this change the taxation of the annuity payments?

(4) Assume that everything is as described in the original example, except that instead of the CGA rate, Jimmy says, "What are friends for?" and offers Lois an 11.6 percent annuity rate producing a charitable deduction of $48,510. Is this okay?

(5) Assume the gift agreement in this transaction includes the following sentence: "The property funding this gift shall be held by Metropolis University in a separate account from which all annuity payments shall be made." Does this present any problems?

Answers:

(1) New York does not allow gift annuities funded with tangible personal property. Check your own state law. The deduction for tangible personal property is limited to basis unless the charity will, or the donor in good faith believes the charity will, use the property in furtherance of the charity's exempt purposes. Note that an intervening interest results in postponement of the deduction in most cases where a gift of tangible personal property is made through a charitable remainder trust. To avoid the postponement of the deduction, a charitable gift annuity, which constitutes a current gift, is the alternative of choice. *Donaldson outline, I. E.* Note that, in this example, if the test for deductibility of the full fair market value of the tangible personal gift is not met, then the charitable deduction from the gift annuity must be computed on the basis only of the property. The result is that the charitable deduction is reduced from $227,550 to $4,600.

(2) This results in gain being taxed immediately to the donor upon creation of the annuity. To obtain deferral over the donor's life expectancy, the donor must be the first or the only annuitant, and the annuity must be nonassignable except to charity. *Donaldson outline, II. G. 4.*

(3) The exclusion ratio is permanent for gift annuities entered into before January 1, 1987, so that the tax-free portion of the annuity continues even after the investment in the contract has been recovered. Where appreciated property is involved, the entire exclusion ratio amount becomes permanently tax-free once the gain is reported out over the donor's life expectancy. For purposes of gift annuities entered into after December 31, 1986, once the investment in the contract is recovered, the annuity becomes fully taxable. In all cases, tracking of these changes as they occur is required to provide accurate tax information to donors. *Donaldson outline, II. G. 3.*

(4) Code Section 514(c)(5), which contains provisions related to unrelated debt-financed income (unrelated business income), provides that for a gift annuity not to result in unrelated debt-financed income/unrelated

business income, the following circumstances must exist:

(a) The value of the charitable deduction must exceed 10 percent of the value of the contributed property. Said another way, the value of the annuity interest must be less than 90 percent of the value of the contributed property. The donor cannot receive any other consideration.

(b) The annuity must be payable for one life or for two lives in being, not for a term of years.

(c) There can be no minimum or maximum number of payments specified in the document.

(d) The annuity cannot be adjustable with reference to any external factor, e.g., income earned from the property. In this example the charitable deduction is not more than 10 percent of the value of the contributed property. Note that this also triggers the application of Code Section 501(m) which results in unrelated business income and potentially jeopardizes the tax-exempt status of the issuing charity. *Donaldson outline, II. E. and II. F.*

(5) PLR 8851030, relying on Rev. Rul. 80-280, indicates that this gift annuity does not qualify for income, gift or estate tax charitable deductions. This results from a perceived attempt to contravene the split-interest rules, thus violating the partial-interest rules. You cannot specify the source of the annuity payments other than to make the payments a general obligation of the charity. No restrictions on the investment of the annuity proceeds can be placed on the charity by the donor. *Donaldson outline, II. K.*

Fact Situation Number Two:

Fluffy Martin is a retired businesswoman, age 78. She has an estate of approximately $2,500,000, having made her money through the establishment of a chain of day-care centers for pets. After twenty years in the business, she discovered that she was allergic to cat hair. She immediately sued her doctor for misdiagnosis of her illness and promptly recovered $1,000,000 in damages. Additionally, she sold her business at a nice profit, and became the dog food critic for the Daily News. Mrs. Martin owns a small office building near State University in Dallas which, even in this depressed real estate environment, has a value of $1,200,000. Her basis in the building is $1,099,764. She has a stock and bond portfolio of $1,000,000, spread equally between highly appreciated securities and high-grade medium term bonds. She owns her house which is valued at $250,000. Fluffy wants to make a substantial gift to the Veterinary School at State University, but does not feel she can afford to make a gift during her lifetime. State University, coincidentally, is in need of a new administration building for its Veterinary Department. Fluffy, whose husband is deceased, also has one daughter, for whom she would like to provide financial security. Her daughter's name is Mitzi, and she is 48. She contacts Augie Dogatelli, the Development Officer at State University, and gives him these facts. Among other things, Augie raises the issue of acquiring Fluffy's office building with a gift annuity. Fluffy is concerned that in the event of her premature death, her estate and thus her daughter will have received little benefit from the gift annuity.

(1) Augie proposes a gift annuity funded with the office building for Fluffy's life. Any problems?
(2) Assume the same facts, except that Fluffy wants her daughter, Mitzi, to receive the annuity for the rest of Mitzi's life if Mitzi survives Fluffy. Any thoughts about this arrangement?
(3) Assume that Fluffy is willing to accept an annuity benefiting only her, funded with the building. She has agreed to accept an annuity of $7,200 per month ($86,400 per year). However, she is afraid she will die prematurely, with the result that her estate will have been denied the full expected return on her gift. Can we suggest something that will work for Fluffy?

Answers:

(1) A gift of real estate is prohibited in New York. You must check local law. Whenever real estate funds a gift annuity, valuation problems are practically unavoidable, so that the actual income from the property or from the proceeds of its sale may be different from that projected prior to the establishment of the annuity, even though the actual annuity amount agreed to in the document must still be paid. Additionally, the illiquidity of the gift may force the charity to rely upon its general funds for payment of the annuity if the property cannot be sold in

a timely fashion or is not income-producing. Additionally, subsequent to the gift, the real estate could decrease in value. This would result in an annuity which, based on the sales price, is higher than the originally agreed to annuity rate. Nonetheless, a gift annuity can be a cost effective way for a charity to acquire property for use in the charity's exempt function.

(2) This is a taxable gift of a future interest. Accordingly, there is no annual gift tax exclusion available. The gift can be rendered incomplete by retaining the right for Fluffy to revoke Mitzi's interest. If Fluffy makes Mitzi the only beneficiary, then an immediate taxable gift has occurred and the annual exclusion is available. However, the gift cannot be rendered incomplete. *Donaldson outline, II. D. 1.–3.* Also, all gain attributable to the sale portion of the transaction (the annuity portion) is reportable immediately. *Donaldson outline, II. G. 5.*

(3) Installment bargain sale. Note that the property must be used by the charity in furtherance of its exempt function or else the note will constitute acquisition indebtedness producing unrelated debt-financed income (unrelated business income) from the property. *Donaldson outline, I. F. 3.*

STATE UNIVERSITY
Fact Situation Number Two
Bargain Sale Alternative

Assume property is sold by Fluffy to State University in a charitable bargain sale. The sales price is $569,284, all payable in an installment note payable monthly over 10 years, which approximates Fluffy's life expectancy. The monthly payments would be approximately $7,200 per month, which is comparable in amount to the alternative of the monthly gift annuity payment. Because this is a bargain sale, gain will be recognized on the sale because a proportionate basis allocation is required, using the following formula:

$$\frac{X}{\text{Basis in entire property}} = \frac{\text{Sales price in bargain sale transaction}}{\text{Total fair market value of property sold}}$$

$$X = \text{Basis allocable to sale portion of transaction}$$

In Fluffy's transcation:

$$\frac{X}{\$1{,}099{,}764} = \frac{\$\ 569{,}284}{\$1{,}200{,}000}$$

$$X = \$\ 521{,}732$$

Gain recognized over payment period of note:

\$ 569,284	Sales price
−521,732	Allocable basis
\$ 47,552	Gain recognized

Charitable deduction:

\$1,200,000	Fair market value
−569,284	Sales price
\$ 630,716	Charitable deduction

As a gift of appreciated property, the deduction is available to offset up to 30 percent of adjusted gross income with a five-year carryover of excess deduction. As an alternative, the Internal Revenue Code allows a donor to give up the appreciation element of the gift in computing the charitable deduction with the result that the remaining deduction is available to offset up to 50 percent of adjusted gross income. This is especially attractive when the gift has a high basis, as with Fluffy's building. The result in her case is as follows:

\$1,099,764	Basis in entire property
−521,732	Basis allocable to sales portion of transaction
\$ 578,032	Basis allocable to charitable deduction

\$ 630,716	Charitable deduction
−578,032	Basis allocable to charitable deduction
\$ 52,684	Reduction amount

\$ 630,716	Charitable deduction
−52,684	Reduction amount
\$ 578,032	Charitable deduction after reduction, now subject to the 50% of adjusted gross income percentage limitation.

Fact Situation Number Three:

Melissa ("Matchmaker-to-the-Stars") Matrimony, is a suddenly and recently retired owner of a computer dating service. Her last match (she was quoted at that time as saying, "This is a couple you won't believe") was Robin Givens and Mike Tyson. Ms. Matrimony is 60 years old, has a $2,500 per month pension and has an estate of approximately $1,000,000, much of which was inherited from her parents. The estate includes $750,000 in cash and securities and $250,000 in a small family farm. The farm has a basis of $50,000. She would like to give her entire estate to the local art museum. However, she needs a good income from her estate, and for sentimental reasons, would rather not pass the farm to the museum until her death. The museum's Development Director proposes a gift of a remainder interest in the farm. Melissa is interested, but wants some income from the farm. What might the development director propose?

Assume alternatively that Melissa is willing to give $250,000 in cash to the museum, and while she doesn't need income now from the $250,000, she does feel she will need income from the money later. What might work here?

Answers:

(1) A remainder interest gift of the farm can be combined with a gift annuity. The charitable deduction for the remainder interest gift of the farm is $63,773. This constitutes the amount which can fund a gift annuity. A charitable deduction of $29,296 results, and the annuity at the recommended rate of 7 percent is $4,464.

(2) A deferred gift annuity could be established with cash at the current age 60 with the commencement date being when the donor attains age 65. This increases the annuity from a gift of $250,000 in cash from $17,500 (7 percent) to $22,250 (8.9 percent). The charitable deduction is $158,815.

Fact Situation Number Four:

Mr. and Mrs. Hailon Wheels own a motorcycle dealership and supply company which they started from the ground up twenty years ago. From an original investment of $1,000, the company has grown in value to approximately $2,000,000 today. Mr. and Mrs. Wheels are devoted to motorcycling (their letterhead proclaims that they are "the official supplier to the United States Chapters of Hell's Angels"), but they also realize that motorcycling is a dangerous sport. Accordingly, they would like to make a substantial gift to the local hospital for supplementation of its emergency room. Mr. Wheels is 75 years old and his wife, "Foxy Momma" is 40. Mr. and Mrs. Wheels have shared this information with the development officer at the local hospital, and they have agreed to make a gift of $250,000 in publicly-traded securities with a basis of $100,000 to the hospital. If the stock is Mr. Wheel's separate property, what are the gift tax issues involved, and how will the appreciation in the gift of stock be treated for tax purposes? If the stock is jointly-owned or is community property, what are the gift tax issues and how will the appreciation be handled?

Answers:

(1) This gift is made from the separate property of Mr. Wheels. The survivorship annuity for Mrs. Wheels is a taxable gift not qualifying for QTIP/marital deduction treatment: the gift is not vested. So, to postpone the gift, the right to revoke Mrs. Wheels' interest must be retained by Mr. Wheels. The gain is reportable over Mr. Wheels' life expectancy of 25.6 years. The exclusion ratio continues for 42.6 years, the joint life expectancy of Mr. and Mrs. Wheels and is fully tax-free (no capital gain), after 25.6 years. The ordinary income element stays the same for the entire 42.6 years. After 42.6 years, the entire annuity becomes fully taxable. *Donaldson outline, II. D. 4. and 5.*

(2) Here, there are no taxable gift problems and the long-term capital gain reporting period and the exclusion ratio period are both 42.6 years. *Donaldson outline, II. D. 4. and 5.*

Fact Situation Number Five:

John "Cannonball" Donor owns a block of publicly-traded stock. He paid $20,000 for it, but it is now worth $100,000. His income is approximately $300,000. He made his fortune as a "human cannonball" with the circus. Mr. Donor has been considering making a gift of the block of stock to charity (to assist children of his colleagues who missed the net, among other worthy causes). However, his accountant tells Mr. Donor that his gift would subject him to the alternative minimum tax. The accountant notes Mr. Donor also has $30,000 of tax preference items in addition to any preference items resulting from the gifts. What alternatives are available to Mr. Donor to avoid the AMT?

"CANNONBALL" DONOR AND THE AMT

Code Sec. 57(a)(6), entitled "Appreciated Property Charitable Deduction," includes the appreciation element of a charitable deduction resulting from a gift of appreciated property to charity as an item of tax preference for purposes of the alternative minimum tax calculation found in Sec. 55. In some cases, a bargain sale to charity may provide the means of escape from the alternative minimum tax provision for gifts of appreciated property. For instance, assume that Mr. Donor makes his gift of $100,000 in stock to charity in 1988. The resulting tax consequences will be as follows:

1988 Regular Tax Calculation	
$ 300,000	Total income
–0–	Total adjustments
$ 300,000	Adjusted gross income
−90,000	Itemized deductions
−1,950	Personal exemption
$ 208,050	Taxable income
$ 58,800	Regular tax (after phase out of 15% bracket and personal exemption)

1988 AMT Calculation	
$ 208,050	Taxable income
+100,000	Tax preferences
$ 308,050	AMT income
$ 64,691	Alternative minimum tax

Actual tax due = $64,691 from alternative minimun tax calculation.

While Mr. Donor benefits from his gift to charity, the benefit is reduced because of the application of the alternative minimum tax. As an alternative, Mr. Donor might sell the stock to charity for $30,000 in a bargain sale transaction. This would reduce Mr. Donor's charitable deduction to $70,000, with the compensating cash payment of $30,000 being received in lieu of the additional deduction. This bargain sale will result in the alternative minimum tax being avoided. Considering the tax deduction available and the cash received, Mr. Donor is in rough equivalence, economically, with the result which would have been produced with an outright gift. The bargain sale transaction and the resulting tax computation are set out below:

1988 Regular Tax Calculation	
$ 324,000	Total income
–0–	Total adjustments
$ 324,000	Adjusted gross income
–70,000	Itemized deductions
–1,950	Personal exemption
$ 252,050	Taxable income
$ 71,120	Regular tax (after phase out of 15% bracket and personal exemption)

1988 AMT Calculation	
$ 252,050	Taxable income
86,000	Tax preferences
$ 338,050	AMT income
$ 70,991	Alternative minimum tax

Actual tax due = $71,120 from regular tax calculation.

Fact Situation Number Six:

"Buck" James, renowned surgeon and cowboy, has been told by his accountant that he has "topped out" in his contributions to his pension plan. Buck is interested in endowing trauma research at the teaching hospital with which he is associated, and ever more interested in finding a new form of tax-advantaged retirement planning. Buck is 50 years old. What advice might the hospital planned giving officer give to Buck?

TEACHING HOSPITAL
Deferred Gift Annuity Calculator
Summary of Benefits

Assumptions:

Buck James at age 50 purchases a deferred gift annuity with $10,000 payable at age 65 (15 years).

Each year thereafter, he purchases an additional deferred gift annuity with $10,000 payable at age 65.

Charitable Deductions:

1st year	$ 8,389
2nd year	8,268
3rd year	8,141
4th year	8,007
5th year	7,849
6th year	7,701
7th year	7,526
8th year	7,341
9th year	7,146
10th year	6,942
11th year	6,693
12th year	6,426
13th year	6,189
14th year	5,839
15th year	5,518
TOTAL	$ 107,975

Total Annuity Payable at Age 65:

Tax-free income	$ 2,091
Ordinary income	13,609
Annuity	$ 15,700

Annuity Rate on Amount Given: 10.46%

After 20.1 years from the year the payments begin, when the investment in contract has been fully recovered, the entire annuity becomes ordinary income.

NOTE: In all calculations, the new mortality experience, effective May 1, 1989, and the new discount rates (11.6 for May, 1989) are used.

Deferred gift annuities are calculated based on interest rate assumptions adopted by the 20th Conference on Gift Annuities.

WORKSHOP SESSION—POOLED INCOME FUND—BASIC

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I. INTRODUCTION

a. General Description of Pooled Income Funds

The pooled income fund is a trust, maintained by a charitable organization, which receives contributions of multiple donors. A pooled income fund must be established under the provisions of the Internal Revenue Code (IRC) in order to qualify to receive deductible contributions. However, it need not be a trust under state law in order to quality under the IRC.

The pooled income fund maintains an account for each contribution and units are assigned to each account to reflect the account's "ownership" in the fund. Based on the number of units, income is distributed to the income beneficiary or beneficiaries during lifetime. At the death of the last surviving income beneficiary, the shares in the account are severed from the fund and the proceeds are distributed to the charity.

Although separate accounts are maintained for each contribution, the assets of the fund are commingled and are invested together.

b. Pooled Income Fund vs. Charitable Remainder Trusts

There are a number of differences, as well as similarities, between the pooled income fund and charitable remainder trusts. The pooled income fund commingles the contributions of all donors in a single trust whereas an individual charitable remainder trust is maintained for each donor. The income payment to fund income beneficiaries is based upon the net investment earnings of the fund, whereas the income payments from charitable remainder trusts can be structured in a variety of ways which may depend only in part on earnings.

In many cases, donors with smaller contributions make use of a pooled income fund whereas donors with larger contributions or using certain types of property will utilize a charitable remainder trust. Charitable remainder trusts can provide for income interests measured by the life of the income beneficiary or for a term not to exceed 20 years, whereas the income interest from a pooled income fund must be measured by the life of the income beneficiary(ies).

Charitable remainder trusts and pooled income funds provide the donor with present income tax deductions for a portion of the value of the contribution, income to income beneficiaries, and a remainder gift to the designated charity.

c. Commingling of Funds

In order to qualify as a pooled income fund, the contributions of the various donors must be joined together (commingled) for both administrative and investment purposes. Although accounts are maintained for each donor/income beneficiary, no donor/income beneficiary owns any particular asset in the fund but rather owns a proportionate share in the entire fund.

II. QUALIFYING THE FUND

a. Governing Instrument

In order to qualify as a pooled income fund, the fund must have governing documents which comply with the requirements of Section 642(c)(5) of the Internal Revenue Code and the regulations promulgated thereunder. Funds generally have two documents, a "Declaration of Trust" which governs the operation and establishment of the fund, and an "Instrument of Transfer" by which assets are transferred to the fund.

Revenue Procedure 88-53, a copy of which is attached, provides certain guidance in drafting both the Declaration of Trust and the Instrument of Transfer. However, this Revenue Procedure contains only "bare-bones" provisions and in many cases may need to be supplemented to address the particular structure of the fund.

With the issuance of Rev. Proc. 88-53, it may no longer be necessary to apply for a private letter ruling requesting an initial determination that the fund qualifies as a pooled income fund. However, should the governing instruments contain ususual provisions, a private letter ruling may still be warranted.

Following the establishment of the fund, the fund must be maintained according to the requirements of Section 642(c)(5) in order to retain its qualification.

b. Maintained by a Public Charity

In order to qualify, the charity designated as the remainder beneficiary must maintain the fund. Furthermore, the charity must be a "public" charity rather than a private foundation. Although the charity need not serve as the trustee, it must retain the power to remove the trustee.

A pooled income fund can be maintained by a national organization for the benefit of its local affiliates. Thus, contributions can be made into a single, national fund and managed in that fund until the donor's interest is severed and distributed to the designated local affiliate of the national organization.

c. Trustee

Any person having trust powers (individual, bank, corporation, or the charity maintaining the fund) under local law may be named the trustee of the fund. However, donors or income beneficiaries of the fund cannot serve as trustees and the governing instrument must contain this prohibition. The definition of "trustee" has been rather broadly construed, and as a result the retention of certain powers by a charity's board of directors (although not serving as the trustee) may cause the board to be deemed the trustee. As a result, many charities have delegated the responsibility for the pooled income fund to a small committee of the board so that the entire board is not disqualified from being a donor or income beneficiary.

III. INCOME INTEREST

a. Income Beneficiary

May be one or more persons living at the time property is transferred to the pooled income fund. They may receive the life income jointly, consecutively or both. While the charitable remainderman can be designated to receive part of the income this will not usually be the <u>best</u> taxwise. The principal amount needed to fund the income should be donated outright to receive an income tax charitable contribution.

b. Term of Income Interest

Must be for the life of the beneficiary or beneficiaries. It cannot be for a term of years or for the life of someone other than a beneficiary.

c. Determination dates (valuation dates)

A determination date is the time when the property's valuation in the fund is determined. The fund must be valued on the first day of its tax year. In addition the fund must be valued no less frequently than every three months. Thus a full tax year would have a minimum of four determination dates.

d. Transfers to Fund Between Determination Dates

The number of the units to be credited to the donor may be determined by taking the average of the FMV of the funds assets on the determination dates immediately before and after the transfer to the fund excluding all property donated between these two determination dates. While this as well as other approved reasonable methods may be used, the original declaration of trust when the fund is created should clarify the method to be followed.

e. Assignments of Units in the Fund

A donor's number of units is determined by the proportion of the FMV of the property donated to the total value of the fund when the gift is made. Example: It may be arbitrarily stipulated at the formation of the fund that everyone who donates $100.00 will receive one unit. There is a total of $100,000 donated making a total of 1000 units. At the end of the year there are no additional contributions and the fund is valued at $110,000. Thus at that determination date each unit is worth and must be purchased at $110.00 per unit.

f. Allocating and Distributing Income from the Fund

As mentioned above the number of units assigned for income purposes is the proportionate value of the property donated to the fund. The formula for this can be stated:

$$\text{Number of Units of beneficiaries income} = \frac{\text{FMV of Property Transferred}}{\text{FMV of a Fund Unit}}$$

To determine the value of a fund unit the following formula may be used:

$$\text{Value of a Fund Unit} = \frac{\text{FMV of Fund Assets}}{\text{Total Number of Units}}$$

A summary sheet of distributions made to income beneficiaries on the determination date of December 31, 1988 could look like this:

Income Fund
Distribution & Unit Report
December 31, 1988
Unit Value = $107.3961

Name	Transaction	Amount	Previous Unit Balance	Units Credited and Distributed	Present Unit Held
John Smith	Income	1,029.00	436.89	+9.58	
	Distribution	1,029.00		−9.58	436.89
Eve Adams	Income	627.51	266.64	+5.84	272.48
Bob Edwards	Income	2,622.67	1,113.28	+24.42	
	Distribution	2,622.67		−24.42	1,113.28

g. Termination of Income Interest

The income interest must either terminate at the last payment before the beneficiary's death or be prorated to the date of the death of the beneficiary. The governing instrument must state which method is to be used.

IV. CONTRIBUTION DEDUCTION TO DONOR

a. Rate of Return of the Fund

Since the charitable deduction is based on what is left after the income interest, the rate of return influences the value of the charitable deduction. Any new fund is presumed to have a 9% rate. As of this date, it is still uncertain how, if at all, the new appropriate monthly federal interest rates will affect this. Otherwise, the highest yearly rate of return in the previous three tax years is used. To determine this the following steps are used:

(i) The average FMV of the property in the fund must be found. This is done by adding all the valuations during the year on the determination dates and dividing by the number of dates.

EXAMPLE:

	FMV of Property
January 1	$2,000,000
April 1	2,200,000
July 1	2,100,000
October 1	2,300,000
Total	$8,600,000

8,600,000 divided by 4 = 2,150,000 or Average FMV

(ii) Then there must be a corrective term adjustment. Without going into detail this is an adjustment for when the income is received. The following is an example of income being received on the following dates:

Determination date	Percent	Income Received		
January 1	(100% x)	$50,000	=	$50,000
April 1	(75% x)	60,000	=	45,000
July 1	(50% x)	45,000	=	22,500
October 1	(25% x)	45,000	=	11,250
		$200,000		$128,750

Yearly rate of return =

$$\frac{\text{Fund Income (200,000)}}{\text{Average FMV (2,150,000) minus 128,750 corrective term adjustment}}$$

The rate of the fund = .0989 or 9.89%

b. Present Value of Remainder Interest of the Charitable Deduction.

The actual rate of return for the pooled fund is calculated as above and the highest return for the three previous years taken. The charitable remainder interest is calculated by correlating the highest rate of return with the appropriate age or ages and factors found in Table G of IRS Regulations under Section 642 or for two-life IRS publication 723D(9-84). *Actuarial Values I: Valuation of Last Survivor Charitable Remainders, Part D, Two-Life Last to Die Pooled Income Fund Factors*. This publication may be obtained from: Superintendent of Documents, U.S. Government Printing Office, Washington D.C. 20402. It is anticipated that these actuarial tables will be updated this year.

EXAMPLE:

Taking 9.89% as the highest rate of return and correlating this with the valuation found in 723D(9-84) for two persons with ages of 78 and 69.

Table E(2)—Part 4

		Yearly Rate of Return									
O	Y	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10%
78	69	.36437	.35684	.34951	.34239	.33546	.32873	.32217	.31580	.30959	.30356

We must make an adjustment for 9.89% falling between 9.8% and 10%. This is done as follows:

Factor at 9.8%	=	.30959
Factor at 10.0%	=	.30356
Difference		.00603

Interpolation adjustment:

$$\frac{9.89\% - 9.8\%}{.2} = \frac{x}{.00603}$$

$.2x = .00603 \times (9.89\% - 9.8\%)$
$.2x = .00603 \times .09$
$.2x = .0005427$
$x = .0027135$

Factor at 9.8% for 78 & 69	.3095900
less: Interpolation adjustment	.0027135
Interpolated factor	.3068765

Present value of remainder interest on a $100,000 donation to fund = ($100,000 x .3068765) or $30,687.65.

V. CERTAIN REQUIREMENTS

a. The remainder beneficiary's interest at the death of the income beneficiaries.

An amount equal to the value of the property upon which the income interest was based must be severed and paid to the charitable remainderman or set aside for its use. The governing instrument should set forth the proper method chosen, and clearly stated the value would either be as of the determination date immediately before or after the last regular payment before the death of the income beneficiary.

b. Fiscal Year

The Tax Reform Act of 1986 dictates all Pooled Income Funds to adopt a calendar year as their tax year. Thus the year the fund begins may be a short year for tax purposes.

c. Prohibitions as to Investment

Cannot invest in tax exempt securities. Capital gains cannot be distributed as income but must be kept in the fund for the charitable purpose.

VI. OTHER TAX CONSIDERATIONS FOR THE DONOR

a. Gift Tax Consequences upon Making Gift

If the donor is the sole income beneficiary, there is no gift tax due because the value of the remainder interest qualifies for the gift tax deduction. If the donor provides for succeeding income beneficiaries and the donor does not reserve the right by will to terminate the income interest, a present gift tax will be due for the value of the future income interest. It is not clear if the donor can reserve the right to terminate an income interest if he/she is not also an income beneficiary, although Rev. Proc. 88-53 would appear to give that right.

If the donor provides for her/his spouse as an income beneficiary, and there are no income beneficiaries other than the donor and spouse, the gift qualifies for the gift tax marital deduction.

b. Using Appreciated Property to Make the Gift

Under most circumstances, the donor will not be taxed upon the capital gain inherent in appreciated property used to make a gift into the pooled income fund. However, the use of such property to make a charitable gift is considered to be a tax preference item subject to the Alternative Minimum Tax.

c. Estate Tax Consequences

If the donor is the sole or surviving income beneficiary, the value of her/his interest in the pooled income fund is included in the value of her/his estate. However, the entire amount may be then deducted as an estate tax charitable contribution deduction.

If the donor/income beneficiary predeceases a successor income beneficiary, the value of the donor's interest in the pooled income fund is included in his/her estate. However, the estate is entitled to an estate tax contribution deduction for the value of the remainder interest passing to charity calculated as of the date of death of the donor (or the alternate valuation date). If the donor has revoked the succeeding interest by will, then the estate is entitled to a contribution deduction for the entire value of the interest in the pooled income fund.

If the succeeding income beneficiary is the donor's spouse, the income interest can qualify for the estate tax marital deduction. Regardless of income beneficiary, attention must also be paid to gift taxes paid within the three years preceding the date of death of the donor.

VII. INCOME TAX CONSEQUENCES

a. Taxation of the Pooled Income Fund

Pooled income funds are taxed as complex trusts. However, in most cases pooled income funds do not pay tax because of deductions to the fund for (1) amounts required to be distributed annually to the income beneficiaries, and (2) amounts permanently set aside for charity. The fund can keep without tax all long term gains; however, short term gains will be taxed to the fund.

b. Character of Income in the Hands of the Income Beneficiary

Income beneficiaries are taxed on their proportionate share of the earnings of the fund. The income retains the same character in the hands of the income beneficiary as in the fund.

VIII. SECURITIES IMPLICATIONS

a. SEC Position

The Securities and Exchange Commission has taken the position that pooled income funds need not register with the SEC as long as the charity maintaining the fund abides by the following conditions:

1. The fund must qualify as a beneficiary of tax-deductible contributions under Section 642(c)(5) of the Internal Revenue Code;
2. Each prospective donor must receive a written disclosure that fully and fairly describes the fund's operation; and
3. All solicitation is done by volunteers or persons employed by the charity in its overall fundraising. The compensation of solicitors cannot be in the form of commissions or any other type of payment that is based on the amount of contributions transferred to the fund.

b. Disclosure statement

The disclosure statement must clearly describe the operation of the fund; the irrevocable nature of the contribution; the tax consequences of the contribution; the relationship among the parties (donor, charity and trustee); and information concerning the fund's earnings and activity during the preceding three years. The disclosure statement should be revised annually.

c. State Securities Implications

Many states have adopted the Uniform Securities Act, which contains a provision which exempts from registration funds issued by persons defined as being "not for private profit." However, it may be that broker-dealer or agent registration will apply. In any event, local counsel should be consulted with regard to the applicability of local law.

SOURCES*

Internal Revenue Code, Section 642(c)(5) (Lastest Manual) *Planned Giving Course,* PHILANTHROPY TAX INSTITUTE, 13 Arcadia Road, Old Greenwich, Connecticut 06870

Tax Economics of Charitable Giving, Arthur Andersen & Co., 69 West Washington Street, Chicago, Illinois 60602

Charitable Giving and Solicitation, Stern, Sullivan and Schumachor, Prentice-Hall, Englewood Cliffs, New Jersey 07632

*These are only a sample of good material explaining the "Pooled Income Fund"

REVENUE PROCEDURE 88-53

SECTION 1. PURPOSE

This revenue procedure makes available a sample form of declaration of trust and instruments of transfer that meet the requirements for a pooled income fund as described in section 642(c)(5) of the Internal Revenue Code.

SEC. 2. BACKGROUND

The Internal Revenue Service receives and responds to many requests for rulings dealing with the qualification of trusts as pooled income funds and the availability of deductions for contributions made to such trusts. In many of these requests, the trust instruments and charitable objectives are very similar. Consequently, in order to provide a service to taxpayers and to save the time and expense involved in requesting and processing a ruling on a proposed pooled income fund, taxpayers who make transfers to a trust that substantially follows the model trust instrument contained herein can be assured that the Service will recognize the trust as meeting all of the requirements of a qualified pooled income fund, provided the trust operates in a manner consistent with the terms of the trust instrument and provided it is a valid trust under applicable local law.

SEC. 3. SCOPE AND OBJECTIVE

The sample declaration of trust and instruments of transfer made available by this revenue procedure meet all of the applicable requirements for a pooled income fund under section 642(c)(5) of the Code, if the trust document also creates a valid trust under local law. If the public charity responsible for the creation and maintenance of a pooled income fund makes reference in the trust instrument of the fund to this revenue procedure, and adopts substantially similar documents, the Service will recognize the trust documents as satisfying all of the applicable requirements of section 642(c)(5) of the Code and the corresponding regulations. Moreover, for transfers to a qualifying pooled income fund, the remainder interest will be deductible under sections 170(f)(2)(A), 2055(e)(2)(A), and 2522(c)(2)(A) of the Code for income, estate, and gift tax purposes, respectively. Therefore, it will not be necessary for a taxpayer to request a ruling as to the qualification of a substantially similar trust, and the Service generally will not issue such a ruling. See Rev. Proc. 88-54, page 16, this bulletin.

SEC. 4. SAMPLE DECLARATION OF TRUST

On this __________ day of ______________________________, 19____, the Board of Trustees of ______________________________ Public Charity (hereinafter referred to as "Public Charity") desiring to establish a pooled income fund within the meaning of Rev. Proc. 88-53 and section 642(c)(5) of the Internal Revenue Code (hereinafter referred to as "the Code"), hereby creates the ______________________________ Public Charity Pooled Income Fund (hereinafter referred to as "the Fund") and designates ______________________________ as the initial trustee to hold, manage, and distribute such property hereinafter transferred to and accepted by it as a part of the Fund under the following terms and conditions.

1. *Gift of Remainder Interest.* Each donor transferring property to the Fund shall contribute an irrevocable remainder interest in such property to Public Charity.

2. *Retention of Life Income Interest.* Each donor transferring property to the Fund shall retain for himself or herself an income interest in the property transferred, or create an income interest in such property for the life of one or more named beneficiaries, provided that each income beneficiary must be a living person at the time of the transfer of property to the Fund by the donor. If more than one beneficiary of the income interest is named, such

beneficiaries may enjoy their shares concurrently and/or consecutively. Public Charity may also be designated as one of the beneficiaries of the income interest. The donor need not retain or create a life interest in all of the income from the property transferred to the Fund and any income not payable to an income beneficiary shall be contributed to, and within the taxable year of the Fund in which it is received paid to, Public Charity.

3. *Commingling of Property.* The property transferred to the Fund by each donor shall be commingled with, and invested or reinvested with, other property transferred to the Fund by other donors satisfying the requirements of this instrument and of section 642(c)(5) of the Code or corresponding provision of any subsequent federal tax law. The Fund shall not include property transferred under arrangements other than those specified in this instrument and satisfying the said provisions of the Code.

All or any portion of the assets of the Fund may, however, be invested or reinvested jointly with other properties not a part of the Fund that are held by, or for the use of, Public Charity. When joint investment or reinvestment occurs, detailed accounting records shall be maintained by the Trustee specifically identifying the portion of the jointly invested property owned by the Fund and the income earned by, and attributable to such portion.

4. *Prohibition Against Exempt Securities.* The property transferred to the Fund by any donor shall not include any securities whose income is exempt from taxation under subtitle A of the Code or the corresponding provisions of any subsequent federal tax law. The Trustee of the Fund shall not accept or invest in such securities as part of the assets of the Fund.

5. *Maintenance by Public Charity.* Public Charity shall always maintain the Fund or exercise control, directly or indirectly, over the Fund. Public Charity shall always have the power to remove any Trustee or Trustees and to designate a new Trustee or Trustees.

6. *Prohibition Against Donor or Beneficiary Serving as Trustee.* The Fund shall not have as a Trustee a donor to the Fund or a beneficiary (other than Public Charity) of an income interest in any property transferred to the Fund. No donor or beneficiary (other than Public Charity) shall have, directly or indirectly, general responsibilities with respect to the Fund that are ordinarily exercised by a Trustee.

7. *Income of Beneficiary to Be Based on Rate of Return of Fund.* The taxable year of the Fund shall be the calendar year. The

Trustee shall pay income to each beneficiary entitled thereto in any taxable year of the Fund in the amount determined by the rate of return earned by the Fund for the year with respect to the beneficiary's income interest. Payments must be made at least once in the year in which the income is earned. Until the Trustee determines that payments shall be made more or less frequently or at other times, the Trustee shall make income payments to the beneficiary or beneficiaries entitled to them in four quarterly payments on or about March 31, June 30, September 30, and December 31 of each year. An adjusting payment, if necessary, will be made during the taxable year or within the first 65 days following its close to bring the total payment to the actual income to which the beneficiary or beneficiaries are entitled for that year.

On each transfer of property by a donor to the Fund, there shall be assigned to the beneficiary or beneficiaries of the income interest retained or created in the property the number of units of participation equal to the number obtained by dividing the fair market value of the property transferred by the fair market value of a unit in the Fund immediately before the transfer. The fair market value of a unit in the Fund immediately before the transfer shall be determined by dividing the fair market value of all property in the Fund at the time by the number of units then in the Fund. The initial fair market value of a unit in the Fund shall be the fair market value of the property transferred to the Fund divided by the number of units assigned to the beneficiaries of the income interest in that property. All units in the Fund shall always have equal value.

If a transfer of property to the Fund by a donor occurs on other than a determination date, the number of units of participation assigned to the beneficiary or beneficiaries of the income interest in the property shall be determined by using the average fair market value of the property in the Fund immediately before the transfer, which shall be deemed to be the average of the fair market values of the property in the Fund on the determination dates immediately preceding and succeeding the date of transfer. For the purpose of determining the average fair market value, the property transferred by the donor and any other property transferred to the Fund between the preceding and succeeding dates, or on such succeeding date, shall be excluded. The fair market value of a unit in the Fund immediately before the transfer shall be determined by dividing the average fair market value of the property in the Fund at that time by the number of units then in the Fund. Units of participation assigned with respect to property transferred on other than a determination date shall be deemed to be assigned as of the date of the transfer.

A determination date means each day within a taxable year of the Fund on which a valuation is made of the property in the Fund. The property of the Fund shall be valued on January 1, April 1, July 1, and October 1 of each year; provided, however, that where such date falls on a Saturday, Sunday or legal holiday (as defined in section 7503 of the Code and the regulations thereunder), the valuation shall be made on the next succeeding day which is not a Saturday, Sunday or legal holiday.

The amount of income allocated to each unit of participation in the Fund shall be determined by dividing the income of the Fund for the taxable year by the outstanding number of units in the Fund at the end of the year, except that income shall be allocated to units outstanding during only part of the year by taking into consideration the period of time the units are outstanding during the year.

For purposes of this instrument, the term "income" has the same meaning as it does under section 643(b) of the Code or corresponding provision of any subsequent federal tax law and the regulations thereunder.

The income interest of any beneficiary of the Fund shall terminate with the last regular payment of income that was made before the death of the beneficiary. The Trustee of the Fund shall not be required to prorate any income payment to the date of the beneficiary's death.

8. *Termination of Life Income Interest.* Upon the termination of the income interest of the designated beneficiary (or, in the case of successive income interests, the survivor of the designated beneficiaries) entitled to receive income pursuant to the terms of a transfer to the Fund, the Trustee shall sever from the Fund an amount equal to the value of the remainder interest in the property upon which the income interest is based. The value of the remainder interest for severance purposes shall be its value as of the date on which the last regular payment was made before the death of the beneficiary. The amount so severed from the Fund shall be paid to Public Charity. If at the time of severance of the remainder interest Public Charity has ceased to exist or is not a

public charity (an organization described in clauses (i) through (vi) of section 170(b)(1)(A) of the Code), the amount severed shall be paid to an organization selected by the Trustee that is a public charity.

9. *Prohibited Activities.* The income of the Fund for each taxable year shall be distributed at such time and in such manner as not to subject the Fund to tax under section 4942 of the Code. Except for making the required payments to the life income beneficiaries, the Trustee shall not engage in any act of self-dealing as defined in section 4941(d) and shall not make any taxable expenditures as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Fund within the meaning of section 4944 or retain any excess business holdings within the meaning of section 4943.

10. *Depreciable or Depletable Assets.* The Trustee shall not accept or invest in any depreciable or depletable assets.

11. *Incorporation by Reference.* The provisions of this document may be, and are intended to be, incorporated by reference in any will, trust, or other instrument by means of which property is transferred to the Fund. Any property transferred to the Fund whereby an income interest is retained or created for the life of one or more named beneficiaries, where this document is not incorporated by reference, shall become a part of the Fund and shall be held and managed under the terms and conditions of this document, unless the instrument of transfer is inconsistent with such terms and conditions, in which case the Trustee shall not accept the property.

12. *Governing Law.* The operation of the Fund shall be governed by the laws of the State of ______________________________. However, the Trustee is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Fund under section 642(c)(5) of the Code and the corresponding regulations.

13. *Power of Amendment.* The Fund is irrevocable. However, Public Charity shall have the power, acting alone, to amend this document and the associated instruments of transfer in any manner required for the sole purpose of ensuring that the fund qualifies and continues to qualify as a pooled income fund within the meaning of section 642(c)(5).

IN WITNESS WHEREOF ________ [PUBLIC CHARITY] and ______________________________ [TRUSTEE] by their duly authorized officers have signed this agreement the day and year first above written.

____
[PUBLIC CHARITY]

By ____________________________

____
[TRUSTEE]

By ____________________________
[Acknowledgements, Witnesses, etc.]

SEC. 5. SAMPLE INSTRUMENT OF TRANSFER: ONE LIFE

On this __________ day of ______________________________, 19___, I hereby transfer to the ______________________________ Public Charity Pooled Income Fund, under the terms and conditions set forth in its Declaration of Trust, the following property: ____________.

The income interest attributed to the property transferred shall be paid as follows:

_______A. To me during my lifetime.

_______B. To ______________________________ during his or her life. However, I reserve the right to revoke, solely by will, this income interest.

Upon the termination of the income interest, the Trustee of the Fund will sever from the Fund an amount equal to the value of the remainder interest in the transferred property and transfer it to Public Charity:

_______A. For its general uses and purposes.

_______B. For the following charitable purpose(s): __________.

However, if it is not possible for Public Charity in its sole discretion to use the severed amount for the specified purpose(s), then it may be used for the general purposes of Public Charity.

This instrument and the transfer of property made pursuant thereto shall be effective after acceptance by both the Donor and the Trustee.

IN WITNESS WHEREOF ______________________ and ______________________ [TRUSTEE] by its duly authorized officer have signed this agreement the day and year first above written.

____
[DONOR]

____
[TRUSTEE]

By ______________________
[Acknowledgements, Witnesses, etc.]

SEC. 6. SAMPLE INSTRUMENT OF TRANSFER: TWO LIVES, CONSECUTIVE INTERESTS

On this ________ day of ______________________, 19____, I hereby transfer to the ______________________ Public Charity Pooled Income Fund, under the terms and conditions set forth in its Declaration of Trust, the following property: ______________________

The income interest attributable to the property transferred shall be paid as follows:

______A. To me during my lifetime, and after my death to ____________ during his or her lifetime. However, I reserve the right to revoke, solely by will, his or her income interest.

______B. To ____________ during his or her lifetime, and after his or her death, to ____________ during his or her lifetime. However, I reserve the right to revoke, solely by will, the income interest of either or both beneficiaries. Upon the termination of the income interest, the Trustee of the Fund will sever from the Fund an amount equal to the value of the remainder interest in the transferred property and transfer it to Public Charity.

Upon the termination of the income interest, the Trustee of the Fund will sever from the Fund an amount equal to the value of the remainder interest in the transferred property and transfer it to Public Charity:

______A. For its general uses and purposes.

______B. For the following charitable purpose(s): ________.

However, if it is not possible for Public Charity in its sole discretion to use the severed amount for the specified purpose(s), then it may be used for the general purposes of Public Charity.

This instrument and the transfer of property made pursuant thereto shall be effective after acceptance by both the Donor and the Trustee.

IN WITNESS WHEREOF ________________________ and ______________________ [TRUSTEE] by its duly authorized officer have signed this agreement the day and year first above written.

____
[DONOR]

____
[TRUSTEE]

By ____________________________
[Acknowledgements, Witnesses, etc.]

SEC. 7. SAMPLE INSTRUMENT OF TRANSFER: TWO LIVES, CONCURRENT AND CONSECUTIVE INTERESTS

On this ________ day of ______________________, 19___, I hereby transfer to the ______________________________ Public Charity Pooled Income Fund, under the terms and conditions set forth in its Declaration of Trust, the following property: ____.

The income interest attributable to the property transferred shall be paid as follows:

______A. ______% to me during my lifetime, and ______% to ______________________________ ________________ during his or her lifetime. After the death of the first income beneficiary to die, the survivor shall be entitled to the entire income. However, I reserve the right to revoke, solely by will, ______________________'s income interest.

______B. ______% to ______________________________ during his or her lifetime and ______% to ______________________ during his or her lifetime. Upon the death of the first income beneficiary to die, the survivor shall be entitled to receive the entire income. However, I reserve the right to revoke, solely by will, the income interest of either or both beneficiaries.

Upon the termination of the income interest, the Trustee of the Fund will sever from the Fund an amount equal to the value of the remainder interest in the transferred property and transfer it to Public Charity:

______A. For its general uses and purposes.
______B. For the following charitable purpose(s): ________.

However, if it is not possible for Public Charity in its sole discretion to use the severed amount for the specified purpose(s), then it may be used for the general purposes of Public Charity.

This instrument and the transfer of property made pursuant thereto shall be effective after acceptance by both the Donor and Trustee.

IN WITNESS WHEREOF ____________________ and ____________________ [TRUSTEE] by its duly authorized officer have signed this agreement the day and year first above written.

____
[DONOR]

____
[TRUSTEE]

By ____________________
[Acknowledgements, Witnesses, etc.]

SEC. 8. APPLICATION

The Service will recognize a trust as meeting all of the requirements of a qualified pooled income fund under section 642(c)(5) of the Code if the public charity responsible for the creation and maintenance of the trust makes reference in the trust instrument of the fund to this revenue procedure and adopts substantially similar documents, provided the trust operates in a manner consistent with the terms of the trust instrument, and provided it is a valid trust under applicable local law. A trust that contains substantive provisions in addition to those provided by this revenue procedure (other than provisions necessary to establish a valid trust under applicable local law) or that omits any of those provisions will not necessarily be disqualified, but neither will it qualify under the provisions of this revenue procedure.

SEC. 9. EFFECTIVE DATE

This revenue procedure is effective for ruling requests received in the National Office after November 28, 1988, the date of publication of this revenue procedure in the International Revenue Bulletin.

DRAFTING INFORMATION

The principal author of this revenue procedure is John McQuillan of the Office of Passthroughs and Special Industries. For further information regarding this revenue procedure, contact John McQuillan on (202) 535-9540 (not a toll-free call).

Rev. Proc. 88-53, 48 IRB 13

WORKSHOP SESSION–POOLED INCOME FUND–ADVANCED

Mr. James B. Potter
Director of Planned Giving
American Lung Association

This workshop will address real problems with hands on, real life solutions that I have experienced or have seen over several years of administering several pooled income funds, both large and small, old and new. As we all know, we learn from our mistakes better than from our successes. I hope the subjects I address here will help you in not having to learn some of these lessons as I did, namely the hard way.

For openers, be sure you get a copy of the Committee on Gift Annuities' Red Book, that helps one understand how to compute the charitable deductions for gifts to a pooled income fund. Also, I recommend you subscribe to one of the many tax services on planned giving, so you can stay current with changes in the laws and regulations on these funds. Then, because the deductions your donors can claim for pooled income fund gifts now change monthly due to the use of the new Applicable Federal Rate (AFR) interest (120% of the annual mid-term) rate, you will want to become familiar with the several computer programs now available to help you do these computations. See Exhibit C for a list of these vendors. Prices vary widely, so check out several of them to be sure you get one that meets your needs. All do the simple computations. Some provide a wide array of other computations and illustrations, including charts and graphs.

Different ways to Administer Pooled Income Funds

1. The charity can be the trustee. A Pooled Income Fund is unique, with all kinds of special rules and regulations. It is not a simple endowment fund. The average business office of a charitable institution should not try to administer the pooled income fund by itself. The pitfalls are legion and normally, that is asking for trouble. Key to this decision is to realize that if your Fund is found to be invalid by the IRS at some later date, all past gifts to the Fund are invalid and the tax deductions claimed by those donors are invalid as well. Imagine the negative public relations to your organization that would result by having to tell all past donors to refile their tax return for the year(s) of their gift(s), removing their tax deduction, and paying back interest and penalties. Since the chances are remote that you will be able to

correct the error in the Fund retroactively, the risk is not worth taking.

2. The charity still maintains control of the Fund if it employs a bank as trustee or if it wants to be the legal trustee, employ the bank as custodian of the assets and administrator of the Fund. The charity should get away from the day to day administrative paperwork and concentrate on donor relations and contact. Use a bank for what it does best, handling tax returns, collecting, computing and distributing income, and the like.

Do not become the bank's first Pooled Income Fund client. Seek out banks with proven long term track records. They do not have to be geographically close to you. They can be a continent away without any problem. Exhibit D lists those banks and other professional organizations that I have used or known about for many years and can recommend to you. I know of others but they are not on the list because I cannot presently recommend them. The list is a good one, but not all inclusive by any means. Check out every organization on the list and measure them against others you may wish to consider. You will find that their methods for setting fees are not uniform, so run several "what if" situations of different size funds, number of gifts annually and the like, using each one's fee schedule, to help determine what it will actually cost to use them.

3. Your organization may be related to or a part of a national organization, like a church denomination or group of colleges or secondary schools, etc. that could use the pooled income fund of the umbrella organization. Be careful here, for the issue of control of your charity by the umbrella organization is important. Have your legal counsel give an opinion here. Technically, the organization that controls the Fund must control the remainderman, the organization that benefits from the gift. Again, be conservative in such decisions. You do not want to find out that you are part of an invalid pooled income fund because one or more charitable beneficiaries do not qualify as appropriate remaindermen. There is very limited case law on this issue, but there is a difference between a remainderman that is related to the organization controlling the fund and one that is controlled by it.

Some of the tests on related vs. controlled revolve around whether or not your organization's board is approved by the organization controlling the Fund and what happens to the assets of your charity if you close your doors. If the assets revert to the organization running the Fund, this is one proof that your organization is controlled by the one running the pooled income fund. Again, have legal counsel review this issue in light of the regulations.

Starting a Fund

Despite what some bank trustees suggest, start your fund with two gifts on the same day. A pooled income fund is a fund that commingles gifts from multiple donors. It could be separate participations from a married couple, as long as each makes a separate gift, receiving income on their gift first and each naming the spouse as second income beneficiary.

Or, get a supporter of your organization to agree to make a gift on the same day you find your first donor. Have that supporter give you an undated check or promise to mail their gift on the same day you obtain the first one. In any event, get two gifts on the same day to initially fund your pooled income fund. Don't listen to banks that tell you to ignore this point. What happens if you close your trust year and you only have your first gift? Do you have a bonafide pooled income fund? Raising such questions is just asking for an IRS audit. I would not want that question to come up in the minds of the IRS. You don't want them to tell you that you have an invalid fund and that all past donors had made gifts that did not qualify for a tax deduction.

Valuation Date problems

Become familiar with the rules and make sure your organization and your Fund's trustee follows them. Even experienced banks make errors. A case in point. We established a pooled income fund with one bank, that used the last day of the quarterly months, March, June, September and December (MJSD-31) as the income payout dates, with a June 30 trust year ending date. The fund's administration plan called for quarterly income payments as of those dates. We changed trustees to a bank that used the last day of February, May, August and November (FMAN-31) as their payout dates with a May 31 trust year ending date.

Since the regulations require the trustee to distribute all net income within 65 days of the end of the trust year, I questioned the second bank about holding the June income until the end of August, thereby missing the 65 day deadline rule. After months of being told their counsel had reviewed it and it was acceptable, and that the trust officer had ten years' experience and I should trust them, I demanded an opinion in writing. Some five months later, I was told that after further review, I was right, the fund was not meeting the 65 day requirement and a separate distribution was made each June to meet the rules, until later regulations made all funds conform to a December 31 trust year ending date. Moral: Learn the rules yourself and question, question, question.

Another example: I was involved with a fund that qualified as a pre-existing pooled income fund back in the days of the Tax Reform Act of 1969 that created this gift vehicle. We created our pooled income fund by identifying those participations in our Regular Life Income Fund that qualified as pooled income fund participations and overnight we had a pre-exisiting pooled income fund. We distributed income as of the last day of the quarterly months (MJSD-31). Our valuation dates were the same as the income distribution dates.

Many months later we attempted to get an IRS letter qualifying our Pooled Income Fund. We were told our fund was invalid because we did not use January 1 as the first valuation date for the year. Our counsel even traveled to Washington to argue the point, stating that the market was not open on January 1, so we used December 31 instead.

We were refused because the rules state you must go forward not back to establish valuation dates. We had an invalid fund. We added a fifth valuation date (January 1) but that "extra" valuation cost us $500 in expenses, which did not please our Board. We ended up changing the valuation dates to JAJO-01 while retaining the payment dates of MJSD-31. Problem solved. Since that was in the early days of pooled income funds, we were permitted to change our Administration Plan to qualify the Fund prior to getting our Private Letter Ruling. Recently, the IRS ruled they would no longer provide separate letters for each fund.

My first experience in starting a new pooled income fund was a nightmare. We received several small gifts of from $1,000 to $5,000 each in the first quarter of the fund. Toward the end of that first quarter we received a gift of highly appreciated stock worth $100,000, more than all the other gifts to date. The stock gift was admitted to the fund on the gift date, as it should have been, but it was mailed to us and many days were lost in transit and getting it sold. The sale price and resulting proceeds were about ten percent less than the fair market value and no income was earned on the gift value until it was reinvested close to end of the quarter.

We started our fund at an arbitrary $10.00 per unit with the first gift. At the end of first quarter, the unit value was $8.95 and much of the income earned by the other gifts was assigned to the large gift. When I reviewed the proposed income distribution, I felt faint. In talking with the bank trustee, I was advised that nothing could be done since our plan did not allow for valuation dates other than the four per year specified in the plan. Our plan had been drafted by a very prestigious law firm at a high fee. The regulations provide a way to resolve the problem, but the Plan must allow the Fund to be valued on any day the trustee wishes.

By adding additional wording to our Administration Plan, we were able to fairly distribute the income to the earlier gifts and not have to give it away to the larger gift that came in late in the quarter without earning its own share of income for the Fund. Besides the stipulated quarterly valuation dates, we added the words ". . . and the Fund may be valued on any other day in any taxable year, including but not limited to, any day in which a transfer is made by a donor to the Fund. Income may also be distributed on additional dates as determined by the trustee." The addition of those words to your new fund's Administration Plan will help you in the unlikely event that you get a very large gift compared to the total value of your fund and that large gift does not earn its fair share of the fund's income immediately after its admission to your fund.

Terminating Income Interests

There is much confusion in this area. It is my feeling that many funds compute the terminating interests incorrectly. Several Private Letter Rulings have been superceded by a Revenue Ruling, but it is not clear how many funds may still be doing it wrong.

Two methods are acceptable, but your Plan must spell out which you use. The income interest could terminate with the date of death or the last regular quarterly payment before the date of death. The latter method is easier to administer. That just means that the right to income ends on that date. It has nothing to do with the removal of the remainder value from the Fund.

One removes the units from the Fund on the Fund's valuation date immediately following the termination of the income interest. If you do not learn of the death for some time, you remove the funds on the next valuation date following your learning of the death, but at the unit value of the valuation date immediately following the termination of the income interest, not at the unit value on the date you remove the principal. Any income earned on the units in the fund until their removal are payable to the remainderman. You will want to review Revenue Ruling 76-196 and be guided by the examples given.

Types of Gifts to a Pooled Income Fund

From the viewpoint of the donor, the best gift is appreciated property, because long term capital gain tax is avoided and the donor is assigned units on the fair market value of the gift. While stock traded on a major exchange or over the counter is probably the most obvious example, the key to avoiding problems is to make sure you know the donor's acquisition date.

Do not accept any gift that does not qualify for long term capital gain handling. If you accept short term gain property, be sure you hold it until it becomes long term gain before the Fund sells it. The Fund takes over the donor's holding period and cost basis.

The Fund pays short term capital gain tax if it sells short term gain property. Since that transaction must be shown on the Fund's annual tax return, paying the tax just invites an IRS audit. It is a red flag that tells the IRS the trustee doesn't know how to run the fund, so perhaps they should take a closer look at the fund. Do not let your bank trustee sell (withdraw) short term gain assets (units) to pay themselves their fee.

If you transfer your fund to a new bank trustee that invests your fund in its common investing fund, the entire fund is short term capital gain property until the assets qualify for long term capital gain handling beginning with the investment date in the new bank's fund. Pay the trustee fees from income or from other organization funds, but do not remove principal units to pay the fees until the units qualify for long term capital gain handling. Remember that the holding period is a year and a day or six months and a day, depending on the rules in effect on the date the asset was purchased. Don't get caught by not waiting that extra day. The rules keep changing, so know them well.

You can avoid paying capital gain tax on the sale of short term gain property by distributing pro rata to each participant, but you can do that only if your Plan says you can do it. If you distribute it, at least your Fund's tax return does not have to show it as a taxable event, for which your fund must pay the tax. Paying the tax is a good way to invite an audit, in my opinion.

Do not invest in or accept into your Fund any asset that is free from Federal Income Tax. Know every gift a donor wants to give your fund. If you are dealing with the donor's broker in completing the gift, be sure you are told each asset the donor is gifting and its cost basis and holding period. If it is earning tax-free income or is short term gain property, don't accept it into your Fund, and don't let your bank trustee accept it either. Know the rules and be sure your trustee does as well. One "bad apple" ruins the barrel and you could end up with an invalid pooled income fund.

Earnings Record vs. Fund Yield

It is important to know the difference between your Fund's Earnings Record and the net income it earns and distributes. Since your fund operates something like a mutual fund, would you invest in a mutual fund that could not tell you its unit value and income per share history? Why should a donor make an irrevocable gift to your fund if you cannot provide the same data? An example of a Pooled Income Fund's unit and income value and yield history is found in Exhibit A.

Note that of the three annualized yield percentages shown, only column 3 is an accurate one. Columns 1 and 2 use assumptions which make the numbers slightly inaccurate. Note also that column 1 is the method used by all mutual funds to show their "current" rate of return. It is the most inaccurate method of the three. When is the last time you received an income check on the day you made an investment? The problem in illustrating yields is that the fund has a daily changing unit value. Since a gift is assigned units on the day it enters the fund, that fixes the unit value that determines the yield. Each donor is getting a different yield on their gift with each income check.

Do not use the column 1 method to quote your Fund's rate of return. No participant is receiving that rate and to tell all participants that this is the rate will anger those who entered your fund at a higher unit value than the one on the distribution date, since their yield will be lower than the number you are quoting. If possible, compute the annualized yield for each participant in your fund as you make each quarterly distribution and advise them of their current rate of return, not the Fund's current rate of return. Good gift administration is good gift development. Don't anger or confuse your donors unnecessarily.

Your Fund's Earnings Record is the rate of return used to compute a new donor's charitable deduction for a gift to your fund. After your fund has a three year history, (trust years not calendar years) the highest rate of the last three years must be used to compute the charitable deduction. Exhibit B illustrates a Three Year Earnings Record. Since the donor's advisor cannot compute a charitable deduction without knowing the highest rate of the three years prior to the year of the gift, the charity must be able to provide the prospective donor's advisor with the computations as shown in Exhibit B.

Be sure you maintain such a record and begin using it in the fourth trust year of your fund. Note that the first year of a new fund may be less than a full calendar year. Under present rules, all pooled income fund trust years end on December 31. A short trust year can result from the changeover to December 31 trust year ending dates (in 1987) and with new funds whose first gifts are received after January 1. A new fund whose first two gifts are received in October has a three month first trust year.

Your Offering Brochure

You must publish an Offering Brochure, (Disclosure Statement or Prospectus) for your Fund which includes a layman's description of how the fund operates, your Administration Plan, copies of your Declaration of Trust and your Instrument of Transfer. The detailed requirements for the latter two items are found in the Tax Code and Regulations. As your Fund matures, you must provide a historical record of the five year history of a $10,000 gift in that document, showing the number of units assigned, and the annual net income from that gift for each year, as well as the rate of return of the income annually. This can be done by printing paste-over labels updating that record annually and affixing the labels to your published Prospectus.

Be sure that each donor is given a copy of this Disclosure Statement before making the gift. Make a paper trail record of this fact by referring to the donor's prior receipt of the document at the time you acknowledge the gift in writing. In a future audit, you may need to prove to the IRS that each donor did receive this document prior to their making their first gift.

Commingling of Assets

The invested assets of your Pooled Income Fund can be commingled with other invested assets as long as the participations of your Pooled Income Fund and each participant can be identified through unitization. This could include investment in your charity's endowment fund as long as it and your pooled income fund are both unitized, or it could be invested in a bank's common investing fund which is always unitized.

Through unitization, your Fund owns a proportionate share of all the assets in the larger investment fund. Your charity could provide the seed money for the Pooled Income Fund by placing part of its endowment fund in a separate investment and using that as the initial pooled income fund investment.

Investing your Pooled Income Fund

It is important that the larger fund have the same investment goals as your Pooled Income Fund. If your Endowment Fund does not, then you will have to place some monies in an investment fund that can be invested with the same goals as your Pooled Income Fund.

The easy way out is to use a commercial bank's common investing funds, using percentages of their equity, bond and money market funds that will produce the investment goal you are seeking. You should monitor the performance regularly, and be willing to make changes in the percentage mix that will result in the investment goals you need. This constant monitoring and periodic changes in investment mix to accomplish your goals is critical to your fund's long term success. Every quarter that goes by is building a permanent fund history that cannot be undone retroactively. Note again Exhibits A and B.

Note the prohibitions of investing in municipal bonds or any assets that are free from federal income tax as outlined above in the section on Types of Gifts.

You could also use mutual funds but you should be aware of the dates of income and dividend distribution and make sure they fit with your Pooled Income Fund quarterly distribution dates. If they don't, you may have unhappy donors who expected four checks a year and find they are receiving less due to your mutual fund investment choices. If mutual funds are used, use only no load funds, for you want all the assets working for your participants. Investigate telephone switching and check writing privileges, so you have flexibility in control and administration. Only use mutual funds if you are knowledgeable about how such funds work and the funds you use have a long term track record that meets your goals. The expenses, fees and minimum investment amounts in such investments can cause you problems. Investigate before you invest.

Your Board member as a Donor

Contrary to an initial cursory reading of the regulations, your Board members can be donors to your Pooled Income Fund, if the board member resigns or will refrain from making investment or any decisions relating to your Pooled Income Fund and your

Board Minutes always state that fact when such decisions are made, referring to the donor/board member by name.

Gifts of Real Property

The problems with accepting real estate into a pooled income fund are too many to try to resolve. It is best to avoid accepting such assets into your Pooled Income Fund. With the advent of necessary appraisals by qualified appraisers, the amount of shrinkage of market value to net proceeds due to high sale and transfer costs, having to hold non-income producing property in the fund while a buyer is sought, as well as other problems in administering the gift, it is not worth the headaches involved in trying to find ways to accept real property into a Pooled Income Fund. Simply put, don't do it. At the very least it is unfair to those who trusted you by giving you irrevocable gifts before your real property donor appeared, for the real property donor will be receiving some of the income that was actually earned by the prior donors' gifts. Use an income only charitable remainder unitrust for such gifts.

Corporate Donors to a Pooled Income Fund

You will want your counsel to investigate the possibility of the acceptance of gifts from corporate donors to your Pooled Income Fund. You should be aware that it is possible to do. See Revenue Ruling 85-69.

Real Property Investing

Pooled Income Funds can now invest in certain types of real property and the depreciation and investment credits can be passed on to the income beneficiaries to reduce the taxability of their income. Be sure your counsel reviews this carefully before you launch into this approach. Bob Harding will share with you more detailed information about this latter subject.

EXHIBIT "A"

UNIT AND INCOME VALUES AND YIELD

Pooled Income Fund B was established by the American Lung Association on February 14, 1985 at an arbitrary $10.00 per unit of participation effective with the first gift added to the Fund. The investment goal of Pooled Income Fund B is to earn high income consistent with safety of principal.

Valuation Date	Per Unit (Share) Market Value	Per Unit (Share) Income	Yield Annualized as Percent of (1) Current Unit Value	(2) Last Quarter's Unit Value	(3) Year Ago Unit Value
02-14-85	$10.000000				
05-31-85	11.317825	.302216	10.68% (a)	11.17% (a)	
		$ .302216	10.68% (a)	11.17% (a)	**12.09%** (b)
08-31-85	11.764980	.275760	9.38%	9.75%	
11-30-85	11.124757	.306696	11.03	10.43	
02-28-86	11.476274	.302622	10.55	10.88	
05-31-86	11.522337	.301144	10.45	10.50	
		$1.186222	10.35% (a)	10.39% (a)	**10.48%** (b)
08-31-86	11.705286	.281637	9.62%	9.77%	
11-30-86	11.591898	.287815	9.72	9.84	
02-28-87	11.637817	.271417	9.33	9.37	
05-31-87	10.899248	.268962	9.87	9.24	
		$ 1.109831	9.64% (a)	9.56% (a)	**9.63%** (b)
06-30-87	10.966232	.084249*	9.22%	9.28%	
09-30-87	10.564923	.256271	9.70	9.35	
12-31-87*	10.659196	.271818	10.20	10.29	
		$ .612338*	9.71% (a)	9.64% (a)	**9.63%** (b)
03-31-88	10.805071	.261505	9.68%	9.81%	
06-30-88	10.691040	.268007	10.03	9.92	
09-30-88	10.625739	.265063	9.98	9.92	
12-31-88	11.410735	.259118	9.08	9.75	
		$1.053693	9.69% (a)	9.85% (a)	**9.89%** (b)

Note: (a) Annual income yield for trust year is average of four quarterly yields.

(b) Annual income yield is total annual income divided by year-end unit value of previous year. This is the **most accurate** rate of return of the three shown, for it contains **fewer assumptions.** It reflects the actual annual income paid for a gift made on the last day of the prior trust year (May 31 for 1987 and earlier and December 31 for 1987 and later).

*Trust year ending date changed from May 31 to December 31 and payment dates changed to 3/31, 6/30, 9/30 and 12/31 on 6-30-87 to conform to the Tax Reform Act of 1986. Income for one month was distributed 6-30-87 to bring payment dates into line.

EXHIBIT "B"

THREE YEAR EARNINGS RECORD

For Computing Charitable Deductions for 1989 Gifts

Tax Year: 6-1-86 to 5-31-87:

Valuation Date	Quarterly Income	Income Adjustment Factor	Adjustment Amount	Fund Fair Market Value
08-31-86	$ 7,592.71	x 75%	$ 5,694.53	$ 315,565.24
11-30-86	7,883.03	x 50%	3,941.52	317,493.06
02-28-87	7,698.93	x 25%	1,924.73	330,115.28
05-31-87	7,629.32	x -0-	-0-	309,165.25
	$30,803.99		$11,560.78	$1,272,338.83/4 = 318,084.71

Average Annual Rate of Return for Tax Year:

$$\frac{30{,}803.99}{318{,}084.71 - 11{,}560.78} = \frac{30{,}803.99}{307{,}523.93} = \underline{10.017\%}$$

Tax Year: 6-1-87 to 12-31-87:

Valuation Date	Quarterly Income	Income Adjustment Factor	Adjustment Amount	Fund Fair Market Value
06-30-87	$ 2,389.78	x 84%	$ 2,007.42	$ 311,065.29
07-31-87				309,182.14
08-31-87				306,956.99
09-30-87	7,387.23	x 59%	4,358.47	304,567.29
10-31-87				308,608.51
11-31-87				311,575.04
12-31-87	7,836.00	x 42%	3,291.12	312,489.70
	$17,613.01		$ 9,657.01	$2,164,444.42/7 = 309,206.42

Average Annual Rate of Return for Tax Year:

$$\frac{[\quad 17{,}613.01 \quad]}{[309{,}206.42 - 9{,}657.01]} \;/\; .58334 = \frac{[\,17{,}613.01]}{[299{,}549.41]} = \frac{.058798}{.58334} = \underline{10.079\%}$$

Tax Year: 1-1-88 to 12-31-88:

Valuation Date	Quarterly Income	Income Adjustment Factor	Adjustment Amount	Fund Fair Market Value
03-31-88	$ 8,875.78	x 75%	$ 6,656.83	$ 462,310.00
06-30-88	11,467.06	x 50%	5,733.53	457,431.00
09-30-88	11,341.07	x 25%	2,835.27	454,637.00
12-31-88	11,327.95		-0-	498,847.00
	$43,011.86		$15,225.63	$1,873,225.00/4 = 468,307.25

Average Annual Rate of Return for Tax Year:

$$\frac{43{,}011.86}{468{,}307.25 - 15{,}225.63} = \frac{43{,}011.86}{453{,}081.62} = \underline{9.493\%}$$

Notes:

- Formula for Rate of Return computation found in Internal Revenue Code Regulations Section 1.642(c) -6(c)
- Use highest Rate of Return (10.079% for trust year ending 12/31/87) in computing charitable deduction for gifts made during 1989.

IBM COMPATIBLE COMPUTER SOFTWARE PLANNED GIVING CALCULATION PACKAGES

Company (State) Contact/Phone	Program(s)	Price & 1st Yr Update	Annual Update
Aaron & Associates (MO) Jim Nicolls (314) 464-1308	1) Planned Gift Consultant	$ 595	$275
Planned Giving Consultants, Inc. (also Blackbaud Inc.) (NH) Doug White (603) 668-2434 (NH) (800) 635-8016 (other)	1) Planned Giving I 2) Planned Giving II	995 2,495	179.25 374.25
Comdel (CA) Charles Schultz (805) 987-0565	1) Crescendo	2,090	595
Deerwood Computer Systems (IN) John Rogers (812) 829-6011	1) EZ Gift Planner (5/1) (prior to 5/1)	475 375	as needed
PG Calc (MA) Gary Pforzheimer (617) 497-4970	1) Planned Giving Manager 2) Mini Manager 3) Gift Annuity Organizer	2,400 1,300 3,000	400 400 500
Philanthrotec (NC) Lee Hoffman (704) 554-1646	1) Unitrust Marketing System 2) Scenario 3) Scenario Plus	695 1,895 2,495	300 395 595

SELECTED LIST OF EXPERIENCED BANKS AND COMPANIES OFFERING POOLED INCOME FUND TRUST SERVICES

(Trusteeship, Custodianship, Administration, & Investments)

State Street Bank & Trust Company, N.A.
225 Franklin Street
Boston, MA 02101
Elaine Anderson, VP
(617) 654-3218

The Connecticut Bank & Trust Company, N.A.
One Constitutional Plaza
Hartford, CT 06115
John W. Dixon, VP
(203) 244-5806

Wachovia Bank & Trust Company, N.A.
P.O. Box 3099
Winston-Salem, NC 27150
David Taylor, Ass't VP
(919) 770-6222

Hemmenway & Reinhardt, Inc.*
107 Rutgers Avenue, #4
Swarthmore, PA 19081
Peter W. Hemmenway, President
(215) 544-4545

*Note: All but custodianship and investment services.

WORKSHOP SESSION—PASS-THROUGH POOLED INCOME FUNDS

Robert E. Harding, Esq.
Gray, Plant, Mooty, Mooty & Bennett, P.A.

I'm pleased and relieved to be able to follow Jim Potter's comprehensive presentation. Knowing that he has given you a thorough grounding in the administration of pooled income funds, I can feel more confident about launching into my topic, which is much more specialized. I'm going to be talking to you about a rare species, but I hope not an endangered one: the so-called Depreciation Pass-Through Pooled Income Fund. This animal evolved during the early 1980's in an attempt to take advantage of the new tax benefits created by the Economic Recovery Tax Act of 1981.

To help you start thinking about this slightly esoteric subject, I would like to pose three riddles, all of which I hope to answer in the course of my presentation. First, when can a charity use a deferred gift right away? Second, how can an income beneficiary of a pooled income fund receive tax-exempt income even though the fund itself is prohibited from investing in tax-exempt securities? Third, when does an income interest in a pooled income fund look like a fixed income investment? As I'm sure you've already guessed, the answers to all of these puzzles have something to do with pass-through pooled income funds.

1. Comparison with Conventional Pooled Income Fund.

How does a depreciation pass-through pooled income fund differ from a conventional pooled income fund? The most basic difference between the two is the way in which the fund's assets are invested. With a garden variety fund, the trustee typically invests the trust corpus in a portfolio of marketable securities. These investments generate income in the form of dividends and interest, which are then distributed ratably to the fund's income beneficiaries. With the pass-through fund, the trust corpus is invested in a piece of depreciable property which the trustee leases to the charitable remainder beneficiary. The lease generates net income for the fund in the form of rental payments. The difference in investment policy between pass-through and conventional funds has consequences both for the income beneficiaries of the fund and for its charitable remainderman.

Each income beneficiary of a conventional pooled income fund receives a ratable portion of the fund's net income according to his or her units of participation in the fund. Because the fund is prohibited from investing in tax-exempt securities, a beneficiary's entire distribution is included in her or his federal gross income. In addition, the fund generates no deductions or credits for its beneficiaries. Thus, a beneficiary's share of the fund's net income will be taxable unless he or she has deductions or credits from other sources which can be used to shelter the distribution from federal income taxation. Because the income from the fund constitutes "portfolio income," losses from tax shelters such as real estate partnerships or oil and gas partnerships cannot be used to offset it. With a pass-through pooled income fund, each income beneficiary receives a ratable portion of the trust's net income, and she or he must include that distribution as federal gross income. However, the trust also generates certain tax benefits for its income beneficiaries. First, a portion of the depreciation deduction allowable with respect to the depreciable property owned by the fund "passes through" ratably to the beneficiaries. Second, rental income received by the fund and distributed to its income beneficiaries will apparently be characterized as "passive activity income." As a result, beneficiaries can use losses from conventional tax shelters to offset that income. As we will see, the combination of the depreciation deductions and the passive character of the distributions makes it possible, in theory at least, for an income beneficiary to avoid federal income tax on his or her entire distribution from a pass-through fund.

The benefits for the charitable remainderman of a pass-through fund also differ from those for the charitable beneficiary of a conventional fund. In the usual case, the charity receives nothing from the fund until income interests begin to expire. Even then, the charity only receives a ratable portion of the trust assets corresponding to the units allocated to the expired income interest. By contrast, the charitable remainder beneficiary of a pass-through fund is able to enjoy the use of the entire trust corpus immediately, albeit in exchange for rental payments.

2. Structure and Operation of a Pass-Through Pooled Income Fund.

As the first step in setting up a pass-through pooled income fund, a charity identifies a capital project, such as a new building, for which it wishes to obtain financing. The charity creates a pooled income fund by executing a declaration of trust, then solicits contributions to the fund which are sufficient to finance the project. (In the balance of my presentation I will assume that the charity wishes to finance construction of a new building.)

Once the fund-raising effort is complete, the pooled income fund finances construction of the building in one of two ways. First, it could actually construct the building with the solicited contributions. This method has the disadvantage, however, that the fund will generate no income for its income beneficiaries during the construction period. That problem is avoided with the other financing method, under which the fund lends its assets to the charity in exchange for the charity's promissory note. The charity uses the loan proceeds to construct the building, and the interest on its note generates income for the fund during the construction period. Once the building is complete, the fund returns the charity's note in exchange for the building.

At this point, the pass-through fund is ready to begin its characteristic mode of operation. It leases the land on which the building is located, presumably from the charity, then it leases the building to the charity under a long-term lease and subleases the land back to the charity. All of these leases should call for rental payments at fair rental value, and rental rates should be based on an independent appraisal of the rental values of the building and the land. The precautionary step of obtaining an appraisal protects the charity both in its own right and in its capacity as trustee of the fund. If the charity were to pay excessive rent for the use of the building, it is possible, in theory at least, that it would lose its tax-exempt status under Code Section 501(c)(3) on the grounds that some of its net earnings were "inuring" to the benefit of private individuals, namely, the income beneficiaries of the fund. *E.g., Texas Trade School v. Commissioner,* 30 T.C. 642 (1958), *aff'd,* 272 F. 2d 168 (5th Cir. 1959). If the charity, as trustee of the fund, were to charge less than a fair rental rate, it might be violating its fiduciary responsibility to the income beneficiaries of the fund. *E.g., Restatement of the Law, Second, Trusts 2d,* §181 (1959). This second problem is especially acute because of the obvious conflict of interest facing the charity in its role as trustee. More about that later.

Over time income interests in the fund will expire, and as they do, corresponding portions of the trust assets must be "severed" and transferred to the charity. This process raises two questions: how are units in the fund "severed" when the fund owns a a single nonliquid asset, a building, and how does the diminishing ownership of the fund in the building affect the rental payments? The answers to these questions follow easily from the concept of undivided fractional ownership in a piece of real property. The owners of undivided fractional interests in real estate share all of the rights in the property in proportion to their respective interests. Therefore, the fund can satisfy its obligation to transfer a fraction of the fund assets to the charity by executing a deed of an appropriate undivided fractional interest in the building. As ownership of the building gradually shifts from the fund to the charity, the charity's rental payments under the lease should decrease proportionally. It would be inequitable, and also inconsistent with the concept of undivided fractional ownership, for the charity to continue to pay rent at the full rate once it owns only a portion of the building. The overall effect of this arrangement is that the charity gradually obtains ownership of the building as its rental payments decrease. When the last income interest in the fund expires, the lease terminates and the charity owns the entire building outright.

We are now in a position to answer the first riddle: the charitable remainderman of a pass-through fund is able to enjoy the use of deferred gifts immediately. In effect, deferred gifts to the fund provide the charity with financing, on favorable terms, for a current capital project. Typically, we do not think of a *deferred* gift as providing that kind of benefit. Why do I say that the financing is obtained on favorable terms? The charity obtains the funds necessary to construct a building just as it would with a conventional construction financing loan. As with a conventional loan, the charity must pay for the cost of the funds. With a conventional loan, that cost is paid in the form of interest; with a pass-through fund the rental payments represent the cost. In both cases the charity's payments decrease as its "equity" increases. The major difference is that with the conventional loan the charity must repay principal as well as interest. With a pass-through fund, on the other hand, the charity's "equity" increases automatically as income interests in the fund expire: fractional interests in the building pass to the charity without any corresponding payment on its part. In effect, what the charity obtains through a pass-through fund is "principal-free" financing.

I should point out that a pass-through pooled income fund will work even if the charity does not need to, or is unable to, solicit enough contributions to the fund to finance the entire building. The fund can simply purchase whatever fractional interest it can afford with the solicited contributions. Thus, a charity might be able to fund part of a capital development project with outright gifts and might turn to a pass-through pooled income fund to raise the balance. In another case, a charity might have difficulty raising any outright gifts, might solicit a portion of the construction costs through a pass-through fund and might obtain the balance through a conventional loan. In either of these cases, the fund can own any fractional interest in the building initially, and rental payments at the beginning of the building lease term will be set accordingly. Of course, if a charity believes it can only solicit enough contributions to a pass-through fund to purchase a small fractional interest in a building, it may decide that the administrative costs involved make the pass-through fund an unviable fund-raising mechanism.

I would like to turn next to the question of how tax benefits pass through the fund to its income beneficiaries, but before I do, I would like to point out why a pass-through pooled income fund may be attractive to donors even if they cannot take advantage of those tax benefits. In a sense, donors to a pass-through fund can have their cake and eat it too. They are making deferred gifts, so they obtain a continuing benefit from their donations in the form of lifetime income. However, they are also able to have the satisfaction of contributing to a current capital project. They may even be able to see a plaque with their names on it when the building is completed.

3. Depreciation Pass-Through

How do depreciation deductions pass through a pooled income fund to its income beneficiaries? A pooled income fund is a trust, and there is a general rule under the Treasury Regulations for allocating depreciation deductions between trusts and their beneficiaries. To understand that rule, let's turn first to the concept of a depreciation reserve. A depreciation reserve is an amount set aside out of a trust's gross income. Its purpose is to preserve the value of that portion of the trust corpus which is invested in a wasting asset, that is, an asset whose value will decrease in time if market conditions remain steady. The law of most states does not require a trustee to set aside a depreciation reserve when a trust holds wasting assets, but instead allows the trust instrument itself to mandate such a reserve or to give the trustee discretion to set aside a reserve in any amount. *E.g.*, Minn. Stat. §501.49, subd. 1(a) 1989).

Treasury Regulations provide that depreciation deductions allowable with respect to trust property will be allocated to the trust itself to the extent of any depreciation reserve set aside out of trust income. Treas. Reg. §1.167(h)-1(b). If all of the trust's income, after the set-aside for the reserve, is allocated to the beneficiaries, as with a pooled income fund, the portion of the depreciation deduction in excess of the depreciation reserve will be allocated to the income beneficiaries in proportion to their respective shares of trust income. *Id.* Between 1981 and 1987, this allocation rule made the pass-through of depreciation from a pooled income fund quite attractive. The Service issued a number of private rulings which apparently applied this rule to situations in which the trustee of the fund had complete discretion as to the size of the depreciation reserve. *E.g.*, PLR 8712046, dated December 22, 1986. If the trustee set aside no reserve, *all* of the depreciation would apparently be allocated to the fund's income beneficiaries. In addition, depreciation deductions available under the Accelerated Cost Recovery System ("ACRS") were quite favorable during that period. Commercial real estate could be depreciated using the straight line method over 19 years. Consequently, an income beneficiary of a pass-through pooled income fund would receive an annual depreciation deduction equal to slightly more than 5 percent of the amount of the contribution which created his or her income interest. If the fund had an annual rate of return of 7.5 percent, over two-thirds of each income beneficiary's annual distribution would be sheltered from federal income tax by an accompanying depreciation deduction.

In 1987 the amount of depreciation passing through a pooled income fund to its income beneficiaries was substantially reduced, partly by provisions of the Tax Reform Act of 1986 and partly by a change in the IRS position on depreciation reserves for pooled income funds. TRA 1986 created a new sub-category of depreciable property, so-called "tax-exempt use property." I.R.C. §168(h). Under the new depreciation rules, nonresidential real property which is tax-exempt use property must be depreciated using the straight line method over 40 years. I.R.C. §168(g)(2)(C). The Service has ruled privately that real property rented by a pooled income fund to its charitable remainder beneficiary constitutes tax-exempt use property. *E.g.*, PLR 8828068, dated April 19, 1988. Therefore, the depreciation deduction allowable for a building owned by a pooled income fund will be 2.5 percent of the building's value when placed in the fund, in other words, roughly half the depreciation which would have been allowed in the same situation prior to 1987.

Not only is the allowable depreciation deduction smaller than it used to be, the portion of the deduction passing through to beneficiaries is smaller, too. During 1987 the Internal Revenue Service began requiring, on an informal basis, that the trustees of pooled income funds set aside depreciation reserves according to Generally Accepted Accounting Principles ("GAAP"). *E.g.*, PLR 8830045, dated May 3, 1988. GAAP appear to require that a depreciation reserve for real property be set aside based on depreciation computed on the straight line method over the property's useful life. The net result of this new IRS position is that depreciation passes through a pooled income fund to its beneficiaries only to the extent that the tax depreciation exceeds the GAAP depreciation. In other words, for depreciation to pass through, the useful life of the building, which is used as the depreciation period for computing the depreciation reserve, must be greater than the tax depreciation period of forty years. For example, if a new building has a useful life of 50 years, the annual tax depreciation will be 2.5 percent of the building's initial value, and the GAAP reserve will be 2 percent of that value. Consequently, a depreciation deduction equal to .5 percent of the building's initial value will be allocated among the fund's income beneficiaries each year. In short, the depreciation reserve "soaks up" the bulk of the depreciation, so that only a fraction of the deduction passes through to the fund's beneficiaries.

Not only does the creation of a depreciation reserve decrease the pass-through of depreciation deductions to the fund's beneficiaries, it also decreases the fund's net income because the reserve is set aside out of that income. As a result, the amount available to distribute to beneficiaries is decreased as well. However, there appears to be nothing which prohibits the trustee from investing the reserve to generate additional income for the fund, which can be distributed to the fund's beneficiaries. So the net income of a pass-through fund, and hence the annual distributions to the beneficiaries, will gradually increase along with the size of the depreciation reserve.

As I mentioned earlier, pass-through pooled income funds should be attractive to many donors who are not even looking for tax benefits. Being able to make a deferred gift which the charity can use immediately is especially appealing. Nevertheless, the attenuation of depreciation pass-through described above, if taken alone, would have made pass-through funds less attractive to that class of donors who are seeking tax-sheltered income.

Fortunately, TRA 1986 inaugurated other changes which enhanced the market for units in pass-through funds while dealing a blow to the market for conventional tax shelters.

4. Passive Activity Income

The Tax Reform Act of 1986 created several new categories of income and losses, including "portfolio" income and losses, and "passive activity" income and losses. I.R.C. §469. Portfolio income includes stock dividends and interest on debt securities, I.R.C. §469(a)(1)(A)(i)(I), and rental income constitutes passive activity income. I.R.C. §469(C)(2). Passive losses include losses which investors receive from conventional tax shelters.

Prior to 1987 investors could use passive losses, such as losses from tax shelters, to offset portfolio income. However, after the enactment of the 1986 Tax Act, passive losses may be used only to offset passive income. I.R.C. §469(e)(1)(A). As a result, there are many investors who bought into conventional tax shelters before 1986 to obtain losses to offset dividends and interest income but who now have excess, i.e., unusable, passive losses: they can no longer use those losses against their portfolio income, and they have no passive activity income. There is an adage among stockbrokers that Wall Street loves a bull, it can abide a bear, but it cannot stand a pig. That has changed after the 1986 Tax Act, because investors with excess passive losses are now looking for PIGs, i.e., Passive Income Generators.

The new rules about passive losses and portfolio income which were a blow to investors were a boon to pass-through pooled income funds. The IRS has ruled privately that the passive character of rental income received by a pass-through fund retains that character in the hands of the fund's income beneficiaries. PLR 8806065, dated November 19, 1987. Thus, if an income beneficiary of a pass-through fund has passive losses in excess of her or his other passive income, those passive losses can be used to shelter rental income which passes through the fund to the beneficiary. Depending on the amount of the beneficiary's excess passive losses, he or she may be able to receive the entire distribution from the pooled income fund tax free. Here we have the answer to our second riddle. A pooled income fund cannot invest in securities which generate tax-exempt income, but it can invest in property which generates rental income, which is a form of passive activity income. Income beneficiaries with excess passive losses can use those losses to offset the rental income they received *via* the pooled income fund, converting those distributions to tax-exempt income.

5. Sample Computation

To see how the pass-through of depreciation and passive activity income affects the tax situation of beneficiaries of a pass-through pooled income fund, consider the following sample computation. It shows the tax consequences for three hypothetical donors, A, B, and C, who have different amounts of excess passive losses.

A. Assumptions
   1. PIF buys $1,000,000 building with useful life of 50 years.
   2. PIF rents building to charity at 10%, *i.e.*, $100,000.
   3. Donors A, B and C have each contributed $100,000 to PIF, so each holds 10% of PIF's units.
   4. Donor A has no excess passive losses; Donor B has $3,500 of excess passive losses annually; Donor C has $7,500 of excess passive losses annually.

B. Taxation of annual payments
   1. Trustee sets aside GAAP depreciation reserve out of net income (50 year useful life: annual set aside = 1/50 × $1,000,000 = $20,000)
   2. Net income of trust = $80,000
   3. A, B, C each get 10% of net income = $8,000
   4. Tax depreciation = 1/40 × 1,000,000 = $25,000
   5. Aggregate depreciation allocated to income beneficiaries = total depreciation minus GAAP reserve, *i.e.*, $25,000 – $20,000 = $5,000
   6. A, B, C are each allocated 10% of excess depreciation deduction: $500
   7. Taxable income of A*

a. Gross income	$8,000
b. Minus depreciation	500
c. Taxable income	$7,500*

   8. Taxable income of B*

a. Gross income	$8,000
b. Minus depreciation	500
c. Minus passive losses	3,500
d. Taxable income	$4,000*

9. Taxable income of C*

a. Gross income	$8,000
b. Minus depreciation	500
c. Minus passive losses	7,500
d. Taxable income	-0-*

*In initial year of PIF. If depreciation reserve is invested in a way which generates portfolio income, gross income of all three beneficiaries will increase, and income beneficiaries will receive some taxable income in the form of portfolio income.

6. Miscellaneous Aspects of Pass-Through Funds

a. Rate of Return

Let me begin this section of the presentation by answering the last of the three riddles: when does an interest in a pooled income fund look like a fixed income investment? Once the fund purchases its building from the charitable remainder beneficiary, its only income, initially at least, will be fixed rental payments under a long-term lease. Although rental payments will decrease as income interests expire, they will do so proportionally. Therefore, the rental payments allocated to a particular income beneficiary will remain fixed so long as the lease is in force. Thus, the rental payments establish a floor on the annual distributions to the income beneficiaries, assuming the trust expenses remain relatively constant. The annual set-aside for the depreciation reserve will not change during the useful life of the building, and it should be relatively easy for the trustee to keep other trust expenses fixed. Therefore, during the term of the lease the net income of the fund should never drop below the amount of the annual rental payment minus the depreciation reserve and expenses for the year. In addition, as the depreciation reserve grows and generates increasing income, the annual net income of the fund will increase correspondingly. Thus, an income interest in a pass-through pooled income fund is not, strictly speaking, a fixed income investment, but it comes very close. However, if the lease expires or the charitable remainder beneficiary later buys the fund's remaining interest in the building, the fund's annual income may change and may vary thereafter from year to year depending on the way the proceeds are reinvested.

b. Charity's Option to Buy

As I just mentioned, the charity may decide at some point to "buy out" the fund's remaining fractional interest in the building. This could happen once the fund's interest becomes too small to justify the continued administration of the rental arrangement. To facilitate this transaction, the lease should include an option for the charity to buy the fund's interest in the building at fair market value once the fund's interest drops below a certain size, 25 percent of the entire building, for example. The exercise of the option could affect the pay-out from the fund to the beneficiaries in two ways. First, income payments may begin to vary from year to year, depending on the type and performance of the trust's new investment. Second, the pay-outs to the beneficiaries will no longer constitute passive activity income if the proceeds from the sale of the fund's remaining fractional interest are reinvested in "portfolio" investments.

c. Accepting Transfers of Real Estate

As explained above, a pass-through pooled income fund may be especially appealing to a donor who has excess passive losses. Such donors tend to be sophisticated investors, and they may very well have appreciated real estate investments which they would like to use to purchase units in the fund. However, acceptance of such gifts presents the same problems as it does with a conventional pooled income fund. The risk of a decrease in the value of the property between the time of the gift and the time of its later sale is spread, somewhat unfairly, among all of the fund's beneficiaries. A preferable alternative would be to have that donor transfer his or her appreciated piece of real property to a "pass-through charitable remainder trust."

d. Pass-Through Charitable Remainder Trusts

The operation of a pass-through charitable remainder trust is similar to that of a pass-through pooled income fund. The trust uses the property contributed to it to finance construction of all or part of a building. The trust then acquires an interest in the building and leases it to the charitable remainder beneficiary at fair rental value. The trust receives rental payments and pays out the required annual amount to the noncharitable beneficiary. Unlike pooled income funds, however, charitable remainder trusts generally have annual distribution requirements which are not tied to the trust's net income. The only exception is the so-called "income-only" unitrust, which pays out the lesser of a unitrust amount or the actual trust income. With any of the other varieties of charitable remainder trust, the trustee must distribute trust principal to satisfy the annual payout requirement if the trust income is insufficient.

With a pass-through charitable remainder trust, distribution of principal to noncharitable beneficiaries to satisfy the payout requirement would be awkward at best: minute undivided interests in the building owned by the trust would have to be deeded to the beneficiary. The charity would then wish to buy those interests, both to give the beneficiary a usable distribution and to prevent an undesirable fractionalization of ownership.

There are two ways to avoid the situation in which a pass-through charitable remainder trust must pay trust principal to its noncharitable beneficiary. First, the trust can be structured as an income-only unitrust, so the issue of a distributing principal never arises. However, as I will explain in a minute, the pass-through of depreciation deductions may be smaller with an income-only unitrust than with other types of charitable remainder trust. Second, the rental payments for the building can be set at a level which insures that the trust's net income will always equal or slightly exceed its annual distribution requirement. The payout for an annuity trust is fixed when the trust is created, but a unitrust amount, by definition, can vary from year to year, so an annuity trust is probably the better choice for a pass-through charitable remainder trust.

The amount of depreciation which passes through a pooled income fund to its beneficiaries depends on the size of the depreciation reserve which the trustee sets aside out of trust income, and the IRS has taken the position, informally at least, that a pooled income fund must maintain a reserve computed according to GAAP "in order to protect the trust corpus for the benefit of the charitable remainderman." This requirement makes sense because only net income can be paid out to the noncharitable beneficiaries. Thus, a depreciation reserve actually protects trust corpus since it "stays in" the trust. An income-only unitrust would seem to be like a pooled income fund in this respect: only the trust's income can be paid out, so a depreciation reserve genuinely protects trust corpus against the "wasting" of depreciable assets. Therefore, the IRS "logic" would seem to require that a pass-through, income-only unitrust set aside a GAAP depreciation reserve. The Service has not, to my knowledge, ruled on the issue, either publicly or privately, but if it does adopt this position, the result should be the same as for a pooled income fund: most of the depreciation deduction will be "trapped" in the reserve so that only a small fraction passes through to the noncharitable beneficiary.

When we turn to annuity trusts and "simple" unitrusts, however, the rationale for requiring a depreciation reserve evaporates. Because the trustee may distribute principal as well as income to satisfy the distribution requirement, the concept of a "reserve set aside out of income" is virtually meaningless. No reserve "set aside" in such a trust is inviolate: it can always be used, if needed, to help make the payment to the noncharitable beneficiary.

Even if a depreciation reserve were "maintained" for an annuity trust or a simple unitrust, however, it is arguable that its presence would not prevent depreciation from passing through the trust to the recipient of the annual distribution. Under the "tier system" for characterizing distributions received from a charitable remainder trust, those distributions carry out all of the trust's current and accumulated ordinary income first, then its currently and accumulated capital gains, and finally its current and accumulated nontaxable income. I.R.C. §664(b). As a result, it appears that the noncharitable beneficiary may receive the benefit of the entire depreciation deduction, even if that entire deduction is "allocated" to the trust.

Suppose a charitable remainder annuity trust buys a building worth $1,000,000 and leases it to the charitable remainderman at an annual rent of $80,000. Assume in addition that the payout percentage is eight percent of the initial value of the trust assets. Finally, suppose that the building has a useful life of 40 years and that the IRS requires the trust to maintain a GAAP depreciation reserve. In its first year the trust has a payout requirement of $80,000. It receives $80,000 of rental income, "sets aside" a depreciation reserve of $25,000 (1/4 x $1,000,000) and is allowed a depreciation deduction of $25,000. (1/4 x $1,000,000). Its depreciation deduction is allocated to its ordinary rental income. Treas. Reg. §1.664-1(d)(2). It therefore has $55,000 of net ordinary income and $25,000 of nontaxable income. Its payout of $80,000, in the hands of the beneficiary, is made up of $55,000 of ordinary income and $25,000 of nontaxable income. In effect, the depreciation deduction of $25,000 has passed through despite the set-aside for the "reserve." Whether depreciation actually passes through a simple unitrust in this fashion we don't know, because the Service has not ruled on the question. However, this interpretation of the relevant provisions of the Code and Treasury Regulations appears to be a defensible one. If it is correct, pass-through charitable remainder trusts may be even more attractive for substantial donors than pass-through pooled income funds.

However, even if this interpretation is correct, there are two situations in which the noncharitable beneficiary will not receive the full benefit of the depreciation deduction. First, suppose the rental income of the trust is somewhat higher than the annual distribution requirement, $90,000 instead of $80,000 in the previous example. The trust has net ordinary income of $65,000, so the first $65,000 of the $80,000 annual payout is treated as ordinary income in the hands of the recipient and only $15,000, instead of $25,000, is tax-exempt. This situation is less likely to arise with an annuity trust, where the annual payout can be set to equal the rental income, than with a unitrust, where the payout can vary from year to year—another reason for preferring an annuity trust as a pass-through vehicle. The pass-through of depreciation will apparently also be attenuated if the donor funds the trust with appreciated property which the trustee later sells. Under the "tier system" described above, all of the capital gain on the sale must pass through to the beneficiary ahead of any tax-exempt income. In our original example, $25,000 per year would be capital gain until all of such gain has passed out. Only at that point will the beneficiary begin to receive the benefit of the depreciation deductions.

The other unsettled issue for pass-through charitable remainder trusts is the treatment of passive activity income. In PLR 8806065, dated November 19, 1987, the Service ruled that passive activity income passes through a pooled income fund to its beneficiaries in the same proportion as the passive activity income of the fund included in the fund's distributable net income ("DNI") for that year bears to the fund's entire DNI for that year. That ruling rests on an explicit statement in Code Section 662(b) that amounts distributed from a "complex trust," such as a pooled income fund, to its beneficiary have the same character in the hands of the beneficiary as in the hands of the trust. A different Code section, 664(b), characterizes distributions received from charitable remainder trusts. Unlike Section 662(b), which is phrased completely generally, Section 664(b) deals only with the pass-through of specific categories of income, and passive activity income is not among them. Nevertheless, from the overall scheme of Section 664(b) and the Treasury Regulations which interpret it, an argument can be made that the trust's rental income passes through to the noncharitable beneficiary as ordinary income and retains its passive character. If the long-awaited regulations under Section 469 do not resolve this issue explicitly, donors who wish to create pass-through charitable remainder trusts to obtain passive activity income would be well advised to obtain their own rulings.

e. Self Dealing

Typically, the charitable remainder beneficiary of a pooled income fund also acts as its trustee. However, with a pass-through fund, the trustee of the fund must make a loan of trust assets to the charity, purchase a building from the charity with trust assets, lease land from the charity and lease trust assets to the charity. Therefore, if the charity acts as the trustee of a pass-through fund, certain "self-dealing" issues must be addressed under both federal and state law. Under the Internal Revenue Code, the trustees of "split interest" trusts, including pooled income funds, are generally prohibited from engaging in such transactions with the trust. I.R.C. §§4947(a)(2), 4941(d)(1)(A), 4941(d)(1)(B). However, there is an exception for a trustee which is a §501(c)(3) organization. Treas. Reg. §53.4946-1(a)(8). Under state law, the problem is somewhat more complicated. In many states sale, rental and loan transactions between a trustee and a trust would constitute breaches of fiduciary duty to the trust beneficiaries, which would expose the trustee to fiduciary liability, *unless* the trust instrument *explicitly* permits such transactions. *E.g., In The Matter of the Trust of Kemske,* 305 N.W.2d 755 (Minn. 1981). General language which gives the trustee broad administrative powers will not necessarily be sufficient to remove the stigma of self-dealing. *E.g., In re Trust Created by Anneke,* 229 Minn. 60, 38 N.W.2d 177 (1949). Therefore the declaration of trust for a pass-through fund must contain language which explicitly permits the various transactions which are necessary to implement the fund but which would normally constitute self-dealing under state law.

f. Converting a Conventional Fund

Charities which have existing pooled income funds may wish to consider converting them to pass-through funds. In order to make this conversion, however, the charity may have to amend the declaration of trust which governs the fund. First of all, as just mentioned, language may have to be inserted in the document which explicitly permits certain transactions which would otherwise constitute self dealing. In addition, as a condition of issuing a favorable private ruling under Code Section 642(c)(5), the IRS has been requiring that pass-through pooled income funds include language in their governing instruments to the effect that "the trustee will maintain a depreciation reserve sufficient to protect the trust corpus for the benefit of the charitable remainderman." Moreover, the IRS General Counsel's office has recently issued a memorandum which concludes that the IRS may legitimately require pass-through funds to include in their declarations of trust language to the effect that the trustee will maintain a depreciation reserve according to generally accepted accounting principles. G.C.M. 39709, dated March 4, 1988. An existing conventional fund which decides to convert will probably wish to obtain a private ruling that it will continue to qualify under Code Sections 642(c)(5) if it is operated as a pass-through fund. Thus, to obtain such a ruling, it may have to amend its declaration of trust. The difficulty is that a declaration of trust is typically an irrevocable document whose terms do not permit amendment. Under the law of some states, however, it is possible to amend an irrevocable trust agreement, provided that all contributors to the trust and all of its beneficiaries consent to the amendment. *E.g., In re Warner's Trust,* 263 Minn. 449, 117 N.W.2d 224 (1962). Thus, it may be practical to convert an existing pooled income fund to a pass-through fund only if the number of donors and beneficiaries is relatively small.

7. Conclusion

One word of caution. The Internal Revenue Service's position with respect to the pass-through of depreciation and passive activity income is still in flux. No Revenue Ruling has been issued on the question of the size of a mandatory depreciation reserve for a pooled income fund, even though the General Counsel Memorandum cited above would seem to indicate that the Service intends to require a reserve maintained according to Generally Accepted Accounting Principles. On the issue of pass-through of passive activity income, the Service issued one favorable private Ruling in 1988 and has issued none since that time. One possible explanation for that phenomenon is that Temporary Regulation §1.467-8T, which is slated to deal with the application of the passive income and loss rules to trusts and their beneficiaries, has not yet been promulgated. The Service may have decided that it is unwilling to issue additional private rulings in this area until that Temporary Regulation is issued.

WORKSHOP SESSION—CHARITABLE REMAINDER TRUSTS—BASIC

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I. INTRODUCTION

A. In 1987 the total giving in the USA was $93.68 billion. Of this, individuals gave $76.82 billion, or 82%. Bequests (testamentary distributions) accounted for $5.89 billion or 6.38%. Since bequests are individual gifts, the total for individuals amounts to $82.8 billion or 88.39% of all giving.

B. It is ingrained in the American conscience that we share our bounty with others. We believe the desire to give is part of the "Image of God" in which we are created.

C. Because of our complex and intricate tax structure it is incumbent on us (the charities) to inform our publics. If a third party is ready to match your gift you will probably give more. The tax benefits to donors amount to matching gifts by our government. The options which can expand our donors' giving capabilities are all variations of the basic trust concept.

II. WHAT IS A TRUST?

A. (Law) "A fiduciary arrangement in which property is held and managed by one party for the benefit of another." (American Heritage Dictionary, 1981)

B. It is a written legal document in which a TRUSTOR (Settlor-Creator-Donor-Grantor) places assets in the hands of a TRUSTEE and directs, in writing, how the Trustee is to manage the CORPUS (principal) of the trust. Instructions will include the method of payment of INCOME (and principal if so directed) to the BENEFICIARY for the TERM (Lifetime-Term of Years-Event) of the Trust and at the termination of the Trust the payment of the corpus (REMAINDER) to the named Remainderman.

C. A trust is not usually considered a contract and will generally be dependent on its own capabilities for the generation of income. Trust law will usually permit the TRUSTEE to borrow, lend, service debt, pay taxes, etc.

These laws can be restricted (or changed) by the trust if desired, or all the trust provisions can be included by reference.

D. There is a general restriction on trusts called in law, "The Rule Against Perpetuities." This limits the length of time a trust can exist and demands termination at some point. The maximum allowable trust life is, "Lives in being plus twenty-one years, plus nine months." The one exception is for trusts paying income to charity. A trust can also be drawn to exist for a term of years. In the case of Irrevocable Charitable Remainder Trusts, the maximum term is twenty years.

E. There is also a set of laws (which will vary by state) that place significant responsibility and accountability on the Trustee whether an individual(s) or Corporate Fiduciary. This is "The Prudent Man Rule," and says that if a trustee fails to manage the trust assets in the way a prudent person would manage his or her own assets, the trustee will be liable for the losses incurred and the replacement of assets.

F. Trusts can be created during the lifetime of the trustor and as such are called "Living (Inter-Vivos; Latin for 'Among the Living') Trusts." It is the trustor that is living, not the trust, and should not be confused with a living will.

Trusts can be created after the lifetime of a trustor by placing the provisions of the trust in the Last Will and Testament (Testamentary Trust). All the decisions are made by the trustor during life to take effect later.

G. A trust can be revocable, and as such can be changed or revoked in whole or in part any time at the wish of the Trustor or other person given that power by the Trustor.

H. A trust can be irrevocable and as such cannot be changed or revoked except in special cases and under strict guidelines sometimes requiring the jurisdiction of the court.

III. WHAT IS A CHARITABLE REMAINDER TRUST?

A. This is a variation of the basic trust concept which names a charity as the recipient of all or part of the remainder in the trust when it ends. The trust can be revocable or irrevocable, it can be Inter-Vivos or Testamentary. What is a gift? Before we proceed with the Charitable Trust discussion, let us define this:

"A gift is something given voluntarily and without compensation; A present."

If I make a gift to your charity expecting it to be deductible and tell you I want a return or benefit, I have not made a completed gift unless I give it through one of the formats approved by congress in the 1969 Tax Reform Act, which are:

1. A Charitable Remainder Annuity Trust
2. A Charitable Remainder Unitrust
3. A Pooled Life Income Trust
4. A Charitable Gift Annuity
5. A Remainder Interest in a personal residence or farm.

B. Through the use of these approved vehicles a donor can do some or all of the following:

1. Make a completed gift to your charity.
2. Receive a charitable contribution deduction in the year of the gift and use the five year carry over rule for any excess gift not usable the first year.
3. Receive benefit or income for his or her life and the life of one or more survivor beneficiaries.
4. Avoid or substantially reduce the Capital Gains Tax on appreciated property that would be due if the donor had sold the asset instead of funding a Charitable Agreement.
5. Eliminate or substantially reduce any Federal Estate Tax attributable to the assets given.
6. Increase the Trustor's income on low yield assets which would not otherwise be possible.
7. Provide income and management for the Trustor's heirs.
8. Establish an on-going relationship with the charity of choice that extends beyond the life of the Donor/Trustor.

C. These trusts have two interested parties (called Split Interest); that of the income beneficiary(s), (usually the Donor/Trustor) and the Remainderman (your charity). In the management of the trust assets the trustee must be fully aware of these interests and satisfy them both. It is possible for a Charitable Remainder Trust to demand more than it can produce, run out of money, and leave the donor without income and the charity without Remainder.

The opposite would produce the maximum income to the trustor for life while leaving a Remainder at least equal to the original amount transferred and hopefully more.

IV. CHARITABLE REMAINDER UNITRUST IRC §664; Reg. §1.644-3

A. *Payment of Unitrust Amount.* The governing instrument must provide for payment, at least annually, of a "unitrust amount" equal to a fixed percentage, at least 5%, of the net fair market value of the trust corpus valued annually. IRC §664(d)(2)(A). (Plan I unitrust).

B. *Alternative Payments.* The trust may provide that only trust income, up to the unitrust amount percentage, will be paid out each year (Plan III unitrust) or that excess income can be used to make up for underpayments in prior years (Plan II unitrust). IRC §664(d)(3); Reg. §1.664-3(a)(I)(i)(b).

C. *Additions to Trust.* Additions to the trust corpus can be made if permitted by the governing instrument. Reg. §1.664-3(b).

D. *Payments from Trust.* No payment, other than the unitrust amount, can be made except to charity. Reg. §1.664-3(a)(4).

E. *Fluctuation of Payments.* The unitrust offers the possibility of increased annual payments to the income beneficiaries as well as the risk of lower payments should the net fair market value of the trust decrease.

F. *Commingling of Trust Assets.* Assets of unitrust and annuity trusts may be commingled for investment purposes. Rev. Rul. 83-19. However, such must be permitted under state law, the donor should give permission in the trust instrument, state securities laws must be observed, and an SEC "no action" letter should be obtained.

V. CHARITABLE REMAINDER ANNUITY TRUST IRC §664; Reg. §1.664-2

A. *Payment of Annuity Amount.* The trust must provide for the payment, at least annually, of a sum certain (the annuity amount) that is at least 5% of the initial fair market value of the trust. IRC §664(d)(1)(A). The annuity amount can be expressed as a fixed dollar amount or as a percentage. Reg. §1.664-2(a)(1)(ii) and (iii).

B. *Additions to Trust.* There can be no additions to the trust after it has been funded. Reg. §1.664-2(b).

C. *Payments from Trust.* No payment, other than the annuity amount, can be made except to charity. Reg. §1.664-2(a)(4).

D. *Charitable Deduction "5%" Rule.* At the establishment of the trust, the donor is entitled to a charitable contribution deduction for the actuarial value of the remainder interest passing to charity. Reg. §1.664-2(d). In Rev. Rul. 77-374, IRC 1977-40, 17, the IRS took the position that no deduction would be allowed if the probability exceeds 5% that a noncharitable beneficiary of the trust will survive to the exhaustion of the trust. A 1982 tax court decision, *Moor* (TC Memo 1982-299, 5/27/82), eased compliance somewhat with the "5%" rule, and the 10% tables make it easier to pass the "so remote as to be negligible" test.

E. *Constant Payment.* The annuity trust provides a constant unchanging flow of income to the income beneficiary(ies). There is no increase or reduction in the annuity payment as the result of a change in the fair market value of the trust, unless the principal of the trust is reduced to zero.

VI. DETERMINATION OF DEDUCTION

The amount of the contribution deduction is determined by the use of single life, two life, and term of years tables provided in the regulations. Rev. Rul. 83-128 increased the underlying interest assumption from 6% to 10% and eliminated the distinction between female and male mortality. Sample remainder factors are as follows:

CHARITABLE REMAINDER FACTORS
SINGLE LIVES
(Payable Quarterly)
UNITRUSTS

	6%	7%	8%	9%
Age 55	.33486	.28739	.24877	.21704
Age 65	.46772	.41905	.37723	.34107
Age 75	.61677	.57365	.53475	.49951
Age 85	.75491	.72265	.69237	.66390

CHARITABLE REMAINDER FACTORS
SINGLE LIVES
(Payable Quarterly)
ANNUITY TRUSTS

	6%	7%	8%	9%
Age 55	.50205	.41906	.33607	.25307
Age 65	.57717	.50670	.43623	.36576
Age 75	.67559	.62152	.56746	.51339
Age 85	.78004	.74338	.70672	.67006

CHARITABLE REMAINDER FACTORS
TWO LIVES
(Payable Quarterly)
UNITRUSTS

	6%	7%	8%	9%
M 55; F 55	.22218	.17590	.14013	.11227
M 65; F 65	.34522	.29244	.24865	.21214
M 75; F 75	.50181	.45014	.40457	.36425
M 85; F 85	.66445	.62243	.58354	.54749

CHARITABLE REMAINDER FACTORS
TWO LIVES
(Payable Quarterly)
ANNUITY TRUSTS

	6%	7%	8%	9%
M 55; F 55	.43863	.34507	.25151	.15794
M 65; F 65	.49724	.41345	.32965	.24586
M 75; F 75	.58985	.52149	.45313	.38478
M 85; F 85	.70489	.65570	.60651	.55733

VII. MANDATORY TRUST PROVISIONS

The code, regulations, and revenue rulings provide for a number of mandatory trust provisions. Some, but not all, are as follows:

A. The charity must qualify as a 170(c) organization at the time of any distribution to it.

B. The trust must provide for the proration of payments for short taxable years.

C. The trust cannot be obligated for the payment of any death taxes.

D. The trust must provide for the correction of over or under payments as a result of incorrect trust valuation.

E. Certain of the private foundation rules must be addressed. Under IRC §508(e) and 4947(a)(2), certain private foundation rules apply to split-interest trusts, "not all of the unexpired interests in which are devoted to" charitable purposes. Thus, the rules apply to charitable remainder annuity trusts, unitrusts, and pooled income funds. The rules are contained in IRC §4940 through §4948 and the regulations promulgated thereunder. Substantial penalties can be assessed for violation of these rules.

1. *Self-Dealing. IRC §4941*

   a. Self-dealing is defined as "any direct or indirect:

      (1) sale or exchange, or leasing of property between a private foundation and a disqualified person;

      (2) lending of money or other extension of credit between a private foundation and a disqualified person;

(3) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
(4) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
(5) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and
(6) agreement by a private foundation to make any payment of money or other property to a government official as defined in §4946(c), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating within a 90-day period."

The payment of the annuity or unitrust amount is not an act of self-dealing. IRC §4947(a)(2)(A).

b. There are certain exceptions to the self-dealing rules, the most common of which is the transfer of real or personal property by a disqualified person to a private foundation. This shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer. [NOTE: If the private foundation does not assume the mortgage and if the mortgage was placed on the property outside the 10-year period, it is not self-dealing. Several private letter rulings have held that the initial transfer of mortgaged property is not an act of self-dealing.]

2. *Excess Business Holdings. IRC §4943*

a. Generally, a private foundation may not hold substantial amounts of the voting stock of an incorporated business. Restrictions are also applicable to partnerships. IRC §4943(c) (2); §4843(c)(3).

b. The excess business holdings rule will not apply to charitable lead trusts if the income interest is not more than 60% of the fair market value of the trust. IRC §4947(b)(3)(A).
c. Similarly, the excess business holdings prohibition will not apply to a remainder trust if none of the annuity amount or unitrust amount (prior to termination) can be distributed to a 170(c) organization. IRC §4947(b)(3)(B).

3. *Jeopardizing Investments. IRC §4944*
a. §4944 prohibits a private foundation from investing in investments which "jeopardize the carrying out of any of its exempt purposes." IRC §4944 (a)(1). Such investments are not defined in the code or regulations and are reviewed on a case by case basis. Certain items which will be "closely scrutinized" are margin tradings in securities; trading in commodities; working interests in oil and gas wells; the purchase of puts, calls, and straddles; the purchase of warrants and selling short. Reg. §53.4944-1(a)(2)(i).
b. As with excess business holdings, IRC §4944 will not apply to certain lead trusts and to remainder trusts from which no charity receives income prior to termination of the trust. IRC §4947(b)(3)(A) and (B).

4. *Taxable Expenditures. IRC §4945*
Taxable expenditures are defined as any amount paid or incurred by a private foundation:
a. To carry on propaganda or otherwise influence legislation;
b. To influence the outcome of an election or carry on a voter registration drive except under certain circumstances;
c. To provide grants for travel or study except under certain circumstances;
d. To give a grant to another organization except under certain circumstances; and
e. To carry on any purpose other than one specified in IRC §170(c)(2)(B). IRC §4945(d).

F. *Reformation of Faulty Trust.* The Tax Reform Act of 1984 provided for the reformation of certain faulty charitable remainder trusts. In order to be eligible for reformation, a trust must evidence the intent to comply with the appropriate provisions of the IRC, or meet certain pre-1969 requirements. As a result of the reformation, there can be no more than a 5% difference in actuarial value, the noncharitable portion of the trust must end at the same time, and interest is payable on any pre-reformation tax liability.

There is no time limitation for reformation for those trusts that meet the intent to comply test; reformation for trusts that would have qualified under pre-1969 law but do not meet the intent to comply test beginning within 90 days after the filing date for the estate tax return, or if no return is due, within 90 days after the due date of the trust's first income tax return.

VIII. CHOICE OF MOST APPROPRIATE INSTRUMENT

A. *Annuity Trust*

1. The annuity amount is fixed at inception; never changes unless the corpus is exhausted.
2. Additions to corpus after initial funding are prohibited.
3. Generates a higher charitable contribution factor than the Unitrust.
4. Recommended for hard to value assets; only the initial appraisal is required.
5. Provides a lesser degree of inflation protection than the Unitrust.

B. *Unitrust*

1. Charitable contribution deduction is the same for Plans I, II, and III.
2. Assets may be added to corpus from time to time if the trust so provides.
3. Plan I
    a. Uses the four tier concept (see below) for payouts to beneficiary; nearest to the Annuity Trust in this regard.
    b. Provides some inflation protection; however, income may drop based on annual valuation of the corpus.
4. Plan II (income only, with makeup provisions)

a. May be best for trust funded with unproductive or underproductive assets.
b. Charity is assured that principal will not be invaded for beneficiaries.

5. Plan III (income only, no makeup)
   a. Most favorable to the charity but not attractive to donors generally.
   b. Found to have very little demand and is seldom used.

C. *Other Planned Giving Instruments*
   1. Gift Annuity or Deferred Payment Gift Annuity.
   2. Pooled Fund Life Income Agreement.
   3. Deed of farm or residence with reserved life estate(s).
   4. Revocable trust.
   5. Present gifts may be best.

IX. THE FOUR TIER CONCEPT

Used to determine the nature for tax purposes of distributions to beneficiaries of Annuity Trusts and Unitrusts, Plan I. All funds in the first category must be exhausted before the second category is deemed to be paid out, etc.

A. Ordinary income.
B. Capital gains.
C. Other income (primarily tax exempt income).
D. Return of principal.

X. SELECTION OF RATE OF RETURN

A. Minimum rate is 5% for both Annuity Trusts and Unitrusts.
B. The higher the rate selected, the lower is the charitable contribution deduction factor.
C. Do not select a rate of return in excess of anticipated rate of return, especially for Unitrust, Plan II or Plan III, as end result is a loss of charitable contribution deductions.

XI. SELECTION OF TRUSTEE

A. The donor may serve as trustee, but this is not recommended.
   1. The donor seldom has expertise to administer the trust properly.
   2. Powers of the trustee are deemed to have been

retained by the donor and this may result in unfavorable tax consequences.

B. The charitable organization itself frequently serves as trustee.
   1. Trust administration requires accounting, legal, investment, and real estate expertise which can be expensive.
   2. A potential conflict of interest must be recognized.

C. An independent institutional fiduciary may serve.
   1. The fee structure tends to penalize both donor and charity, especially for trusts of small or medium size.
   2. The charity may be able to negotiate more favorable rates on a blanket basis.

D. A qualified individual may serve as trustee.

XII. SELECTION OF TERM

A. Income may be payable to one or more individuals living at the inception of the trust;

B. Income may be payable for a term certain not to exceed twenty years;

C. Income may be payable for a life in being followed by a life in being, or by a term of years, whichever is shorter.

D. Since younger lives greatly reduce the charitable remainder factor, consider terms of years to benefit children, grandchildren or others in younger generations than the donor, perhaps taking into account the anticipated completions of their education.

XIII. THE REMAINDER BENEFICIARY

A. All distributions of income or principal must be made only to a qualified charity or charities.
   1. §170(c)—qualified for income tax charitable contributions.
   2. §2055—qualified for estate tax charitable deduction.
   3. §2522(a)—qualified for gift tax charitable deduction.

B. The trust instrument may name alternate beneficiaries in the event the primary remainder beneficiary does not qualify, such as a parent or affiliated organization.

C. As a fail-safe provision, trustee is typically given discretion to select one or more qualified charities to receive distribution if the named charitable remainder beneficiaries do not qualify at time of distribution.

XIV. SELECTION OF ASSETS

A. *Cash.* After-tax cash is a universally accepted asset. It may pave the way for tax exempt income to the beneficiaries, if desired.

B. *Traded Securities.* Traded securities may be placed in trust without capital gains tax implications and may later be sold by the trust, also without capital gains tax. This often presents a donor with an opportunity to diversify without adverse tax consequences.

C. *Closely Held Securities.* While they may present some difficult valuation problems, closely held securities may be placed in an Annuity Trust or Unitrust.

D. *Real Property,* other than a residence, office, or other property which the donor plans to occupy in the future, may be transferred into trust.

1. Unproductive or underproductive real property will typically be sold by the trustee and the net proceeds reinvested in income producing assets. A Unitrust, Plan II, may be the best vehicle for administration of such property in trust.
2. Certain real property interests, such as oil and mineral rights, may be very hard to value. An Annuity Trust may be utilized because it requires valuation only once at the time of funding.
3. Encumbered property poses a number of problems which may be difficult or impossible to resolve and for that reason is frequently avoided when funding Annuity Trusts and Unitrusts.

E. *Stamps, Coins, Antiques* and other items of tangible personal property are generally recognized as unsuitable for the funding of Annuity Trusts and Unitrusts because of the special rules which govern them for charitable giving purposes.

XV. WHAT ARE THE BENEFITS TO THE CHARITY?

A. The heart of the concept is that someday the charity will receive usable assets for the advance of its cause.

B. It builds a discernible future asset base to assist the charity in its planning.

C. It can make assets available to the charity on a loan basis for present use.
D. It gives the charity a unique relationship with a segment of donors who receive periodic income checks from a Charitable Trust. This is more intense where the charity serves as Trustee.
E. It enhances the current (lifetime) gifts of these donors.
F. It intensifies the donor's interest in all the charity does.
G. It attracts gifts the charity would otherwise not receive due to the donor's need to retain the capital for income purposes.
H. It attracts larger gifts because they come from accumulated assets and not from annual earnings.

WORKSHOP SESSION—CHARITABLE REMAINDER TRUSTS—ADVANCED

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Executive Director of Development

I. FUNDING ASSETS—OPPORTUNITIES AND IMPLICATIONS

A. Real estate

A charitable remainder trust is an excellent vehicle for a gift of appreciated real estate. Through such a gift the donor unlocks the gain and converts it to income without loss of sales proceeds through taxation. Typically, real estate will be transferred to a net-income unitrust so that payments to beneficiaries can be limited to actual income until the property is sold. If raw land is transferred, no payments will be made until the property is sold and the proceeds reinvested. Donors will likely be more accepting of a deferral of income if a make-up provision is included in the trust agreement. That provision, however, won't make a lot of difference to the beneficiaries if the sales proceeds are invested in growth stocks with a dividend yield less than the pecentage payout. It is possible, though, to have deficiencies made up out of capital gain realized by the trust if the trust's accounting income, as defined in the trust instrument and local law, includes such gain. IRC Sec. 664(d)(3), 643(b); Reg. Sec. 1.643(a)(3)(a)(1).

Donor involvement. When the property is transferred to the trust, the donor must be prepared to vacate the premises. Continuing to live in the house rent-free would constitute a prohibited other payment, and paying rent to the trust would be an act of self-dealing since the donor is a disqualified person. Reg. Sec. 53.4941(d)-2(b). A possible resolution, if the donor wants to continue occupying the residence, is to partition the homestead portion of the real estate and not transfer it to the trust. It could be added later as an addition to the trust when the donor is ready to move. Some limited involvement by the donor is permissible. For instance, the donor could be retained by the trustee to oversee the property and provide certain services and be reasonably compensated.

The donor is likely to want to be consulted about the sale since future payments depend on the amount realized. This raises the question whether the trustee should consult the donor before responding to an offer, or simply exercise his own judgment and inform the donor after the fact. The former might be construed as the exercise of a restriction contrary to the requirements of Reg. Sec. 1.644-1(a)(3), particularly if the donor's consent is required before the offer can be accepted. The latter could result in a very unhappy donor if a cherished property is sold well below what he thinks it is worth. Provided the donor understands that he cannot veto a sale or dictate the terms, soliciting his counsel is quite appropriate and will be greatly appreciated even if the trustee does not follow the donor's recommendations.

Problems with mortgaged property. Mortgaged property may be accepted for a unitrust provided the following problems have been considered and satisfactorily resolved:

1. *Self-dealing.* If a donor or a member of his family placed a mortgage on the property within 10 years before the gift, the transaction will be an act of self-dealing. IRC Sec. 4941(d)(2)(A). However, the initial funding of a charitable remainder trust with mortgaged property does not constitute an act of self-dealing regardless of when the mortgage was placed on the property. The reason is that the regulations provide that "the term 'self-dealing' does not . . . include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction." Reg. Sec. 53.4941(d)-1a. While an *initial* transfer of mortgaged property to fund a charitable remainder trust would not be an act of self-dealing whatever the age of the existing mortgage, a *subsequent* transfer of mortgaged property (for example, an addition to a unitrust) would be an act of self-dealing if the donor or a member of his family placed the mortgage on the property within ten years of the gift.

2. *Unrelated business taxable income (UBTI).* A charitable remainder trust is not exempt from taxes if it has any unrelated business taxable income, which includes debt-financed income. It will have such income if it acquires gift property subject to a mortgage. However, IRC Sec. 514 sets forth two exceptions to this general rule: first, where the property is acquired by bequest or devise; second, where the mortgage was placed on the property more than five years before the gift. IRC Sec. 514(c)(2)(B). These exceptions do not apply if the trust assumes and agrees to pay all or any part of the indebtedness secured by the mortgage or makes any payment for the equity owned by the decedent or donor in the property. Reg. Sec. 1.514(c)-1(b)(d)(iii).

   The fact that the trust would have to pay UBTI should not in itself cause the gift to be rejected. Sometimes it makes good sense for the trust to accept the property and pay the taxes, but the liability should be carefully calculated before proceeding.
3. *Bargain sale rule.* Under the bargain sale rule, when encumbered property is transferred, the amount of the indebtedness is treated as an amount realized in calculating gain or loss, even if the recipient does not assume the indebtedness. Reg. Sec. 1.1011-2(a)(3). Charitable remainder trusts fall within the scope of this rule. Thus, the donor who transfers mortgaged property will recognize the portion of the gain allocated to the debt. If, for example, the debt constitutes 40% of the value of the property, 40% of the gain will have to be reported in the year of the gift. The charitable deduction may or may not be large enough to offset the gain. Even when the deduction is larger than the taxable gain, the amount of deduction that can actually be used under the deduction ceiling may be less than the taxable gain. In that case the gift could cost the donor money. It may still make sense to incur initial out-of-pocket expenses for the long-term benefits, but the donor must be fully informed of the consequences.

4. *Prohibited payments.* Authorized payments from charitable remainder trusts are limited to payments of the annuity or unitrust amount and distributions to charities. Reg. Sec. 1.664-2(b)(4). Yet, payments are permitted if they are for "full and adequate consideration." Reg. Secs. 1.664-3(a)(4) and 1.664-2(b)(4). While the meaning of this term is not fully clear, mortgage payments are arguably a form of investment and thus are made for "full and adequate consideration."

B. Closely held stock

Some of the largest fortunes have been amassed, not by the CEOs who rose through the ranks of public corporations, but by entrepreneurs who started with only an idea and daring. Most of their wealth is likely to be represented by the closely held stock of their company, so a large cash gift is out of the question. However, a charitable remainder trust funded with such stock is very appealing because the trust offers a partial solution to their concerns about the sale or continuity of the business and about income and estate taxes.

Advantages. The trust may simply retain the stock for an indefinite period since it is exempted from excess business holdings tax under IRC Sec. 4947(b)(3). For instance, the primary owner of a corporation intends to run it until retirement, after which it can be sold. He is drawing a large salary from the business, but the stock pays no dividends. He contributes some of his shares to a charitable remainder trust. No market exists for a minority interest, and the corporation makes no redemption offer because all surpluses are needed for expansion, so the trustee simply holds the stock in expectation of an eventual sale of the business. As a result of the contribution, which poses no threat to his control of the company, the owner sharply reduces his current income taxes. This situation calls for a net-income unitrust with or without a make-up provision. An annuity trust or regular unitrust won't work because of the required payments. The primary disadvantage is the annual valuation of the stock, which can be rather expensive. Since the trust will have no assets to pay for these annual appraisals, the donor could be asked to make a cash contribution to the trust or to have the company redeem at least some of the shares.

A charitable remainder trust works particularly well when the principal stockholder is contemplating a sale of the business. By transferring all or part of his stock prior to the conclusion of a sales agreement, he avoids tax on the gain, thereby preserving more of the proceeds for income production. If the trust owns all of the shares, instead of selling the corporation, it might liquidate it. This course could be followed, for example, with a personal holding company whose assets are entirely liquid. The plan of liquidation must be adopted following the gift. Otherwise, the shareholders may be liable for the capital gain under the assignment of income theory.

Occasionally, other stockholders who are not disqualified persons may wish to purchase the stock from the trust, but a redemption by the corporation will be more likely. In either case, the stock which, in the owner's hand, paid no dividend will have been converted to an income-producing trust asset, and the donor will have received an income tax deduction in the process. A redemption, of course, could be one way to solve an excess retained earnings problem. A corporation receives no deduction for a redemption of the stock, but if the corporation has an Employee Stock Ownership Plan (ESOP), it can contribute the cash to that plan and take a deduction, whereupon the ESOP can use the cash to redeem the stock from the trust.

Problems with redemption of stock. It is rather well-established that a redemption of closely held stock by the corporation is possible without adverse consequences to the donor if the charity is not legally bound nor cannot be compelled by the corporation to surrender shares for redemption. *Palmer vs. Commissioner,* 62 TC684 and Rev. Rul. 78-197. However, if the charitable remainder trust, in conjunction with a defined class of family members, owns more than 35% of the voting stock of the corporation, then the corporation itself is a disqualified person, and any transaction between the trust and corporation would be a prohibited act of self-dealing. Fortunately, Reg. Sec. 53.4941(d)-3(d) permits a redemption of stock by the corporation, even when the corporation is a disqualified person, provided an offer of redemption is made to all persons who hold securities of the same class and the trust receives no less than fair market value. An independent appraisal and a record of corporate minutes and correspondence evidencing that a bona fide offer was made to all shareholders would be essential.

Valuation. The factors to be considered in valuing closely held stock were set forth in Rev. Rul 59-60, but the application of them is difficult, especially if a minority interest is being valued. It is not enough to determine the intrinsic value of the entire company and divide that figure by the total number of outstanding shares to arrive at the per-share value of contributed stock. When a minority interest is contributed the intrinsic value of the shares must be discounted, both because of the lack of marketability and the fact that the owner of a minority interest is powerless to affect a company's future. The size of the discount is constantly disputed, and the IRS refuses to give any rules of thumb, arguing that each case must be considered on its own merits. Tax Courts have commonly allowed discounts in the range of 20-35%. The fact that the appraiser discounts the stock will not necessarily discourage the donor if a redemption is anticipated for the appraised value. More shares would have to be given to reach the charitable objective, but a sole stockholder would still own 100% of the company. If the children are also stockholders, the result would be to transfer more equity ownership to them.

The appraisal should be done by an independent, qualified appraiser, not by the donor's personal accountant. Where a unitrust is funded with closely held stock and the charity is the trustee, it is advisable to have a co-trustee charged with the responsibility of arranging an appraisal on the annual valuation date, or at least to stipulate that valuation is to be done by an independent appraiser.

Unrelated business income. A charitable remainder trust does not pay tax on passive income derived from rents, interest, and dividends unless any of those items derive from a "controlled corporation." In IRC Sec. 368(c)(1) "control" is defined as ownership of at least 80% of the combined voting stock and at least 80% of all other classes of stock. Ordinarily a trust will not continue to hold a controlling interest, but if it does, dividends and other income it receives from the company will be taxed.

C. Tax-exempt securities

Many retired persons have portfolios of tax-exempt securities, often with distant maturity dates. Their intention is to retain them for a predictable source of income to cover basic living expenses. They would consider contributing them if they could retain the same amount of tax-free income and reduce taxes on their other taxable income. These objectives can be achieved if they transfer some of the tax-exempts to a remainder trust and the tax-exempts are retained by the trust.

Unless they anticipate making additional transfers, an annuity trust is preferable. The fixed payment from the trust can be made exactly equal to the bond interest so that the donor is in the same position as before. So long as these same bonds are retained the trustee will not have to invade corpus—nor will there be any growth of principal. If any of the bonds are callable, or have to be replaced for other reasons, the new bonds might or might not have equivalent yields, possibly necessitating some invasion of principal to meet the fixed payments. While this could diminish the charity's remainder, the donors could count on their predictable tax-free income. With a unitrust they would receive less than their accustomed income if the bonds fall in value because the unitrust amount would be less than the bond interest.

Not only may a trustee receive and retain tax-exempts but also purchase tax-exempts with trust assets. A cash contribution, for instance, could be invested in municipals of the donor's home state or in a bond fund—perhaps one that only includes municipals of a particular state in order to have income free of both state and federal income tax. Even if tax-exempts are the only investment, the status of the trust will not be affected.

Investment restrictions. Problems arise when the trustee is *required* to keep tax-exempt investments. A trust will be disqualified if the trust agreement includes a provision "which restricts the trustee from investing the trust assets in a manner which could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets." Reg. Sec. 1.644-1(a)(3). An investment in high quality municipal bonds arguably realizes a reasonable amount of income, but prudence dictates that the trust instrument impose no investment restrictions on the trustee and that it contain a paragraph stating that nothing in this instrument shall be construed as imposing such restrictions.

When appreciated property is contributed to the trust, and the trustee is obligated to sell it and invest in a prescribed manner, the donor may be personally liable for the gain. The well-known Pomona Rule (Rev. Rul. 60-370) specifically pertained to an expressed or implied obligation to reinvest in tax-exempt securities, but the IRS has on a number of occasions sought to broaden its scope to cover an exchange of appreciated property for any type of investment. The IRS's position is that the donor, by creating an obligation, effectively sold the property and contributed the cash proceeds.

Exactly what is meant by an "implied" obligation is not clear. Is it, for instance, an "implied" obligation if the charity's sales brochure illustrates the financial benefits of a remainder trust funded with tax-exempts? Or when a representative of the charity orally promises that the trustee will invest in tax-exempts even though the agreement contains no prescription? Or when the donor states an investment preference, but the trustee makes no commitment? While there must be no restrictions in the agreement and no commitments, it would seem that a trustee acting independently, with knowledge of the donor's situation and preference and concern for the charity's best interest, should be able to invest in tax-exempts when it seems appropriate. A bank trustee may be reluctant to invest in tax-exempt securities rather than a higher-yielding taxable investment because of concern about fiduciary responsibility to the charity. The charitable trustee, on the other hand, is more free to maintain tax-exempt trusts, believing that its own interests are ultimately best served by responding to the donor's preferences.

D. Tangible personal property

Paintings, jewelry, antiques and other items of tangible personal property may be contributed to a charitable remainder trust, but no income tax deduction will be allowed. According to IRC Sec. 170(a)(3), if an individual contributes a future interest in tangible personal property and an intervening interest is held by the donor or a member of his family, no deduction is allowed to the donor until the intervening interest expires. Clearly, a gift to a charitable remainder trust is a gift of a future interest, and family beneficiaries normally hold the intervening interest.

The denial of a deduction doesn't make as much difference since the Tax Reform Act of 1986, for that Act limits the deduction for "unrelated use" tangible property gifts to the cost basis. Even if a deduction were allowed, it would be calculated on the cost basis, not the fair market value, and the cost of such donated items is likely to be low relative to their current value.

The charitable deduction may be of secondary importance in any case. More important is taking an idle asset, which is costing money for insurance and storage, and converting it to a stream of income, especially if no tax is incurred on the gain when the trust is funded. An interesting question is whether the untaxed gain would be a tax preference item if no charitable deduction were allowed.

As with real estate, a net income unitrust should be used unless the objects can be readily sold. If an annuity trust is selected, one should keep in mind that auction houses typically charge commissions in the range of 20%, and the objects may bring less than anticipated. Thus, the net proceeds might be insufficient to sustain the fixed payments over a period of time.

II. PLANNING IDEAS

A. Present as well as deferred benefits for the charity

The charity normally doesn't benefit from a charitable remainder trust until the death of the beneficiaries or the expiration of a specified term. The benefits may be accelerated, however, through any of the following arrangements:

Name the charity as an income beneficiary. In the trust instrument the charity can be named as one of the income beneficiaries. For example, a unitrust with an 8% payout rate can pay 75% of the income to noncharitable beneficiaries and 25% to a charity, which may or may not be the charity named as remainderman. This arrangement is appealing to donors who require some, but not all, of the income and want to help their favorite organization now. The fact that a portion of the income will be paid to charity does not increase the size of the income tax charitable deduction, though the portion paid to charity is not subject to income tax.

Contribute a portion of the trust income to charity. The disadvantage of having a charity as income beneficiary is that flexibility is sacrificed. Should the individual beneficiary need all of the trust income in the future, the portion paid to charity is not accessible. An alternative is for the individual beneficiary to receive the entire trust income and contribute back a portion to the charity. This, of course, is nothing more than a series of outright gifts made with money that happens to come from the trust. The trust payments are taxable to the beneficiary according to the four-tier structure, but the beneficiary receives an offsetting charitable deduction for each contribution. Assuming trust payments are taxable as ordinary income and the contribution is within the deduction limitation, the income tax consequences are the same as if the charity were an income beneficiary of the trust. In the one case, the deduction offsets the taxable income; in the other the income paid to charity is not taxed. Yet, flexibility is preserved should the beneficiary's financial situation change in the future.

Some people who can afford to make a major outright gift hesitate because they may need additional income in the future. They can be encouraged to establish a charitable remainder trust and contribute back all of the income on a regular basis. To simplify the procedure, the donors could sign a letter of intent authorizing the charity to retain the trust payments as a donation. As a result, the charity receives regular, outright gifts now, as well as a deferred gift of the remainder interest. Should the donors' financial circumstances change in the future, they may direct the charity to begin sending them the income.

Donate an income interest to the charity. The beneficiary of an existing income interest may donate that interest to the charity and receive income and gift tax deductions for the transfer. Rev. Rul. 86.60, Letter Ruling 8805024. Such a transfer may be suggested to beneficiaries who have ample income from other sources or who wish to respond to a capital campaign with a present gift. If the donor is the sole income beneficiary of the trust, the charity would own both the remainder and income interests following the transfer in which case, subject to applicable state law, the trust would terminate and all of the assets be immediately available to the charity. If there are other beneficiaries, the trust would continue and the charity would receive a portion of the income.

Often trust income will be divided between two concurrent beneficiaries, and then the entire income will be paid to the survivor. Instead of this arrangement, when one of the concurrent beneficiaries dies, his or her share of the income could be paid to the charity. This may result in an additional gift or estate tax deduction for the trustor.

Still another possibility for a trust already in operation is for the beneficiary to give a portion of his interest to the charitable remainderman. It isn't necessary to surrender all of the income. He will be entitled to a charitable deduction for his fractional interest. This appears to be supported in Reg. Sec. 1.664-3(a)(3)(i), which says that a unitrust amount must be payable to or for the use of a named person or persons, at least one of which is not an organization described in IRC Sec. 170(c).

Borrow against trust principal. The IRS has issued several private letter rulings allowing trustees of charitable remainder trusts to guarantee loans made to charitable remaindermen by third parties. The trust assets were pledged as collateral. Letter Ruling 8807082 specifically allowed the inclusion of a paragraph permitting the trustee to guarantee loans made by third parties and, in the event of default, to sever assets to deliver to the creditor. It may also be possible to include language permitting the trustee to loan trust assets directly to the charity. The loan would not be a prohibited act of self-dealing since the charity is not a disqualified person with reference to the trust.

B. Charitable remainder trusts established by corporations

Ordinarily charitable remainder trusts are marketed to individuals, but under certain circumstances they may appeal to corporate donors as well. For example, a corporation with an extended charitable commitment could transfer some long-term capital gain property (undeveloped land, for instance) and receive trust income for a term of years. Reg. Secs. 1.664-2(a)(5)(i) and 1.664-3(a)(5)(i). When the income is payable to a corporate beneficiary, the trust must necessarily be established for a term of years rather than the lifetime of an individual. Like an individual trustor, the corporation receives an income tax deduction for the remainder interest and avoids tax on the capital gain.

If the corporation donates stock in another domestic corporation which the trustee retains, or the trustee sells the donated property and purchases such stock, the corporation may be entitled to the 70%

dividends-received deduction under IRC Sec. 243. Rev. Rul. 66-72 allowed this for a revocable trust, though there has been no specific ruling for charitable remainder trusts. Should the deduction apply, the corporation would receive a tax deduction, avoid tax on capital gains, and reduce tax on the income.

Instead of having the income payable to itself, the corporation could name certain key employees as beneficiaries of the trust. This could be part of an employee compensation package. While the corporation may wish the payments to be contingent on the employee's remaining with the company, such a provision could disqualify the trust because the income interest would not extend over either the life of a beneficiary or a term of years. Possibly the trust could be established for a term of years with income payable to the company for the balance of the term if the employee leaves. Whoever the income beneficiaries, the corporation can retain the power, exercisable at any time, to designate remaindermen in lieu of the ones named in the trust instrument. Rev. Rul. 76-371.

C. Versatility of term-certain charitable remainder trusts

The availability of the term-certain option makes possible a number of gifts that might otherwise be lost. Following are only a few of the applications:

Trust for younger beneficiaries. Many charities that act as trustees of charitable remainder trusts have minimum age requirements for beneficiaries. This is necessary because the costs of administering a trust over the lifetimes of younger beneficiaries may exceed the present value of the future interest. An alternative is to create a term-certain trust. Many donors who want to provide supplemental income for children or grandchildren are quite content to limit the subsidy to a term of years.

Trust for the unborn. If a trust is created for the lifetimes of the beneficiaries, they must all be alive at the time the trust is created. Not so, however, for a term-certain trust. Reg. Sec. 1.664-2(a)(3)(i). A grandparent, for example, could establish a 20 year annuity trust to pay a fixed sum of income equally divided among all grandchildren now alive or born during the term of the trust.

College trust. One of the most common uses of the term-certain trust is to provide college expenses for a child or grandchild. The trust may be established the year prior to the student's freshman year, timed so that the first trust payments will be received by the time tuition and other expenses are due. The duration of the trust will depend on whether graduate and professional, as well as undergraduate education is to be provided. Waiting until the student is ready to enter college will, of course, necessitate a rather large contribution to generate the required income. The prudent parent or grandparent may prefer to establish the trust in the early childhood years. In that case, high-growth, low- or non-income-producing trust investments are preferred. A net-income unitrust funded with zero coupon bonds maturing at the time the student is of college age would be ideal. At that point the trustee could reinvest the redemption proceeds to maximize current income. The imputed interest under IRC Sec. 1272 is not imputed through the trust to the noncharitable beneficiary. Hence, there is not the problem of unwanted income taxed at the parents' bracket before the child reaches age 14. Upon the redemption of the bonds the entire increment in value should not be taxed to the beneficiary if (a) no make-up provision is included or (b) the trust agreement provides that such increment is to be allocated to principal rather than income. Obviously, applicable state trust law must be taken into consideration in drafting the trust agreement, and the trustee must be free from investment restrictions.

Once the trust starts distributing income, it will be taxed to the college student, but this should be of small consequence because the student's tax bracket presumably will be low. The parent or grandparent who creates the trust receives a charitable deduction and is able to fulfill a responsibility with capital gain property without being taxed on the gain. This is immensely better than funding the education with after-tax dollars. The trustor will have made a taxable gift to the student of the income interest, though the amount of the taxable gift can be reduced through the annual exclusion, and any tax may be covered by the unified credit if it has not previously been used up.

High payout short-term trust. Suppose a donor with some highly appreciated real estate or stock has decided that now is the time to sell. He is interested in a charitable gift, but wants to retain most of the proceeds for himself. A bargain sale is, of course, one alternative. Another is a short-term, high-payout annuity trust. For example, he could transfer stock having a market value of $100,000 to create a five-year annuity trust paying him $15,000 per year. Over the five-year period he recovers $75,000 of the value plus the tax savings on a charitable deduction of $43,138, and the charity will receive approximately $40,000 at the end of five years. Effectively, he has sold the stock on the installment basis and fulfilled his charitable intention while minimizing taxes. Although the payout is high, the annuity trust passes the 5% probability test because of the short trust term.

D. Advantages of a Qualified Terminable Interest Property (QTIP) Trust with remainder to charity

A QTIP trust, with the remainder payable to charity upon the death of the surviving spouse, is a type of charitable remainder trust. When the objective is to provide a surviving spouse with life income, a QTIP trust is generally preferable to an annuity trust or unitrust for the following reasons:

—The entire income is paid out to the surviving spouse.

—Invasion of principal for the survivor is permitted.

—Self-dealing rules do not apply, so sales of assets between the trust, family members and family businesses are permitted.

—A family member can be named as trustee.

The estate tax consequences are the same for a charitable remainder trust and a QTIP trust where the sole beneficiary is the surviving spouse, and a charity is the remainderman. In the first case trust assets escape estate taxes because the spouse's income interest qualifies for the marital deduction and the remainder interest qualifies for a charitable deduction. In the second case they escape estate taxes because a marital deduction is allowed for the trust assets in the estate of the first spouse to die (IRC Sec. 2056(b)(7)), and upon the death of the second spouse a charitable deduction is allowed for the remainder passing to charity. Although the entire corpus is included in the estate of the surviving spouse, it is offset by the charitable deduction. Considering the fact that estate tax is avoided with either alternative, it is usually advantageous to select the more flexible QTIP trust.

Of course, the charitable remainder trust must be used if the objective is to reduce income taxes while both spouses are alive. Many couples will create intervivos annuity trusts or unitrusts with the dual purpose of securing an income tax deduction now and providing income that continues throughout the lifetime of the survivor. A charitable remainder trust is likewise the only alternative if the surviving beneficiary is someone other than a spouse. With a charitable remainder trust, the decedent will at least be entitled to an estate tax deduction for the remainder interest. A nonqualified trust provides no such benefit.

Charities haven't exploited the full potential of QTIP trusts because they usually aren't in the loop. Many charities serve as trustees of charitable remainder trusts and aggressively market them. Probably most such trusts are, in fact, initiated by a planned giving officer. However, the QTIP trust is more likely to be drafted by the client's attorney with no input from the charity. In many cases clients probably would name favorite charities as remaindermen along with family members if the idea were proposed. The idea of using a QTIP trust to fulfill a threefold responsibility—to spouse, to family, and to the community—needs to be communicated more effectively to donors and their advisors.

The requirements of a QTIP trust are relatively simple compared to charitable remainder trusts. The surviving spouse is entitled to all of the income; she (he) must be able to compel conversion of non-income-producing property into income-producing property; no one can be given a power to appoint trust property to someone other than the spouse. In a few cases the inclusion of QTIP trust property in the estate of the surviving spouse could limit the ability to defer estate tax under IRC Sec. 6166.

III. SELECTED PROBLEMS

A. Floating discount rates

New actuarial tables for valuing annuities, remainders, reversions, life interests and term-of-years interests become effective in May, 1989. Unlike the current tables which are based on a 10% interest assumption, the new tables will be based on a floating interest (discount) rate equal to 120% of the federal mid-term interest rate, as revised monthly. This rate can generally be found in *The Wall Street Journal* or the *Internal Revenue Bulletin* on or about the 20th of each month. Look under Mid-Term AFR (Applicable Federal Interest Rates) for "120% of AFR" and use the annual percentage. This is the rate that applies for the following month.

Donors will have the option of using the current month rate, or the rate for either of the two previous months. Thus, a financial illustration could be presented to a donor with assurance that the deduction will not diminish if the gift is completed within a three month period. If the rate changes result in a larger deduction, the donor can take advantage of it. The donor could, in fact, choose among the rates for four successive months by waiting until the 20th of the current month to see the applicable rate for the following month. If that rate is more favorable, he can delay completion of the gift until the first of the month. Otherwise, he can choose either the current month's rate or the rate of either of the two preceding months—whichever results in a larger deduction.

Calculating the deduction. Those who have purchased one of the software packages for computing deductions need only enter the applicable rate when it is published. Vendors of this software are modifying their programs to accommodate floating rates. It will still be possible to do the calculation manually by using the new IRS tables and formulas. These new tables will contain interest assumptions ranging from 2% to 25% at 2/10% intervals. As a first step, round off the published applicable rate to the nearest 2/10%. Next, find the number in the table for that rate, and then use a formula to apply the table to the type of interest being valued. The new tables are to include formulas.

Impact on unitrust and annuity trust remainders. Unitrust remainders will be affected very little by the floating rates because unitrust tables have no built-in discount rate assumptions. The deduction for a unitrust with annual payments and annual valuation date, both at the end of the year, will be the same whether the applicable federal interest rate is 2% or 25%. Unitrusts are, however, slightly affected because the Frequency Adjustment Factor (Table F) is geared to the discount rate. This table must be used to adjust the payout rate for all unitrusts that don't provide for an annual payment and valuation date at the end of the year. Consequently, the deduction will vary with the federal discount rates, but the variation is hardly enough to affect the donor's decision.

Annuity trusts, on the other hand, will be dramatically affected by changes in the federal discount rate. If that rate exceeds 10%, the deduction will be larger than now, and conversely. For example, compare the deductions for an annuity trust having two life beneficiaries, both age 65, funded with $100,000, 8% payout, with annual payments and zero months until the first payment:

Discount Rate	Deduction
6%	$12,647
8%	25,431
10% (current)	35,345
12%	43,182
14%	49,486

These figures would have to be adjusted for payment frequencies other than annual, and the frequency-of-payment factors are based on the federal discount rates. These new factors are to be published with the new tables.

Marketing implications. Unitrusts will continue to have essentially the same appeal as before, and so long as the applicable rate hovers around 10%, annuity trusts likewise will retain their present marketability. If interest rates rise sharply, as they did in the early 1980s, annuity trusts should become a hot item, although donors would probably insist on higher payments thus somewhat reducing their deductions. In a period of low interest rates, payments to beneficiaries of annuity trusts must be lowered to preserve a respectable deduction. In such a climate unitrusts will probably have relatively more appeal.

The primary marketing problem is providing promotional literature with accurate illustrations. Omitting concrete examples is not a good idea because actual cases are highly effective in explaining the concept. Yet the shelf-life of the numbers in these examples is only three months. Case studies can still be used with an appropriate caveat such as the following: "The charitable deduction is based on the applicable federal interest rate at the time of this publication (illustration), and that rate fluctuates from month to month. The deduction could be higher or lower in the future." A similar caveat should be used on all financial illustrations beginning in May.

B. Another trust as income or remainder beneficiary of a charitable remainder trust

Payments from a charitable remainder trust may be made to a second trust established for the benefit of an individual beneficiary. For example, parents of a mentally-retarded adult child want to assure the child's support whether or not they are living, so they establish a unitrust for the child's life and direct that the income be paid to a second trust from which monthly payments are made for the child's care. This arrangement is permitted in Rev. Rul. 76-270. The unitrust amount would be taxed to the individual beneficiary even though paid to a trust.

Likewise, the remainder of a charitable remainder trust may, upon termination of the income interests, remain in trust for the benefit of a publicly supported charity. If substantially all of the trust's income is paid to the public charity, and the trust is a charitable trust under state law, the trust will be a supporting organization as described in IRC Sec. 509(a)(3), and not a private foundation. The tax benefits will be the same as if the remainder were paid directly to the public charity.

The donor could designate the remainder for a private family foundation, but the tax benefits won't be as great. The deduction ceiling, for instance, will be 30% of adjusted gross income if the trust is funded with cash or ordinary income property, 20% if funded with long-term appreciated, marketable securities. If the trust is funded with closely held stock, the deduction must be reduced by all appreciation attributable to the remainder interest.

C. Donor as trustee

Some individuals are attracted to a charitable remainder trust because it offers, in addition to tax benefits, professional management of assets. Others forfeit the tax advantages because they are unwilling to surrender investment control. They don't necessarily believe they are more astute investors than a professional manager, but following the market and investing may be a source of great enjoyment. A charitable remainder trust would be appealing if they could act as trustee.

The IRS has not ruled specifically on whether donors can act as trustees of their own trusts. However, Rev. Rul. 77-285 indicated that a trust could give a donor the power to remove the trustee and appoint anyone, including himself, as successor trustee. From this ruling one could infer that a donor might be named as trustee from the outset. Clearly the donor should not be trustee if the donor-trustee has a power to sprinkle income among the beneficiaries. This would cause the donor to be treated as owner of the trust and result in its disqualification. Reg. Sec.

1.664-1(a)(4). It is also inadvisable for the donor to serve as trustee of a unitrust when the trust is funded with hard-to-value assets such as real estate or closely held stock, unless the trust instrument provides for an independent co-trustee, who is the sole party responsible for making the annual determination of value.

Usually, the donor-trustee will not wish to do the custodial work of keeping accounting records and filing fiduciary tax returns. A trust institution or accountant could be retained for that purpose, or the donor and a commercial trust institution could be named as co-trustees. When the donor acts as trustee, the donor's broker may be included in the action if the donor transfers securities from his individual brokerage account to one established in the name of the trust. The broker can be retained to buy and sell securities inside the trust. The ability to continue investment relationships and make investment decisions may persuade some persons to establish charitable remainder trusts who would not otherwise do so.

D. Payment of trustee fees and other expenses when the trust generates insufficient income

If a charitable remainder trust is funded with an illiquid asset such as real estate, no cash may be available for current expenses. Presumably a "net income" unitrust will have been selected for this type of asset, so no payments need to be made to the beneficiaries until the property is sold and the trust begins to generate income. Nevertheless, other expenses such as trustee fees, real estate taxes, insurance, utilities and assessments may have to be paid in the meantime. Ideally, the donor will contribute cash along with the property to provide the trust with operating funds. If he is disinclined to do so, he could loan money to the trust, repayable when the property is sold. An interest-free loan from the donor to a charitable remainder trust is not self-dealing. Reg. Sec. 53.4941(d)-2(c)(2). The loan could also come from the charitable remainderman. Encumbering the property to secure a loan from an external lender would not be a good idea, for such a loan would probably be defined as acquisition indebtedness, causing the gain upon sale of the property to be taxed. Another possibility is for the charitable remainderman to purchase a fractional interest in the property from the trust. The charity could then sell its fractional interest at the same time the trust sold its interest.

Many charities that act as trustees either do not collect a trustee fee at all or use some portion of the distributed remainder for the administrative expenses of trust management. The latter should not be a problem if no commitment has been made to the donor to use the entire remainder for a specified purpose, such as a named scholarship. The charity might decide to absorb not only the cost of administration but also certain expenses of the trust. While this alternative can be expensive to the charity, it may be a viable way to avoid the problem of unrelated, debt-financed income.

E. Alternative Minimum Tax (AMT)

In one respect charitable remainder trusts are less affected by the alternative minimum tax than outright gifts are. When a person makes an outright gift of capital gain property, the entire appreciation element is a tax preference item, but when the same property is contributed to a remainder trust, only the portion of the appreciation attributable to the remainder interest is counted as a tax preference. Compare, for example, the tax preference when securities valued at $100,000 and having a cost basis of $20,000 are contributed outright and to a unitrust. Assume that the charitable remainder factor for the unitrust is .30000.

	Outright Gift	Unitrust
Value of Gift	$100,000	$100,000
Cost Basis	20,000	20,000
Total Gain	80,000	80,000
Tax Preference for AMT	80,000	24,000*

*.30000 x $80,000 = $24,000. This is a short-cut computation. Technically, the portion of the basis allocated to the gift is subtracted from the portion of the market value allocated to the gift.

Sometimes an outright gift will trigger the alternative minimum tax, but the same gift to a charitable remainder trust does not. In those instances the donor may be inclined to the trust because he gains an income stream without sacrificing much in tax savings. When a donor to a charitable remainder trust is subject to the alternative minimum tax, the net effect is to limit the deduction to the cost basis of the gift portion.

CONCLUSION

"Give your heart to the trade you have learnt, and draw refreshment from it." –Marcus Aurelius

WORKSHOP SESSION—MARKETING PLANNED GIVING: OPPORTUNITY OR OBLIVION

Douglas K. Freeman, J.D., LL.M.
Freeman, Freeman & Smiley

I. ABC's of Planned Giving

A: Assess —Create and update your donor profile

B: Build —Develop the policies, brochures and techniques necessary to attract and educate the marketplace.

C: Cultivate —Classic "friend-raising" effort.

D: Deliver —Present your story and strength in seminars, articles, direct mail; but never promise what you can't deliver.

E: Execute —Be prepared to facilitate the documentation, appraisals and management.

F: Follow-up—Your best giver is your previous giver; don't abandon; recognize, reward and respect.

II. Overview of the Charitable Marketplace

1987 total contributions—$93.68 billion

88% from individual gifts and bequests ($82.8 billion)

Lowest income group (under $10,000) gave highest percentage of income—2.8%

Average incomes ($75,000-$100,000) gave—1.7%

Over 66% of contributions came from individuals with household income under $40,000

20 million people gave as much as 5%

Average person gifts approximately 2% of gross income

45% of all adults volunteered an average of 4.7 hours per week in 1987

12% gave more than 5 hours per week

80 million people donated 19.5 billion hours worth over $150 billion

4.4 million Americans have wealth of $300,000 or more; total net worth of $2.4 trillion

0.5% of American households (420,000 families) own more than 3.7 trillion dollars in wealth (35% of total wealth in the country). Bequests average about 20 times the size of the last annual gifts

Lifetime giving does not predict planned giving

In one study of estate returns, 13 of 21 persons who left $1 million or more to charity gave less than $10,000 in annual gifts on their last returns

III. Economic Perspectives

Loss of non-itemizer deduction for 62 million Americans, contributing $25 billion

Federal support for social services has dropped 55% since 1980

1987-88 budget reduces revenues to non-profits by $22 billion

Personal giving in 1987 increased 6.7% over 1986, but down from 9.2% the year before

Foundation giving rose in absolute dollars, but declined in rate

Corporate giving was flat

IV. Tax Reform and Legislative Horizons

The dark side for fund raisers

. . . Rate reductions

. . . Alternative minimum tax increased

. . . Contribution deduction for gifts to private foundations reduced to basis

. . . Deduction for gifts of personal property limited to cost basis unless used for exempt purposes

. . . Generation-skipping tax on lead trust gifts

. . . Grantor tax rules on lead trust income

. . . Loss of non-itemizer deduction

. . . Monthly changes in valuation of remainder and income interest

The bright side for fund raisers

. . . Capital gain increased from 20% to 28%

. . . Passive loss limitations preclude using losses from real estate to offset income from earnings

. . . Recovery period for depreciation extended from 19 years to 31.5 years (Compare 40 year useful life for tax exempt leasing)

. . . Loss of investment tax credit

. . . Loss of minimum deposit life insurance and single premium insurance

. . . Loss of consumer deductions

. . . Retirement plan changes

—Actuarial reductions for contributions to defined benefit plans

—Limitation of annual benefits of $117,500

—15% excise tax on excess distributions

—15% excise tax on reversion to corporation

—Non-deductible IRA contribution

—§401(k) salary reduction plans reduced to $7,000 per participant

—Tougher non-discrimination and coverage tests

. . . Fiscal year changes for personal service corporations

. . . Double tax on corporate liquidations

V. Market Perspective

Consider—

. . . Narrowed options have eliminated many distractions for estate owners and tax advisors

. . . The public is eager to learn new rules and is receptive to new planning options

. . . The related professional planners are anxious to utilize tried and tested techniques

But—

. . . Confusion and fear have immobilized many

. . . Long range planning is difficult in a climate of constantly changing laws and regulations

. . . The untrained efforts of many in and out of fund raising may create abuse and excesses which could lead to legislative reactions

Objective—

. . . The secret to successful marketing is to design a program or product that meets the perceived needs of the consumer

VI. Analyzing the Planned Giving Donor Base

Tireless—

. . . Age 40-60

. . . High income ($150,000 +)

. . . Modest estates ($750,000 +)

. . . Concerns

Retirement

Protection from creditors

Diversification

Professional financial management

Retired—

. . . Age 60-75

. . . Stable income ($100,000 +)

. . . Estates subject to death taxes (more than $600,000 for single individual and $1,200,000 for married)

. . . Concerns

Transferring the business to family or selling it to outsiders

Capital gain tax

Alternative minimum tax

Sheltering the tax on level income

Avoiding high risk to capital

Planning the estate for children and grandchildren

Impact of inflation

Tired—

. . . Age 75 and older

. . . Concerns

Stable income

Professional financial management

Resources for catastrophic illness

Immortal—

. . . Those who wish to perpetuate an ideal, a dream or piece of one's ego

VII. Some Cautionary Remarks

Promises that can't be kept

Expensive short cuts (no appraisals, in-house or canned documents)

Jumping on moving train going nowhere (fund raising gimmicks)

Walking blindfold on the edge (untried and overly aggressive techniques that could backfire on donors and institutions)

**MARKETING PLANNED GIFTS:
FITTING THE CONCEPT
TO THE CONCERN**

ISSUES:	1 SALE OF APPRECIATED ASSETS	2 SUPPLEMENTAL RETIREMENT INCOME	3 PERSONAL RESIDENCE & INADEQUATE INCOME	4 EXCESS INCOME/ ASSETS TO CHILDREN OR GRANDCHILDREN	5 SALE OR LIQUIDATION OF CORPORATION	6 TRANSFER OF BUSINESS TO CHILDREN	7 MEGA ESTATE (OVER $20 MILLION)
Ages 45	—	Wealth Accumulation Plan (1) Unitrust (2) Deferred gift annuity	—	—	—	—	—
55	—	Wealth Accumulation Plan	—	Intervivos annuity lead trust for children	Unitrust	Gift of minority interest/redemption or sale to children	—
65	Unitrust	Partial rollover of excess funding to Unitrust	—	Intervivos annuity lead trust	Unitrust	Gift of minority interest	Excess assets to support foundation
75	Unitrust Annuity trust Gift annuity	Partial rollover	Bargain sales of remainder: (1) Installment (2) Gift annuity	Testamentary lead trust for grandchildren	Unitrust Annuity trust	Gift of minority interest	Excess assets to support foundation
85	Annuity Trust Gift Annuity		Full sale of remainder: Gift annuity	Testamentary lead trust	Annuity trust	Gift of minority interest	Excess assets to support foundation

WORKSHOP SESSION—MARKETING LIFE INCOME GIFTS

John S. Ryan, CFRE
President
Major Gifts, Inc.

I. Introduction

It is my privilege to share the session with Doug Freeman, who is recognized as one of the country's outstanding legal experts in the field of charitable gift planning. We will be focusing on marketing, as opposed to the tax or technical aspects of planned giving, with special emphasis on how to recognize and communicate with those individuals who have the potential to be philanthropists.

II. Challenge of the professional/volunteer: What I Would Like to Be.

It has been my experience that all nonprofit staff have common frustrations and concerns. Staff participating in my training sessions— regardless of their level of experience—have consistently commented they are being asked to do things they have never done before, such as go out and directly solicit endowment or planned gifts. The concerns they raise boil down to five basic issues: Who do I call on? What is the purpose of my call? What do I say? How do I interpret responses? And what do I do next? I have discovered that this is equally true of volunteers. How can we address these issues and develop the skills we need to build a bridge between our "present situation" and what we would "like to be" in our assigned tasks? (See Illustration I.) A key element often overlooked by Volunteers and professional staff is the psychology of the donor. What is the donor's perspective? Is the donor happy in his or her present situation?

Early in my career, I thought that a donor's distribution patterns were fixed in concrete. Experience has taught me that if you delve beneath the surface, you will invariably discover that the donor does not like his or her present distribution pattern. But how can we move a donor from where they are now to where they would like to be—how do we create a bridge between their present situation and actually move the prospect closer to what they would like to accomplish? If successful, we have assisted the donor in making a superior decision and usually that superior decision will positively impact our endowment resources.

I have asked many successful individuals, "Do you have a canned sales talk?" Their initial reaction is generally guarded or negative. However, upon reflection, they typically acknowledge, "Yes, I do have a canned sales talk, although I don't think of it that way."

Successful people are so good at what they do, and so pre-programmed to ask the right questions and respond appropriately, that they don't think in terms of their dialogue as being canned. Doug Freeman has redefined the canned sales talk as a programmed response. Depending upon the response to a specific question, one either further develops the answer or makes an appropriate diversion down another avenue. The use of appropriate questions and programmed responses will help us become facilitators in a process of helping a prospect move from their present situation to where they would like to be. Thus, we are not manipulating a donor but simply using questions as a catalyst to assist a good friend in making a more satisfying decision.

III. What is the source of charitable dollars?—see Illustration II.

There are two sources of funds for charitable ventures. The first is cash flow, or income; the other is net worth, or capital. It is critical to recognize that the approach to each of these sources is different.

A. Cash flow. A well known Minnesota arts organization had a common problem. They had an insatiable appetite for new revenue and yet it appeared that they were either tapped out or worn out as they approached their established friends. Their annual giving program had over 40,000 donors and a battery of paid telethoners were calling them faithfully and practicing double and triple dipping. In fact, they were running out of people to phone and referred to this as being "tapped out."

B. In their capital campaign, some wonderful friends had given over $30 million. It would be great if they could go to these friends and ask them for additional resources, except over half of these individuals were still paying off their earlier pledge. They were "worn out." So, here we have an organization needing more money, "tapped out" on the annual level and "worn out" on the capital campaign level. Let me illustrate this point by referring to a wonderful Minnesota philanthropist. Let's call him Carl. Carl is one of the wealthier individuals in the state and made a $25 million commitment to a $300 million campaign. The papers reported that at the time of his commitment his net worth was anywhere from $600 million up to $1 billion. I would set forth the following question: Did Carl have anything left after he made his $25 million commitment? The obvious answer is, "of course." And when Carl made his commitment and the gift was announced, do you think Carl actually gave the $25 million on the same day? Once again, the answer is obvious. How long do you think it took Carl to give his $25 million? Usually the answer is 5 or more years. If an entrepreneur was fortunate enough to have a net worth of a billion dollars, could they expect to earn 5 percent on their funds? This would be $50 million a year. Thus, if our generous friend was earning $50 million annually on his net worth, and was giving $5 million a year, he was giving 10 percent of his annual cash flow. So, ultimately, did Carl give cash flow or net worth to the campaign? People rarely give capital or net worth to a capital campaign. Rather, they generally give a much higher annual gift for an extended period of time.

Returning to the concern that this arts organization has for more funds, if new resources are needed and we are tapped out and worn out at the cash flow level, then certainly it would appear that there are significant untapped resources if we can ever get our friends' attention concerning the distribution of their net worth. In fact we haven't even scratched the surface of successfully seeking this new source of philanthropic funding.

C. Suggested questions for moving donors from cash flow giving to net worth distribution decisions.

I have found several questions will move cash flow donors to considering a net worth gift. First, when a donor offers to give you a significant gift you respond by asking "Can you afford to make this gift? Will you be depriving yourself of what you need to maintain your lifestyle and dignity? Will you be depriving an heir of the funds represented in this gift? Will you be depriving another charity of the funds represented in this gift?" Listening to responses, using specific follow-up questions depending on the answers, can actually assist the donor in making a superior decision and can actually change the source and the magnitude of the gift.

On the other hand, a bequest donor who has already committed the majority of his or her estate to us as a future commitment, can often be moved to cash flow giving by the following questions: "Do you need more income? Do you need additional net worth? Are you saving money? What happens to the money that you are saving? Who will eventually get it? Is it wise to continue saving?"

These questions might help redirect friends from earlier cash flow or net worth giving decisions to a deeper and more generous philanthropic involvement. Thus, the questions referred to later in Illustration V do give us a few examples of what every caller is concerned about, what do I say.

IV. Locating those on our Agenda—see Illustration III.

This Illustration is referred to as an Indicator Grid.

The majority of development activity seems concerned with converting people from their agenda to our agenda. What would happen if we could find a reliable method of determining in advance those individuals who would positively respond during an interview if we could ask the right questions? The indicator grid is a beginning of this exercise. I am indebted to Paul Schmitt of the Minnesota Orchestral Association for introducing me to this concept which I continue to use and modify with each of my clients. This exercise is an absolute necessity if we are to narrow down our prospect base from 40,000 to 4,000 to 40. Forty highly qualified, closely connected individuals is a manageable number of individuals to call on. The grid consists of a number of items including linkage, interest, ability, age, signals and values.

What is linkage? Board members, former board members, long-term employees, long-time subscribers. Paul Schmitt's research indicates that those who have taken music lessons are better prospects than those who haven't. Those who have played in an orchestra or sung in a chorus are better prospects than those who haven't. Soloists are better prospects than those who just play or sing in a group. His studies also reveal that those who consider themselves experts in music are better prospects than those, like myself, who simply enjoy fine music but can't articulate much about what they've heard.

My experience has taught me that financial ability is part of the grid that carries very little weight. But please remember that the primary focus of my fund raising activity is seeking to find resources originating from net worth. Every prospect represents a potentially large gift. I have been surprised to discover that those with the least resources are often those who respond favorably when properly approached. Age is certainly a factor, and in the economy of our desire for results, it would appear that our quickest way to affect the bottom line is to deal with those who are the oldest, simply because all the charitable vehicles except a cash gift require a person to die prior to any benefit coming to the nonprofit.

Signals may be given by multiple inquiries to direct mail programs. Yet, more frequently than not, those leads are never followed up. Certainly someone who has inquired 5 or more times is giving an important signal. Signals are also given to staff and faculty members in subtle ways, yet they often reveal that person's life has been favorably affected or changed dramatically by the mission of the nonprofit. We may also discover that some of your best friends had parents, aunts and uncles who were on the faculty, great musicians, researchers and made a significant difference in your institution and on your potential donor's life.

I insist that every nonprofit I work with develop their own grid. It is amazing how analyzing who their best prospects are currently, will help them build the grid, and how building the grid will help them recognize their best prospects. It's a two-way street. Building the grid also enables you to narrow down your prospect's base from 40,000 to 40 and will virtually guarantee a high rate of positive response when the call is made. This can usually be done in a two hour meeting and doesn't require an expensive investment in time and budget for a researcher.

V. Two approaches to the prospect?— see Illustration IV.

The traditional approach to a planned giving prospect is what I would refer to as the United Way approach. An individual worth $500,000 is asked to consider a $50,000 gift in order to perpetuate his $2,500 annual gift. The approach is very direct. Before the prospect responds he has to process certain data. This data requires a subtraction exercise in which he has to take $50,000 away from other people or other charities. This is what I refer to as making the approach on "our" agenda. I do not feel comfortable with this approach, and I also find both professional staff and volunteers are not very comfortable with this approach. However, it is a classical capital campaign approach where people are put on a hit list, rated and asked for a specific amount.

I prefer to approach the prospect on "their" agenda as opposed to the nonprofit's agenda. You will notice that the bottom part of Illustration IV first directs attention to the donor's net worth. By asking the prospect, is there an upper limit to how much you want to give your heirs, the donor has an opportunity to establish a specific dollar measurement for his loved ones. (This is a question that follows a whole series of inquiries relating to the individual's feelings about the nonprofit as well as questions concerning the prospect's family.) If his measurement for a niece (his only heir) is $100,000, then the implication for the nonprofit is that there may be $400,000 left from which the donor has an opportunity to build a philanthropic dream.

If we had used the earlier "our" agenda approach and limited our request to $50,000, we would have received less than using the "their" agenda approach. We have forced the prospect to re-evaluate his whole distribution pattern rather than simply extracting $50,000 from his net worth.

VI. Suggested questions for certain ages—see Illustration V

This illustration outlines a series of questions that might be useful tools in communicating with your very best friends. The questions have usefulness beyond the confines of the ages wherein they are listed.

Doug uses questions very effectively with clients who do not consider themselves philanthropists. After a fairly accurate appraisal of estate taxes which always sends a client into shock, he often says, "All that tax money won't even pay for one missile launching. Is that where you want your money to go, in a missile launching?"

My suggested list of questions is simply meant to be a starting point for you to stimulate your very best friends to make better decisions on what they would like to see happen with what has taken them a lifetime to accumulate. We are actually assisting them in regaining control of the distribution of their net worth.

VII. Conclusion

Who do I call on? Why am I calling? What do I say? How do I process responses? What do I do next? Is addressing the above issues and the use of appropriate questions in marketing life income gifts productive? A study I designed on net worth decision-making addresses these issues. Now in its fifth phase, the study has been conducted by using carefully chosen volunteers who go out and "survey" prospective donors. The survey takes approximately half an hour. The questions therein address attitudes toward the nonprofit, the family and whether there is a correlation between the donor's warm feelings toward the nonprofit and the way these friends make decisions concerning their net worth.

In a recent model 7 out of 10 of those interviewed made positive statements about an estate gift commitment. Why was this so successful? We were able to address the issues of the reason for the call; we called on the right people; we asked the right people to make the call; and we equipped the callers with the right questions.

We discovered that we could just as easily equip volunteers as we could professionals. We found that asking recently retired individuals who had already made an estate commitment to do the calling was very productive. Also, we discovered that when we asked people who scored extremely high on our indicator grid to do the calling, they accepted the assignment.

We also discovered to our surprise that when we picked highly motivated volunteers who were already on the nonprofit's agenda, and exposed these volunteers to the preparative training, that a surprising number of them gave indications that they had reevaluated their own estate decision making. These volunteers ended up making initial or larger future commitments or even outright cash flow commitments to the institution. This experience reaffirmed my belief that if we can address the initial concerns that every professional and volunteer has about their involvement in endowment building or planned giving, we can get results within months.

Both Doug and I wish you the best in helping your best friends make better decisions through the use of questions which will be the basis for your programmed responses.

My experience has been that people properly approached on their agenda will welcome your assistance toward philanthropic decision making.

Illustration I

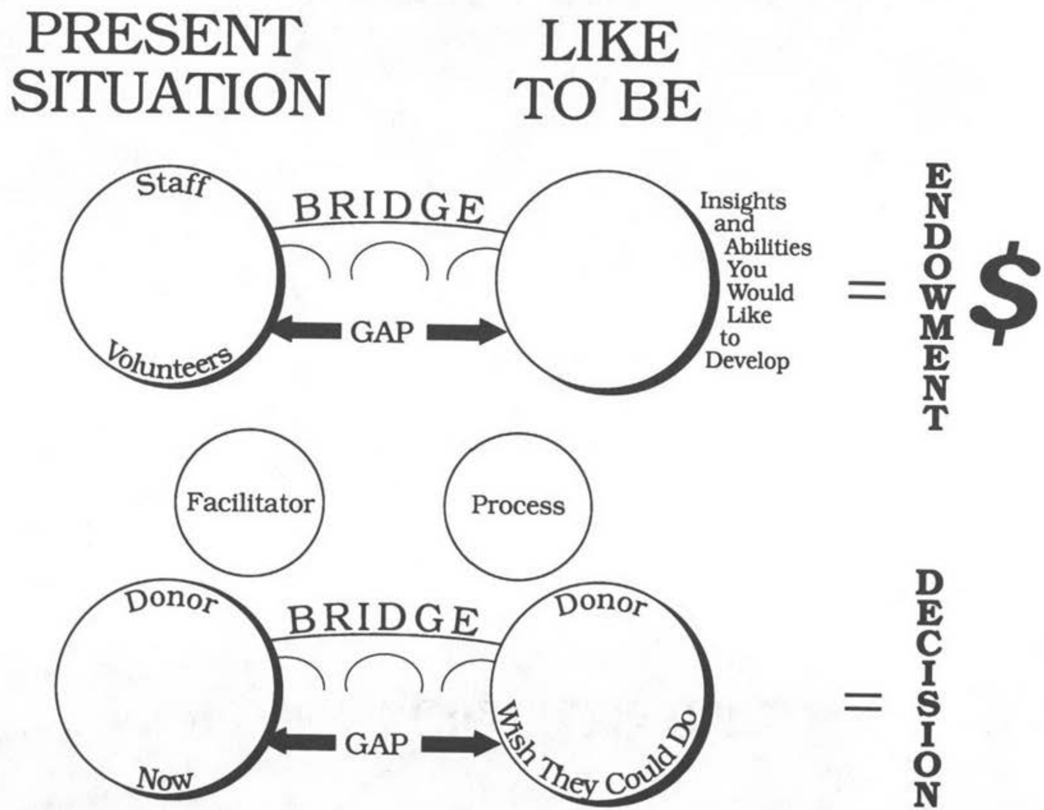


Illustration II

Source of Charitable Dollars

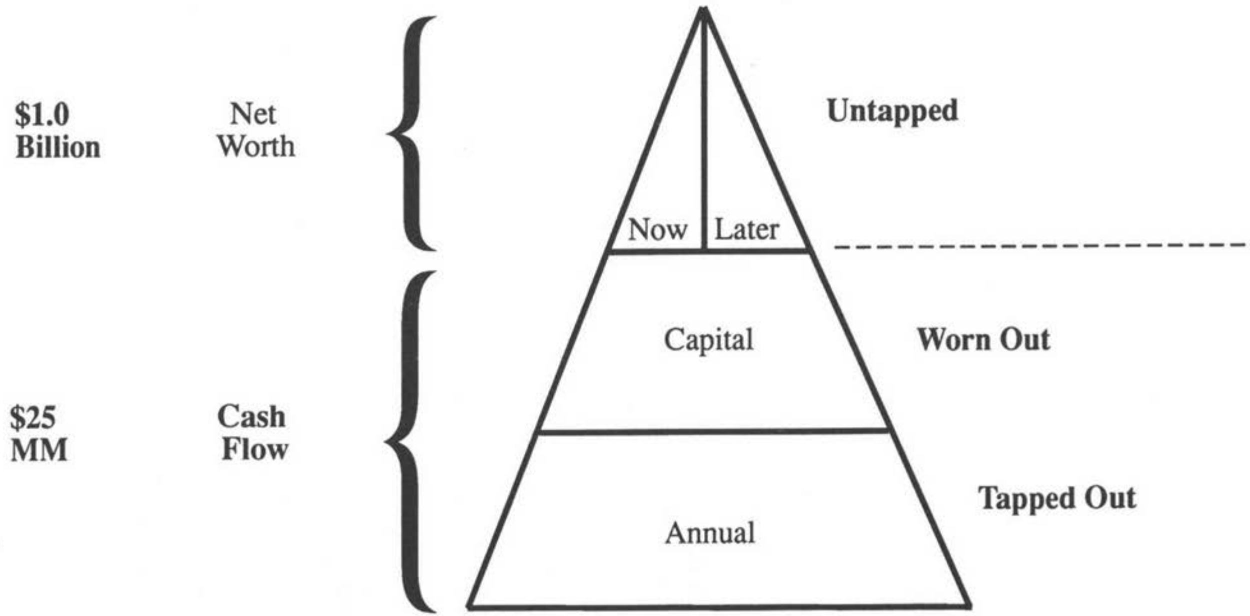


Illustration III

Indicator Grid for Building a List of Friends to be Interviewed

LINKAGE:

A.
B.
C.
D.
E.

INTEREST:

A.
B.
C.

AGE:

A.
B.

SIGNALS:

A.
B.
C.

VALUES:

A.
B.

ABILITY:

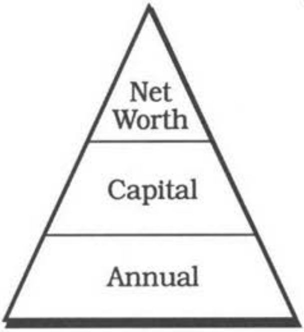
A.
B.

Illustration IV

AGENDA

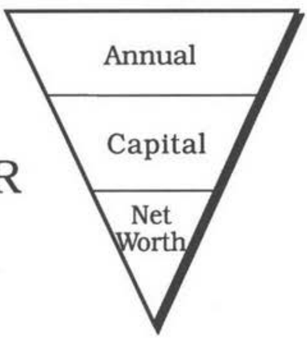
Before Leaving
$50,000 to _____
What Issue do
I Have to Process?

OUR



Net Worth	$500,000
NonProfit	-50,000
Heirs	**$450,000**

THEIR



Net Worth	$500,000
Upper Limit	+100,000
What's Left or Charitable Dream	**$400,000**

ILLUSTRATION V

MARKETING LIFE INCOME GIFTS TO CREATE ENDOWMENTS OR EQUIVALENT CASH FLOW FOR NONPROFITS

AGE	DESCRIPTION	QUESTIONS TO STIMULATE	PRODUCT
45	High income individual who is at capacity of retirement savings.	1. Would you like to set aside additional funds for your retirement? 2. Do you pay capital gain taxes? 3. Would you like to avoid capital gain taxes on sale of appreciated assets? 4. Did you know that capital gain taxes may be optional? 5. How much do you give away? 6. Do you give away appreciated stocks? 7. What tax problems will you have when you decide to sell your professional building, apartment house, or business?	
55	Achieved all professional goals and provided more than adequately for family. Bored and wants a more satisfying mountain to climb.	1. Who will carry on the business? 2. Do you have key employees who would be capable of carrying on? 3. Do they have the resources to buy you out? 4. Is your wife/husband capable of managing resources? 5. Is there an upper limit to how much you want to leave your family/heirs? 6. What will they do with the money? 7. Would you want them to have the money all a once?	
65	Approaching retirement or already there. Strong connections yet benefiting heirs seems to be primary concern.	1. How old will your heirs be when they inherit your estate? 2. What would you estimate is the amount of tax shrinkage on your estate? 3. Should you take lower retirement (80%) including your wife or take 100% excluding her?	

AGE	DESCRIPTION	QUESTIONS TO STIMULATE	PRODUCT
75	Family and grand-children grown. Concern over generation skipping devices. Wants to pass everything on to family yet has deep attachment to nonprofit. Has inferred a bequest will be forthcoming.	1. Do you need more income? 2. Would you like more tax exempt income? 3. Do you have enough capital, net worth? 4. What is your combined income tax bracket? 5. Are you pleased with the amount of your quarterly estimated tax payments? 6. Have you lost any stocks to hostile takeovers? 7. You want to give $25,000 in stock . . . can you afford to/will you be depriving an heir of needed funds? 8. Do you hold investments in real estate? 9. Does it produce income? 10. What is your yield?	
85	Still active. Has taken care of children but wants to give at least $100,000 to nonprofit.	1. How old will your heirs be when they benefit? 2. How are they doing? 3. Who will take care of you when? 4. Do you have enough to see you through? 5. Are you concerned about this issue? 6. How much money are you saving each year? 7. Do you enjoy details connected with supervising your portfolio? 8. Would you rather give your heirs capital or income? 9. Do they need the money? 10. What will they do with it? 11. If you had the funds available to create your charitable dream . . . what would your dream look like? 12. Did you know that paying estate taxes may be optional?	

WORKSHOP SESSION—USE OF CHARITABLE REMAINDER TRUSTS IN RETIREMENT PLANNING

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"Charitable Giving Tax Service"
Longman/R&R Newkirk

I. A. BASIC TRUST CONCEPTS

A trust is simply an alternative way to own property. The characters on the trust stage are:

—the creator (grantor), who establishes the trust, either during life (an "inter vivos" or "living" trust) or at death (a "testamentary" trust).

—the trustee, who holds title to the trust property (the corpus, or principal), manages and invests assets and distributes trust income and principal according to instructions set out in the trust instrument.

—the beneficiaries, who can be income beneficiaries or remainder beneficiaries (or sometimes both).

Trusts set during life can be *revocable* or *irrevocable*. Revocable trusts change nothing, tax-wise, for the grantor of the trust (trust deductions and income are all reported on his or her tax return). Irrevocable trusts (except tax-exempt trusts) are subject to tax on income that is not distributed to beneficiaries.

B. CHARITABLE REMAINDER TRUSTS

Charitable remainder trusts are irrevocable trusts that donors establish, during life or by will, for the benefit of designated income beneficiaries and one or more charitable "remaindermen." The trusts last for the lifetimes of the income beneficiaries or for a term of years (20 years maximum).

Charitable remainder trusts can provide a variety of tax and financial advantages to donors, in addition to facilitating important gifts to charity. These trusts have the ability to:

—Increase a donor's income by reinvesting low-yield or no-yield properties in high-income investments.

—Provide tax-free income if the trust is funded with or invested exclusively in tax-exempt securities.

—Avoid capital gains taxes when property is sold and reinvested by the trustee.

—Provide substantial income tax and estate tax charitable deductions that greatly reduce the cost of benefiting charity. Deductions depend on the ages and number of the income beneficiaries (or the terms of years the trust is to last), the amount of income retained for the beneficiaries and the interest/discount rates in effect at the time the trust is established.

Charitable remainder trusts come in two varieties: Annuity Trusts and Unitrusts.

1. Annuity trusts pay an unchanging dollar amount (a minimum of 5% of the initial value of the trust assets) to beneficiaries. The payout is unaffected by fluctuations in income or future value of the trust. Annuity trusts must pass a "5% probability test"—that is, no deduction is allowed if there is more than a one in 20 chance that the trust assets will be exhausted when the trust ends. Donors may not make additional contributions to annuity trusts. Deductions for annuity trusts tend to go higher than those for unitrusts, except where beneficiaries are in their 80s or 90s. Tax-free bonds work best in annuity trusts.
2. Unitrusts (so called because trust principal and trust income generally are treated as a "unit" in calculating payouts) pay beneficiaries a percentage (minimum 5%) of the value of the trust as revalued at least once a year. Payments will rise or decline according to the investment success of the trustee. Additional contributions may be made to unitrusts; payouts can be limited to the *lesser* of the trust's net income or the unitrust percentage (a "net income" or "income exception" unitrust), and provision also can be made for "make-up" or "catch-up" of deficiencies from years in which payouts were less than the payout percentage stated in the unitrust agreement [Reg. Sec. 1.664-3(a)(1)(i)(b)]. The trustee may make up prior years' deficiencies in payouts to the extent *current income* of the trust *exceeds* the specified unitrust amount.

The following tables show how a net-income unitrust and a net-income-with-make-up-provision unitrust work. These trusts permit principal to grow rapidly if the payout percentage is low and the income earned by the trust is high. Trust principal can expand even faster if the trustee invests in growth stock or other investments expected to have substantial growth but pay little or no income that could be paid to beneficiaries. Growth stock typically yields small dividends but high appreciation.

5% NET INCOME UNITRUST

Year	Value of Trust Assets	Specified Unitrust Amount	Trust Income	Required Payout?
1989	$100,000	$5,000	$6,000	
1990	110,000	5,500	5,000	
1991	90,000	4,500	5,000	
1992	120,000	6,000	6,000	

It's clear that the trustee will never have to tap trust principal to make payments to the income beneficiaries. Income beneficiaries may have years in which they receive less income than they would be entitled to under a "straight" unitrust.

5% NET INCOME UNITRUST WITH CATCH-UP PROVISION

Year	Value of Trust Assets	Specified Unitrust Amount	Trust Income	Required Payout?
1989	$100,000	$5,000	$6,000	
1990	110,000	5,500	5,000	
1991	90,000	4,500	6,000	
1992	120,000	6,000	5,500	
1993	110,000	5,500	5,800	

Here again, the trustee never has to dip into corpus to pay income beneficiaries. But they get paid back for past deficiencies in years when the trust has substantial income.

II. PRE-RETIREMENT UNITRUSTS FOR WEALTHY EXECUTIVES AND PROFESSIONALS: THE CHARITABLE IRA

BACKGROUND: In recent years Congress has cut back on the deductibility of contributions to qualified retirement plans, including company pension plans, 401(k) plans, Keogh plans, profit sharing and stock bonus plans, simplified employee pension plans (SEPs) and others. All gainfully employed Americans can still contribute to Individual Retirement Accounts, but deductions have been eliminated except for persons of modest incomes or those not covered by other retirement savings arrangements.

THE PROBLEM: Wealthy professionals and executives have found themselves with increased tax burdens as a result of the retirement plan cutbacks and the more recent attacks on traditional tax shelters brought by the Tax Reform Act of 1986. These individuals generally are looking for tax relief during their years of high income and for a supplementary retirement savings vehicle that permits tax-free growth of the nest egg.

ONE SOLUTION: The "Retirement Unitrust," sometimes referred to as a "Charitable IRA," can be a useful planning tool for wealthy individuals—assuming they have a motivation to provide substantial benefit to a charitable organization. (Note: This workshop is devoted to charitable remainder trusts, but it should be added that deferred payment gift annuities and gifts to growth pooled income funds also can be exceptional retirement planning tools.).

A. The tax laws do not recognize a creature called a deferred payment charitable remainder trust. But it is possible to set up such an arrangement (or a reasonable facsimile thereof) through a "net income" ("income only") unitrust, possibly paired with a "catch-up" or "make-up" provision. With proper planning, such a trust could provide:
   1. An income tax deduction for part of the funds or property transferred to the trust, based on the age of the grantor at the time of contribution and the amount of income retained (minimum 5%).

2. Deferral of much—perhaps all—of the trust income until the grantor retires. Principal would grow quickly because the trust is tax-exempt.
3. Payment of substantial income after retirement, reflecting rapid growth of principal within a tax-exempt trust—and perhaps make-up of payment deficiencies during years grantor was receiving little or no trust income.
4. An important gift to the grantor's charity when the trust ends.

The trustee would invest initially in growth stocks, growth mutual funds or other investments (some have suggested zero-coupon bonds) that will swell the trust principal but pay very little income until the grantor retires. At retirement the trustee would switch trust investments to high-yield investments producing a substantial return. Income beneficiaries then would begin receiving a payout percentage based on a very large trust value. If the trust has a "catch-up" provision, the trustee also can begin paying income in excess of the payout percentage to make up for deficiencies from past years. The trust instrument cannot require the trustee to invest in the manner described above. But the trustee, if properly selected, will understand the financial needs of the trust beneficiaries and invest accordingly.

B. SINGLE-CONTRIBUTION RETIREMENT TRUSTS. Suppose Greene, at age 55, transfers property worth $100,000 to an "net income" unitrust. He reserves income for life equal to the actual trust income or 6% of the value of the trust, whichever is less, with any deficiency to be made up in any subsequent year in which trust income exceeds 6%. Based on his age (using the new mortality tables), the 6% payout and an applicable federal rate (monthly interest/discount rate) of 11%, Greene is entitled to an immediate charitable contribution deduction of $30,676. The trustee invests in growth stock designed to cause the value of the trust to grow to $200,000 by the time Greene retires at 65. The trustee will sell the growth stock and buy securities that produce substantial annual income. The trustee can begin paying Greene 6% of $200,000 and if the trust assets earn more than 6% he can pay Greene extra amounts based on deficiencies during previous years.

C. THE "CHARITABLE IRA" (MULTIPLE CONTRIBUTIONS). Donors have the option of making additional contributions to charitable remainder unitrusts. So an executive or professional might contribute $25,000 a year to a retirement unitrust—a sort of "charitable IRA"—but without the $2,000 contribution ceiling that applies to true individual retirement accounts. The donor could deduct a *portion* of each contribution, and the size of the deduction would grow each year as the donor grows older. If a donor established a one-life 5% payout unitrust at age 45, about 26% of any amount transferred would be deductible; an additional contribution made at age 60 would be about 43% deductible.

A married person probably would want to establish the retirement unitrust for two lives (to include the life of the surviving spouse). Alternatively, a donor could have the trust last for only his or her life and use some of the tax savings and income from the unitrust to purchase life insurance payable to family beneficiaries. The insurance could replace the trust assets lost to the estate from the unitrust. The insurance proceeds could pass free of federal estate tax if the policies are purchased within an irrevocable life insurance trust (sometimes called a "wealth replacement trust").

As a retirement savings vehicle, the unitrust offers income deferral, tax-free buildup of principal (remember that it is a tax-exempt trust, so long as it has no unrelated business taxable income) and deductions for part of each contribution.

The following table illustrates financial results from a one-life 5% unitrust started by a professional at age 45. She plans to make $25,000 contributions at the start of each year for 20 years. The second column shows results from a similar trust in which the professional names her husband, also 45, as survivor beneficiary. The calculations employ the new mortality tables and an 11% applicable federal rate. (Deductions courtesy of Deerwood Computer Systems, 208 E. Market Street, Spencer, IN 47460)

	One-Life			Two-Life	
Age	Gift	Deduction	Ages	Gift	Deduction
45	$ 25,000	$ 6,411	45/45	$ 25,000	$ 4,213
46	25,000	6,656	46/46	25,000	4,403
47	25,000	6,908	47/47	25,000	4,601
48	25,000	7,166	48/48	25,000	4,806
49	25,000	7,430	49/49	25,000	5,018
50	25,000	7,699	50/50	25,000	5,238
51	25,000	7,963	51/51	25,000	5,465
52	25,000	8,253	52/52	25,000	5,700
53	25,000	8,540	53/53	25,000	5,943
54	25,000	8,831	54/54	25,000	6,194
55	25,000	9,129	55/55	25,000	6,453
56	25,000	9,431	56/56	25,000	6,720
57	25,000	9,740	57/57	25,000	6,996
58	25,000	10,053	58/58	25,000	7,279
59	25,000	10,372	59/59	25,000	7,571
60	25,000	10,695	60/60	25,000	7,870
61	25,000	11,021	61/61	25,000	8,177
62	25,000	11,349	62/62	25,000	8,491
63	25,000	11,680	63/63	25,000	8,812
64	25,000	12,014	64/64	25,000	9,140
	$500,000	$181,351		$500,000	$129,091

In an average 28% tax bracket, the one-life trust would have saved the donor $50,778 in deduction tax savings; the two life trust would have saved $36,145 in a 28% bracket.

How much income would the beneficiaries of these trusts receive at retirement? That depends on how the trustee invested during the 20-year "deferral period." Suppose the trustee were able to invest in growth stock that paid 1% dividends but grew at an average annual rate of 8%. The following table illustrates that investments of $1,000 annually at 8% interest would grow to $49,423 over 20 years. So $25,000 contributed annually would be worth about $1,235,575 (25 x $49,423) at the end of 20 years.

RESULTS OF $1,000 INVESTED ANNUALLY AT VARIOUS ANNUAL INTEREST RATES OVER VARIOUS PERIODS OF TIME
(Investment Made at Beginning of Each Year)

Years	6%	8%	10%	12%	15%	18%
1	$ 1,060	$ 1,080	$ 1,100	$ 1,120	$ 1,150	$ 1,180
2	2,184	2,246	2,310	2,374	2,473	2,572
3	3,375	3,506	3,641	3,779	3,993	3,215
4	4,637	4,867	5,105	5,363	5,742	6,154
5	5,975	6,336	6,716	7,115	7,754	8,442
6	7,394	7,923	8,487	9,089	10,087	11,142
7	8,897	9,637	10,436	11,300	12,727	14,327
8	10,491	11,488	12,579	13,776	15,786	18,086
9	12,181	13,487	14,937	16,549	19,304	22,521
10	13,972	15,645	17,531	19,656	23,349	27,756
11	15,870	17,977	20,384	23,133	28,002	33,931
12	17,882	20,495	23,523	27,029	33,352	41,219
13	20,015	23,215	26,975	31,393	39,506	49,818
14	22,276	26,152	30,772	36,280	46,580	59,965
15	24,673	29,324	34,960	41,753	54,717	71,939
16	27,213	32,750	39,546	47,774	64,075	86,068
17	29,906	36,450	44,599	54,750	74,836	102,740
18	32,760	40,446	50,159	62,440	87,212	122,414
19	35,786	44,762	56,275	71,052	101,444	145,628
20	38,993	49,423	63,002	80,699	117,810	173,021
21	42,392	54,457	70,403	91,503	136,632	205,346
22	45,996	59,883	78,543	103,603	158,276	243,487
23	49,816	65,765	87,497	117,156	183,168	288,494
24	53,866	72,106	97,347	132,334	211,793	341,603
25	58,156	78,954	108,182	149,334	244,712	404,272
26	62,706	86,351	120,100	166,374	282,569	478,221
27	67,528	94,339	133,210	189,699	326,104	565,481
28	72,640	102,966	147,631	213,583	376,170	668,447
29	78,058	112,283	163,494	240,333	433,745	789,948
30	83,802	122,346	180,943	270,293	499,967	933,319
35	118,121	186,102	298,127	483,463	1,013,346	2,143,649
40	164,048	279,781	486,852	859,142	2,045,954	4,912,591
45	225,508	417,426	790,795	1,521,218	4,122,898	11,247,261
50	307,756	619,672	1,280,299	2,688,020	8,300,374	25,739,451

The trustee would sell the growth stock when the beneficiaries retire and invest in something that pays high income. The beneficiaries could start receiving 5% of $1,235,575 ($61,778.75) a year.

Suppose the trustee reinvests in U.S. Treasury bills or bonds paying 9% annually. If the unitrust were a net-income trust with a catch-up provision, the trustee could also begin paying the beneficiaries additional amounts for payout deficiencies that occurred during years when the trust was invested in growth stock. The beneficiaries would receive the five percent unitrust amount ($61,778.75) plus the extra trust income earned every year until the deficiencies are paid up. That likely will be the full 9%—in this case, $111,201.75 (9% x $1,235,575) for several years.

Computer software is available that illustrates the tax and financial results of "retirement unitrusts," allowing donors to play "what if" games that assume various investment returns and payout percentages.

III. FUNDING CHARITABLE REMAINDER TRUSTS WITH LUMP-SUM RETIREMENT BENEFITS: THE NEXT BEST THING TO "ROLLING IT OVER"

At least once a week a client calls with the following scenario: "Mr. Jones is getting ready to retire and he will be receiving a $500,000 lump sum distribution from his qualified retirement plan. Jones really wants to help our organization and he wants to know if he can 'roll over' his retirement benefits into a charitable remainder trust. Can he do it?"

The answer, unfortunately, is "no." "Roll over" means to transfer without tax liability, as with a "rollover IRA." The IRS is determined to receive taxes from income that was untaxed going into a retirement savings arrangement—or that accumulated tax free before the taxpayer retired. Any time a taxpayer exercises control over retirement funds, either by receiving payments or directing that money be transferred somewhere, he or she is said to "recognize" that income—and must pay tax on it. Bottom line: You can't sneak retirement funds past the tax collector into a charitable remainder trust, gift annuity or pooled income fund.

The Tax Reform Act of 1986 increased the taxes on retirement payments. One change was to replace 10-year forward averaging treatment for lump-sum distributions with five-year forward averaging. Previously, a retiree could elect to take a lump-sum distribution in the first year of retirement while paying tax on the amount as if it has been received over 10 years. This reduced the tax bite in the year the money was received. Under TRA '86 the distribution must be spread over only a five-year period, meaning a shorter averaging period and therefore higher tax.

Even with the change in tax treatment, there has been an increase in the number of employees receiving lump sums upon retirement. The size of these lump sums is expected to increase due to longer coverage periods. So, even without the potential for a charitable "rollover," there are good opportunities to make charitable gifts during the early years of retirement. One possibility is a charitable remainder unitrust.

For example, suppose George is going to receive a $300,000 lump-sum distribution from his company's retirement plan. The company's personnel specialist has advised him that he can use forward averaging to cushion the taxes. But George will still have a substantial tax bill.

Suppose, however, that George uses a part of his pension distribution—$100,000—to fund a charitable remainder unitrust that will pay him and his wife income of 7% for the rest of their lives. If they are both 65 George can deduct about $26,337 of the $100,000 they place in trust (new mortality tables, 11% applicable federal rate).

The $26,337 deduction has no direct effect on the tax due on George's lump-sum distribution. The forward-averaging computation is unaffected by charitable deductions. But the deduction will reduce George's regular income taxes and the overall effect is a net reduction in his tax bill. And George has the satisfaction of making a truly magnificant gift to charity. George also has the option to make additional contributions to the trust in future years. Next we'll look at how charitable remainder trusts can help retirees like George and his wife.

IV. PUTTING A CHARITABLE REMAINDER TRUST TO WORK AFTER RETIREMENT

Charitable remainder trusts can be extremely useful to people during their retirement years, both as a means of channeling their charitable contributions and as a way of solving various tax and financial problems. Here is a potpourri of charitable remainder trust ideas for retirees.

A. REDUCING THE CATASTROPHIC CARE SURTAX. You're undoubtedly hearing a lot from retired donors about the new catastrophic care "surtax" on Medicare recipients. Under the recent Medicare Catastrophic Care Act, married couples on Social Security now may owe up to $1,600 additional tax when they file their tax returns next April (it's as much as $800 for single people). By 1993, the tax can reach $2,100 for marrieds and $1,050 for singles. This is a surtax that in 1989 adds $22.50 to each $150 in federal income taxes paid by people on Medicare. The extra tax applies on taxable income up to $52,384 (joint returns) or $27,573 (single taxpayers).

Stragegy: If retirees' incomes are less than the above "caps" on the surtax, they should try to increase their itemized deductions or reduce their taxable income in other ways (buying tax-free bonds, for example). Remember, however, that switching investments may produce other costs, such as capital gains taxes and broker's fees.

A charitable option: Retirees can both increase their deductions and reduce their taxable income (thereby cutting the new surtax) by switching some fully-taxed income to a charitable remainder annuity trust paying tax-exempt income.

Suppose Mr. and Mrs. Smith, both 74, have joint taxable income of $40,000. They are in the 28% tax bracket, but the Catastrophic Care surtax actually boosts them into a 32.2% bracket. Suppose that, at the beginning of 1989, they take $100,000 from savings on deposit at 7.5% to purchase tax-free municipal bonds paying 7.5%. They immediately transfer the bonds to a charitable remainder annuity trust that will pay them 7.5% for the rest of their lives.

If they had left the $100,000 in savings all year, they would have owed $315 in Catastrophic Care surtax on the $7,500 in interest ($7,500 times 28% divided by $150 times $22.50) in addition to $2,100 in regular federal tax. But because they switched to tax-free bonds and established the annuity trust, they reduce their taxes two ways:

1. They receive a charitable deduction of $47,394 that saves them $4,177 in regular taxes and $626 in surtax for 1989. (They can use only $20,000 of the $47,394 deduction in '89).
2. For the 1990 tax year they can deduct another $20,000 of carried-over charitable deduction, which saves them an additional $4,177 in regular taxes and several hundred more in Catastrophic Care surtax. In all future years, the switch to tax-free bonds will continue to save them surtax dollars and regular tax as well (their $7,500 of annuity income will be all tax free unless the trustee invests in something other than tax-exempt securities).

Obviously, the Smiths could have switched investments to tax-free bonds without the annuity trust. But their tax savings in the first two years—and their satisfaction—are much higher with the gift.

B. RETIREES WHO RELOCATE. Charitably minded retirees who decide to move to warm-weather locales (or just to smaller quarters) might consider transferring a personal residence to a charitable remainder trust from which they will receive income for life (and for that of a spouse or other beneficiary). The value of the property at the time of the gift, not the original cost, will be used to figure the charitable deduction.

The trustee can sell and reinvest the proceeds free of capital gains tax. This may be especially important where appreciation in the home exceeds the $125,000 exclusion amount for homeowners over 55 (Code Sec. 121). In some cases the retiree will not have any of the $125,000 exclusion available. Donors can retire to the beach with increased income, substantial tax savings—and the relief of having transferred investment burdens to a trustee who pays them a good income every year.

C. CAPITAL GAINS TAX RELIEF. Many retirees own stock that they inherited or purchased years ago. Such stock may be worth substantial amounts but be burdened with large capital gains. Capital gains tax rates now are as high as 33%—meaning that as much as one-third of an investor's "paper profit" will go to the tax collector when the retiree wants to sell and reinvest for higher income.

Establishing a unitrust with highly appreciated stock or real estate can avoid these taxes, plus provide donors with substantial income tax charitable deductions (subject to erosion from alternative minimum tax). If the trust allows for additional contributions, donors can repeat this tax-saving strategy any time they wish.

DEDUCTION COMPARISON

We ran some numbers to see what will happen to deductions where gifts are made in the three situations: (1) Before May 1, (2) May 1 through June 30 and (3) July 1 and thereafter. We have used a donor aged 70 in all cases. For gifts made May 1—June 30 we assumed donors selected an interest rate of 11.6% (that was the actual rate for April). Here are the results—and some obvious lessons. For the July 1 and later gifts we also assumed an interest/discount rate of 11.6%, for the sake of uniformity.

Gift by Donor Age 70	Pre May 1	May 1–June 30	July 1 & Later
$100,000 Annuity Trust Paying 7% quarterly	$56,077	$59,364	$57,161
$100,000 Unitrust Paying 7% quarterly	$49,399	$49,677	$46,158
$100,000 Pooled Fund Gift (8% "old" Fund)	$45,821	$45,821	$42,248
$100,000 Pooled Fund Under 3 Years Old	$42,451	$42,451	$34,829*
Gift of Remainder in $100,000 of Farm property (reserved life estate)	$39,478	$35,405	$31,903

*Assumed rate of return is 90% of 11.6% monthly rate (10.4%).

You can see that there isn't much difference in deductions for annuity trusts before May 1 and after June 30. But the May-June period is a time of opportunity for high deductions. It makes little difference to donors whether they set up unitrusts in April, May or June—so long as the May-June donors elect April interest rates and can use the old mortality tables. But deductions deteriorate July 1. Same for pooled income fund gifts. Gifts of remainder interests in farms and homes plummet by about 20% in July, compared to a gift in April. May-June donors of remainder interests in farms and homes should elect the *March* interest rate.

WORKSHOP SESSION—RETIREMENT PLANNING WITH CHARITABLE REMAINDER UNITRUST

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I. RETIREMENT PLANNING SINCE THE INTERNAL REVENUE CODE OF 1986

A. *The Market*

1. Mom and Pop—the current 40 to 55 year-olds.
2. Doctors, Lawyers, professionals, etc.
3. Self-employeds.
4. Business owners.
5. Corporate executives.
6. Anyone without an IRA deduction.
7. You.

B. *Where Did the Market Come From?*

1. 1986 Tax Reform Act.
2. Bothersome, complex rules and penalties.
   a. Penalties for taking too much, too little, too soon, or too late.
3. Penalty on your estate after you die, calculated as if you had lived!
4. Early vesting—costly to employer.
5. Coverage—very broad.
6. Nondiscrimination—must benefit rank and file as well as high-paids.

C. *A Brief Look at the Plans.*

1. Two basic types.
   a. Defined benefit—the "pension plan".
      (1) The ultimate benefit is targeted on amount the employee will receive. Current contributions then determined actuarially to achieve that benefit in the future.
      (2) Maximum benefit—
      Smaller of:
         (i) $98,064/year at age 65
         or
         (ii) 100% of average compensation for highest 3 years (compensation counted up to $200,000 in a year)

(3) Payout of benefits—
   (i) Generally an annuity that amortizes principal and interest. Generally drops to percentage (e.g. 50%) for survivor spouse where in the form of joint and survivor.
   (ii) Generally no death benefit.

b. Defined contribution.
   (1) The current contribution is defined by the plan; the ultimate benefit is not a factor in the determination of current contribution.
   (2) Types
      (i) Profit-sharing (discretionary contributions up to maximum).
      (ii) Money purchase (mandatory level of funding by employer).
      (iii) ESOP—Employee Stock Ownership Plan (comes in the form of (i) or (ii) above), must purchase employer securities.
      (iv) 401(k) plans—Salary reduction up to $7,627 per year.
      (v) Stock bonus plan.
   (3) Generally employer funded.
      (i) Except 401(k) plan
      (ii) Limits
         —Employer can deduct only 15% of total compensation of *all* participants, *and*
         —Annual allocation to *one* participant can be no more than $30,000 or 25% of compensation.

II. CHARITABLE VEHICLES AS A SUPPLEMENT TO QUALIFIED PLANS

A. What Can We Offer?

1. Filling the gap in the marketplace.
   a. Is the charitable vehicle a supplement to the traditional plan? or a replacement?
   b. Deferred gift annuity vs. Net income unitrust.
      (1) DGA requires many contracts for regular contributions every year, causing administrative burden.
      (2) DGA requires fixed payment commence-

ment date, despite what may happen in future such as hardship, disability, or death. Suggest staggered starting dates.

(3) NIU far more flexible, but much lower deduction.

B. Differences Between Charitable Vehicles and Qualified Retirement Plans.

1. Deductions.
   a. Amount is greater with qualified plan, but some deduction is better than none.
   b. Above-the-line (plan contribution) vs. below-the line (charitable plan, must be itemized to claim).
2. Non-discrimination rules don't exist for charitable vehicles. Employer can compensate specific individuals.
3. Withdrawal under a plan vs. use of IOU trusts and sprinkle powers: Hardship or loans vs. trustee discretion to create high yield at any time.
4. ERISA vs. 1969 Tax Reform Act and subsequent rulings; prohibited transactions, self-dealing, trusteeship—these are pretty much the same for both.
5. Form of contribution.
   a. Appreciated property cannot be given to a qualified plan, but can be contributed to a charitable plan.
   b. Unearned income, the same is true here.
6. Asset distribution
   a. When.
      (1) Mandatory distribution prevails in the qualified plan at age 70½.
      (2) Trustee discretion controls the charitable plan, is more flexible.
   b. To whom.
      (1) Charitable intent?
      (2) Spouse, family, others? Wealth replacement concept may be an attractive adjunct plan.

C. Communicating the Concept of Using Charitable Vehicles for Retirement Planning.

1. Caution on charitable intent.
   a. Deduction available? Intent to make a gift is necessary.

b. Is transfer of assets to charity what the individual wants? Make sure the donor understands the irrevocable commitment of assets.

2. Avoidance of confusion in the donor's mind. Keep charitable plans separate in the donor's mind from qualified plans.

D. *Who Should Manage the Charitable Plan?*

1. Problem: Many low level contributions are hard to manage and may be costly to administer.

2. Choices.

a. Bank as trustee. Few understand the plan, or even charitable remainder trusts, and therefore are not willing to take multiple low-level transfers. State Street Bank, Boston and Connecticut Bank and Trust, Hartford have expressed interest and have large charitable portfolios.

b. Charity as trustee. Costly to administer because these are typically trusts that will continue for 30-40 years.

c. Charity as trustee with charitable "plan administrator" (analogous to a pension plan administrator). Charity directs investments, administrator handles everything else.

d. Donor as trustee. Check to ensure that donor is financially sophisticated, train donor in 4-tier system, chapter 42 penalties and reporting requirements.

e. Donor as trustee with charitable "plan administrator" handling all administration while donor/trustee directs investments.

WORKSHOP SESSION—ADMINISTRATION, GIFT MANAGEMENT AND COST EFFECTIVENESS

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While the assigned title of Administration, Gift Management and Cost Effectiveness of Planned or Deferred Giving Programs conveys what could be well described as the "Nuts" and "Bolts" of a Planned Giving Program, I intend, without shame or reservation, to demonstrate that in establishing a truly professional and successful Planned Giving Program, there is one over-riding and indispensable principle with which I will begin and end, and it is the critical message. What is the magic essence? It is, in a word,

CREDIBILITY

In an article written several years ago, while riding a wave of home grown rhetoric, I said, *"CREDIBILITY TO A CHARITABLE INSTITUTION IS WHAT MORALITY IS TO AN INDIVIDUAL."*

No matter how slick your brochures, no matter how profound your software, no matter how skilled your marketing efforts; the *bottom line* of generosity in the philanthropic community has been, and for the foreseeable future, will be *credibility.* It is the lifeline from the beginning to the end of a relationship with a donor, particularly a planned gift donor.

This all important charge has been very much in the headlines in the past year. Even going beyond the well-publicized cases of infamous television evangelical fundraisers, and the maddening proliferation of sweepstake fundraising, we, as a community, seeking voluntary contributions, are now forcibly on the defensive as the Internal Revenue Service implements their Publication 1391, requiring charities to: "more accurately inform taxpayers as to the deductibility of payments to any patrons of your fundraising events."

The Congress, notwithstanding the fiscal challenges of a budget deficit, trade deficits, and rising rates of interest and inflation, is posed to legislate penalties on charities that fail to disclose that the $100 a donor gives to attend a church supper, must be reduced for charitable deduction purposes by reason of the fact that the good sisters of the congregation pooled their shopping and cooking talents to put on that dinner at their own expense, and the fair market value of the repast offered, has a value of $42.75 or more.

While no one here, and for the most part, elsewhere in the land, countenances collusion or fraud, this broad based attack is clearly evidence of a loss of *credibility* on the part of our community. We have, in many cases, of necessity, moved into the never-never land of cause-related fundraising and should not be surprised that the rules of the bazaar are different from the rules of the temple.

The point is that we sometimes lose the perspective on our *reason for being*—seeking resources not for sake of those resources, but for the support of health, welfare, education, religion, culture, preserving the environment as well as nurturing every cause for the betterment of society that human imagination has been capable of organizing.

How does this relate to Planned Giving Programs? The answer is visible on several fronts. Are we competing with a profit-making enterprise when we advertise pooled income fund gifts and charitable remainder trusts as alternatives to pension plans or IRA's? Do we transgress any trip wires when we allow as how our charitable institution absorbs trust fees which would otherwise be charged by a bank or trust company? How do we look when we market our plans comparing our rates of return with certificates of deposit or money market funds? What is the right answer when a planned giving officer for a college turns up as the Executor of a donor's estate or as a Trustee of a charitable remainder trust? These are real questions to be faced and this is the forum where we will try to show how sound policies and guidelines for administration can and must clear the air and reinforce the credibility of a charitable institution raising funds through the grand design of trusts and annuities without apology.

First on the agenda must be a thoughtful set of ethical guidelines for those staff or volunteers who are part of the planned giving team. A set of sample ethical guidelines was produced by my good friend, Lynda Moerschbaecher, and reprinted in the February 1988 edition of *Fund Raising Magazine*. I have reproduced them as an appendix to these remarks. Common sense, understanding the principles of conflict of interest, and a fundamental appreciation of right and wrong is their theme. Articles have been proliferating on ethics in fundraising but for our purposes today, sufficient to say, a well-managed program should hang its ethical rules of conduct out front to guide all those involved in a Planned Giving Fundraising Program.

Let's examine planned giving today. For fund-raising executives, that examination must go beyond simply defining the common tools of planned giving, such as:

Charitable Remainder Unitrusts and Annuity Trusts.
Charitable Remainder Pooled Income Funds.
Current and Deferred Charitable Gift Annuities.
Charitable Lead Unitrusts and Annuity Trusts.
Qualified Non-Grantor Trusts.
Non-Qualified Non-Grantor Trusts.
Remainder Gifts of Residences or Farms.
Clifford Trusts.
Revocable Trusts.
Specific Bequests.
Residuary Bequests.
Testamentary Trusts.
Reversionary Trusts.

Similarly, I believe, we must include for inspection that melange of potential gift assets, other than cash or publicly marketable securities, which often fall in the lap of the development officer responsible for planned giving, such as:

Interests in Real Estate.
Limited Partnership Interests in Tax Shelters.
Interests in Life Insurance.
Stock Options and Warrants.
Closely Held or Unregistered Stocks and Bonds.
Interests in Tangible Personal Property; e.g. art, yachts, furniture and furnishings, manuscripts, etc.
Interests in Oil and Gas Leases.
Interests in Individual Retirement Accounts and Pension Funds.

In discussing planned giving we are talking about major and endowment giving; in fact, the three terms are interchangeable. Another way of describing planned giving is to call it "reflective giving," since all of us know that major gifts are far from spontaneous. The significance of such gifts, to a university, for example, is perhaps best illustrated by what distinguished New York lawyer-diplomat Elihu Root once said:

> "To have builded oneself into the structure of undying institutions, to have aided in the development of these priceless instruments of civilization, is to have not lived in vain, but to have lived in perpetuity."

To measure the capacity of a charitable organization or institution to accommodate an up-to-date planned giving program, one might first ask: *What do you need to know?* The answer, at least in part is:

> Your institution, its aspirations and its gift constituencies among people.
>
> An understanding of people, particularly as it relates to estate planning motives . . . characterized by respect, empathy, sincerity.
>
> The questions to ask and to whom those questions should be directed.
>
> A basic vocabulary of financial and estate planning; not less—but not too much more.
>
> A basic understanding of federal tax incentives to charitable giving-but not more than to know how to put the questions to a professional adviser, be he or she lawyer, accountant or financial planner.

The next question could well be: *What do you need to have?*

> Administrative support in concept and budget. With a time-frame of three to five years.
>
> Direct mail program and carefully crafted lists.
>
> Materials to mail on a periodic basis describing the methods of creating such gifts and why.
>
> Capacity and material to follow up responses in person.
>
> Legal counsel who is knowledgeable and responsive.
>
> Sympathetic and helpful business officer, treasurer, comptroller, and investment committee or adviser.
>
> Ground rules and flexibility.
>
> Procedures—work flow chart.
>
> Short-range and long-range goals.

How about the steps to take, or: *What do you need to do?*

> Be certain that you can fulfill every representation made to a prospect and perform every obligation undertaken with a donor.
>
> Determine "image"—create an institutional as well as a departmental identity.
>
> Make program known to all within institution or organization starting with telephone operators.

Determine approach to your constituencies, direct and indirect.

Determine your offering package—methods of management and disposition of gifts . . . based on cost-effective guidelines.

Determine role of volunteers.

Determine mailing and advertising programs—create or buy—with reply cards and personal contact programs—seminars.

Determine strategy with other development efforts of institution or organization.

Follow through.

Follow up.

Among the prerequisites for sustaining and nurturing a successful planned giving program are creativity, performance, persistence and patience. Underlying these sterling characteristics are a few bedrock principles:

1. Part of the effectiveness of a planned giving program rests in broad exposure. Accordingly, all institutional or organizational fund raisers must be made aware of planned giving fundamentals. The broad concept of "lifetime giving" for a donor can only be exploited with the combined use of all methods of charitable giving, backed up, if necessary and desirable, by testamentary gift commitment.
2. On the proven theory that giving must be made easy, procedures and lines of communication must be available to the planned giving "experts" by everyone concerned with the effort.
3. Life income agreement holders and persons who have created trusts in which the charity is a beneficiary are valuable sources for continuing cultivation. The most successful institutions with highly developed planned giving programs find repeat and referral gifts are frequent among this group. This is particularly true where a charitable remainder pooled life income fund has creditable investment performance.
4. Stewardship is a critical element of a successful planned giving program. Many charities make an effort to deliver the first life income check in person. At least annual written communication is had with each such benefactor and where possible, visits are made to these people on birthdays and at other times, very often on a visit unrelated to fund raising.

5. The importance of stewardship is self-evident when it is realized that all bequests are revocable.
6. Because of the complexity of the subject matter of planned giving, it is universally agreed that volunteers should be primarily utilized:
   a. to identify prospects.
   b. to introduce staff to prospects.
   c. to become expectancies themselves.
   d. to assist in communication, cultivation and stewardship.
7. An essential comprehension of the role and interest of the donor, the charity, and the donor's attorney, is indispensable in the administration of a planned giving program.
8. All literature on planned giving that contains tax information should be dated and monitored because of the volatility of federal and state tax and probate laws and regulation. Danger lurks in outdated presentations.
9. Administrators and a governing board must not be ignored in the proper promotion of a planned giving program.
10. General experience indicates that brochures are most effective when they deal with one form of planned giving rather than attempting to cover the waterfront—overkill is to be avoided with literature.
11. Prospects for planned giving as opposed to capital campaigns should not necessarily be judged by past giving or standard of living. There are so many experiences with "sleepers" that external criteria may be irrelevant.
12. Return cards with promotional mailings in planned giving rarely yield more than a one percent response, suggesting patience in promotion and short-term expectations.
13. Planned giving administrators are often unaware of and insensitive to the lawyer's true role in this area. All lawyers, not only probate specialists, must be cultivated, since the lawyer-client relationship is essentially one of trust and confidence between two persons on whatever level they communicate. A bequest to or a charitable remainder for a specific charity may or may not be recommended, implemented or encouraged by the attorney. When talking with lawyers, bequests and trusts should be emphasized so as to create potential business for lawyers. Effective relations with lawyers will depend in good part on how the charity can assist them in serving their clients and, incidentally, cementing their professional relationship with clients.

Donor education is a vital part of planned giving. Few donors will understand the workings of trust administration, much less the impact of inflation over an extended period of time. A first-class planned giving officer is obligated to educate donors to these realities so they can deal with the issues and make significant decisions both for themselves and the charity of their choice. It is no sin, in my judgment, to discuss the preservation of principal with donors and their advisers when considering a gift subject to reservation of a life income. Be careful is the caution—and, be forthright is the admonition. Trying to outperform the money market funds may be an investment officer's dream, but it frequently bears little or no relevance to the true objectives of a charitable remainder life income gift.

The trend toward increased development staff and budgets continues at all levels, and inflation and greater institutional expectation push them even higher. Presidents, chief executive officers and trustees have responded with increased attention to the costs and productivity of this activity whose primary justification is its importance to the financial strength and security of the institution.

We used to talk about being administrators; now, with questioning of costs and demands for accountability, we need to be concerned with a broader outlook of management—the people, budgets and office support that make things happen on an organized and effective basis.

Unfortunately, there are no simple answers. The development officer, in trying to establish a basis for management decisions, faces challenges not entirely unlike those in business and industry. The bases for evaluation are less firm. For instance, business and industry may use sales volume and profit as principal criterion for success. We can use fund-raising results as they use sales volume, but when it comes to profit, there is no such exact basis for judging cost-benefit success in fund raising. Controversy also surrounds profit, for some commentators see an obsession for profits as a handicap to future planning in business.

In the United States, we live in a corporate world. The organization we know best is the corporation; without it, the free enterprise system wouldn't work. Starting a business of any kind involves consideration of the form of enterprise. Starting a deferred or planned giving program requires no less.

Here the comparisons between the profit and non-profit corporations are strikingly similar, particularly in their origins.

For this reason, executives of non-profit institutions cannot ignore some of the fundamental considerations which determine whether an enterprise should go forward or be abandoned, and cost-effectiveness is one of them. That is the rationale for the book that Howard Metzler and I have written, *The Costs and Benefits of Deferred Giving*, applying cost accounting, benefits analysis and actuarial and econometric forecasting to the Pomona plan. The Pomona plan is Pomona College's (Claremont, California) extremely successful deferred giving program, one of the first established in the country.

Simply put, if costs are to exceed benefits, you're in the wrong business. However, if you can turn that around; you will have a going concern.

Very few of us have a notion of what a dollar given today, subject to a life or term agreement, will be worth, when, as, and if, it is finally delivered to the institution or organization, unencumbered, and when the remainder is finally released.

Assume, for example, that there is a $100,000 gift to a charitable remainder unitrust for one male beneficiary, age 50, receiving a payment of 6 percent. According to government tables, the present value of that charitable remainder interest, hence the deduction, is about $27,700; at 8 percent, the value is $19,600.

For a 6 percent annuity trust the deduction is $47,300; for an 8 percent annuity trust, $29,700, and so it goes with all similar kinds of gifts.

That figure, in each case, according to government tables, is meaningful for only one purpose, namely, for the income tax charitable deduction. Factored into that number is a national mortality table, a discount rate, the gift value, the rate of return and the beneficiary data.

But what is that gift actually worth to the charitable institution? On the up side, how do the government actuarial tables relate to the experience of the institution?

What earning rates can it expect? What investment policy should be pursued? And what about inflation?

On the down side, how about the marketing and management costs of running that annuity trust or the unitrust for 20 to 30 years? In every deferred gift there are three unknown elements at the time of gift and these questions reflect those unknown elements.

Until recently, most fund raisers confined their inquiry to the government resolution of these issues through the tables. To satisfy those within the institutions who viewed these gifts of future interest with dismay, rules of thumb were readily established as to what is and what is not acceptable.

Most often it was, and is, based primarily on considerations involving investment and convenience. Colleges and universities frequently use $5,000 for the value of initial gifts to a pooled income fund and $50,000 for a separately managed charitable remainder trust. These are nice round numbers, but without consideration of ages, rates of return, investment choices and projections, number of beneficiaries and concern for the future dollar, they tell very little about what the institution will ultimately realize.

The Pomona study creates a framework for answering the present value question not only in terms of mortality, earnings, and the economy, but also in terms of every single cost because we believed it was essential to try and determine what the actual value of that $100,000 gift, subject to a term or life income arrangement, would be, in constant dollars, and when it was finally received.

Will that $100,000 unitrust gift in fact be worth $27,700 to the institution when it is finally received? What will be the real purchasing power of the remainder; 10 cents or $200,000?

As far as we knew, no one had tackled these issues before. The issue, common to all these transactions, is *the determination of present value.* Valuing the charitable remainder gift in constant dollars, whether created by annuity agreement or by trust indenture is the core question of the study.

To determine value, it is essential to know costs. The traditional measurement of cost per dollar of gift received does not address the economic complexities of deferred giving programs. The legislative push to regulate charitable fund raising through cost limitations must take into account the special nature of these gifts.

The period over which the costs of gift acquisition are normally incurred exceeds the standard business time cycle. A single year, either calendar or fiscal, is inadequate. The marketing process for deferred gifts can be expected to take at least 18 months from first contact to signed agreement and usually more. Frequently, it is impossible to attribute all-inclusive costs because a casual alumni meeting or seminar on deferred gifts in estate planning can plant a seed of interest that will bear fruit five or ten years later.

Costs in this study have been categorized into two segments, each of which normally extends well beyond a year. They are, first, the cultivation and solicitation costs incurred to obtain the agreement or the outright bequest; and, second, the costs incurred to maintain and service the agreement as long as it's outstanding.

Management policy considerations for a successful planned giving program include the following:

> The institution must gain rather than lose from contributions in the form of charitable remainder life income gifts or annuities, but, by the same token, risks must be undertaken with courage where certainty may be elusive.
>
> The institution should periodically evaluate its life income gift and annuity program to assure that the advantages to the institution outweigh the disadvantages.
>
> The institutional development program should include a range of methods of giving encouraged by tax incentives, so donors have all the options available to fit their own personal circumstances.
>
> Because new methods of giving require new methods of preparation, solicitation and management, the institution and its staff must be alert to changing laws and circumstances.
>
> The institution's fund raising officers, lawyers, and those charged with the management and disposition of these funds, must coordinate their efforts and communicate continuously and constructively.
>
> The institution must draw up sanguine and productive guidelines for its planned giving programs; however, they should be flexible enough to accommodate special situations.
>
> The institution's stewardship and management of the planned giving program should be of a quality that encourages repeat gifts.
>
> All well-known legal risks that could lead to wrongful liability must be overcome in a negotiation and execution of life income agreements.
>
> Responsibilities and authority for the institution must be defined and delineated to permit prompt and efficient decision-making.

In the context of such management policy, we established goals for the Pomona study. They were:

1. For charitable institutions with deferred gift programs or contemplating undertaking deferred giving programs, what are the methods by which value effectiveness can be assessed and how can the criteria therefore be established, both as to costs and benefits?
2. Since 1969, deferred giving has become an increasingly significant method of giving by which charities have prospered. Where do such programs fit in the context of a total charitable gift campaign and what kind of ultimate return can be expected from institutional investment in supporting such programs?
3. Is it feasible to apply modern economic and accounting principles to determine the present value of a gift of a future interest in terms of investment, inflation and life expectancy?
4. Charitable remainder unitrusts, annuity trusts, pooled income funds and gift annuities are all available to donors; but which plan is more beneficial to the charity and what are the methods by which each type of gift can be analyzed in terms of cost benefits?
5. Development programs are financed with precious unrestricted funds. What type of investment is needed to assure a successful deferred gift program and where the money will be spent?
6. If the celebrated Pomona plan has been successful with alternative marketing approaches (for example, to alumni rather than responders to a Wall Street Journal advertisement) by other institutions such as Grinnell College and Wellesley College, can such a program be even more productive?
7. Are responses possible to hitherto unanswerable questions of financial officers and trustees such as:

   How do we determine which deferred gift is acceptable and which is not?

   What can we actually expect from the gift of a remainder interest of a trust?

   Does the operation of the development office or the investment office determine what is the true value of such a gift?

   How do we show a donor that his proposed deferred gift will result in a liability rather than a benefit to the charity?

Where do the risks of loss or benefit lie?

How may we assess the cost-effectiveness of a deferred gift program?

What are the internal rates of return for gifts of remainder interests? Do they vary by type of gift? What are the variations and how are they computed?

When can we expect a return on the investment in a deferred gift program?

Are programs seeking charitable bequests worthwhile?

8. In a time of increased competiton for the donative dollar and greater demand for accountability, how can charitable institutions and organizations establish a sound economic rationale for their development programs, and particularly for deferred giving programs?
9. State legislation and proposed federal legislation regulating fund raising has been largely based on cost limitations; however, costs in one year have little to do with benefits received in that year for deferred giving programs. Such legislation is therefore unrealistic and improper unless it covers a broader time period and encompasses the accounting concept of internal rates of return or something akin to it.

GENERAL OBSERVATIONS

General observations which help establish the framework for what follows include:

> It is possible to estimate the cost-benefit ratio of a planned giving program.
>
> A process, derived from the cost-benefits analysis, is possible to permit the average charitable institution to analyze an existing planned giving program or to decide to undertake a new program.
>
> The cost-effectiveness of the Pomona plan showed a substantial return on investment (for example, the total cost of operating the program).
>
> The ultimate cost to obtain a dollar of benefit (measuring value at release time) was much higher than expected.
>
> The cost of acquiring deferred gift agreements on a per dollar basis (the dollar valued at the signing of the agreement) falls into the expected range, 10 cents or less, on a dollar.

It is the continuing costs during the management period and the reduction in benefit value attributable to the years of deferral that combine to reduce the cost-benefit ratio.

On the out-of-pocket cost side, the use of assumptions in allocations of budget expenditures is not worrisome, for such costs tend to remain fixed at widely ranging operating levels, notwithstanding the dollar volume of new agreements under management.

The analysis of the benefit side is far more complicated than that of the cost side.

The factors which make prediction imprecise in attempting to project the value of the remainder at the time an agreement is terminated are the inherent uncertainties in both actuarial estimates and econometric projections.

The most significant reduction in value (and therefore increase in cost) occurs in the process of discounting the future value of the remainder interest to its present value (for example, the cost of having to wait, or, expressed another way, the capital opportunity cost).

The time element can be focused on two parameters: the first, actuarial assumptions and calculations; the second, gift acceptance criteria. Both require data on age, sex, and number of beneficiaries as well as type and terms of agreement.

For this study, using life insurance industry data as well as Pomona experience, Ernst & Whinney actuaries selected an appropriate mortality table. Comparison with IRS tables will show significant differences since the populations vary substantially.

Criteria for the acceptability of gifts subject to a life income or a term of years will more realistically and inexpensively serve charitable institutions than a comprehensive self-analysis of cost-benefit of their planned giving program.

Recognizing that charitable fund raising is more of an art than a science, there should not be a preoccupation with numbers in establishing development policy, but prudence today suggests that numbers must be a part of the considerations of that policy.

Bearing in mind that the study of the Pomona plan was but a means to the end of translating usable principles for all charities, let's examine the Pomona study.

IMPORTANT FINDINGS

As of June 30, 1978, Pomona's true cost of acquiring 1,808 life income agreements aggregating $35,632,000 was 8.7 cents per dollar (Wellesley, 4.3 cents; Grinnell, 2 cents).

For bequests over the same period of time, the cost of acquisition was 2.2 cents per dollar.

By any standard, these figures are impressive. Perhaps more importantly, the question is raised about present value of these remainder interests and there we determined that there are three major cost and risk of loss areas. These are, 1) actuarial experience, 2) agreement maintenance costs, 3) inflation rates and investment yields.

POMONA COSTS PER DOLLAR

1. *For 213 gift annuities 66 cents per dollar, translating into an internal rate of return (IRR) of 55.9 percent in 1978. In 1984, there were 185 gift annuities with a market value in excess of $7 million with costs at 6% for an internal rate of return of 48%.*
2. *For 1,190 pooled income fund gifts, 78 cents per dollar, translating into an IRR of 27.7 percent in 1978. In 1984, there were over 1000 such gift agreements with a market value of $17.5 million, at a cost in excess of 11% for an internal rate of return of 25%.*
3. *For 405 separately managed trusts, 84 cents per dollar, translating into an IRR of 18.4 percent in 1978. After the study and new criteria for gift acceptance in 1984, there were 202 separately managed trusts with a market value in excess of $15.5 million. Costs were estimated to be $750,000, something less than 5%. The internal rate of return is projected at 40%.*

We concluded that for Pomona, without including bequests, 20 percent to 30 percent was a reasonable estimate of the annual internal rate of return in 1978. In 1984, that rate of return was measurable at about 37%. For Wellesley and Grinnell, where the conditions were vastly different, the overall internal rates of return in 1978 were 50 percent to 60 percent and 100 percent to 150 percent respectively.

Based on the "Wharton Expected Case," the internal rate of return on all deferred gifts including outright bequests attributable to the Pomona plan was 92 percent in 1978. The addition of bequests with its very low direct costs at 2.2 cents per dollar measurably enhanced the rate of the return.

RELEASES OF PRINCIPAL

Over 20 years, it is possible to project the following releases of principal to Pomona College. 1) annuities, 84 percent; 2) pooled income funds, 56 percent; 3) separately managed trusts, 52 percent.

This represents a cash flow to Pomona of between one and two million dollars a year for the next 20 years.

In fact, the cash flow, for the eight-year period from 1978 to 1986, was about $11,800,000, almost $1.5 million per year.

Based upon 1,500 lives, of which 43.5 percent were male and 56.5 percent were female, the combined aggregate one-life table compared favorably to the Society of Actuaries 1971 individual annuity mortality table adjusted by a 10 percent decrease in mortality.

Agreement maintenance costs, while less in aggregate than acquisition costs in each year of the study, had to be projected over the life of the agreements. Separately managed trusts imposed the heaviest cost burden at 85 percent of the annual maintenance expenses, with pooled funds at 10 percent and annuities at 5 percent.

To illustrate the cost analysis, we looked in every conceivable corner.

For 1975, the total cost of the program was about 26% higher than the annuity and trust department budget, while in 1979 it was about 36% higher than the annuity and trust department budget. The additional costs, based on allocations, came from the budgets of: the vice president for development, annual giving college relations, the office of public relations, publications, the alumni office, the treasurer's office, the president's office, the business office, auditing, the mail center, personnel services, unemployment insurance, business services, information processing, mimeograph, utilities, rent and other miscellaneous items.

In other words, we included all the things which go into the consideration of costs in a profit making enterprise to determine whether there is money to pay stockholders. We went into a thorough cost analysis, not just the budget of the trust and annuity program; or even the budget of the development program, but every dollar that related to getting those dollars.

Those are the true costs which are not often considered by development managers. We must, however, start to consider full costs to make fund raising more professional and accountable. *We must know what it costs to raise money, because we must know how much money to ask for in order to raise that money.* That is a critical inquiry with which non-profit institutions have not come to grips.

Perhaps the most important implication of the study is the creation of methods by which, depending on what an institution believes should be its return on such gifts, acceptance criteria can be determined. A few principles are required for the preparation of acceptance criteria.

Determine the minimum acceptable remainder value, taking into consideration purchasing power, cumulative costs that may have to be offset, and designated uses. Obviously, a deferred gift to construct a building is going to involve different consideration than an unrestricted gift.

Estimate acquisition costs and agreement maintenance costs. Decide how to allocate costs to individual agreements. Whether an institution is going to assume the cost or make a charge, it is nonetheless imperative to know that figure so that it can be accommodated over the period of management.

Calculate the management period, using appropriate mortality tables to estimate life expectancies of the payees.

Make capital market assumptions that will assign investment yields as well as a total return on investments.

Choose an investment mix that is appropriate to the level of income payments.

Calculate minimum gift sizes, valued at the time an agreement is to be set up.

I know that many of the judgment calls I've referred to in the cost-effective study do not fall within the institutional jurisdiction of fundraisers, however, they all relate to the planned giving fundraising process. Returning to my initial theme of credibility, how better can you explain to a donor that an excessive rate of return for a life income gift will not produce any significant benefit to your institution than with this kind of data. My experience is that donors are not inclined to impose unreasonable burdens with their gifts, provided you can document the burden.

How better can you seek an increase in your budget for planned giving by proving that the internal rate of return on the institution's investment exceeds 37% per annum. Have your treasurer compare that with his record of return on endowment investment.

In summary, I am reminded of an old jazz ballad which Ella Fitzgerald and Cab Calloway made famous. I don't remember the title, but I'll never forget the first line:

"IT AIN'T WATCHA DO, IT'S *THE WAY* THAT YOU DO IT . . ."

That about sums up the lesson of professional planned gift administration and management. Well done, the program will stand as a beacon of attraction to all prospects and as a generous pool of resources for your institution.

In the business of fundraising, it is said, the road to success is always under construction. I wish you all a safe journey.

APPENDIX
SAMPLE ETHICAL GUIDELINES

A. Responsibilities.

In all professional functions, a planned giving officer (PGO) should be competent, prompt, and diligent. A PGO's conduct should conform to the requirements of the law. A PGO should be guided by personal conscience and the approbation of professional peers. A PGO should strive to attain the highest level of skill. A PGO's ethical problems arising from conflicts between his or her representation to clients and an employing entity should be resolved through the exercise of sensitive and moral judgment. The rules contained herein are rules of reason.

Who is the client for a PGO? A PGO represents to the charity the donor's intent and represents to the donor the charity's needs. Both are clients to the PGO.

B. Competence.

A PGO shall provide competent representation to a client. Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and the use of methods and procedures meeting the standards of competent practitioners in this field. It also includes adequate preparation.

C. No criminal, fraudulent or sham transactions.

A PGO is required to give an honest opinion about the actual consequences that are likely to result from a client's conduct. When the client's course of action is already begun and continuing, the PGO's responsibility is especially delicate. A PGO should not participate in a sham transaction—for example, a transaction to effectuate criminal or fraudulent escape of tax liability.

D. Diligence.

A PGO shall act with reasonable diligence and promptness in representing a client. A PGO should act with commitment and dedication to the interests of the client. No professional shortcoming is more widely resented than procrastination, and a client's interests can often be adversely affected by the passage of time or change of conditions. In extreme circumstances, unreasonable delay can cause a client needless anxiety and undermine confidence in the PGO's trustworthiness. A PGO should carry through to conclusion all matters undertaken for a client.

E. Communication.

A PGO shall keep a client reasonably informed about the status of a matter and promptly comply with reasonable requests for information. A PGO shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation. The client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued. Adequacy of communication depends in part on the kind of advice or assistance involved. The information to be provided is that appropriate for a client who is a comprehending and responsible adult.

F. Confidentiality of information.

A PGO shall not reveal information relating to a representation of a client. The confidentiality rule applies not merely to matters communicated in confidence by the client, but also to all information relating to the representation, whatever its source.

G. Conflict of interest.

A PGO shall not represent a client if the representation of that client will be directly adverse to another client. A PGO shall not represent a client if the representation of that client may be materially limited by the PGO's responsibilities to another client or a third person or by the PGO's own interest. Loyalty to a client is impaired when a PGO cannot consider, recommend, or carry out an appropriate course of action for the client because of the PGO's other responsibilities or interests. The conflict in effect forecloses alternatives that would otherwise be available to the client. The critical questions are the likelihood that a conflict will happen and, if it does, whether it will materially interfere with the PGO's independent professional judgment in considering alternatives, or foreclose courses of action that reasonably should be pursued on behalf of the client. The PGO's own interests should not be permitted to have an adverse effect on representation. The PGO may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interests even though there is some difference of interest among them.

H. Prohibited transactions.

A PGO shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client. A PGO shall not use information relating to a representation of a client to the disadvantage of the client. A PGO shall not provide financial assistance to a client.

I. The entity as a client.

The organization employing the PGO is a client and is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees, and shareholders are the constituents of the corporate organizational client. Thus, duties and responsibilities of the PGO flow to the legal entity through such persons. When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the PGO, even if their utility or prudence is doubtful. Clear justification should exist for seeking review over the head of the constituent to whom responsible. In extreme cases, it may be reasonably necessary for the PGO to refer the matter to the organization's highest authority.

J. Declining or terminating representation.

A PGO shall not represent a client or where representation has commenced shall withdraw from such representation if: 1) the representation will result in violation of the rules of professional conduct or other law; 2) the

PGO's physical or mental condition materially impairs the PGO's ability to represent the client; or 3) the PGO is discharged.

K. Acting as advisor.

In representing the client, the PGO shall exercise independent professional judgment and render candid advice. In rendering such advice, a PGO may refer not only to law and tax, but to other considerations such as moral, economic, social and political factors that may be relevant to the client's situation.

L. Maintaining the integrity of the profession.

A PGO shall not knowingly make a false statement of material fact, fail to disclose a fact necessary to correct misapprehension known by the person to have arisen in the matter, or knowingly fail to respond to a lawful demand for information.

M. Misconduct.

It is professional misconduct for a PGO to: 1) violate or attempt to violate the rules of professional conduct, knowingly assist or induce another to do so, or do so through the acts of another; 2) commit a criminal act that reflects adversely on the PGO's honesty, trustworthiness or fitness as a PGO in other respects; 3) engage in conduct involving dishonest, fraud, deceit or misrepresentation; 4) engage in conduct that is prejudicial to the administration of justice; or 5) state or imply an ability to influence improperly a government agency or official.

(Excerpted from Model Rules of Professional Conduct adopted by the House of Delegates of the American Bar Association (1983) and altered as necessary for planned giving.)

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WORKSHOP SESSION—ADMINISTRATION, GIFT MANAGEMENT AND COST EFFECTIVENESS

Mr. Robert B. Turner
Associate Director, Planned Giving
Princeton University

A CHECKLIST

RELATIONSHIPS

1. Cooperativeness with the Development Office.
2. Credibility with the Treasurer, President, and the Board of Trustees.
3. Creativity and flexibility of Gift Administration staff.
4. On-time performance.
   —Initial gift processing
   —Income payments and tax reporting
   —Terminations
5. Courtesy to donors and prospects.

FINANCE AND INVESTMENTS (GIFT MANAGEMENT)

1. Ability to handle security gifts.
   —Regularly traded stocks and bonds
   —Closely held stocks
   —Unusual securities
2. Handling of commingled assets versus individual investments.
3. Safekeeping of records—both paper and computerized, including duplication in the event of a catastrophe such as a fire.
4. Smooth banking functions.
   —How much do you hire a bank to do?
5. Handling of real estate gifts.
6. Ability to handle a very unusual gift.
   —Knowing when to say, "no!"

LEGAL REQUIREMENTS

1. Ability to respond to legal requirements of Planned Giving using staff or outside counsel.
2. Keep Agreement forms up to date.
3. Assist with creative gift planning.
4. Ability to work with donor's counsel when appropriate.

5. Request IRS rulings as needed.
6. Ability to call upon attorneys with other expertise. (e.g., securities registration, real estate)
7. Sensitive to donor relations *and* legal issues.

TAX AND INSURANCE REPORTS

1. Tax Reports
   —To income recipients
   —To the IRS
2. Gift Annuities reports

COST EFFECTIVENESS

1. Buy services from vendors or develop internal competence.
   —Legal, accounting, tax reporting, investment
2. Who pays for Gift Administration?
   —Each gift, Development Office, Treasurer's Office
3. Decisions about staffing levels.
   —In Development
   —In Gift Administration
4. Developing and maintaining technical competence.
   —You can get into a *lot* of trouble!

COMPUTER SYSTEMS

1. For proposals and calculating charitable deductions.
2. For access to gift records and donor information.
3. For tax and annual beneficiary reports.
4. For specialized mailings (e.g., mailing to all unitrust beneficiaries).
5. Gift Administration programs for gift annuities and Pooled Income Funds.
6. Linkage to word processing equipment.
7. Electronic mail for a dispersed staff.

UNDERSTANDING THE GIFT ADMINISTRATION DEPARTMENT: Tensions and Common Themes

Planned Giving Development Officer(s)

As we see them:	As they see us:
Get any gift	Excessive concern for efficient handling
Concern for gift credit	Concern for present value
Pushing to accept more gifts	A drag; more gifts means more work
Impractical/hair brain	Bureaucrats stuck in routine, non-creative
Needing more precision	Needing more cooperative spirit

Common Concerns

Desire to get meaningful gifts.

A closeness to donors and income recipients.

The Bank

As we see them:	As they see us:
Excessive concern for uniform handling	Get any gift
Concern for order	Concern for just this gift
A drag	Pushing
Bureaucrats stuck in routine	Impractical/hair brain
Needing more staff on our account	Needing more cooperative spirit
Concerned about accounting	Concerned about minimizing fees
Overly careful	Overly speedy

Common Concerns

A desire to systematize gift processing.

A desire to give and receive accurate, brief and clear messages.

The Treasurer's Office

As we see them:	As they see us:
They give us few resources, little money or help	A lot of money spent on administration
Concern for accounting and legal issues which they do not understand	Providing few assets to the institution and lots of potential liability
They force us to do it cheap	Expanding demands upon the budget
Concerned about accountability to the board and the organization's cause	Accountability to the law, IRS regulations and recipients

UNDERSTANDING THE GIFT ADMINISTRATION DEPARTMENT: Tensions and Common Themes (Continued)

Common Concerns

A concern that the work be done fairly, legally and to the benefit of the charity.

The keeping of accurate and permanent records.

With the Investment Manager (and the Investment Staff)

As we see them:	As they see us:
Not understanding planned giving requirements	Lacking investment sophistication
Wanting too much commingling	Wanting everything in separate funds
Concern to evaluate the manager	Concern about the special purposes of each fund

Common Concerns

The greatest return possible to the income beneficiary and the charity.

Dislike for excessive risk.

Knowledge that the other person's area is complex but important.

Senior management of the charity

As we see them:	As they see us:
Not understanding taxes, legal requirements, special accounting and fiduciary relationships	A small cog in the organization
Lacking in technical concern	Lacking a strategic vision
Needing our technical skill	Needing to give us clear direction, policies and adequate compensation
Wanting quality, timely service	Wanting precision and accuracy

Common Concerns

Desire to serve the charity *and* the donor.

A desire for a clear understanding of the place and the responsibility of the gift administration department within the overall charity.

A desire to get meaningful gifts for the charity.

WORKSHOP SESSION—CHARITABLE LEAD TRUST

Winton C. Smith, Jr., J.D.
Memphis, TN

LIVING UNITRUST LEAD TRUST

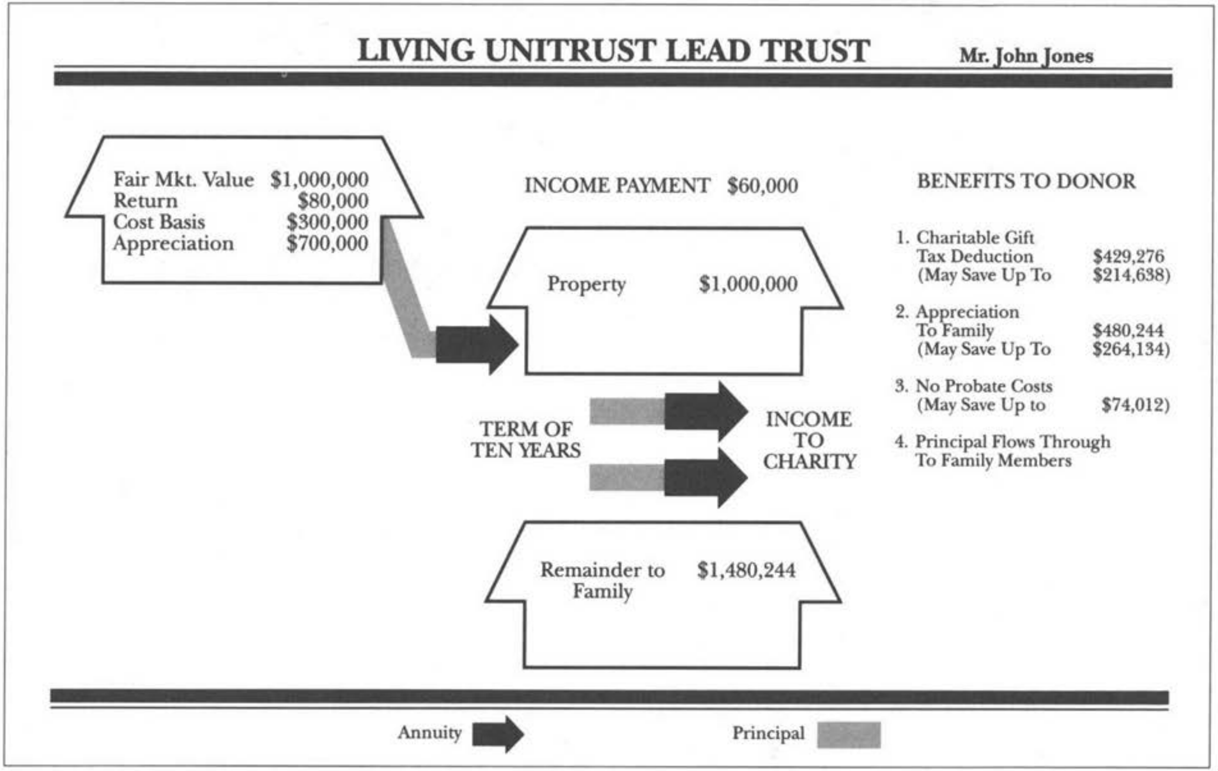
Property may be transferred to family members at very low tax rates by permitting the income to go first to charity for a period of years and then transferring the corpus to family. This method of transferring property at very low tax cost is called a Living Unitrust Lead Trust. A percentage of the value of the trust is distributed each year to the selected charities for a chosen number of years. At the end of the chosen term of years, the principal is distributed to family members.

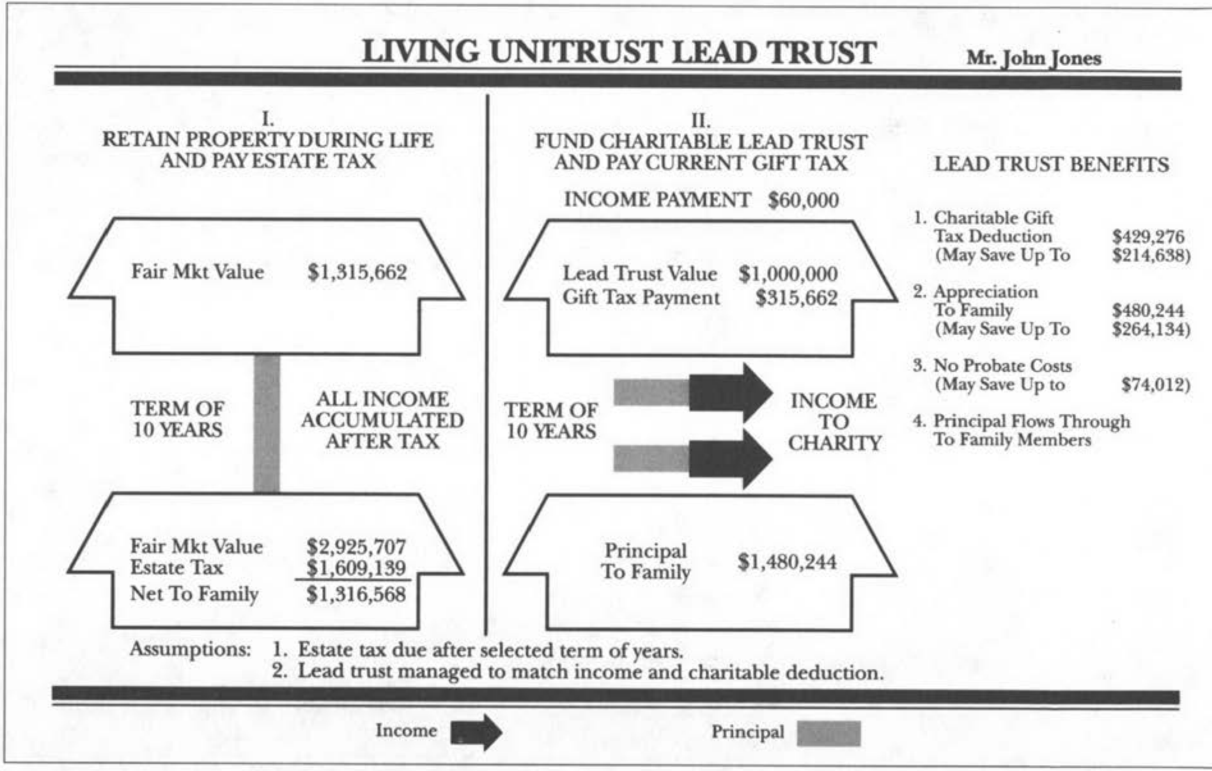
GIFT TAX CHARITABLE DEDUCTION

When the unitrust lead trust is funded, there is a GIFT charitable deduction for the current value of the income which will be distributed to charity. The difference between the fair market value and the gift deduction is the actual taxable gift to family members. In many cases, it is possible to offset this taxable portion of the transfer through use of the donor's exemption equivalent. For example, at present a person could transfer over $1,000,000 to family members through the charitable lead trust with no payment of gift or estate taxes through use of a combination of the charitable deduction and the exemption equivalent. This lead trust is particularly beneficial if the property has great appreciation potential. Property which appreciates very rapidly could increase to such an extent that during the latter years of the trust the majority of the earnings or appreciation simply increase the total value of the trust corpus. Many persons have used these trusts to pass at little or no tax cost very valuable properties to children and to grandchildren.

PROPERTY TRANSFER TO FAMILY

This trust is excellent for transferring a particular property to family members. For example, a trust might be funded in part with public securities and in part with development land.


LIVING UNITRUST LEAD TRUST
Mr. John Jones
Fair Mkt. Value $1,000,000
Return $80,000
Cost Basis $300,000
Appreciation $700,000
INCOME PAYMENT $60,000
Property $1,000,000
TERM OF
TEN YEARS
INCOME
TO
CHARITY
Remainder to
Family
$1,480,244
BENEFITS TO DONOR
1. Charitable Gift
Tax Deduction $429,276
(May Save Up To $214,638)
2. Appreciation
To Family $480,244
(May Save Up To $264,134)
3. No Probate Costs
(May Save Up to $74,012)
4. Principal Flows Through
To Family Members
Annuity
Principal


LIVING UNITRUST LEAD TRUST
Mr. John Jones
I.
RETAIN PROPERTY DURING LIFE
AND PAY ESTATE TAX
Fair Mkt Value $1,315,662
TERM OF
10 YEARS
ALL INCOME
ACCUMULATED
AFTER TAX
Fair Mkt Value $2,925,707
Estate Tax $1,609,139
Net To Family $1,316,568
II.
FUND CHARITABLE LEAD TRUST
AND PAY CURRENT GIFT TAX
INCOME PAYMENT $60,000
Lead Trust Value $1,000,000
Gift Tax Payment $315,662
TERM OF
10 YEARS
INCOME
TO
CHARITY
Principal
To Family $1,480,244
LEAD TRUST BENEFITS
1. Charitable Gift
Tax Deduction $429,276
(May Save Up To $214,638)
2. Appreciation
To Family $480,244
(May Save Up To $264,134)
3. No Probate Costs
(May Save Up to $74,012)
4. Principal Flows Through
To Family Members
Assumptions: 1. Estate tax due after selected term of years.
2. Lead trust managed to match income and charitable deduction.
Income
Principal

During the term of years, the trust distributes dividends and some of the securities to charities. At the end of the term of years the trust distributes the land and the remaining cash and securities to family members. If the land is selected properly, the property will have changed from rural to prime commercial development property during the term of years and the value will have increased many times. The children or grandchildren will receive an extremely valuable asset and in most cases will have no transfer taxes to pay upon receiving the property.

1. SIMPLE WILL

Chart 12 illustrates the simple will—all to surviving spouse in the first estate and equal shares to children after the demise of the surviving spouse. This will is frequently used by those with smaller estates and facilitates transfer of assets in these estates. However, in the larger estate, this plan can result in oppressive estate taxes.

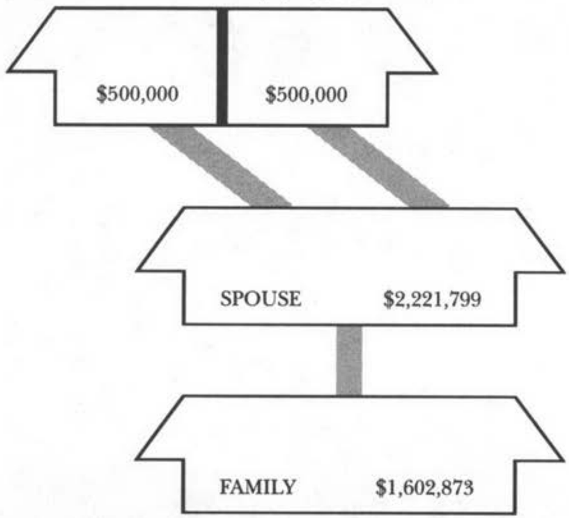
1989 Father and Mother each own the indicated portions of the total estate. Each has a simple will with the survivor as beneficiary. Many persons with estates of the size indicated have simple wills which were signed when the estate was much smaller.

2010 In nine out of ten cases, father will pass away first and mother is the beneficiary of an "I love you" will—that is, "I love you and you will receive everything including all of the property management responsibilities, all of the debt obligations and all of the business, investment and estate planning responsibilities." Since there exists an unlimited estate tax MARITAL DEDUCTION, mother pays no federal estate tax, and thus pays only last illness costs, debts, attorney's fees and probate costs on father's estate. Based upon national averages, the total of these costs is assumed to equal five percent (5%) of father's

1. SIMPLE WILL

Mr. John Jones

TOTAL ESTATE $1,000,000



1989

2010 First Estate	
Costs	$56,969
Tax	$0

2013 Second Estate	
Costs	$124,961
Tax	$771,388

Shrinkage	$953,318

Income ➡ Principal

estate. After payment of costs, mother owns outright the entire family estate. Since the estate appreciates each year at the indicated rate, the estate has increased in size substantially from 1989 to 2010 and will again grow much larger between 2010 and 2013.

2013 For planning purposes, the assumption is made that father will pass away in 2010 and mother will pass away in 2013. With the simple will in 2013 there is NO MARITAL DEDUCTION and, absent a bequest to charity, NO CHARITABLE DEDUCTION. The executor merely pays the costs and then pays both the federal and state estate taxes. Although the federal government permits during and after 1989 tax free transfer of property with a value of $600,000, every dollar over this amount will be taxed at rates from 37% to approximately 55%. By placing all assets in one estate the simple will assures the LARGEST POSSIBLE ESTATE TAX. For larger estates, the SHRINKAGE (total of costs and taxes) may absorb one-half of the estate. Many executors have had to sell assets in a poor market to obtain the cash required to pay these substantial taxes. Although the simple will plan is easy to create, the total estate may be drastically diminished by significant shrinkage.

2. CREDIT SHELTER TRUST

The illustrated credit shelter trust plan is an excellent plan and a substantial improvement over those plans which were popular prior to the Economic Recovery Tax Act of 1981. Thousands of families who have executed wills prior to September 12, 1981, should consider the credit shelter trust plan as an alternative to their present plan. Even though the intent of the plan under the old will may have been to utilize the maximum marital deduction available, absent state law changes which create that result, the old wills may result in payment of a substantial tax upon the husband's death. By redrafting the will to include the credit shelter trust and the new unlimited marital deduction, in some cases hundreds of thousands of dollars of estate tax can at least be deferred until the second estate. Nearly all persons who consider the options decide to defer the tax until the second estate.

1989 Father and Mother again each own the indicated portions of the total estate. Each has a will signed after Sept. 12, 1981 which establishes testamentary Credit Shelter and QTIP trusts.

2010 Credit Shelter Trust

The credit shelter trust is a very descriptive title for a trust which receives the amount that can be passed without payment of estate taxes in the first estate. This amount is technically taxed in the first estate and the tax payable is offset by the unified credit available in that tax year. The major advantage of the trust is that this amount is then not subject to any further estate taxation and thus benefits the spouse with income for life and then children and other relatives with deferred principal with no further shrinkage due to costs or estate taxes. Income and principal from the CST usually are distributable to the spouse, but may also be given to children if the trust document permits such distributions.

Qualified Terminable Interest Property Trust

One of the four methods which qualify for the marital deduction is also utilized in this plan. The four methods are (i) the distribution outright to spouse, (ii) the former marital trust with testamentary power of appointment for spouse, (iii) the qualified husband and wife charitable remainder annuity trust or unitrust and (iv) the qualified terminable interest property trust.

The qualified terminable interest property trust enables the first spouse to pass away to establish a trust for his or her spouse which will pay income to the surviving spouse at least annually. All of the income must be paid to the spouse and none of the principal can be appointed to any person other than the spouse during the lifetime of the spouse. The major difference between the QTIP trust and the prior marital deduction trust is that the first spouse can determine the ultimate distribution of the principal from the QTIP trust. For example, the first spouse can transfer income through the QTIP trust to a surviving spouse for life and then the terms of the trust established in the will of the first spouse to die will determine the division of the trust principal among the children after the death of the surviving spouse. This option is particularly useful to protect the children of a first marriage or to protect the children in the event that the surviving spouse should remarry.

2013 Estate Taxation

As a result of the establishment of the credit shelter trust and a QTIP trust, there is no tax in the first estate and the tax burden in the second estate is greatly reduced. The property which is owned by the surviving spouse (with the appreciation of that property) is subject to estate costs and the value of that property (less costs) is added to the value of the QTIP trust. Estate taxes are then computed. One may wish to note that the shrinkage has been substantially reduced when comparing the credit shelter trust plan with the simple will. Reduced shrinkage will increase the total value of the distributions to family. The CST/QTIP plan thus benefits the entire family. Mother does not have to pay any estate tax from father's estate and can enjoy the added security of investments which under a simple will would have been used to pay estate taxes. After mother passes away, children receive the full value plus appreciation from the credit shelter trust without ever paying any federal estate tax on the trust corpus. The total benefits to family are excellent and should be considered by any family with a substantial estate.

2. CREDIT SHELTER TRUST

Mr. John Jones

Savings Over Simple Will $352,167

1989

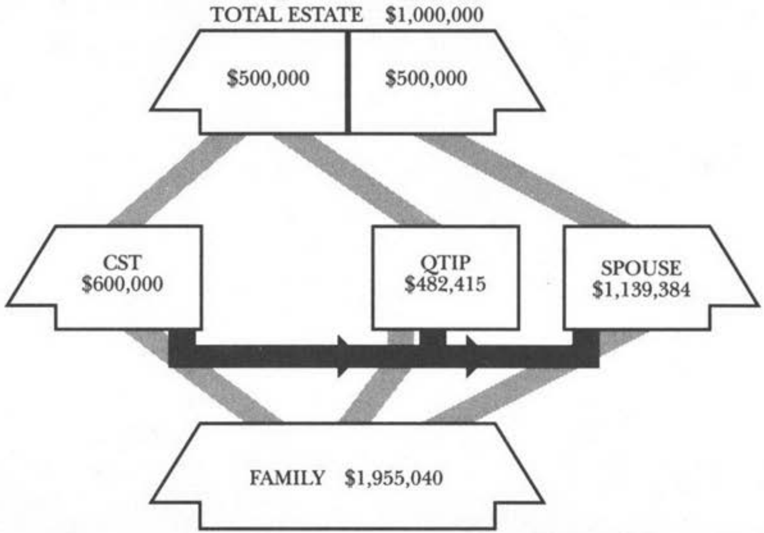
2010 First Estate

Costs–	$56,969
Tax–	$0

2013 Second Estate

Costs–	$64,083
Tax–	$480,099

Shrinkage $601,151



13

Income

Principal

3. CREDIT SHELTER—QTIP TRUST—LIVING UNITRUST

Present income tax savings can be achieved by adding a unitrust to the prior credit shelter and QTIP plan. The unitrust illustrated on chart #14 is a husband and wife unitrust which qualifies in the first estate for both a marital and charitable deduction. The income interest to the surviving spouse qualifies for a marital deduction after the 1981 Economic Recovery Tax Act and the remainder interest, as in prior years, qualifies for a remainder interest charitable deduction. The net result—an income tax deduction in the year the trust is funded and a total gift and estate tax deduction.

1989 Charitable Remainder Unitrust

Major benefits of a unitrust include (i) bypass of capital gains, (ii) increased income and (iii) charitable deduction which reduces current income taxes. Unitrusts are usually funded with low yield highly appreciated stocks, land or buildings. The person establishing the trust selects the income recipients, the unitrust percentage, and the charities to receive the principal of the trust AFTER all income payments to the income recipients are completed. For example, father might transfer into a unitrust stock with a cost basis of $10,000 and a fair market value of $100,000. He selects an 8% income for both himself and mother for life and directs that after the death of both the principal be distributed to charity.

The stocks would be transferred and the trustee could sell the stocks and invest in a much higher yield security WITHOUT PAYMENT OF CAPITAL GAINS TAX. Mother and Father would receive a considerably LARGER INCOME which would in part be sheltered by a CHARITABLE DEDUCTION.

2013 The unitrust may result in substantially increased income to husband and wife during their lifetimes. This increase in income enables the husband and wife to increase the size of their estate and may allow increased current gifts to family

3. CREDIT SHELTER – QTIP TRUST – LIVING UNITRUST

Mr. John Jones

Savings Over	
Simple Will	$371,145
Plus Gift	$197,359
Total Sav.	$568,503

1989

Present Income Taxes Saved	$9,650

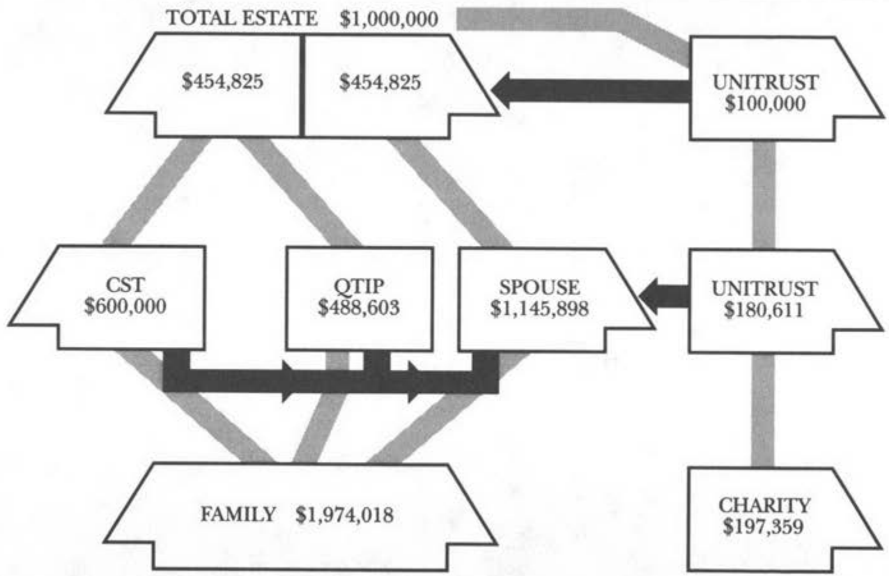
2010 First Estate

Costs–	$57,295
Tax–	$0

2013 Second Estate

Costs–	$65,532
Tax–	$495,627

Shrinkage	$618,454



Income Principal

members. The savings in income taxes, probate costs and estate taxes (the unitrust passes to charity and is fully estate tax deductible) enable the parents to make a generous charitable gift, enjoy greater income during life and, in many cases, pass nearly as much to family members as they would have without the unitrust.

4. TWO LIVES PLUS TERM OF YEARS UNITRUST

Many persons at senior ages are interested in receiving the present income tax benefits of a unitrust, yet would like some income benefits to be distributed to children or nephews and nieces. For these persons, a two lives plus term of years unitrust is ideal for providing income to both donors for life and then to other family members. In addition, donors receive substantial tax benefits—bypass of capital gains tax on appreciated assets transferred to the trust and a large income tax deduction in the year of the transfer.

1989 Chart #15 illustrates a two lives plus term of 10 years unitrust which benefits the entire family. The usual unitrust advantages—capital gains bypass, increased income and charitable deduction—are present. Mother and father receive income for their two lives and other family members receive income payments for the remaining term of 10 years.

2010 The estate plan is similar to chart #14, except the QTIP trust is eliminated by instead making distribution to the surviving spouse of the amount not transferred to the credit shelter trust. Since one-half of the unitrust is included in the estate of the first decedent, the credit shelter trust is reduced by the income interest of that one-half of the unitrust.

2013 The ability to transfer assets to the unitrust, sell without paying capital gains tax and reinvest in greater income producing assets is readily apparent when one compares the total value to family with the amount which would be received under chart #14. Although it is not often that by mak-

4. TWO LIVES PLUS TERM OF YEARS UNITRUST

Mr. John Jones

Savings Over	
Simple Will	$452,745
Plus Gift	$530,467
Total Sav.	$983,212

1989

Present Income Taxes	
Saved	$9,754

2010 First Estate

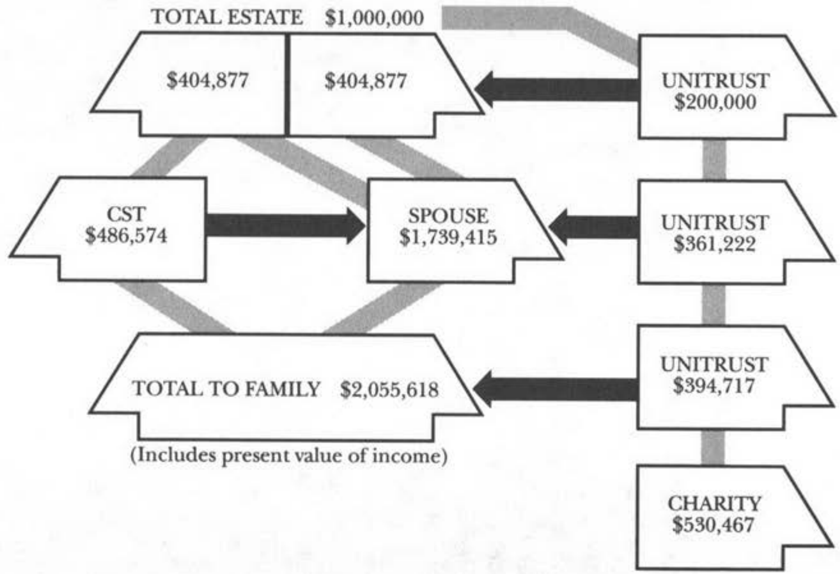
Costs–	$57,077
Tax–	$0

2013 Second Estate

Costs–	$99,997
Tax–	$586,906

2023 Distribution of Charity

Shrinkage	$743,980



15 Income Principal

ing gifts the family will actually receive greater distributions, in some situations it is in fact possible through a combination of tax benefits and improved investments to transfer greater assets to the family through charitable planning than if no planning had been accomplished.

6. LEAD TRUST—REMAINDER TRUST

For the larger estate, the combination of a charitable remainder unitrust for income tax and investment benefits and a testamentary annuity lead trust for estate tax benefits is excellent. In the first estate, estate taxation is reduced to zero by use of a credit shelter trust and one of the four methods for obtaining a marital deduction. In the second estate, there is no further opportunity (usually) to utilize a marital deduction and the lead trust therefore enables the second estate to generate large charitable deductions that greatly reduce (and may eliminate) estate taxes. Through use of the unitrust for income tax savings, the unlimited marital deduction in the first estate and the lead trust in the second estate, one can save income taxes, transfer substantial value to family members and minimize payment of gift or estate taxes.

1989 — In 1989 a low yield highly appreciated asset is transferred to a unitrust. Thus, there are present income tax savings; and the property transferred to the unitrust can be sold without payment of capital gains tax. The sale proceeds may then be reinvested in a higher yield investment.

2010 — Income is distributed from the unitrust to husband and wife for their lifetimes and then to family members for a term of years after the death of husband and wife. Since the unitrust has beneficiaries other than husband and wife, the unitrust does not qualify for the marital deduction. The income interest of one-half of the trust will be taxed in the estate of the husband and the estate of the wife, respectively.

2013 — When mother passes away, any taxes are paid and the balance of her estate is divided between outright transfers to children and transfers to an

6. TWO ESTATES – LEAD TRUST – REMAINDER TRUST Mr. John Jones

1989
Present Income
Taxes Saved $14,630

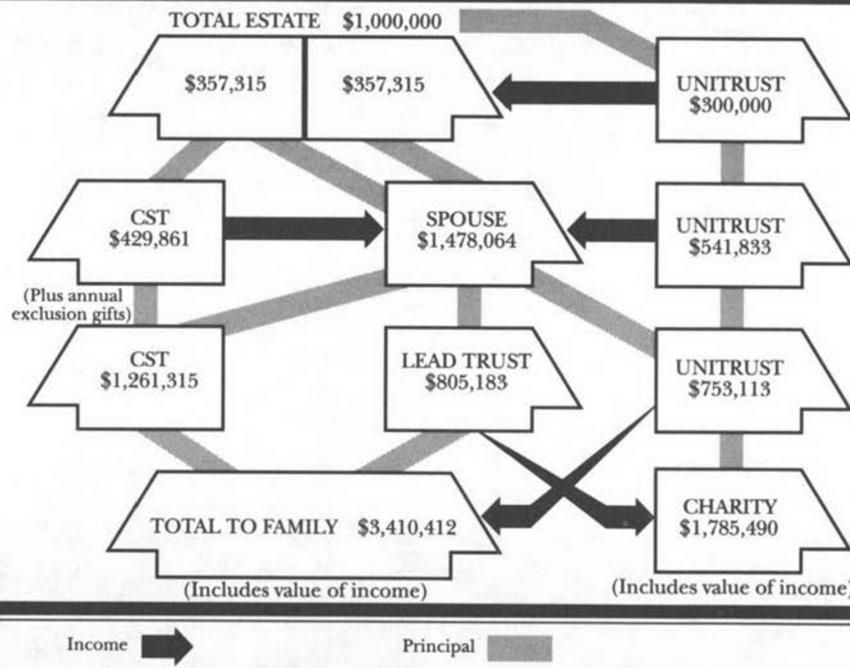
2010
Costs– $48,921
Tax– $0

2013
Costs– $84,756
Tax– $268,238

Present Value in 2013
Family– $2,123,118
Charity– $997,008

2023
Final Distribution

Shrinkage $401,915



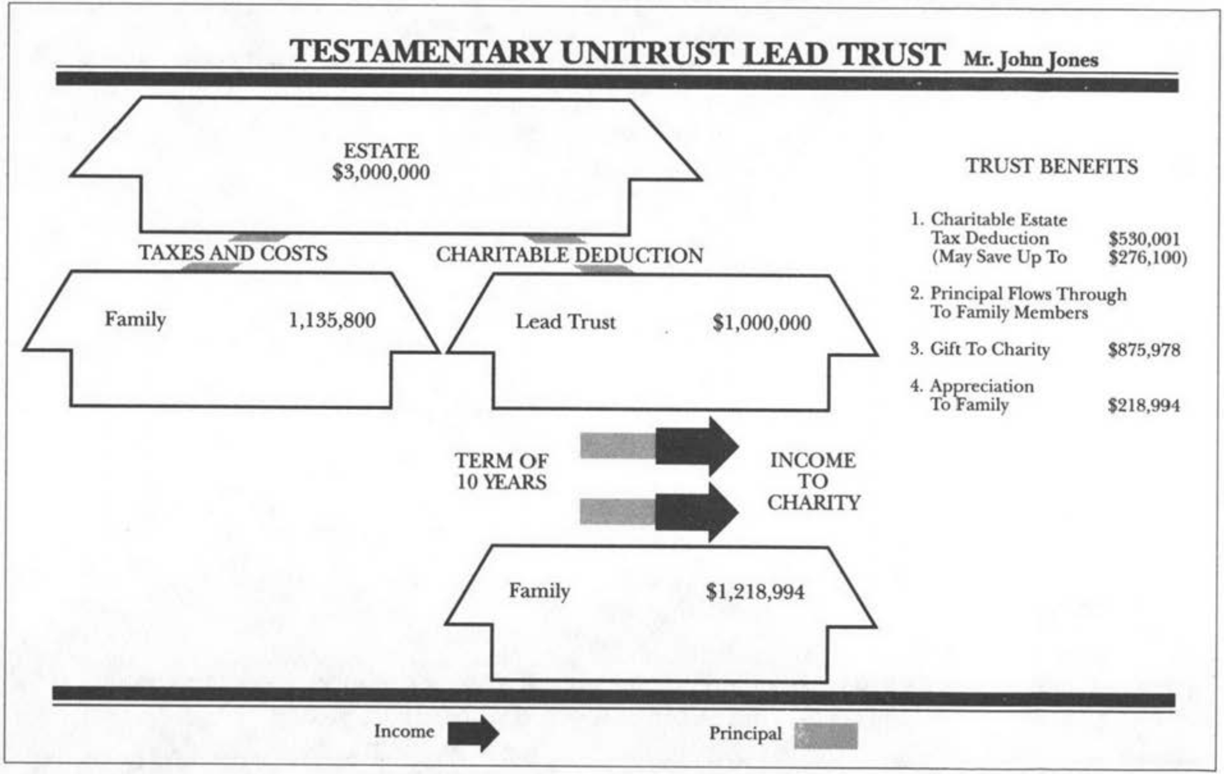
annuity lead trust and the existing charitable remainder unitrust. The charitable annuity lead trust will receive an estate tax deduction for the value of the income paid to charity. At the end of the selected number of years, the trust principal will be distributed without further estate tax to children or grandchildren. If the investment yield exceeds the annuity, the lead trust will make payments from income for the selected number of years and the principal plus appreciation can then be transferred to the family at the termination of that term of years. Lead trusts are an excellent means for transferring appreciated assets to grandchildren at little or no estate tax cost.

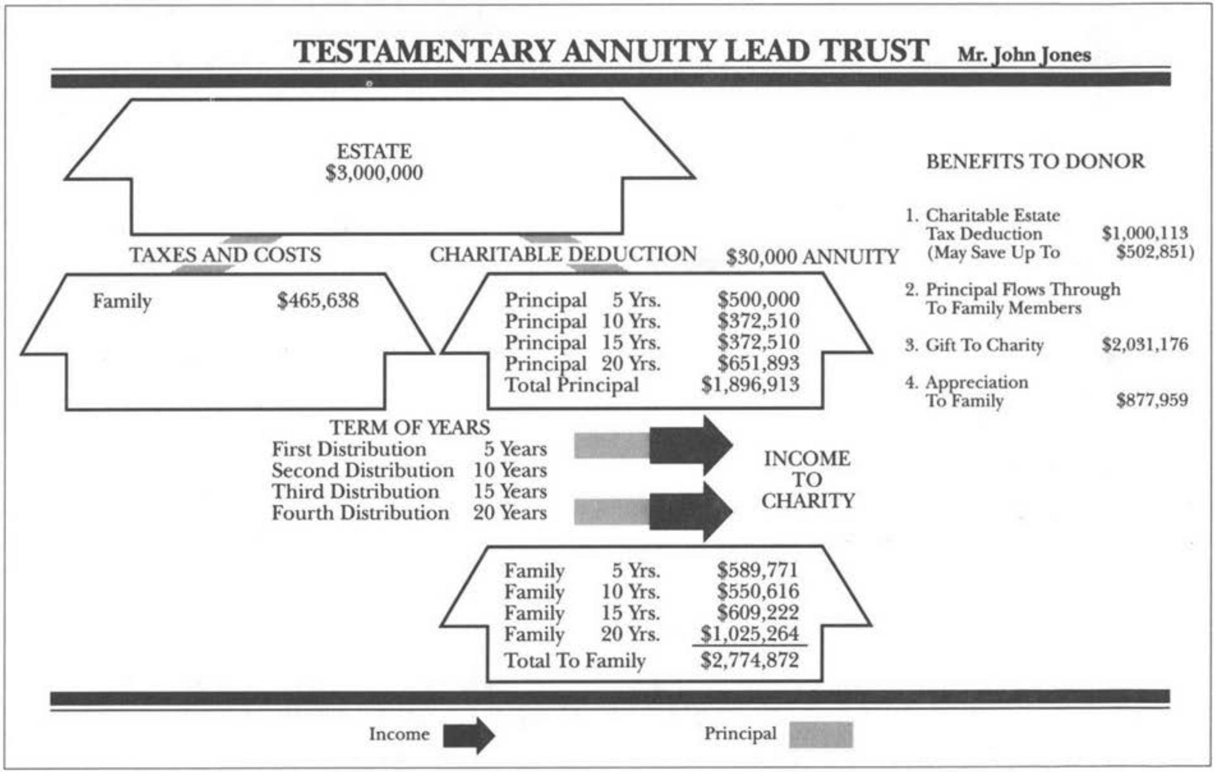
TESTAMENTARY LEAD TRUST

The best planning for family members is to provide for distributions of gifts during life, principal and income from the estate and additional principal at a future time. The lead trust is an excellent means for transferring principal to family members at a future time and saving substantial estate taxes while effecting this transfer. The donor directs that a portion of the estate is set aside into the lead trust. For the selected period of time the trust pays income to charity. After the term of years, the principal is distributed to family members. Since a substantial income payment will be made to charity, there can be a very large estate tax charitable deduction.

ESTATE TAX DEDUCTION

The donor selects the initial trust payout percentage, the term of years and the percent of the estate which will be allocated to the trust. The initial lead trust payout percentage is multiplied times the annual trust fair market value and that amount is then distributed each year to charity. If there is any appreciation or accumulation in excess of the income amount, this can be retained in the trust and will eventually be passed through to family members. The treasury tables are used to value the charitable deduction based upon the annuity percentage and the term of years selected. For many lead trusts, one-half to three-


TESTAMENTARY UNITRUST LEAD TRUST
Mr. John Jones
ESTATE
$3,000,000
TAXES AND COSTS
CHARITABLE DEDUCTION
Family
1,135,800
Lead Trust
$1,000,000
TERM OF
10 YEARS
INCOME
TO
CHARITY
Family
$1,218,994
TRUST BENEFITS
1. Charitable Estate
Tax Deduction $530,001
(May Save Up To $276,100)
2. Principal Flows Through
To Family Members
3. Gift To Charity $875,978
4. Appreciation
To Family $218,994
Income
Principal



TESTAMENTARY ANNUITY LEAD TRUST
Mr. John Jones
ESTATE
$3,000,000
TAXES AND COSTS
CHARITABLE DEDUCTION
$30,000 ANNUITY
Family $465,638
Principal 5 Yrs. $500,000
Principal 10 Yrs. $372,510
Principal 15 Yrs. $372,510
Principal 20 Yrs. $651,893
Total Principal $1,896,913
TERM OF YEARS
First Distribution 5 Years
Second Distribution 10 Years
Third Distribution 15 Years
Fourth Distribution 20 Years
INCOME
TO
CHARITY
Family 5 Yrs. $589,771
Family 10 Yrs. $550,616
Family 15 Yrs. $609,222
Family 20 Yrs. $1,025,264
Total To Family $2,774,872
BENEFITS TO DONOR
1. Charitable Estate Tax Deduction $1,000,113
(May Save Up To $502,851)
2. Principal Flows Through To Family Members
3. Gift To Charity $2,031,176
4. Appreciation To Family $877,959
Income
Principal

fourths of the initial value of the trust may be taken as an estate tax charitable deduction.

TRANSFER OF APPRECIATING PROPERTY

The major benefit of the lead trust is the ability to transfer appreciating property to family members at very low tax cost. The property is initially valued as of the date of creation of the trust and, as noted above, the trust may enjoy a very substantial charitable deduction. If the property appreciates substantially during the term of years, the value distributed to family members may be very much greater than the initial value of the trust. Many families have used lead trusts to transfer very large and valuable properties to family members at little or no tax cost. This trust, often in conjunction with other trusts which provide income while the family is waiting for the lead trust principal, can be a truly dramatic way to pass great wealth to family members with little or no estate tax cost.

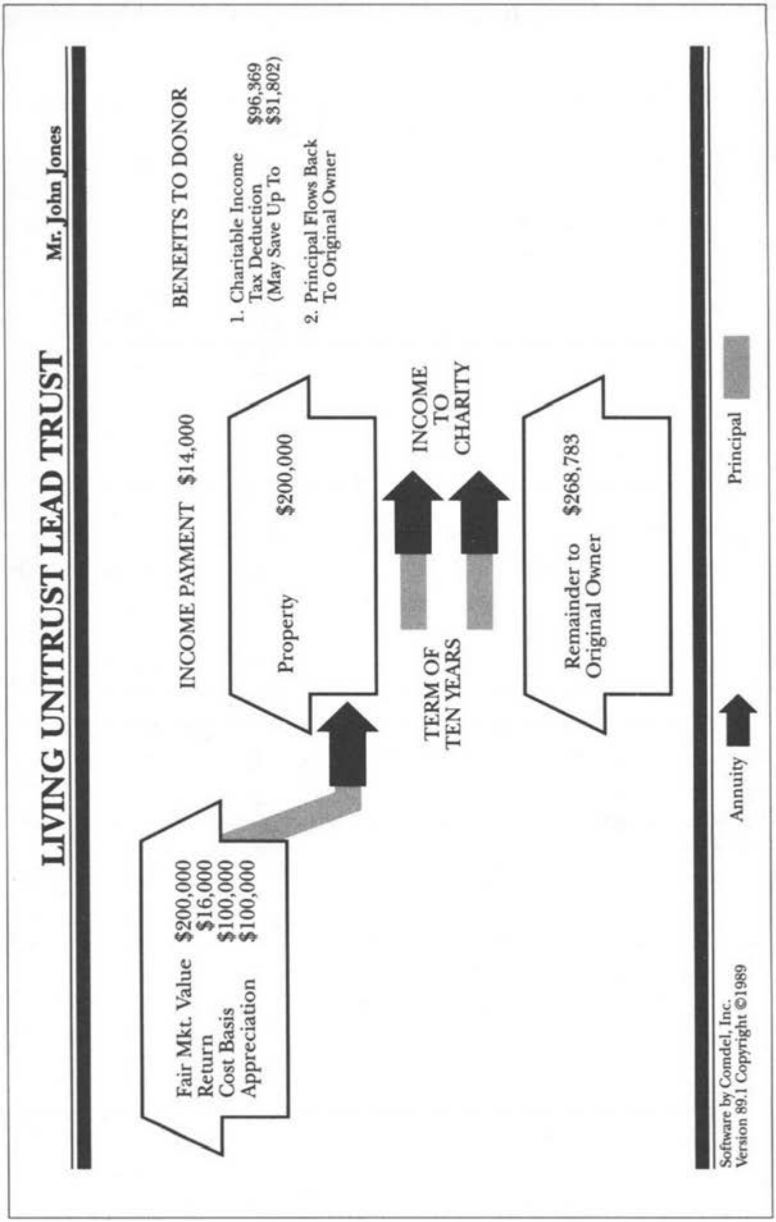
LIVING LEAD TRUST

A current income tax deduction may be obtained by creating a living lead trust for a term of years. Property is transferred to the trust and a selected income amount is paid to charity for the chosen number of years. After all income payments have been made, trust principal plus any accumulation is returned to the original owner.

INCOME TAX CHARITABLE DEDUCTION

When this grantor lead trust is funded, there is an income tax charitable deduction for the current value of the income which will be distributed to charity. This deduction is taken in the year of the transfer to the lead trust.

Under current tax laws, the trust donor receives a current deduction even though he or she will receive the property back again after the term of years. However, these same tax provisions require the donor to report the amounts given to charity as taxable income on the donor's income tax return. Since this income must be reported,



LIVING UNITRUST LEAD TRUST
Mr. John Jones
Fair Mkt. Value $200,000
Return $16,000
Cost Basis $100,000
Appreciation $100,000
INCOME PAYMENT $14,000
Property $200,000
TERM OF TEN YEARS
INCOME TO CHARITY
Remainder to Original Owner $268,783
BENEFITS TO DONOR
1. Charitable Income Tax Deduction $96,369
(May Save Up To $31,802)
2. Principal Flows Back To Original Owner
Annuity
Principal
Software by Comdel, Inc.
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most grantor living lead trusts are funded with tax free municipal bonds. If the income distributed to charity is from the tax free bonds, reporting it on the donor's tax return does not affect his or her taxes during the term of years. In some states municipal bonds which avoid both federal and state income taxes may make this agreement even more attractive.

HIGH INCOME YEAR

Living lead trusts with property eventually returned to the original owners are especially attractive for persons who have a large current income and anticipate lower income years in the future. A regular charitable giving pattern can be maintained while gaining maximum benefit from the charitable deduction during the high income year.

PROPERTY TRANSFER BACK TO THE DONOR

This trust is an excellent method for giving to favorite charities without permanently releasing title to property. Donors give up only the right to income for the selected number of years. After the term of years, all trust principal and accumulated income is returned to the donor. A living lead trust combines a current deduction with gifts to favorite charities and still allows the donor to retain his or her property.

CODE SEC. 2642. INCLUSION RATIO.

(a) INCLUSION RATIO DEFINED. For purposes of this chapter-
  (2) APPLICABLE FRACTION. For purposes of paragraph (1), the applicable fraction is a fraction—
    (A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in such skip), and
    (B) the denominator of which is—
      (i) the value of the property transferred to the trust (or involved in the direct skip), reduced by
      (ii) the sum of—
        (I) any Federal estate tax or State death tax actu-

ally recovered from the trust attributable to such property, and

(II) any charitable deduction allowed under section 2055 or 2522 with respect to such property.

Amendment Notes

Act Sec. 1014(g)(4)(B) amended Code Sec. 2642(a)(2) by striking out the last sentence. Prior to amendment, the last sentence of Code Sec. 2642(a)(2) read as follows:
Except as provided in paragraphs (3) and (4) of subsection (b), the value determined under subparagraph (B)(i) shall be of the property as of the time of the transfer to the trust (or the direct skip).
The above amendment is effective as if included in the provision of the Tax Reform Act of 1986 (P.L. 99-514) to which it relates.

(e) SPECIAL RULES FOR CHARITABLE LEAD ANNUITY TRUSTS:

(1) In General: For purposes of determining the inclusion ratio for any charitable lead annuity trust, the applicable fraction shall be a fraction—

(A) the numerator of which is the adjusted GST exemption, and

(B) the denominator of which is the value of all of the property in such trust immediately after the termination of the charitable lead annuity.

(2) Adjusted GST Exemption: For purposes of paragraph (1), the adjusted GST exemption is an amount equal to the GST exemption allocated to the trust increased by interest determined—

(A) at the interest rate used in determining the amount of the deduction under section 2055 or 2522 (as the case may be) for the charitable lead annuity, and

(B) for the actual period of the charitable lead annuity.

(3) Definitions: For purposes of this subsection—

(A) Charitable Lead Annuity Trust: The term "charitable lead annuity trust" means any trust in which there is a charitable lead annuity.

(B) Charitable Lead Annuity: The term "charitable lead annuity" means any interest in the form of a guaranteed annuity with respect to which a deduction was allowed under section 2055 or 2522 (as the case may be).

(4) Coordination With Subsection (d): Under regulations, appropriate adjustments shall be made in the application of subsection (d) to take into account the provisions of this subsection.

Amendment Notes

Act Sec. 1014(g)(3)(A) amended Code Sec. 2642 by adding at the end thereof new subsection (e) to read as above.
The amendment applies for purposes of determining the inclusion ratio with respect to property transferred after October 13, 1987.

WORKSHOP SESSION—COMBINING CHARITABLE REMAINDER GIFTS WITH LIFE INSURANCE TRUSTS

Winton C. Smith, Jr., Esq.
Memphis, TN
Mr. Miles W. McNally, CLU, ChFC
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Minneapolis, MN

I. CONCEPTS OF CHARITABLE PLANNING

A. Importance of Donative Intent

1. Key factor for outright gifts or bequests
2. Secondary importance in deferred gift—superceded by financial motivations for donor

B. Success dependent on solicitation technique

1. Ability of Development Officer to discern deferred gift prospect
2. "Team players" necessary to bring deferred gift to actuality
3. Needs of the charity must be secondary—shared with other charities in presentation
4. "Problem solving" requires knowledge of Deferred Giving Techniques and their relative values and limitations

C. Charitable Planning Team

1. Development Officer—determine prospect
2. Insurance advisor—analyze solutions
3. Client's attorney—approve solution, documents
4. Client's accountant—confirm tax computations
5. Charity Trustee—understand investment philosophy

D. Use of Computer in Charitable Planning

1. Calculation of tax savings in deferred gifts
2. Comparison of specified interest rate assumptions
3. Projection of benefits to Donor and Charity
4. Graphic presentations enhance understanding and lead to logical solution

E. Limitations on Presentation

1. Confined to discussion of Charitable Remainder
2. Gifts coupled with Irrevocable Life Insurance Trust

II. BACKGROUND AND BASIC RULES

A. Internal Revenue Code Section 170(a)(1) provides:

"General Rule.—There shall be allowed as a deduction any charitable contribution (as defined in subjection (c)) payment of which is made within the taxable year."

B. Types of Charitable Gifts

1. Outright
2. Deferred—separate agreement
   a. Provision by Will
   b. Charitable Remainder Annuity Trust
   c. Charitable Remainder Unitrust
3. Deferred—agreement with charity
   a. Pooled Income Fund
   b. Gift Annuity
   c. Life Insurance Contract

C. Percentage Limitations

For individuals, there are three percentage limitations, all of which are to the taxpayer's "contribution base", i.e., adjusted gross income computed without regard to any net operating loss carry back. Sec. 170(b)(I)(F).

1. The 50% limitation applies to gifts to "public charities" of cash or unappreciated property. Sec. 170(b)(I)(A).
2. The 30% limitation applies to all gifts of appreciated long-term capital gain property to "public charities", and to cash gifts to "private foundations". Sec. 170(b)(I)(B) and (C).
   a. Special election to reduce deduction to cost basis only allows use of charitable contribution up to 50% of "contribution base." Sec. 170(b)(I)(C)(iii).
3. The 20% limitation applies to contributions of appreciated property to private foundations, and to all contributions for the use of the donee. Sec. 170(b)(I)(D).
4. Five year carryover of unused deduction permitted.

III. SPECIAL RULES AFFECTING PROPERTY GIFTS

A. Gifts of Appreciated Property

1. Capital Gains tax avoided (provided property is LTCG)

2. Full fair market value deductible
3. 30% limitation applies, but with 5 year carry forward
4. Alternative Minimum Tax

B. Ordinary Income Gifts

A donor may deduct only his original cost basis for gifts of ordinary income type property and short-term property.

C. Tangible Personal Property Gifts

Gifts of tangible personal property held for more than six months (such as books, works of art, etc.) will be deductible on present fair market value:

1. With no capital gains tax on the appreciation only if the use of the property is related to the donee's exempt function (appraisal required if over $5,000).
2. If unrelated, the deduction is the donor's cost basis.

D. Bargain Sale Results in Partial Gain (IRC Sec. 1011(b))

If a donor sells property to a charity at less than fair market value with the intent of making a gift of excess over the sale price, he is required to allocate his cost basis between the gift portion and the sale portion of the property.

E. Bargain Sales of Encumbered Property

If property is transferred subject to indebtedness, the indebtedness is treated as an amount realized for determining whether there is a sale or exchange under IRC per 1011(b), even though the transferee does not assume or agree to pay the indebtedness.

F. Charitable Transfers: Timing

1. Year of contribution deduction: requirement of payment
   a. Payment of cash contributions by check
   b. Payment by completed transfer
2. Special Rules applicable to gifts of stock
   a. Appraisal if non-traded securities

G. Partial Interest in Property

1. Contribution of donor's entire interest in property

2. Contribution of undivided portion of donor's entire interest

IV. CHARITABLE REMAINDER TRUSTS

Allows separation of property—income stream directed to non-charitable beneficiaries, remainder to charity. Present value of remainder deductible, provided in form of

Annuity/Unitrust

A. Annuity Trust (IRC Sec. 664(D)(I))
1. Specifies fixed dollar amount of the annual income payable to income beneficiary—at least 5%
2. Must be at least 5% probability that charity will receive a remainder

B. Unitrust (IRC Sec. 664(d)(2))
1. Specifies fixed percentage of fair market value of trust assets as determined annually—at least 5% (no 5% probability test)
2. Duration of Trust
   a. For designated lifetime of beneficiary (1-3)
   b. For designated term of years
3. Optional Trust Provisions
   a. **Standard**—fixed percentage for duration
   b. **Net Income**—actual amount earned if less
   c. **Makeup**—deficiencies in distributions must be made up in later years if trust income exceeds the fixed percentage

C. Unitrust (or Annuity Trust) Features
1. Overview of characteristics
2. Charitable Contribution Deduction—$100,000 Gift (10% Rate Table*) (Amount of deduction dependent on duration of the trust (life expectancy) and selected percentage)

*Rate of the Month required after May, 1989

Age of Donor	Yield	Deduction
50	5%	$34,568
	10%	15,259
60	5%	46,865
	10%	25,512
70	5%	60,423
	10%	39,479

3. Tax-Exempt Entity
   a. No tax to donor on earnings or appreciation (unless distributed)
   b. Exemption from tax lost if trust has unrelated Business Income (UBI) and must file Fiduciary form 1041

   Trust holding debt-financed property = UBI, (unless mortgage placed on property more than 5 years before transfer, and donor held property more than 5 years)
4. Trust Assets protected from Creditors
   a. Insolvency Planning to provide protection against
      (1) Malpractice Claims, or
      (2) Business Reversals
5. Investment Flexibility
   a. Most types of Investments are acceptable (avoid self-dealing and Unrelated Business Income)
   b. Hazardous investments should be avoided
   c. Selection of Trustee important, to consider donor's income needs and tax status, and to maintain objectivity of trustee
6. Payout Sequence to donor or beneficiary
   a. Character of Income flows through to beneficiary
   b. All ordinary income distributable first
   c. Capital gain income distributable second
   d. Tax-free income distributable third
   e. Principal not distributed unless income insufficient to provide required payout.

V. WEALTH REPLACEMENT TRUST

A. Attractive when coordinated with Charitable Remainder Gift

Highly appreciated assets, otherwise includable in donor's estate at death, transferred to charitable remainder trust, pooled income fund, or annuity

1. Lifetime income to donor and spouse
2. No realization of gain on transfer to trust, pooled fund, or annuity
3. Charitable deduction based on present value of remainder interest offsets current income taxes, or funds replacement of asset

B. Wealth Replacement Trust (Irrevocable Defective Crummey Insurance Trust)

Annual payments from charitable trust (or tax savings) fully funds survivorship whole life insurance, payable on death of survivor of donor and spouse

1. Insurance available with short-term payment alternative—premiums fully paid after 6-9 years
2. All incidents of ownership in insurance policy transferred to irrevocable trust—donor retains no beneficial interest in trust
3. Each premium payment by donor is gift for gift tax purposes
   a. Must qualify premium payment as present interest qualifying for annual gift tax exclusion
   b. Trust beneficiaries must have present right to withdraw premium "contribution" each year—Crummey Power
4. Insurance proceeds not includible in donor's estate if donor survives three years after transfer of policy to trust (note Sec. 2036 changes)
5. Proceeds available 100% for family—children, grandchildren, or other relative.

VI. PROBLEM SOLVING WITH CHARITABLE REMAINDER UNITRUST

A. Fact Pattern

1. 60 Year old male, spouse 58

2. One daughter (married to an attorney) financially successful
3. Two grandchildren
4. Contemplating retirement in Florida (condominium)
5. Major annual donor to hospital

B. Response to Capital Fund Campaign

1. *Unable* to make capital gift (retirement)
2. In process of establishing Florida residence
3. Liquidating assets to simplify life style
4. Business has been sold to key employees under leveraged buyout
5. Apartment building is remaining obstacle to a problem-free retirement

C. Analysis of Real Estate

1. Current Market Value—$500,000
2. Net/net/net income before taxes—$32,500 @6.5%
3. Anticipated growth in value 2%
4. Fully depreciated down to land value $60,000
5. Willing to sell, reinvest in municipals

D. Development Officer suggests Charitable Remainder Unitrust

1. Donate property to hospital, retaining income stream for lifetime of donor and/or his spouse (Type II)
2. Rate of Income selected determines tax deduction
   a. Computer printout calculates deduction in 1/2% increments (see following schedule)
   b. Lower income = greater tax deduction
3. Reinvestment by charity/trustee of sales proceeds avoids capital gain taxation (tax-free trust)
4. Selection of lower income stream enhances future income—"Cost of Living Adjustments"
   a. Election of 5% payout rate = largest deduction
   b. Reinvestment by Trustee @10% = 5% COLA
   c. Taxation of income stream as important as amount (reinvestment in capital gain-type property may make 5% more valuable than 6.5% rent—if congress reinstates differential in Capital Gain tax rates)

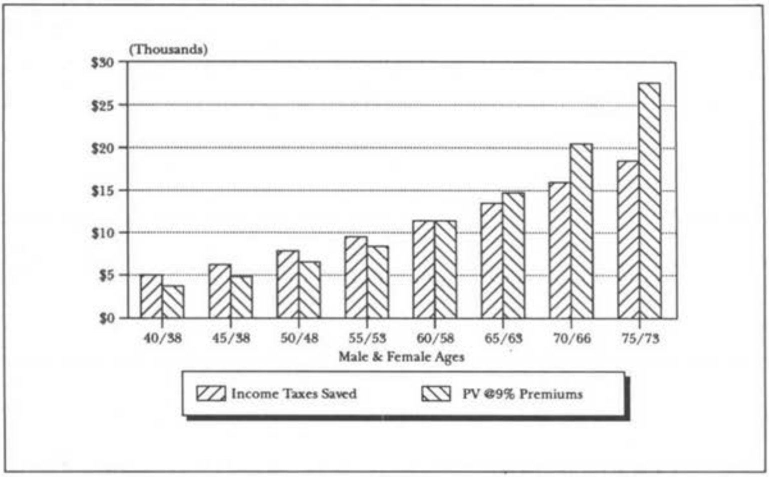
Unitrust
Two Lives—Multiple Payout Rates
Mr. McNally

INPUT ASSUMPTIONS

Date of transfer 12/31/1988
Fair market value of property transferred 500,000.00
Unitrust payout rate 7.00%
Payment sequence .... Annually
Annually Number of months between the valuation date and the first payout for the first full taxable year of the trust 12
Adjusted cost basis of property transferred 350,000.00
Charles Donor's age on the date of the gift is 60
Virginia Donor's age on the date of the gift is 58

Payout Rate	Deduction Factor	Deduction Amount
5.00%	0.341410	170,705
5.50%	0.308190	154,095
6.00%	0.278620	139,310
6.50%	0.252110	126,055
7.00%	0.228330	114,165
7.50%	0.207030	103,515
8.00%	0.187980	93,990
8.50%	0.170840	85,420
9.00%	0.155420	77,710
9.50%	0.141600	70,800
10.00%	0.129150	64,575
10.50%	0.117920	58,960
11.00%	0.107790	53,895
11.50%	0.098680	49,340
12.00%	0.090430	45,215
12.50%	0.082970	41,485
13.00%	0.076220	38,110
13.50%	0.070110	35,055
14.00%	0.064570	32,285
14.50%	0.059530	29,765
15.00%	0.054960	27,480
15.50%	0.050800	25,400
16.00%	0.047010	23,505
16.50%	0.043550	21,775

Tax Savings on $100,000 5% Unitrust
To Fund Survivorship Life Premiums



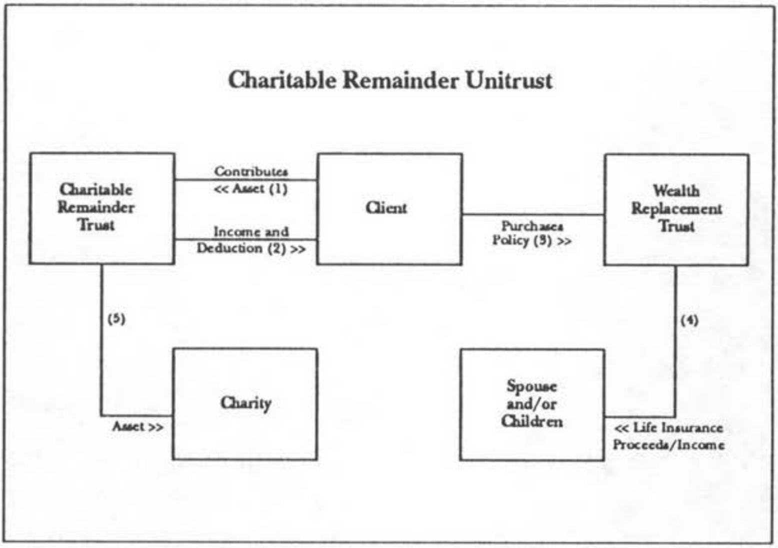
—AGES— Male	Female	INCOME TAXES SAVED @ 33%	PRESENT VALUE @ 9% OF PREMIUMS	PERCENT OF WEALTH REPLACED
40	38	5,015	3,560	141%
45	43	6,217	4,769	130%
50	48	7,653	6,363	120%
55	53	9,338	8,403	111%
60	58	11,267	11,274	100%
65	63	13,433	14,798	91%
70	68	15,804	20,360	78%
75	73	18,328	27,443	67%

1 Although income stream retained for lifetime of either donor, charitable gift of remainder interest creates current tax deduction, usable over 6 years up to 30% AGI if appreciated property.

2 Dividend Additions purchased in earlier years enable owner to "vanish" premiums after 7-8 years, with future premiums paid by applying current dividends and surrender of additions. The Wealth Accumulation Trust is a

separate taxpayer, so Trustee can invest in high yield securities. (Present Value assumed @ 9%)

3 If asset retained in donor's estate, value will be eroded by Federal Estate Taxes of 50-55% based on size of total estate, so replacement of 50% or more creates gain in value to heirs.



The diagram above illustrates one way to utilize a charitable remainder unitrust. Many variations have been used with the advice of legal counsel:

1. Client properly transfers income-producing assets to a charitable remainder unitrust. This removes the assets from the estate for estate tax purposes. In addition, a charitable income tax deduction can be taken for the present value of the remainder interest.
2. Income is paid out to the client and/or the spouse, or some other selected beneficiary.
3. Tax savings created by donating the property are used to purchase life insurance in an amount equal to the donated property. This insurance is purchased and owned by an irrevocable life insurance trust, which we call the Wealth Replacement Trust.

4. At death, the insurance proceeds in the Wealth Replacement Trust go directly to the family. The assets may be dispersed to the spouse outright or they may be kept in the trust, interest paid to the spouse and principal passing to the children at the spouse's death—also avoiding taxation at the second death. When the value of the asset is replaced by insurance in this way, the trust actually preserves the size of the estate by allowing the proceeds to pass estate tax-free to the family*, and without being taxed in the donor's estate.
5. The income-producing assets pass to the charity upon the death of the donor, or upon the second death if two-life unitrust.

* Excluded if second death occurs at least three years after creation of the Trust.

VII. OBJECTIONS TO UNITRUST SOLUTION

A. Utilizing tax savings *alone* can fund wealth replacement trust

1. Present value of tax deductions (payable one year hence) can cover present value of insurance premiums
2. Use of Survivorship Life Insurance can create asset in hands of heirs (free of estate tax) when remainder reverts to charity
   a. Death Benefit paid at second death
   b. Cost effective since two lives insured—comparable to zero coupon bond compounding investment earnings until second death
   c. Relaxed underwriting
   d. Psychologically easier to accept

B. Economic advantages of unitrust over retention of property can be demonstrated, without fear of loss to heirs of remainder interest

1. Lack of charitable intent—already decided; only decision is to which charity: IRS or charities of your choosing

2. Computer "what if" scenario can compare possible solutions with forceful accuracy

C. "Investment Options" Computer Program

1. Enter 16 variables in LOTUS 1.2.3 Program

2. Compares retention of property management with conversion to municipal bonds, and with conversion to unitrust and wealth replacement

3. Bottom line
   a. Property retained IRS receives as much as donor, spouse, and heirs together
   b. Municipal Bonds—low level income, but zero hedge against inflation
   c. Conversion to Unitrust—donor, spouse, and heirs receive comparable benefits—IRS reduction goes to charity

4. Alternate scenarios
   a. High growth rate of property enhances heirs, but produces low income stream to donor and spouse
   b. Comparison of after-tax incomes shows power of growth factors in unitrust and tax treatment of income distribution

D. Completing the Gift Transaction

1. Suggest Community Foundation to receive remainder interest—retains power of choice by Donor

2. Convince Trustee of Investment Philosophy to maximize net income to *benefit donor* and to enhance eventual gift to charity

3. Use Type II Unitrust (with makeup provisions) to protect charity/trustee until property sold

4. Establish insurability of donor and spouse before final decision—payment of initial premium to Wealth Replacement Trust will help close case

5. Requires teamwork

COMPARISON OF INVESTMENT STRATEGIES
Appreciated Securities or Real Estate

Donor: Charles Donor — **Spouse: Virginia Donor**

Owner Age: 60 Spouse Age: 58	Market Value of Property	$500,000	Cost Basis of Property	$60,000	Unitrust Income Selected	$ 7.00
	Investment Return before Taxes	6.50	Income Tax Bracket	35.00	Unitrust Investment Rate	9.00
	Growth Rate of Property	2.00	Capital Gains Tax Bracket	35.00	Tax Savings created by Unitrust	39,958
	Liquidation or Sales Cost	7.00	Estate Tax Bracket	50.00	Present Value Insurance Premiums	
	Assumed Cost of Money Factor	7.00	Municipal Bond Investment Return	7.00	to fund Wealth Replacement Trust	44,885

		OPTION 1: RETAIN PROPERTY @ 6.50%				OPTION 2: CONVERT/MUNICIPAL 7.00%				OPTION 3: CONVERT/UNITRUST 7.00%			
Age of Owner	Age of Spouse	Net Income after taxes to Owners	Market Value of Property	Federal Income Tax Paid	Remainder Paid to Charity	Net Income after taxes to Owners	Market Value of Property	Federal Income Tax Paid	Remainder Paid to Charity	Net Income after taxes to Owners	Death Ben. of Wealth Repl. Trust	Federal Income Tax Paid	End of Year Death Ben. to Charity
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
60	58	, 21,125	500,000	11,375	0	22,628	323,250	141,750	0	17,823	375,000	12,250	474,300
61	59	21,548	510,000	11,603	0	22,628	323,250	0	0	21,581	375,889	11,620	483,786
62	60	21,978	520,200	11,835	0	22,628	323,250	0	0	22,012	376,778	11,853	493,462
63	61	22,418	530,604	12,071	0	22,628	323,250	0	0	22,453	378,448	12,090	503,331
64	62	22,866	541,216	12,313	0	22,628	323,250	0	0	22,902	381,899	12,332	513,398
65	63	23,324	552,040	12,559	0	22,628	323,250	0	0	23,360	388,855	12,578	523,666
66	64	23,790	563,081	12,810	0	22,628	323,250	0	0	23,827	398,448	12,830	534,139
67	65	24,266	574,343	13,066	0	22,628	323,250	0	0	24,303	409,273	13,086	544,822
68	66	24,751	585,830	13,328	0	22,628	323,250	0	0	24,789	398,368	13,348	555,718
69	67	25,246	597,546	13,594	0	22,628	323,250	0	0	25,285	389,267	13,615	566,832

70	68	25,751	609,497	13,866	0	22,628	323,250	0	0	25,791	381,737	13,887	578,169
71	69	26,266	621,687	14,143	0	22,628	323,250	0	0	26,307	378,557	14,165	589,732
72	70	26,792	634,121	14,426	0	22,628	323,250	0	0	26,833	376,453	14,448	601,527
73	71	27,327	646,803	14,715	0	22,628	323,250	0	0	27,369	375,297	14,737	613,558
74	72	27,874	659,739	15,009	0	22,628	323,250	0	0	27,917	375,002	15,032	625,829
75	73	28,431	672,934	15,309	0	22,628	323,250	0	0	28,475	375,576	15,333	638,345
76	74	29,000	686,393	15,615	0	22,628	323,250	0	0	29,045	376,617	15,639	651,112
77	75	29,580	700,121	15,928	0	22,628	323,250	0	0	29,626	378,260	15,952	664,135
78	76	30,172	714,123	16,246	0	22,628	323,250	0	0	30,218	380,336	16,271	677,417
	77	30,775	728,406	16,571	0	22,628	323,250	0	0	30,822	382,886	16,597	690,966
	78	31,391	742,974	16,903	0	22,628	323,250	0	0	31,439	385,894	16,929	704,785
	79	32,018	757,833	17,241	0	22,628	323,250	0	0	32,068	389,350	17,267	718,881
	80	32,659	772,990	17,586	0	22,628	323,250	0	0	32,709	393,252	17,613	733,258
	81	33,312	788,450	17,937	0	22,628	323,250	0	0	33,363	397,594	17,965	747,923
	82	33,978	804,219	18,296	0	22,628	323,250	0	0	34,031	402,372	18,324	762,882
	83	34,658	820,303	18,662	0	22,628	323,250	0	0	34,711	407,581	18,691	778,139
	84	35,351	836,709	19,035	0	22,628	323,250	0	0	35,405	413,217	19,064	793,702
Estate Tax Liability			(426,722)	426,722			(161,625)	161,625			0	0	
Total Benefits		782,707	426,722	848,179	0	633,570	161,625	303,375	0	780,577	419,278	422,963	809,576
		(Owners)	(Heirs)	(IRS)	(Charity)	(Owners)	(Heirs)	(IRS)	(Charity)	(Owners)	(Heirs)	(IRS)	(Charity)
		Payments to All Parties			2,057,608	Payments to All Parties			1,098,570	Payments to All Parties			2,432,394

COMPARISON OF INVESTMENT STRATEGIES
Explanation of Columns

Column 1	Assuming rentals on fully-depreciated real estate or dividends, income to the owners is reduced by ordinary income tax rates. Net income is projected to increase at the same growth rate as market value, since rents or dividends will keep pace with inflation.
Column 2	Market Value of the property is assumed to increase in value at the assumed growth rate as specified.
Column 3	Federal Income Taxes Paid are based on the assumed incremental Income Tax Bracket selected. Estate Taxes are levied at the second death, since unlimited marital deduction is assumed at the first death; Federal Estate Tax rates assume other estate assets exhaust the $600,000 exemption. State Income and Estate Tax rates are omitted for simplicity, but can be included by adjusting incremental tax rates.
Column 4	Since full control is retained by owners, there is no contractual payment to charity.
Column 5	If the appreciated property or real estate is sold and reinvested in municipal bonds, Liquidation or Sales Cost and Capital Gains Taxes must be deducted from the market value before calculating the net investment return.
Column 6	Market Value of municipal bonds purchased with net proceeds ignore market fluctuations attributable to variations in market interest rates. At the second death, estate values are reduced by estate taxes.
Column 7	Long-Term Capital Gains Rates are assumed to determine Income Tax Liability on sale proceeds of the property, less the cost basis. Although 1988 Tax Rates eliminate the Capital Gains Tax differential, it is assumed that Congress will re-establish distinct Capital Gains Rates.
Column 8	Since full control is retained by owners, there is not contractual payment to charity.
Column 9	The trustee of the unitrust is assumed to invest net proceeds from the property donated to the unitrust in capital gain type property, so that only 50% of donors' income will be taxed as ordinary income. First-year net income is increased by the tax savings generated by the remainder gift, less amounts contributed to the Wealth Replacement Trust.
Column 10	Sufficient contributions are made by donors to the Wealth Replacement Trust (an irrevocable, defective insurance trust, with Crummey powers) to cover Survivorship Life Insurance premiums on the donors' lives, with premiums to the "vanish point" where future premiums will be covered by assumed dividends. (Dividend projections based on 1988 Scale—not guaranteed.)

Column 11 Federal Income Taxes (50% ordinary, 50% long-term capital gains) on distributable income from the unitrust are assumed, since reinvestment will be in capital gain type property, with modest dividends. The income and income taxes increase annually, since the unitrust is distributing less than the growth rate assumed on reinvested assets of the unitrust.

Column 12 At the second death, the unitrust terminates and the principal of the unitrust reverts to the designated charity. The unitrust principal increases annually, since the growth rate assumed for the unitrust is greater than the distribution payout rate selected by the donors when the unitrust was created.

PRESENT VALUE ANALYSIS

In order to properly compare different income streams, a common analytical technique is to include the "time value of money" by discounting the unequal income streams to their present value at a common discount rate. This technique shows the amount of money needed today which will pay the exact incomes at the end of each year, based on a specified interest rate earned.

	OPTION 1—Retain Management of Property				OPTION 2—Convert to Municipals @ 7.00%				OPTION 3—Convert to Unitrust @ 7.00%			
	Net Income to Owners (1)	Market Value (2)	Fed. Income Taxes Paid (3)	Remainder to Charity (4)	Net Income to Owners (5)	Market Value (6)	Fed. Income Taxes Paid (7)	Remainder to Charity (8)	Net Income to Owners (9)	Wealth Repl. Trust (10)	Fed. Income Taxes Paid (11)	Remainder to Charity (12)
Present Value 7.00%	311,867 (Owners)	64,180 (Heirs)	232,108 (IRS)	0 (Charity)	274,632 (Owners)	24,309 (Heirs)	156,785 (IRS)	0 (Charity)	309,230 (Owners)	63,060 (Heirs)	168,988 (IRS)	121,762 (Charity)
	Payments to All Parties (Pres. Value 7.00%)			608,155	Payments to All Parties (Pres. Value 7.00%)			455,727	Payments to All Parties (Pres. Value 7.00%)			663,041

VIII. THE 15% PENALTY ON "SUCCESS" (TAX REFORM ACT 1986)

A. New policy established on qualified plans: absolute limits on total amounts accumulated or distributed by tax-favored retirement plans.

1. All retirement savings plans included: Pension, Profit Sharing, Keogh, 401K, IRA, and Tax-Qualified Annuities (403b Plans) of Tax-Free organizations
2. 15% Excise Tax (in addition to Income Tax) on "Excess Distributions" over threshold amount
   a. Exemptions—after-tax employee contributions; payments to former spouse under Qualified Domestic Relations Order (QDRO)
3 15% Excise Tax (in addition to Income & Estate Tax) on "Excess Accumulations" over threshold amount
4. Threshold amount (excluded from 15% Excise Tax) dependent on decision to "grandfather" account balances exceeding $562,500 on August 1, 1986 (1988 tax return)

B. The dilemma facing the highly-compensated executive

1. Traditionally, sound financial planning led to maximum income deferral to retirement years
   a. "Probably in lower tax bracket after retirement." FACT: 15% SURTAX AFTER 65 (to pay for Comprehensive Health Insurance Program)
   b. "Commencement of income at my discretion . . . when needed." FACT: Minimum distributions must commence by age 70½, subject to 50% penalty for underwithdrawals
   c. "Deferrals, compounded on tax-deferred basis, will build substantial estate for my heirs." FACT: Spouse subject to 15% Excise Tax unless virtually entire balance (99%) rolled into Spousal IRA; children subject to veritable confiscation of remaining balance
2. Impact of substantial deferrals on Estate Liabilities
   a. Children must "draw down" account balances over 5 years or less—"bunching" of income

b. Account Balances taxed as income and included in estate for estate tax purposes (IRD Property)
c. 15% Excise Tax on amounts over threshold level in addition to income and estate taxes
d. Total taxation is confiscatory (Estate Tax, Income Tax, Excise Tax)
   (1) Middle-size estate = 50% + (35% * 50%) + 15% = 82.5%
   (2) Large estate = 60% + (35% * 40%) + 15% = 89.0%
   (3) Note Chart following (figures from Schedule A at end of outline)

C. Steps to be taken:

1. Reduce or withdraw contributions to qualified plan
2. Commence withdrawals before retirement
   a. 10% penalty if before age 59½ (may be less than 15% excise tax in later years)
   b. Termination of employment no longer a requirement for qualified plan withdrawals (called "in-service withdrawal")
3. If additional income not needed:
   a. Increase charitable contributions (replace estate bequests with cash gifts—Schedule B)
   b. Use wealth replacement concept: fund irrevocable trust with survivorship life insurance (proceeds exempt from income taxes, and exempt from estate taxes if second death at least 3 years after trust created—Schedule C)
   c. Utilizing small amount of discretionary income, substantial charitable gifts and wealth replacement can be combined
   d. Charitable *Remainder* Gifts (rather than cash gifts) will enhance retirement income, but increase income taxes somewhat (since deduction less than 100%)
4. Reduce investment return within qualified plan
   a. Only *cash value* of insurance subject to income tax and 15% Excise Tax (proceeds still subject to Estate Taxes)
   b. Oil & Gas investments valued at net present value for estate and excise taxes; triple discounts tradi-

tional for estate valuation (inflation, risk, lifting costs)

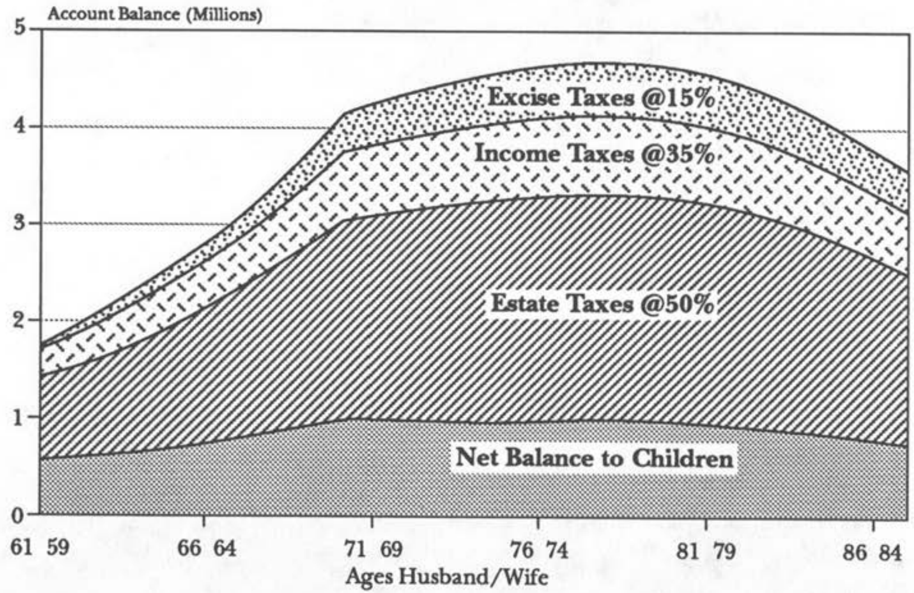
D. Conclusions:

1. Property held too long subject to almost confiscatory taxation before receipt by heirs
2. No longer tax-effective to accumulate qualified retirement funds beyond absolute limits established by Congress
3. Restructuring property or directing discretionary income or remainder to charity can magnify gift at little after-tax cost to donor and spouse
4. Use of Irrevocable Trust (funded with Survivorship Life Insurance) can replace Assets or Income donated to charity, at little after-tax cost to donor and spouse
5. New investment philosophy applied to qualified plans:
   "DON'T TAKE TOO MUCH, BUT DON'T START TOO LATE. IF YOU WAIT TOO LONG, IT'S GONE!

Qualified Death Benefits to Children

1,500,000 Bal @60 + 9% + 30,000 to 70

PV Income Stream: 1,117,015



QUALIFIED PLAN DISTRIBUTIONS AFTER TRA '86
(Impact of Excise, Income, & Estate Taxes)

CURRENT PLAN

SCHEDULE A

23-Mar-89

Name of Parent Corporation	Johnson Trucking Co.	Participant's Age:	60	Exempt Amount (1989):	122,580
Qualified Plan Participant	Elmer Johnson, Sr.	Age of Spouse:	58	Investment Rate:	9.00%
Account Balance 12/31/88	1,500,000	Assumed Retirement Age	70	Income Tax Rate:	35.00%
Grandfathered Acct Balance	1,500,000	W/D at Retirement	0	Estate Tax Rate:	50.00%
Deposit to Retirement Age	30,000			Soc Sec Inflation Rate:	3.00%

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Att'd Age	Att'd Age Spouse	Annual Deposit to Plan	Withdrawal or required Min Distrib	Net Income After Income & Excise Tax	Account Balance @ 9.00%	Excise Tax Exempt Amount	Estate Taxes @ 50.00%	Income Taxes @ 35.00%	Excise Taxes @ 15.00%	Total Tax Payments by Heirs	Net Balance of Account to Children	Total % Net after Taxes to Children
60	58	30,000		0	1,667,700	1,500,000	833,850	291,848	25,155	1,150,853	516,848	30.99%
61	59	30,000		0	1,850,493	1,500,000	925,247	323,836	52,574	1,301,657	548,836	29.66%
62	60	30,000		0	2,049,737	1,500,000	1,024,869	358,704	82,461	1,466,033	583,704	28.48%
63	61	30,000		0	2,266,914	1,500,000	1,133,457	396,710	115,037	1,645,204	621,710	27.43%
64	62	30,000		0	2,503,636	1,500,000	1,251,818	438,136	150,545	1,840,500	663,136	26.49%
65	63	30,000		0	2,761,663	1,500,000	1,380,832	483,291	189,249	2,053,372	708,291	25.65%
66	64	30,000		0	3,042,913	1,500,000	1,521,456	532,510	231,437	2,285,403	757,510	24.89%
67	65	30,000		0	3,349,475	1,500,000	1,674,738	586,158	277,421	2,538,317	811,158	24.22%
68	66	30,000		0	3,683,628	1,500,000	1,841,814	644,635	327,544	2,813,993	869,635	23.61%
69	67	30,000		0	4,047,854	1,500,000	2,023,927	708,375	382,178	3,114,480	933,375	23.06%
70	68		252,991	151,206	4,159,170	1,500,000	2,079,585	727,855	398,876	3,206,316	952,855	22.91%
71	69		271,841	161,373	4,261,654	1,350,000	2,130,827	745,790	436,748	3,313,365	948,290	22.25%
72	70		291,894	172,163	4,353,309	1,200,000	2,176,655	761,829	472,996	3,411,480	941,829	21.63%
73	71		313,188	183,596	4,431,919	1,050,000	2,215,960	775,586	507,288	3,498,833	933,086	21.05%
74	72		335,751	195,688	4,495,041	998,673	2,247,520	786,632	524,455	3,558,608	936,433	20.83%
75	73		359,603	208,448	4,539,991	995,919	2,269,995	794,498	531,611	3,596,105	943,886	20.79%
76	74		381,512	220,262	4,567,078	992,199	2,283,539	799,239	536,232	3,619,010	948,069	20.76%
77	75		407,775	234,278	4,570,341	987,542	2,285,170	799,810	537,420	3,622,400	947,941	20.74%
78	76		431,164	246,885	4,550,507	981,839	2,275,253	796,339	535,300	3,606,892	943,614	20.74%
79	77		455,051	259,767	4,505,002	974,925	2,252,501	788,375	529,512	3,570,388	934,614	20.75%
80	78		474,211	270,314	4,436,241	966,580	2,218,121	776,342	520,449	3,514,912	921,329	20.77%
81	79		498,454	283,432	4,337,049	956,994	2,168,524	758,984	507,008	3,434,516	902,533	20.81%
82	80		516,315	293,389	4,211,068	946,433	2,105,534	736,937	489,695	3,332,166	878,902	20.87%
83	81		533,047	302,812	4,057,018	934,836	2,028,509	709,978	468,327	3,206,814	850,203	20.96%
84	82		548,246	311,500	3,873,904	921,916	1,936,952	677,933	442,798	3,057,683	816,220	21.07%
85	83		561,435	319,216	3,661,120	907,507	1,830,560	640,696	413,042	2,884,298	776,822	21.22%
86	84		563,249	321,278	3,427,371	892,568	1,713,686	599,790	380,220	2,693,696	733,675	21.41%

Present Value @ 7% of Net Income **1,117,015** **To Spouse Life Expectancy. . . Age 84**

QUALIFIED PLAN DISTRIBUTIONS AFTER TRA '86
(Impact of Excise, Income, & Estate Taxes)

WITHDRAWAL OF CONTRIBUTIONS & EARNINGS
CHARITABLE CONTRIBUTIONS OF 225,000

SCHEDULE B
23-Mar-89

Name of Parent Corporation	Johnson Trucking Co.	Participant's Age:	60	Exempt Amount (1989):	122,580
Qualified Plan Participant	Elmer Johnson, Sr.	Age of Spouse:	58	Investment Rate:	9.00%
Account Balance 12/31/88	1,500,000	Assumed Retirement Age	60	Income Tax Rate:	35.00%
Grandfathered Acct Balance	1,500,000	W/D at Retirement	135,000	Estate Tax Rate:	50.00%
Deposit to Retirement Age	30,000			Soc Sec Inflation Rate:	3.00%

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Att'd Age	Att'd Age Spouse	Annual Deposit to Plan	Withdrawal or required Min Distrib	Net Income After Income & Excise Tax	Account Balance @ 9.00%	Excise Tax Exempt Amount	Estate Taxes @ 50.00%	Income Taxes @ 35.00%	Excise Taxes @ 15.00%	Total Tax Payments by Heirs	Net Balance of Account to Children	Total % Net after Taxes to Children
60	58	7,500	143,175	89,975	1,500,000	1,500,000	750,000	262,500	0	1,012,500	487,500	32.50%
61	59	7,500	143,175	90,526	1,500,000	1,350,000	750,000	262,500	22,500	1,035,000	465,000	31.00%
62	60	7,500	143,175	91,094	1,500,000	1,200,000	750,000	262,500	45,000	1,057,500	442,500	29.50%
63	61	7,500	143,175	91,679	1,500,000	1,050,000	750,000	262,500	67,500	1,080,000	420,000	28.00%
64	62	7,500	143,175	92,282	1,500,000	956,814	750,000	262,500	81,478	1,093,978	406,022	27.07%
65	63	7,500	143,175	92,903	1,500,000	965,880	750,000	262,500	80,118	1,092,618	407,382	27.16%
66	64	7,500	143,175	93,064	1,500,000	974,087	750,000	262,500	78,887	1,091,387	408,613	27.24%
67	65	7,500	143,175	93,064	1,500,000	981,404	750,000	262,500	77,789	1,090,289	409,711	27.31%
68	66	7,500	143,175	93,064	1,500,000	987,740	750,000	262,500	76,839	1,089,339	410,661	27.38%
69	67	7,500	143,175	93,064	1,500,000	992,998	750,000	262,500	76,050	1,088,550	411,450	27.43%
70	68		135,000	87,750	1,500,000	997,023	750,000	262,500	75,447	1,087,947	412,053	27.47%
71	69		135,000	87,750	1,500,000	999,649	750,000	262,500	75,053	1,087,553	412,447	27.50%
72	70		135,000	87,750	1,500,000	1,000,749	750,000	262,500	74,888	1,087,388	412,612	27.51%
73	71		135,000	87,750	1,500,000	1,000,349	750,000	262,500	74,948	1,087,448	412,552	27.50%
74	72		135,000	87,750	1,500,000	998,673	750,000	262,500	75,199	1,087,699	412,301	27.49%
75	73		135,000	87,750	1,500,000	995,919	750,000	262,500	75,612	1,088,112	411,888	27.46%
76	74		135,000	87,750	1,500,000	992,199	750,000	262,500	76,170	1,088,670	411,330	27.42%
77	75		135,000	87,750	1,500,000	987,542	750,000	262,500	76,869	1,089,369	410,631	27.38%
78	76		141,509	91,981	1,493,491	981,839	746,745	261,361	76,748	1,084,854	408,637	27.36%
79	77		149,349	97,077	1,478,556	974,925	739,278	258,747	75,545	1,073,570	404,986	27.39%
80	78		155,637	101,164	1,455,988	966,580	727,994	254,798	73,411	1,056,203	399,785	27.46%
81	79		163,594	106,336	1,423,433	956,994	711,716	249,101	69,966	1,030,783	392,650	27.58%
82	80		169,456	110,147	1,382,086	946,433	691,043	241,865	65,348	998,256	383,830	27.77%
83	81		174,948	113,716	1,331,526	934,836	665,763	233,017	59,503	958,283	373,242	28.03%
84	82		179,936	116,958	1,271,427	921,916	635,714	222,500	52,427	910,640	360,787	28.38%
85	83		184,265	119,772	1,201,591	907,507	600,795	210,278	44,113	855,186	346,405	28.83%
86	84		184,860	120,159	1,124,874	892,568	562,437	196,853	34,846	794,136	330,738	29.40%

Present Value @ 7% of Net Income 1,117,694 **To Spouse Life Expectancy. . . Age 84**

QUALIFIED PLAN DISTRIBUTIONS AFTER TRA '86
(Impact of Excise, Income, & Estate Taxes)

WITHDRAWAL OF CONTRIBUTIONS & EARNINGS
INSURANCE OUTSIDE PLAN (IRREVOCABLE TRUST)

SCHEDULE C
23-Mar-89

Name of Parent Corporation	Johnson Trucking Co.	Participant's Age:	60	Exempt Amount (1989):	122,580
Qualified Plan Participant	Elmer Johnson, Sr.	Age of Spouse:	58	Investment Rate:	9.00%
Account Balance 12/31/88	1,500,000	Assumed Retirement Age	60	Heirs' Inc Tax Rate:	35.00%
Grandfathered Acct Balance	1,500,000	W/D at Retirement	135,000	Estate Tax Rate:	50.00%
Deposit to Retirement Age	30,000	Survivorship Insurance:	750,000	Soc Sec Inflation Rate:	3.00%

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Att'd Age	Att'd Age Spouse	Deposit Less Ins Premium	Withdrawal or required Min Distrib	Survivor Insurance Premium	Net Income After Income & Excise Tax	Account Balance @ 9.00%	Excise Tax Exempt Amount	Survivor Insurance Proceeds	Estate Taxes @ 50.00%	Income Taxes @ 35.00%	Excise Taxes @ 15.00%	Total Tax Payments by Heirs	Net Balance of Account to Children	Total % Net after Taxes to Children
60	58	30,000	167,700	14,025	88,212	1,500,000	1,500,000	750,000	1,125,000	262,500	0	1,387,500	862,500	57.50%
61	59	30,000	167,700	14,025	88,764	1,500,000	1,350,000	751,777	1,125,889	262,500	22,500	1,410,889	840,889	56.06%
62	60	30,000	167,700	14,025	89,332	1,500,000	1,200,000	753,555	1,126,778	262,500	45,000	1,434,278	819,278	54.62%
63	61	30,000	167,700	14,025	89,917	1,500,000	1,050,000	756,896	750,000	262,500	67,500	1,080,000	1,176,896	78.46%
64	62	30,000	167,700	14,025	90,520	1,500,000	956,814	763,797	750,000	262,500	81,478	1,093,978	1,169,819	77.99%
65	63	30,000	167,700	14,025	91,141	1,500,000	965,880	777,710	750,000	262,500	80,118	1,092,618	1,185,092	79.01%
66	64	30,000	167,700	14,025	91,780	1,500,000	974,087	796,895	750,000	262,500	78,887	1,091,387	1,205,508	80.37%
67	65	30,000	167,700	13,699	92,765	1,500,000	981,404	818,546	750,000	262,500	77,789	1,090,289	1,228,257	81.88%
68	66	30,000	167,700		107,142	1,500,000	987,740	796,735	750,000	262,500	76,839	1,089,339	1,207,396	80.49%
69	67	30,000	167,700		107,841	1,500,000	992,998	778,533	750,000	262,500	76,050	1,088,550	1,189,983	79.33%
70	68		135,000		87,750	1,500,000	997,023	763,474	750,000	262,500	75,447	1,087,947	1,175,527	78.37%
71	69		135,000		87,750	1,500,000	999,649	757,114	750,000	262,500	75,053	1,087,553	1,169,561	77.97%
72	70		135,000		87,750	1,500,000	1,000,749	752,905	750,000	262,500	74,888	1,087,388	1,165,517	77.70%
73	71		135,000		87,750	1,500,000	1,000,349	750,593	750,000	262,500	74,948	1,087,448	1,163,145	77.54%
74	72		135,000		87,750	1,500,000	998,673	750,004	750,000	262,500	75,199	1,087,699	1,162,305	77.49%
75	73		135,000		87,750	1,500,000	995,919	751,151	750,000	262,500	75,612	1,088,112	1,163,039	77.54%
76	74		135,000		87,750	1,500,000	992,199	753,333	750,000	262,500	76,170	1,088,670	1,164,663	77.64%
77	75		135,000		87,750	1,500,000	987,542	756,520	750,000	262,500	76,869	1,089,369	1,167,151	77.81%
78	76		141,509		91,981	1,493,491	981,839	760,672	746,745	261,361	76,748	1,084,854	1,169,309	78.29%
79	77		149,349		97,077	1,478,556	974,925	765,771	739,278	258,747	75,545	1,073,570	1,170,757	79.18%
80	78		155,637		101,164	1,455,988	966,580	771,787	727,994	254,798	73,411	1,056,203	1,171,572	80.47%
81	79		163,594		106,336	1,423,433	956,994	778,700	711,716	249,101	69,966	1,030,783	1,171,350	82.29%
82	80		169,456		110,147	1,382,086	946,433	786,503	691,043	241,865	65,348	998,256	1,170,333	84.68%
83	81		174,948		113,716	1,331,526	934,836	795,187	665,763	233,017	59,503	958,283	1,168,429	87.75%
84	82		179,936		116,958	1,271,427	921,916	804,743	635,714	222,500	52,427	910,640	1,165,530	91.67%
85	83		184,265		119,772	1,201,591	907,507	815,161	600,795	210,278	44,113	855,186	1,161,566	96.67%
86	84		184,860		120,159	1,124,874	892,568	826,433	562,437	196,853	34,846	794,136	1,157,171	102.87%

Present Value @ 7% of Net Income **1,123,489** **To Spouse Life Expectancy. . . Age 84**

Note: Premiums on Survivorship Life Insurance are assumed payable until future Dividends are sufficient to "vanish" premiums (based on 1989 Div Schedule—Not Guaranteed). Ledger Statements provided by Insurance Carrier are considered an integral part of this illustration.

QUALIFIED PLAN DISTRIBUTIONS AFTER TRA '86
(Impact of Excise, Income, & Estate Taxes)

WITHDRAWAL OF CONTRIBUTIONS & EARNINGS
INSURANCE OUTSIDE PLAN (IRREVOCABLE TRUST)
CHARITABLE CONTRIBUTIONS OF 150,000

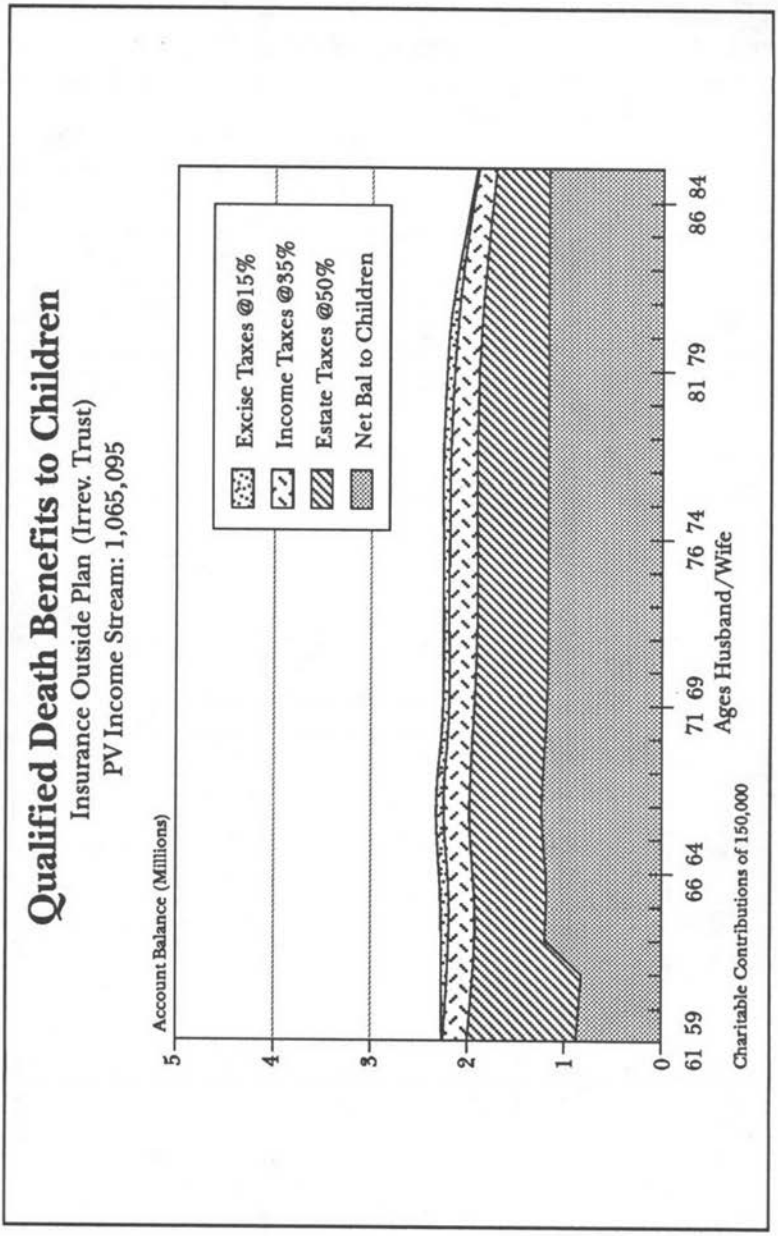
SCHEDULE D
23-Mar-89

Name of Parent Corporation	Johnson Trucking Co.	Participant's Age:	60	Exempt Amount (1989):	122,580
Qualified Plan Participant	Elmer Johnson, Sr.	Age of Spouse:	58	Investment Rate:	9.00%
Account Balance 12/31/88	1,500,000	Assumed Retirement Age	60	Heirs' Inc Tax Rate:	35.00%
Grandfathered Acct Balance	1,500,000	W/D at Retirement	135,000	Estate Tax Rate:	50.00%
Deposit to Retirement Age	30,000	Survivorship Insurance:	750,000	Soc Sec Inflation Rate:	3.00%

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
Att'd Age	Att'd Age Spouse	Deposit Less Ins Premium	Withdrawal or required Min Distrib	Survivor Insurance Premium	Net Income After Income & Excise Tax	Account Balance @ 9.00%	Excise Tax Exempt Amount	Survivor Insurance Proceeds	Estate Taxes @ 50.00%	Income Taxes @ 35.00%	Excise Taxes @ 15.00%	Total Tax Payments by Heirs	Net Balance of Account to Children	Total % Net after Taxes to Children
60	58	15,000	151,350	14,025	80,037	1,500,000	1,500,000	750,000	1,125,000	262,500	0	1,387,500	862,500	57.50%
61	59	15,000	151,350	14,025	80,589	1,500,000	1,350,000	751,777	1,125,889	262,500	22,500	1,410,889	840,889	56.06%
62	60	15,000	151,350	14,025	81,157	1,500,000	1,200,000	753,555	1,126,778	262,500	45,000	1,434,278	819,278	54.62%
63	61	15,000	151,350	14,025	81,742	1,500,000	1,050,000	756,896	750,000	262,500	67,500	1,080,000	1,176,896	78.46%
64	62	15,000	151,350	14,025	82,345	1,500,000	956,814	763,797	750,000	262,500	81,478	1,093,978	1,169,819	77.99%
65	63	15,000	151,350	14,025	82,966	1,500,000	965,880	777,710	750,000	262,500	80,118	1,092,618	1,185,092	79.01%
66	64	15,000	151,350	14,025	83,605	1,500,000	974,087	796,895	750,000	262,500	78,887	1,091,387	1,205,508	80.37%
67	65	15,000	151,350	13,699	84,590	1,500,000	981,404	818,546	750,000	262,500	77,789	1,090,289	1,228,257	81.88%
68	66	15,000	151,350		98,378	1,500,000	987,740	796,735	750,000	262,500	76,839	1,089,339	1,207,396	80.49%
69	67	15,000	151,350		98,378	1,500,000	992,998	778,533	750,000	262,500	76,050	1,088,550	1,189,983	79.33%
70	68		135,000		87,750	1,500,000	997,023	763,474	750,000	262,500	75,447	1,087,947	1,175,527	78.37%
71	69		135,000		87,750	1,500,000	999,649	757,114	750,000	262,500	75,053	1,087,553	1,169,561	77.97%
72	70		135,000		87,750	1,500,000	1,000,749	752,905	750,000	262,500	74,888	1,087,388	1,165,517	77.70%
73	71		135,000		87,750	1,500,000	1,000,349	750,593	750,000	262,500	74,948	1,087,448	1,163,145	77.54%
74	72		135,000		87,750	1,500,000	998,673	750,004	750,000	262,500	75,199	1,087,699	1,162,305	77.49%
75	73		135,000		87,750	1,500,000	995,919	751,151	750,000	262,500	75,612	1,088,112	1,163,039	77.54%
76	74		135,000		87,750	1,500,000	992,199	753,333	750,000	262,500	76,170	1,088,670	1,164,663	77.64%
77	75		135,000		87,750	1,500,000	987,542	756,520	750,000	262,500	76,869	1,089,369	1,167,151	77.81%
78	76		141,509		91,981	1,493,491	981,839	760,672	746,745	261,361	76,748	1,084,854	1,169,309	78.29%
79	77		149,349		97,077	1,478,556	974,925	765,771	739,278	258,747	75,545	1,073,570	1,170,757	79.18%
80	78		155,637		101,164	1,455,988	966,580	771,787	727,994	254,798	73,411	1,056,203	1,171,572	80.47%
81	79		163,594		106,336	1,423,433	956,994	778,700	711,716	249,101	69,966	1,030,783	1,171,350	82.29%
82	80		169,456		110,147	1,382,086	946,433	786,503	691,043	241,865	65,348	998,256	1,170,333	84.68%
83	81		174,948		113,716	1,331,526	934,836	795,187	665,763	233,017	59,503	958,283	1,168,429	87.75%
84	82		179,936		116,958	1,271,427	921,916	804,743	635,714	222,500	52,427	910,640	1,165,530	91.67%
85	83		184,265		119,772	1,201,591	907,507	815,161	600,795	210,278	44,113	855,186	1,161,566	96.67%
86	84		184,860		120,159	1,124,874	892,568	826,433	562,437	196,853	34,846	794,136	1,157,171	102.87%

Present Value @ 7% of Net Income 1,065,095 **To Spouse Life Expectancy. . . Age 84**

Note: Premiums on Survivorship Life Insurance are assumed payable until future Dividends are sufficient to "vanish" premiums (based on 1989 Div Schedule—Not Guaranteed). Ledger Statements provided by Insurance Carrier are considered an integral part of this illustration.


Qualified Death Benefits to Children
Insurance Outside Plan (Irrev. Trust)
PV Income Stream: 1,065,095
Account Balance (Millions)
Excise Taxes @15%
Income Taxes @35%
Estate Taxes @50%
Net Bal to Children
0
1
2
3
4
5
61 59
66 64
71 69
76 74
81 79
86 84
Ages Husband/Wife
Charitable Contributions of 150,000

MINUTES

Twentieth Conference on Gift Annuities
Royal York Hotel, Toronto, Ontario

Wednesday, April 5, 1989

First Plenary Session

The Conference was called to order at 9:00 A.M. by Chairman Darold H. Morgan. The place of meeting was the Concert Hall of the Royal York Hotel.

Invocation was delivered by Major Stan Ratcliffe, Foundations/Planned Giving, The Salvation Army, Toronto, Ontario.

Welcoming remarks were made by Dr. Morgan. The text is set forth in this booklet beginning on page 5.

Chairman Morgan stated that the Committee on Gift Annuities has proposed the following persons to constitute the Resolutions Committee:

Chairman: MR. CHARLES N. O'DATA, Vice President of Development, Geneva College

MR. ROGER K. PAROLINI, Director of Endowment, Aurora University

MR. JOHN SOUTH, Director of Development, Father Flanagan's Boys' Home

DR. CHARLES W. BAAS, CGA Secretary

MR. MICHAEL MUDRY, CGA Actuary

DR. JOHN D. ORDWAY, CGA Member

MR. EUGENE L. WILSON, CGA Member

DR. DAROLD H. MORGAN, Ex Officio, CGA Chairman

The Conference accepted the above persons as the Resolutions Committee.

Mr. Cyrus P. Durgin, Vice President, Constitution Capital Management, was then introduced to discuss the topic, "Economic Review and Projection." His remarks were directed to a series of charts which depicted various facets relating to the state of the economy. A summary of his remarks is set forth in this booklet beginning on page 7. A most appreciative audience applauded his talk enthusiastically.

A coffee break recess took place from 10:20 to 10:50 A.M.

When the Conference reconvened, Mr. Michael Mudry, Senior Vice President, Hay/Huggins Company, Inc., was called upon to present the report of the Actuary and the "Actuarial Basis for Immediate and Deferred Gift Annuities." His paper and the supporting schedules are set forth in this booklet beginning at page 10.

Tal Roberts Esq., then presented a report on State Regulation. He introduced the members of his Subcommittee and asked one member, James Potter, to speak on New York State Regulation concerning the reinsurance of gift annuities.

The full text of Mr. Roberts' remarks are reproduced in this booklet, beginning at page 20 and Mr. Potter's remarks begin on page 25.

The first plenery session was declared in recess at 11:55 to resume at 12:30 for luncheon.

Luncheon Session

Grace was offered by the Reverend Les E. Niemi, Director, Special and Planned Giving, Suomi College.

There was no luncheon program.

The Conference recessed from luncheon to designated locations to participate in Workshop Sessions.

Workshop Sessions

The following workshops convened at 2:00 P.M.

1) CHARITABLE GIFT ANNUITIES—BASIC

Leaders: Ms. M. Elizabeth Brothers
Associate Vice President for Development
Rollins College

Dr. Robert B. Gronlund
President
Gronlund, Sayther & Associates

2) CHARITABLE GIFT ANNUITIES: IMMEDIATE AND DEFERRED—ADVANCED

Leaders: David M. Donaldson, Esq.
Partner—Ropes & Gray

Terry Simmons, Esq.
Vice President & Trust Counsel
Baptist Foundation of Texas

3) POOLED INCOME FUND—BASIC

Leaders: Kathryn E. Baerwald, Esq.
Associate General Counsel
United Way of America

G. Tom Carter, Esq.
Director, Trust Services
General Conference of
Seventh-day Adventists

4) POOLED INCOME FUND—ADVANCED

Leaders: Robert E. Harding, Esq.
Gray, Plant, Mooty, Mooty & Bennett

Mr. James B. Potter
Director of Planned Giving
American Lung Association

5) CHARITABLE REMAINDER TRUSTS—BASIC

Leaders: Richard A. James, Esq.
Legal Counsel
Loma Linda University

Mr. Frank J. Mayo
Planned Gifts Officer
Saint Vincent Medical Foundation

6) CHARITABLE REMAINDER TRUSTS—ADVANCED

Leaders: Mr. James G. Marshall, Jr., FNAHD
Vice President, Development
Meriter Foundation, Inc.

Dr. Frank D. Minton
Executive Director of Development
University of Washington

7) MARKETING LIFE INCOME GIFTS

Leaders: Douglas Freeman, Esq.
Freeman, Freeman & Smiley

Mr. John Ryan
President
Major Gifts, Inc.

8) USE OF CHARITABLE REMAINDER TRUSTS IN RETIREMENT PLANNING

Leaders: Marc Carmichael, J.D.
Publisher
Charitable Giving Tax Service

Lynda Moerschbaecher, Esq.
Trucker & Moerschbaecher

9) ADMINISTRATION, GIFT MANAGEMENT & COST EFFECTIVENESS

Leaders: Norman S. Fink, Esq.
Senior Counsel
John Grenzabach Associates, Inc.

Mr. Robert B. Turner
Associate Director, Planned Giving
Princeton University

10) EFFECTIVE USE OF CHARITABLE LEAD TRUSTS; COMBINING CHARITABLE REMAINDER TRUSTS WITH LIFE INSURANCE TRUSTS

Leaders: Mr. Miles McNally, ChFC, CLU
Vice President Marketing
McNally, Dunnavan & Lund, Inc.

Winton C. Smith, Jr., J.D.
Memphis, TN

The first workshops (Session "A") concluded about 3:15 P.M. for a coffee break of approximately 30 minutes, with the second workshops (Session "B") following. At their conclusion, about 5 P.M., the Conference recessed for dinner.

Optional Evening Sessions

The following optional sessions convened at 7:30 P.M.:

CANADIAN TAXATION

Mr. James A. Chisholm, Director of Development
Vancouver School of Theology

CREATIVE GIFT OPPORTUNITIES AND PROFESSIONAL ETHICS IN FUND RAISING

Winton C. Smith, Jr., J.D.
Memphis, TN

Chairman Morgan reconvened the Conference at 8:30 A.M. in the Concert Hall.

Mr. Charles N. O'Data, Chairman of the Resolutions Committee, submitted the following Resolutions:

1) BE IT RESOLVED, that the present maximum immediate gift annuity rates, as adopted by the Eighteenth Conference on Gift Annuities on May 5, 1983 and reaffirmed by the Nineteenth Conference on Gift Annuities on May 1, 1986 be continued as the Uniform Gift Annuity Rates recommended by the Twentieth Conference on Gift Annuities.

   BE IT FURTHER RESOLVED, that the maximum interest rates used to calculate interest factors for Deferred Gift Annuities be increased by ½ of 1% as follows:

   from 4½% to 5% first ten years of deferred period;
   from 4% to 4½% next ten years;
   from 3½% to 4% next ten years;
   from 3% to 3½% for the remaining deferred period.

2) BE IT RESOLVED, that in no event should a gift annuity, immediate or deferred, be written unless the charitable gift portion—using applicable Treasury tables—exceeds 10% of the money or value of property transferred in exchange for the gift annuity.

Mr. O'Data moved adoption of these Resolutions which were promptly seconded. After discussion and minor amendment they were ADOPTED unanimously.

The Conference recessed to previously designated locations to resume participation in Workshop Sessions "C" and "D". A 30 minute coffee break separated the Sessions at approximately 10:15 A.M.

Following these sessions at 12:15 luncheon was served. Grace was offered by the Reverend Myles H. Walburn, Treasurer, United Church Board for World Ministries.

The Conference reconvened at 1:30 P.M. in the Concert Hall. Chairman O'Data of the Resolutions Committee presented the report of that committee. The full text of the Resolutions Committee Report is printed beginning on page 297. Mr. O'Data reviewed the entire report and moved its adoption. It was seconded and ADOPTED unanimously.

Dr. Morgan then introduced the speaker for the final session of the Conference, Conrad Teitell, Esq., Partner, Prerau & Teitell, and Editor of *Taxwise Giving*. His topic was "Federal Tax Legislation." Mr. Teitell reported on recent regulations. He informed and entertained the audience with his unique style of presentation and received an enthusiastic ovation.

The Conference adjourned at 3:00 P.M. with the benediction given by G. Tom Carter, Esq., Director of Trust Services, General Conference of Seventh-day Adventists.

Respectfully submitted,
Charles W. Baas, Secretary

REPORT OF THE RESOLUTIONS COMMITTEE

1) BE IT RESOLVED, that the present maximum immediate gift annuity rates, as adopted by the Eighteenth Conference on Gift Annuities on May 5, 1983 and reaffirmed by the Nineteenth Conference on Gift Annuities on May 1, 1986 be continued as the Uniform Gift Annuity Rates recommended by the Twentieth Conference on Gift Annuities, and
BE IT FURTHER RESOLVED, that the maximum interest rates used to calculate interest factors for Deferred Gift Annuities be increased by ½ of 1% as follows:
   from 4½% to 5% first ten years of deferred period;
   from 4% to 4½% next ten years;
   from 3½% to 4% next ten years; and
   from 3% to 3½% for the remaining deferred period.

2) BE IT RESOLVED, that in no event should a gift annuity, immediate or deferred, be written unless the charitable gift portion—using applicable Treasury tables—exceeds 10% of the money or value of property transferred in exchange for the gift annuity.

3) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities note with special interest and appreciation the information set forth in Chairman Morgan's opening statement.

4) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express its sincere appreciation to Mr. C. Peter Durgin, Vice President of Constitution Capital Management, for his timely and authoritative address on the subject, "Economic Review and Projection."

5) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express appreciation to Mr. Michael Mudry, Actuary, Senior Vice President of Hay/Huggins Company, Inc., for his study on the rate structure for both standard and deferred gift annuities.

6) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express deep appreciation to those other persons who made plenary session presentations on matters of continuing concern, namely:

Tal Roberts, Esq., Executive Vice President
Baptist Foundation of Texas

and

Mr. James B. Potter, Director of Planned Giving
American Lung Association

"Report on State Regulation"

Conrad Teitell, Esq., Partner-Prerau & Teitell
Editor, *Taxwise Giving*

"Federal Tax Legislation"

7) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express gratitude to the leaders of the various workshop sessions who graciously shared their knowledge and expertise during this Conference, namely the following:

Ms. M. Elizabeth Brothers, Associate Vice President for Development, Rollins College
Dr. Robert B. Gronlund, President, Gronlund, Sayther & Associates
David M. Donaldson, Esq., Partner—Ropes & Gray
Terry Simmons, Esq., Vice President & Trust Counsel, Baptist Foundation of Texas
Kathryn E. Baerwald, Esq., Associate General Counsel, United Way of America
G. Tom Carter, Esq., Director, Trust Services, General Conference of Seventh-day Adventists
Robert E. Harding, Esq., Gray, Plant, Mooty, Mooty & Bennett
Mr. James B. Potter, Director of Planned Giving, American Lung Association
Richard A. James, Esq., Legal Counsel, Loma Linda University
Mr. Frank J. Mayo, Planned Gifts Officer, Saint Vincent Medical Foundation
Mr. James G. Marshall, Jr., FNAHD, Vice President Development, Meriter Foundation, Inc.
Dr. Frank D. Minton, Executive Director of Development, University of Washington

Douglas Freeman, Esq., Freeman, Freeman & Smiley
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Mr. Robert B. Turner, Associate Director, Planned Giving, Princeton University
Mr. Miles McNally, ChFC, CLU, Vice President, Marketing, McNally, Dunnavan & Lund, Inc.
Winton C. Smith, Jr., J.D., Memphis, TN

8) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express appreciation to those persons conducting optional sessions and pre-Conference introductory sessions, namely:

Mr. James A. Chisholm, Director of Development, Vancouver School of Theology
Winton C. Smith, Jr., J.D., Memphis, TN
Roland C. Matthies, J.D., Vice President and Treasurer Emeritus, Wittenberg University
Dr. Charles W. Baas, Secretary, Committee on Gift Annuities

9) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities recommend to the various societies, agencies, boards, institutions, colleges, universities, homes and hospitals, that for the purpose of uniformity and a better understanding of gift annuity agreements:

a) the agreement between the donor and the issuing agency be referred to as a "gift annuity agreement";
b) the periodic payment under gift annuity agreements be referred to as "annuity payments"; and
c) in discussing, promoting or advertising gift annuity agreements, such terminology as "bonds," "interest," "investment," "principal"

which apply to other forms of financial transactions, be carefully avoided.

10) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities recommend that organizations issuing gift annuity agreements maintain the funds related to their gift annuity program as "segregated funds" to make certain that all required annuity payments can be made.

11) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities recommend that religious, educational, health, and charitable groups which cooperate with the Committee on Gift Annuities be requested to send to the Chairman of the Committee copies of new rulings by Federal or State authorities dealing with gift annuities or life income agreements.

12) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities strongly urge and encourage all organizations issuing gift annuity agreements to adopt the Uniform Gift Annuity Rates as maximum rates.

13) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities send greetings to Mr. Forrest Smith, Honorary Treasurer; and to Mr. Charles L. Burrall, Jr., Dr. J. Homer Magee, and Dr. Chester A. Myrom, Honorary Members, remembering their many contributions to the work of the Committee.

14) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express its appreciation for the special helpfulness extended to Conference delegates in connection with all arrangements for the Conference by Miss Mary Lou Ruegg of the American Bible Society, Miss Ileen Bray of the Annuity Board of the Southern Baptist Convention, Mrs. Charles W. Baas, and the staff and management of the Royal York Hotel.

15) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express its warm thanks and hearty commendation to Miss Jane Stuber and Tal Roberts, Esq., for their excellent leadership as conveners of the Program Committee and Arrangements Committee, respectively, for this Conference.

16) BE IT RESOLVED, that the Twentieth Conference on Gift Annuities express to Dr. Darold H. Morgan, Chairman; Miss Jane Stuber and Tal Roberts, Vice Chairmen; Dr. Charles W. Baas, Secretary; Dr. John D. Ordway, Treasurer, and to the other members of the Committee on Gift Annuities, its appreciation for this outstanding Conference and for their many services since the last Conference.

Charles N. O'Data, Chairman
Roger K. Parolini
John South
Charles W. Baas
Michael Mudry
John D. Ordway
Eugene L. Wilson
Darold H. Morgan, Ex Officio

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Catholic Diocese of Toledo
Catholic Family Sharing Appeal
Catholic Fdn. Diocese of Tucson
Catholic Fdn. of Eastern OK, Inc.
Catholic Foundation
Catholic Foundation of N/C LA, Inc.
Catholic Foundation of Rhode Island
Catholic Indian Mission
Catholic Near East Welfare Association
Catholic Relief Services
Cattaraugus County Rehab. Fund
Cedar Lake Home Campus Fdn., Inc.
Cedars Home for Children Fdn., Inc.
Cedars Medical Center
Cedarville College
Central Baptist Theological Seminary
Central Christian Church Foundation
Central Christian College of the Bible
Central College, Pella, IA
Central College, McPherson, KS
Central Trust Company, N.A.
Chambersburg Memorial YMCA
Charitable Funding Services, Inc.
Chestnut Hill Benevolent Assn.
Chi Systems, Inc.
Chicago Symphony Orchestra
Child Evangelism Fellowship
Children's Hospital Fdn., Denver, CO
Children's Hospital Fdn., Philadelphia, PA
Children's Hospital Fdn., Seattle, WA
Children's Hospital Medical Center
Children's Hospital Nat'l Medical Ctr.
Children's Medical Foundation of Texas
Children's Memorial Foundation
Children's Memorial Hospital Foundation
Children's Mercy Hospital
ChildServ
Christ for the Nations, Inc.
Christian & Missionary Alliance, Canada
Christian & Missionary Alliance, Nyack, NY
Christian Aid Mission
Christian Aid Mission (Canada)
Christian Appalachian Project, Inc.
Christian Broadcasting Network
Christian Children's Fund
Christian Church Extension Fdn.
Christian Church Foundation
Christian Church Homes of Kentucky, Inc.
Christian Church in Kansas
Christian Homes, Inc.
Christian League for the Handicapped
Christian Light Publications, Inc.
Christian Reformed World Missions
Christian Schools International Fdn.
Christian Stewardship Services, Toronto, Ontario
Christian Stewardship Services, Harrisburg, PA
Christian Theological Seminary
Christmount Christian Assembly
Church of God
Church of God—Bd. Church Ext./Home Missions
Church of God, Inc., Bd. of Pensions
Church of the Brethren
Church of the Lutheran Brethren
Church of the Nazarene
Church of the United Brethren in Christ
Church Pension Fund
Churches of Christ in Christian Union
City of St. Jude

Claremont McKenna College
Claremont Univ. Center & Graduate School
Clark University
Clarke School for the Deaf
Clemson University
Coe College
Colby College
Colby-Sawyer College
Colgate Rochester Divinity School
College for Financial Planning
College of Mount St. Joseph
College of New Rochelle
College of Saint Benedict
College of So. Idaho Fdn., Inc.
College of St. Catherine
College of St. Thomas
College of William & Mary
College of Wooster
Colonial Williamsburg Foundation
Colorado College
Colorado School of Mines Fdn.
Colorado State University
Columbia Theological Seminary
Columbia University
Comboni Missionaries
Comdel, Inc.
Community Hospitals Fdn., Inc.
Community Hospitals of Central CA
Compassion International
Computone Systems, Inc.
Concordia College
Congregation Beth Israel
Connecticut Bank & Trust Co.
Connecticut College
Connie Maxwell Children's Home
Cono Christian School
Conservative Baptist Assn. of America
Conservative Baptist Foundation of AZ
Conservative Baptist Stewardship Ministries
Convalescent Home for Children Fdn.
Coral Ridge Ministries, Inc.
Cornell College
Council of Jewish Federations
Counselor Association, Inc.
Couzens, Lansky & Roeder
Covenant College
Covenant Foundation
Covenant House
Covenant Trust Management
Crichton College
CRISTA Ministries
Crosier Fathers
Crosier Fathers of Onamia
Crossroad
Crystal Cathedral/Reformed Church America
Culver Educational Foundation
Culver-Stockton College
Cumberland College
Cumberland Presbyterian Church
Dakota Wesleyan University
Dallas Christian College
Dallas Methodist Hospitals Fdn.
Dallas Theological Seminary
Dana College
Danbury Hospital Development Fund, Inc.
David & Margaret Home, Inc.
David Livingstone Missionary Fdn.
Davidson College
Davis Stuart, Inc.
Dayton Christian Schools, Inc.
Deaconess Development Foundation
Deaconess Foundation, St. Louis, MO
Deaconess Foundation, Cleveland, OH
Deaconess Medical Center Fdn.
Debevoise & Plimpton
Deborah Hospital Foundation
Decatur Memorial Hospital
Dechert, Price & Rhoads
Deerfield Academy
Delco Memorial Foundation
Deloitte, Haskins & Sells
Denison University
Denver Conservative Baptist Seminary
DePaul University
DePauw University
Deseret Trust Company
Development Analysis, Inc.
Development Management Associates
Dickinson College
Diocese of Belleville
Diocese of Brooklyn
Diocese of Colorado Springs
Diocese of Des Moines
Diocese of E. Carolina
Diocese of Erie
Diocese of Fort Worth—The Catholic Center
Diocese of Green Bay
Diocese of Harrisburg
Diocese of Helena
Diocese of Kansas City-St. Joseph
Diocese of Phoenix
Diocese of Pittsburgh
Doheny Eye Institute
Dominican Friars' Guilds

Drew University
Dwight-Englewood School
Eagle Village, Inc.
Earlham College
East Tennessee Children's Hospital
Easter Seal Society of Oregon
Eastern Baptist Theological Seminary
Eastern College
Eastern Mennonite College
Eastern Michigan University
Ebenezer Foundation
Echoing Hills Village, Inc.
Eckerd College
Eden Theological Seminary
Eger Homes & Foundation
Elmhurst College
Elmira College
Elyria United Methodist Home
Emmanuel School of Religion
Emporia State University
Endowment Board/Conference Claimants
Endowment Fdn. of Thomas More Prep—Marian
Environmental Defense Fund
Episcopal Church Center
Episcopal Diocese of Los Angeles
Episcopal Diocese of Western NC
Episcopal Retirement Homes, Inc.
Erskine College
Essex, Inc.
Estate Archetypes, Inc.
Eureka College
Evangelical Alliance Mission
Evangelical Covenant Church
Evangelical Free Church of America
Evangelical Lutheran Church in America
Evangelical Lutheran Good Samaritan Society
Evangelistic Faith Mission, Inc.
Every Home for Christ
Faegre & Benson
Fairfield University
Faith Baptist Bible College
Faith for Today, Inc.
Family Service of Rochester, Inc.
Far East Broadcasting Co.
Father Flanagan's Boys' Home
Fathers of St. Edmund So. Missions Inc.
Feed the Children
Fellowship of Reconciliation
Findlay College
First Assembly of God Church
First Christian Church Foundation
First Church of Christ, Scientist
Flat Rock Home for Children & Adults
Florida Baptist Children's Homes
Florida Hospital Foundation
Florida Institute of Technology
Florida Lutheran Consortium
Florida Sheriffs Youth Fund, Inc.
Florida State University Fdn.
Florida United Methodist Children's Home
Florida United Presbyterian Homes
Folts Foundation, Inc.
Fordham University
Fort Sanders Foundation
Fort Wayne Bible College
Foundation for Chiropractic Educ. & Research
Foundation for Christian Living
Francis W. Parker School
Franciscan Missionary Union
Franklin & Marshall College
Franklin College
Fred Hutchinson Cancer Research Center
Fredonia College Foundation, Inc.
Free Will Baptist Foundation
Freedom from Hunger Foundation
French Camp Academy
Friars of the Atonement, Inc.
Friends Bible College
Friends Committee on Nat'l. Legis.
Friends Enterprise House NY Institute of Technology
Friends Homes, Inc.
Friends of Israel Gospel Ministry
Friends of Mercy
Friends University
Fund Raising Video Systems
Furman University
Futures for Children
Gardner-Webb College
Garrett-Evangelical Seminary
Gateway United Meth. Youth & Family Services
Gaylord Hospital
GBMC Foundation
Geisinger Foundation
General Conference Mennonite Church
General Council of the Assemblies of God
General Health, Inc.
Geneva College
George Washington University
Georgetown College

Georgia Baptist Children's Homes
Georgia Baptist Foundation, Inc.
Georgia Sheriffs Youth Homes, Inc.
Girl Scout Council of St. Croix Valley
Girl Scouts of the USA
Glendale Federal Savings
Glenmary Home Missioners
Glenwood School for Boys
Glimmerglass Opera, Inc.—Building Fund
Go Ye Mission, Inc.
Golden Years Assistance Society, Inc.
Gonser, Gerber, Tinker & Stuhr
Gonzaga University
Good Samaritan Fdn., Dayton, OH
Good Samaritan Fdn., Portland, OR
Good Samaritan Hospital Fdn., San Jose, CA
Good Samaritan Hospital Fdn., Kearney, NE
Good Samaritan Hospital Fdn., Cincinnati, OH
Good Samaritan Medical Center Fdn.
Good Shepherd Home Foundation
Goodwill Industries Rehab. Ctr.
Goodwill Industries-Suncoast Inc.
Gordon College
Gordon-Conwell Theological Seminary
Gospel Assn. for the Blind, Inc.
Gospel Fellowship Association
Gospel Missionary Union
Gospel Volunteers, Inc.
Governor Dummer Academy
Grace Bible College
Grace Brethren Financial Planning Services
Grace College of the Bible
Graduate School & Univ. Center of CUNY
Grand Rapids Baptist College & Sem.
Grand Rapids School of the Bible & Music
Grant Hospital Development Fdn.
Gray Cary Ames & Frye
Gray Plant Mooty Mooty & Bennett
Greater Europe Mission
Greater Minn. Assoc. of Evangelicals
Greater Tacoma Community Foundation
Grinnell College
Gronlund, Sayther & Associates
Guideposts Associates, Inc.
Guilford College
Gustavus Adolphus College
Halifax Humane Society of Volusia Co. Inc.
Hamilton College
Hamline University
Hampden-Sydney College
Hanley-Hazelden Foundation
Hardin-Simmons University
Hartford Fdn. for Public Giving
Harvard Business School
Harvard Law School
Harvard Management Company
Harvard Medical School
Harvey Mudd College
Hauck & Associates
Haven of Rest Ministries
Haverford College
Hawthorne Gospel Church
Hay/Huggins Company, Inc.
Hazelden Foundation
Healthaven Corporation
HealthEast Foundation
Heifer Project International
Heritage Plantation of Sandwich
Hillcrest Family Services
Hillsdale College
Holland Home
Hollins College
Holston Valley Health Care Fdn.
Holy Land Christian Mission
Homemakers of Strafford County
Hope College
Hope Haven, Inc.
Hospital Sisters of St. Francis Fdn.
Houghton College
Hudelson Baptist Children's Home
Hunterdon Medical Center Fdn.
Huntingdon College
Huntington College
Iliff School of Theology
Illinois Benedictine College
Illinois Wesleyan University
Immaculata College
Indiana Wesleyan University
Ingalls Development Foundation
Inner City Impact, Chicago, IL
Inner City Impact, Skokie, IL
Institute of Logopedics
Inter-Mountain Deaconess Home
Inter-Varsity Christian Fellowship
International Bible Society
International Center of NY, Inc.
International Ministries to Israel
Iowa Methodist Health Foundation
Iowa State University Fdn.
J. Donovan Associates
Jacob Engle Foundation, Inc.
Jane Addams Peace Association, Inc.
Jerome F. Seaman & Associates, Inc.
Jesuit Deferred Funds

Jesuit Development Office, Chicago, IL
Jesuit Development Office, Baltimore, MD
Jesuit High School
Jesuit Mission Bureau
Jesuit Provincial Residence
Jesuit Seminary & Mission Bureau
Jesuit Seminary Association
Jews for Jesus
John Brown Limited
John Brown University
John R. Rogers Company
Johns Hopkins University
Johnson Bible College
Johnson City Medical Center Fdn.
Judson College
Juniata College
Kansas Masonic Home
KCTS/9
Kennedy Sinclaire, Inc.
Kent State University
Kentucky Baptist Foundation
Kentucky Baptist Homes for Children
Kentucky Christian College
Kentucky Wesleyan College
Kenyon College
Kewanee Public Hospital
Kingswood Manor
Kirksville College of Osteopathic Medicine
KRMA-TV
LA Society-Prevention, Cruelty to Animals
Lafayette College
Lake Bluff/Chicago Homes for Children
Lake Forest College
Lakeside Association
Lakeview Methodist Health Care Fdn.
Lambuth College
Lancaster Bible College
Lancaster General Hospital
Landon School
Latin America Missions, Inc.
Laubach Literacy International
Laudholm Trust
LaVida Mission
Lawrence University
LDS Foundation
Lee Bernard & Company
Lehigh University
Leland Stanford Junior University
LeSea, Inc.
LeTourneau College
Lexington Theological Seminary
Lincoln Christian College
Lindsey Wilson College
Little Company of Mary Hospital
Little Sioux
Living Bibles International
Loma Linda University
Long Beach Community Hospital Fdn.
Longwood College
Loras College
Los Angeles Orthopaedic Fdn.
Louisiana Baptist Foundation
Louisiana College
Louisville Presbyterian Theological Seminary
Lowell General Hospital
Lower Eastside Service Center
Loyola Marymount University
Loyola University
Lubbock Christian University
Luther College
Luther Northwestern Theological Seminary
Lutheran Bible Institute
Lutheran Church in America Fdn.
Lutheran Church-Missouri Synod Fdn.
Lutheran Fdn. of the Southwest
Lutheran Health Care Foundation
Lutheran Home at Germantown
Lutheran Homes, Inc.
Lutheran Medical Center
Lutheran School for the Deaf
Lutheran Social Service of Minnesota
Lutheran Social Services—East Region
Lutheran Social Services of Illinois
Lutheran Social Services of MI
Lutheran Social Services of So. CA
Lynchburg College
M. J. Clark Memorial Home
MacAlester College
Maenner Relocation, Inc.
MAF Foundation
Malone College
Manhattan Christian College
Mankato State University
MAP International
Mare and Company
Marian College
Marianist Mission
Marine Biological Laboratory
Marine Military Academy
Marion College
Marquardt Memorial Manor, Inc.
Marquette University
Mars Hill College
Marshall & Melhorn

Martin Luther Home Foundation
Marts & Lundy, Inc.
Mary College
Mary Washington College
Maryknoll Fathers and Brothers
Marymount College
Marymount Collge of Kansas
Marymount College of Virginia
Masonic Charity Foundation of CT
Masonic Charity Foundation of NJ
Massachusetts College of Pharmacy
Massachusetts General Hospital
Massachusetts Eye & Ear Infirmary
Mayo Foundation
McCallie School
McKendree College
McPherson College
Medical Ambassadors International
Memorial Fdn. of Allen Hospital
Memorial Hospital Foundation
Memorial Medical Center Foundation
Memorial Mission Foundation
Memorial Sloan-Kettering Cancer Center
Menninger Foundation
Mennonite Brethren Stewardship Ministries
Mennonite Foundation, Harleysville, PA
Mennonite Foundation, Inc., Goshen, IN
Mercy Boys' Home
Mercy Health Center
Mercy Hospital Fdn., San Diego, CA
Mercy Hospital Fdn., Pittsburgh, PA
Meredith College
Meriter Foundation, Inc.
Merrill Lynch
Messiah College
Messiah Village
Methodist Home
Methodist Hospital
Methodist Hospital Foundation
Metrocrest Medical Foundation
Metropolitan Medical Center Fdn.
Metropolitan Opera Association, Inc.
Mid-America Baptist Theological Seminary
Middlebury College
Midland Lutheran College
Midland Mutual Life Insurance Co.
Milbank, Tweed, Hadley & McCloy
Miller Dwan Medical Center Fdn.
Millikin University
Milliman & Robertson, Inc.
Millsaps College
Minneapolis Children's Foundation
Minnesota Medical Foundation
Minnesota Orchestral Association
Minnesota Public Radio
Missionaries of Africa
Missionaries of the Sacred Heart
Missionary Church/Investment Fdn. Inc.
Missionary Oblates of Mary Immaculate
Missouri Baptist Foundation
Moffitt Cancer Center
Montclair State College
Moody Bible Institute
Moral Re-Armament, Inc.
Moravian Church
Moravian Church in America
Moravian College
Moravian Manor
Morning Cheer, Inc.
Mount Angel Abbey & Seminary
Mount Hermon Association, Inc.
Mount Holyoke College
Mount Mercy College
Mount Saint Mary's College
Mount St. Joseph's Residence & ECC
Mt. San Antonio Gardens
Muhlenberg College
Multnomah School of the Bible
Murry State University Foundation
Museum of Science and Industry
Musick, Peeler & Garrett
Muskingum College
Mutual of America Life Insurance Co.
Na'Amat, USA
Narramore Christian Foundation
Nat'l Academy of Public Admin.
Nat'l Assoc./Congregational Christian Churches
National Benevolent Assn., Rosemead, CA
National Benevolent Assn., St. Louis MO
National Church Residences
National Easter Seal Society
National Meth. Fdn. for Christian Higher Education
National Wildlife Federation
Nature Conservancy
Nebraska Children's Home
Nebraska Methodist Hospital Fdn.
Nebraska Wesleyan University
New Britain General Hospital
New England Baptist Hospital
New England Medical Center

New Jersey Institute of Technology
New Mexico Baptist Foundation
New Mexico Boys & Girls Ranch Fdn.
New Mexico Conference Methodist Fdn.
New Tribes Mission, Inc.
New York University
Newcomb Hospital Foundation, Inc.
Niessen, Dunlap & Pritchard-CPA's
Nixon, Hargrave, Devans & Doyle
Noble & Greenough School
Noel-Schopen & Company
North American Baptist Seminary
North American Baptists, Inc.
North Carolina Baptist Fdn., Inc.
North Carolina State University
North Central College
Northeastern Illinois University
Northeastern University
Northern Arizona University
Northern Baptist Theological Seminary
Northern Rocky Mtn. Easter Seal Society
Northland College
Northridge Hospital Development Assn.
Northwest Baptist Foundation
Northwest Baptist Seminary
Northwest Nazarene College
Northwestern College
Northwestern Memorial Foundation
Northwestern University
Northwood Institute
Nutter, McClennen & Fish
NY—CT Fdn. of United Methodist Church
Nyack College
O'Connor Foundation
O'Melveny & Myers
Oak Grove Lutheran High School
Oakwood College
Oberlin College
Oblate Missions
Occidental College
Ohio Presbyterian Retirement Serv. Fdn.
Ohio State University
Ohio Wesleyan University
Oklahoma Christian College
Oklahoma United Methodist Fdn., Inc.
Old Dominion University
Old Time Gospel Hour
Omaha Home for Boys
OMS International, Inc.
On Earth Peace Assembly
Open Bible Standard Churches
Open Doors With Brother Andrew
Oral Roberts Evangelistic Assn., Inc.
Oregon State University Fdn.
Orlando Regional Medical Center Fdn., Inc.
Otterbein Home
Ouachita Baptist University
Our Lady of Victory Homes of Charity
Overlake Hospital Foundation
Ozanam Home for Boys
Ozark Christian College
Pacific Garden Mission
Pacific Lutheran University
Pacific Union College
Packer Collegiate Institute
Paducah Community College
Paoli Memorial Hospital
Park College
Park Street Church
Pasadena Christian School
Paul A. McCann & Associates, Inc.
Peace College
Pendle Hill, Quaker Study Center
Peninsula United Methodist Homes, Inc.
Pennsylvania College of Optometry
Pennsylvania State University
Penrose-St. Francis Healthcare Fdn.
Pension Fund of the Christian Church
Pentera, Inc.
People-to-People Health Fdn., Inc.
Pepperdine University
Peter Becker Community
PG Calc Incorporated
Phil Brain Associates, Inc.
Philadelphia College of Bible
Philip Converse & Associates
Phoebe-Devitt Homes
Phoenix Children's Hospital
Piedmont College
Piedmont Technical College Fdn.
Pikeville College
Pilgrim Place
Pine Manor College
Pinecrest Manor
Pinellas Assn. for Retarded Children
Pittsburgh State University
Planned Giving Consultants, Inc.
Planned Parenthood Federation of America
Planned Parenthood of SB, Ventura & San Luis Obispo Counties

Pleasant View Homes, Inc.
Plymouth Congregational Church
Plymouth Place, Inc.
Point Loma Nazarene College
Pomona College—Annuity & Trust
Port Huron Hospital Foundation
Prairie Bible Institute
Prairie View, Inc.
Presbyterian Church in America Fdn.
Presbyterian Church (USA) Fdn.
Presbyterian Home of South Carolina
Presbyterian Homes of Minnesota, Inc.
Presbyterian Homes of NJ Foundation
Presbyterian Homes, Inc.
Presbyterian Intercommunity Hospital Fdn.
Presbyterian Manors of Mid-America
Price Waterhouse
Priests of the Sacred Heart
Princeton Theological Seminary
Princeton University
Prison Fellowship Ministries
Private Alternative, Inc.
Public Relations Counselors, Inc.
Quakerdale Home
Quincy College
R &R Newkirk/Longman
Radcliffe College
Radio Bible Class Trust
Randolph-Macon College
Randolph-Macon Woman's College
Ravinia Festival
RBMU International
Red Cloud Indian School, Inc.
Redemptorist Fathers Foundation
Redlands Community Hospital Fdn.
Reed College
Reformed Church of Bronxville
Reformed Theological Seminary
Regis College
Rescue Mission Alliance
Resource Development, Inc.
Rhode Island College
Rhodes College
Rice University
Rideout Hospital Foundation, Inc.
Rio Grande Bible Institute, Inc.
Ripon College
Riverside Community Hospital Fdn.
Roanoke College
Robert F. Sharpe & Co., Inc.
Roberts Wesleyan College
Rockefeller University
Rockhurst College
Rocky Mountain College
Rocky Mountain United Methodist Homes & Ministries
Rollins College
Roman Catholic Diocese of Marquette
Roosevelt University
Rosary College
Rotary Fdn. of Rotary Int'l.
Roxbury Latin School
Rutgers University Foundation
Sacred Heart League
Sacred Heart Medical Center Dev. Fund
Sacred Heart Program
Salem Academy & College
Salem Children's Home
Salem Lutheran Home
Salesian Missions
Saline Community Hospital Foundation
Samaritan Charitable Trust
San Diego State University Fdn.
Sansum Medical Research Foundation
Santa Clara University
Santa Monica Hospital Medical Center Fdn.
Save the Children Federation, Inc.
School of the Ozarks
School of Theology at Claremont
Schreiner College
Scripps College
Scripps Memorial Hospital
Scripture Union
Seamen's Church Institute
Seeing Eye, Inc.
SEND International
Seven Oaks General Hospital Fdn.
Seventh-day Adventists, Allegheny E. Conf.
Seventh-day Adventists, Allegheny W. Conf.
Seventh-day Adventists, AR/LA Conf.
Seventh-day Adventists, Arizona Conf.
Seventh-day Adventists, Assn. of CO
Seventh-day Adventists, Atlantic Union Conf.
Seventh-day Adventists, Carolina Conf.
Seventh-day Adventists, Central CA Assn.
Seventh-day Adventists, Chesapeake Conf.
Seventh-day Adventists, Col. Union Conf.

Seventh-day Adventists, Florida Conf.
Seventh-day Adventists, GA/Cumb. Assn.
Seventh-day Adventists, Gen. Conf. Loma Linda, CA
Seventh-day Adventists, Gen. Conf. Washington, DC
Seventh-day Adventists, Greater NY Conf.
Seventh-day Adventists, Gulf States Conf.
Seventh-day Adventists, Illinois Conf.
Seventh-day Adventists, Indiana Conf.
Seventh-day Adventists, KY/TN Conf.
Seventh-day Adventists, Lake Union Conf.
Seventh-day Adventists, Michigan Conf.
Seventh-day Adventists, Mid/America Union
Seventh-day Adventists, N. CA Conf.
Seventh-day Adventists, N. New England Conf.
Seventh-day Adventists, N. Pacific Union Conf.
Seventh-day Adventists, New Jersey Conf.
Seventh-day Adventists, Northeastern Conf.
Seventh-day Adventists, NY Conf.
Seventh-day Adventists, Ohio Conf.
Seventh-day Adventists, Oklahoma Conf.
Seventh-day Adventists, Ont. Conf. Corp.
Seventh-day Adventists, Pacific Union Conf.
Seventh-day Adventists, Penna Conf.
Seventh-day Adventists, S. Atlantic Conf.
Seventh-day Adventists, S. Central Conf.
Seventh-day Adventists, S. New England Conf.
Seventh-day Adventists, S. Union Conf.
Seventh-day Adventists, S.E. CA Assn.
Seventh-day Adventists, S.W. Union Conf.
Seventh-day Adventists, Southeastern Conf.
Seventh-day Adventists, Texas Conf.
Seventh-day Adventists, Texico Conf. Assn.
Seventh-day Adventists, Wisconsin Conf.
Sharp Hospitals Foundation
Shriners Hospitals for Crippled Children
Sierra View Homes, Inc.
Silver Cross Hospital
SIM USA, Inc.
SIM, Canada
Simmons College
Simpson College
Sioux Falls College
Sisters of Providence
Smith College
Society for the Propagation of the Faith
Society of St. James
South Dakota Children's Aid Fdn.
South Dakota Synod, E.L.C.A.
South Dakota United Methodist Fdn.
Southeastern Baptist Theo. Seminary
Southern Arkansas University
Southern Baptist College
Southern Baptist Convention—Annuity Board
Southern Baptist Convention—Foreign Mission Board
Southern Baptist Foundation
Southern California College of Optometry
Southern California Presbyterian Homes
Southland Lutheran Home
Southwest Baptist University
Southwest Community Health Services
Southwest Florida Retirement Center
Southwest State University
Southwestern Baptist Theological Seminary
Southwestern College
Southwestern Ohio Seniors' Services, Inc.
Spring Arbor College
Spring Hill College
Springfield College
St. Anthony's Foundation
St. Barnabas Development Fdn.
St. Clair Health Corp./St. John Hosp.
St. Cloud State University Fdn., Inc.
St. Columban's Foreign Mission Society
St. Francis College
St. Francis Homes, Inc.
St. Francis Hospital & Medical Center
St. Francis Hospital of Evanston

St. John's College
St. John's Mercycare Foundation
St. John's University
St. Joseph Health Care Fdn.
St. Joseph Medical Center Fdn.
St. Joseph's College
St. Joseph's Hospital & Medical Ctr.
St. Joseph's Indian School
St. Lawrence Seminary
St. Lawrence University
St. Louis Christian College
St. Louis University
St. Luke's Hospital Fdn. Inc.
St. Mary College
St. Mary's College
St. Mary's Hospital of Rochester, MN
St. Mary's Hospital, Inc.
St. Mary's Medical Center
St. Meinrad Archabbey & Seminary
St. Michael's College
St. Norbert College
St. Olaf College
St. Paul Bible College
St. Paul Foundation
St. Paul School of Theology
St. Thomas Hospital Development Fdn.
St. Thomas Theological Seminary
St. Vincent Foundation, Birmingham, AL
St. Vincent Foundation, Little Rock, AR
St. Vincent Medical Center
St. Vincent Medical Foundation
St. Vincent's Services, Inc.
St. Xavier College
St. Xavier High School
St. Vladimir's Orthodox Theological Seminary
Stanford University
Starr Commonwealth Schools
State Street Bank & Trust Co.
State University College of Oswego Fdn.
Stauffer & Company
Sterling College
Stetson University
Stout University Foundation, Inc.
Strafford County Homemakers
Sunnyside Presbyterian Home
Sunset Manor, Inc.
Suomi College
Sussex County Assn. for Retarded Citizens
Swarthmore College
Swiss Village, Inc.
Tarpon Springs General Hospital
Teachers College, Columbia University
Temple University
Texas Methodist Foundation
Texas Presbyterian Foundation
Texas Wesleyan College
The Augustinians
The Free Methodist Fdn.
The Hill School
The Humane Society of the US
The King's College
The Mises Institute
The Navigators
The Paulist Fathers
The Pocket Testament League, Inc.
The Salvation Army
- Phoenix, AZ
- Fresno, CA
- Los Angeles, CA
- Western Territorial Hdqtrs., Rancho Palos Verdes, CA
- San Francisco, CA
- Denver, CO
- National Capital & VA Division, Washington, DC
- Florida Division, Tampa, FL
- Georgia Division, Atlanta, GA
- So. Territorial Hdqtrs., Atlanta, GA
- Honolulu, HI
- N. Dearborn St., Chicago, IL
- Pulaski Rd., Chicago, IL
- Indiana Division Hdqtrs., Indianapolis, IN
- KY & TN Division, Louisville, KY
- Baltimore, MD
- Jackson, MS
- St. Louis, MO
- N & SC Division, Charlotte, NC
- Newark, NJ
- Verona, NJ
- Eastern Territorial Hdqtrs., New York, NY
- Empire State Division, Syracuse, NY
- Greater NY Division, New York, NY
- Cincinnati, OH
- NE Ohio Div. Hdqtrs., Cleveland, OH
- OK-AR Div. Hdqtrs., Oklahoma City, OK
- London, Ontario
- Canada & Bermuda Territory, Toronto, Ontario
- Toronto, Ontario

Portland, OR
Philadelphia, PA
Western PA Division, Pittsburgh, PA
Texas Division, Dallas, TX
Seattle, WA
The Stelter Company
The Temple, Congregation B'nai Jehudah
The Visiting Nurse Assn. of Chicago
Thiel College
Thomas Havey & Company
Thomas Jefferson University
Thompson & McJarrow Stewardship Ministries
Thoms Rehab. Hosp. Health Services Fdn.
Toccoa Falls College
Toledo Museum of Art
Toronto Symphony
Trans World Radio
Tressler-Lutheran Service Associates
Trevecca Nazarene College
Trinity University
Trucker & Moerschbaecher
Tufts University
Tulane University
Twin Towers: Retirement Community
UCI College of Medicine Fdn.
UCLA Foundation/Public Affairs
Union Hospital Foundation
Union League Foundation for Boys' Clubs
Union Rescue Mission
Union Theological Seminary in VA
United Catholic Social Services
United Christian Missionary Society
United Church Board for World Ministries
United Church Homes, Inc.
United Church of Canada
United Church of Christ, IL South Conf.
United Church of Christ, KS-OK Conf.
United Church of Christ, Planned Giving Dept.
United Church of Christ, Planned Giving Program
United Church of Christ, So. Cal. Conf.
United Church of Christ, The Pension Boards
United Church of Christ, Washington-No. Idaho Conf.
United Church of Religious Science
United Hospital Foundation
United Jewish Appeal-Fed. of Jewish Philanthropies
United Methodist Children's Home
United Methodist Church
United Methodist Church, Board of Discipleship
United Methodist Church, Central PA Conf.
United Methodist Church, Central IL Conf.
United Methodist Church, Central TX Conf.
United Methodist Church, General Council F&A
United Methodist Church, North IN Conf.
United Methodist Church, Rocky Mtn. Conf.
United Methodist Church, S. New Eng. Conf.
United Methodist Church, So. IN Fdn.
United Methodist Church, W. NC Conf.
United Methodist Church, West Ohio Conf.
United Methodist Church Fdn., Holston Conf.
United Methodist Church Fdn., Inc.
United Methodist Fdn. of Louisiana
United Methodist Fdn. of the Northwest
United Methodist Fdn. of West Michigan
United Methodist Fdn. of Western PA
United Methodist Fdn., AL/W. FL Conf.
United Methodist Fdn., Baltimore Annual Conf.
United Methodist Fdn., CA-Pacific Conf.
United Methodist Fdn., Detroit Conf.
United Methodist Fdn., Kansas Area
United Methodist Fdn., NC Conf.
United Methodist Fdn., No. IL Conf.
United Methodist Fdn., Peninsula Conf.
United Methodist Fdn., SC Conf.
United Methodist Fdn., Texas Ann. Conf.
United Methodist Homes for the Aging
United Methodist Homes of NJ
United Methodist Retirement Homes

United Methodist Village, Inc.
United Methodist Youthville, Inc.
United Nations Assn. of the USA, Inc.
United Theological Seminary
United Way of America
United Way of Greater Toronto
United Way of Santa Barbara County
United Way Services
United Way/Centraide Canada
Unity School of Christianity
University at Buffalo Fdn.
University of Calif., Berkeley Fdn.
University of Calif., San Francisco
University of California
University of Chicago
University of Cincinnati Fdn.
University of Colorado Fdn., Inc.
University of Connecticut Fdn.
University of Denver
University of Florida Fdn., Inc.
University of Hartford
University of Hawaii Foundation
University of Illinois Foundation
University of Indianapolis
University of Louisville
University of Miami
University of Minnesota
University of Missouri
University of North Carolina
University of Northern Iowa Fdn.
University of Oregon Fdn.
University of Portland
University of Puget Sound
University of Redlands
University of Rhode Island Fdn.
University of Richmond
University of San Diego
University of Scranton
University of Texas Foundation, Inc.
University of the South
University of Vermont
University of Virginia
University of Washington
University of West Florida Fdn.
University of Wisconsin,—River Falls Fdn., Inc.
Upstate Home for Children, Inc.
Upton Foundation
Uta Halee Girls Village
Valley Baptist Medical Center Fdn.
Valley Hospital Foundation
Valparaiso University
Vanderbilt University
Vassar College
Vennard College
Vermont Health Foundation
Vernon Advent Christian Home, Inc.
Vicenti, Lloyd & Stutzman
Villa Maria Geriatric Center
Virginia Polytechnic Inst. & State University
Viterbo College
Voice of China & Asia Missionary Soc. Inc.
Voice of Prophecy
Walker Sponsors Fund
Warner Southern College, Inc.
Warner, Norcross & Judd
Warren Wilson College, Inc.
Wartburg Seminary
Washington & Lee University
Washington Bible College
Washington University
Water Street Rescue Mission
Wayland Academy
Wayne State University
Wellesley College
Wentworth Institute of Technology
Wesley Foundation
Wesley Retirement Services
Wesley Willows Corporations
Wesleyan Church
Wesleyan University
West Mont
West Virginia Baptist Foundation
West Virginia Wesleyan College
Westbrook College
Western Maryland College
Westminister Academy
Westminster School
Westminster Theological Seminary
Westminster-Canterbury of Lynchburg
Westmont College
Wheaton College, Wheaton, IL
Wheaton College, Norton, MA
Wheelock College
Whitman College
Whitworth College/Whitworth Foundation
Wichita State University Endowment Assoc.
Willamette University
Willamette View Manor Foundation
William Tyndale College
Williams College
Wilmington College
Wilmington Financial Group, Inc.
Winebrenner Theological Seminary
Wisconsin Evangelical Lutheran Synod

Wittenberg University
WNET/Thirteen
Wofford College
Woodward & Slater
Word of Life Fellowship, Inc.
Words of Hope
World Evangelistic Enterprise Corp.
World Home Bible League
World Mission Prayer League
World Missionary Press, Inc.
World Neighbors, Inc.
World Radio Missionary Fellowship
World Vision, Inc.
Wycliffe Bible Translators
Wynn, Brown, Mack, Renfro & Thompson
Yale University/Yale Alumni Fund
Yellowstone Boys & Girls Ranch
YMCA of Greater New York
York College of Pennsylvania
York Hospital
Young Harris College
Young Life Foundation
Youville Hospital
YWCA of Minneapolis Area
YWCA of the USA-National Board

CONSTITUTION
of the
COMMITTEE ON GIFT ANNUITIES

ARTICLE I

The Committee on Gift Annuities, hereinafter referred to as the Committee, shall continue the activities of the Committee on Annuities organized in 1927 as a Sub-Committee on Annuities of the Committee on Financial and Fiduciary Matters of the Federal Council of the Churches of Christ in America.

The Committee shall study and recommend the proper range of rates for charitable gift annuities and the accepted methods of yield computations for pooled income fund agreements.

The Committee may also study and recommend the form of contracts, the amount and type of reserve funds, and the terminology to be used in describing, advertising, and issuing charitable gift annuities, pooled income fund agreements, and such other deferred gift agreements as the Committee shall decide.

The Committee may ascertain and report as to legislation, taxability, and related matters regarding charitable gift annuities, pooled income fund agreements, and such other deferred gift agreements as determined by the Committee.

The Committee shall call a conference on charitable gift annuities at least once each four years and invite those who contribute to its activities to attend.

ARTICLE II

The membership of the Committee shall consist of not more than 25 persons. These members shall be chosen by a majority vote of the Committee from important religious, educational, charitable, and other organizations or from groups of such organizations issuing and experienced in gift annuities and/or life income agreements. In electing members to the Committee, the Committee shall secure representation from the member groups, but such member is not the agent of the organization or group from which he or she comes, nor is the organization or group bound by any decisions reached by the Committee.

As a general rule, only one representative shall be selected from each organization or group of related organizations unless for special reasons an additional member is selected by the Committee.

Membership on the Committee shall not continue beyond the time the member terminates service with the organization or group of organizations with which he or she was associated at the time of election to the Committee.

Persons who are not affiliated with organizations or groups of organizations above defined may be elected by the Committee present and voting by unanimous vote only.

ARTICLE III

In order to finance its activities and its research in actuarial, financial, and legal matters, and the publication and dissemination of information so obtained, the Committee will collect registration fees from those who attend its Conferences and fees from those who make use of its findings and services. It may set a periodic membership fee and may request gifts from those groups that cooperate with it to cover the expenses of its various activities, such amounts to be decided by the Committee. The Committee will also sell its printed material to pay for its out-of-pocket expenses.

ARTICLE IV

This Constitution may be changed, provided the proposed changes are presented at one meeting of the Committee and voted upon at the next meeting. Any proposed changes shall be provided to every member of the Committee, prior to the meeting at which it shall be voted upon, and approval by two-thirds of the members present and voting shall be necessary for final approval.

BY-LAWS
COMMITTEE ON GIFT ANNUITIES

I. The Officers shall be a Chairman, one or more Vice Chairmen, Treasurer, Secretary, Assistant Treasurer, and Assistant Secretary, who shall be elected at the Committee meeting next following the Charitable Gift Annuity Conference and shall serve until the first meeting after the next such Conference or until their successors have been elected and installed. Officers may be elected to one or more successive terms and a majority vote of Members present will elect.

II. Vacancies in the offices of the Committee shall be filled by the Committee at any meeting. A vote of a majority of those present will elect.

III. The Chairman, Vice Chairmen, Treasurer, Secretary, Assistant Treasurer, and Assistant Secretary of the Committee shall fulfill the usual duties of those offices during their term of office. The Treasurer shall keep the accounts, and the Secretary shall keep the Minutes of the meetings of the Committee and each shall perform such other duties as may be assigned them by the Chairman of the Committee.

IV. The Chairman, or in his absence a Vice Chairman, shall call the meetings of the Committee at such time and place as seems desirable either to the Committee if it is in session or to the Chairman if the Committee is not in session. At least two weeks' notice of the forthcoming meeting should ordinarily be given.

V. Conferences of Gift Annuities shall be called periodically as required by the Constitution of the Committee on Gift Annuities. A majority vote of Committee Members shall be required to call a Conference.

VI. A membership nominating committee shall be appointed by the Chairman. It may submit nominations for consideration at any meeting when the membership of the Committee consists of less than the maximum established in the Constitution. A vote of a majority of those present will elect as provided in the Constitution.

VII. A quorum necessary for the conduct of business of the Committee shall consist of seven Members.

VIII. The Committee shall carry Directors and Officers liability insurance to protect its Members from any claims that might be filed against the Committee or against a Member in his or her capacity as a Committee Member, and it shall provide indemnity to its Members for any costs or other liability incurred with respect to such claims to the extent permitted by law.

IX. These By-Laws may be amended at any regularly called meeting of the Committee, provided the proposed changes are approved by a two-thirds vote of the Members present and voting.

UNIFORM GIFT ANNUITY RATES
SINGLE LIFE

Adopted by
Conference on Gift Annuities
May 5, 1983

Age	Rate	Age	Rate
35 and under	6.0%	63	7.1%
36	6.1%	64	7.2%
37	6.1%	65	7.3%
38	6.1%	66	7.4%
39	6.2%	67	7.5%
40	6.2%	68	7.6%
41	6.2%	69	7.7%
42	6.3%	70	7.8%
43	6.3%	71	7.9%
44	6.3%	72	8.0%
45	6.4%	73	8.2%
46	6.4%	74	8.3%
47	6.5%	75	8.5%
48	6.5%	76	8.7%
49	6.5%	77	8.9%
50	6.5%	78	9.1%
51	6.6%	79	9.4%
52	6.6%	80	9.6%
53	6.6%	81	9.9%
54	6.7%	82	10.2%
55	6.7%	83	10.6%
56	6.8%	84	10.9%
57	6.8%	85	11.4%
58	6.9%	86	11.8%
59	6.9%	87	12.3%
60	7.0%	88	12.8%
61	7.0%	89	13.4%
62	7.1%	90 and over	14.0%

These rates were reconfirmed by the 19th Conference on Gift Annuities, May 1, 1986, and the 20th Conference, April 6, 1989.

UNIFORM GIFT ANNUITY RATES
TWO LIVES – JOINT AND SURVIVOR

Adopted by Conference on Gift Annuities, May 5, 1983

AGE OF YOUNGER LIFE

AGE OF OLDER LIFE

AGE	35*	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53	54	55
35*	5.8																				
36	5.8	5.9																			
37	5.8	5.9	5.9																		
38	5.8	5.9	5.9	5.9																	
39	5.8	5.9	5.9	5.9	6.0																
40	5.8	5.9	5.9	5.9	6.0	6.0															
41	5.8	5.9	5.9	5.9	6.0	6.0	6.0														
42	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1													
43	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1												
44	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1											
45	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2										
46	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2									
47	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3								
48	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3							
49	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3						
50	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3					
51	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4				
52	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4			
53	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4		
54	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.4	
55	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.4	6.4
56	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.4	6.5
57	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
58	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
59	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
60	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
61	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
62	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
63	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
64	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
65	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
66	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
67	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
68	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
69	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
70	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
71	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
72	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
73	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
74	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
75	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
76	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
77	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
78	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
79	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
80	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
81	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
82	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
83	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
84	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
85	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
86	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
87	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
88	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
89	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
90	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
91	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
92	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
93	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
94	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5
95	5.8	5.9	5.9	5.9	6.0	6.0	6.0	6.1	6.1	6.1	6.2	6.2	6.3	6.3	6.3	6.3	6.4	6.4	6.4	6.5	6.5

AGE	56	57	58	59	60	61	62	63	64	65	66	67	68	69	70	71	72	73	74	75
56	6.5																			
57	6.5	6.5																		
58	6.5	6.5	6.5																	
59	6.5	6.5	6.5	6.6																
60	6.5	6.5	6.6	6.6	6.6															
61	6.5	6.5	6.6	6.6	6.6	6.6														
62	6.5	6.6	6.6	6.6	6.6	6.6	6.7													
63	6.6	6.6	6.6	6.6	6.6	6.7	6.7	6.7												
64	6.6	6.6	6.6	6.6	6.7	6.7	6.7	6.7	6.7											
65	6.6	6.6	6.6	6.6	6.7	6.7	6.7	6.7	6.8	6.8										
66	6.6	6.6	6.6	6.7	6.7	6.7	6.7	6.8	6.8	6.8	6.9									
67	6.6	6.6	6.6	6.7	6.7	6.7	6.8	6.8	6.8	6.8	6.9	6.9								
68	6.6	6.6	6.7	6.7	6.7	6.7	6.8	6.8	6.8	6.9	6.9	6.9	7.0							
69	6.6	6.6	6.7	6.7	6.7	6.8	6.8	6.8	6.9	6.9	6.9	7.0	7.0	7.0						
70	6.6	6.6	6.7	6.7	6.7	6.8	6.8	6.9	6.9	6.9	7.0	7.0	7.0	7.1	7.1					
71	6.6	6.6	6.7	6.7	6.8	6.8	6.8	6.9	6.9	6.9	7.0	7.0	7.1	7.1	7.1	7.2				
72	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	6.9	7.0	7.0	7.1	7.1	7.1	7.2	7.2	7.3			
73	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	6.9	7.0	7.0	7.1	7.1	7.2	7.2	7.3	7.3	7.4		
74	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.0	7.1	7.1	7.2	7.2	7.3	7.3	7.4	7.4	7.5	
75	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.0	7.1	7.1	7.2	7.2	7.3	7.3	7.4	7.5	7.5	7.6
76	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.1	7.2	7.2	7.3	7.3	7.4	7.4	7.5	7.6	7.6
77	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.1	7.2	7.2	7.3	7.4	7.4	7.5	7.6	7.6	7.7
78	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.1	7.2	7.3	7.3	7.4	7.5	7.5	7.6	7.7	7.7
79	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.2	7.3	7.4	7.4	7.5	7.6	7.6	7.7	7.8
80	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.2	7.3	7.4	7.5	7.5	7.6	7.7	7.8	7.9
81	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.3	7.4	7.5	7.6	7.6	7.7	7.8	7.9
82	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.4	7.5	7.6	7.7	7.8	7.9	8.0
83	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.5	7.6	7.7	7.8	7.9	8.0
84	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.6	7.7	7.8	7.9	8.0
85	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	7.9	8.0	8.1
86	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	7.9	8.0	8.1
87	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	7.9	8.0	8.2
88	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.2
89	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.2
90	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.3
91	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.3
92	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.3
93	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.3
94	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.3
95	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.1	7.2	7.3	7.4	7.5	7.6	7.7	7.8	8.0	8.1	8.3

AGE	76	77	78	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95
76	7.7																			
77	7.8	7.8																		
78	7.8	7.9	8.0																	
79	7.9	8.0	8.0	8.1																
80	7.9	8.0	8.1	8.2	8.3															
81	8.0	8.1	8.2	8.3	8.4	8.5														
82	8.1	8.2	8.3	8.4	8.5	8.6	8.7													
83	8.1	8.2	8.3	8.4	8.6	8.7	8.8	8.9												
84	8.2	8.3	8.4	8.5	8.6	8.8	8.9	9.0	9.1											
85	8.2	8.3	8.5	8.6	8.7	8.8	9.0	9.1	9.3	9.4										
86	8.3	8.4	8.5	8.6	8.8	8.9	9.1	9.2	9.4	9.5	9.7									
87	8.3	8.4	8.6	8.7	8.9	9.0	9.2	9.3	9.5	9.7	9.8	10.0								
88	8.3	8.5	8.6	8.8	8.9	9.1	9.3	9.4	9.6	9.8	10.0	10.1	10.3							
89	8.4	8.5	8.7	8.8	9.0	9.2	9.3	9.5	9.7	9.9	10.1	10.3	10.5	10.6						
90	8.4	8.5	8.7	8.9	9.0	9.2	9.4	9.6	9.8	10.0	10.2	10.4	10.6	10.8	11.1					
91	8.4	8.6	8.7	8.9	9.1	9.3	9.5	9.7	9.9	10.1	10.3	10.6	10.8	11.0	11.3	11.5				
92	8.5	8.6	8.8	9.0	9.2	9.3	9.6	9.8	10.0	10.2	10.4	10.7	10.9	11.2	11.5	11.7	12.0			
93	8.5	8.6	8.8	9.0	9.2	9.4	9.6	9.8	10.1	10.3	10.6	10.8	11.1	11.4	11.7	12.0	12.2	12.5		
94	8.5	8.7	8.8	9.0	9.2	9.4	9.7	9.9	10.1	10.4	10.7	10.9	11.2	11.5	11.8	12.1	12.4	12.7	13.0	
95	8.5	8.7	8.9	9.1	9.3	9.5	9.7	10.0	10.2	10.5	10.7	11.0	11.3	11.7	12.0	12.3	12.6	12.9	13.2	13.5

*Applies to all ages 35 and younger.

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