

23rd CONFERENCE  
ON GIFT ANNUITIES

April 14-16, 1998  
Atlanta Marriott Marquis

Sponsored by  
The American Council on Gift Annuities  
70 Years of Service  
to  
America's Charities



Atlanta Convention & Visitors Bureau photo by Kevin C. Rose



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A M E R I C A N

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C O U N C I L   O N

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G I F T   A N N U I T I E S

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70 Years of Service  
To  
America's Charities



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# A M E R I C A N C O U N C I L O N G I F T A N N U I T I E S

70 Years of Service  
To  
America's Charities

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A. Gordon Nelson, Canadian Association  
on Charitable Gift Annuities

James B. Potter, President, Planned  
Giving Resources

### ACTUARY

Michael Mudry, Hay/Huggins Company, Inc.

### COUNSEL

Conrad Teitell, Cummings & Lockwood

### CONFERENCE PROGRAM

#### COMMITTEE

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### CONFERENCE PROMOTION

#### COMMITTEE

Cam Morin Kelly, Chair  
Elaine D'Amours  
Gerry C. Gunnin

### CONFERENCE MANAGER

Beverly Judge

# CONFERENCE AGENDA

## Tuesday, April 14

12 Noon - 6:00 p.m.      **Registration**

6:00 p.m.                      **Opening Dinner and Keynote Address**  
Speaker - Dr. Eugene Tempel

## Wednesday, April 15

8:30 - 10:00 a.m.      **Plenary Session**  
President's Address -- Tal Roberts  
The New Recommended Rates: An Explanation and  
Rationale -- Frank Minton

10:00 - 10:30 a.m.      **Refreshment Break in Exhibit Area**

10:30 - 11:45 a.m.      **Breakout Sessions**  
Bequests and Other Revocable Gifts: Foundations of a  
Planned Giving Program (Ellen Estes)  
Understanding Gift Annuities: Tax Aspects, Administration  
Basics, and Planning Opportunities (Elizabeth Brown)  
Bargain Sales and Retained Life Estates (Bruce Bigelow)  
Donor Relations: Cultivation and Stewardship  
(Shirley Anne Peppers)  
Trust Investments (Alan Korthals)  
Economic Benefits of Gift Plans (Charles Schultz)  
Planned Giving Administration Goes High-Tech for the 21st  
Century (Steve Bone)  
State Regulation of Gift Annuities (Jim Potter,  
Clint Schroeder)  
Gifts of Non-Traditional Assets (Andre' Donikian)  
Case Studies: Application of Gift Planning Principles  
(Jonathan Tidd)  
Planning Strategies Under the 1997 Tax Act  
(Emil Kallina)

12 noon                      **Networking Luncheon and Economic Update**  
Speaker - Dr. Donald Ratajczak

1:30 - 2:45 p.m.      **Breakout Sessions (10:30 a.m. sessions repeated)**



# CONFERENCE AGENDA

- 2:45 - 3:15 p.m. Refreshment Break in Exhibit Area
- 3:15 - 4:30 p.m. Plenary Session  
Panel Discussion: How to Work With Your Legal Counsel - Zoe Hicks, Donna Barwick, Benjamin White, James Hasson
- 4:45 - 5:45 p.m. Optional Session Update on Canada  
(Gord Nelson)

## Thursday, April 16

- 8:30 - 9:45 a.m. Breakout Sessions  
Charitable Remainder Trusts/Pooled Income Funds  
(Winton Smith)  
Marketing Fundamentals (Roger Schoenhals)  
FASB Accounting Standards: Issues Affecting Not-For-Profits (Tim Jones)  
Setting Financial Goals for Planned Giving Programs  
(Marc Carmichael)  
Principled Decision Making in Gift Planning  
(Dr. Albert Anderson)  
Legal Update: Cases and Rulings, Including the Gift Annuity Lawsuit (Terry Simmons)  
Creative Gifts of Real Estate: Real Cases, Real Gifts  
(Paul Harkess)  
Problem Solving with Charitable Gift Annuities  
(David Wheeler Newman)  
Marketing Sophisticated Gift Plans (Laura Hansen Dean)  
Charitable Estate Planning: Legal Framework and Practical Perspectives (Elizabeth Mathieu)
- 9:45 - 10:15 a.m. Refreshment Break in Exhibit Area
- 10:15 - 11:30 a.m. Breakout Sessions (8:30 a.m. sessions repeated)
- 11:45 a.m. - 1:30 p.m. Closing Luncheon  
Speaker - Conrad Teitell

# BREAKOUT SESSIONS

Learning tracks geared to your personal needs

## Track 1 ◆ Fundamentals

- Bequests and Other Revocable Gifts: Foundations of a Planned Giving Program (Ellen Estes)
- Charitable Remainder Trusts/Pooled Income Funds (Winton Smith)
- Understanding Gift Annuities: Tax Aspects, Administration Basics, and Planning Opportunities (Elizabeth Brown)
- Marketing Fundamentals (Roger Schoenhals)
- Bargain Sales and Retained Life Estates (Bruce Bigelow)
- Donor Relations: Cultivation and Stewardship (Shirley Anne Peppers)
- Charitable Estate Planning: Legal Framework and Practical Perspectives (Elizabeth Mathieu)

## Track 2 ◆ Financial, Investment and Administrative Issues

- Trust Investments (Alan Korthals)
- FASB Accounting Standards: Issues Affecting Not-For-Profits (Tim Jones)
- Economic Benefits of Gift Plans (Charles Schultz)
- Setting Financial Goals for Planned Giving Programs (Marc Carmichael)
- Planned Giving Administration Goes High-Tech for the 21st Century (Steve Bone)

## Track 3 ◆ Issues in Gift Planning

- Principled Decision Making in Gift Planning (Albert Anderson)
- Legal Update: Cases and Rulings, Including the Gift Annuity Lawsuit (Terry Simmons)
- State Regulation of Gift Annuities (Jim Potter, Clint Schroeder)
- How to Work With Your Legal Counsel (Zoe Hicks, Donna Barwick Benjamin White, James Hasson) - PLENARY SESSION PANEL DISCUSSION

## Track 4 ◆ Advanced Gift Planning

- Gifts of Non-Traditional Assets (Andre' Donikian)
- Case Studies: Application of Gift Planning Principles (Jonathan Tidd)
- Planning Strategies Under the 1997 Tax Act (Emil Kallina)
- Creative Gifts of Real Estate: Real Cases, Real Gifts (Paul Harkess)
- Problem Solving with Charitable Gift Annuities (David Wheeler Newman)
- Marketing Sophisticated Gift Plans (Laura Hansen Dean)

# CONFERENCE SPEAKERS



Albert Anderson



Donna G. Barwick



Bruce Bigelow

## Albert Anderson

Albert Anderson has over thirty years of experience in teaching, administration, and development in private and public higher education. Prior to his present position as interim President of College of Misericordia (Pennsylvania) he has served as consultant to a broad range of nonprofit and government organizations. Other positions include President of Lenoir Rhyne College (NC), Vice President for Planning/Administration at University of Minnesota Foundation, and Senior Development Officer/Adjunct Professor (ethics and public policy) at the Humphrey Institute of Public Affairs. He holds advanced degrees from Harvard (PhD) and University of Minnesota (MA) and certificates from Institute for Educational Management (Harvard) and The Fund Raising School. He has received various honors and awards, most recently a Dove Fellowship from the Center on Philanthropy; and his published works in the field include an essay in *The Responsibilities of Wealth* and a book, *Ethics for Fundraisers*, both published by Indiana University Press/Center on Philanthropy.

## Donna G. Barwick

Born Atlanta, Georgia 1953. Admitted Georgia 1977. **Education:** The University of Georgia (A.B., Magna Cum Laude 1974) (J.D., Cum Laude 1977); Order of the Coif; Georgia Law Review; Phi Delta Phi; **Member:** American Bar Association, Real Property, Probate and Trust Law Section, Council (1985-1995), Membership Committee Co-Chairman, Chairman 1990-1996), Managing Editor, Section Books and Media Program, Task Force on Legal Financial Planning, Task Force on Professionalism, Articles Editor, *Probate and Property Magazine* (1986-1988), American Bar Association House of Delegates, Post 5 Georgia (1983-1987), Fellows of the American Bar Foundation; State Bar of Georgia, Board of Governors (1991 to date), Young Lawyers Section (1989), Editor, *YLS Newsletter* (1980-1981), Fiduciary Law Section Chairman (1989-1990), Judicial Nominating Commission (1989-1990), Fellows of the Georgia Bar Foundation; American College of Trusts & Estates Council, Practice and Demographics Committees; International Academy of Estate and Trust Law, Atlanta Estate Planning Council; Chairman, C.F.P. Board of Standards (1996-1997); American Arbitration Association Large and Complex Case Panel; Adjunct Professor, Emory University School of Law (1983-1985); Lawyers Club of Atlanta. Frequent lecturer and author of articles on estate planning. **Professional Employment:** Troutman, Sanders, Lockerman & Ashmore (1977-1990); Ernst & Young (1990-1993); Lefkoff, Duncan, Miller, Grimes, Miller & Barwick, P.C. (1993-present). Specializing in Trusts and Estates with an emphasis on Estate Planning.

## Bruce Bigelow

Dr. Bigelow currently serves as the Vice President for Development and College Relations at Hood College in Frederick, Maryland. Prior to coming to Hood in July 1989, Dr. Bigelow served as Associate Vice President for Development at Gettysburg College and prior to that as Director of Major Gifts and Planned Giving, also at Gettysburg. Dr. Bigelow continues to maintain a strong interest and involvement in the planned giving field and served for three years on the Board of Directors of the National Committee on Planned Giving. He has chaired the national task force on planned giving research for NCPG, currently chairs the Committee on International Outreach and is active in the debate on standards of conduct for planned giving professionals. In 1992 he chaired the national NCPG Annual Conference. He is a founding member of the Chesapeake Planned Giving Council in Baltimore and is a member of both the Planned Giving Council of Greater Washington, DC and the CANARAS Group.

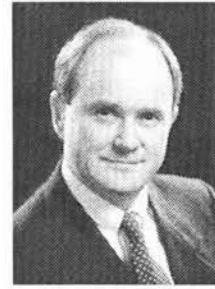
# CONFERENCE SPEAKERS



Steven Bone



Elizabeth A.S. Brown



Marc Carmichael, J.D.

## **Steven R. Bone, J.D., CLU**

Steve Bone, Senior Counsel for Renaissance Inc., has been with the company since 1989. He is a graduate of the Indiana University Schools of Business and Law, having graduated from the former in 1972, with distinction, and the latter in 1976, cum laude. Steve was associated with the Richmond, Indiana law firm of Harlan, Schussler, Keller & Boston for five years where he engaged in the general practice of law with emphasis on insurance defense litigation, commercial law, and tax and estate planning. At Renaissance, Steve created and currently co-manages the company's Custom Charitable Remainder Trust Document Drafting Service. Steve and his staff have drafted over 3300 charitable remainder trusts for attorneys representing donors in all 50 states. He is the author or co-author of many of the technical memoranda published by Renaissance and has been published in *The National Underwriter*, *Trust & Estates*, *The Exempt Organization Tax Review* and *Charitable Gift Planning News*. He works closely with donors' attorneys to help design, draft and implement charitable remainder trust plans.

## **Elizabeth A.S. Brown**

Elizabeth A.S. Brown is an attorney and a C.P.A., and is employed by the Moody Bible Institute of Chicago as Assistant General Counsel, a position she has held for 15 years. She has also served as Vice President and Treasurer and has overseen the tax, investment accounting, and the investment departments at Moody. Her work at Moody involves estate planning and planned giving, real estate, contract and general corporate law. Prior to coming to Moody, she was an associate attorney for McDermott, Will & Emery in Chicago. Mrs. Brown has a B.A. in Math, Summa Cum Laude, from North Park College in Chicago, and a J.D. from the University of Chicago, with honors. She has served on the board of the American Council on Gift Annuities since 1988.

## **Marc Carmichael, J.D.**

Marc Carmichael has been publisher and director of seminars for the Chicago-area R&R Newkirk Company since 1976. R&R Newkirk publishes the *Charitable Giving Tax Service*, a four-volume reference library on planned giving and charitable estate planning, "The Advisor" charitable estate planning newsletter and "The Federal Tax Pocket Guide for Advisors and Planners." His company also provides gift planning training and promotional literature for hundreds of organizations. Marc is a graduate of the Indiana University School of Law and is a member of the Indiana State Bar Association. He serves on the board of directors of the Chicago Planned Giving Council and the board of the National Committee on Planned Giving, of which he is president for 1998. He has spoken at national fundraising conferences, state bar association meetings and the National Conference on Financial Planning. He was chair of the 1996 National Conference on Planned Giving in Chicago.

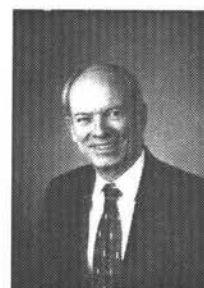
# CONFERENCE SPEAKERS



Laura Hansen Dean



Ellen G. Estes, LL.B.



Paul Harkess

## **Laura Hansen Dean**

Laura Hansen Dean, attorney at law, is an experienced charitable gift planner and consultant with over 18 years experience. Her firm, Laura Hansen Dean and Associates, provides counsel on the design, implementation and evaluation of major and planned giving programs and endowment campaigns for a wide variety of charitable organizations. She served on the board of directors of the National Committee on Planned Giving 1990-92; was president of the Planned Giving Group of Indiana 1995-97; and serves on the editorial review panel for the *Journal of Gift Planning*. She serves as the charitable gift planning consultant to the Lilly Endowment's project for Indiana community foundations and as Senior Legal Counsel and Director of Gift Planning Services for the Central Indiana Community Foundation, Inc.

## **Andre Donikian**

Andre R. Donikian is a member of the New York Bar and president of Pentera, Inc., Indianapolis, Indiana. He has been actively engaged in the planned giving profession since 1969. He is a founder and has served as a member of the board of the Planned Giving Group of Indiana. He currently serves on NCPG's Board of Directors and is a member of the Board of Advisors of Union College.

## **Ellen G. Estes, LL.B.**

Ellen G. Estes, LL.B., a graduate of Yale Law School, started her career as an estate planning and tax attorney. She then became Legal Counsel to the Campaign for Yale, and later served as the first Director of Development of the acclaimed Long Wharf Theatre in Connecticut. Ellen now consults with non-profit organizations nation-wide on major and planned gift matters, and is widely recognized for her no-nonsense, basic seminars, "Planned Giving - Plain and Simple." Ellen is a regular speaker at professional conferences around the country. She also writes the planned giving column for *Contributions*, the bi-monthly newspaper for non-profit professionals.

## **Paul Harkess**

Mr. Harkess is an Individual Giving Officer of Mayo Foundation for Medical Education and Research, responsible for major and planned gifts and for Estate Gifts Promotion. Prior to joining Mayo in July 1996, he served in planned giving and major giving roles for Union College (New York), Harvard Medical School and The Cleveland Clinic Foundation and as Vice President of Prudential Real Estate Gifts. Currently a member of the Minnesota Planned Giving Council, Mr. Harkess has been active in local councils in each location and has been an occasional speaker for planned giving councils, CASE, AHP and the organizations he represents.

# CONFERENCE SPEAKERS



James Hasson, Jr.



Zoe M. Hicks, J.D., LL.M.



Timothy A. Jones

## **James K. Hasson, Jr.**

Jim Hasson, a partner in the law firm of Sutherland, Asbill & Brennan LLP, has obtained broad experience in the tax, reimbursement, financing, contracting and organizational concerns of universities, hospital, physician group practice organizations, foundations, research organizations and other tax-exempt organizations. His experience in these matters has included the continuing representation of several universities, academic medical centers, physician group, hospitals, foundations, and research organizations located throughout the United States. Jim has been a member of the IRS Commissioner's Exempt Organization Advisory Group and is a former Chair of the Committee on Exempt Organizations of the American Bar Association's Tax Section. In addition, he served as a professor of law at Emory University, teaching a course on Exempt Organizations, among others, from 1976 through 1994. He is a graduate of Duke University (B.A., 1967; J.D., *with distinction*, 1970), a frequent speaker on exempt organization issues, and a member of numerous professional organizations which focus on issues of concern to exempt organizations.

## **Zoe M. Hicks, J.D., LL.M.**

Ms. Hicks has worked with clients for twenty-one years in the tax, estate planning and charitable giving areas. She has lectured nationwide on estate planning topics and published articles in many professional journals. She has developed, coordinated and sponsored many seminars to educate clients and their advisors on estate planning and charitable giving techniques. She is a member of the Board of Trustees of the Georgia Federal Tax Conference, a Director of the Atlanta Estate Planning Council, past president of the Georgia Planned Giving Council, and a former Board member of the National Committee on Planned Giving. She is a member of the American College of Trust and Estate Counsel and a founding faculty member of The American Institute for Philanthropic Studies in Long Beach, California. She has recently authored *The Woman's Estate Planning Guide* which will be released this fall by Contemporary Books.

## **Timothy A. Jones**

Tim Jones joined The University of Colorado Foundation in 1989 as Assistant Treasurer and, after moving through various financial positions at the Foundation, was promoted to Senior Vice President for Finance and Administration in 1996. Tim is a Colorado licensed C.P.A. and is a current Board Member of the Colorado Society of C.P.A.s. Tim is also a member of the American Institute of C.P.A.s and the National Association of College and University Business Officers. Tim has been active in Boulder community affairs, serving on a number of non-profit boards. Prior to joining the Foundation, Tim was Assistant Treasurer at The Kansas University Endowment Association. He has also worked in public accounting for Deloitte & Touche. He holds joint B.S. degrees from the University of Kansas in accounting and business administration.

# CONFERENCE SPEAKERS



Emanuel J. Kallina, Esq.



C. Alan Korthals



Elizabeth L. Mathieu

## **Emanuel J. Kallina II, Esq.**

Emanuel ("Emil") Kallina, II attended Bowdoin College (B.A., 1970), the University of Maryland School of Law (J.D., 1973), and then obtained his Masters of Laws in Tax at New York University (1974). Emil focused his early practice on estate and general tax planning for the small business owner, the handling of estates, corporate law and corporate tax, partnership law and partnership tax, and real estate transactions with major shopping center and office building developers throughout the State of Maryland. In 1982 Emil began what is now known as Kallina & Ackerman. Since 1985, in addition to estate and tax planning, Emil has focused his law practice on charitable giving. Emil has developed a national reputation in the charitable giving and planned giving areas, especially in connection with creative uses of charitable gift vehicles such as the charitable remainder trust, the pooled income fund and gift annuity. Currently, he is the Chairman of the Government Relations Committee for the National Committee on Planned Giving. Emil is admitted to practice law in Maryland and Washington, D.C.

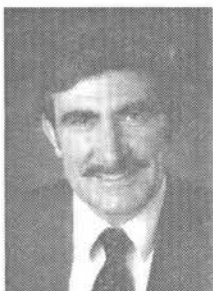
## **C. Alan Korthals**

Mr. Korthals is Director of Client Support at Kaspick & Company, a leading provider of comprehensive investment management and administration services for planned gifts. He directs Kaspick & Company's planned giving program consulting activities, and is responsible for a number of client relationships. Prior to joining Kaspick & Company in 1997, Mr. Korthals was Manager of Gift Services for The First Church of Christ, Scientist. For 11 years he was responsible for overseeing both gift planning and the administration and investment of the Church's substantial and diverse planned giving program. He is an honors graduate of the University of Texas at Austin in Finance and a graduate with high honors from the American Bankers Association's National Graduate Trust School. Mr. Korthals is a past President of the Planned Giving Group of New England.

## **Elizabeth L. Mathieu**

Elizabeth L. Mathieu, Esq. is President and CEO of the Neuberger & Berman Trust Company. She came to Neuberger & Berman, LLC from Chase Manhattan Bank, where she was in charge of Chase's Delaware Trust Division and Philanthropic Advisory Services. Elizabeth speaks extensively around the country to individuals, legal, accounting and planned giving professionals, and charities and their donors. She addresses matters of trust and tax laws and estate and charitable gift planning techniques. She is also a member of the development committees of a number of New York charities. A Certified Trust and Financial Advisor, as well as an Accredited Estate Planner, Elizabeth is a member of the New York, Massachusetts and Rhode Island Bars. Elizabeth received her undergraduate degree from Vassar, her law degree from Suffolk University Law School, and her Masters in International Affairs/Economics from Columbia University. She has worked in 22 countries.

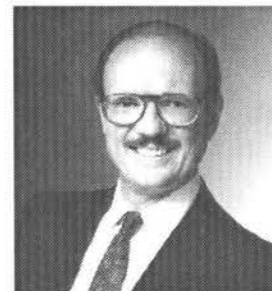
# CONFERENCE SPEAKERS



Frank Minton



Gordon Nelson, C.F.P.



David Wheeler Newman

## **Frank Minton**

Frank Minton (President and Founder of Planned Giving Services) has over twenty years of experience in charitable gift planning at two major universities and since 1991, as a private consultant. He is a past president of the National Committee on Planned Giving and serves on the board of directors of the American Council on Gift Annuities. He is a frequent speaker at seminars, the author of numerous publications and co-author of *Planned Giving for Canadians*.

## **Gordon Nelson, C.F.P.**

Gord Nelson serves in an advisory capacity on the Board of the American Council on Gift Annuities as a representative of Canada. He also currently sits on the Board of our sister organization, the Canadian Association on Charitable Gifts and is a past Board member of the Canadian Association of Gift Planners. He has 18 years of direct experience in the planned giving field, and presently holds the position of Director, Planned Giving for the Christian Blind Mission International. A Certified Financial Planner, Gord is known to be a person who is always willing to share his experience and expertise with other charities and planned giving professionals.

## **David Wheeler Newman**

David Wheeler Newman is a partner with the Los Angeles law firm of Mitchell, Silberberg & Knupp, where he chairs the firm's Charitable Sector Practice Group. For over 17 years, he has represented tax exempt organizations with a special emphasis on charitable gift planning. Mr. Newman represents regional and national charities, including colleges and universities, health care providers and social service agencies. He is a frequent speaker on the tax and legal aspects of planned giving, and has addressed national meetings of the National Society of Fund Raising Executives, the Association for Hospital Philanthropy, and the National Committee for Planned Giving (NCPG). Mr. Newman is Chair-Elect of the Taxation Section of the Los Angeles County Bar. He was a member of the Board of Directors of the National Committee on Planned Giving, where he served for two years on its Executive Committee, and is a member of the American Council on Gift Annuities Task Force on State Regulation of Gift Annuities.

## **Shirley Anne Peppers**

Shirley Peppers has been a professional fund raiser since 1974 when she began her career as an annual fund officer for Stanford University, her alma mater. From 1978 to 1984 she served Harvard University first as a special gifts officer and then as a major gifts officer responsible for identification, cultivation and solicitation of gifts of \$100,000 and up. As Associate Director of University Development for Major and Planned Gifts at UCLA, for seven years beginning in 1984, she coordinated the solicitation of gifts of \$100,000 and up and oversaw the planned giving program. Her current position with Harvard includes responsibility for the direction and coordination of all Faculty of Arts and Sciences fund raising in California, Washington, and Oregon, with concentration on gifts of \$250,000 and above.



# CONFERENCE SPEAKERS



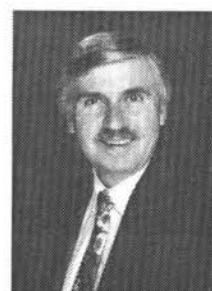
Shirely Anne Pepers



James Potter



Dr. Donald Ratajczak



G. Roger Schoenhals

## **Dr. Donald Ratajczak**

Dr. Donald Ratajczak, a nationally known economist and one of the leading forecasters in the country, directs the Economic Forecasting Center in the College of Business Administration. He is also a Professor of Economics in the School of Policy Studies, and serves on several financial advisory and community boards as well as government committees. Dr. Ratajczak has developed econometric models of the United States and several individual states. From the Economic Forecasting Center, he currently produces seven publications on economic conditions in the nation and in the Southeast. His inflation analysis regularly receives prominent attention in the national media. *The Wall Street Journal* has described Dr. Ratajczak as one of the twenty most widely quoted economists in the world. *Business Week* described Dr. Ratajczak as the most accurate predictor of the 1996 economic climate. On November 9, 1994, Dr. Ratajczak was presented with the Economic forecasting Award for the most accurate U.S. Blue Chip economic forecast during the past four years. He is regularly interviewed on CNN, CNBC, all the major networks and has appeared numerous times on the Today Show, on Night Line, and Good Morning America. He writes a weekly column for the *Atlanta Journal-Constitution* and bi-monthly column for the *CLU Journal*. He obtained his B.A. from Haverford College, and his Ph.D. in economics from M.I.T.

## **Tal Roberts**

Born December 8, 1942 in Shreveport, Louisiana. Tal and wife Nancy have two children, Jennifer and Rebecca attending Baylor and Vanderbilt University respectively. Tal received his BBA from Baylor University in 1964 and his LLB from Baylor in 1966. From 1969 to 1997 he was with the Baptist Foundation of Texas as Executive Vice President and COO, 1980 - 1997. From 1966 to 1969 he was a Special Agent with the Federal Bureau of Investigation. Boards and Professional Affiliations: American Council on Gift Annuities (Chairman). Buckner Retirement Services, Inc. (Board Member), Concord Trust Company (Chairman of the Board and State Bar of Texas (Inactive Status). Church Affiliation: First Baptist Church, Richardson, Texas (Deacon - inactive) and Teacher, International Sunday School Class.

## **James Potter**

Mr. Potter is a planned giving consultant with Planned Giving Resources of Alexandria, Virginia. After 21 years as a planned giving officer for the United Presbyterian Church Foundation and the American Lung Association, Jim Potter went into full time planned giving consulting in 1991. Jim now serves over 60 charities nationwide, helping to develop and administer planned gifts. He serves on the Board of the American Council on Gift Annuities where he presently chairs the State Regulations Committee and is a frequent speaker on charitable gift annuities.

## **G. Roger Schoenhals**

G. Roger Schoenhals of Seattle, Washington, is the publisher and editor of *Planned Giving Today*, a subscription-based, monthly newsletter for gift-planning professionals. Launched in September 1990, the publication has acquired 5,000 readers in 50 states and several Canadian provinces. It is regarded by many as the premier publication in the field of planned giving. In addition to the newsletter, Roger has published several books relating to planned giving. He also provides planned giving consulting services for charitable organizations and professional advisors on a limited basis. Before creating *Planned Giving Today*, Roger served several years as director of Seattle Pacific Foundation and as the chief planned giving officer for Seattle Pacific University. Roger has lived in the Seattle area for 35 years. He and his wife, Sandra, have four children ranging in age from 17 to 26 years.

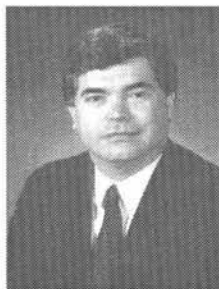
# CONFERENCE SPEAKERS



Clinton A. Schroeder



A. Charles Schultz, J.D.



Terry L. Simmons



Winston C. Smith, Jr., J.D.

## **Clinton A. Schroeder**

Mr. Schroeder is a principal in the law firm of Gray, Plant, Mooty & Mooty & Bennett in Minneapolis. He is former President of the Minnesota State Bar Association and is a Fellow of the American Bar Foundation. He is also a member and Vice Chair of the American Council on Gift Annuities. Mr. Schroeder is a regular lecturer at seminars regarding taxation and charitable gifts sponsored by various non-profit organizations.

## **A. Charles Schultz, J.D.**

Charles Schultz, author of *Crescendo*, is a California attorney who previously was in private practice. He began his work in the field of planned giving with the Lutheran Church - Missouri Synod Foundation in St. Louis. For the past twelve years, he has been President of Comdel, Inc. and is the author of the *Crescendo* Planned Giving Software system. Charles writes, speaks and publishes extensively each year. In addition to publishing the *Crescendo Notes* quarterly newsletter, he is on the editorial advisory board for a monthly newsletter, *Planned Giving Today*. His published articles include "Target Marketing For Planned Giving: in *Fund Raising Management* and "Charitable Options: The Use of an Option Agreement to Facilitate Gifts of Real Estate to Charitable Remainder Trusts," in *Tax Management Estates, Gifts and Trusts* magazine. Charles received his law degree from the University of Michigan, with further tax specialization training at Washington University in St. Louis. He and his wife Ardie have two daughters attending college.

## **Terry L. Simmons**

Terry Simmons practices estate planning, charitable gift planning, general tax and exempt organizations law in the 225-member Dallas based law firm of Thompson & Knight, P.C. He is co-editor and co-publisher of *Charitable Gift Planning News*, a monthly national newsletter for attorneys, accountants, planned giving officers, life underwriters and financial planners covering the planned giving field. He has B.B.A. and J.D. degrees from Baylor University and an LL.M. (Master of Laws in taxation) degree from Southern Methodist University School of Law. Nationally, he is recognized as one of the foremost experts on the law and tax implications of charitable giving. Mr. Simmons was named the "1994 Planned Giving Professional of the Year" by *Planned Giving Today*. Mr. Simmons is a leading advocate for philanthropy in Washington and across the nation with regard to legislative and regulatory issues affecting philanthropy. Recently, as President of *Charitable Accord* Mr. Simmons conceived of and led the successful efforts in Congress to enact the Philanthropy Protection Act of 1995 and the Charitable Gift Annuity Antitrust Relief Act of 1995. In 1996, the NCPG awarded its Distinguished Service Award to Mr. Simmons. In 1997 Mr. Simmons was named "The NonProfit Times" Executive of the Year" by the editors of *The NonProfit Times*.

## **Winton C. Smith, Jr., J.D.**

Winton Smith is a practicing attorney who specializes in estate tax strategies and tax planning, financial development and planned giving for charitable organizations. His background includes 21 years of practical experience in structuring and marketing major gifts. He represents both individual philanthropists and charitable institutions, keeping them informed of the latest tax law changes affecting charitable gifts. He conducts the Council for the Advancement and Support of Education (CASE) Planned Giving Institute in various cities across the country each year. Winton has been a frequent speaker at programs sponsored by the National Committee on Planned Giving (NCPG), the National Society of Fund Raising Executives (NSFRE) and the Association for Healthcare Philanthropy (AHP). He regularly presents charitable tax strategy seminars and workshops for bar associations, estate planning councils, colleges, universities, law schools and hospitals, as well as natural resource and conservation, religious, social welfare and other charitable organizations.

# CONFERENCE SPEAKERS



Conrad Teitell



Eugene R. Tempel



Jonathan G. Tidd



Benjamin T. White

## **Conrad Teitell**

Mr. Teitell is a partner in the Connecticut - and Florida-based law firm of Cummings & Lockwood. He is an adjunct professor at the University of Miami Law School. Mr. Teitell is Director of the Philanthropy Tax Institute and Editor of *Taxwise Giving*. He lectures and writes on taxes, estate planning and philanthropy and is author of the five-volume set *Philanthropy and Taxation*. Mr. Teitell is a recipient of the National Committee on Planned Giving's Distinguished Service Award. He is listed in *The Best Lawyers in America*.

## **Eugene R. Tempel**

In addition to serving as Executive Director of the Indiana University Center on Philanthropy, Gene Tempel also serves as an adjunct associate professor of philanthropic studies and higher education. Associated with the Center on Philanthropy from its beginning, he chaired its organizing committee in 1985-86 and its policy committee from 1987 to 1993. He is a member of the Center's Board of Visitors and its Board of Governors. Dr. Tempel is a nationally recognized expert in the study and practice of philanthropy. He is vice chairman of the National Society of Fund Raising Executives Board and has authored several articles and book chapters. He is co-author with Margaret Duronio of the book, *Fund Raisers; Their Careers, Stories, Concerns and Accomplishments*. Dr. Tempel is also co-editor of the Jossey-Bass publication series *New Directions in Philanthropy Fund Raising*.

## **Jonathan G. Tidd**

Jonathan G. Tidd is an attorney whose practice is limited to charitable gift planning issues. He is a member of the Connecticut, Illinois, Indiana and New York Bars. His clients include a wide range of educational, health care, arts, human rights and social service organizations. His articles on charitable gift planning have appeared in *The Journal of Taxation; Estate Planning; Taxes - The Tax Magazine; Trusts & Estates*; and other professional journals. Formerly, he served as planned giving director for New York University. His office is in West Simsbury, Connecticut.

## **Benjamin T. White**

Benjamin T. White is a partner in the law firm of Alston & Bird in Atlanta, where his practice emphasizes estate and tax planning as well as exempt organizations. He is an honors graduate of the University of North Carolina, and he graduated cum laude from the Harvard Law School in 1973. He is a member of the Section of Real Property, Probate and Trust Law of the American Bar Association and also serves as a member of the Exempt Organizations Committee of the American Bar Association Tax Section. Mr. White is a Fellow of the American College of Trust and Estate Counsel and a member of the faculty of the American Institute for Philanthropic Studies, and has served as Chairman of the Fiduciary Law Section of the State Bar of Georgia and as President of the Harvard Law School Association of Georgia. A member of the Atlanta Tax Forum and former member of the Board of Directors of the Atlanta Estate Planning Council, Mr. White has published and lectured extensively on estate planning, exempt organizations, and other tax and fiduciary subjects. He is profiled in *The Best Lawyers in America*.

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SPECIAL  
PRESENTATIONS



## Chairman's Remarks

### 23rd Conference on Gift Annuities

Atlanta, Georgia

April 15, 1998

Welcome to Atlanta and the 23rd Conference on Gift Annuities. We have come together this week just as development officers and planned giving officers have been coming together for this meeting for over 70 years. The very first Conference on Gift Annuities was held in April of 1927 in New York City. There were 48 people in attendance representing 47 different charitable and professional organizations, the overwhelming majority of which were religious organizations. This week there are almost 800 of us representing over 500 different organizations. We have come from all over the country. We work for colleges, universities, seminaries and academies; hospitals and medical research organizations; churches and missionary societies; homes that care for children and the elderly; world-wide health and relief organizations; organizations that provide opportunities for growth and learning for boys and girls; historical societies; legal aid societies; botanical gardens and biological laboratories; community foundations; organizations that protect and preserve wildlife and the environment; humane societies; adoption agencies; art museums, and more.

If you want to know what's good about this country; if you want to know who is—day in and day out—meeting the needs of the citizens of this country; if you want to know who's providing care to those who can't care for themselves; if you want to know who's educating our young people; if you want to know who's making this world a better place in which to live—physically, mentally, emotionally, spiritually, educationally, environmentally and culturally—just look around you. The people in this hall are part of the finest system of private philanthropy the world has ever known, and we at the American Council on Gift Annuities—we who work for the same kinds of organizations you do—are pleased to welcome you to this conference and are proud to be counted, along with you, among the ranks of planned giving and development professionals.

As you know, unless you've been out of the country for the last three or four years, the American Council, the members of its board, and the organizations those board members work for, have been through a difficult three years since we gathered for the 22nd Conference in San Francisco in May of '95. By way of update, the Ozee lawsuit, filed in December, 1994, is now back before the U.S. Court of Appeals for the Fifth Circuit, having been remanded there by the U.S. Supreme Court on last December 8, for—and I quote—"further consideration in light of the Charitable Donation Antitrust Immunity Act of 1997." We are awaiting the Fifth Circuit's action.<sup>1</sup>

This is the second time the Fifth Circuit has seen this case. In the fall of 1995, Congress passed—and President Clinton signed into law—two pieces of legislation dealing with the Ozee lawsuit: One exempting gift annuities from federal securities laws and the other exempting gift annuities from federal antitrust laws by allowing charities to join together in setting and using gift annuity rates. The securities legislation was immediately successful in defeating that portion of the lawsuit, but the Fifth Circuit, in April of 1997, ruled that because there were a few representatives of for-profit organizations who had attended past conferences where rates were voted on, the court was not willing to dismiss the antitrust claim. Congress responded immediately, and during the last week of June, 1997, passed the Charitable Donation Antitrust Immunity Act of 1997, which made it crystal clear that the antitrust laws of the United States do not apply to charitable gift annuities or charitable remainder trusts. The statute said that **any** person subjected to **any** legal proceeding for damages, injunction, penalties or other relief of **any** kind under the antitrust laws on account of setting or agreeing to annuity rates, or otherwise being involved in the planning, issuance or payment of charitable gift annuities or charitable remainder trusts shall have immunity from suit under the antitrust laws, including the right **not** to bear the cost, burden or risk of discovery and trial for such conduct.

I want to take a few minutes and gratefully acknowledge the help that many of you in this hall—and others not here today—have given us during this period. We didn't have just "a *little* help from our friends," we had a *lot* of help. Help from old friends and friends we didn't even know we had.

Sometimes that help was financial. We have paid huge amounts of money to defend ourselves in the Ozee lawsuit, quickly and completely depleting our treasury. We begged. We borrowed. We never stole, but I was surely tempted a couple of times. Many of you and the organizations you work for stepped in and helped at critical times during the last three years. You know who you are, and we are very grateful to you for your help. One organization that helped in a particularly significant way was the W. K. Kellogg Foundation, which provided the Council with a life-saving grant of \$90,000. The funds were not used for legal defense, but rather they enabled us to carry on the day-to-day activities of the Council, which otherwise we would not have been able to do. To all of you who helped financially, we say, "Thank you."

Sometimes the help was organizational. When Terry Simmons and Charitable Accord got organized and went to work on their legislative agenda; and when you joined forces with them; and when people and organizations from all over this country were sending the message to Washington that something indeed was rotten in the state of Denmark, then we saw the Legislative and Executive Branches of the government respond, with uncommon speed and unanimity, to enact and sign into law—not once, but twice in a little over eighteen months—legislation that sent the message loud and clear: "Stop the Ozee lawsuit!" To all of you who helped in this way, "Thank you."

Sometimes the help was simply a word of encouragement. We are told that the name of the biblical character, Barnabas, means “son of encouragement.” Many of you, over the last now-almost-three-and-a-half years have been sons and daughters of encouragement. I know that I speak not just for myself, but for everyone at the American Council, when I say, “Thank you,” for your calls, your letters, your many expressions of support and encouragement. You kept us going.

And while I’m thanking people, I would surely be remiss if I didn’t acknowledge the time and effort of the men and women who serve on the board of the American Council. (Their names are listed on page one of your conference book.) Men and women who have voluntarily and faithfully served this organization for years. In fact, the twenty people actively involved in the work of the board at this time have an accumulated service to the Council of 260 years. Not included in that number is one former director, Charley Baas, who retired in 1996, after serving for fifty years. As many of you remember, Charley was the long-time treasurer of the American Bible Society and was chairman of this organization from 1959 to 1986. To all of these people, who have labored tirelessly for the cause of philanthropy in this country, I want to say, “Thank you.” And, to the organizations they work for, which, as their thanks for letting their employees serve on this board, were dragged into the Ozee lawsuit and as a result have spent millions of dollars defending themselves—to these fine organizations—I also want to say, “Thank you.”

The American Council has a proud past: A tradition of service to the charitable community in this country dating back to 1927. The Council also has a bright future. We will recover from the financial toll taken by the lawsuit and we will once again be there to serve you and your donors as you assist them in their plans to benefit your institutions while at the same time provide for their own financial needs.

Part of our past has been the generous support of two very special organizations: The American Bible Society, in New York, and The Annuity Board of the Southern Baptist Convention, in Dallas, which, between the two of them, have provided the Council with a home for much of the last fifty years. The Council has always been an all-volunteer organization. We have never had any employees—not a single one—so that all the services we have provided you in the past have been provided by people who had a “real job” doing something else. Prior to the Ozee lawsuit, the Council’s board had begun to discuss ways in which we could become financially able to hire our own staff and have our own “home,” in order to provide you with the level of service that you expected and were entitled to. Obviously, those plans had to be put on hold, but they have never been far from our minds. Last year, we began to address this issue again, and over the course of several months, an idea began to emerge that seemed to make a lot of sense. The more the board explored it, the more we liked it. The idea involved another organization in the planned giving field, the National Committee on Planned Giving. And, when we talked to the leadership of NCPG, they seemed to like the idea also. So, after discussions by and between the two boards, a formal relationship was entered into between the Council and

NCPG whereby, the Council would move its operations to NCPG's offices in Indianapolis, and NCPG, for a contracted amount, would provide day-to-day administrative and operational support to the Council. We have just concluded the first 90 days of this new arrangement, and I, for one, could not be more delighted with the results. I can only hope that Tanya Johnson, Executive Director of NCPG, is as happy with the arrangement as I am. What you can expect out of this working agreement is better service, a larger selection of up-to-date materials, new resource development for your gift annuity programs, and more. As the number of charities offering gift annuities has increased dramatically in the last few years, the job of keeping up with the needs of those charities in this area has become more and more demanding. It is a job that the Council simply could not do in an all-volunteer environment. But, we are back, and you will be hearing from us.

As we move forward, a major focus of the American Council will continue to be these conferences, now held every three years. At this time, I want to take the opportunity to recognize publicly some of the people, without whose effort, this conference would not be a reality today:

- Bob Coffman, Chair, and Betsy Mangone, Vice Chair, of the Conference Program Committee, along with the other members of their committee, Elizabeth Brown, Gerry Gunnin and Frank Minton
- John Jacobs, Chair of the Conference Arrangements Committee, and the other members of his committee, Elaine D'Amours and Art Caccese
- Cam Kelly, Chair of the Conference Promotion Committee, and the others on her committee, Gerry Gunnin and Elaine D'Amours
- Beverly Judge, our Conference Manager, who works harder and smarter than any three people I know
- Kay Ramsey, Staci Tingley and Gloria Kermeen at our new home at NCPG's office in Indianapolis
- And, of course, all of the conference speakers—those who will be making presentations in the breakout sessions, and those in the plenary sessions—a word of gratitude for the work you have done in preparing for this conference.

Yes, the conferences are a major focus for the American Council. Another major part of what the Council does is the publishing of suggested gift annuity rates. I get calls from people every week asking, "Where do the Council's rates come from? How are they arrived at? What are they based on?" Well, in just a moment you're going to be hearing from the man with the answers to those questions—and more—but first, let me remind you of the rate process that the Council adopted a couple of years ago.

Many of you will remember that in years past, proposed gift annuity rates would be presented by the Council to those in attendance at the Conference, and in one of the plenary sessions, a vote on the rates would be taken. In 1996, a task force was appointed to study the Council's process for suggesting rates. The work of that task force resulted in a streamlining of the process, making it even more responsive to charities and their donors. A system has been put in place in which a standing committee of the Council's board is charged with the responsibility of annually reviewing the rates and the assumptions on which they're based. Then, as a result of that review, and in light of current economic and actuarial developments, a recommendation is made to the board as to whether the suggested rates published by the Council should (1) remain the same, (2) be raised, or (3) be lowered. The first implementation of the new procedure occurred in November of 1996, when the board approved, effective March 1, 1997, a new table of suggested gift annuity rates. Those rates, and the assumptions behind them, were published shortly thereafter.

The board has continued to fine-tune the process, and has adopted a plan, whereby at the beginning of every year, the Committee on Rates will update its review and analysis of the current rates, and will present to the board, at its April meeting, a recommendation on rates. If a change is to be made in the rates, new rates will be published as soon after the April meeting as possible, with an effective date of July 1, following. As you will hear in a moment, it is in no way contemplated that the Council's suggested rates will change annually. However, they will be reviewed annually.

Now, I am pleased to introduce to you Council board member and chair of the Committee on Rates, Frank Minton, who will bring the report on rates. On the platform with Frank will be Mike Mudry, the Council's distinguished actuary. Mike is with the Hay Group, the Philadelphia actuarial and consulting firm that has represented the Council for many years.

As Frank is coming, let me tell you again how pleased we are that you are here. We think you will find this conference to be extremely worthwhile and productive, and remember, it's not too early to mark your calendars for the **24th** Conference, which will be in St. Louis on April 4-6, 2001.

Tal Roberts  
Chairman  
American Council on Gift Annuities

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<sup>1</sup> On June 12, 1998, the Fifth Circuit dismissed the plaintiff's antitrust claims against the American Council and all other defendants.









# **NEW GIFT ANNUITY RATES**

**23RD CONFERENCE ON GIFT ANNUITIES**

**April 14 - 16, 1998**

Presented by:

**Frank Minton**

Chair, Gift Annuity Rates Committee  
American Council on Gift Annuities

&

President, Planned Giving Services  
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## I. INTRODUCTION

The Board of the American Council on Gift Annuities (ACGA) has decided to reduce the suggested rates for both immediate and deferred gift annuities, effective July 1, 1998. For most ages the reduction in immediate gift annuity rates is .2 to .3 percent. The credited return during the deferral period of deferred payment gift annuities is lowered by .25 percent.

In arriving at this decision the ACGA considered historical and current returns on equity and fixed income investments, and possible investment portfolios, taking into consideration permitted investments in states that regulate gift annuities. Other relevant factors – the amount of the residuum, mortality tables, and administrative expenses – were also reviewed.

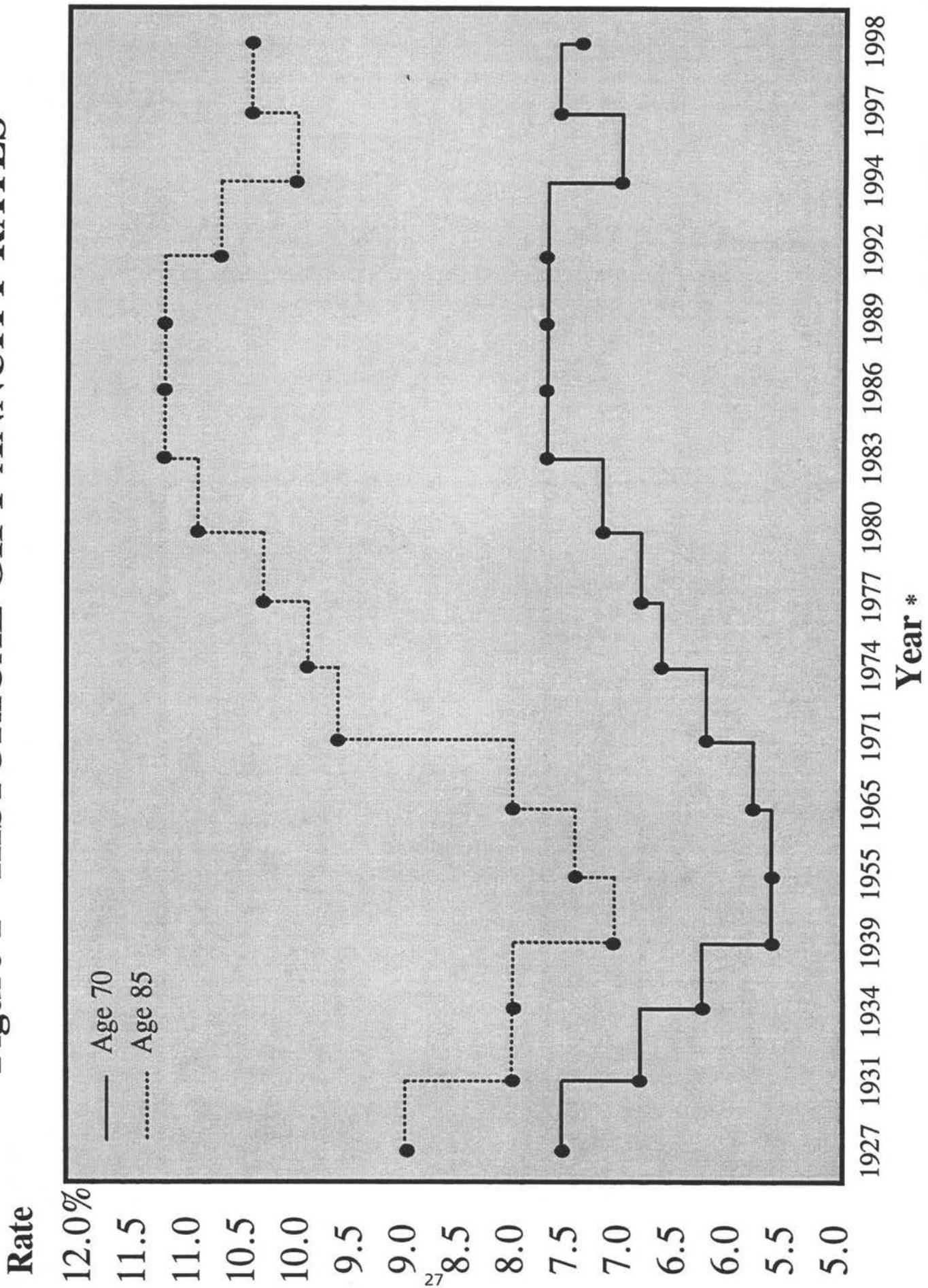
The ACGA decided on a slight reduction of rates even though most respondents to a recent ACGA survey thought the current rates were at the right level. The majority of those who did recommend a change in the rates thought they should be reduced. The reasons for the ACGA action are explained in this paper.

Although the new schedule of rates will become effective just 16 months after the effective date of the current rates, it should not be assumed that the rates will change yearly in the future. They will be reviewed annually, but, out of consideration for charities and vendors that must incur the expense of changing literature and software, the ACGA will adjust the rates only when there are significant changes in financial markets, or when changes in expense and mortality assumptions are deemed necessary. The current adjustment is advisable in order to begin the new procedure with a schedule of rates based on realistic assumptions, taking current and anticipated state regulatory activity into consideration.

## II. HISTORICAL GIFT ANNUITY RATES

Before analyzing the new gift annuity rates, it is illuminating to look at historical rates. As might be expected, they reached their lowest levels during the Great Depression. They remained at low levels through the 1950's due to continuing low interest rates.

# Figure 1 - HISTORICAL GIFT ANNUITY RATES



\* Horizontal lines not to scale.

**Figure 2 – HISTORICAL GIFT ANNUITY RATES**

Age	<u>1927</u>	<u>1931</u>	<u>1934</u>	<u>1939</u>	<u>1955</u>	<u>1965</u>	<u>1971</u>	<u>1974</u>	<u>1977</u>	<u>1980</u>	<u>1983</u>	<u>1986</u>	<u>1989</u>	<u>1992</u>	<u>1994</u>	<u>1997</u>	<u>1998</u>
65	6.8%	6.2%	5.7%	5.1%	5.0%	5.2%	5.6%	6.0%	6.2%	6.6%	7.3%	7.3%	7.3%	7.3%	6.5%	7.2%	7.0%
70	7.6	6.7	6.2	5.5	5.5	5.7	6.2	6.6	6.8	7.1	7.8	7.8	7.8	7.8	6.9	7.7	7.5
75	8.7	7.3	7.0	6.2	6.3	6.5	7.0	7.4	7.7	7.9	8.5	8.5	8.5	8.5	7.7	8.4	8.2
80	9.0	8.0	8.0	7.0	7.4	7.6	8.2	8.5	9.0	9.2	9.6	9.6	9.6	9.6	8.8	9.4	9.2
85	9.0	8.0	8.0	7.0	7.4	8.0	9.7	10.0	10.5	11.2	11.4	11.4	11.4	10.9	10.0	10.5	10.5
90	9.0	8.0	8.0	7.0	7.4	8.0	10.0	10.0	12.0	14.0	14.0	14.0	14.0	12.0	11.0	12.0	12.0

Action was taken on the rates in the above years.

### III. THE NEW ACGA SUGGESTED RATES

A complete schedule of the new rates, including interest factors for calculating suggested maximum deferred gift annuity rates, is attached to this paper. As shown in the charts below, for most ages the new rates are .2 percent lower than the existing rates.

**Figure 3 - COMPARISON OF 1997 AND 1998 RATES**

#### One Life

<u>Age</u>	<u>1997</u>	<u>1998</u>	<u>Change</u>
20	5.7%	5.5%	-.2%
30	6.0	5.8	-.2
40	6.2	6.0	-.2
50	6.5	6.3	-.2
60	6.9	6.7	-.2
70	7.7	7.5	-.2
80	9.4	9.2	-.2
90	12.0	12.0	no change

**Figure 4 - COMPARISON OF 1997 AND 1998 RATES**

#### Two Lives

<u>Age</u>	<u>1997</u>	<u>1998</u>	<u>Change</u>
20/20	5.5%	5.3%	-.2%
30/30	5.8	5.6	-.2
40/40	6.0	5.8	-.2
50/50	6.3	6.1	-.2
60/60	6.6	6.4	-.2
70/70	7.1	6.8	-.3
80/80	8.2	8.0	-.2
90/90	10.8	10.6	-.2
95/95	11.6	11.4	-.2

## Why have one-life rates not been capped at a lower level?

The current rates for older annuitants, even without a further reduction, are below the rates that would follow from the new assumptions.

There is a greater differential between commercial and gift annuity rates for ages above 80 than for ages 60 to 80.

The present value of the residuum in the case of an older donor is higher than the present value of the residuum in the case of a younger donor, as shown below.

### Donor, Age 90

Contribution	\$100,000
Annuity rate	12%
Annual payment	12,000
Residuum (Assuming 6.0% net return and 5.0 year life expectancy)	65,314
Present value of residuum (6.0% discount rate)	48,806

### Donor, Age 65

Contribution	\$100,000
Annuity rate	7.0%
Annual payment	7,000
Residuum (Assuming 6.0% net return and 20.0 year life expectancy)	61,822
Present value of residuum (6.0% discount rate)	19,276

The present value of the gift by the older annuitant will be higher even if the annual return and discount rate are higher. Assume, for example, that both the return and discount rate are 9.0 percent.

### Donor, Age 90

Residuum	\$81,316
Present value	52,850

### Donor, Age 65

Residuum	\$209,559
Present value	37,392



## IV. ASSUMPTIONS UNDERLYING CURRENT AND NEW ACGA SUGGESTED RATES

**Figure 5 – ASSUMPTIONS FOR IMMEDIATE ANNUITIES**

**1997 Rates**

1. 50% Residuum
2. Life Expectancies:  
Annuity 2000 Tables  
Based on female ages with  
one-year setback  
Projections for increased  
life expectancies
3. Semi-Annual Payments, End of Period
4. Annual Expenses - .75%
5. Total Annual Return - 7.0%
6. Some rate adjustment for younger  
and older ages

**1998 Rates**

1. 50% Residuum
2. Life Expectancies:  
Annuity 2000 Tables  
Based on female ages with  
one-year setback  
Projections for increased  
life expectancies
3. Semi-Annual Payments, End of Period
4. Annual Expenses - .75%
5. Total Annual Return - 6.75%
6. Some rate adjustment for younger  
and older ages, except lesser  
adjustment at older ages

**Figure 6 – ASSUMPTIONS FOR DEFERRED ANNUITIES**

**1997 Rates**

1. Total Return Credited During  
Deferral Period - 6.75%.
2. Annual Expenses - .75%
3. Net Total Return Credited During  
Deferral Period - 6.0%.

**1998 Rates**

1. Total Return Credited During  
Deferral Period - 6.50%.
2. Annual Expenses - .75%
3. Net Total Return Credited During  
Deferral Period - 5.75%.

## **V. RATIONALE FOR ASSUMPTIONS**

### **A. 50 Percent Residuum**

1. It assures a significant benefit to the charity.
2. Since 1939 the residuum has been 50 percent. Prior to 1939 it was 70 percent.
3. Most charities favor a 50 percent residuum.

Per the 1994 ACGA survey:

78.8 percent said the residuum should remain at 50 percent.

17.7 percent said it should be higher.

3.5 percent said it should be lower.

### **B. Life Expectancies**

1. Rates are based on most recent mortality tables.
2. The practice, first begun in 1931, of basing life expectancies on female ages has been continued.
3. Following another historical practice, ages are set back one year.
4. Starting in 1997, projected increases in life expectancies during the life of the contract have been taken into consideration.

The practices described in (2) and (3) are followed because of the belief that life expectancies of annuitants of gift annuities may be longer than life expectancies of annuitants in general.

### **C. Expenses**

1. Seventy-five basis points may be too low for charities that outsource gift annuity administration, and for charities that operate in regulated states.
2. Seventy-five basis points may be too high for charities that manage gift annuities internally and don't operate in regulated states.
3. But it seems an appropriate average for all charities.

(In the 1997 ACGA Survey, 80.0 percent of respondents thought it was about right.)

#### **D. Total Annual Return Immediate Annuities**

The 6.75 percent total return for immediate annuities is based on a portfolio of:

- 20 percent equities,
- 70 percent bonds,
- 10 percent cash,

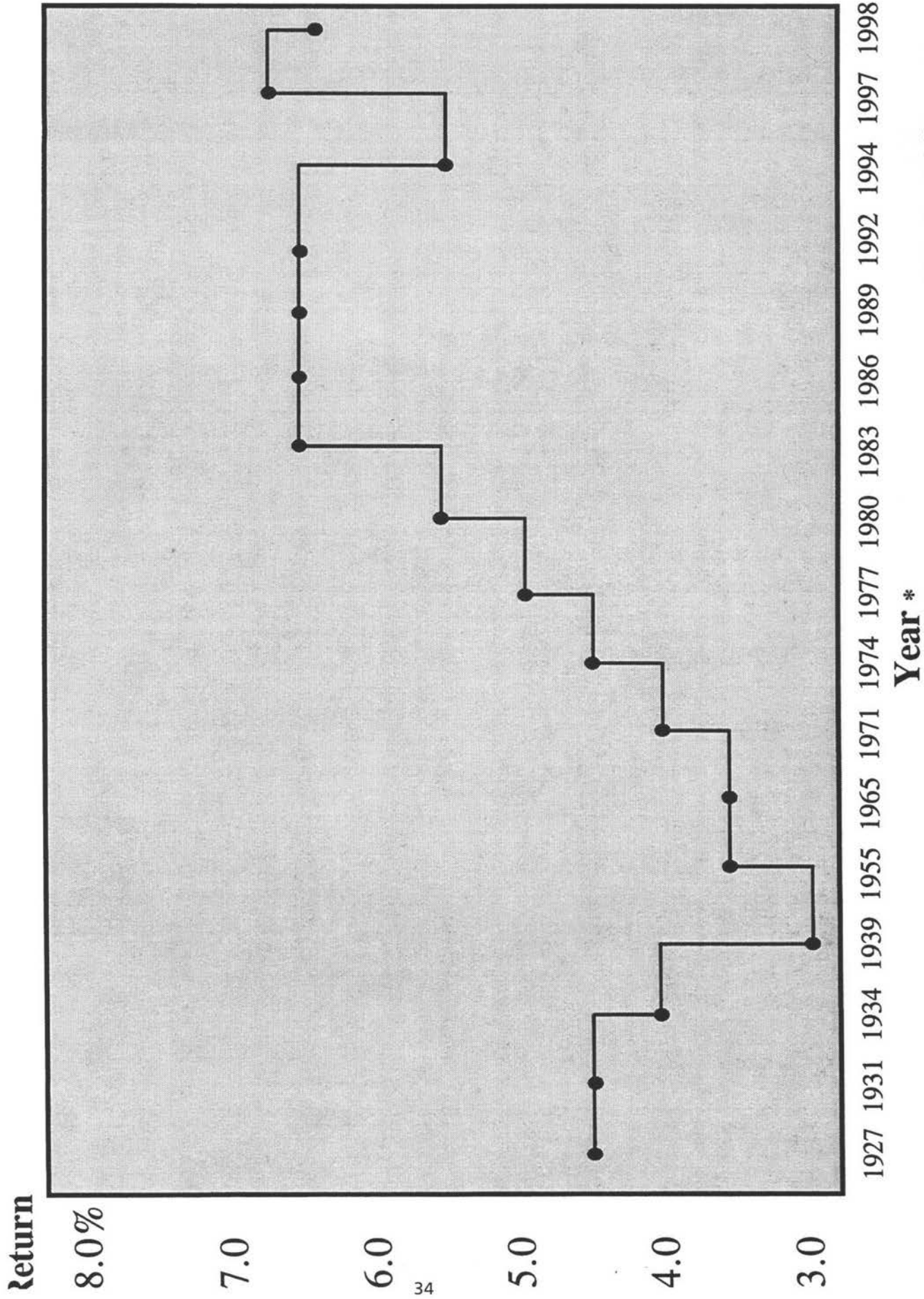
using 70-year average returns for equities, and current returns for long-term government bonds and cash.

The graph in Figure 7 shows the assumed total returns beginning with the formation of the Committee on Gift Annuities (the predecessor of the ACGA) in 1927. Assumed returns reached their lowest point, not during the Great Depression, but in the 1950's. They remained at 6.5 percent from the early 1980's to 1993, when interest rates dropped precipitously. In response to falling interest rates, the ACGA Board, meeting in a special session in October of 1993, reduced the earnings assumption from 6.5 to 5.5 percent, and consequently reduced the rates rather significantly. These lower rates became effective January 1, 1994 and remained in effect until March 1, 1997.

Interestingly, the gift annuity rates in 1927 were nearly as high as now, even though the assumed total return in 1927 was only 4.5 percent. Very likely, the rates were at a relatively high level because of shorter life expectancies.

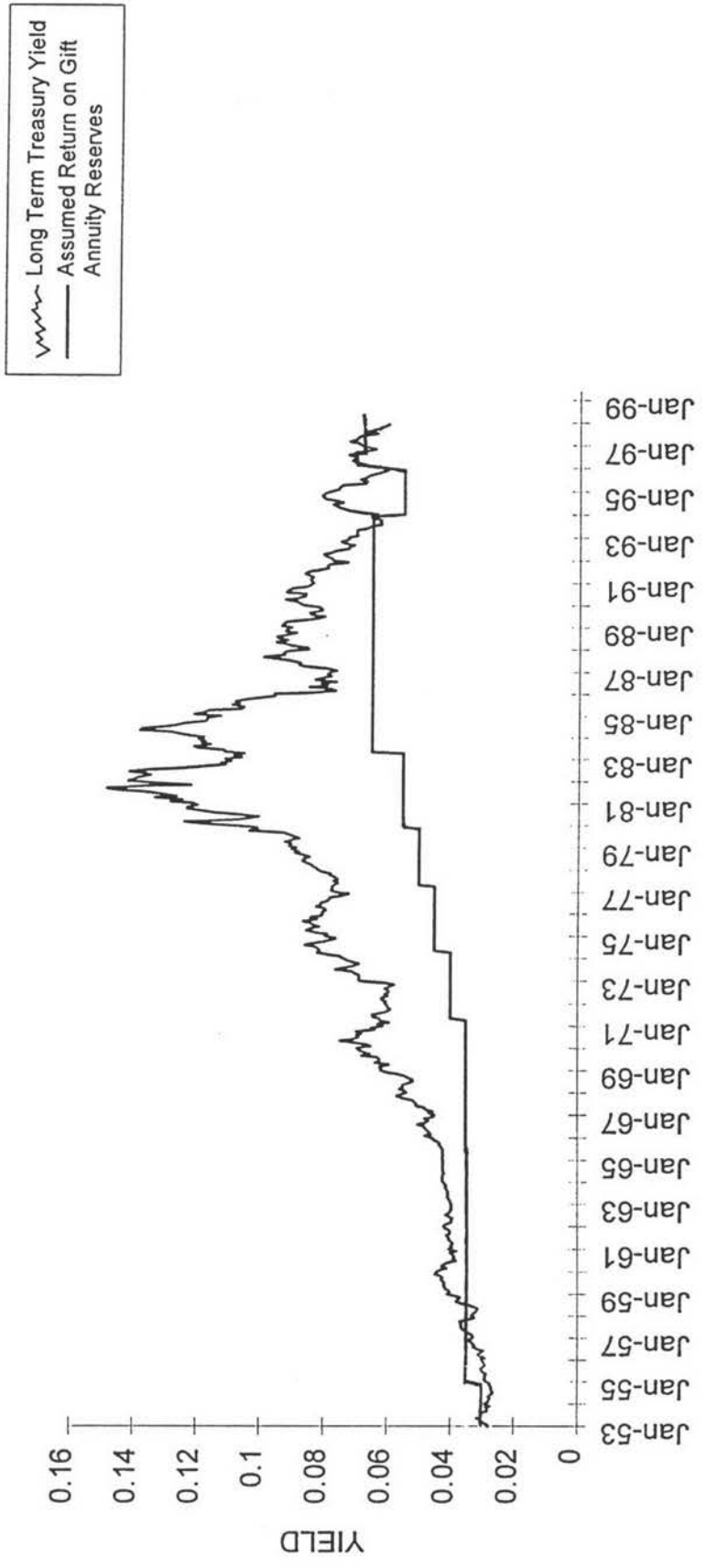
In the past, the long-term Treasury yield was something of a benchmark in determining the assumed return of gift annuity reserves. However, the assumed returns on these reserves only changed every few years, and they were almost always below the Treasury yields – well below during periods when Treasury yields reached quite high levels (See Figure 8.). Now the benchmark for the return on gift annuity reserves is the return on a certain portfolio that includes equities, bonds, and cash.

**Figure 7 - HISTORICAL ASSUMED TOTAL RETURNS**



\* Horizontal lines not to scale

**Figure 8**  
**LONG TERM TREASURY BOND YIELD AND**  
**ASSUMED RETURNS ON GIFT ANNUITY RESERVES**  
**1953 TO PRESENT**



Prepared by Delmar R. Mohler, CPA with data from Ibbotson

### Figure 9 – HISTORICAL ASSUMED TOTAL RETURNS

1927	4.5%	
1931	4.5	
1934	4.0	
1939	3.0	
1955	3.5	
1965	3.5	
1971	4.0	
1974	4.5	
1977	5.0	
1980	5.5	
1983	6.5	
1986	6.5	
1989	6.5	
1992	6.5	
1994	5.5	
1997	7.0	(6.25% net of expenses) (6.65% adjusted)
1998	6.75	(6.0% net of expenses) (6.41% adjusted)

Prior to 1997, the charity was assumed to set aside 5 percent of the contribution for expenses and invest the remaining 95 percent at the assumed rate of return. The 5 percent was effectively a front-end load. Beginning in 1997, expenses were assumed to be 75 basis points per year rather than 5 percent of the contribution.

If the former way of allowing for expenses had been continued in 1997 and 1998, the assumed total returns for those years would have been 6.65 percent and 6.41 percent, respectively.

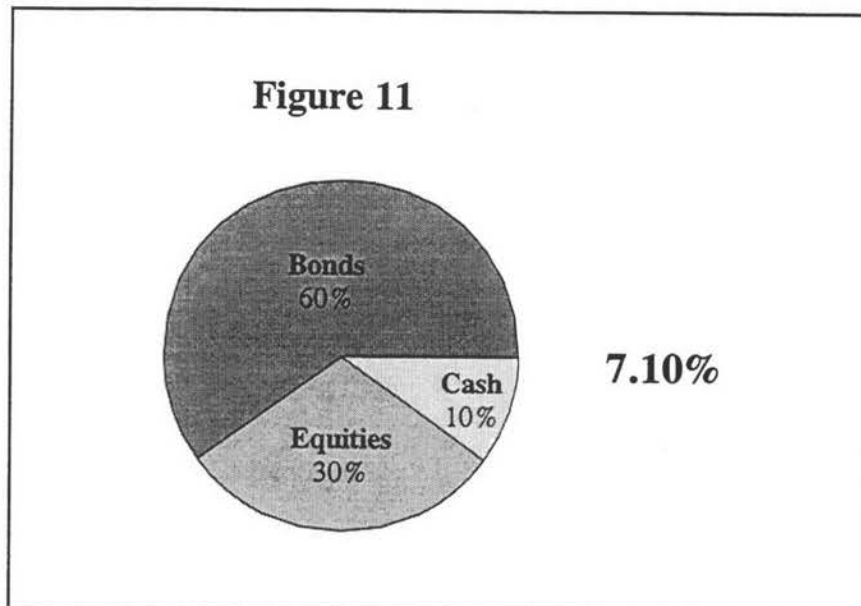
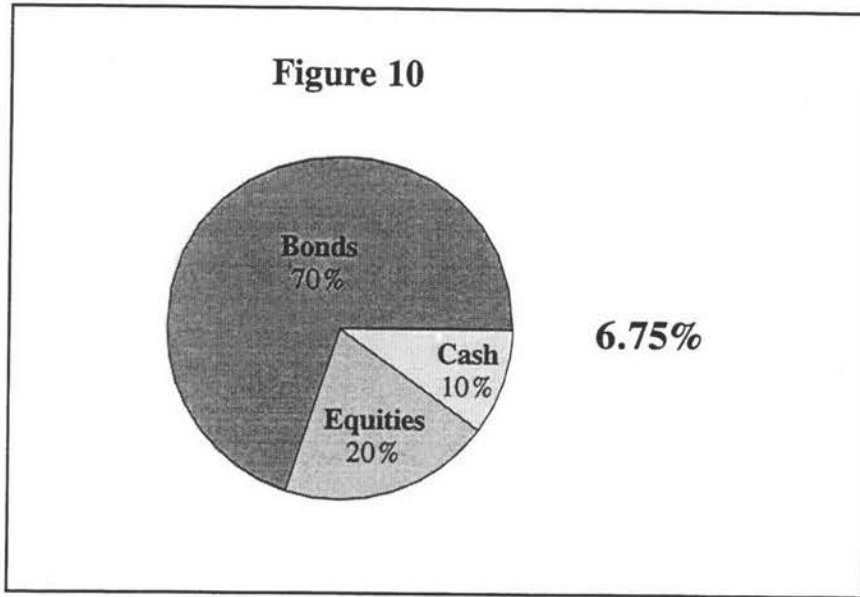
#### **E. Total Annual Return Deferred Annuities**

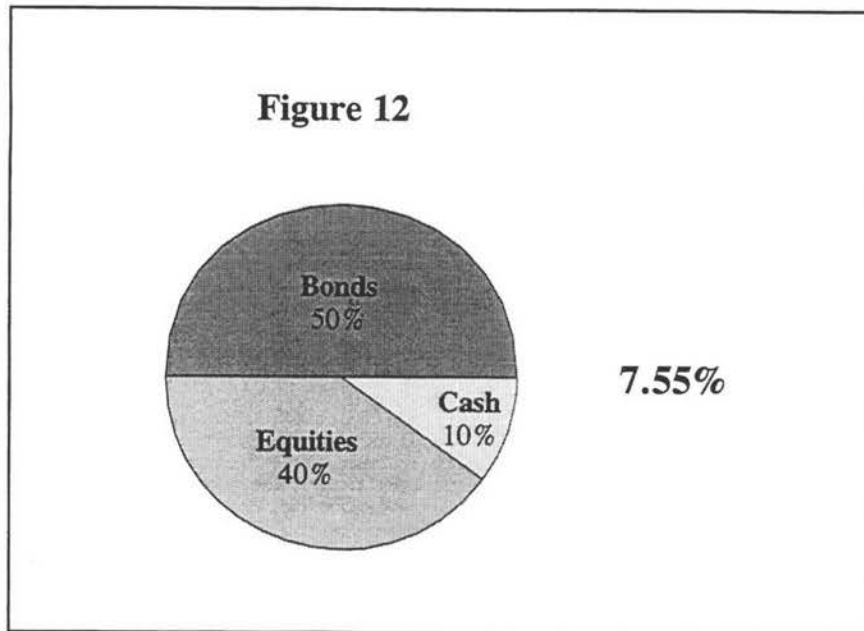
Historically, the total return credited on deferred annuities prior to the start of annuity payments has been lower than the total return assumed for immediate gift annuities. That is because of the greater uncertainty about yields in the more distant future.

The assumed return during the deferral period is 6.50 percent, which is .25 percent lower than the assumed return on immediate annuities. The differential is the same as for the 1997 rates.

## F. Returns on Various Portfolios

Based on 70-year average stock returns, and current long-term government bond and cash interest rates, here are the returns of various portfolios (rounded to nearest .05 percent):





**G. How Do Charities Actually Invest Gift Annuity Reserves?**

- Per the 1994 ACGA Survey, the average portfolio mix for all charities was 40 percent equities, 50 percent bonds, and 10 percent cash.
- Charities that operate in non-regulated states probably invest a significant percentage in equities, and in recent years their total returns have greatly exceeded the return on which the ACGA rates are based.
- However, charities that operate in certain regulated states are severely restricted in the amount of equity investments. New York and California, for example, permit no more than 10 percent of required reserves to be in equities.
- The assumed portfolio is possible for charities operating in regulated states and realistic for charities with conservative investment philosophies.

**H. Strategy for Charities Operating in Certain Regulated States**

***DON'T** keep all gift annuity assets in the segregated reserve fund.*



If you do, and you operate in a state like New York or California, your portfolio will look like this:

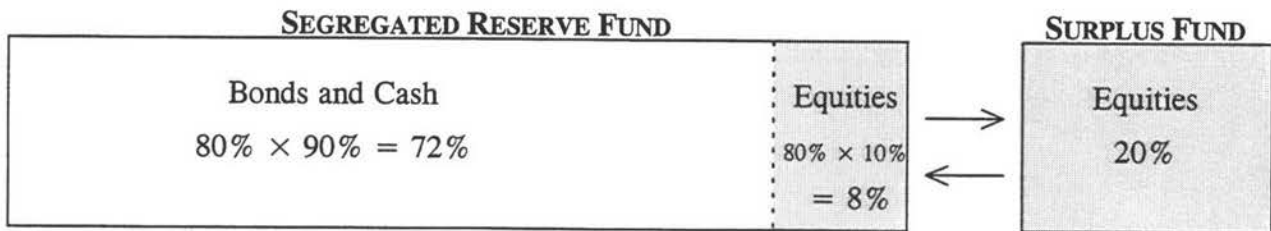
**Figure 13 - ALL GIFT ANNUITY ASSETS IN SEGREGATED FUND**

REQUIRED RESERVE FUND	
Bonds and Cash 90%	Equities 10%

*DO maintain the required amount in the segregated reserve fund and invest the surplus in an equity account.*

Then your portfolio may look like this:

**Figure 14 - SURPLUS GIFT ANNUITY ASSETS INVESTED OUTSIDE SEGREGATED FUND**



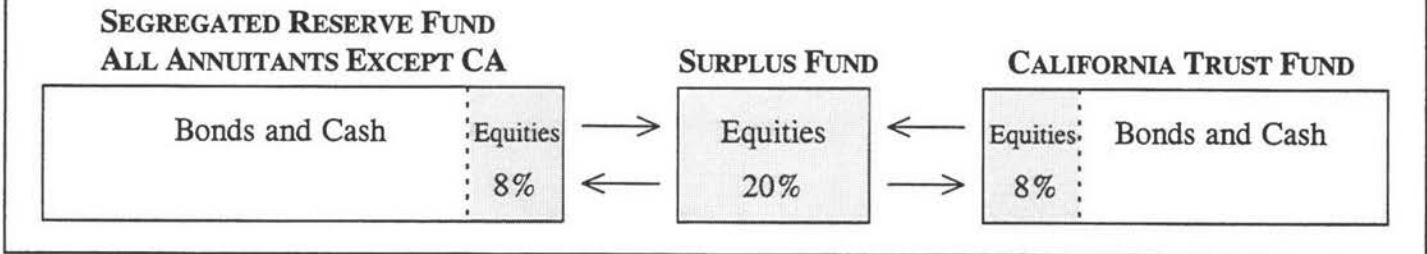
**Total Bonds and Cash - 72%**

**Total Equities - 28%**

*If you operate in California, you will have to maintain a separate trust fund for California annuitants.*

**Figure 15 – SURPLUS GIFT ANNUITY ASSETS  
INVESTED OUTSIDE SEGREGATED FUND**

**Charity Operates in California  
and Other Regulated States**



**I. What Percentage of Gift Annuity Contributions Must Be Kept in the Segregated Reserve Fund?**

**70 – 90 percent, Depending on**

- Gift annuity rates
- Interest rate and mortality tables prescribed by state for calculating reserve requirements
- Excess reserves required by state (10 percent is common)

**J. Attainable Portfolio**

For charities operating in certain regulated states and following the recommended strategy, a portfolio consisting of:

- 20 percent equities**
- 70 percent bonds**
- 10 percent cash**

should always be attainable.

That is why this particular portfolio was selected.

## **K. Charities Affected by State Investment Restrictions**

- All charities domiciled in Arkansas, California, Florida, New Jersey, New York, and Wisconsin.
- All charities, wherever domiciled, that issue annuities in the above states. (Florida permits a charity to invest per the rules of the state where it is domiciled).
- Charities either domiciled in, or issuing annuities in, other states that may in the future adopt regulatory statutes limiting certain types of investments.

## **L. What's on the Horizon?**

The National Association of Insurance Commissioners (NAIC) charged its Annuities Working Group with the responsibility of drafting a model act regulating gift annuities. They completed this work and referred the draft to the "A Committee" (the NAIC committee responsible for life insurance and annuities) in March. Then it was referred to the NAIC Executive Committee at its meeting in Boston on June 22, 1998.

Meanwhile, the charitable community contacted Therese Vaughan, chair of the A Committee, plus other members of the executive committee, and recommended the following action:

1. Amend the model regulatory act to (a) provide for a uniform way of calculating required reserves so that different actuarial reports would not be required for different states, and (b) allow for reserves to be invested per a prudent investor standard rather than in accordance with the restrictive rules applicable to domestic insurers.
2. Circulate to the states not only the model regulatory act but also a simplified regulatory act, such as many states have adopted. We have sometimes referred to this as a "model exemption statute," but it is more accurately described as simplified or streamlined regulation, for it would impose certain requirements, such as the charity's having to have been in existence a minimum number of years, have a minimum amount of assets, file a notice with the state, and include certain disclosure language in each gift annuity agreement. Still, it would be much easier for charities to comply with these requirements than with the full-blown regulatory requirements of states such as New York and California.

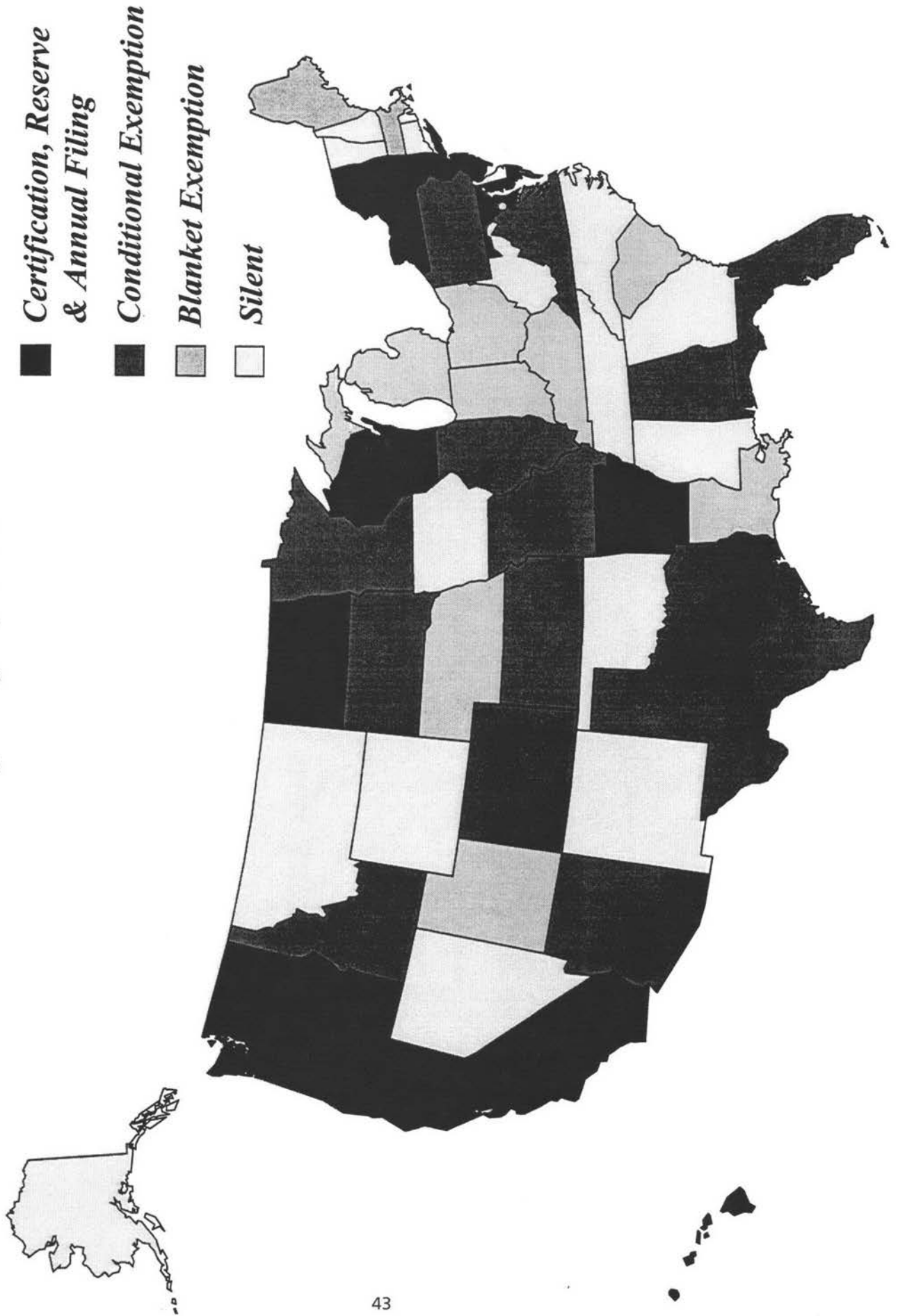
The Executive Committee referred the model regulatory act back to the A Committee with instructions to address certain issues including calculation of required reserves. It also instructed the A Committee to consider drafting a simplified regulatory act that could be presented to the states as an alternative to more full-blown regulation.

Ms. Vaughan will reconstitute the Annuities Working Group, which will consider these two items and present their drafts and recommendations to the A Committee. Then the A Committee will take action and submit their recommendations once again to the NAIC Executive Committee. It is unlikely that the matter will be ready for consideration by the Executive Committee before March of next year.

In the meantime the charitable community can continue to be part of the process and make their views known. From the beginning the NAIC, through the Annuities Working Group, and then through the A Committee and the Executive Committee, have been willing to listen to the concerns of the charitable community and cooperate with it. Given this spirit of cooperation there is now an opportunity to work with the NAIC towards regulations that protect annuitants without being unduly burdensome and expensive to charities.

# STATES BY REGULATORY CATEGORIES

as of July 1, 1998



# STATE REGULATORY CATEGORIES

## Charitable Gift Annuities

July 1, 1998

### I. STATE LAW REQUIRES CERTIFICATION, RESERVE AND ANNUAL FILING (10):

AR CA HI MD NJ NY OR WA WI

State	Years in operation	Board resolutn.	Disclos. in agrmt.	Reserve required	Annual filing	Investment limitations	Notes:
CA	10	yes	---	yes <sup>1</sup>	yes	strict <sup>1</sup>	<sup>1</sup> CA annuitants only
NY	10	yes	---	yes	yes	strict <sup>2</sup>	<sup>2</sup> Rules apply to reserves for all states
NJ	10	yes	---	yes	yes	strict <sup>2</sup>	<sup>2</sup> Rules apply to reserves for all states
AR	5	yes	---	yes	yes	less strict <sup>2</sup>	<sup>2</sup> Rules apply to reserves for all states
WI	10	---	---	yes	yes	less strict <sup>2</sup>	<sup>2</sup> Rules apply to reserves for all states
HI	10 in HI	---	---	yes	yes	---	Law requires \$5 million assets in Hawaii (proposed 1998 legislative change did not pass)
MD	10 in MD	---	yes	yes	yes	---	
ND	---	---	---	yes	yes <sup>3</sup>	---	<sup>3</sup> Submission of audited financial statements
OR	20 in OR <sup>4</sup>	---	yes	yes	yes	---	<sup>4</sup> Certain types of charities
WA	3	---	---	yes	yes	---	Requires \$500,000 of unrestricted net assets

### II. STATE LAW PROVIDES FOR CONDITIONAL EXEMPTION\* (13):

AL AZ CO FL ID IL KS MN MO ND PA SD TX VA

State	Years in operation	Board resolutn.	Disclos. in agrmt.	Reserve required	Notice to state	Avail. Assets	Notes:
AL	---	---	yes	---	yes	---	Exemption granted by Securities Dept.
AZ	---	---	yes	---	---	---	
CO	3	---	yes	---	---	---	
FL	5	---	yes	yes	yes	---	Investment limitations in some cases
ID	3	---	yes	---	yes	\$100k	
IL	20 <sup>5</sup>	---	---	---	---	\$2 mil. <sup>5</sup>	<sup>5</sup> Waived if annuities reinsured
KS	---	---	---	---	yes	---	Exemption granted by Securities Dept.
MN	3	---	---	---	yes	\$300k	Exemption granted by Securities Dept.
MO	3	---	yes	---	yes	\$100k	
PA	3	---	yes	yes	---	\$100k	Must comply with PA char. solicit. law
SD	5	---	yes	---	---	---	Exemption applies to SD charities only
TX	3	---	yes	---	yes	\$100k	
VA	3	---	yes	---	---	\$100k	

\*Conditional exemption is sometimes referred to as simplified regulation.

### III. STATE LAW GRANTS BLANKET EXEMPTION (10):

IN KY LA MA ME<sup>6</sup> MI<sup>7</sup> NE<sup>6</sup> OH<sup>7,8</sup> SC<sup>6</sup> UT

<sup>6</sup> Years in operation: Maine - 5; Nebraska - 3; South Carolina - 5

<sup>7</sup> Exemptions are administrative rather than statutory.

<sup>8</sup> Agreement must be signed by charity as well as by donor.

### IV. STATE LAW DOES NOT SPECIFICALLY ADDRESS GIFT ANNUITIES (18):

AK CT DE D.C. GA<sup>9</sup> IA<sup>10</sup> MS MT NV NH NM NC OK RI TN VT WV WY

<sup>9</sup> Even though gift annuities are not specifically mentioned in the statute, they are believed to be regarded as securities, for which a limited exemption may be available.

<sup>10</sup> Exemption previously granted by Securities Bureau, under now rescinded administrative rule.

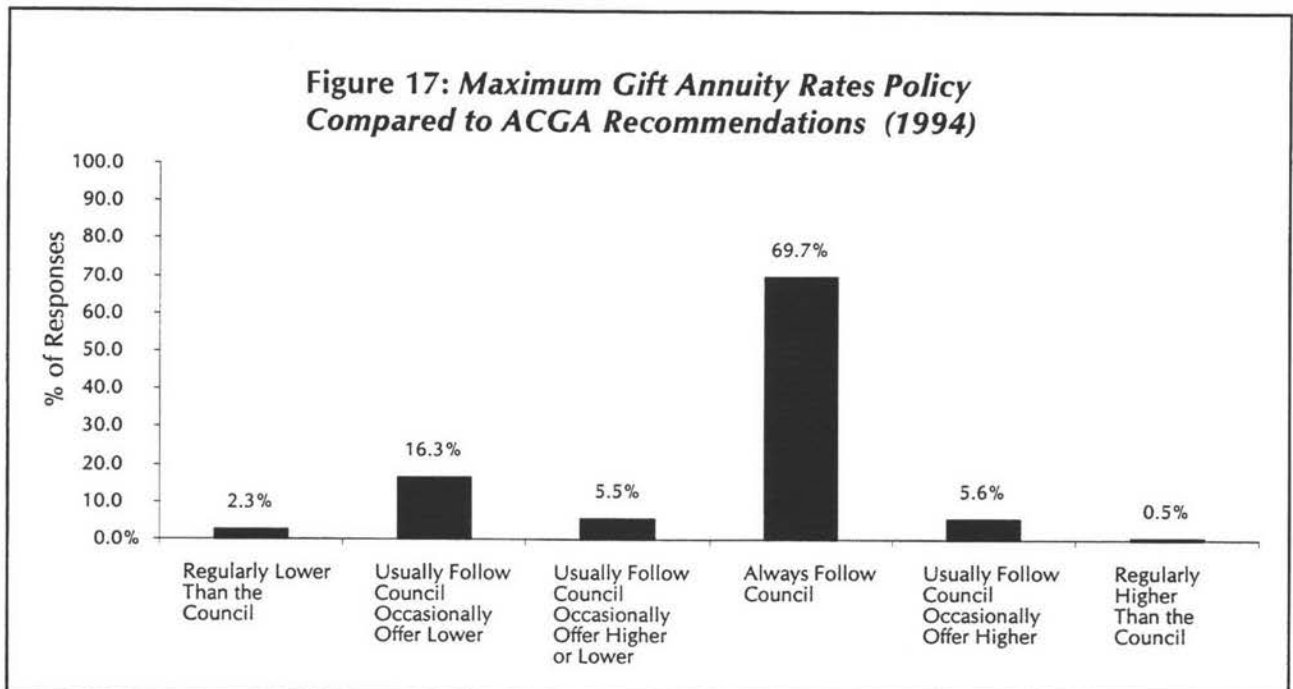
## M. Other Reasons for Reducing Gift Annuity Rates

Gift annuity rates will remain below commercial rates and will not be perceived as competing with them.

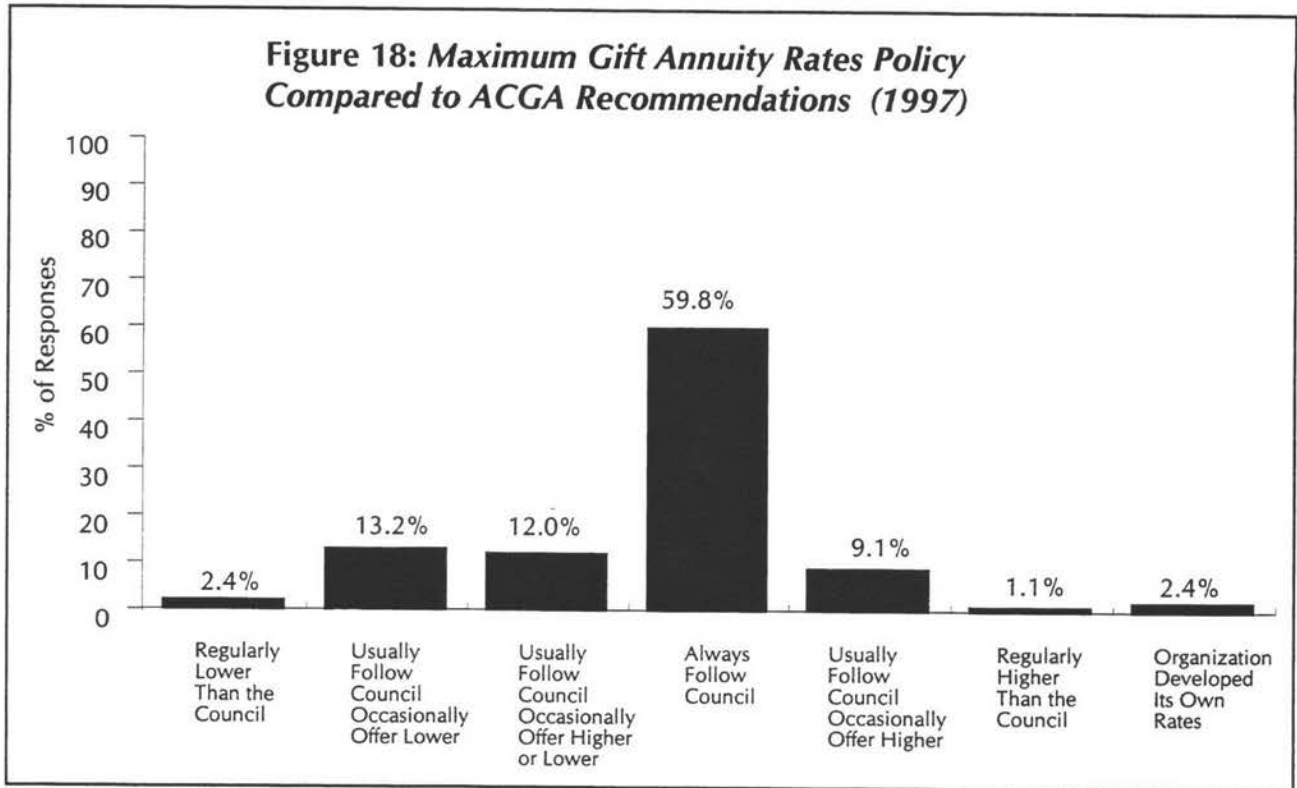
Deferred gift annuity rates will be acceptable in New York and New Jersey for at least a 20-year deferral period, based on current interest assumptions of those states. (Questions have been raised in those states as to whether current deferred gift annuity rates meet state requirements for longer deferral periods.)

## VI. PERCENTAGE OF CHARITIES THAT FOLLOW ACGA SUGGESTED RATES

In 1994 the ACGA conducted a survey in which it sought to discover, among other things, how many charities were following the ACGA rates and how many were choosing to offer different rates, whether higher or lower. A similar question was asked in another ACGA survey conducted at the end of 1997.



**Figure 18: Maximum Gift Annuity Rates Policy Compared to ACGA Recommendations (1997)**



### Are Charities at Risk if They Follow the ACGA Suggested Rates?

As shown in the tables below, the risk is quite minimal. In projecting a total net return, the organization should factor in all administrative expenses, including the cost of state filings and reports. The total returns shown in the chart are net of expenses.

#### Analysis of Risk (Immediate Annuities)

<u>Age of annuitant(s)</u>	<u>Annuity rate</u> <sup>(1)</sup>	<u>Life expectancy</u> <sup>(2)</sup>	<u>Number of years to exhaust fund at:</u>		
			<u>5.0% return</u>	<u>6.0% return</u>	<u>7.0% return</u>
65	7.0%	20.0	25.21	32.67	∞
65,65	6.6	25.0	28.52	40.26	∞
70	7.5	16.0	22.11	27.02	39.02
70,70	6.8	20.6	26.75	35.93	∞
75	8.2	12.5	18.94	22.09	27.69
75,75	7.3	16.5	23.24	28.97	∞



<u>Age of annuitant(s)</u>	<u>Annuity rate</u> <sup>(1)</sup>	<u>Life expectancy</u> <sup>(2)</sup>	<u>Number of years to exhaust fund at:</u>		
			<u>5.0% return</u>	<u>6.0% return</u>	<u>7.0% return</u>
80	9.2%	9.5	15.78	17.73	20.62
80,80	8.0	12.8	19.74	23.27	29.97
85	10.5	6.9	13.01	14.23	15.83
85,85	9.0	9.6	16.32	18.45	21.67
90	12.0	5.0	10.85	11.64	12.62
90,90	10.6	7.0	12.84	14.02	15.56

(1) Assumes quarterly payments, end of quarter.

(2) These life expectancies are the average of male and female expectancies, based on the 1983 IRS Tables. The life expectancies would be longer if they were based on the Annuity 2000 tables used for computing gift annuity rates.

### Observations

1. If the charity achieves a total net return of only 5.0 percent on annuity assets, an annuitant (or two annuitants) would have to exceed life expectancy by five to six years before the charity would lose money on a particular annuity.
2. If the charity achieves a total net return of 6.0 percent on annuity assets, an annuitant (or two annuitants) would have to live to age 97, and in most cases exceed age 100, before the charity would lose money on a particular annuity.
3. If the charity achieves a total net return of 7.0 percent on annuity assets, an annuitant would have to live to well over 100 before the charity would lose money.

## VII. CONCLUSION

The ACGA periodically publishes a schedule of suggested maximum gift annuity rates as an actuarial service to the charitable community. Charities are, of course, free to develop their own schedule of rates. Those that elect to follow the ACGA rates can do so with the knowledge that the rates are based on carefully-considered and realistic assumptions, with the objective of enabling philanthropic individuals to make a gift to a favorite charity while providing life payments for themselves and/or other persons.

A schedule of the new ACGA rates is attached.

# **SUGGESTED CHARITABLE GIFT ANNUITY RATES**

**APPROVED BY THE AMERICAN COUNCIL ON GIFT ANNUITIES,  
APRIL 14, 1998  
EFFECTIVE JULY 1, 1998**

## SINGLE LIFE

<u>Age</u>	<u>Rate</u>	<u>Age</u>	<u>Rate</u>
20 and under	5.5%	56	6.5%
21	5.6	57	6.6
22	5.6	58	6.6
23	5.6	59	6.6
24	5.6	60	6.7
25	5.7	61	6.7
26	5.7	62	6.8
27	5.7	63	6.9
28	5.7	64	6.9
29	5.8	65	7.0
30	5.8	66	7.1
31	5.8	67	7.2
32	5.8	68	7.3
33	5.9	69	7.4
34	5.9	70	7.5
35	5.9	71	7.6
36	5.9	72	7.7
37	6.0	73	7.8
38	6.0	74	8.0
39	6.0	75	8.2
40	6.0	76	8.3
41	6.1	77	8.5
42	6.1	78	8.7
43	6.1	79	9.0
44	6.1	80	9.2
45	6.2	81	9.4
46	6.2	82	9.6
47	6.2	83	9.9
48	6.3	84	10.2
49	6.3	85	10.5
50	6.3	86	10.8
51	6.3	87	11.1
52	6.4	88	11.4
53	6.4	89	11.7
54	6.4	90 and over	12.0
55	6.5		

## TWO LIVES – JOINT AND SURVIVOR

<u>Younger Age</u>	<u>Older Ages</u>	<u>Rate</u>	<u>Younger Age</u>	<u>Older Ages</u>	<u>Rate</u>
20 and under	All*	5.3	56	56+	6.3
21	21+	5.4	57	57-63	6.3
22	22+	5.4	57	64+	6.4
23	23+	5.4	58	58-61	6.3
24	24+	5.4	58	62+	6.4
25	25+	5.5	59	59-60	6.3
26	26+	5.5	59	61+	6.4
27	27+	5.5	60	60-65	6.4
28	28+	5.5	60	66+	6.5
29	29+	5.6	61	61-64	6.4
30	30+	5.6	61	65+	6.5
31	31+	5.6	62	62-63	6.4
32	32+	5.6	62	64-68	6.5
33	33+	5.7	62	69+	6.6
34	34+	5.7	63	63-67	6.5
35	35+	5.7	63	68-72	6.6
36	36+	5.7	63	73+	6.7
37	37+	5.8	64	64-65	6.5
38	38+	5.8	64	66-70	6.6
39	39+	5.8	64	71+	6.7
40	40+	5.8	65	65-69	6.6
41	41+	5.9	65	70-73	6.7
42	42+	5.9	65	74+	6.8
43	43+	5.9	66	66-67	6.6
44	44+	5.9	66	68-71	6.7
45	45+	6.0	66	72-76	6.8
46	46+	6.0	66	77+	6.9
47	47+	6.0	67	67-70	6.7
48	48+	6.1	67	71-74	6.8
49	49+	6.1	67	75-78	6.9
50	50+	6.1	67	79+	7.0
51	51+	6.1	68	68-69	6.7
52	52+	6.2	68	70-72	6.8
53	53+	6.2	68	73-76	6.9
54	54+	6.2	68	77-80	7.0
55	55-57	6.2	68	81+	7.1
55	58+	6.3	69	69-71	6.8
			69	72-74	6.9

<u>Younger Age</u>	<u>Older Ages</u>	<u>Rate</u>	<u>Younger Age</u>	<u>Older Ages</u>	<u>Rate</u>
69	75-77	7.0	76	76	7.4
69	78-82	7.1	76	77-78	7.5
69	83+	7.2	76	79-80	7.6
70	70	6.8	76	81-82	7.7
70	71-72	6.9	76	83-84	7.8
70	73-75	7.0	76	85-86	7.9
70	76-79	7.1	76	87-89	8.0
70	80-83	7.2	76	90+	8.1
70	84+	7.3	77	77	7.5
71	71	6.9	77	78	7.6
71	72-74	7.0	77	79-80	7.7
71	75-77	7.1	77	81-82	7.8
71	78-80	7.2	77	83-84	7.9
71	81-84	7.3	77	85-86	8.0
71	85+	7.4	77	87-88	8.1
72	72-73	7.0	77	89-91	8.2
72	74-75	7.1	77	92+	8.3
72	76-78	7.2	78	78-79	7.7
72	79-81	7.3	78	80	7.8
72	82-84	7.4	78	81-82	7.9
72	85+	7.5	78	83	8.0
73	73-74	7.1	78	84-85	8.1
73	75-76	7.2	78	86-87	8.2
73	77-79	7.3	78	88-89	8.3
73	80-81	7.4	78	90-92	8.4
73	82-84	7.5	78	93+	8.5
73	85+	7.6	79	79	7.8
74	74-75	7.2	79	80	7.9
74	76-77	7.3	79	81-82	8.0
74	78-79	7.4	79	83	8.1
74	80-81	7.5	79	84-85	8.2
74	82-84	7.6	79	86	8.3
74	85-87	7.7	79	87-88	8.4
74	88+	7.8	79	89-90	8.5
75	75-76	7.3	79	91-93	8.6
75	77-78	7.4	79	94+	8.7
75	79-80	7.5	80	80-81	8.0
75	81-82	7.6	80	82	8.1
75	83-84	7.7	80	83	8.2
75	85-87	7.8	80	84	8.3
75	88-90	7.9	80	85-86	8.4
75	91+	8.0	80	87	8.5

<u>Younger Age</u>	<u>Older Ages</u>	<u>Rate</u>	<u>Younger Age</u>	<u>Older Ages</u>	<u>Rate</u>
80	88-89	8.6	84	89	9.3
80	90-91	8.7	84	90	9.4
80	92-93	8.8	84	91	9.5
80	94+	8.9	84	92	9.6
81	81	8.1	84	93-94	9.7
81	82	8.2	84	95+	9.8
81	83	8.3	85	85	9.0
81	84	8.4	85	86	9.1
81	85	8.5	85	87	9.3
81	86	8.6	85	88	9.4
81	87-88	8.7	85	89	9.5
81	89	8.8	85	90	9.6
81	90-91	8.9	85	91	9.7
81	92-93	9.0	85	92	9.8
81	94+	9.1	85	93	9.9
82	82	8.3	85	94	10.0
82	83	8.4	85	95+	10.1
82	84	8.5	86	86	9.3
82	85	8.6	86	87	9.4
82	86	8.7	86	88	9.5
82	87	8.8	86	89	9.7
82	88	8.9	86	90	9.8
82	89-90	9.0	86	91	9.9
82	91	9.1	86	92	10.0
82	92-93	9.2	86	93	10.1
82	94+	9.3	86	94	10.2
83	83	8.5	86	95+	10.3
83	84	8.6	87	87	9.6
83	85	8.8	87	88	9.7
83	86	8.9	87	89	9.9
83	87-88	9.0	87	90	10.0
83	89	9.1	87	91	10.1
83	90	9.2	87	92	10.3
83	91	9.3	87	93	10.4
83	92-93	9.4	87	94	10.5
83	94	9.5	87	95+	10.6
83	95+	9.6	88	88	9.9
84	84	8.8	88	89	10.0
84	85	8.9	88	90	10.2
84	86	9.0	88	91	10.3
84	87	9.1	88	92	10.5
84	88	9.2	88	93	10.6

<b>Younger</b> <b><u>Age</u></b>	<b>Older</b> <b><u>Ages</u></b>	<b><u>Rate</u></b>
88	94	10.7
88	95+	10.9
89	89	10.2
89	90	10.4
89	91	10.6
89	92	10.7
89	93	10.9
89	94	11.0
89	95+	11.1
90	90	10.6
90	91	10.8
90	92	10.9
90	93	11.1
90	94	11.3
90	95+	11.4
91	91	10.8
91	92	10.9
91	93	11.1
91	94	11.3
91	95+	11.4
92	92	10.9
92	93	11.1
92	94	11.3
92	95+	11.4
93	93	11.1
93	94	11.3
93	95+	11.4
94	94	11.3
94	95+	11.4
95 and over	All*	11.4

\* Rate applies for all older ages when younger age is as shown.

**UNIFORM INTEREST FACTORS FOR CALCULATING  
SUGGESTED MAXIMUM DEFERRED GIFT ANNUITY RATES**

<u>At Least</u>	<u>Years of Deferral* But Less Than</u>	<u>Interest Factor** at 5.75% Per Annum, Compounded Annually</u>
0	1	1.000
1	2	1.058
2	3	1.118
3	4	1.183
4	5	1.251
5	6	1.323
6	7	1.399
7	8	1.479
8	9	1.564
9	10	1.654
10	11	1.749
11	12	1.850
12	13	1.956
13	14	2.068
14	15	2.187
15	16	2.313
16	17	2.446
17	18	2.587
18	19	2.736
19	20	2.893***
20	21	3.059***
21	22	3.235***
22	23	3.421***
23	24	3.618***
24	25	3.826***
25	26	4.046***
26	27	4.278***
27	28	4.524***
28	29	4.785***
29	30	5.060***
30	31	5.351***
31	32	5.658***
32	33	5.984***
33	34	6.328***
34	35	6.692***
35	36	7.076***
36	37	7.483***
37	38	7.914***
38	39	8.369***
39	40	8.850***



- \* Number of years is from the date of issue of the agreement to the annuity starting date. Annuity starting date is assumed to be the date six months before the first deferred annuity payment is scheduled to be made.
- \*\* WARNING: The resulting annuity rates should not be used if the gift portion using applicable IRS tables is not more than 10% of the amount paid for the annuity.
- \*\*\* It may be necessary to reduce this factor at some ages in some states, such as New York, in order for the resulting deferred annuity rate to comply with applicable state law.



SPEAKER

PAPERS



# UPDATE ON CANADA

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## PART I

### A BRIEF HISTORY OF THE GROWTH OF PLANNED GIVING IN CANADA

## PART II

### PLANNED GIVING INSTRUMENTS IN CANADA AND THEIR TAX IMPLICATIONS

- (1) *Gift Annuities (Self-Insured)*
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(2) *Gift/Plus Annuities (Reinsured)*

(a) The Agreement

(b) Tax Implications

(3) *Life Insurance Policies*

(a) The Methods

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(4) *Charitable Remainder Trusts*

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(b) Tax Implications

- (5) *Strip Bonds*
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PART III

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- (1) *Influences for Change*
  
  
  
  
  
  
  
  
  
  
- (2) *Income Tax Bulletin 111R2*

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(1) *Americans Giving to Canadian Charities*

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(4) *U.S. - Canada Tax Convention*

PART V

RATES OF  
GIFT ANNUITIES AND GIFT/PLUS ANNUITIES  
IN CANADA

*History and Method of Change:*

*Current Rates Being Used:*







## BEQUESTS AND OTHER REVOCABLE GIFTS

### What Are They?

Revocable gifts – gifts that a donor arranges now, but can take back later, if necessary, include:

Bequests – gifts under a person's will

Revocable Living Trusts – revocable trusts established during a person's lifetime

Beneficiary designations under life insurance contracts

Beneficiary designations under IRA's and qualified retirement plans

Interest-free loans – repayable on demand

“Temporary” charitable gifts – Charitable Lead Trusts

The Totten Trust – available in some jurisdictions

### Why Are Revocable Gifts Attractive?

#### A. To the Donor –

1. Changing demographics: People are living longer, healthier, more active lives. They need to keep resources for their own use and enjoyment – and make sure that they do not outlive their resources. Because of these factors, the only way that many people can make a major gift to charity is to make a gift that is revocable.
2. The baby boomers have special problems and concerns. As a group they married later in life, started families later than their parents did, will be paying education expenses at a much older age, are concerned about possible illness or disability, are concerned about the financial security and well being of their parents, and have a need to save for their own retirement – as well as a desire to maintain their comfortable lifestyle. The combination of these factors understandably gives many baby boomers pause when they think about parting with assets irrevocably during lifetime. Therefore, revocable gifts may be the only viable option for them.
3. Entrepreneurs – individuals with energy, talent, creativity and ideas who are starting businesses now that may evolve into successful enterprises later – cannot part with assets irrevocably at this stage. These folks will be more receptive to an approach that allows flexibility and revocability now, with the expectation that an irrevocable major gift may come later when the business succeeds.
4. Some donors have expressed concerns about how charities will use and manage their money. These folks may be willing to make a revocable gift now and “wait and see” how the charity uses it before making an irrevocable commitment.
5. Potential tax reform: If the tax proposals that would reduce or eliminate the income tax charitable deduction become law, there will be no tax incentive for making irrevocable major gifts during lifetime, and many donors may choose to postpone their gifts. Also, many professional advisers may advise clients against making outright irrevocable major lifetime gifts, recommending that their clients “keep control” of their assets longer.

#### B. To Your Organization –

1. The changes in the lifestyle and attitudes on the part of donors will mean that these folks will have a different approach to charitable giving than their parents had. The challenge for charitable

organizations will be to alter our fund raising focus somewhat. We need to be sensitive to donor concerns, focus on the different needs and goals of our donors, start building relationships with donors, and think creatively about the kinds of gifts that they will be willing and able to make. This approach leads to promoting revocable gifts.

2. Talking about revocable gifts is an easy, non-threatening way to open discussions with donors – especially donors who express some of the concerns outlined above. The discussion begins a relationship that can build over time and can lead to irrevocable major gifts later on.

3. We used to talk in terms of a giving continuum: starting with annual gifts, through major gifts, and then to the ultimate gift – often by bequest. This progression is still true in many cases, but there is also another way of looking at the situation: Talking with your donors about bequests now can serve as the beginning of the continuum – talking first about revocable gifts, and then progressing to irrevocable gifts later on.

#### How to Get Them? (Marketing Opportunities)

- A. Effective communication and information about what you are doing and how your constituents can support your mission continues to be critical. You can communicate with your donors and prospects in a variety of ways: through personal solicitations, direct mail, testimonials in your newsletter or magazine, information in your annual report, etc. The important thing is to keep information flowing.
- B. Some issues to keep in mind:
  - 1. The Taxpayer Relief Act of 1997 made changes in the tax law which, among other things, increased the amount of an estate that will be exempt from the federal estate tax. The new law can provide an excellent reason to talk with your donors about the need to review their estate plans – in light of the new law. This also provides a golden opportunity to encourage them to include your organization in their plans.
  - 2. Personal visits provide an opportunity to listen to your donors and find out about their interests, concerns, and goals. These visits can help build long-term relationships that may start with revocable gifts but evolve into irrevocable gifts later.
  - 3. All outreach materials (newsletters, magazines, annual report, etc.) can be used as vehicles to keep your donors informed about your important work and suggest non-threatening ways that they can give their support.
  - 4. Mailings to targeted prospects about bequests one time, about revocable trusts another time, then about other gift options, can start the education process and get your constituents thinking about supporting you now in non-threatening ways.
  - 5. Seminars can be used to educate donors about the importance of estate planning, to inform them about the important things your organization is doing, and to plant seeds about ways that they may be able to support your efforts.
  - 6. A recognition society can often be a great way to recognize, thank, and cultivate donors who have included your organization in their estate plans: through intended bequests, life insurance gifts, gifts of retirement plan assets, irrevocable life income gifts, etc. The society can also serve as a marketing tool to inspire others to make these kinds of gifts.

#### More Details About the Different Revocable Gift Opportunities

##### Bequests

- A. What they are and what they do:

1. Technically, a bequest is a gift under a person's Will. A will may be revised or revoked at any time, so long as the testator (maker of the will) is competent to do so. An individual can name one or more charities as beneficiaries under his or her will.

2. A will should be drafted by an attorney experienced in estate planning. In order to be valid, a will must be executed in accordance with the formalities prescribed by state law (usually requiring witnesses, etc.)

3. If a person dies intestate (without a Will) the laws of that person's home state will determine who gets his or her assets. That statutory distribution may have no relationship whatsoever to that person's wishes, desires, or plans. Therefore, it is important for everyone to have a Will. And, you will be doing your constituents a service to remind them about the importance of Wills, whether or not you are named as a beneficiary.

B. Charitable Bequests can take several forms:

1. *Outright* - an unconditional outright gift. (For example, "I give and bequeath \$25,000 to the ABC charity, located at 123 Main Street, Anywhere, USA, to be used for its general purposes.")

2. *Residuary* - A gift of all or a portion of the residuary estate (the assets that remain after specific bequests to others, taxes, etc. have been paid.) (For example, "All the rest, residue and remainder of my estate I give as follows: 1/2 to my wife, Alma, and 1/2 to the XYZ School, located in Learningsville, PA., to be used for scholarship purposes.")

3. *Contingent* - A bequest that will come to your organization only if a contingency occurs. (For example, "I give \$10,000 to my niece, Laurey, but if Laurey predeceases me, I give that amount to the Get Well Hospital Foundation, located in Feel Good, CT, to be used for its joint replacement unit.")

4. *Bequest to Endow the donor's Annual Gift* - A donor can make a large bequest and direct the charity to invest the gift as part of its endowment, and credit the income each year to the annual fund in the donor's name. If the bequest amount is at least 20 times the donor's annual gift, and if the endowment earns at least 5% annually, this bequest will generate an amount equal to the donor's regular annual gift each year. The bequest, will, in effect, "endow" the donor's annual gift, and make it live on --- in perpetuity.

5. *Bequest of a Remainder Interest* - A donor can set up a Charitable Remainder Trust or make a gift to a Pooled Income Fund by Will, providing income to a named individual for life, remainder to your organization.

6. *Bequest of an Income Interest* - A donor can set up a Charitable Lead Trust by Will, providing income to your organization for a specified period of time, with the remainder to family members. This approach provides income to charity as soon as the trust becomes effective, and can substantially reduce estate taxes on assets going to family members later.

7. *Bequests in conjunction with lifetime gifts* - For example, a donor can set up a Charitable Remainder Trust during her lifetime, the remainder of which is to be used to fund a professorship upon her death. The balance of the professorship can be funded through a bequest in the donor's Will. Both gifts will become effective at the same time --- and fully fund the professorship upon the donor's death.

C. Key Features. Bequests are -

1. Easy to understand. Most people are familiar with the concept of Wills.

2. Easy to promote. You can use simple materials and talk with prospects of any age about any kind of assets and any form of gift.

3. Not affected by changes in the economy. People do estate planning even in difficult economic times, to preserve and protect themselves and their families now, and in the future.
4. Non-threatening. Donors do not have to part with anything during lifetime.
5. Inexpensive for your organization to promote. There are minimal pre-transfer stewardship and management costs. However, make sure to continue to cultivate and communicate with all donors who tell you that they have included your organization in their estate plans.
6. Often the largest gift an individual can make - *the ultimate gift*.

#### D. Benefits for the Donor

1. Most personal form of charitable giving. During the estate planning process the donor has time to reflect on what is important and meaningful, and can consider ways to preserve and protect what is important for the family and for favorite charities.
2. Charitable bequests enjoy unlimited Federal estate tax deductibility. No percentage limits as under the income tax.
3. The donor can bequeath any asset to any charity. No "related vs. unrelated" issues to deal with.
4. A Will preserves confidentiality. No one need know what is in a Will during the donor's lifetime.
5. A Will provides simplicity. There are no complicated tax rules to apply.
6. Minimal cost to the donor. Putting in bequests to favorite charities is just one element of the estate planning process, and does not add much to the overall cost of making a Will.
7. Can provide contingency protection. If a family member predeceases the donor, that person's bequest can go to a favorite charity or charities.
8. Revocable. The donor has the comfort of knowing that he or she can always change the Will if circumstances should change.

#### E. Benefits to your Organization

1. Bequests are easy to understand and easy to promote.
2. Starting a bequest program will enable you to begin a long-term cultivation of your donors and prospects that will lead to larger (and often irrevocable) gifts later on.
3. Getting bequests in the pipeline NOW will ultimately provide an on-going source of funding to endow your organization's future.

#### Revocable Living Trusts

##### A. What they are and what they do:

1. Revocable living trusts are trusts that are set up during a person's lifetime that can be revised or revoked at any time, so long as the grantor (maker of the trust) is competent to do so. A living trust can be a complement to a will in an estate plan. A living trust usually provides income to the grantor (and another person, if appropriate) for life, after which the trust ends, and trust assets go to beneficiaries (individuals and/or charitable organizations) named by the grantor in the trust agreement. The assets transferred under the trust agreement do not have to go through probate.



2. An individual can set up a charitable remainder trust that is revocable. The trust would pay income to a donor (and another person, if appropriate) for life. The donor can retain the right to receive all of the trust's net income, to invade principal, and to terminate the trust at any time. After the lifetime of the income beneficiary(ies), if the trust has not been revoked, the trust assets will go to the charity or charities named in the trust agreement.

#### B. Key Features of a Revocable Charitable Remainder Trust

1. The income beneficiary(ies) can receive all (or part of) the net income earned by the trust for life.
2. Additional contributions can be made to the trust at any time.
3. Unlimited withdrawals can be made from the trust at any time.
4. Since the trust can be revoked, the donor does not get an income tax deduction for setting it up, nor will the donor avoid capital gains taxes if appreciated assets are transferred to the trust.
5. The donor can make the trust irrevocable at any time, by amending the trust agreement so that the trust qualifies as a charitable remainder unitrust or a charitable remainder annuity trust. Once this is done, the donor will be entitled to the tax and other benefits related to irrevocable charitable remainder trusts.
6. If the revocable trust is still in existence when the donor dies, the assets will go to the charity(ies) named by the donor in the trust agreement. The donor's estate will then be entitled to a Federal estate tax deduction for the charitable gift.

#### C. Benefits for the Donor

1. All of the trust income can be used for the donor and/or other named beneficiaries (no percentage limitations as with an irrevocable CRT.)
2. The revocable CRT provides maximum flexibility. If the donor's circumstances should change and the donor needs the assets, he or she can revoke the trust and re-acquire the assets. The donor can also invade principal at any time, providing protection against future unknown contingencies.
3. The donor can act as trustee of the trust, and manage and invest the trust assets, if desired. On the other hand, the donor may prefer to choose a corporate trustee to provide professional management of the trust assets, thereby relieving the donor of these responsibilities.
4. There is no income tax deduction for this gift, since the trust can be revoked at any time. However, if the trust is in existence at the time of the donor's death, the assets will go to charity, and the donor's estate will be entitled to a Federal estate tax deduction for the charitable gift.
5. The donor can make the trust irrevocable at any time by amending the trust agreement so that the trust qualified as a charitable remainder unitrust or a charitable remainder annuity trust. If the donor does this, he or she will be entitled to all of the tax and other advantages of irrevocable charitable remainder trusts.
6. The trust assets will not have to go through probate, thereby avoiding probate costs and expenses.
7. The trust provisions can always remain private.

#### D. Benefits to your Organization

1. Another way to encourage your donors and prospects who cannot part with income or assets now to make a gift for the future benefit of your organization. This revocable trust arrangement can often provide large gifts that would not otherwise be received.
2. A good cultivation tool. Talking with donors about revocable trusts can get them thinking about your organization's long-range future, and can help to build the relationship.
3. May lead your donors to make other irrevocable gifts during lifetime, as well as to consider making the "ultimate gift" later on.
4. Promoting revocable trusts as a gift option can help provide endowment gifts later on, to preserve and protect your organization's future.

E. Example

### THE REVOCABLE LIVING TRUST

#### SITUATION

Mr. Black, a widower in his 70's, is a retired investment banker. One of his greatest pleasures is following the stock and bond markets closely and overseeing his considerable portfolio of investments. Mr. Black has also been a strong supporter of several charities over the years. He would like to make a significant gift to a favorite charity, but is concerned about irrevocably parting with assets now that he is getting older and may face the possibility of long-term medical care and expenses later on.

#### SUGGESTION

Suggest that Mr. Black set up a trust now which he can revoke at any time. The trust will pay income to him as he needs it, and he can invade principal, if he so desires. Mr. Black can be the Trustee of his trust, thereby enabling him to continue to manage and invest his portfolio. After his lifetime, the trust assets will be distributed to the charity or charities he names in the trust agreement.

**BENEFITS** - By establishing the trust during his lifetime the donor can -

- Maintain complete control over the management and investment of his assets.
- Revoke the trust at any time and re-acquire the assets, thereby providing maximum flexibility and security during his retirement years.
- Choose a successor Trustee to step in and continue to manage the trust for the benefit of the donor in the event of an accident or illness - providing an effective plan for continuing the management of his financial affairs.
- Avoid probate of the trust assets. If the trust is still in existence when the donor dies, the assets will be distributed to the charity in accordance with the terms of the trust agreement - and will not have to go through probate.
- Save estate taxes. If the trust is in existence when the donor dies, the assets will go to the charity, and the donor's estate will be entitled to a charitable deduction.
- Make a major gift to one or more of his favorite charities.

## Beneficiary Designations Under Life Insurance Contracts

### A. How this gift can work:

1. Life insurance may be an important asset in an individual's estate. However, if the insurance is no longer needed to protect the original beneficiaries, a donor may wish to name your organization as the primary beneficiary of his or her life insurance policy. To add flexibility, the donor can reserve the right to change beneficiaries at any time.
2. Alternatively, a donor may wish to name your organization as a contingent beneficiary of his or her life insurance policy, so that your organization will receive the insurance proceeds if the primary beneficiary should predecease the donor.
3. The donor is not entitled to an income tax deduction for these revocable/contingent beneficiary designations. However, if the life insurance proceeds actually do go to charity at the donor's death, the donor's estate will be entitled to an estate tax charitable deduction for the gift.

### B. Benefits for the Donor

1. Donor retains maximum flexibility, since he or she can always change the beneficiary, as circumstances dictate.
2. Donor may be able to make a major gift to a favorite charity, simply and easily.

### C. Benefits to your Organization

1. A non-threatening way to encourage donors and prospects to think about making a significant gift to your organization. Another opportunity to talk with your donors creatively.
2. A good cultivation tool. Discussing these kinds of gifts can bring the donor closer to your organization, and may lead to irrevocable gifts later on.

## Beneficiary Designations Under IRA's and Qualified Retirement Plans

### A. Background:

1. Retirement plans make up a steadily increasing share of wealth in this country, so you should not overlook this important gift opportunity – especially since many people won't "use up" the amounts in their retirement plans during lifetime – and these funds can be an excellent source of gifts to charity.
2. The tax rules governing retirement plans are extremely technical and complex, and we will not go into detail here. However, it's important to note that the attractive aspect of qualified plans is that they allow an individual to accumulate assets without paying an income tax on contributions to the plan, or on the appreciation in the plan, until the plan assets are distributed. Upon distribution, however, substantial taxes come into play.
3. In general, a plan participant will incur a 10% penalty if he or she withdraws funds from a qualified plan before reaching the age of 59 ½. In addition, the plan participant must start taking distributions from a qualified plan after reaching age 70 ½. The distributions will be taxed as ordinary income to the recipient, and there are very specific rules about the minimum amount that must be withdrawn each year. (You should note that if your donor is concerned about having to take high distributions from his or her plan each year after age 70 ½, naming a charity as a designated beneficiary could exacerbate the problem by increasing the required minimum withdrawal.)

### B. Charitable Gift of Retirement Plan Assets During Lifetime

1. Under current law a gift of plan assets to charity during a donor's lifetime will usually not be attractive from a financial and tax standpoint, because the donor will be taxed on the withdrawal from the plan, and then get an offsetting income tax deduction for the gift to charity (resulting in a wash – so long as the cash gift does not exceed the donor's deductibility limit in the year of the gift).

2. However, as we go to press, there is legislation pending in Congress that, if passed, would make charitable donations of lifetime withdrawals from an IRA more attractive. Under the proposed law, a rollover of IRA funds to a charity as an outright gift or to a life income gift (such as a CRT or a CGA) would not be subject to income tax at the time of the rollover, if the IRA holder is at least age 59 ½. The donor would receive a charitable deduction only to the extent that the gift had "basis" as a result of after-tax contributions to the IRA. While this kind of gift is important to keep in mind, it would, obviously, have to be an irrevocable gift for the tax benefits to be available. Nevertheless, this option would give a donor great flexibility as to the timing and amount of gifts to charity from retirement plan assets.

#### C. Charitable Gift of Retirement Plan Assets At Death

1. Under current law the transfer of retirement plan assets to family members after the death of the plan participant may trigger two potential federal taxes: the estate tax and the income tax. If plan assets are payable to a surviving spouse, the spouse will probably be able to postpone some or all of these taxes until his or her death. However, if the beneficiary of plan assets is someone other than the surviving spouse, the combination of federal estate and income taxes could possibly consume more than 70% of plan assets, leaving the heirs with very little. That is why many estate planners recommend that donors give their retirement plan assets to charity at death, and give other assets (such as cash, securities, real estate, life insurance proceeds, etc. that will not be taxed as heavily) to family members.

2. Because of the tax problems outlined above, you should encourage your charitably motivated donors to consider designating your organization to receive retirement plan assets after their lifetimes. By doing this a donor can make a charitable gift at minimal cost to family members, since, in many cases, the heirs would actually receive very little of plan assets anyway. In addition, the donor will be making a significant gift to your organization – completely free of both estate and income taxes – providing a win/win situation for everyone.

3. The beneficiary designation must be made in the IRA or Plan itself (when the plan permits the designation of charitable beneficiaries). However, in most cases, the donor can change the beneficiary designation at any time – allowing the most flexibility for the donor.

4. Another option is for the donor to use plan assets to fund a charitable remainder trust at death. The safest way to do this is for the donor to create a CRT during lifetime – but fund it with plan assets at death. The income beneficiary of the CRT could be the donor's spouse, or another individual. If set up properly, the CRT can be established with plan assets in a way that will reduce or avoid estate taxes and also avoid income taxes on the funding of the CRT.

#### D. Benefits for the Donor and his or her family

1. Donor may be able to make excellent use of retirement plan assets that may have become troublesome.

2. Donor may be able to make a substantial gift to a favorite charity at a very low cost to heirs.

#### E. Benefits to your Organization

1. A great marketing opportunity. Many of your constituents may not be aware of the tax traps involved with transferring retirement plan assets to heirs. It is important to educate charitably motivated individuals about these issues. You will be performing a service for them – and possibly generating a gift for your organization later on.

2. A good cultivation tool...a non-threatening way to encourage donors and prospects to think about making a significant gift to your organization. Can bring donor closed to your organization and possibly lead to other kinds of irrevocable gifts later on.

#### Interest-free Loans - Repayable on Demand

##### A. What they are and how they work:

1. A generous individual can benefit a favorite charity by making an interest-free loan to the organization, repayable on demand.
2. The donor does not get an income tax deduction for making the revocable loan – no tax benefit.
3. But, will there be a tax detriment? No - so long as the loan amount (principal) to any given charity does not exceed \$250,000, *and* the purpose of the loan is to benefit the charity (not for tax-avoidance motives), the donor will suffer no adverse tax consequences because of the arrangement. (If the loan amount exceeds \$250,000, or the transaction is deemed to have been made to avoid taxes, the donor will have adverse tax consequences: the donor must include "phantom interest" in his or her taxable income, based on a statutory rate of interest, reflecting what should have been charged on the loan if it had been made in an arm's length transaction. See IRC Section 7872.)
4. Later on, the donor can "forgive" all or part of the loan (principal), and the charity will then get to keep the forgiven amount. If the donor does this, the donor will be entitled to a Federal income tax deduction for the value of the gift (the forgiven amount) at that time.
5. During the period that the loan is outstanding, the charity will receive all of the income generated by the loaned amount. The donor will avoid paying taxes on that income – which will reduce his or her income taxes.

##### B. Key Features

1. Donor lends a significant amount of cash, interest free, to a favorite charity, to help the organization meet current expenses, etc.
2. Donor reserves the right to call the loan on demand.
3. The charity can use the principal and the income generated by the loaned amount for its exempt purposes.
4. The donor can always call the loan and get the principal back if he or she needs the money for personal use, or if circumstances otherwise change.
5. The donor does not get an income tax deduction for making the interest-free loan to charity. However, since the donor has parted with the loaned assets (usually cash), the donor will not be taxed on the income generated by those assets.
6. If the donor later forgives all or part of the loan, he or she will be entitled to an income tax deduction for the "gift" at that time.

##### C. Benefits for the Donor

1. Satisfaction of providing financial assistance to a favorite charity - at least for a short time.
2. Security in the knowledge that, since the loan is payable on demand, the donor can always regain the principal if he or she needs the money for personal use.

3. Donor will avoid paying tax on the income generated by the loaned amount.
4. Donor could use this arrangement as a way to "endow" his or her annual gift.
5. This can be an appropriate option for donors who do not itemize deductions, or for donors who cannot use additional charitable deductions currently – but who want to benefit a favorite charity now.

D. Benefits to your Organization

1. A way to increase your financial security immediately – you get cash to use up front.
2. A way to cultivate donors --- to help build the relationship --- hopefully leading to additional irrevocable gifts later on.
3. A way to encourage donors to endow their annual gifts --- simply and easily.

E. Example

**AN INTEREST-FREE LOAN - REPAYABLE ON DEMAND**

**SITUATION:**

Mr. and Mrs. Smith, both in their 70's, have been making gifts of \$500 per year to their church. They would like to continue supporting the church, now and in the future, but are concerned about making an irrevocable commitment at this time.

**SUGGESTION:**

Make an interest-free loan to the church, repayable on demand, in the amount of \$10,000 (20 times their annual gift of \$500). If the church can invest the cash for a return of at least 5%, the loan will produce \$500 each year for the church, to be added to the annual fund in the donors' names (relieving them of the necessity of writing out a contribution check each year.) In the event of an emergency or other change in their circumstances, the donors can call the loan and get the \$10,000 back. They can also provide in their wills that the loan is to be canceled upon the death of the survivor of them, and at that time, the \$10,000 is to be added to the church's endowment, to endow their annual gift in perpetuity.

**BENEFITS:**

1. Donors do not have to write checks to the church each year, since their annual gift is now covered by the income generated by the loan. Donors will continue to get full credit as \$500 annual donors to the church.
2. Donors can call the loan at any time, in the event that their circumstances should change and they need to get the \$10,000 back.
3. Donors may also enjoy some tax savings as a result of the loan. Let us assume that the donors had been receiving interest of \$500 per year on their \$10,000 investment, paying tax on that \$500 (in the amount of \$140 in their 28% bracket), and then making a gift of that \$500 to the church each year. Let us further assume that the donors do not itemize deductions on their income tax return, so that they do not get any tax benefit from their annual gift to the church. If the donors now take that \$10,000 and use it to make an interest-free loan to the church, they will no longer be taxed on the \$500 income, so that they will enjoy some tax savings as a result of the loan.
4. Donors can provide in their wills that if the loan is still outstanding at the time of the death of the survivor of them, the loan will be forgiven. They can also direct that the gift be used to "endow" their annual gift to the church in perpetuity.

5. Here, the donors are able to make a major financial commitment to their church, benefiting the church during their lifetimes, as well as benefiting the church in the future when the loan is forgiven.

### Charitable Lead Trust - a "Temporary" Gift to Charity

#### A. What they are and how they work:

1. The charitable lead trust is the mirror image of a charitable remainder trust. The lead trust pays *income to charity* for a specified period of time (either for a specified number of years, or for the lifetime of an individual). When the trust ends, the trust assets go to the individual(s) (usually family members) named by the donor.
2. There are several different kinds of Lead Trusts. However, the *non-grantor lead trust* is the one we will focus on here.
3. Although the lead trust must be irrevocable in order to produce the important tax benefits for the donor's family, the gift to charity is temporary, and the trust assets later go to the donor's heirs, often at substantial savings in gift and estate taxes.

#### B. Key Features

1. The donor transfers assets to a trustee that will manage and invest those assets and make payments at least annually to one or more qualified charitable organizations named by the donor.
2. The annual payment to the charity must be either a fixed dollar amount (Charitable Lead Annuity Trust) or a fixed percentage (Charitable Lead Unitrust.)
3. When the trust ends (either at the end of a specified number of years, or upon the death of a named individual), the remaining assets go the donor's family. Because charity has benefited up front, the trust assets can often go to the donor's heirs later at substantial savings in Federal gift and estate taxes.
4. There is no Federal income tax deduction for the donor who establishes a non-grantor charitable lead trust. However, the donor does receive an income tax "benefit", since the income generated by the non-grantor lead trust is not considered to be "income" to the donor, and, therefore, is not taxed to the donor.
5. The non-grantor lead trust is often used as a way to transfer assets from the donor to his or her children and/or grandchildren at a much lower transfer tax cost. This gift option will provide the most benefits for the donor who has a large estate (in excess of \$4 million.)
6. Charitable lead trusts can be established by a donor during lifetime or by Will.

#### C. Benefits for the Donor

1. The charitably motivated donor can make a major gift to favorite organizations now and still preserve assets for heirs later.
2. The lead trust may enable a donor to transfer specific assets (such as stock in a family-owned business or income-producing real estate) to heirs with little or no transfer taxes. Can be an important estate planning tool.
3. The lead trust gift may result in a substantial reduction in gift and estate taxes --- allowing the donor, ultimately, to transfer more assets to the family and less to the IRS.
4. If the lead trust is created during the donor's lifetime, the trust assets will not have to go through probate.

D. Benefits to your Organization

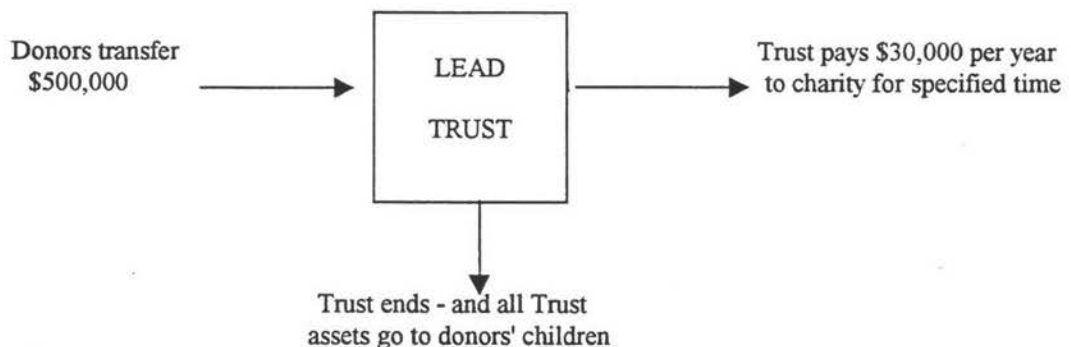
1. This is an *immediate gift* for the charity, since lead trust payments begin when the trust is created.
2. An interesting option to discuss with your wealthy donors who have concerns about paying huge estate taxes. May provide an important service to them.
3. May be an appropriate planned gift opportunity to use in a capital campaign.

E. Example

**THE CHARITABLE LEAD TRUST**

Mr. and Mrs. Jones, both in their sixties, would like to make a major gift to their favorite charity. Because they have a large estate (approximately \$5 million) they are also quite concerned about transferring as much of their assets as possible to their children - at the lowest possible tax cost. They already make individual gifts of \$10,000 per year to family members, and they have also used up their unified credit by making additional gifts to their children. If they do no further estate planning, the estate will ultimately be subject to a 55% marginal tax rate - and what is left will go to their children.

In talking with their attorney about their estate plan the Jones' discover that they can set up a Trust that will pay income to their favorite charity for a period of time, and then the Trust assets will go to family members. Because the charity will benefit up front, the Trust assets will go to the family later on at substantial savings in gift and estate taxes. Here is how the gift can work:



**BENEFITS:**

1. Because the charity receives income from the Trust first, the tax cost of giving the trust assets to the donors' children later is *substantially reduced*.
  - a. Let's assume that the Trust will pay \$30,000 per year to charity for 20 years, and then all of the Trust assets go to their children. Here the donors are deemed to have made a gift to charity of \$303,525, and a taxable gift to their children of \$196,475.
  - b. Let's also assume that the total return of the Trust (income plus growth of principal) is 9% annually, and that the Trust assets appreciate to \$1,132,927 at the end of the Trust term (when the assets are paid to the children.)
  - c. When the children receive the \$1,132,927 from the Trust, the \$632,927 in growth passes to them completely free of gift or estate taxes.
2. Here, donors are able to transfer over \$1.1 million to their children at substantial savings in Federal gift and estate taxes. They are also able to make a significant gift to their favorite charity.



The Totten Trust --- Another interesting option --- available in states (like New York) which permit this kind of arrangement.

A. How Totten Trusts work

1. Donor deposits cash in a bank account, naming himself or herself as trustee for the benefit of a favorite charity.
2. The donor reserves the right to withdraw from the account or to cancel it at any time.
3. Upon the death of the donor, if the account is still open, the cash in the account goes to the charity.

B. Key Features

1. The donor can use the account as his or her own, during lifetime.
2. The donor can add to the account, withdraw from the account, or cancel the account at any time.
3. The donor does not get an income tax deduction for setting up the account, since it can be revoked at any time.
4. The donor can make the gift irrevocable at any time by making an unequivocal, irrevocable gift to the charity. If this is done, the donor will be entitled to an income tax deduction for the gift.
5. If the Totten Trust account is in existence when the donor dies, the assets in the account will go to the named charity, and the donor's estate will be entitled to a Federal estate tax deduction for the gift.

C. Benefits for the Donor

1. Donor can use the account for his or her own purposes during lifetime.
2. This arrangement provides flexibility for the donor. He or she can always cancel the account and take the money back, if circumstances change.
3. The donor gets no income tax deduction for setting up the Totten Trust. However, if the account is in existence at the time of the donor's death, the money will go to the named charity, and the donor's estate will be entitled to a Federal estate tax deduction for the gift.

D. Benefits for the Charity

1. A way to encourage your donors and prospects who cannot part with income or assets now to make a gift for the future benefit of your organization – and to keep control of those assets for life. This kind of arrangement may provide large gifts that would otherwise not be received.
3. Can be a good cultivation tool, to get your donors thinking about your organization in long-range terms, possibly leading to irrevocable gifts later on.

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# CRUTS, CRATS AND PIFS

*by*

*Winton C. Smith, Jr., J. D.*

## CHARITABLE REMAINDER UNITRUST

### The Gift That Pays You Back

When you make a gift to our organization, there is nothing more gratifying than the knowledge that you are making a meaningful contribution toward the future. Because your gift is important to us, we want to be certain that it makes a contribution to your future as well. One of the ways to accomplish this is through a charitable remainder unitrust.<sup>1</sup>

The charitable remainder unitrust allows you to set aside a portion of your assets as a gift for our organization while you maintain — and even enhance — your present and future income. Here are some potential benefits you receive from a charitable remainder unitrust:

- \* Increase current income from appreciated assets
- \* Obtain a generous income tax charitable deduction
- \* Bypass an onerous penalty capital gains tax
- \* Save estate taxes and probate costs
- \* Further our organization's goals

### How Trusts Work

When you establish a charitable remainder unitrust, you donate cash or property to fund the trust. You then decide what percentage of the fair market value of the trust assets you wish to receive as income. For example, you may donate \$1 million in cash to a unitrust and receive 8% income per year.

With the unitrust, you have a wonderful hedge against inflation. As the value of the trust rises, so does your income. In this way, if the trust increases dramatically, you are assured of receiving a share of that increase.

Conversely, if the value of the unitrust declines for some reason, you still receive your fixed percentage, but your income payment is smaller. You may also give additional assets to the unitrust after it has been established, adding to the trust's value and increasing the income paid to you.

## Advantages of a Unitrust

The charitable remainder unitrust is an ideal gift in many circumstances. Consider a unitrust if:

- \* You have made a charitable bequest in your will
- \* You want to increase income for yourself, your spouse, or another person
- \* You want to enhance your retirement income
- \* You own highly appreciated stock or real estate that provides a low income
- \* You own a highly appreciated business
- \* You are considering selling any of your appreciated assets.

## Saving Capital Gains Tax

Does this sound familiar? You own an appreciated asset, such as stock or real estate, and you would like to sell it. Your cost basis, however, is so much lower than the current fair market value that you will be hit by an onerous capital gains tax after the sale. You are virtually trapped by this wonderful asset.

### Illustration

Mr. Smithson purchased ABC stock 15 years ago for \$200,000. This growth stock is now worth \$1 million and pays him approximately 2% income per year, or \$20,000. While selling the stock would net an impressive \$800,000 profit, it would also trigger a hefty capital gains tax of \$160,000.

Mr. Smithson does not wish to incur this penalty tax, yet he would like to increase the income from this stock. His solution is to transfer the stock into a charitable remainder unitrust. The trustee then sells the highly appreciated stock free of any capital gains tax.<sup>2</sup>

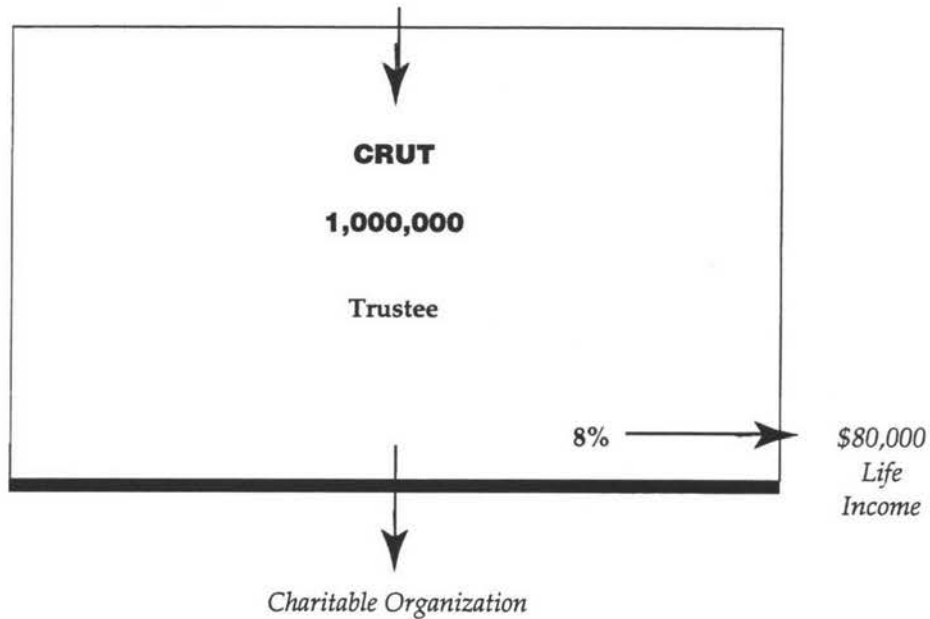
Mr. Smithson sets up the trust to pay income equal to 8% of the value of the trust assets. Since the trust assets in the first year equal \$1 million, his income from the unitrust is \$80,000, four times more than he earned from the stock prior to making the gift.

In addition to freeing him from the penalty capital gains tax, the gift also provides him with a substantial income tax charitable deduction between 40% and 60% of the value of the property transferred into the trust. He takes a deduction of up to 30% of his adjusted gross income for a period of six years until the full amount is deducted. Mr. Smithson has quadrupled his income from that asset. He has also saved substantial federal income tax, avoided the capital gains tax, and eliminated estate tax.

You should consider transferring highly appreciated assets into a charitable remainder unitrust when you are considering the sale of any of the following:

- \* Appreciated growth stock
- \* Appreciated real estate
- \* Appreciated family business
- \* Any property with appreciated value.

### Mr. and Mrs. Smithson's Unitrust



### Results

- Increase in Income from \$20,000 to \$ 80,000
- Income Tax Savings of \$200,000
- Capital Gain Tax Saving of \$160,000
- Estate Tax Savings of \$500,000

### Income Tax Savings

As you have seen, the income tax savings from a unitrust can be significant. If you itemize deductions, you obtain a charitable deduction in the year you make the contribution, a deduction that can be carried over for five additional tax years. The amount of the deduction is based on the fair market value of the trust assets, the age of the income recipient, the percentage of income to be paid, the applicable federal rate (AFR) and the number of payments per year.

All these factors are calculated by the Internal Revenue Service and published in tables. Using those tables, the following chart illustrates the tax deduction available for a gift of \$200,000 from which the contributor wishes to receive a 7% annual income. The deductions are based on an AFR of 7%.

If the contributor wishes the income to go to two people, the deduction would be slightly reduced. Unitrusts also can be established to run for a specific number of one to twenty years, rather than for the life of a recipient, which would change the amount of the deduction.

<b>AGE</b>	<b>CHARITABLE DEDUCTION</b>
50	\$40,000
55	\$50,000
60	\$62,000
65	\$76,000
70	\$90,000
75	\$106,000
80	\$122,000

Depending on the property given (cash, stock, real estate, tax-free bonds, etc.), you can deduct 30%-50% of your adjusted gross income.<sup>3</sup> If the entire deduction is not used in the first year, it can be carried over for five more years until the deduction is expended.<sup>4</sup>

### **Estate Tax Savings**

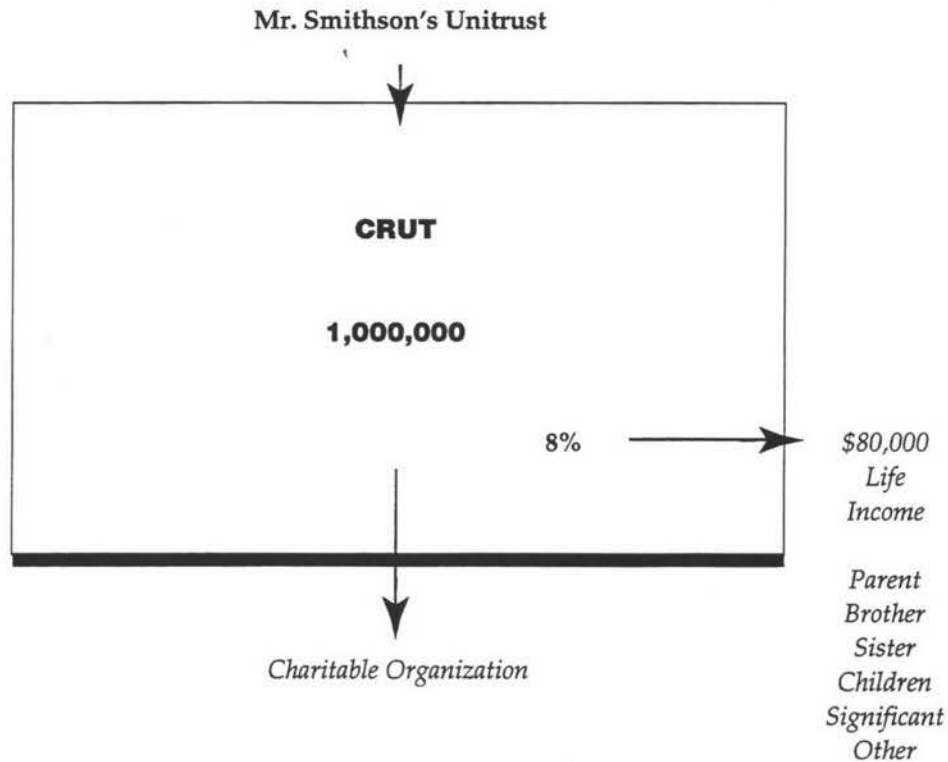
If you establish a unitrust with yourself as the income beneficiary, your estate will pay no estate taxes on the property since it will pass immediately to a charitable organization. If your spouse is also a beneficiary, the combined marital and charitable tax deductions will eliminate estate taxes in both estates.

### **Gift Tax Issues**

If someone other than your spouse is an income beneficiary, the unitrust income payments may be subject to gift or estate tax. However, the amount of either tax is reduced by the value of the unitrust that eventually passes to a charitable organization. It is important that the trust contain special language to eliminate gift tax.

### **Results**

- \* Provides Income to Non-Spouse
- \* Income Tax Deduction of 500,000
- \* Gift to Non-Spouse of 500,000
- \* Possible Annual Exclusion for first year's income payment
- \* Possible Gift Tax Unless Mr. Smithson Uses Unified Tax Credit to Avoid Payment of Gift Tax



### Other Taxing Matters

When you receive income from a charitable remainder unitrust, the income is taxed according to how it is earned by the trust. It is often possible for the trust to pay income to you at favorable capital gains rates or, in some cases, tax-free. The Internal Revenue Service has a four-tier system it uses to determine how this income is taxed.<sup>6</sup>

- 1) Ordinary income
- 2) Long-term capital gains
- 3) Tax-free income
- 4) Tax-free distribution of principal

This means that the money earned by the trust is distributed to you in the form of ordinary income first, followed by capital gains income, and finally by tax-free income.<sup>7</sup>

### Consider the Four Types of Charitable Remainder Unitrusts

- \* The Standard CRUT
- \* The Net Income CRUT
- \* The Net Income plus Makeup CRUT
- \* The Flip CRUT

## **Establish a Unitrust in Your Will**

If life income is not an important factor for you, you can create a unitrust in your will to provide a life income for your survivors. If your estate exceeds the unified tax credit, the unitrust offers an excellent way to save estate tax and increase a survivor's income.

## **Consider the 10% Minimum Remainder Requirement**

The Taxpayer Relief Act of 1997 says that the value of the charitable interest must be at least 10% of the initial fair market value of the property at the time of transfer. This new limit applies to both CRUTs and CRATs. It is important to check carefully in all cases to make certain that the 10% charitable remainder requirement is satisfied.

## **Establish a Unitrust To Provide for Your Retirement**

You can make the most of your retirement income while saving taxes through the use of a charitable remainder unitrust. A typical plan uses a "net income-plus makeup" unitrust, and one of its most appealing features is its flexibility.<sup>8</sup>

You select:

- \* The amount you will add to the plan each year
- \* The trustee
- \* The amount of retirement income you will receive

You can then:

- \* Take a current income tax deduction
- \* Maximize your retirement income
- \* Avoid the penalty capital gains tax

## **How This Plan Differs**

This charitable remainder unitrust plan differs from other plans in that you establish it 10-15 years before you retire. Until your retirement, you continue to add to the trust assets, but you also receive a modest income from those assets. The amount you receive may be an annual percentage of the trust's fair market value or the income it generates, whichever is less.

While you are still working, your purpose is to increase the value of the trust as much as possible. The trust assets can be sold and invested for maximum growth, and you pay no capital gains tax. Also, you may choose to reinvest your income from the trust back into the trust principal. By donating this trust income, you may help offset federal income tax.

After you retire, the fund's objective changes — it is now invested to yield the maximum income to you and your spouse. Your trustee can use the "makeup" provision to make up any shortfall in your income from earlier years.

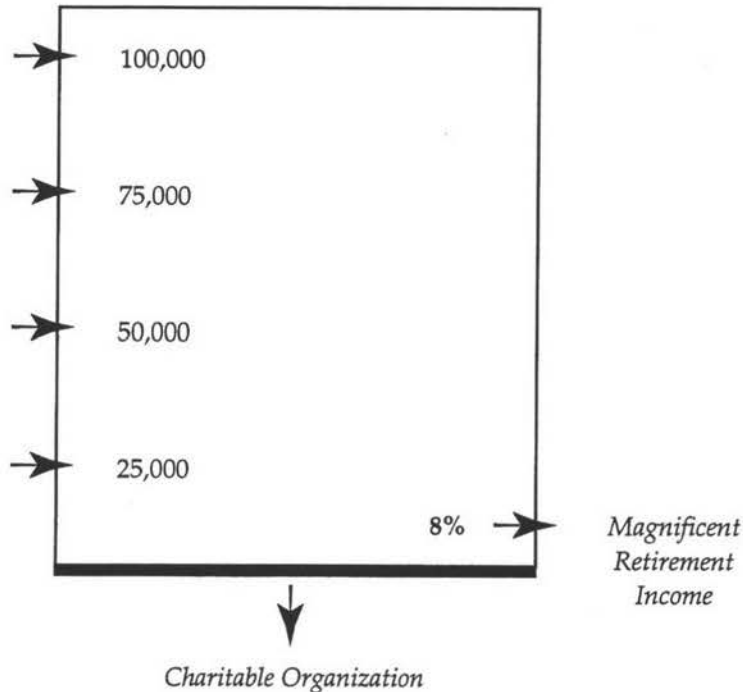
Thus, it provides you with maximum retirement income for the rest of your life and that of your spouse. After both donor and spouse die, the remainder of the trust passes to charity.



## Charitable Remainder Unitrust Plan

### *Planning for Retirement*

Ages 55 - 55



## CHARITABLE REMAINDER ANNUITY TRUST

### The Reliable Life Income Gift

The charitable remainder annuity trust is also known as a life income gift because once you have made the gift, it pays you income for the rest of your life, or the life of another, if you desire.<sup>9</sup> When you contribute assets to an annuity trust, you determine what percentage of the trust's initial fair market value you would like to receive as income. That's all there is to it.

### Some Concrete Benefits

There are a number of benefits to be obtained from annuity trusts:

- \* An annuity trust provides reliable, stable income that is not subject to market fluctuations
- \* Your gift generates an income tax deduction that can be carried forward five additional years
- \* By transferring appreciated assets to the trust, you avoid the penalty capital gains tax on the sale of those assets
- \* You often avoid estate taxes.

## Other Taxing Matters

When you receive income from a charitable remainder annuity trust, the income is taxed according to how the trust earned it.<sup>10</sup>

The Internal Revenue Service has a four-tier system it uses to determine how this income is taxed.

- 1) Ordinary income
- 2) Long-term capital gains
- 3) Non-taxable income
- 4) Tax-free distribution of principal

This means that the money earned by the trust is distributed to you in the form of ordinary income first, then by capital gains, and finally by tax-free income.<sup>11</sup>

### Illustration

Mrs. Roberts' charitable remainder annuity trust, which pays her \$80,000 per year, earned ordinary income equal to \$100,000 in its first year. It also earned \$200,000 in capital gains income.

The trustee is obligated to distribute all ordinary income first. Therefore, her \$80,000 payment is made from the ordinary income, and she pays taxes on it at her ordinary rate, which is 36%.

In its second year, the trust earns \$20,000 in ordinary income without any other type of earnings. This is added to the remaining ordinary income from the previous year (or years), for a total of \$40,000 in ordinary income. The trustee's payment to Mrs. Roberts consists of \$40,000 in ordinary income and \$40,000 in capital gains, which were earned by the trust in the previous year.

### Why Tax-Exempt Bonds Are Tax-Wise

The IRS tax structure makes the funding of your annuity trust extremely important. If you already own tax-exempt bonds, you understand the benefits of income that is free from federal and state income taxes. When you use these bonds to fund a charitable remainder annuity trust, you can realize even greater savings.

- \* Current income tax deduction, useable over a period of six years
- \* Tax-free income
- \* A magnificent gift to our organization

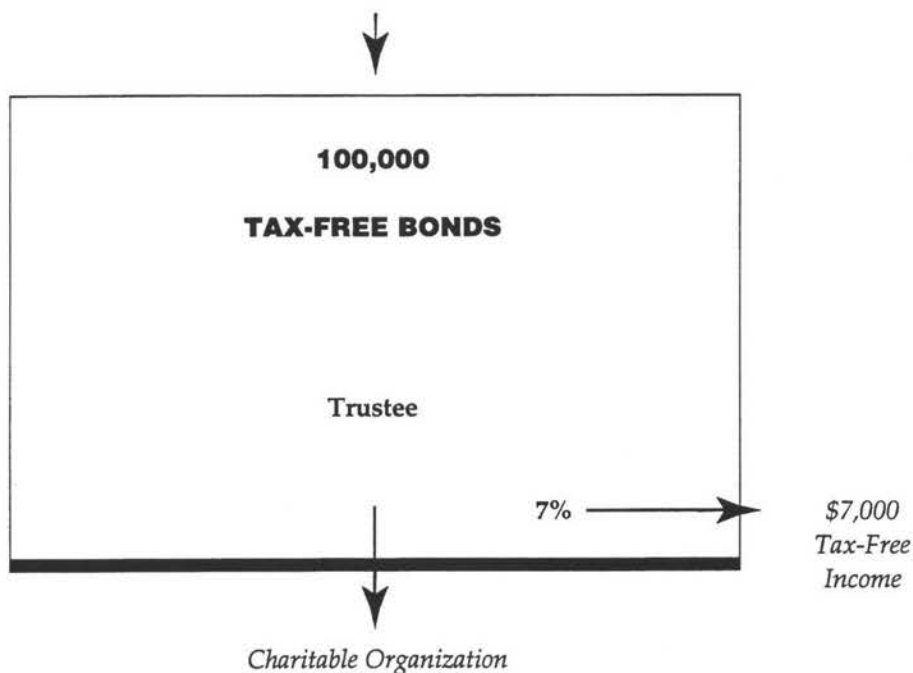
### Illustration

Mrs. Gray funds her charitable remainder annuity trust with tax-exempt bonds worth \$100,000. Her tax deduction is calculated using IRS standards based on her age, the amount of the trust, the applicable federal rate and the income she will receive. The deduction totals \$45,000, and because she is in the 36% tax bracket, this provides a current income tax savings of \$16,200. She then receives \$7,000 annually, which is tax-free, because the money earned by the trust is tax-free.

There may be a time when she pays a tax on the income from the trust, such as when a bond matures and is sold. This would be distributed at the more favorable capital gains rate, however, and once that income is distributed, her income returns to its tax-free status.

#### Mrs. Gray's Charitable Remainder Annuity Trust

*(Funded with Tax-Exempt Bonds)*



## Determining Your Tax Deductions

The amount of your charitable deduction depends upon the age of the income beneficiary or beneficiaries and the percentage of income received from the trust. The smaller the income percentage, the larger your deduction. The table below shows the percentage of the gift that can be deducted when the trust has one income beneficiary.

For example, if you are age 70 and you elect to receive 7% income from your charitable remainder annuity trust, you can deduct 45% of the gift used to fund the trust. For a \$100,000 gift, you would receive a \$45,000 deduction.

## Saving Gift and Estate Taxes

Charitable remainder annuity trusts offer a way to save estate taxes as well as income taxes. The savings depends upon who receives the trust income.

- 1) You are the sole beneficiary. Your estate will pay no estate tax.
- 2) You and your spouse are beneficiaries. When you die, combined marital and charitable deductions eliminate the estate tax.
- 3) A person who is not your spouse is the trust's income beneficiary. This gift is subject to gift or estate tax, but the tax is reduced by the amount of the trust that will eventually provide for the charitable organization.

AGE	PERCENTAGE OF INCOME FROM GIFT					
	5%	6%	7%	8%	9%	10%
50	0.42	0.30	0.19	0.00	0.00	0.00
55	0.46	0.35	0.24	0.00	0.00	0.00
60	0.50	0.40	0.30	0.00	0.00	0.00
65	0.55	0.46	0.37	0.00	0.00	0.00
70	0.61	0.53	0.45	0.37	0.00	0.00
75	0.66	0.59	0.53	0.46	0.00	0.00
80	0.72	0.67	0.61	0.56	0.50	0.00

*CAUTION: The grey shaded area does not provide a 5% charitable gift or pass the 10% MDI test, and therefore a qualified charitable remainder annuity trust is not possible with the specified payments. This calculation changes with the rate of the month.*

## PENSION PLANS AND CRUTS

For many donors, the best method of giving is a Pension Plan gift. Pension plans are often subject to extremely high tax rates which result in an unintended major gift to the federal government. Pension plan tax rates are often in the 60% to 70% range, and the result is unplanned philanthropy for the federal government.

### Confiscatory Taxation

Pension plans are often subject to tax rates which practically confiscate the pension plan for the government. Many qualified pension plans are eventually subject to the following taxes:

1. Federal Estate Tax ..... 55% Rate
2. Federal Income Tax ..... 40% Rate
3. State Inheritance Tax ..... 10% Rate
3. State Income Tax ..... 10% Rate

### Pension Plan Strategies for You and Your Spouse

Many married couples defer receiving income from qualified pension plans until they reach the mandatory age of 70½. The couple then takes the minimum income distribution over their joint lives, and thus the plan continues to grow and eventually faces confiscatory taxation. The key to avoiding excessive taxation is often to name your spouse as primary beneficiary of the plan and then name a charity as secondary beneficiary.

An alternative tax-saving strategy is to name a charitable remainder unitrust or annuity trust as primary beneficiary of the plan at your death. The trust then provides an income to the surviving spouse for his or her lifetime. The trust saves federal estate tax and federal income tax and also continues to provide tax-free growth, and thus it provides an increased income to the surviving spouse while making an important eventual charitable gift.

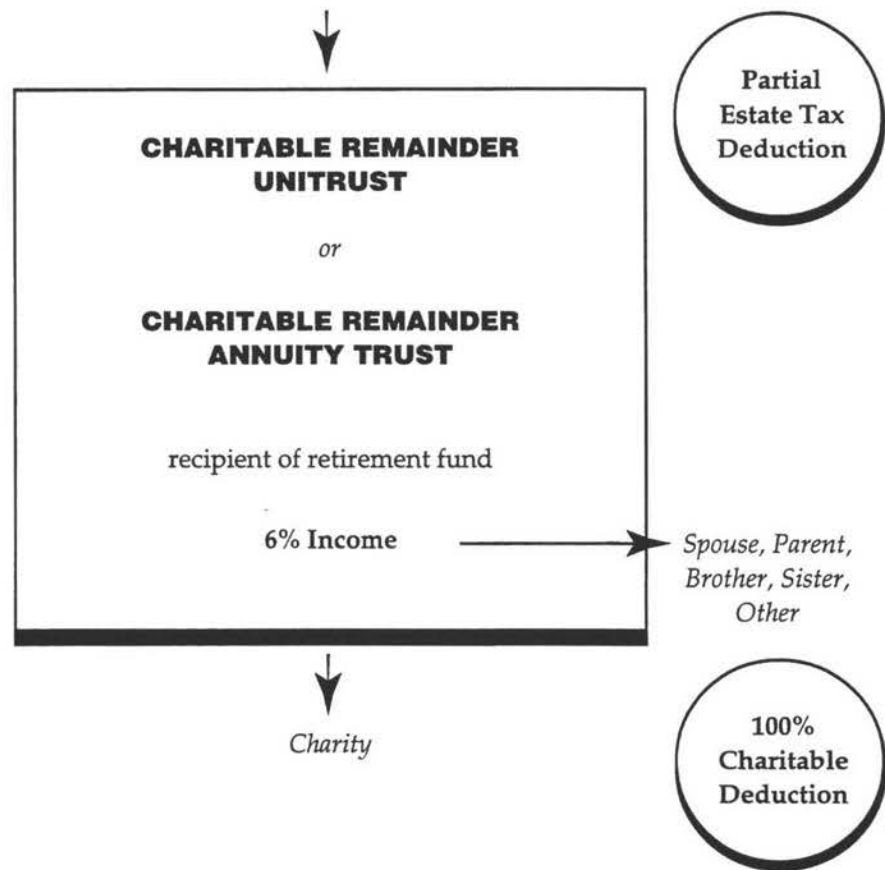
An additional tax-saving strategy is to name a charitable remainder unitrust or annuity trust as primary beneficiary of qualified plan assets with income paid to your children or others for a specific term of one to twenty years with an important eventual gift for charity.

### Pension Plan Strategies for the Single Person

Many single persons defer receiving income from qualified pension plans until they reach the mandatory age of 70½. The single person then takes the minimum income distribution over his or her life, and thus the plan continues to grow and eventually face confiscatory taxation. The key to avoiding excessive taxation is often to name a charitable remainder unitrust or annuity trust as primary beneficiary of the plan at your death.

The Trust then provides an income to a survivor for his or her lifetime. The Trust often saves federal estate tax and federal income tax, and thus provides an increased income to the survivor while making an important eventual gift for charity.

## IRA's, KEOGH's, 403b and Defined Contribution Plans



## POOLED INCOME FUNDS

### Working Together for the Future

A pooled income fund<sup>12</sup> combines your gift with the gifts of other donors who are interested in supporting our organization. The funds are invested jointly, and each contributor receives a pro rata share of the income based upon the fund's performance. In this way, you can make a significant gift and enjoy the benefits of a life income in return. You have the satisfaction of seeing your gift put to work during your lifetime, and you also take advantage of a current income tax charitable deduction, avoid capital gains tax, and possibly increase income for yourself or another beneficiary.

### Some Benefits

**Simplicity.** No separate trust is needed. You can contribute cash, securities or another asset to a pooled income fund through a simple one-page agreement.

**Low Cost.** Some pooled income funds accept gifts as small as \$5,000, and you are free to add even smaller amounts to the fund at any time after the initial gift. We will be happy to provide you with information about minimum contributions to our pooled income fund.

**Attractive Income.** You receive income based on the performance of the pooled income fund, not on a set rate of return. Some pooled income funds pay 8% or more, four times higher than the typical return on investment in growth stock. Their flexible payout structure also provides an attractive hedge against inflation.

**Current income tax charitable deduction.** The amount of your deduction depends upon your age and the fund’s historical rate of return.<sup>13</sup> Assuming the fund has earned an average 8% over the past three years and you are 65, you could obtain a current tax deduction of 35% of your gift.

Following is a chart showing current income tax charitable deductions based upon a gift of \$10,000 to a fund that pays 8% to one beneficiary.

AGE	INCOME TAX DEDUCTION
50	\$1,800
55	\$2,300
60	\$2,800
65	\$3,500
70	\$4,200
75	\$5,000
80	\$5,900
85	\$6,700

**Capital Gains Tax Savings**

By contributing a highly appreciated asset such as stock or real estate to a pooled income fund, you avoid any capital gains tax on the sale of that asset.<sup>14</sup> Also, the income you receive from the fund may be higher than the income you receive from the asset itself.

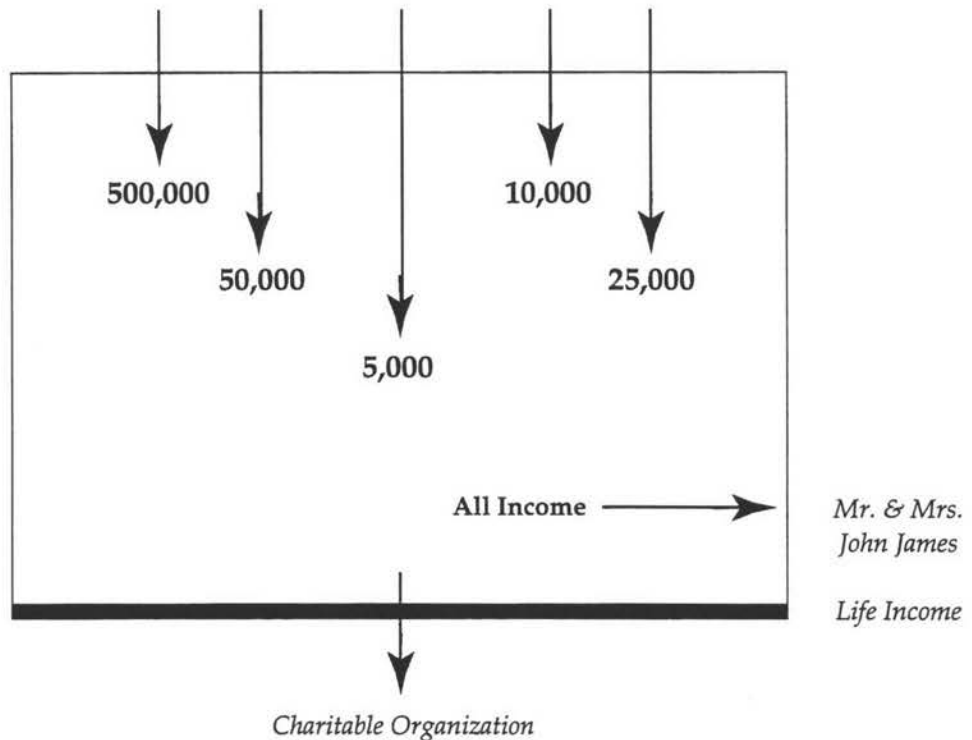
*Illustration*

Seven years ago, Mr. and Mrs. John James paid \$3,000 for AZX Co. stock that is now worth \$50,000. The dividends pay them 2%, or \$1,000 per year, and they would like to sell the stock in order to increase their income. Because they paid only \$3,000 for it, they face a 20% capital gains tax on the \$47,000 difference, for a tax of \$9,400.

Instead of selling the stock, they contribute it to our pooled income fund. The fund sells the stock completely free of any capital gains tax, and the Jameses receive a life income that averages 9%, or \$4,000 per year, more than quadrupling their income from the investment.

## Mr. and Mrs. John James

### *Pooled Income Fund*



### Some More Benefits

**Estate tax savings.** Estate tax savings depend upon the relationship of the contributor to the beneficiary or beneficiaries. When you are the income beneficiary, your estate pays no estate tax after your death. If your spouse is also an income beneficiary, no estate tax will be owed due to the combined marital and charitable deductions.<sup>15</sup>

If you name another relative or an unrelated person as beneficiary, some gift or estate tax may be due, but it is reduced by the amount in the fund that will eventually pass to charity. It is also important that the gift contain special language to eliminate the possibility of incurring any gift tax. When your final beneficiary dies, the remainder of the assets go directly to benefit charity.

**Professional portfolio management.** The pooled income fund is managed by experienced investment experts. You also have the added security of a diversified portfolio that can only be accomplished through the combination of your gifts with those of other contributors.

### Simple Reporting Procedures

All payouts from a pooled income fund are taxed as ordinary income. Every year the fund will send you a statement explaining exactly how to report this income on your federal tax return.



### **You Should Consider a Pooled Income Fund If**

1. You would like to make a charitable gift that pays a life income to you or another person
2. You would like to increase the income you currently receive from appreciated assets such as stock or real estate
3. You would like to save current income tax
4. You are considering the sale of appreciated assets to generate current or future income and you would like to avoid the capital gains tax
5. You have made a bequest that will save estate tax and you would like to make a gift that will provide you with a current income tax deduction as well
6. You would like to make a life income gift without establishing a trust.

### **Cited References**

- 1 I.R.C. Sec. 664(d)(2)
- 2 I.R.C. Sec. 664(c)
- 3 I.R.C. Sec. 170(b)(1)(A), (B) and (C)
- 4 Ibid.
- 5 I.R.C. Sec. 55
- 6 I.R.C. Sec. 664(b)(1) - (4)
- 7 Ibid.
- 8 I.R.C. Sec. 664(d)(3)
- 9 I.R.C. Sec. 664(d)(1)
- 10 I.R.C. Sec. 664(b)
- 11 Ibid.
- 12 I.R.C. Sec. 642(c)(5)
- 13 I.R.C. Secs. 170(f)(2)(A) and 642(c)(5); see also Reg. §1.642(C) - 6(d)
- 14 I.R.C. Sec. 642(c)(3)
- 15 I.R.C. Sec. 2056

### **For Further Information**

This information is not intended as specific legal advice. Consult your attorney when considering any legal matter. State laws which govern wills and contracts vary and are subject to change. For more information about these and other planned giving ideas, please contact:

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- I. What is a Gift Annuity?
  - A. Contract
  - B. Donor gives a certain amount of money; Charity agrees to pay fixed income for life.
  - C. General obligation of the Charity.
    - 1. Not dependent on charity's earnings.
    - 2. All assets of Charity could be used to pay annuity obligation, not just the "annuity fund".
    - 3. Annuitants would likely stand in the same place as other unsecured creditors in the event of a bankruptcy.
  - D. Not a trust
    - 1. There is no separate pool of assets supporting an individual annuity contract, or the annuity contracts in general.
    - 2. "Annuity fund" is probably not protected from general creditors.
- II. Types of Annuity Contracts
  - A. Single life - pays a fixed amount for one person's life.
  - B. Two life - pays a fixed amount for two people's lives.
    - 1. Joint - pays income simultaneously to the two annuitants, either jointly or in equal shares. After first death, full amount paid to the other annuitant.
    - 2. Successor - pays all of the income to one annuitant until his death, then to the other annuitant.
  - C. Immediate - begins to pay the annuity immediately.
  - D. Deferred - payments begin at a specified later date. Note that the date must be fixed at the time the contract is established. You cannot decide later.
  - E. Cannot have a charitable gift annuity for more than two lives.
- III. Annuity Rates
  - A. Suggested rates established by the ACGA, based on assumptions regarding:
    - 1. Mortality.
    - 2. Rate of return.
    - 3. Expense load.

4. Residuum. For a long time, this assumption has been 50%. This means that, if Charity's earnings exactly meet assumptions, and the person dies when the actuarial tables say they're supposed to, and the expense assumption is also accurate, then at the annuitant's death the Charity will have 50% of the original gift left.

B. Survey regarding experience of charities.

C. State regulation may affect rates, also.

D. IRS requires a minimum 10% gift. This could affect rates.

E. Assumptions for deferred rates.

F. Charity individuation. May use higher or lower rates. May have age limits. But ACGA rates are designed to assist charities and protect them from losing money on annuities.

#### IV. Tax effects of gift annuities.

##### A. Income Tax

1. Charitable deduction. Reg. § 1.170A-1(d)(1): "In the case of an annuity...purchased from an organization described in section 170(c), there shall be allowed as a deduction the excess of the amount paid over the value at the time of purchase of the annuity...purchased."

2. Value of the annuity. Reg. § 1.170A-1(d)(2); Reg. § 1.101-2(e)(1)(iii)(b)(2); Reg. § 20.2031-7.

3. Taxation of annuity payments - IRC §72.

a) Exclusion Ratio - ratio of the "investment in the contract" to the "expected return." IRC §72(b); Reg. § 1.72-4

b) Expected Return - Reg. § 1.72-5.

(1) Single life - calculated by multiplying the annual annuity payment by the multiple shown in Table V of Reg. § 1.72-9 (Called the "expected return multiple.")

(2) Two-life - calculated by multiplying the annual annuity payment by the multiple shown in Table VI of Reg. § 1.72-9. (Called the "expected return multiple.")

(3) Adjustments required if payments are to be made less frequently than monthly, or if first payment will cover a partial period. See Reg. § 1.72-5(a)(2)(i).

(4) Note that different tables apply to pre-1986 contracts.

c) Investment in the Contract

- (1) General rule of § 1.72-6. Investment in the contract is the aggregate amount of premiums or other consideration paid, reduced by any return of premiums or any other amounts received which were excludable from income.
- (2) However, in the case of a gift annuity, the “value of the annuity” (see above) is the investment in the contract. The amount deductible as a charitable contribution is not part of the investment in the contract. See Rev. Rul. 62-137, 1962-2 CB 28, which provides older valuation rules for charitable annuities, and states, “The values prescribed herein will apply for the purpose of determining the aggregate amount of consideration paid for the contract (investment in the contract) for purposes of section 72 of the Internal Revenue Code of 1954. Also see Rev. Rul. 70-15, 1970-1 CB 20, which states, “The amount in excess of the fair market value of an annuity contract purchased from an organization described in section 170(c) of the Code may not be treated as an ‘investment in the contract’; such amount may be deducted as a charitable contribution.”

d) Exclusion limited to investment; unrecovered investment.

- (1) The total exclusion over the life of the contract cannot exceed the total investment in the contract. Thus, if the annuitant has recovered the entire investment in the contract, thereafter, his annuity payments are fully includible.
- (2) Conversely, if the annuitant dies before the investment in the contract is fully recovered, the unrecovered investment is allowed as a deduction on his final income tax return.
- (3) These rules do not apply to any annuities with a start date before 1986. For those contracts, the exclusion ratio remains the same for the life of the contract.

4. Capital Gains implications

- a) Exchange of property for an annuity is considered a bargain sale. See Reg. § 1.170A-1(d)(3) and Reg. § 1.1011-2(a)(4)(i).
- b) The “consideration” received in the bargain sale is the “value of the annuity” (determined in accordance with §2031 and the regulations thereunder.) The “basis” in the property sold is determined by multiplying the donor’s basis in the property exchanged by a fraction whose numerator is the value of the annuity and whose denominator is the face value of the annuity.

- c) Example: Donor transfers appreciated securities to charity in exchange for an annuity that pays \$5,000 per year for life. The fair market value of the securities transferred (and the face amount of the annuity) is \$100,000. The donor's basis in the property transferred is \$20,000. The value of the annuity is \$59,755, per IRS tables, and the charitable contribution is \$40,245 (\$100,000 minus \$59,755). The donor's basis in the portion of the property "sold" is  $\$20,000 \times \$59,755/\$100,000$ , or \$11,951. The consideration received for the portion "sold" is \$59,755, and so the gain which must be recognized is \$47,804 (\$59,755 minus \$11,951).
- d) If the annuity is nonassignable, the gain is reported ratably over the period of years measured by the "expected return multiple", or the donor's life expectancy.
- e) Only the donor's life expectancy is considered. The survivor annuitant's life expectancy is not considered.
- f) The maximum capital gain reportable in any year cannot exceed the amount treated as return of investment each year, in other words, the excludible amount.
- g) Upon the death of the annuitant, no further gain must be reported. However, if there is a survivor annuitant, the unreported gain will continue to be reported on the same basis by the survivor annuitant.

B. Estate and Gift Tax

- 1. *Single life annuity established by the donor during his lifetime.* There is nothing to include in the donor's taxable estate, since his right to income terminates with death, and there is no remaining value in the contract.
- 2. *Annuity established by donor during life with a survivor annuitant.* The value of the survivor's interest is included in the donor's gross estate. IRC § 2039. If the survivor is the donor's spouse, the marital deduction is available. IRC § 2056(b)(7)(c).
- 3. *Annuity established at death for another beneficiary.* If a testator provides in his will or trust that an annuity should be established for someone else, e.g. a child, niece, etc., the entire amount of the annuity is included in his gross estate, and a charitable deduction is available for the charitable portion (same computation as for income tax.)
  - a) If spouse is the only annuitant, marital deduction is available.
  - b) Beware of two-life annuity established testamentarily for spouse and another beneficiary, e.g., wife then daughter. There is no marital deduction available for the spouse's interest. Charitable deduction is still available, however.



4. Where donor establishes annuity for another beneficiary inter vivos, there are potential gift tax issues.
  - a) If a donor establishes a single life annuity for another beneficiary, e.g., a sister, daughter, niece, etc., a taxable gift has been made. The gift does qualify for the annual exclusion (\$10,000), as it is a present interest.
  - b) If a donor establishes a two-life annuity for himself and a survivor beneficiary, e.g., to donor during his lifetime and then to his daughter, he has made a completed taxable gift to his daughter, and this gift does not qualify for the annual exclusion, because it is not a present interest. Gift tax return would need to be filed, and donor would either pay tax or claim part of his unified credit. Problem can be avoided if donor retains the right to revoke the survivor's interest by his will. Then a completed gift has not occurred, and there is no taxable event for gift tax purposes. However, the survivor's interest will be included in donor's gross estate at death (see discussion above.)
5. Beware of an income tax issue when annuities are established out of a decedent's estate or a testamentary trust. If the donor's will or trust provides that "10% of my residual estate shall be paid to ABC Charity to establish a single life gift annuity for the benefit of my niece, Susie," then 10% of the income earned by the estate during administration will add to the face value of the annuity. However, someone has to pay the income tax on this income earned during administration. I believe there are three possible results:
  - a) If the annuity can be set up immediately (within one month of death?) possibly income can be avoided by back dating the annuity to the date of death.
  - b) If the annuity can be established immediately after the close of the estate's or trust's tax year, the estate or trust could report and pay tax on the income earned in the prior year, withholding the amount of tax due from the share used to establish the annuity. A charitable income tax deduction is available for that portion of the income which represents the charitable portion of the annuity.
  - c) If the annuity is established mid year, the only possible result seems to be that the beneficiary will have to receive a 1041-K-1 for the non-charitable portion of the income which is added to the annuity, even though she does not actually receive the income. This is the least desirable result, as Susie will not understand why she has taxable income to report when she has not yet begun to receive the income from the annuity.
  - d) None of these issues exist if the bequest is stated as a specific dollar amount, as specific bequests generally do not benefit from income earned during administration. However, fairness would require setting up the annuity as soon as possible so that the beneficiary begins receiving income as the decedent intended.

V. Managing the Annuity Fund

A. Segregation of assets

1. There is no general overriding requirement that annuity assets be segregated from the general assets of the charity. The obligation to pay the annuity is a contractual obligation backed by all of the charity's assets, not just the annuity fund.
2. State law may require that there be a segregated fund, and may dictate how much must be in the fund.
3. Prudence requires that the charity maintain a separate fund, at least in an accounting sense, designated the "annuity fund." This should be done for the following reasons:
  - a) This may provide greater protection to annuitants, as in some states there may be an argument that these assets are unavailable to general creditors if the charity goes bankrupt. This argument would be based on constructive trust or a similar theory. Although the ultimate success of these arguments is doubtful, bargaining position vis a vis other creditors in a reorganization might be improved. Surely, if the assets are not segregated, they will be gobbled up by general creditors.
  - b) A separate fund facilitates accounting and tracking of performance.
  - c) Charity may wish to employ a different investment strategy with annuity assets than for the general fund or the endowment fund, or it may be required to do so by state regulations. Charity may wish to have the fund, or part of it, professionally managed, or may wish to hire a different investment manager than for its other funds.
4. In some cases, further segregation within the annuity fund may be desirable. For example, it may be desirable to create a separate sub-fund for California or New York annuities, since those states have rigid investment restrictions. The charity would then be free to invest the remaining annuity funds as it wishes.

B. How much should be in the annuity fund? Or, when does the charity get to take out its share and spend the money for its charitable programs? There are two basic approaches:

1. At a minimum, the charity should keep the required reserves in the annuity fund. This is the amount that, actuarially, will enable it to meet the obligations which it has incurred for all of its annuity contracts.
  - a) If this approach is taken, the charity will likely take some of the face value of the annuity out up front, and will invest only a portion of the funds received from the donor.
  - b) On a periodic basis (at least annually), the charity will recalculate its required reserve based on the annuity contracts then in effect. If the annuity fund exceeds this amount, the charity can withdraw funds and add them to its general fund. If the fund is insufficient to meet the required reserves, the charity will have to add money to the annuity fund out of its general fund.

- c) Under this approach, the death of a donor will not result directly in funds being made available to the charity. However, the termination of that contract will affect the reserve calculation at the end of the year (or whenever it is done.)
- d) A key issue is what assumptions are used to calculate the reserves.
  - (1) There is one set of actuarial assumptions that are implicit in the IRS tables, but these are not likely to be the ones used for the charity's reserve calculations. In other words, if a donor acquires a \$100,000 annuity, and the income tax charitable deduction is \$45,000, this does not mean that the charity can keep \$45,000 and spend it on general purposes.
  - (2) There is another set of actuarial assumptions that determine the annuity rates. These are discussed above. These assumptions may or may not be the ones the charity wishes to use in its reserve calculations.
  - (3) State regulation may dictate a set of assumptions that must be used. (E.g., California) In that case, the charity must use assumptions which are at least as conservative as the state regulation requires, at least for that portion of its fund. Keep in mind that the charity may always choose to use assumptions which are more conservative than state regulation requires.
  - (4) It is always best to be conservative in your assumptions, considering the long term of the obligations incurred. However, the assumptions must also be reasonable, or the accountants will object.

2. The other approach is to account for each annuity contract individually.

- a) Under this approach, the entire face amount of the annuity is invested.
- b) Income earned in the fund is allocated to each contract, and payments are deducted from that contract.
- c) When an annuitant dies, the amount remaining in that contract is transferred to the general fund.
- d) In some instances, the contract may even be individually invested, e.g., a \$100,000 30-year Treasury Bond may be purchase to support a \$100,000 annuity.

3. Which approach should you use?

- a) How large is your fund? Are you constantly growing the fund through new contracts?
- b) Is your actuarial risk diversified?

- c) How confident are you in your investment performance? Do you regularly beat the assumptions which determine the rates?
- d) How conservative is your organization?
- e) What would be the implications if you had to add money to your annuity fund? Would your board and financial officer be able to accept this as a natural consequence of taking the less conservative approach?

4. Accounting issues

- a) FASB pronouncements may require the charity to recognize as income in the year received any amount received for an annuity which exceeds the actuarially required reserve.
- b) However, there is a great amount of flexibility, within what is reasonable, in calculating the reserve.
- c) Even though the excess must be recognized as income, it is not required to be spent, and could be retained in the segregated annuity fund, if the organization wishes to take the more conservative approach.

C. Investing the Annuity Fund

1. Objectives

- a) Meet or beat the return assumption which determines the rates. All things being equal, if you beat the assumption, your residuum will be greater than 50%, and if you do not meet the assumption, it will be less than 50%.
  - (1) The key figure is total return, including gains. It is not necessary to produce income equal to the return assumption.
  - (2) Return is looked at on an average, multi-year basis. There may be years in which the assumption is not met. However, if, in any year, you do not meet your own assumption used to calculate the reserve, you may be forced to add money to the fund.
- b) Maintain sufficient liquidity to meet annuity payment obligations. In theory, the current income from the fund will not be sufficient to meet the annuity payment obligations for two reasons:
  - (1) Focus is on total return, not income.
  - (2) Rates contemplate dipping into principal, with only 50% remaining at termination of contract.

2. Specific investments
    - a) Stocks - acceptable within state regulation guidelines, and sufficient diversification. (Note: California limits equity portion of portfolio to 10%). Stocks generally produce better return than bonds in the long run, but are not likely to produce large amounts of current income, so liquidity needs must be met elsewhere in the portfolio.
    - b) Bonds - generally produce better income than stocks. But value of bonds may vary greatly with swings in interest rates. In one sense, it doesn't matter if you hold to maturity, because you will get full value. But a dip in the bond market could greatly affect your reserve calculation, so you need to think carefully before buying long term bonds.
    - c) Real estate - In some cases, real estate could be an appropriate investment for the annuity fund. It probably should be income producing, such as a triple net leased commercial property, or apartment building. This may produce a better return, but there are different risks associated with real estate. And there are management issues, as well. Mortgages and land contracts may also be held in the annuity fund.
  3. Should you have professional management?
    - a) In-house expertise?
    - b) Portfolio mix - equities v. fixed income
    - c) Cost
    - d) Mutual funds as a way to approximate professional management.
    - e) Charity is still liable to make annuity payments if professional managers do not perform to expectations.
  4. Investment issues are far more difficult in the earlier years of the fund. It is much easier to achieve diversification in a larger fund, and the actuarial risk is less the larger the fund. Liquidity is also harder to achieve in a small fund, because generally, the more liquid, the smaller the return.
  5. Reinsurance
    - a) Possibly a way to manage actuarial risk, particularly on a very large contract or when fund is just starting out.
    - b) Prohibited in some states (New York).
    - c) Charity is still liable if insurance company goes under.
- D. State Regulation - Do you need to register in your state? In the other states where your annuitants reside?

E. Administrative issues

1. Making timely payments. Need a method to produce checks and keep records.
  - a) Check endorsements - how do you know the annuitant is still alive?
  - b) Direct deposit.
  - c) ACH payments.
  - d) Power of attorney/ guardian.
2. Calculation of charitable deductions, capital gains, etc.
3. Calculation of reserves.
4. Tax Reporting.
  - a) Annual 1099-R to all annuitants. Magnetic tape to IRS.
  - b) Keep track of when investment in the contract is recovered.
  - c) Capital gains.
5. Software.

F. Decisions for your annuity program

1. Minimum annuity contract
2. Frequency of payment, or minimum payment
3. What types of assets will you accept in exchange for an annuity?
4. Annuities for young beneficiaries.

G. Marketing

H. Comparison to other charitable giving vehicles.

1. Pooled Income Fund
  - a) PIF has a fluctuating (generally growing) income stream.
  - b) All income is taxable.
  - c) Capital gains totally avoided on gifts of appreciated property.
  - d) Assets are protected from general creditors, but no guarantee of payments. Charity only obligated to pay income earned in the trust.
  - e) Can create PIF interest for more than two lives.

2. Charitable remainder unitrust
  - a) Separately invested. Larger amount required to create a CRUT than a gift annuity.
  - b) Fluctuating income and valuation. In an income-only trust, beneficiary receives only income earned in the trust, up to the limitation. In straight unitrust, beneficiary receives percentage of FMV of trust assets, valued annually, which can go up or down.
  - c) Generally, all payments received are taxable income. There may be distributions of principal which are not taxed in a straight unitrust. Also, a unitrust may invest in tax exempt securities (but watch out for accumulated capital gains.)
  - d) Assets in trust protected from general creditors. Income obligation is not backed by charity's general assets.
  - e) Complete elimination of capital gains (unless the tier system of income payouts dips into the capital gains layer.)
  - f) Can create for more than two lives (provided 10% rule is satisfied), or for a term of years up to 20.
  - g) Can provide for contingent income beneficiaries, or a class of income beneficiaries in a term of years trust.
3. Charitable remainder annuity trust
  - a) Separately managed trust. Requires larger amount to set up.
  - b) Annual payment is a fixed amount which does not vary.
  - c) Initially, complete elimination of capital gains. However, if principal is distributed, capital gains could be carried out under tier system.
  - d) Payment is not guaranteed by general assets of charity. If trust runs out of money, payments cease.
  - e) Assets are protected from the charity's general creditors.
  - f) Can create for more than two lives, or for a term of years.
4. In general, gift annuity, PIF, and charitable remainder trusts all provide similar, albeit not identical, tax benefits, namely income tax deductions when established inter vivos, estate tax deductions at death, and some shielding from capital gains when funded with appreciated property.

5. Which vehicle is best?
- a) If the amount being used to fund the gift is small, e.g., less than \$25,000, consider annuity or PIF.
  - b) For older beneficiaries (at least 65), consider annuity or annuity trust.
  - c) For younger beneficiaries, consider PIF or unitrust.
  - d) For illiquid assets, e.g., real estate, consider charitable remainder trust, probably an income-only unitrust.
  - e) Where contingent beneficiaries are important, use term of years remainder trust.

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**FUNDAMENTALS OF MARKETING  
A PLANNED GIVING PROGRAM**

Presented By  
G. Roger Schoenhals  
*Planned Giving Today*®

Introduction

I. Build A Good Foundation

A. Assess Your Strengths

1. Knowledge Base
2. Skill Level
3. Experience Quotient
4. Linkage to Organization
5. Other Factors

B. Review Your Resources

1. Personnel
2. Budget
3. Upper-Level Support
4. Planned Giving Tools

C. Know Your Institution

1. History and Mission
2. Programs and Personnel
3. Integrity Factor

D. Embrace the Mission

E. Analyze Your Audience

1. Board Members (past and present)
2. Employees
  - a. upper-level management
  - b. planned giving personnel
  - c. other current employees
  - d. former employees

3. Donors
    - a. planned giving donors
    - b. major donors
    - c. regular annual donors
    - d. occasional donors
  4. Family/Friends of Key Donors
  5. Volunteers
  6. Beneficiaries (alumni, patients, etc.)
  7. Community
  8. Broader Audience
- F. Define Your Objectives
1. Build Awareness
  2. Provide Answers
  3. Offer Assistance
  4. Generate Action
- G. Create a Marketing Plan
1. Mission Statement
  2. Summarize Goals for the Year
  3. List Action Steps to Achieve Each Goal
    - a. name of person(s) to perform function
    - d. date when action will be completed
  4. Monthly Planning Calendar for the Year
  5. Summarize Goals for Next Five Years
  6. Appendices
- G. Prepare for Results
1. Develop a Reporting Process
  2. Obtain Computer Tracking System
  3. Establish Follow-Up Activities

## II. Opportunities Abound

### A. Marketing Through Personal Relationships

#### 1. Three Things About Relationships

- a. pre-eminent
- b. costly
- c. rewarding

#### 2. Basic Elements of Productive Relationships

- a. trust
- b. passion
- c. honor

#### 3. Be Progressive

- a. make positive first impression
- b. establish rapport
- c. gather information
- d. tell stories
- e. present a plan
- f. urge action
- g. assist advisors
- h. provide affirmation

### B. Marketing Through Printed Materials

#### 1. Periodicals

- a. institutional
- b. planned giving
  - 1) from vendor
  - 2) do yourself
- c. format/content
  - 1) articles
  - 2) ads

#### 2. Brochures

#### 3. Personalized Letters

#### 4. Stuffers

- a. with receipts
- b. testimonial cards
- c. response forms

#### 5. Increase Effectiveness

- a. repeat regularly
- b. vary the look
- c. address felt needs

- d. be personal
- e. keep it simple
- f. look professional
- g. make response easy

C. Marketing Through Planned Events

- 1. Seminars
- 2. Recognition Society Meetings
- 3. Small Dinners
- 4. Facility Tours
- 5. Signing Ceremonies

D. Marketing Through Public Media

- 1. Newspapers
  - a. news releases
  - b. display ads
  - c. feature articles
- 2. Radio
- 3. Internet
  - a. web page
  - b. selected e-mail postings
    - 1) donors
    - 2) professional advisors
    - 3) others

E. Marketing Through Positive Referrals

- 1. From Development Staff
- 2. From Satisfied Donors
- 3. From Professional Advisors
  - a. advisory board
  - b. personal networking
  - c. providing services
  - d. post gift follow-up
- 4. From Others
  - a. various employees
  - b. key volunteers

### III. Targeting Your Marketing

- A. Role of Mass Marketing
- B. Role of Target Marketing
  - 1. Defining Your Target
  - 2. Tailoring Your Message
- C. Examples

### IV. Miscellaneous

- A. Focus Groups
- B. Phone Solicitation
- C. Cooperative Marketing

### V. Some Do's and Don'ts

#### A. Do's

1. Do Focus on Relationships
2. Do Get Out of the Office and Visit
3. Do Keep Things Simple
4. Do Budget Your Time
5. Do Blow Your Trumpet
6. Do Keep Growing Professionally

#### B. Don'ts

1. Don't Swamp Yourself
2. Don't Oversell
3. Don't Ignore the Family
4. Don't Push
5. Don't Delay
6. Don't Give Up

### Conclusion

(Continued on next three pages.)

## GREAT MARKING IDEAS

By *Planned Giving Today* Readers

The following marketing ideas were supplied by readers of *Planned Giving Today* in response to a readership survey. (From *Gaining More Planned Gifts*, Copyright 1997 by G. Roger Schoenhals.)

- ◆ We have found great success in providing materials, training and services for attorneys, accountants and other planning professionals. We provide calculations and explanatory materials regardless of the intended charitable recipient. Consequently, we are now viewed as *the* resource for gift-planning advice in our community.
- ◆ We run a column on planned giving for every issue of our newsletter. The column is in the same space every issue. Generally, the article is about a donor or the work accomplished with a bequest. The newsletter is quarterly and includes my picture along with the column. Using my picture helps to put donors at ease when they recognize me on a first visit.
- ◆ We concentrate on providing service to our existing donors which, in turn, leads to more gifts. We assume that our existing donors have already made a commitment to our institution and that we need only to professionally manage their agreement, get their checks out on time and show them our appreciation in any (and every) way. When we do, repeat gifts and referrals come.
- ◆ I personalize letters to segmented groups of about 100 people, offering to come for a visit. Then I follow up with phone calls to as many as possible. To those who did not respond, I ask whether they received the mailing and whether I could visit them to speak about their financial plan or to answer questions and provide information on planned giving instruments. To those who responded to the mailing, I call to arrange a visit. On average, I obtain about 15 contacts from 100 letters.
- ◆ I provide "lunch and learn" sessions in brokerage and financial planning firms during the lunch hour. I bring in food to the firm's conference room for any staff who attend the program. I emphasize those things in charitable giving that benefit the firm, such as replacement wealth policies, freeing up assets they can trade and helping to solve client problems.
- ◆ I ask prospective donors this question: "If you were to make a planned gift, what would you like it to accomplish?" Then I open my three-ring binder of ideas ready with cost figures, 8x10-inch color pictures and so forth. I look through this with them and try to match their wishes to a specific gift opportunity. Once we find a match, I review their assets to see whether they can make the gift now — or defer it through one of the planned giving vehicles. This process works better for me than trying to "sell" the gift vehicle first.
- ◆ We distribute more than 700 scholarships annually. Throughout the year, we meet with scholarship donors to thank them and bring them up-to-date on their scholarship. Many times, these "thank-you" visits result in another gift or in a discussion of their bequest plans. We also host a scholarship banquet each fall to bring the donors and the scholarship recipients together. It's very effective — a great education for us and the scholarship recipients leave having a better understanding of what our program is all about.
- ◆ Being associated with a radio broadcasting network, I produce "promos" for airing several times daily, 30-60 seconds each. Topics include wills and annuities, and end with the station's telephone number for those wanting more information. I developed a special telephone response coupon pad so we get the proper information including birth dates. The phone receptionist checks off what the caller wants and faxes it to my office where the request is filled. We are getting 50-100 leads per month, of which about half are followed up with a personal visit from one of our area representatives.



♦ I make every attempt to relate the stories of actual donors and their advisors using common English. People understand and relate to the circumstances and motivations of others in similar situations, so I strive to associate real people to each gift plan example I use. Too many non-donors focus on the plan rather than on the gift, which usually wastes resources; so I take every opportunity to emphasize the gift with the belief that the appropriate plan will follow.

♦ Throughout the state we have five professional advisory councils which are composed of more than 250 professionals. For almost four years, we have been meeting quarterly for breakfast to discuss the technical side of planned giving. Referrals from these groups now account for one half of our planned gifts.

♦ The use of enclosures on planned giving in current gift receipts continues to be very effective. The enclosure has a small amount of copy and then allows the donor to request a brochure on a planned giving topic. This is an inexpensive but effective way to reach the best prospects.

♦ We started a new gift annuity program last year and received about 11 annuities worth \$600,000 in the first year. We appealed to security for senior citizens (first), tax benefits (second) and support for the institution (third). We used letters, workshops, articles and personal calls.

♦ Train professional advisors (attorneys, trust officers, CPAs, CFPs, CLUs and securities brokers) in charitable gift planning.

♦ After explaining the reason I have been employed by a charity to arrange a visit with my prospect, and the things I may be able to do to facilitate a generous gift (relating a few of my previous experiences), I ask for permission to discuss possibilities with his or her CPA. I do this knowing that no decision will be made without the CPA's recommendation.

My visit to the CPA is in lieu of the client's visit so there is no additional expense to him/her. When he/she receives the CPA's bill for the time spent, along with an affirmative recommendation, we are well along the way to an agreement. If the CPA is negative, the cause would be lost anyway. If the CPA is positive, dealing with the lawyer is much easier.

♦ We had a good response to our last fiscal year's disclosure request mailing, written under the president's signature. We received notice of more than 30 disclosures and more than 20 requests for information on wills from a mailing to 2,000 donors.

♦ Other than going out and seeing prospects, our most effective strategy has been putting articles in every alumni bulletin. Another effective strategy is the staff training I've done with development officers.

♦ We formed an honorary society to encourage donors to give \$100,000 or more now or in their estate planning as unrestricted gifts or as endowments to perpetuate their annual campaign gifts. Donors could use direct gifts or deferred giving arrangements. The society was just inaugurated with 43 members.

♦ Build long-lasting, one-to-one relationships with top prospects/donors over a period of years. Focus on the top 100 or so of these wonderful people.

♦ While I hesitate to refer to this as my most effective marketing strategy, an unusual way to market planned giving and our recognition society began a few years ago when I attached our two society pins to my reunion name tag.

I now wear them to every function. People always ask about them and it gives me a non-threatening and appropriate way to mention our planned giving program. (I can trace several gifts directly to conversations that began because of those pins on my name tags.)

♦ I work for a religious organization. Each month, our organizational newsletter goes to about 10,000

households. I have an article in each edition — but not a formal column. If it were a column, a lot of people would automatically skip it. This way, they may read any article that catches their eye.

- ◆ I am building a network of persons who will provide referrals. These people do not need to be specialists, just individuals who have a commitment to our organization and know that we can solve problems.

- ◆ Last year, our president wrote a letter on gift annuities. It resulted in more than \$100,000 in gifts. ◆

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## BARGAIN SALES AND RETAINED LIFE ESTATE

I was first introduced to bargain sales when the College for which I was working wanted to acquire some houses on the periphery of campus for special interest student residences. However, the owners of these buildings were not willing to consider an outright gift. Finances were clearly the key issue in the transaction. Eventually, we worked out a bargain sale. The owners received what they would have netted in an outright open market sale and the college acquired the property at a net outgo 14% less than the open market price. We'll look at some numbers in a minute to see, in concrete terms, how this worked.

But this led me to look much more broadly at bargain sales—and their second cousins, retained life estates—as ways of working with owners of real property (and sometimes other assets too) to mutual benefit.

First, just what is a bargain sale? Simply put, it is a sale of an asset by a donor to a charity for less than fair market value. Example:

Asset worth - \$100,000

I sell to charity for \$75,000

Tax deduction = \$25,000 (difference between sale price and FMV)

One other general principle of bargain sales we should know before looking at some concise applications. How do we allocate capital gains?

Basic principle: Capital gains are appropriated equally between the sale portion and the gift portion of the transaction. The donor still owes the tax on the gain associated with the sale portion (as would normally be the case in sales of appreciated property) and avoids the tax on the

gain associated with the gift portion (as would normally be the case with all charitable gifts).

Example:

Asset worth \$100,000

Sell to charity for \$75,000

Charitable gift = \$25,000

Original cost basis = \$50,000

Total gain = \$50,000

$$\begin{aligned}\text{Gain associated with sale} &= \text{sale price/FMV} \times \text{total gain} \\ &= 75,000/100,000 \times 50,000 = 37,500\end{aligned}$$

So donor still owes capital gains tax on \$37,500, which can be partially offset by \$25,000 charitable tax deduction.

With those principles in mind, let's look at some specific ways these vehicles can help us find gifts we might otherwise miss:

Example A: Charity wishes to acquire asset at minimal cost; donor wishes to net roughly what an open market sale would produce.

Facts: FMV = \$300,000

Cost Basis = \$100,000

Taxable Gain = \$200,000

Open Market Sale

Purchase Price = \$300,000

Capital Gains Tax = 20% of \$200,000 = \$40,000

Net Benefit = \$240,000

### Bargain Sale

Purchase Price = \$260,000

Capital Gains Tax = 20% of \$173,300 = \$34,700

Charitable deduction = \$40,000

Charitable tax savings (at 39.6%) = \$15,800

Net Benefit = \$260,000 - \$34,700 + \$15,800 = \$241,100

Example B: Donor wishes to recover cost basis or pay off debt

Same facts: FMV = \$300,000

Cost Basis/debt = \$100,000

Capital Gain = \$200,000

### Open Market Sale

Gross Revenue = \$300,000

Capital Gains Tax = 20% of \$200,000 = \$40,000

New revenue = \$240,000

### Bargain Sale

Gross revenue = \$100,000

Capital Gains Tax =  $100/300 \times 200 = \$67,777 \times 20\% = \$13,516$

Charitable deduction = \$200,000

Tax Savings (assuming AGI = \$150,000) =  $\$45,000 \times 31\% =$   
\$13,950

Net Revenue =  $\$100,000 - 13,516 + 13,950 = \$100,434 +$   
\$155,000 carry over deduction, worth over 6 years another  
\$47,050

Result: Donor makes \$200,000 gift at net cost of \$97,516

### Example C: Installment Bargain Sale

Same as outright bargain sale except that the sale component is paid to donor in installments.

This is an excellent way of providing an income stream (just as with a trust or annuity) where

- a) the donor would like a fixed term greater than 20 years;
- b) for whatever reason you wish to vary the payments from year to year (such as a larger “down payment” up front);
- c) the donor wishes to live on the property for a period of time or there is the possibility of the charity’s selling the property to a “disqualified person” under the private foundation trust rules.

Calculating the charitable deduction and the capital gain implications are easy and computed much as one would similar factors in an ordinary mortgage authorization table.

- You need:
1. an applicable discount rate = federal short, mid, or long term rate, depending on the term of the installment sale;
  2. a net present value analysis based on the NPV of the stream of principal payments.

In developing IBS scenarios, you can work from

1. the cash flow to the donor
2. the desired gift

If you are using the donor’s cash flow as your independent vehicle, you can

1. provide the same payment each year to a term of years (just as most mortgages or annuities work);



2. provide an initial payment larger than the others and then graduated payment for a period of years;
3. delay the initial payment for some period to give the charity time to market the property.

Let's look at some example of each of these:

INSTALLMENT BARGAIN SALE OPTIONS:

Applicable Discount Rate: 6.00%

EXAMPLE 1: FIXED PAYMENTS FOR FIXED PERIOD OF TIME

Year		1	2	3	4	5	6	7	8
FAIR MARKET VALUE OF ASSET	\$300,000								
INTEREST ACCRUED THIS PERIOD		\$14,452	\$14,059	\$13,643	\$13,201	\$12,733	\$12,237	\$11,712	\$11,154
NET UNPAID INTEREST		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
CASH PAYMENT		\$21,000	\$21,000	\$21,000	\$21,000	\$21,000	\$21,000	\$21,000	\$21,000
INTEREST		\$14,452	\$14,059	\$13,643	\$13,201	\$12,733	\$12,237	\$11,712	\$11,154
PRINCIPAL		\$6,548	\$6,941	\$7,357	\$7,799	\$8,267	\$8,763	\$9,288	\$9,846
NET PRESENT VALUE	\$240,868								
CHARITABLE DEDUCTION	\$59,132								

EXAMPLE 2: LARGER INITIAL PAYMENT THEN FIXED PAYMENTS FOR FIXED PERIOD OF TIME

Year		1	2	3	4	5	6	7	8
FAIR MARKET VALUE OF ASSET	\$300,000								
INTEREST ACCRUED THIS PERIOD		\$14,503	\$9,373	\$9,095	\$8,801	\$8,489	\$8,158	\$7,808	\$7,436
NET UNPAID INTEREST		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
CASH PAYMENT		\$100,000	\$14,000	\$14,000	\$14,000	\$14,000	\$14,000	\$14,000	\$14,000
INTEREST		\$14,503	\$9,373	\$9,095	\$8,801	\$8,489	\$8,158	\$7,808	\$7,436
PRINCIPAL		\$85,497	\$4,627	\$4,905	\$5,199	\$5,511	\$5,842	\$6,192	\$6,564
NET PRESENT VALUE	\$241,711								
CHARITABLE DEDUCTION	\$58,289								

EXAMPLE 3: DEFERRED INITIAL PAYMENT THEN FIXED PAYMENTS FOR FIXED PERIOD OF TIME

Year		1	2	3	4	5	6	7	8
FAIR MARKET VALUE OF ASSET	\$300,000								
INTEREST ACCRUED THIS PERIOD		\$12,668	\$13,428	\$14,233	\$15,087	\$14,552	\$13,986	\$13,385	\$12,748
NET UNPAID INTEREST		\$12,668	\$26,095	\$40,328	\$31,416	\$21,968	\$11,954	\$1,339	\$0
CASH PAYMENT		\$0	\$0	\$0	\$24,000	\$24,000	\$24,000	\$24,000	\$24,000
INTEREST (REAL OR IMPUTED)		\$0	\$0	\$0	\$24,000	\$24,000	\$24,000	\$24,000	\$24,000
PRINCIPAL		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$9,914
NET PRESENT VALUE	\$211,126								
CHARITABLE DEDUCTION	\$88,874								

EXAMPLE 4: FIXED PAYMENTS OVER A FIXED TIME BASED ON CHARITABLE DEDUCTION

Year		1	2	3	4	5	6	7	8
FAIR MARKET VALUE OF ASSET	\$300,000								
INTEREST ACCRUED THIS PERIOD		\$12,000	\$11,674	\$11,328	\$10,961	\$10,573	\$10,161	\$9,725	\$9,262
NET UNPAID INTEREST		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
CASH PAYMENT		\$17,437	\$17,437	\$17,437	\$17,437	\$17,437	\$17,437	\$17,437	\$17,437
INTEREST (REAL OR IMPUTED)		\$12,000	\$11,674	\$11,328	\$10,961	\$10,573	\$10,161	\$9,725	\$9,262
PRINCIPAL		\$5,437	\$5,763	\$6,109	\$6,475	\$6,864	\$7,276	\$7,712	\$8,175
NET PRESENT VALUE	\$200,000								
CHARITABLE DEDUCTION	\$100,000								

Retained Life Estates are another very handy but infrequently used gift vehicle.

Like trusts or annuities, the donor is both giving away something of value and keeping something for him or herself. In this case, what is kept is not an income stream but rather the right to live in and “enjoy,” as the lawyers say, the property for the remainder of his or her life. This has value, and the younger the person is, the greater the value.

So how does this work?

Transfer is by a simple deed of trust from the donor to the charity, with the addition of a short clause giving the donors the right to use and enjoy the property for life. The property in question can be a primary or secondary residence, a vacation home or a farm.

Usually, the charity and donor also sign a side agreement laying out all other matters that might arise: e.g.,

Who pays the taxes (usually the donor);

Who maintains the property (usually the donor);

Who take care of major repairs or replacements (new furnace, roof, etc.);

Who carries insurance (usually donor, but also charity's umbrella);

What will happen if the donor no longer wishes to live there?

This last question is the one most people ask and is often the reason life estate gifts do not reach fruition. So it is important to think about the options early on.

Let's see how this works:

Couple 75/75 own a home worth \$250,000

deed to charity yields

charitable deduction = \$82,568

Result: Donor makes ultimate gift of \$250,000 at no current cost

no change in current life style

plus donor receives \$25,596 in tax savings (31% rate)

Sounds like a good deal, but let's return to the sticky questions of "what if..." Let's suppose five years go by and now our donor couple wants to move to a retirement condo, or one of them dies, or needs long-term care.

What are the options?

First, remember that the life estate still has value, less than before and diminishing every year, as life expectancy goes down, but value nonetheless. And it is that value that provides the options.

Option 1: Charity purchases the remaining life estate from donors

Example: Donors, now 80, wish to move

If residence is still worth \$250,000, retained life estate is now worth \$144,464.

However, if the home has increased in value over the five years, say to \$300,000, retained life estate is worth \$175,155.

Whatever the value, if charity purchases the life estate, the purchase payment is treated as capital gain, insofar as it is applicable, and taxed accordingly.

Option 2: Donors rent property – another version of “use and enjoyment”

Now, the current value of property and the value of the life estate are inconsequential. Rents are the key. Donor collects rent and maintains the property just as if there had never been a gift.

Option 3: Donors donate retained life estate.

Go back to example of \$250,000 value and retained life estate worth \$144,464.

Or, alternatively, the \$300,000 value yields a potential gift of \$175,155.

Option 4: Donors exchange the retained life estate for annuity income stream

That \$144,464 at 8.2% will yield an annual income of \$11,846 and a new charitable gift of \$59,952.

Or, if the property value has appreciated, the \$175,155 at 8.2% will yield an annual income of \$111,363 and a new gift of \$72,688.

Conclusion:

What can we say about Bargain Sales and Retained Life Estates?

1. They are very flexible vehicles, with lots of room to be tailored to the specific needs of the donor.
2. Because they are bilateral agreements between donor and charity, they are not subject to the restrictions of the private foundation rules which govern charitable trusts –

no self-dealing issues

no disqualified person issues

Pitfalls: All turn on value, and where real estate is concerned, value may vary a good deal over time. Property can increase or decrease.

Risk: exchanging the charitable gift portion of a retained life estate for a gift annuity

Original 75/75 year old couple  
\$250,000 value  
\$79,451 deduction

Instead of using the whole deduction, they use it to contract for a gift annuity which pays them \$6,194 per year and still leaves a deduction of \$30,713.

Great, unless, as happened in Southern California, property values decrease over time.

Bottom line: Don't forget these very helpful vehicles. They are a wonderful complement to trusts, annuities and PIF's.

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**23RD CONFERENCE ON GIFT ANNUITIES  
DONOR RELATIONS: CULTIVATION AND STEWARDSHIP  
APRIL 15, 1998**

**THE RELATIONSHIP CIRCLE**

- **Commitment To The Cause And To The Work Of The Organization**
- **Educating Yourself About The Institution and Its Needs**
- **Educating Yourself About How To Raise Money**
- **Building Relationships With Donors:**
  - **Between Them And The Institution**
  - **Between Them And You**
- **Involving Donors In The Work Of The Institution**
- **Getting Donors To Give Early As Part Of Their Involvement**
- **Understanding The Donors**
- **Asking For A Gift**
- **Waiting For An Answer**
- **Thanking The Donor**
- **Involving The Donor In The Work Of The Institution**
- **The Best Future Donors Are Prior Donors**
- **The Continual Caring For Donors**

**23RD CONFERENCE ON GIFT ANNUITIES  
DONOR RELATIONS: CULTIVATION AND STEWARDSHIP  
APRIL 15, 1998**

**SHIRLEY ANNE PEPPERS  
DIRECTOR, WEST COAST DEVELOPMENT  
HARVARD UNIVERSITY FACULTY OF ARTS AND SCIENCES**

**BUILDING RELATIONSHIPS WITH MAJOR DONORS  
THROUGH COMMUNICATION**

**WHAT ARE THE GOALS OF COMMUNICATION?**

**1. BUILDING RELATIONSHIPS:**

All of us want and need a variety of personal associations in our lives. In fund raising, as in almost all other businesses, relationships are necessary in order to achieve our goals. Trust, sharing, help and understanding all go to make up the complex relationships that often help us help our schools or institutions and our donors achieve their aims. To build a major gifts program, either for your entire program, or just for you and one of your donors, you must first build a series of relationships.

**2. CREATING TRUST**

Trust rests on a proven history of reliability and honor. You keep your word, you do what you say you will, you are discreet, and you do not take inappropriate advantage of knowledge and confidences. A deep and abiding trust takes a long time to build, but one can begin the process and earn growing degrees of confidence early in a relationship. It's a tough thing to earn, and it's nearly impossible to recapture it once you've done something to lose it.

**3. LEARNING ABOUT THE OTHER PERSON**

If you are a successful development officer, one of the things you probably enjoy most about life is meeting and getting to know other people. As part of building relationships, as part of working toward a successful solicitation, and as part of having a fulfilling career, you want to get to know your prospective donors on more than a superficial basis. While remembering the purpose and the limits of the relationship, getting to know your donors well over time can be rewarding in and of itself.

**4. SHARING YOURSELF**

Communication is not a one-way process. Insofar as it is appropriate, and insofar as the prospect is interested, you will share knowledge about yourself while you are learning about your donors. You are not, solely, an inquisitor or a detective digging up information to solve a mystery. You are developing a long-term association where some of yourself - your thoughts, your attitudes, and your feelings - will be involved, and sometimes shared, with your donors. Always remembering, however, that appropriateness, discretion and reserve are to be courted.

**5. ARE MAJOR DONOR COMMUNICATIONS GOALS ANY DIFFERENT THAN THE UNSPOKEN AND LARGELY SUBCONSCIOUS GOALS YOU HAVE WHEN YOU MEET ANYONE NEW YOU WANT TO KNOW BETTER?**

In some ways, the goals you have when you meet an interesting person are the same ones you have when you meet a major donor. You want to find out what makes her so interesting and how she accomplished

her achievements. You want to make a good impression, leave her with the feeling that she would like to meet with you again, and begin to create the feeling that you have some goals in common.

## **6. WHAT'S DIFFERENT ABOUT COMMUNICATING WITH MAJOR DONORS?**

In spite of the similarities, there are some important differences between communicating with friends and other acquaintances, and with major donors and prospects. You are going to ask this person for a substantial sum of money, in some form, and from the start, that's the basis of the relationship. Everyone involved knows that fact. It may develop into a multifaceted association, but at root, it will always be financially based. You will not, generally, want to behave as a financial or social peer of the donor. And even when the donor feels you and he are very similar, he will always be in the driver's seat, and your taking liberties can end up costing your institution important support, and causing you and the donor confusion and embarrassment.

## **7. ARE YOU GENUINELY INTERESTED IN YOUR PROSPECTS AS PEOPLE?**

Communication with anyone becomes much easier and more genuine when you are actively interested in the other person. Presumably, part of the reason you're a fund raiser is your interest in people. But that interest has to go beyond how to get the best gift from that donor. While it is not possible nor required to develop affection for all your donors, you should care about most of them and be interested in them as people, not in a touchy-feely way, but in a "disinterested" (in the 19th century sense of the word as meaning not interested for personal selfish reasons), as well as an interested way.

## **8. DO YOU RESPECT YOUR PROSPECTS?**

As you get closer to your prospects, you begin to learn more about them, foibles as well as admirable qualities. Just as it would be dishonorable to reveal a friend's quirks in an inappropriate manner, it is imperative that you respect your donors in the same way. That does not mean everything you learn about the donor is a secret from your colleagues. After all, the donor knows for whom you work. But, it does mean that you are very discreet and you share things that need to be shared, but you do not gossip about your donors.

## **9. WHY MIGHT THEY BE INTERESTED IN YOU?**

One of the things that makes it difficult for us to be as pro-active as we might in contacting and visiting donors is the feeling that there's no reason why they'd be interested in us. We are also afraid that they'll feel all we want is their money. Many donors want to know you better because you're the person who's going to help them realize their philanthropic goals, and they want to know whether you're a person to work with and trust. After the initial meetings, they also become interested in you because you're interested in them. We are all like that to some degree: we admire and like people who like us. No healthy person chooses to spend time with someone who is abusive or rude and who thinks little of one and shows it. We all like to be in positive environments that reinforce the good aspects of our characters. As fund raisers, we can create these micro-climates for our donors. They deserve to be treated well, and most of us enjoy treating them well.

### ***SOME QUESTIONS TO ASK YOURSELF***

*Why is communicating with major donors a special topic? Why should it be any different than communication with anyone else? Well, in many ways, it isn't. One way to think about building relationships with major donors is to think about how you would like to be treated. What do you expect from someone or some group for whom you have done a favor? Or who wants you to do him or them a favor?*

**1. YOU EXPECT POLITENESS:** This is so obvious it shouldn't need to be said. Paying attention to all the ramifications of good manners, in the formal as well as the informal sense, is very

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April 15, 1998  
Shirley Anne Peppers

important. Erring on the side of slightly too much formality - not using an older or senior person's first name until asked, waiting until everyone is served before eating, instant thank you notes - is not always appreciated, but is noticed when absent. Also, even for people who prefer a more informal way of interacting, it is usually enjoyable to be treated in a courtly manner. Formality and attention to the rules of polite behavior also lend a certain air of seriousness to the relationship. As you get to know a particular prospect, of course, your behavior will adjust itself in a way that seems natural and appropriate for both you and your prospect.

2. **YOU EXPECT PUNCTUALITY:** This is part of being polite, but not everyone has the same definition of punctuality. If your appointment is for 11 a.m., it doesn't mean turning into the parking lot at 11. It means announcing yourself to the receptionist at 10:55 a.m. It means returning calls within 24 hours, or having your assistant call if you're on vacation or unreachable. It means writing thank you notes, preferably the next morning, and certainly within a few days. It means performing quickly any tasks you've agreed to do.

3. **YOU EXPECT SINCERITY OF THE ASKER:** A fund raiser who seems too obsequious, who seems to be trying to tell you only what you want to hear, one who never gives you a direct answer, and one whose final results are often very different from your initial expectations, tends to make you nervous and distrustful. You don't want to feel used or manipulated, and insincerity usually has just those results. You are not likely to seek out or respond warmly to someone you perceive as insincere.

4. **YOU EXPECT THE SOLICITOR TO CARE ABOUT THE CAUSE HE'S ASKING YOU TO SUPPORT:** Most of us do not respond well to a fund raiser or other requester when we feel she's only doing it "for the money." We are much more receptive and willing, at least to listen, if the asker clearly is committed to the cause. In major donor solicitation, it often takes years to develop the kind of relationships that lead to the gifts that shape the future of the institution. Each of us has to be attached enough to our cause to spend several years building those relationships, sometimes with little tangible reward for great stretches of time. If you don't care, it's difficult to get someone else to care.

5. **YOU EXPECT THE ASKER TO CONVINCING YOU THAT THE CAUSE IS WORTHY:** When I want you to take a certain action, you expect me to tell you why I want you to do this thing. You expect to have me present my case for your support. You expect me to anticipate questions you may have and objections you may be reluctant to raise. You expect me to tell you why you should spend whatever resource I'm asking for - time, money or volunteer effort - on my cause rather than another. You also expect me to try to do all this even in the face of some rejection. You do not expect me to give up in the face of feeble or sporadic resistance, and you may even enjoy the give and take of discovering whether the Case is worthy of support.

6. **YOU EXPECT PROOF THAT AN ORGANIZATION ACTUALLY DOES WHAT IT CLAIMS TO DO:** Well, that's pretty obvious. But, even some of our most worthy institutions take themselves and their donors' understanding and approval too much for granted. If you feel you're the best liberal arts college in the state, can you prove it? I may want you to if you want \$5 million from me and my family. Your own propaganda will not be sufficient. I'll want facts, figures and testimonials, for a start. Is your attention to undergraduates unequalled? Who says so besides you?

7. **YOU EXPECT RECIPIENTS TO SPEND YOUR MONEY AS PROMISED:** Either your track record must speak for itself, or you must present reliable assurances that my money will be spent as you assured me it would be. That's not to say that I can set the priorities of the school, but if you tell me my money will go to support needy undergraduates, I do not expect to hear that my scholarship was awarded to a brilliant but wealthy engineer. If I give you an art collection that you promise to keep together, pieces of it cannot be sold 10 years from now. If you cannot keep a commitment to use a donor's gift as promised, don't promise, even if you have to give up the gift.

8. **YOU EXPECT TO BE INFORMED OF HOW YOUR GIFT IS BEING USED:** The key word here is INFORMED. Getting regular reports on the use of my money is another way of being thanked. It's also a way to remind me of what I've done, to renew those warm feelings I got when I made

the gift, and to help me be receptive to another request. I wanted to do something to help the college, and to hear that what I did continues to help is very gratifying.

**9. YOU EXPECT OTHERS WILL BE ASKED TO DO WHAT YOU'RE BEING ASKED TO DO:** Most people want to know others agree with their decisions to support worthy causes. They also don't want to bail out a sinking ship, particularly if they seem to be the only ones bailing. Similar actions by others with whom we identify provides affirmation and validation of our own behavior, something that is necessary to some degree for most of us. If I'm by far your biggest prospect, I may expect to give the largest gift, but not if others are not asked to do their share.

**10. YOU EXPECT TO BE LISTENED TO:** The feelings that someone has heard your concerns and that what you have said has made some impact are among the most satisfying experiences we can have. Conversely, the awareness that one is not being listened to and that one's words are falling on deaf ears is frustrating to us all. We respond to people who seem to listen wholeheartedly to what we say, and we avoid those whose listening seems to be only a hiatus between monologues, or who don't even try to appear to listen.

**11. YOU EXPECT TO TALK PART OF THE TIME:** As obvious as this sounds, scores of development officers talk themselves out of gifts every day. Whether it's nervousness, thoughtlessness, eagerness to make the CASE or just rudeness, the urge to talk, talk, talk, can be overwhelming for some people. Also, many people are uncomfortable with silence when they're among comparative strangers. When someone babbles at you, even though what he's saying is interesting or important, you get tired of it before too long.

**12. YOU DON'T EXPECT TO BE INTERRUPTED:** Since you're the person the asker is trying to convince, you expect he will defer somewhat to your thoughts and opinions. You feel he should listen to your ideas even if he is unwilling or unable to implement them. You expect to be able to complete your thoughts. You expect to have a moment to compose an answer to a question. It is not your expectation that the solicitor will use your words merely as segues into his own comments or anecdotes.

**13. YOU EXPECT TO BE RESPONDED TO:** If you pose a question, concern or criticism, you expect a response. An honest, clear and straightforward reply not only will provide you with the information you need, but will give you some clues as to the way the solicitor deals with challenges and how the institution intends to deal with you. When the asker doesn't have the information or the authority to make the decision you want, you expect to be told that in a prompt manner. And then, you expect the person who wants you to give time, energy or money to her cause to get back to you promptly with a response.

**14. YOU EXPECT THE REQUESTER WILL KNOW SOMETHING ABOUT YOU:** You weren't picked out of the blue for this request, or were you? You expect that either because of your history with this person or group, or because of known concrete facts about you that make it seem reasonable that you would listen to this case, you have been chosen (as one of many) to hear this request. You would be surprised to learn that you were being visited just because you are rich (particularly if you're not) or because you live in a fancy neighborhood, or you have the same last name as the richest family in town.

**15. YOU EXPECT TO BE ASKED:** While you may be a very generous person and want to support many worthy causes, you have to make choices. Even if you're wealthy, you don't feel you can support everybody who needs money or time. Also, we support people and causes for many reasons. Some of those reasons include ego and being asked.

**16. YOU DON'T EXPECT TO MAKE A DECISION RIGHT AWAY:** Unless you're being asked for something relatively trivial, you will want to think about your response and possibly discuss it with someone else. You may need more information. You may have to weigh this request against others you've received. You may need more convincing. I won't say you may enjoy the process of the solicitation nearly as much as you will enjoy making the actual gift.

**17. YOU EXPECT THE SOLICITOR WILL DO WHAT SHE SAYS SHE'LL DO:** If I ask you to help me organize a group of volunteers for a community action effort, you'll want to know what the group is going to do, maybe you'll be curious about how this problem came about, perhaps you want to know who's funding the effort. If you ask me to get you this additional information and I agree, you expect to hear from me before too long with the answers to my questions. If you then agree to try to drum up support and I say I'll get you a list of names and phone numbers within a week, you expect to get an accurate list with correct, current phone numbers in something less than a week. You do not expect inaccurate numbers a month later. Your opinion of me will be formed, at least partially, on how I perform these tasks, and your allegiance to the cause will be affected positively or negatively because of how I behave.

**18. YOU EXPECT THE ASKER TO KNOW ABOUT YOUR PAST SUPPORT:** If the development officer from your college comes to see you about either a new volunteer role or some sort of special gift, you assume that he knows that you've been a loyal supporter of the annual fund for 34 years, that you led the local phonathon effort from 1983-89, and that you and your sister endowed an undergraduate scholarship in memory of your parents. That the fund raiser is new, very busy, and has much bigger donors to worry about than you means nothing to you. If he doesn't "know who you are," then you will be less well disposed to do what he asks.

**19. YOU DON'T EXPECT TO BE BADGERED:** After you've been asked, you will want some time to think over the request. Even though you may have expected the solicitation, it's a big commitment and you probably weren't sure of the exact details until you heard the proposal. A development officer who doesn't respect your natural desire to take your time or whose organization is so hard up she feels she has to rush you and try to get a decision immediately will probably get a "no" or a much smaller gift. Being pestered and rushed is likely to make you a little suspicious and maybe even a bit angry.

**20. YOU EXPECT TO BE TOLD WHAT YOUR GIFT WILL ACCOMPLISH:** Part of any proposal to you should include specific and clear information about how your gift will help the cause. Even a proposal for an unrestricted gift should provide examples of how that kind of money could be used. If you're asked to spend four hours per week volunteering at a food bank, you want to know how giving your time to this cause will help the hungry. When you get there, you don't want to find yourself doing make-work because they recruited too many volunteers or because they're too poorly organized to use the volunteers they've recruited. You expect to know how your time or money will be used and you expect that use to accomplish the goal you and the organization had when you made the gift.

**21. YOU EXPECT THE REQUESTER TO UNDERSTAND THE PROJECT OR PROGRAM YOU'RE BEING ASKED TO SUPPORT:** A recruiter or solicitor who cannot answer questions about her proposal will not engender confidence. Not only the development officer, but the entire organization will be called into question if the group sends out a fund raiser who appears to be just a "hired gun." A donor or volunteer will have little confidence in you in the future if you start out not knowing the basics about your proposal.

**22. YOU EXPECT TO ASK QUESTIONS:** A solicitor who feels unfairly challenged or criticized by questions is being unfair to the donor. People who are asked to make a substantial commitment of time or money have a right, and indeed an obligation, to make sure the expenditure will be worthwhile. If I have \$1,000 to give away this calendar year and I'm considering giving it to your cause, I'd be foolish not to make sure the gift would accomplish my goal. Do your scholarships go to needy students, or can a rich kid with good grades get money she doesn't need on the basis of academic merit? Will this junior faculty travel grant go to someone who doesn't have tenure yet who's interested in ancient African civilizations? What happens if you don't have anyone who needs this grant this year? My cousin gave you a gift and it wasn't used the way "they" told her it would be used? What happened? How can I be sure that won't happen to my gift? These are all legitimate questions and deserve thoughtful, well-informed, truthful answers.

**23. YOU EXPECT TO BE PERSUADED:** Often, when you're solicited for time or money, you've already made up your mind to help - or you're 75% there and positively disposed. However, for lots of

reasons - uncertainty, insufficient knowledge, donor's remorse, ego, and enjoyment of the attention - you expect and want the development officer to spend a little time convincing you to take the final step. The buildup and anticipation is often a pleasant part of the process. Also, if you're considering a gift bigger than you've ever made before, you're going to be nervous - is this the right thing to do. If I do this, I won't be able to make another big gift for 3 years. How will my children feel about this gift? For any or all of these reasons, you might need and want a bit of persuasion.

**24. YOU EXPECT TO HAVE YOUR OBJECTIONS HEARD:** Even when you're enthusiastic about a project, there may be some aspects about it that bother you, or you may want to participate in a way that the solicitor objects to. If you'd rather not make a pledge, or you feel the college hasn't handled the endowment it already has to the best advantage, or you want some say in who's appointed to your professorship, or you feel your granddaughter was rejected unjustly, or you think the curriculum is too conservative or too liberal, you have a right to expect that someone will respond seriously, completely and thoughtfully to your concerns, not brush them off glibly.

**25. YOU EXPECT TO KNOW WHAT'S GOING TO HAPPEN NEXT:** Pleasant anticipation, possibly tinged with a little anxiety about exactly how much you're going to finally give is part of the donative process for a gift that's significant for you. After each visit or other significant step, you want to have a pretty clear idea of what's going to happen next and when. You don't want to be asked to listen to a serious proposal from the President when you thought your friend, the development officer, was just coming to have a friendly lunch and talk about when you'd like to see a proposal. You certainly don't want to be shocked with a figure unexpectedly, even if you know you're eventually going to be asked for money. It puts you at a disadvantage, and most people don't leave those situations with positive feelings.

**26. YOU EXPECT TO BE THANKED:** When you've acceded to a request, while you're working on fulfilling the request, and once you've completed it, you expect to be thanked. Also, after you've gone through all these steps, you don't expect to be forgotten. That you felt appreciated and continue to feel that way increases the likelihood that you'll respond favorably to the next request from the same person or organization.









## Charitable Estate Planning – Legal Framework and Practical Perspectives

*Neither the writer nor Neuberger&Berman Trust Company guarantee the accuracy of any of the statements below. This document is designed to be used solely to point out ideas and issues facing those individuals and institutions considering planned gifts. Those persons or institutions wishing to enter into any types of gifts described herein are urged to consult with their legal, tax and accounting advisors prior to the creation of any planned giving program or gift.*

### I. Why Discuss Both the Legal and Practical Aspects of Planned Gifts?

Planned giving today is one of the most important efforts a charity can pursue to ensure that it has secure funding for the long-term pursuit of its objectives. Planned giving programs, however, face significant challenges to success from a number of quarters.

First, planned giving is the fastest growing area of emphasis by an increasing number of charities – the competition.

Second, the donors today are informed about the number of benefits that they can enjoy with planned gifts. They demand specific structures. They involve their advisors in the gift structuring. They are demanding with respect to investments of these gifts. They require that the planned gift officer be proactive in advising them about how the gift can benefit both their families and the charity.

Third, because planned gifts provide immediate and/or long-term tax benefits to the donor, they are an established part of sophisticated tax planning. This trend, coupled with “trust mills” “selling” planned gift ideas to persons without charitable inclinations, has focused the attention of Congress and the IRS on this type of fundraising, rendering it vulnerable to future, more stringent, regulation.

The result of this governmental focus is a new federal law restricting donor benefits from charitable remainder trusts and proposed Treasury regulations, which both expands and restricts the way in which such gifts can be structured. Further, while the IRS has stated that it does not wish to draft any new such regulations in the future, how donors and charities pursue this type of donation over time will be an important element in whether this wish is fulfilled or not.

Fourth, a study conducted last year by *Prince Associates*, reported in *The Chronicle of Philanthropy* stated that of the more than 550 donors who had completed a planned gift of \$75,000 or more who were interviewed, 63% were dissatisfied with the advisors involved in the gift and 59% were disappointed in the planned gift officers. Many of these disappointed donors would neither participate in another planned gift nor recommend it to their friends. In contrast, of the donors **satisfied** with their gifts, 80% would participate in or recommend to their friends to entertain this form of giving.

This study also revealed that the donors did not expect the planned gift officers to be as knowledgeable as the advisors involved. Therefore, while the planned gift officer must know the basics of the different types of planned gifts and how they might respond to specific donor needs, as importantly, he or she must carefully choose the trustee, investment managers, and legal and financial advisors to ensure that all of the concerns of a donor are addressed throughout the life of a gift.

The reasons for this conclusion are: donors can be satisfied or dissatisfied with a gift because of the legal requirements, but they can be more satisfied or dissatisfied with the advice received with respect to the gift structure, the comprehensiveness of each advisor's knowledge and experience, the way in which advisors and the charity work together, the timeliness of the completion of the gift, and the effectiveness of the administration and investment of the planned gift over time to satisfy both donor and charity needs. Therefore, there are both legal and practical issues which must be addressed to ensure a successful gift.

This presentation reviews:

- The basics of planned gift options for donors from a legal point of view including some of the implications for gift structures of the new laws and proposed treasury regulations issued in 1997,
- A practical approach to making certain decisions to ensure that gift is both well structured, **and** well administered and managed over its life.

## **II. The Philanthropist's Options**

### **A. Outright Gifts**

Charitable gifts give rise to income and gift or estate tax benefits. And outright gifts during a donor's life are very attractive to charities and can provide substantial and immediate tax benefits to a donor. Indeed, although classified as an outright gift, bequests are among the single most important part of a planned gift program and provide unlimited estate tax deductions for the donor.

Generally speaking, however, while any type of outright gift is usually quite straightforward in how tax benefits arise, planned gifts are, by their very nature, more complicated. The improper structuring of such gifts can result not only in the loss of tax deductions but can result also in the donor's having to pay a gift or estate tax on the amount given to charity in such a structure.

Outright gifts can be the right solution for certain donors' needs. However, if a donor wishes to remain involved in the control, administration and/or financial results of a donation, a planned gift can be an appropriate alternative to suggest.

### **B. Planned Gifts**

Planned gifts are by definition those which continue to involve a donor and/or his or her family over time. That involvement can be represented by annual payments to individuals from the investment of the gift; return of the remaining amounts of the gift after a charity or charities has enjoyed income from the gift over time – so-called “split interest gifts;” or control by the donor of the administration, investment or use of the funds of the gift over time.

Because different types of gift structures involve different levels of cost both in structuring and administration, the following discusses planned gifts in terms of suggestions for appropriate options for small gifts and appropriate options for large gifts. Determining which gifts are to be considered small and which are to be considered large will be a function of the size of a charity's total planned gift program and the actual costs of administration and investment management.

Further, amounts which charities consider small has naturally risen over time. Several years ago, a planned gift of \$100,000 would have been considered large by many charities and therefore appropriate for the types of individually administered and managed trusts which will be described below. Today, an increasing number of charities will consider gifts of under \$500,000 as small and therefore appropriate for the small gift options. These changes are driven, at least in part, by the rising costs of administering gifts, be they large or small. These rising costs are due, at least in part, to the increasing regulatory and reporting requirements associated with such gifts.

### **C. Split Interest Gift Options for Small Donations**

#### *i. Pooled Income Funds*

Pooled income funds operate like mutual funds. They are actually pools of commingled donated funds managed for the benefit of the donor and the charity, and usually the investments are in mutual funds, bank common trust funds or segregated investment management accounts administered solely for the benefit of the pooled income fund. There have been cases in which a pooled income fund has held investments in real estate, but such investments have complicated requirements in terms of reporting and disclosure in the governing trust instrument.

The donor receives his or her share of all of the income (which cannot include either short or long term capital gains) generated each year by the pool, and at the end of his or her life, the remaining funds are transferred to the charity. A donor does not need to retain the right to all of the income. A gift can be structured so that the charity receives a share of the income in the same year that income is generated.

A donor can name additional income beneficiaries when he or she donates funds to a pooled income fund, although such interests are revocable by will. Beneficiaries must be individuals or trusts established for the benefit of individuals who must be alive at the creation of the gift. All income interests must run for the named individuals' lives.

The donor receives an immediate charitable income and gift or estate tax deduction when he or she establishes a gift to a pooled income fund. This deduction is calculated by determining the value of future gift to charity. The income beneficiaries must report all amounts received each year from the pooled income fund as taxable income.

A pooled income fund is not tax-exempt. However, the income distributed to donors is not taxed to the pool. Short-term capital gains are taxable to the pool whereas, long-term capital gains, which remain in the pool, are deductible as "charitable set-asides."

Further, there are a number of specific regulatory requirements under the Internal Revenue Code and Treasury regulations, which require that:

- The remainder interest of the charity in the pool is irrevocable;
- The pooled income fund cannot receive as a contribution, or invest in, tax-exempt securities;
- The pooled income fund must be maintained by the named charity, although the charity can name an outside trustee and retain the right to change the trustee to comply with this requirement;
- A donor cannot be trustee.

Because of these requirements, the donor does not retain the right to control the administration or the investments of the pooled income fund. He or she also cannot control the number of years over which the income interest is paid to the individual beneficiaries. Therefore, this gift is inappropriate for donors interested in a gift structure in which he or she is interested in impacting these aspects of the gift over time.

*ii. Charitable Gift Annuities*

Charitable gift annuities operate in substance like a commercial annuity. A donor gives property to a charity in exchange for the charity's promise to pay the donor a specified amount of money each year for the rest of the donor's life. Usually a charity cites a specific rate of return, which a donor will receive, from the gift. Most charities cite the published rates of the American Council on Gift Annuities.

This practice gave rise to a case in Texas in 1995, which challenged the anti-trust implications of charities relying on these published rates. A Federal law was passed exempting charitable gift annuities from the anti-trust laws and regulations. However, the case is still pending in Texas at the time of this article. This case named over 200 charities and their advisors in a class action suit and has been a very expensive exercise in defending the charitable sector. This case is only one example of a reason a gift officer must understand not only the legal requirements of specific gift structures but also the way in which such structures respond to a donor's needs. The plaintiffs in this case argued that the donor was encouraged to give all of her money to the charity in exchange for an annuity which was insufficient for her to live on.

A charity's promise to pay an annuity is backed by all of the charity's assets. A charity's assets are therefore exposed to risk. As a result, in all states, but not in the District of Columbia, charities must maintain a reserve account to support its promises. These reserve accounts are generally regulated by the states' insurance departments and are subject to very strict requirements with respect to how they are invested.

The annual payments can be structured to begin now, or later, at some future, specified date. The latter structure, a deferred charitable gift annuity, offers donors the benefit of taking a charitable deduction in a year in which their tax rates may be high and enjoy the annuity payment in retirement years when their tax rates may be low.

The donation will give rise to both a charitable gift and a right to receive an annuity payment. Therefore, the value of the annuity a charity pays to a donor will be less than the whole value of the donation. The total value of the donation is determined by taking 120% of the "The Federal Midterm Rate" in the month in which the gift is established (or the rate in any one of the two preceding months) and applying it to the number of years the annuity is expected to last in light of the donor's age. The higher the rate, the higher the charitable deduction. The lower the rate, the higher the tax-free return of principal portion of the annuity payment to the donor.

Therefore, the donor will receive a charitable income and gift tax deduction at the time of the exchange, and the calculation of these deductions is straightforward when the donation is in cash. It is more complicated, however, if a donor wishes to give appreciated property in exchange for the annuity payment. Such a gift is treated as a "bargain sale" for purposes of calculating the deduction. The result of this treatment is that the donor will recognize capital gain with respect to the part of the donor's gift, which is to be paid back to him or her over time. Under certain circumstances, this capital gain does not need to be recognized immediately but can be recognized over time as the annuity payment is received from the charity.

Also, when individuals other than the donor have a right to the annuity payment, the donor must recognize such payments as a gift and pay a gift or estate tax on the value of the annuity payable to the individual. Further, the marital deduction is only applicable where no person has a right to the annuity payment after then termination of the spouse's interest.

Like a pooled income fund, the charitable gift annuity does not permit a donor any control over the administration of the gift. Also, while payments can be deferred to some later date, once they are commenced, they must run for the life or lives of the individuals named in the contract. And finally, the payments are fixed at the time of the gift, preventing the donor and other individual annuitants to benefit from an increase in payments to compensate for inflation over time.

#### **D. Other Planned Gift Options for Small Donations**

Another type of gift structure attractive for small gifts is the donor-advised fund. This fund does not generate any financial payments to individuals over time but does permit the donor to segregate funds in a tax-exempt vehicle to direct to charities of choice over time. Therefore, a donor can benefit from the tax-free growth in a well-managed fund to provide larger donations to favorite charities than would be possible if the assets he or she wishes to donate were invested in a taxable account.

Donor-advised funds are offered through community trusts and over the past few years through retail brokerages and trust companies. These funds must be maintained by a public charity and therefore, the retail brokerage houses and trust companies have established charities to administer and manage such funds.

The donor-advised fund operates in substance like a private foundation without the costs associated with a separate entity. In summary, a donor establishes a specific fund at the community trust or gift fund and retains the right to request that donations from such a fund be donated to different charities over time.

However, the donor does not retain the right to *direct* gifts. He or she can only *recommend* donations. The charity managing the fund must make the ultimate decision with respect to where donations are sent. If there is evidence that a donor is controlling the donation to charities rather than just requesting such donations, the fund runs the risk of being reclassified as a private foundation which is subject to a myriad of reporting requirements, complicated rules about minimum distributions annually and an annual income tax of 1–2% of net investment income.

#### **E. Overview of Planned Gift Options for Large Donations**

Planned gift options for large donations are distinguished from the options described above by the ability of the donor to retain some control over the structuring of the gift, its investment policy and distribution schedule. However, with this flexibility comes more complicated decisions to ensure that each gift is properly structured.

Also the major types of planned gifts for large donations (specifically charitable remainder trusts and charitable lead trusts – “split interest gifts”, and supporting organizations and private foundations - outright gifts), can be distinguished in the donor's point of view, by their differing permissible levels of donor control and corresponding differences in tax benefits.

## F. Split Interest Gifts for Large Donations

### i. Charitable Remainder Trusts (CRTs)

Charitable remainder trusts are the most talked about of all of the types of planned gifts. The reason for their popularity is the ability of such trusts to be structured to specific needs of a donor and family in terms of level and timing of payments to individuals from the trust, the deferral of taxes on all income and capital gains generated in the trust, additional significant tax advantages if low cost basis, highly appreciated assets are contributed, and the ability of a donor to change the name of the charities who will benefit from the gift.

There are five types of charitable remainder trusts. All five provide annual payments to a donor and his or her family (the "income beneficiaries") for life or over a specified number of years. At the termination of these payments, a charity or charities chosen by the donor will receive outright all funds remaining in trust. The charities named in the trust document can be changed by will and a private foundation can be named as the remainder charity.

Generally speaking, all five types of CRTs generate an income and gift or estate tax deduction to the donor at the time the trust is established, and where permitted, when additional donations are made to the trust in future years. These deductions are calculated on the estimated future gift to charity. That estimation is calculated using a federally mandated discount rate to determine the net present value of the charitable gift. This rate is 120% of the federal midterm rate published monthly. A donor has the option of using the rate for the month in which the gift is made to the trust and thus the trust is established or the rate in any one of the two months immediately preceding the month in which the gift is established.

Since August 1997, the value of the charitable remainder must equal 10% of the value of the assets used to fund the trust. This value will reflect both the discount rate described above and the level of annual distributions to the income beneficiaries. Therefore, there can be restrictions on the level of income payments to individual beneficiaries over the term of the trust or the term of the trust must be restricted to ensure that the charitable gift is at least 10%. And in some limited circumstances, a CRT cannot be established for a donor's life!

There are also specific rules about deductions when either tangible personal property or options are used to fund a trust. The result is that these types of assets are not as tax-deduction attractive to donors as donations of cash, marketable securities, business interests and real estate. Also, there are specific rules and restrictions with respect to donations of mortgaged property. Further, business interests generating taxable business income can not be donated to charitable remainder trusts.

A charitable remainder trust is a tax-exempt trust. All income and capital gains generated by a charitable remainder trust are non-taxable. Tax is due from the income beneficiaries only as and when actual distributions are received from the trust and the taxable nature of the distributions is determined by how much the trust has generated in income or capital gains. In some cases, part of the distributions to the income beneficiaries will be return of principal and therefore not taxable if the trust has not generated a certain level of income or capital gains.

This type of trust is attractive for donors with low-cost basis assets. When such assets are donated to the trust, the donor can generally take the market value of the assets rather than their cost basis to calculate charitable deductions. Also, when such assets are sold by the trust, there is no tax, permitting the entire tax proceeds to be invested in the trust benefiting both the income beneficiary and the charity or charities named as remainder beneficiaries.



The five types of CRTs are:

- Charitable Remainder Annuity Trust (CRAT)
- Charitable Remainder Unitrust (CRUT)
- Charitable Remainder Net Income Unitrust (NICRUT)
- Charitable Remainder Net Income with Make-up Unitrust (NIMCRUT)
- FLIP Charitable Remainder Trust

These trusts are generally distinguished by how the annual payments to the individual beneficiaries are calculated. In brief, they differ as follows:

A CRAT provides that a fixed dollar payment will be made each year to the individual beneficiaries named in the trust document. At the termination of trust, the remaining amount in the trust portfolio will be donated to the charity or charities named by the donor. As the dollar amount of the annual distributions is fixed at the time the trust is created, the income beneficiaries will not participate in any increase in the value of the trust portfolio. Also, additional contributions can not be made to the trust after it is established requiring that a new trust document be drafted each time an additional gift is to be made.

A CRUT provides that a specific percentage (the "unitrust amount") of the value of the trust portfolio, revalued each year, will be distributed to the named individual beneficiaries. At the termination of trust, the remaining amount in the trust portfolio will be donated to the charity or charities named by the donor. In this structure the individual beneficiaries participate in any increase in the value of the trust portfolio as it is revalued each year for purposes of determining the amount to be distributed. Also, the donor can make additional contributions to the trust over time, eliminating the requirement that a new trust document be drafted each time a new gift is made.

A NICRUT provides that the income beneficiaries will receive each year the lesser of the actual trust income generated in any one-year or the specific percentage of trust assets set forth in the trust document. Trust income is defined by state, not federal, law. This structure has been used by individuals seeking to defer payments to themselves over a number of years. If the trust portfolio consists of property which does not generate "trust income" as defined by the laws of the state in which the trust is resident, then no distributions are made in that year. All of the income and capital gains generated in such a year are then retained by the trust for further investment. The donor can make additional contributions to the trust over time, eliminating the requirement that a new trust document be drafted each time a new gift is made.

A NIMCRUT operates like a NICRUT except that to the extent that the income beneficiaries do not receive the full percentage of the trust's portfolio in any one year as described in the trust document, they retain the right to receive it in later years when trust income is sufficient to pay the distribution. Additional contributions can be made to the trust by the donor over time, eliminating the requirement that a new trust document be drafted each time a new gift is made.

As of this writing, the Treasury has proposed that a FLIP trust which combines the advantages of a NIMCRUT and a CRUT be permissible. This structure would permit a trustee of a trust whose income beneficiaries wish to delay distributions for a number of years to do so without compromising its duty to manage the trust portfolio for total return and for the benefit of both the income beneficiaries and the charitable remaindermen. When the income beneficiaries wish to begin distributions, both the trustee and the beneficiaries can be confident that the trustee is required to pay out the specified percentage of trust assets annually.

This structure would require that the unproductive property be the majority of the assets in the trustee prior to the FLIP from a NIMCRUT to a CRUT. However, there has been extensive testimony and written submissions by bar associations and planned giving professional groups about the various restrictions proposed to permit such a trust to operate. At the time of this writing, final regulations have not been issued.

This trust also permits additional contributions over time.

In summary, these types of trusts can be structured in a variety of ways to respond to the needs of a donor and family for increased income, tax deductions, marital deductions and gift tax management.

## ii. **Charitable Lead Trusts**

Charitable lead trusts (CLTs) operate in exactly the opposite way in which charitable remainder trusts do. In these trusts, the charity/ies have the lead, or annual distribution, interest, and individuals receive the remaining trust portfolio at the termination of the trust.

Donors generally use this type of trust in cases in which they wish a charity to be able to count on specific annual gifts and also wish to pass the remaining assets on to children and grandchildren at a preferential tax cost. To determine the taxable nature of the gift to family members at the end of the term of the trust, the payments to the charities over the years coupled with the required discount rate which is 120% of the federal midterm rate published monthly can result in a low gift tax cost. Please note that there are significant generation skipping tax issues which can arise if grandchildren are named as the remainder beneficiaries.

CLTs are taxable trusts but who pays the tax on the income generated in the trust is determined by whether the trust is a grantor or non-grantor trust. If the trust is structured as a grantor trust, the donor – or the grantor – retains the tax liability for all income and capital gains generated by the trust portfolio. The donor does not generate charitable tax deductions when the trust is established. At the same he or she does generate a charitable income and gift or estate deduction each year for the payments made to charity from the trust. Additionally, if a trust can distribute securities rather than cash to the named charity, no taxable capital gains will be generated thereby increasing the value of the annual charitable deduction to the donor.

If the CLT is structured as a non-grantor trust, and the trust is established during a donor's life, the donor receives a charitable gift tax deduction – but not an income tax deduction - on the net present value of the payments to the charity or charities. The trust pays tax on the income and capital gains generated by its portfolio offset by the charitable deduction it takes for the annual payments to charity. In this case, the trust generates no tax benefit from donating securities as opposed to cash to the charities as the appreciation over cost basis of the value of the securities donated must be treated as capital gain on the trust tax return.

There are two types of CLTs:

- ✓ Charitable Lead Annuity Trust
- ✓ Charitable Lead Unitrust

A charity's annual payment in an annuity trust is a fixed dollar amount. A charity's interest in a unitrust is calculated as a percentage of the trust portfolio revalued every year. There are different implications for the generation skipping tax in each structure.

## **G. Outright Gift Structures for Large Donations**

### ***i. Private Foundations***

Private foundations are attractive to donors who wish to retain specific control over which charities receive distributions annually, and the level of annual donations and also wish to encourage family involvement in charitable giving over time. Private foundations can be structured as trusts or as corporations. Families wishing to ensure that there is the highest level of accountability in those managing the foundation, choose the trust over the corporate structure.

Private foundations must have only a restricted source of founding. General public support will guarantee that the foundation will be deemed a public charity.

A private foundation must distribute 5% of the value of its assets annually and pay a 1-% tax on its net investment income and capital gains. If it fails to distribute the 5%, the tax will be 2%. There are also a myriad of other reporting requirements and penalty taxes where there is a finding of self-dealing, excess builds holdings, jeopardy investments or taxable expenditures. For the majority of donors considering such a gift structure, the principal question is which type of assets will fund the private foundation. If a donor is considering contributing shares or interests in a closely held business he or she controls, it is important to point out to them that the interests can not be sold to a family member or other connected person without triggering an excise tax on self-dealing.

### ***ii. Supporting Organizations***

Supporting organizations are public charities established by donors to support specifically named charities. These supporting organizations must be intimately involved in the operating of the charities named and their financial support of the named charities must be significant. Significance is determined in a number of different ways. For example, it can be determined that the funding from the supporting organization is a large part of total funding. It can be determined that substantially all income generated by the supporting organization is donated to the named charities and therefore its involvement is significant. Further, there should be participation on the board of the supporting organization of officers of the charity.

Supporting organizations have an advantage over private foundations. They do not pay the net income tax due from private foundations. However, it should be noted that there is a disadvantage relative to private foundations. The donor does not retain any right to change the charity the supporting organization supports whereas a private foundation can also change the list of supported organizations and the amounts they receive yearly.

## **III. Decisions for a Well-Structured Gift**

There are three important decisions which must be made to ensure that both large and small donations are properly administered: 1) which state's laws will govern the gift or program; 2) who will be the trustee of the gift; and 3) who is the investment manager.

### **A. Choosing a State**

State laws govern the operation of most gift structures and state laws are not uniform in their treatment of either charitable and non-charitable gifts in trust. This presents both an opportunity and a challenge to charities and its donors.

With respect to choosing a state's law to govern the operation of a gift, there are states with attractive trust and tax laws which can increase the options for structuring a specific charitable gift and the options available to other financial, retirement and estate planning vehicles a donor is using to manage his or her entire financial picture.

Assuming the view that a charitable gift should fit into a donor's entire plan, laws relating to other aspects of a donor's plans are just as important as those relating specifically to a gift. As there tends to be cost advantages to a donor's locating his or her charitable gift in the same jurisdiction as other planning vehicles, the jurisdiction your donor should consider for a gift should have at least the following laws and characteristics:

With respect to state trust laws, an attractive state should have a long established Prudent Investment Rule, a Principal and Income Act which facilitates NIMCRUTS; no court-required audit of bank common trust funds which can be used in connection with pooled income funds; and complete trust confidentiality. With respect to state tax laws, an attractive state should have: authorized state-tax-free accumulations in taxable trusts and no intangible taxes. There should be a history of efficient charity regulation, attractive corporation laws and a long history of an experience and predictable judicial system and local legal and tax advisors.

## **B. Choosing a Trustee**

Choosing a trustee of a planned gift is also an important decision. Charities are increasingly unwilling to act as trustee of pooled income funds and charitable trusts. In light of the increasingly complicated regulatory environment, the ability of your trustee to respond positively to the following questions can make a difference between a smoothly operating gift and one which is not:

Is the trustee familiar with all types of planned gifts? Does it have officers experienced in integrating charitable gifts into a donor's entire financial plan? Do officers of the trustee have credibility with the legal and charitable communities? Are there professional staff members dedicated to the planning and administration of charitable gifts? Do officers have experience with the valuation and tax reporting for charitable gifts?

Does the trustee operate in more than one state? Are there officers familiar with the laws in the state in which the donor resides or can access legal counsel there to determine the relevant laws? What is the normal response time for client requests? Is the trustee's client profile similar to your donor profile? What is the turnover history in terms of both clients and staff? What is the average number of years of experience of senior and junior staff? Are there lawyers on staff? How clear are the statements issued to donors and to charities? Are automated remittances possible?

How are investment managers of charitable gifts chosen and monitored? How are investments made – mutual funds? Individually managed accounts? How are fees computed? Are they essentially commissions or are they computed as a percentage of the gift's investment portfolio? Are there other fees such as payout and termination fees or co-trustee fees? Are there transaction fees?

## **C. Choosing a Money Manager**

Choosing a money manager for a planned gift program or specific gift is very important, as the best structured legal vehicle can fail as a successful gift if poorly managed! Also, the choice of manager is both more straightforward and more complicated than choosing a trustee. Such a choice is more straightforward because historical investment performance is quantifiable and

there are strict requirements with respect to how performance is shown. However, the choice is at the same time more complicated because of the increasingly specialization among managers as the types of assets available for investment has increased, and the information about each asset class's opportunities and risks has also increased.

When choosing a money manager, answers to the following questions should assist a planned gift officer to evaluate the potential future performance of such a manager relative to market performance and his or her ability to respond to the specific requirements of a planned gift:

How does the money manager's historical performance compare to other managers with the same investment philosophy over one, five and ten years? How is performance computed – by total return or not and with fees or not? Do performance numbers represent a composite of a firm or the specific performance of a specific manager?

How are securities chosen? Are they chosen from a list generated by a software program? Is the manager free to do his or her own research? What is the average price to earning ratios of the average portfolio? Are the average portfolios generally of the same size as the ones your planned gifts will have?

How many years of experience does the suggested money manager have? What is his or her background? Will you and your donors have access to the specific manager? How are companies researched? Is research just done by reading other institution's reports or does the manager speak directly the management of the companies in which he or she makes investments?

How are donor communications handled? Are there minimum account sizes for individually managed accounts?

With respect to specific charitable expertise, does the money manager pursue a different investment policy for taxable versus non-taxable accounts? What is his or her experience with multi-beneficiary accounts? How often is investment policy reviewed?

#### **IV. Conclusion**

In summary, there are so many ways in which to structure a charitable gift to respond to the complicated needs of donors and their families that no one person can expect to be effectively responsible for all the structuring, administering and management decisions associated with a successful gift. Further, there is no guarantee that the laws, regulations and investment alternatives will remain static throughout the entire life of a gift, nor is it assured that a donor's needs will not change over time. Therefore, it is imperative that planned gift officers choose and monitor the other members of the gift advisory team carefully to ensure that they are committed to remain proactive in analyzing donor needs and the legal environment over time, and take seriously the responsibility for careful administration and management of the gift over the years.

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## **Developing an Effective Process for Investing Planned Gifts**

### **The Issues**

Your organization, ABC College, is in the early planning stages of a campaign. The campaign will focus on raising endowment and scholarship funds. As the College's new Director of Gift Planning, you are eager to demonstrate how planned gifts can play an integral role in the campaign. ABC College has achieved some success in securing planned gifts over the years. In fact, today the College serves as trustee for about \$10 million in various types of life income gifts. However, you have begun to have concerns about the way these funds are being managed. During the six months you have been at the College, you have received at least a dozen telephone calls or letters from beneficiaries complaining about a number of issues. Pooled income fund beneficiaries are unhappy about the level of income they are receiving. Several unitrust beneficiaries have complained that the values of their trusts have not grown as much as the market in the past few years; they believe the College's investments are much too conservative. The Business Office called you last week to tell you that two high payout annuity trusts set up some years ago may run out of money in the next few years and asked you to learn more about the beneficiaries. You have talked with the Director of Development several times about these issues, but are not certain whether she understands the seriousness of the problems.

### **The Assignment**

It's Tuesday morning, following a 3 day holiday weekend. You arrive a few minutes late, and there is a telephone message on your desk. The Director of Development has called. She wants you to drop by her office when you arrive. When you stop in to see her, she tells you that she has an assignment for you. She wants you to be part of a task force that is being established to review how the college is investing its planned gifts and how it is communicating with its donors about trust investment issues. The committee's job will be to identify the best practices being followed today in investing planned gifts, and to develop a set of recommendations for the College to consider.

She says that she has been talking with the Treasurer's Office about your concerns for some time, but she hasn't gotten very far. The issue came to a head at last week's Trustees' Investment Committee Meeting. It seems that Bob Smith, one of the College's trustees (and a member of the Trustees' Investment Committee) complained at the meeting about the poor performance of the trust he set up with the College about eight years ago. He also complained about not getting a regular report about the trust's performance. He often feels he doesn't get clear answers when he calls the College with questions about the trust's investments. The Investment Committee asked the Treasurer to look into these issues, and as a result, the task force was set up. The task force will be made up of staff from the Treasurer's Office, the Controller's Office, and the Development Office. The Committee will have 3 months to do the research and develop and present its recommendations.

### **Where Should You Begin?**

Is this the opportunity you've been waiting for, or a potential disaster in the making? Would you be prepared to join this task force if asked? What are the relations like between your development office, treasurer's office, and controller's office? Do you currently work together effectively on planned giving related issues?

Where should the task force begin? What should be the elements of any plan which is developed? In our session today, I will lay out the components of an effective investment process. While our time today will not permit us to go into the full detail of what is required, I hope to give you a good overview of the major issues.

Let's look at what is needed.

1. An investment philosophy and approach for investing planned gifts based on fiduciary and legal requirements
2. An efficient investment structure that is integrated with trust administration
3. A well thought-out investment policy statement
4. Requirements for the investment manager
5. Standards for donor disclosure and informative donor reporting
6. Clearly identified roles and responsibilities for trustee oversight and staff involvement

After reviewing each of these topics, we will end this session by reviewing a 14 point test that you can use to assess the effectiveness of your organization's investment process.

Let's begin by laying a context for a discussion of these issues.

### **Different Perspectives**

**The Donor:** Donors today are more aware, more sophisticated, and more demanding about investment performance and reporting. Many donors are active investors themselves. An article in the *New York Times* on February 11, 1998, reported that stocks now make up over 28% of the average American's household net worth. This amount even exceeds the value of real estate owned. Many individuals invest their personal portfolios as well as direct the investment of their retirement funds. Many have enjoyed the strong performance of the equity markets in recent years, and in some cases have begun to rely on these above average returns continuing indefinitely. They are also accustomed to receiving a regular flow of information from the mutual funds in which they invest.

Institutions which serve as trustee of planned gifts must clearly understand the responsibilities involved when serving in the role of a fiduciary. Serving as trustee places important responsibilities on the institution, particularly in regard to how a trust will be invested. These responsibilities can last up to 20 or 30 years, or longer, depending upon the expected horizon of a trust. Today it is more important than ever before that institutions work closely with their donors to properly set each donor's expectations for how their planned gift will be invested and can be expected to perform over time. Institutions serving as trustee must disclose to donors both the potential rewards and the risks related to the gift type and investment strategy that will be employed. They need to regularly report to donors on their investment results, and keep donors informed of any significant changes in investment strategy.

**The Institution:** Planned gifts have traditionally represented only a small percentage of the average college's or other nonprofit institution's endowment assets. Until now, staff and trustee attention has been largely devoted to the demands of investing the endowment. The needs of planned gifts are complex, and the institution's finance staff doesn't always have the time to devote to understanding them. However, the growing popularity of planned gifts among donors, and the increased reliance on them by institutions to meet campaign and other institutional funding goals is changing all this. Many campaigns today include a 25-35% planned gift component. As the size of many institutions' planned giving programs has grown, so have concerns about fiduciary responsibility and potential liability amid volatile investment markets and added regulatory scrutiny. The investment of planned gifts can no longer take a back burner to the endowment.

### **What's Different About Investing Planned Gifts?**

The requirements of investing planned gifts are different and in some ways more complex than investing endowment assets.

1. Outside financially interested party (donor/beneficiary)
2. Tax consequences to the income beneficiaries of investment decisions

3. A wide range of account sizes, payout requirements, objectives, and time horizons
4. Beneficiaries with different tolerances for payment volatility
5. Regulatory and oversight requirements
6. Administration and donor reporting requirements

### Legal Requirements

Today the investment of planned gifts is subject to increased regulation and scrutiny. The guiding standard for the investment of all trusts is the **Prudent Investor Rule**, which has now been passed by many states around the country. The Rule sets forth a number of requirements.

1. *Each trust's needs must be considered individually.*

While general guidelines can and should be developed as to how specific trust types will be invested, you must not try to adopt a blanket approach.

2. *Make a deliberate assessment of the potential risks and rewards of the investment strategy to be employed, and balance these risks and rewards in decision-making.*

Consideration should be given to the trust's general purposes, specific terms, return requirements, risk tolerance, and other pertinent circumstances.

3. *Prudence is to be judged within the context of the total portfolio.*

No investments or techniques are imprudent per se, but must be examined in the context of the total investment portfolio. The Rule recognizes that specific investments and courses of action are not properly judged in isolation, but on the basis of the roles they are to play in the specific trust portfolio strategy.

4. *Broad diversification is usually required.*

Sound diversification is fundamental to risk management and is therefore ordinarily required of trustees. The Rule considers proper diversification to be a basic element of due care and skill. Suggested diversification includes the use of different asset classes (e.g. international stock) and diversification among many different securities within an asset class.

5. *The risk of inflation or deflation should be factored into any investment strategy.*

Consideration must be given to the potential impact of inflation or deflation on the purchasing power of the income stream over time and on the ultimate remainder value. An appropriate balance needs to be achieved between the production of current versus future income.

6. *The trustee must balance the interests of the income beneficiaries and the remainderman.*

Any strategy adopted must not unduly favor one beneficiary over another.

7. *The tax consequences of any strategy must be identified and examined.*

Any analysis of a beneficiary's income stream should be done on an after-tax basis. The Taxpayer Relief Act of 1997 heightened the importance of this analysis for standard unitrusts and annuity trusts by widening the spread between ordinary and capital gain income tax rates.

8. *Costs incurred by the trust must be reasonable.*

Trustees have a duty to avoid fees, transaction costs, and other expenses that are not justified by the needs of the trust's investment program.

9. *If a trustee lacks sufficient investment expertise, expert assistance must be obtained.*

Trustees have a duty as well as the authority to delegate investment responsibility to others who have the necessary expertise. Trustees are responsible for careful selection of any manager, for giving clear direction to the manager, and for ongoing oversight of the manager's activities.

The **Philanthropy Protection Act** sets forth requirements on the disclosure which is necessary if an institution commingles planned gifts for investment purposes. This Act applies to trusts if they are commingled in a pooled fund or the institution's endowment, and to an institution's pooled income fund and gift annuities. In general, the Act requires that the trustee disclose how the trust or other gift is invested, who invests the assets, how the assets are commingled, and the "workings" of the pool or fund. Institutions should consult their legal counsel to create informational materials which include these required disclosures and update them as necessary.

The **Uniform Principal and Income Act** adopted by many states specifies how receipts should be allocated between the principal and income of a trust. These distinctions are particularly important in the investment of net income trusts such as pooled income funds and net income unitrusts.

The investment of **gift annuities** is restricted in several states. Since this topic will be covered in some depth in another session at the conference, I won't go into it here.

Finally, the **Internal Revenue Code and Regulations** influence the investment of planned gifts in a number of ways, either directly or indirectly. For example, the taxation of short-term gains in pooled income funds influences the ways these funds are managed.

### The Objectives of Your Investment Process

Your task force should begin its work by focusing on the objectives of your investment process. These objectives should be closely related to overall program goals. There should be three major goals for any planned giving program.

*More Valuable Gifts.* An institution's gift acceptance and investment processes should be closely aligned to achieve the goal of creating more gifts of greater value to the institution. Too many institutions still measure the value of planned gifts in terms of face value. Value should be defined in terms of the net present value of the expected remainder of the gift. To get to that number you have to estimate the expected investment return from the asset allocation that will be used for the gift, the expected horizon, costs that will be incurred, the total payout from the trust over time, and the potential impact of inflation.

A 1% decrease in the payout rate or a 1% increase in the expected investment return can have a significant impact on the expected value of a gift. Examples of this are shown in the chart below. As you can see, effort devoted towards reducing trust payout rates and improving investment returns is time well spent.

Net Present Value of the Remainder			
\$100,000 Standard Unitrust			
(Beneficiary --Age 65) *			
Expected Annual Total Return			
	7%	8%	9%
5% CRUT	\$46,000	\$56,000	\$68,000
6% CRUT	\$38,000	\$46,000	\$56,000
7% CRUT	\$31,000	\$38,000	\$46,000

\* Assumes 1% annual fees and 5% institutional inflation

*Satisfied Donors.* Donors are satisfied when they feel good about the gift they have made and the development process. A new donor should understand how the trust will be administered and invested, including the likely outcomes and risks. Donors are satisfied when they receive consistent stewardship over time, including good investment results and useful reporting on the trust's investments and performance.

*Assured Trustees and Staff.* Trustees and staff should understand the objectives of the planned giving program and the responsibilities and risks involved in serving as trustee. Through development of a sound investment process, including policies, practices, and proper oversight, trustees and key staff will be assured that their fiduciary responsibilities are being met.

### **Investment Philosophy and Approach**

The foundation for an effective investment process is the investment philosophy and approach that will be used to invest the assets. You should examine the investment approach currently being used to invest your organization's planned gifts to see if it fulfills the requirements of the Prudent Investor Rule. You may also want to learn more about the approach other organizations have developed for investing these assets. It is increasingly common today when investing planned gifts for institutions to draw upon concepts that have been used successfully for a number of years in endowment and pension investing. These include investing for total return wherever possible and using broad diversification across asset classes and manager styles in order to increase potential investment returns and reduce portfolio volatility and overall risk. Any approach must be tailored to fit the unique requirements of planned gifts, and should include an attention to the unique needs of each trust, including tax considerations.

For example, Kaspick & Company's approach is to broadly diversify each trust portfolio by asset class and manager style. We include hedges to protect against economic extremes. We have developed a range of asset allocation objectives that can be used depending upon the specific needs of each trust. Depending upon the objective selected for a given trust, trusts may include up to ten asset classes, twenty manager styles, and a mix of active and passive management. The exact mix will differ depending upon whether the trust is invested for total return or for net income.

One organization, of which I am familiar, went so far as to develop a set of principles by which they would manage the investment of their planned gift assets. Examples of the principles they adopted are shown below.

1. *Fiduciary Responsibility.* Balance the need to protect income and principal with the need to grow income and principal over each trust's time horizon.
2. *Protection.* Maintain the purchasing power of trust income and principal over time. Where possible, increase purchasing power.
3. *Investment Strategy.* Look broadly and proactively at asset class exposure worldwide. Diversify across investment styles, asset classes, and securities.
4. *Investment Management.* Hire the best manager(s) available. Give clear simple guidelines. Let them operate freely within their area of expertise. Stay in close contact with them. Measure performance by total return over a full market cycle.
5. *Trust Asset Allocation.* Set trust asset allocation based on trust characteristics, and an understanding of beneficiary circumstances, including their tax situations.
6. *Donor and Beneficiary Communication.* Communicate with trust beneficiaries on all relevant issues at the highest standards of quality and timeliness.

Principles such as these, if adhered to, become a guiding force for action when difficult decisions are required.

### **Possible Investment Structures**

The next decision is the investment structure that will be used for investing your planned gifts. The structure chosen should:

1. *Be flexible and accommodate a broad variety of situations and requirements.*

You should have available a range of portfolio alternatives to meet the needs of trusts of various types and payout requirements. You should also have the capability to build custom portfolios as required (to accommodate promissory notes, real estate, or other illiquid assets).

2. *Allow for accounting at the individual trust level.*

This is particularly important for reporting and audit purposes. It also permits efficient cash management.

3. *Allow for daily pricing of the portfolio and daily performance calculation.*

You should be able to quickly invest new trusts and liquidate ones that are closing. You should be able to provide a donor with his or her trust's value and performance when needed.

4. *Provide tax detail at the trust and asset level.*

This permits close monitoring of tax sensitive accounts throughout the year.

5. *Be automated for efficiency, and be linked on an automated basis to trust administration.*

In addition to reducing errors, this facilitates the investment of each account based on a full knowledge of the relevant facts.

6. *Offer flexible, automated oversight and beneficiary reporting.*

Standard reports should provide detail regarding trust holdings and actual performance at the trust level. More detailed reports should be available on demand.

You can use these requirements to examine your current investment structure as well as the various structures used by other institutions and/or their investment managers to invest their planned gift assets. Each has distinct advantages and disadvantages.

**Invest Each Trust in a Separate Portfolio of Stocks and Bonds.** In this environment, each trust has a separate portfolio of assets custodied in its own account at a bank or brokerage firm. If the trustee seeks to fully diversify the trust across asset classes, this approach won't work. Unless a portfolio is valued in the millions of dollars, it is not possible to gain fully diversified exposure to a broad range of asset classes, such as international and emerging market stocks and small cap domestic stocks, without using pooled investments of some type. Investing each account separately is also an expensive structure, because of custody and other charges.

**Invest Trusts in the Endowment.** This method has been viewed as a low cost way of investing these assets in a diversified manner, since it enables the institution to leverage off of the structure that has been built to invest its endowment assets. It has also been viewed as an attractive option by some donors if the institution has had a good endowment earnings record over time. There are significant limitations, however, to this approach. First, only one asset allocation mix is available -- that which is used for the endowment. This will generally not meet the needs of trusts of various types and payout rates. It may be appropriate for investing gift annuity assets, so long as the charity is not subject to the investment restrictions of the regulated states. Tax considerations are generally ignored in investing endowment assets; they can't be when investing trusts. It is difficult to properly account for and report on trusts when they are invested in the endowment and this work is not always done correctly. Finally, the investment of

any portion of the endowment in debt financed or other investments which produce unrelated business income (UBI) would cause a charitable remainder trust to be taxable for capital gains for any years in which these assets are held. This could be disastrous in the first year of a trust if it were funded with appreciated assets that were then sold.

**Pool Trusts.** Some organizations have established separate pools in which their trusts are commingled for investment purposes. This enables the accumulation of assets into larger groups, thus permitting a more diversified investment approach, including multiple managers and asset classes. However, the asset allocations choices are usually still limited and are not sufficient to meet the needs of different trust types and payout rates. This approach can be costly and requires significant staff time to oversee and maintain. The pools generally must be established as partnerships. Accounting and reporting for trusts at the trust level is complex and is often not done correctly, particularly when cash is commingled. Finally, most of these pools are only priced monthly, in order to minimize costs. This limits the frequency with which new funds can be invested and terminating trusts can be liquidated.

**Invest Each Trust in a Portfolio of Mutual Funds.** This option is generally the preferred method. The assets of each trust should be held in a separate auditable account at a bank or brokerage firm. In this environment, daily pricing and performance calculation is possible. It also offers great flexibility in constructing asset allocations to meet the needs of the different trust types and payout rates. Different approaches can be used for trusts that can be invested for total return versus those which can distribute only net income. If managed properly, total return trusts (such as standard unitrusts and annuity trusts) can be invested in a tax efficient manner. Net income trusts can be managed using strategies that increase the income distributed.

Great care must be taken in the selection of mutual funds. The criteria your institution generally uses in selecting funds or managers for the endowment will apply here as well. Funds which charge loads and marketing fees should not be used. Careful attention should be given to exclude funds with high expense ratios. Institutional funds should be used whenever possible. Funds chosen should generally have low portfolio turnover, in order to avoid unnecessary levels of short-term gains in tax sensitive accounts (e.g. pooled income funds, annuity trusts, and standard unitrusts).

### **Investment Policy Statement**

Once a structure is chosen, it's time to think about your investment policy for planned gifts. Do you have one? The planned gift investment policy is an important document, which should guide the implementation of your investment process across all trusts. It provides direction for your investment manager and your staff, and sets forth the responsibilities of all parties involved in the investment process. It should also relate closely to the objectives set forth in the institution's gift acceptance policy.

Your investment policy should provide guidance on the following topics:

1. Asset classes to be used and maximum percentages to be held in each
2. Maximum percentage to be held of an individual asset
3. Identification of asset allocation objectives to be used
4. Criteria for assigning accounts to the asset allocation objectives, including specific guidance for investing various trust types
5. Direction on issues, such as
  - will you attempt to make up deficits
  - how quickly will you sell gifted securities
  - will you immediately invest a new portfolio or average it in over a period of several months
6. Criteria for accepting, and direction for managing, special situations
  - custom portfolios (e.g. restricted stocks, real estate, promissory notes)

- tax-exempt bonds
- retirement trusts

### **Hiring an Investment Manager**

Some organizations invest their planned gifts using staff in the Treasurer's Office. Others choose to hire outside management. As stated earlier, the Prudent Investor Rule is clear that if a trustee lacks sufficient expertise, outside assistance must be secured. If outside management is chosen, the standard criteria used for hiring an endowment manager will apply to hiring a manager of planned gift assets. In addition, whether managed inside or outsourced, the manager of planned gift assets should meet the following requirements:

1. Knowledge of planned giving and key policy decisions
2. Commitment to planned giving investment management
3. Knowledge of the administration and tax issues related to planned gifts
4. Willingness to focus on trusts of all sizes
5. An understanding that people are behind the trusts
6. Willingness to spend time with staff, trustees, and sometimes donors
7. Systems capabilities to integrate the investment of planned gifts with trust administration

### **Donor Disclosure**

Proper disclosure to donors about the investment of a planned gift at the gift's inception, and on an ongoing basis, is both a legal and an ethical necessity.

In the absence of communication and discussion about investment issues, donors:

1. May have needs and objectives that are not fully understood when the gift is established
2. Sometimes form unrealistic expectations
3. May not understand potential risks
4. May make bad decisions
5. And over time, will come to their own conclusions about trust performance, whether good or bad

Without proper disclosure, institutions risk:

1. Unhappy donors/beneficiaries
2. Gifts which don't benefit the donor or the institution as planned
3. Negative publicity
4. Potential lawsuits

To address these needs, institutions should give careful thought to the disclosure and reporting that will occur at the inception of a gift and throughout its term. Institutions should identify staff responsibility for disclosure issues, and set standards for disclosure and beneficiary reporting over the life of a gift.

### **Investment Disclosure During the Gift Planning Process**

1. Develop a checklist of key items to consider and discuss with a prospective donor (See **Appendix A**)
2. Use a tool which illustrates the potential financial flows to the donor and the charity in both nominal and present value dollars. Work with finance staff or your investment manager to develop reasonable investment return assumptions
3. Develop a range of gift scenarios to illustrate issues, including risks
4. Include information in marketing and disclosure materials describing how gifts are invested and administered
  - consider an overview piece describing your investment process and



- strategy
- ask your investment manager to contribute articles on trust investment issues to your planned giving newsletter

### **Ongoing Gift Stewardship**

1. Review the content and frequency of your current beneficiary reporting package; is it adequate? A good annual package should include:
  - summary of trust income and expenses for the year just ended (disclose fees and expenses charged to the trust)
  - current market value, trust asset allocation, and holdings
  - actual trust performance for the year just ended
  - trust valuation for payment purposes and estimated or actual payments for the year
2. Develop a checklist of key items to discuss in periodic meetings with donors/beneficiaries
  - identify changes in donor/beneficiary needs, including tax situation
  - discuss any changes in your investment process and/or strategy
  - review the current asset allocation of the trust, and recent performance
  - review the most recent beneficiary report
3. Develop special reports, such as an annual report on your pooled income fund, which reports on the activity in the fund over the previous year, including investment results

### **Roles/Responsibilities for Ongoing Oversight**

An institution's trustees must retain oversight responsibility over planned gifts for which it serves as trustee. Ideally oversight of planned giving investments should be assigned to a committee, such as the Investment Committee. Trustees should receive a periodic report detailing each trust in the program, including its asset allocation and performance. Performance should be measured against appropriate benchmarks. Exceptions to policy should be noted. Ideally, the committee would meet with any outside manager of planned gift assets periodically.

Staff responsibility for planned gifts should be clearly spelled out in policy documents. When you look inside the organizations of institutions that are successful at planned giving, you usually find the staff of the various offices (development, treasurer's, and controller's) working together as a team.

Organizations with high levels of ongoing stewardship and good investment performance consistently demonstrate high numbers of repeat gifts.

### **Assess Your Program Using Our 14 Point "Diagnostic Kit"**

Do you need to lobby for an internal task force to review your current investment process? Included as **Appendix B** is a 14 point checklist, developed by a colleague, which will enable you to assess the quality of your planned gift investment process. It includes a list of statements which you are asked to identify as either true or false. The more statements you mark as true, the greater the likelihood that you have a sound investment program in place. In fact, if you answer all of the questions true, you probably didn't need to listen to this talk. If you answer many of the questions false, I hope I've shared ideas with you today that will help you improve the investment of your planned giving assets.

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**Investment Issues to Consider and Discuss with a Donor  
When Planning a Gift**

**1. Assess the Donor's Situation**

- Objectives/expectations for the gift
- Motivations for making the gift
- Income reliance
- Tax situation
- Other investments/assets
- Risk tolerance
- Time horizon of the gift arrangement

**2. Review and Consider**

- Net present value of the income and remainder
- Risks to the donor and to the charity
  - does the plan fit the donor's objectives?
  - does the strategy make sense given the horizon of the gift?
  - what might go wrong? Analyze possible performance under different economic situations
- If your organization will be trustee, can you deliver quality results?

**3. Discuss with Prospective Donor**

- Financial benefits of the gift to the donor and to the charity in nominal and present value terms (try to get a sense of the level of donative intent)
- Impact of the trust type and payout rate on performance expectations
- Possible outcomes/risks, including performance under different economic situations
- If your organization will be trustee, discuss:
  - your capabilities and performance record (include information on any outside investment manager(s) if used)
  - your investment process and strategy, including how this gift will be invested
  - the impact of costs (fees, expenses, etc. charged to the trust)

**14 Point Diagnostic Kit for Assessing  
Your Institution's Planned Giving Investment Process**

This “diagnostic kit” is designed to assist you in assessing the quality of your planned gift investment process. It includes a list of statements which you are asked to identify as either true or false. The more statements you mark as *true*, the greater the likelihood that you have a sound investment program in place. Of course, this test addresses only a subset of the issues. In addition, the explanations included are by necessity brief.

*1. In our trust portfolios, cash rarely exceeds 5% of the total market value.*

Over time, cash has a lower expected return than other asset classes, therefore, it should not have a large permanent allocation in a trust portfolio. Adequate liquidity should be maintained to meet cash outflows; the balance should be invested in asset classes with higher expected returns.

*2. We prepare a quarterly report for our Board of Trustees that shows the investment performance and asset allocation of each trust.*

Your Board members need this information to monitor the program and its policies. If they do not have the information necessary to perform their fiduciary duties, your charity should consider not serving as trustee of planned gifts.

*3. We design an asset allocation for each trust based on the trust type, payout rate, and age of the beneficiary.*

The Prudent Investor Rule requires that trustees assess the needs of each trust and balance risk and return objectives. By failing to develop an investment strategy for each trust, you may be violating your fiduciary duties. In addition, you are likely to be generating large opportunity costs for both you and your donors.

*4. We regularly analyze how our investment strategy is impacting the tax character of our beneficiaries' payments.*

Given the large differential in ordinary income and capital gains tax rates, it is important to closely monitor the tax character of beneficiary payments from standard unitrusts and annuity trusts. The tax character of payments is influenced by the trust's asset allocation (stocks versus bonds), manager selection (manager style/portfolio turnover), and portfolio implementation (cash management, frequency of rebalancing and manager changes). An investment manager of planned gifts should clearly understand 4 tier accounting for charitable remainder trusts.

*5. We rarely accept 7% and 8% payout standard unitrusts.*

A common misconception is that as the payout rate increases, the benefit to the donor also increases. While this is true for annuity trusts and usually for unitrust donors over the age of 75, increasing the payout rate will provide little, if any, additional benefit to younger beneficiaries. The higher payout rate will significantly reduce the value to the charity and thus the ability of the gift to meet the donor's objectives.

*6. We provide our donors with annual investment performance data on our trusts.*

Many of today's donors have first-hand investment experience; they are accustomed to receiving this type of performance reporting. Even those with strong donative intent expect accountability and good stewardship.

*7. We never purchase tax-exempt bonds for trusts that are funded with cash.*

Many charitable trustees do not purchase tax-exempt bonds for trusts funded with anything other than tax-exempt securities. This policy arises from a concern that investing trust assets in tax-exempt bonds may violate emerging standards of fiduciary duty, particularly for trusts with long expected lives.

*8. Our trust portfolios are well diversified.*

Standards of prudence today require that trust assets be adequately diversified across securities and asset classes (e.g., international stocks). A portfolio holding 12 common stocks, for example, is not diversified.

*9. We have adopted investment guidelines for our planned gift assets which outline our goals, policies, and procedures.*

A policy statement is an essential part of a successful planned giving program. Preparing a policy statement will force discussion and resolution of key issues.

*10. Our planned giving office and our finance office collaborate on gift design and investment issues.*

Often investment policies and decisions are formulated by treasury staff who do not have a complete understanding of planned giving. At the same time, many planned giving officers lack the knowledge and training to discuss with donors how gifts will be invested and the inherent risks and rewards. These two groups need to work together constructively and to harness their unique skills to set policies and implement the program.

*11. We select the asset allocation for a standard unitrust based on its payout rate and the expected term of the trust.*

Higher allocations to equities offer greater growth of income and remainder value but also greater potential volatility of payments. Higher payout rates will exacerbate this volatility. This trade-off needs to be considered in light of the age of the beneficiary.

*12. We do not necessarily invest our net income trusts to meet the payout rate.*

Net income trust investment policies should be based primarily on the age of the beneficiary. Younger beneficiaries might actually benefit over time from a strategy that does not maximize current income.

*13. We invest our annuity trusts based on the effective payout rate, using a total return approach.*

Annuity trusts can be invested for total return; portfolio income need not equal the payout. Raising the equity exposure in an annuity trust will increase the expected return and the remainder value, without impacting the donor's payments. Trusts with high payouts in relation to the trust's current market value should be examined closely, as they may be at risk of running out of money.

*14. We have disclosed to unitrust beneficiaries how their trusts and payouts would be impacted by a bear market.*

Most standard unitrust beneficiaries have never experienced a year-over-year drop in their payments. During the bear market of 1973-1974, the payout from a 6% payout trust invested 65% in stocks and 35% in bonds fell over 30% (even more in inflation-adjusted terms).





Financial Accounting Standards Board (FASB)  
Accounting Standards and Issues  
Affecting Not-for-Profits (NFPs)

In this paper, I will cover a variety of accounting standards and pronouncements currently impacting NFPs. These standards and pronouncements will come principally from the FASB and the American Institute of Certified Public Accountants (AICPA). As I present the selected standards and pronouncements I will touch on several accounting areas/concepts that have attracted recent interest from regulators and the industry. I'll close with a short quiz covering some of the more major conceptual issues of NFP accounting. I'll also provide a list of resources for future reference.

Concerning the FASB and AICPA pronouncements I'll be discussing, following is a list of items I'll be touching on:

- FASB Statement of Financial Accounting Standards (SFAS) 116  
"Accounting for Contributions Received and Contributions Made"
- FASB Statement of Financial Accounting Standards (SFAS) 117  
"Financial Statements of Not-for-Profit Organizations"
- FASB Statement of Financial Accounting Standards (SFAS) 124  
"Accounting for Certain Investments Held by Not-for-Profit Organizations"
- FASB Interpretation 42  
"Accounting for Transfers of Assets in Which a Not-for-Profit Organization is Granted Variance Power"
- AICPA Statement of Auditing Standards (SAS) 59  
"The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"
- AICPA Statement of Auditing Standards (SAS) 82  
"Consideration of Fraud in a Financial Statement Audit"
- AICPA Statement of Position (SOP) 94-3  
"Reporting of Related Entities by Not-for-Profit Organizations"
- AICPA Statement of Position (SOP) 98-?  
"Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund-raising"

**FASB Statement of Financial Accounting Standards (SFAS) 116**  
**“Accounting for Contributions Received and Contributions Made”**

Effective Date:

This statement has been around for awhile and became effective for fiscal years beginning after December 15, 1994.

Major, key elements include:

- Created the three net asset classes - unrestricted, temporarily restricted and permanently restricted.
- Recognized that only donors can restrict donations.
- Formalized the method with which promises to give (pledges) are to be reflected. Unconditional promises to give are to be placed on the balance sheet with appropriate time value discounts and allowances for uncollectible amounts. Conditional promises to give are to be disclosed in the footnotes to the financial statements.
- Formalized when donated services are recognized: when they create or enhance nonfinancial assets or the service requires specialized skills and would have been purchased if not donated.
- Addressed the issue of museum “collections” - if certain conditions are met, collections need NOT be capitalized.
- Developed the requirement that ALL expenses of a NFP show up as UNRESTRICTED. As temporary restrictions are met, temporarily restricted net assets are transferred to unrestricted net assets to cover the expenditures.

Comments:

Some of the more difficult areas of SFAS 116 that NFPs have had to deal with are how to handle pledges and split-interest gifts properly. Concepts of present values, discount rates and allowances for uncollectible amounts continue to be debated among auditors and within the industry.



**FASB Statement of Financial Accounting Standards (SFAS) 117**  
**“Financial Statements of Not-for-Profit Organizations”**

Effective Date:

Like SFAS 116, this statement has been around for awhile and became effective for fiscal years beginning after December 15, 1994.

Major, key elements include:

- Defined the basic set of financial statements for NFPs as including a Statement of Financial Position, Statement of Activities, Statement of Cash Flows and notes to the financial statements.
- Classified net assets as either unrestricted, temporarily restricted or permanently restricted. Additionally, classified income statement items as either revenues, expenses, gains or losses.
- The Statement of Financial Position gives information about the assets, liabilities and net assets of an NFP. The statement also provides information as to whether an NFP has the ability to continue to provide services, the NFP's liquidity, financial flexibility, ability to meet its obligations and what the NFP's needs for external financing are.
- The Statement of Activities shows the effects of transactions and events on net assets as well as the relationship of transactions and events to each other. The statement also provides information to help evaluate how an NFP has performed during a period, assess an NFP's service efforts and ability to continue to provide services and assess how an NFP's managers have discharged their stewardship responsibilities and other aspects of performance.
- The Statement of Cash Flows provides relevant information about an NFP's cash receipts and disbursements. The statement's information helps donors, creditors and others assess an NFP's ability to generate cash and determine how the cash is used.

Comments:

One of the more difficult areas of SFAS 117 that NFPs have had to deal with is how to properly collect and report transaction data for the Statement of Cash Flows since this is a relatively new statement for the industry. In addition, formats of statements continue to be discussed due to the possibility of a lack of comparability between NFPs.

**FASB Statement of Financial Accounting Standards (SFAS) 124**  
**“Accounting for Certain Investments Held by Not-for-Profit Organizations”**

Effective Date:

This statement followed SFAS 116 & 117, becoming effective for fiscal years beginning after December 15, 1995.

Major, key elements include:

- Required (as opposed to making optional) that all debt investments and all equity investments for which readily determinable market values are available be reflected at fair market value (FMV) on an NFP Statement of Financial Position.
- Determined that fair market value for equities was to be obtained through sales prices or bid/ask prices on established exchanges.
- Excluded the need for FMV reporting for investments reported under the equity or consolidated methods of accounting.
- Required that losses in market value on endowments below original cost basis were to be reflected as reductions in unrestricted net assets. Subsequent gains would first be credited to unrestricted net assets until original cost basis was exceeded.
- Required that certain disclosures in the footnotes be made concerning investments including the computation of investment return, breakout of investments by types (equities, bonds, etc.) and endowment deficiencies, if any.

Comments:

One of the more difficult areas of SFAS 124 that NFPs have had to deal with is how to properly report reinvested endowment investment returns. Whether these reinvested returns should be reflected as unrestricted, temporarily restricted or permanently restricted often comes up and is answered through reference to agreements with donors and local statutory regulation of endowments. SFAS 124 does make mention of the Uniform Management of Institutional Funds Act (UMIFA) which can provide guidance to NFP financial managers and advisors on how to legally administer the investments of endowments.

**FASB Interpretation 42**  
“Accounting for Transfers of Assets in Which a  
Not-for-Profit Organization is Granted Variance Power”

Effective Date:

This interpretation became effective for fiscal years ending after September 15, 1996. The interpretation followed SFAS 116 and the resulting confusion as to when an NFP acted as an “agent” for another NFP.

Major, key elements include:

- The recipient organization of a donation is both donee and donor if the resource provider grants unilateral power to redirect the use of transferred assets to another beneficiary.
- If the recipient organization is not granted unilateral variance power, it is considered an “agent” in which case no gifts are recognized as gift revenue, no net assets result from gifts being received and all gifts received are instead reflected as liabilities.
- The FASB is still looking at agency transactions and will be considering both “discretion based” and “mission based” approaches to determining how to reflect contributions.

Comments:

The major point coming out of this interpretation is that in many cases, fundraising organizations created to support particular charities will no longer reflect contribution revenue when gifts are received. Instead, gifts will be recorded as liabilities payable to the particular charities. The charities will record the gift revenue as opposed to the fundraising organizations. Hence, foundations supporting colleges, museums, hospitals and other charities may desire to report their financial results outside of traditional financial statements formats.

**AICPA Statement of Auditing Standards (SAS) 59**

**“The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern”**

Effective Date:

This statement became effective for fiscal years beginning on or after January 1, 1989.

Major, key elements include:

- Makes it the auditor’s responsibility to evaluate whether there is substantial doubt about an organization’s ability to continue in existence.
- Conditions and events that an auditor is advised to take into consideration include negative trends, indications of possible financial difficulties, internal matters such as labor stoppages and external matters such as legislative changes.
- Auditors are to also take into account management’s plans such as plans to dispose of assets, borrow money, reduce or delay expenditures or increase owner’s equity.

Comments:

The reason this SAS is mentioned in this article is because of the increased attention this standard is receiving from NFP auditors. The primary reason for the increased attention is because of concern over the “borrowing” or expenditure of restricted assets for unrestricted purposes. This can occur inadvertently by “overdrawing” unrestricted net assets in the hopes of generating future unrestricted resources. The auditor’s concern is when and where the unrestricted resources might come. Auditors have also begun to closely scrutinize unrestricted revenues to make sure they are indeed without restriction.

**AICPA Statement of Auditing Standards (SAS) 82**  
**“Consideration of Fraud in a Financial Statement Audit”**

Effective Date:

This statement is effective for audits of financial statements for periods ending on or after December 15, 1997.

Major, key elements include:

- Describes fraud and its characteristics as manipulation of accounting records, misrepresentation in or intentional omission from financial statements or intentional misapplication of accounting principles.
- Requires the auditor to specifically assess the risk of material misstatement due to fraud and provides categories of fraud risk factors to be considered.
- Notes that fraud frequently involves both an incentive to commit and an opportunity to do so.
- Risk factors include management’s influence over the control environment, industry conditions and operating characteristics and financial stability.
- Auditor will look at and consider policies and procedures, documentation, segregation of duties, oversight, physical safeguards over assets, etc.

Comments:

The reason this SAS is mentioned in this article is because of the NFP industry’s tendency to operate in weaker internal control environments. With the desire to keep costs low, NFPs often have lean staffs that can impair the segregation of duties principle. In addition, documentation of policies and procedures is oftentimes limited. Knowing that auditors are charged with assessing the risk of material misstatement due to fraud, now is the time to firm up and document good internal control policies and procedures.

**AICPA Statement of Position (SOP) 94-3**  
**“Reporting of Related Entities by Not-for-Profit Organizations”**

Effective Date:

This statement became effective for fiscal years begun after December 15, 1994.

Major, key elements include:

- If the percentage owned is between 20% and 50%, the parent NFP is to use the “equity method” to account for the subsidiary per Accounting Principles Board (APB) Opinion #18.
- If greater than 50% is owned, the parent NFP is to consolidate the subsidiary per FASB SFAS 94 and Accounting Research Bulletin (ARB) #51.
- If the subsidiary is another NFP, consolidate if the parent has either majority voting interest or majority ownership and an economic beneficial interest.
- The FASB is also working on a consolidation project and is developing a concept of control that includes power to direct the policies and management that guide the activities of another entity so as to benefit from its activities. In such an environment, there does not need to be absolute legal majority ownership or voting rights.

Comments:

The major issue here is that NFPs need to become much more cognizant of the organizations they may have to include in their consolidated financial statements OR they may need to understand when they have to be consolidated into another organization’s financial statements. Consolidated financial statements may or may not tell the story the NFP wishes to convey to its financial statement readers.

**AICPA Statement of Position (SOP) 98-?**  
“Accounting for Costs of Activities of Not-for-Profit Organizations  
and State and Local Governmental Entities That Include Fund-raising”

Effective Date:

This statement is still out for comment and its issuance is expected in 1998 (though the statement has been ten years in the making).

Major, key elements include:

- The statement is a response to perceived abuses in the fundraising area raised by citizens, state attorney generals' offices and watchdog groups. The issue is that some NFPs have aggressively charged much of their fundraising expense to program services thus distorting the supporting services to revenue ratio.
- Sets out allocation of costs to program activities based on purpose, audience and content.
- Allocation methods and disclosure requirements are addressed.
- Most NFP's will increase their allocation of costs to program services as a consequence.

Comments:

The major issue as addressed above is the tendency of some NFPs to reflect fundraising costs as program service costs and thus, appear more efficient. NFPs will need to become aware of the allocation methodologies allowable and will need to be prepared to support methods used to both auditors and financial statement readers.

**Quiz Questions:**

1. A donor promises to give an NFP \$1,000,000 in 5 years if the Executive Director of the NFP at that time is a graduate of ACME University. What should the NFP record in its financial statements the year the promise is first made?
2. Is it permissible to record expenditures of restricted assets in a restricted (temporarily or permanently) expense category? If not, how should the expenditures be recorded?
3. How should reinvested income on endowment funds be recorded?
4. A foundation is established to support a particular NFP. How should donations to the foundation be accounted for by the foundation if the foundation does not have the power (variance power) to direct the donations to another NFP?
5. If an NFP generally raises \$100,000 per year in unrestricted donations, its unrestricted net assets are overdrawn by \$300,000 and the overdraft is growing by \$100,000 per year, what might the auditor consider mentioning in his/her opinion of the NFP's financial statements?
6. Within an NFP, having the same person prepare checks, sign checks and reconcile the bank statement would be indicative of poor what? What might result from this assignment of responsibilities?
7. An NFP receives and holds onto a stock donation representing 80% of the outstanding, voting stock of XYZ Corporation. What might the NFP need to consider with regard to how to account for the stock in XYZ Corporation?
8. A cancer research related NFP spends \$100,000 to mail a fundraising appeal to its donor list. On the bottom of the appeal in 1 point type is an admonition to avoid tobacco products as they may cause cancer. A plastic magnifying glass is provided to help recipients read the admonition. How much of the appeal's cost will likely be allowed to be recorded as program service related?



Quiz Answers:

1. The NFP should record the promise as a conditional promise to give and reflect the promise in the footnotes to its financial statements - not in the body of the financial statements themselves.
2. It is not permissible to reflect expenditures of restricted assets in restricted expense categories. Instead, as expenses are incurred, they are reflected as unrestricted expenditures and transfers are made from temporarily restricted to unrestricted net assets. Note that permanently restricted assets should, by their nature, NEVER be expended.
3. Reinvested endowment income can be recorded as unrestricted if the income purpose is unrestricted, temporarily restricted if the income purpose is restricted, and permanently restricted if the DONOR has required that all or a portion of the reinvested income is to be permanently restricted.
4. The foundation is acting as "agent" for the NFP and should reflect the contributions as liabilities payable to the NFP.
5. The auditor may feel compelled to mention concern as to whether the organization has the ability to continue as a going concern given its inability to generate sufficient unrestricted resources.
6. Having the same person perform all three functions indicates poor internal control which could result in fraud being committed.
7. The NFP may need to consolidate XYZ Corporation into its financial statements since it owns more than 50% of the voting stock of XYZ.
8. Likely little or none of the appeal's cost will be allowed to be reflected as program service related. Instead, the appeal's costs will be reflected as fundraising costs due to the appeal's objective and audience.

**Resources for future reference on accounting issues include:**

Financial Accounting Standards Board (FASB)  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
(203) 847-0700 Voice  
(203) 849-9714 Fax  
Home Page: WWW.FASB.ORG

American Institute of CPAs (AICPA)  
1211 Avenue of the Americas  
New York, NY 10036-8775  
(212) 596-6200 Voice  
(212) 596-6213 Fax  
Home Page: WWW.AICPA.ORG

Practioners Publishing Company (PPC)  
P.O. Box 966  
Fort Worth, TX 76101  
(800) 323-8724 Voice  
(817) 877-3694 Fax  
Home Page: WWW.PPCINFO.Com

**Publications that would be helpful concerning NFP accounting matters include:**

*AICPA Audit and Accounting Guide Not-for-Profit Organizations*

*Practioners Publishing Company (PPC) Guide to Nonprofit GAAP*

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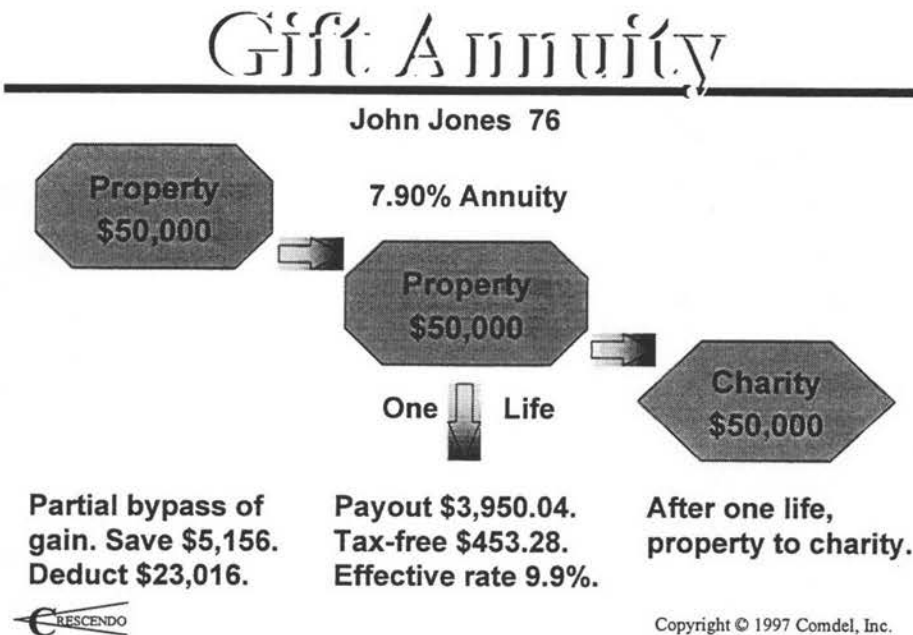
# ANNUITY VALUATION QUESTIONS

By A. Charles Schultz, JD

During the past decade, gift planners have asked the author of this outline several thousand questions about gift annuities and related valuation issues. This outline highlights the most frequently asked questions and the answers to those questions. It includes sections on the questions that are of interest to the donor and those questions that are primarily of interest to the annuity administrator. Each of these two topics is further subdivided into one and two life current annuities, deferred annuities, college annuities, flexible annuities and gift annuities for remainder interests.

## I. Gift Annuities from the donor's perspective.

### A. Current gift annuities



#### 1. How does The American Council on Gift Annuities set gift annuity rates?

The actuary for The American Council on Gift Annuities reviews rates periodically. In general, the rates are created so that there is an approximate 50% residuum, based on current rates of return. This is created for the various one and two life payout tables by assuming an interest rate and then setting the gift annuity rates such that for most gift annuitants, there is some invasion of principal. The base interest rate for current annuities after March 1, 1997 was 7% with an assumed .75% cost or loading factor, resulting in a net return of 6.25%. Over the past decades, the assumed interest rate has been relatively similar to the rate of return for a 30-year Treasury bond. If the bond rates trend higher or lower than the interest rate assumption for gift annuities, it is quite probable that the next adjustment will be toward the existing rate of return of a 30-year Treasury bond.

## 2. What difference do payout rates make on the charitable deduction?

The tax deduction for a gift annuity is calculated by determining a factor under federal tables. This factor considers the Applicable Federal Rate for the month of the annuity (or of the two prior months), the age or ages of the annuitants and an adjustment for monthly, quarterly, or semi-annual payments. Each month Treasury issues a revenue ruling that specifies over 50 different interest rates used for various tax purposes. One of these 50 rates is the rate under Section 7520 of the Code that will be used to determine charitable deduction calculations. The rate technically speaking is 120% of the federal mid-term rate, rounded up or down to the nearest two tenths of one percent. As the Applicable Federal Rate increases, the value to charity is assumed to increase because the underlying assets are assumed to earn at the federal rate. Thus, the largest charitable deduction for a gift annuity calculation is obtained by using the largest of the three permissible Applicable Federal Rates.

Since the factor for an individual is multiplied times the annuity to produce the value of the contract and this contract value is then subtracted from the total value to determine the charitable deduction, if the annuity pays more to the individual, the contract value is higher and the charitable deduction is lower. Logically, if an annuity pays out a higher rate to the person, the benefit to charity and resulting charitable deduction should be less.

## 3. How is the Applicable Federal Rate created?

Each month the IRS surveys several hundred interest rates for short, medium and long-term notes and bonds. Based on their monthly survey, they publish rates for many different tax purposes. The rates are published for monthly, quarterly, semi-annual and annual payments and these rates are also published for short, mid and long-term instruments. The revenue ruling issued approximately the 22<sup>nd</sup> of each month contains over 50 different interest rates that are used for various purposes. One of these 50 rates is 120% of the midterm rate and, this factor, rounded to the nearest 0.2, is typically displayed in table 5 of the monthly revenue ruling. In general, as interest rates trend up, the Applicable Federal Rate trends up and, conversely, as interest rates trend down, the Applicable Federal Rate trends down. Since May 1, 1989 the Applicable Federal Rate has ranged from a high of 11.6% to a low of 6.0%.

## 4. What is the contract value and deduction?

Based upon the Applicable Federal Rate, the age of the annuitant or annuitants and the adjustment for monthly, quarterly or semi-annual payments, an IRS factor is calculated. This factor is then multiplied times the annual annuity amount and that product is the contract value. The contract value represents the retained value by the annuitant. He or she is receiving annuity payments for life and these payments can be quantified as one value.

Under the Bargain Sale Rules in Section 1011 of the Code and regulations thereunder, a gift to charity where a person receives something back entitles that donor to a deduction equal to the gift less the retained portion. With a gift annuity, the contract value is the retained portion and the difference between the value transferred and the contract value is then the charitable gift deduction.

## 5. What is an expected return multiple?

In the regulations to Section 72 of the Internal Revenue Code are life expectancy tables. The IRS defines life expectancy as the expected return multiple. There is a table for one-life multiples and a table for two-life multiples. While it is widely understood that there is a difference between male and female expectancy, since 1986 the IRS has used unisex tables and the assumption is that both male and female annuitants will live for the same length of time. The phrase expected return multiple is appropriate, since if a person has an expectancy of 10 years and is receiving a gift annuity of \$1,000 per year, then the total expected return of \$10,000 is calculated by multiplying the 10 years times the \$1,000 payment.

## 6. How does the exclusion ratio impact the tax-free payout?

The return multiple enables calculation of the total return. Since the contract value represents part of the donor's contribution that is repaid to him or her, it is appropriate to calculate the portion of each payment that represents return of principal to the donor. This is done by dividing the contract value by the

total expected return. For example, if the contract value for a \$10,000 gift annuity is \$5,000 and the payout of \$1,000 for a period of 15 years produces an expected return of \$15,000, then the exclusion ratio is \$5,000 divided by \$15,000 or 33.3%.

This exclusion ratio is then used to calculate the tax-free portion for any year. For example, assume that the first year the person receives only two payments because the annuity was created mid-year. The \$500 in total payment is multiplied times .33 and the tax-free portion is then \$166.67. The balance of the \$500 is then ordinary income.

### **7. Why do some annuities pay out capital gain?**

If an annuity is funded with appreciated stock, then there is a proration of the capital gain to the gift portion and the contract portion. For example, suppose that a gift annuity is funded with \$10,000 of stock with cost basis of \$1,000. There is \$9,000 of gain or .90 of gain for every dollar of value.

If the contract value is \$4,000 and the gift value is \$6,000, then 0.90 of gain per dollar times \$4,000 produces allocated gain to the contract of \$3,600 and allocated gain to the gift portion of \$5,400. The gain on the gift portion does not cause any problem, since there is a bypass of gain on gifts of appreciated property, but the \$3,600 of gain on the contract portion must be reported.

Normally, this is reported over one-life with a single person annuity or, usually, over two-lives for an annuity created by husband and wife. If the return multiple is 10, then one-tenth of the \$3,600 in gain or \$360 is reported as capital gain each year. Rather than reporting \$400 of tax free payout and \$600 of ordinary income on the annuity contract annually, \$360 of the \$400 is not tax free but rather is reported as long-term capital gain. The net result is that the \$1,000 annual annuity is \$600 of ordinary income, \$360 of long-term capital gain and \$40 of return of principal for the years until the projected expectancy of the annuitant or annuitants. Thereafter, all payouts are ordinary income.

### **8. What is pro-rated basis?**

When appreciated stock is transferred in exchange for a gift annuity, the gain and basis are pro-rated between the gift portion and the contract portion. For example, a gift annuity funded with \$10,000 of appreciated stock with basis of \$1,000 will pro-rate the basis between the gift portion and the sale portion. If the gift portion is \$4,000 and the sale portion is \$6,000, then \$4,000 divided by \$10,000 or 40% of the basis is pro-rated to the contract value and 60% of the basis is pro-rated to the gift value. The pro-rated basis of \$400 on the contract value results in a total potential gain of \$4,000 minus \$400 or \$3,600.

### **9. Do all annuities make pro rata payments?**

Some charities pay annuities at the end of the month or quarter based upon the date of funding the annuity. However, most charities pay annuities at regular end of month or end of calendar quarter dates. This practice simplifies gift annuity administration.

If a charity pays gift annuities at the end of the calendar month or quarter, then, since the annuity is invariably funded on a date other than the very first date of the month or quarter, it is probable that the first payment will be a prorated payment. While it is permissible for a donor to make a contribution on the 15<sup>th</sup> of the month and receive a full payment on the 30<sup>th</sup> of the month, virtually no charities choose to do so and virtually no donors would expect the charity to make a one month payment when it has only held the funds for two weeks. If a charity does decide to make a larger than pro-rated first payment, it will be necessary to adjust the charitable income tax deduction to reflect that action.

### **10. What are total basis and total gain?**

Based on the contract value and the pro-rated basis, the gift annuity will have a total basis and a total gain that must be reported annually until each has been fully recovered.

### **11. Why is all payment ordinary after the expectancy of the annuitant or annuitants?**

Under the regulations of Section 72 of the Internal Revenue Code, a donor properly is permitted to receive tax-free payout for the amount that he or she has contributed. This calculation uses the exclusion ratio and pro rates the tax free during the projected expectancy of the donor. However, at expectancy the donor has recovered all of his or her basis in the annuity. Therefore, for gift annuities with starting dates

after December 31, 1986, the annuitant must pay ordinary income tax on all amounts received after projected expectancy. Nevertheless, given the alternative, most donors are delighted to continue to pay tax at this time.

**12. If an annuitant passes away prior to projected expectancy, how much is deducted in the final income tax return?**

Under Section 72(b) of the Code, any unrecovered basis in the agreement is still in effect the property of the donor and is treated as a charitable gift deductible on the final income tax return. The administrator for the charity should be tracking the return of basis and report to the executor for decedent annuitants the value of unrecovered basis.

**13. Is there a maximum limit to capital gain recognition?**

The maximum limit is the amount of excluded property under the exclusion ratio. For some very senior annuitants, because the life expectancy is so short, the calculated capital gain might actually exceed the excluded amount if it were not for this rule. For example, a person age 100 with a life expectancy of 3 years that funds a \$10,000 annuity with cost basis of \$1,000 could have a contract value of \$4,000 and gain of \$3,600. Dividing \$3,600 by 3 years produces a potential long-term capital gain of \$1,200 per year. However, with a \$1,000 gift annuity and, for example, \$400 of ordinary income, there is only \$600 remaining. Thus, the senior person reports only \$600 of capital gain and not the \$1,200 that otherwise would be reported under the normal formula. The net result is that the senior person has \$400 of ordinary income and \$600 of capital gain with her \$1,000 annual annuity.

**14. With a two-life gift annuity and separate property, why is there sometimes no tax-free payout in the initial years of the agreement?**

If a husband and wife create a gift annuity with joint property, then the gain may be reported over two lives and the same amount of capital gain and cost basis will be recognized each year. However, if an annuity is funded with the separate property of the first annuitant, then under the regulations, the gain must be reported over the first lifetime. Since the annuity is going to pay over two lives but the gain must be reported over the first life, with highly appreciated property, the allocation of gain may cause there to be only ordinary income and capital gain until all of the gain has been reported. Thereafter, usually for the second person, the payout will be all ordinary income and tax-free return. In effect, the capital gain is all accelerated into the first life and the return of principal benefit is received by the second person. If a husband and wife create a gift annuity with separate property, it is invariably advisable to convert the property to a jointly held asset prior to funding the gift annuity in order to avoid the result in this answer.

***B. Deferred or retirement annuity.***

**1. Why is the deduction calculation so complicated?**

For a deferred payment gift annuity, particularly a two-life gift annuity, there are multiple adjustments that must be made. The annuity calculation must reflect the period of deferral before the payments start. This deferral period requires certain adjustments so that the increased benefit to the charity can properly be reflected in the charitable deduction. The actual value is adjusted to the annuity starting date and the calculation of the deduction is then completed at the future annuity starting date.

**2. What is an annuity starting date and why does it matter?**

Under the regulations of Section 72 of the Code, the annuity starting date is one period prior to the first payment date. For example, a deferred annuity paid quarterly that makes its first payment on June 1 of the year 2010 will have an annuity starting date on March 1, 2010. Under the regulations, the deduction calculation and the termination of the return multiple are on March 1, 2010. This is consistent with the method for calculating current gift annuities and has been followed by the actuary for the American Council On Gift Annuities since January 1, 1994. For example, if a current gift annuity paying quarterly is funded on March 1, 2010, with first payment on June 1, 2010, the deduction value and return multiple is calculated based on the March 1 date.



3. Why has the actuary for The American Council On Gift Annuities since January 1, 1994 recommended use of the annuity starting date for deduction and return multiple calculations?

The regulations to the Internal Revenue Code in Section 1.72-5(a) state that return multiples shall be calculated "as of the annuity starting date." Therefore, the current method is consistent with the regulations to Section 72 of the code.

4. Can donors recognize capital gain over two lives?

If a gift annuity is funded with appreciated property, then based upon the examples in Section 1011 of the Internal Revenue Code, the gain is recognized over one-life for separate property or two-lives for property held jointly by husband and wife.

5. What happens if the donor dies before payouts commence?

As with any gift annuity, when the donor passes away, the gift annuity payments immediately cease. However, if there is unrecovered basis, then under Section 72(b), the donor should receive a charitable income tax deduction for the value of the unrecovered basis.

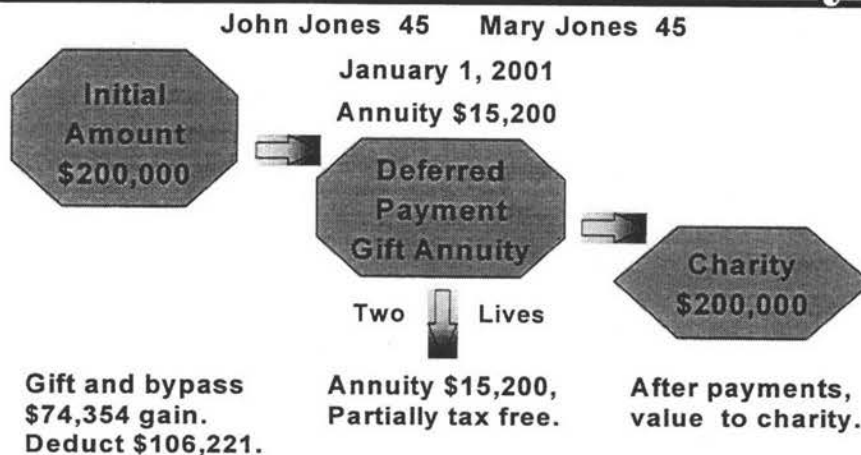
6. On old deferred payment annuities, can I recalculate taxes for reporting on the 1099 if the payment hasn't yet started?

Many charities have gift annuities that were created years ago and are now commencing payments. Under the regulations to Section 72, when the return multiple tables were changed in 1986, donors of annuities that had not yet reached a "annuity starting date" were permitted to elect to use the new tables. Thus, it is possible to fix the contract value and charitable deduction at the amount of the initial deduction claimed and then calculate the new ordinary income, capital gain and tax free return of basis schedule using the current return multiple.

7. Why is the tax-free amount so low for a deferred annuity with a long deferral period?

If a deferred annuity has a long period of deferral, then there is a long period of time for the contract value to grow tax free in the possession of the charity. In proportion to the total payout, the initial cost basis becomes lower and lower as the cumulative growth becomes larger and larger. Thus, for annuities with long deferral periods, it is typical for the excluded amount to be relatively low. For 30 or 40 year deferral periods, the excluded amount can be reduced to 3% to 5% of annual payment.

## Deferred Gift Annuity



## 8. For a retirement annuity, what is the typical payout strategy?

Some individuals desire to make a regular contribution to a deferred annuity with the amounts to be paid at a future time. Ordinarily, a person contributes a regular amount such as \$10,000 per year and then all annuity payments will commence at the same retirement date. Thus, even if there are 8 or 10 contributions and 8 or 10 separate deferred annuity contracts, the individual can then receive one check on a quarterly or monthly basis while he or she is in retirement.

## 9. Will a new calculation be necessary each year for a retirement annuity plan?

Yes, since the Applicable Federal Rate changes and the American Council On Gift Annuities rates may change, it will be necessary to complete a new calculation each year. Donors must be warned that the difference in AFR can have an impact on the charitable deduction and the change potentially in payout rates by the American Council can have significant impact. Particularly since deferred annuity payouts can compound for long periods of deferral, a change of rate assumptions by the ACGA can have dramatic impact on the annuity payout rate. On many occasions, donors have been very surprised by the difference in payout rate up or down after a change of rates by the American Council On Gift Annuities. This effect exists for current annuities, but is especially magnified by the compounding impact of the deferred annuities.

### **C. College Annuity**

#### 1. What is a college annuity?

A college annuity is a deferred payment gift annuity created usually by a grandparent for a young child. For example, Grandmother Jane funds a college annuity with \$50,000 of cash for granddaughter Sue, age 3. The college annuity produces a substantial income tax deduction for Grandmother Jane. Granddaughter Sue can either receive at age 18 an annuity payment for life or, the desired choice, can elect to receive the annuity with much larger payments for a term of 4 years. Since Sue is a minor, the election to take the 4-year payout would typically be made by the parent as legal guardian of Sue.

#### 2. Are college annuities safe without obtaining a Private Letter Ruling?

The additional Private Letter Ruling for the college annuity plan was obtained in 1990. Since that time, there have been several other favorable Private Letter Rulings on the college annuity. Given the political favor extended to education under recent tax acts, it seems highly probable that the college annuities will continue to be viewed favorably by the IRS. Since a Private Letter Ruling only extends to the taxpayer in question, there does not seem to be particular advantage to obtaining additional Private Letter Rulings in this area. Most organizations that issue college annuities appear now to be using this agreement based upon the existing rulings and political climate.

#### 3. What is a typical donor profile?

The typical donor is a grandparent or great grandparent of a child between ages one and twelve. The advantage of the college annuity is that the grandparent receives a partial tax deduction while the funds in the possession of the charity in effect grow tax-free for the period of deferral. When the grandchild reaches college age, he or she receives a monthly or quarterly payment that is normally subject to a relatively low income tax rate on the ordinary income portion.

#### 4. How is the deduction calculated?

The deduction is calculated using the normal deferred payment gift annuity methods. There is a deferral factor from the date of funding to the annuity starting date and the deduction and return multiple are calculated as of that time.

## 5. How does the election work?

The value transferred less the deduction produces a contract value. This contract value is permitted to grow until the annuity starting date. Based upon the growth, the annuity may be calculated as either a one-life value or, under the IRS tables for a term of years, changed to a fixed term of years. Of course, since the term of years is much shorter than the life, the amount paid per year is much larger with the term of years. Prior to the annuity starting date, the beneficiary or his or her guardian is allowed to elect to either take the one-life payout or the term of years payout. The reason a one-life payout is required is that under Section 514 (c)(5) of the Internal Revenue Code, gift annuities may initially be written only for one-life or two-lives. However, the Service has generally permitted existing annuities to then be modified or converted to different payout periods, so long as the contract value of any option selected is identical to the original contract value.

## 6. How is the taxable gift calculated?

When a grandmother transfers an amount, for example \$50,000, in exchange for a gift annuity and receives a charitable deduction of \$20,000, then \$30,000 is the contract value. In the same year that the \$20,000 deduction is claimed on the income tax Form 1040, the donor must file a Form 709 Gift Tax Return and report the same \$20,000 deduction on that form. Since the total value is \$50,000 and the charitable deduction on the gift tax return is \$20,000, there is a taxable gift of \$30,000. Since this is a future interest, the gift exclusion does not apply and the donor uses a portion of his or her exemption equivalent to cover the gift.

## 7. Should a lump sum option be included in the annuity contract in order to attempt to make use of the annual exclusion?

No. While it is theoretically possible to include a lump sum payout option in the agreement and thus qualify for the annual exclusion as a present interest gift, the ability of the student to withdraw and spend the funds at one time would surely be objectionable to most grandparents. While some counsel had theorized that it may be possible to use a lump sum privilege for a shorter period to attempt to qualify the deferred annuity in a method analogous to the "Crummey" power, there is no law or ruling that indicates that this is a viable option.

## 8. What Applicable Federal Rate is used for the conversion?

Under Section 7520 of the Code, there is language that suggests if one or more calculations are done with respect to the same gift, the same AFR should be used. Thus, it seems appropriate to select one of the three permissible AFR's for the deduction calculation and to use that both for the deduction and for conversion calculations. If the calculation is later reaccomplished to accommodate a changed payout plan, it would seem appropriate to continue to use the initial Applicable Federal Rate for that later calculation.

## 9. When should the election to convert to the term of years be completed?

While it seems appropriate to wait at least 3 or 4 weeks, it appears that there is no specific restriction on the election, except that it should be done prior to the annuity starting date. In many circumstances, the grandparent will create the college annuity plan and the parent as guardian for the child can within a period of 4-8 weeks then choose to elect the college payout option. In virtually all cases, this will be the desired result by the grandparent who funds the plan.

## 10. Will the grandchild receive partly tax-free payouts?

Yes, the amount that is calculated under the exclusion ratio for the term of years will benefit the student. He or she will pay tax only on the excess over that amount each year.

## 11. Should I use cash or appreciated property to fund a college annuity?

If a person uses appreciated property to fund an annuity for another individual, then the gain allocated to the contract value must be reported in the year the annuity is created. For example, Grandmother Jones has Intel stock that is 90% appreciated. If she transfers \$50,000 of Intel stock to a college annuity with a charitable deduction of \$20,000 and contract value of \$30,000, then she must

immediately report 90% of \$30,000 or \$27,000 of long term capital gain. While capital gain is taxable at a lower rate than ordinary income and thus her deduction on \$20,000 may save more in tax than the capital gains tax payable on \$27,000 of gain, it still reduces considerably the attractiveness of the college annuity for grandmother to use the appreciated stock. Although it is possible to use appreciated stock, most of the college annuities are funded with cash in order to avoid this gain recognition on the contract value.

## 12. Will the 10% early distribution rule apply?

It does under current law and it may in the future. While Congress has started to exempt payouts to students from agreements such as an IRA, the exemption for the 10% excise tax does not yet apply to annuity payouts. At some future time, Congress hopefully will realize that these plans are in existence and at that time exempt the students from the additional 10% tax.

### ***D. Flexible Annuity***

#### 1. What is a flexible annuity?

The Flexible annuity is the creation of Frank Minton. Frank, a past President of the National Committee On Planned Giving, believed that the deferred payment gift annuity should offer some of the flexibility of commercial annuities. His theory is that a person could set up a gift annuity with a target date and then the charity could offer a range of payouts for earlier or later years. Since the deduction is fixed, the rate would have to change. There would be lower payments if the annuity were taken earlier and higher payments if the annuity payments start at a later date. Each annuitant would have to determine on an annual basis whether or not they wish the annuity payments to start that year.

#### 2. Can we trust a Private Letter Ruling?

While the Service did rule favorably on the concept in PLR 9743054, a private letter ruling is not a legal precedent. Since gift annuities must under the law be created for one or two lives, the service has in the past permitted modification of the annuity payout, so long as the value of the payments represents the same contract value. In short, if one is going to take an annuity earlier, then the payments must be lower or, conversely, if one waits to take annuity for a later period of time, the payments may be higher. So long as the valuation is done correctly, there seems to be no reason why the IRS would change its current position and oppose the change. Indeed, there is a solid argument that the annuity is a contract under state law. Therefore, the state law ability to modify contracts should be respected by the service.

#### 3. How is a deduction determined?

With a deferred payment gift annuity, the deduction is determined under the rules set forth in Section 72 of the Internal Revenue Code. In the booklet published on January 1, 1994, the actuary for the American Council On Gift Annuities specified a method that uses the annuity starting date (one period before the first payment) as the primary date for determining the deferral factors and expected return. This method is consistent with the regulations under Section 72 of the Code.

#### 4. What should be the target year?

The selection of the target year will change the charitable deduction and the payout amount. Years prior to the target year will have reduced payout amounts in order to keep the tax deduction the same as the target year. Ordinarily, these target payout amounts will be lower than the standard American Council On Gift Annuities rates for those years. For payouts after the target year, by decision of the individuals who pursued the Private Letter Ruling, the choice was made to follow the American Council On Gift Annuities rates. Thus, the charitable deduction is fixed and, since the ACGA rate has followed, there will be more tax-free return than would exist with the standard ACGA rate and the normal deduction.

If the goal is to provide the best possible payout, then selecting a deduction year toward the earlier end of the payout range seems to work best. A deduction year two years after the earliest payout is the suggested target year. For example, if the payout range is from age 60 to age 90, then a target year of age 62 is recommended.

## 5. How many years should be projected?

While there is no specific requirement as to the number of years, it is probably best to project a number of years that covers most of the annuitant's life expectancy. It may be possible to project up to 32 years. Since it is quite possible that senior individuals may choose to defer receiving income, in much the same way that these individuals choose to defer or minimize income from an IRA, it is in the charity's interest to project numbers to age 90 or perhaps even higher. Many individuals may wait until quite late in life to start receiving payments. From the perspective of the charity, the longer the deferral period, the better the economic benefit for the charity.

## 6. How are the early payouts determined?

Based on the target year, the charitable deduction is fixed for each earlier year. For that year, the factor based on age and the Applicable Federal Rate is calculated and then the annuity is determined such that the annuity factor times the annuity produces the desired deduction. This process usually results in a payout rate that is somewhat less than the standard ACGA rate for that age. Nevertheless, it is essential that this rate be paid, since the individual has already fixed the charitable tax deduction when the agreement was created.

## 7. What impact on the deduction and tax-free payout will the later payout rates have?

While it is not specifically required by the law, most charities will choose to follow the procedure established by the private letter ruling and pay out the American Council On Gift Annuities rates for the later payments. The result of paying the ACGA rates is that the deduction, if one calculates the annuity separately, would be higher than the deduction for the standard year. However, since the deduction has been fixed and there is no provision in the private letter ruling for an additional deduction, the appropriate calculation method is to set the deduction at the amount that has been previously claimed and this has the effect of then raising the amount of tax free return. The net combination seems quite appropriate. The person receives the ACGA rate and benefits from a slightly higher than normal tax-free return. Since the tax-free return from gift annuities of longer deferral periods is relatively modest, this increase in tax-free could be quite welcome to a beneficiary.

## 8. What is the impact on my deduction and income if I select a later target year?

If you select a later year, the charitable deduction will generally increase. However, when the payout rates are converted for the earlier years, since the contract value is lower with a larger deduction, it then causes the annuity to be considerably reduced for earlier years. If an individual has high charitable intent and desires the maximum deduction, this could be a good strategy. It should be carefully noted that the payout rates in the early years are reduced with this choice.

## 9. Will the flexible annuity be an administrative problem?

With all deferred payment gift annuities, there is a need to monitor the time when the annuity payments commence. With a flexible annuity, the charity will want to periodically notify the donor and perhaps set a date the prior year for election of the initiation of payments. It would be administratively convenient to set a date such as December 31<sup>st</sup> each year by which the decision must be made if payments are to commence in the following year. As long as the charity has created a policy in this regard, the administration should not be significantly different from that of any other deferred payment gift annuity.

## 10. What is probably going to be the practice with respect to starting the payments?

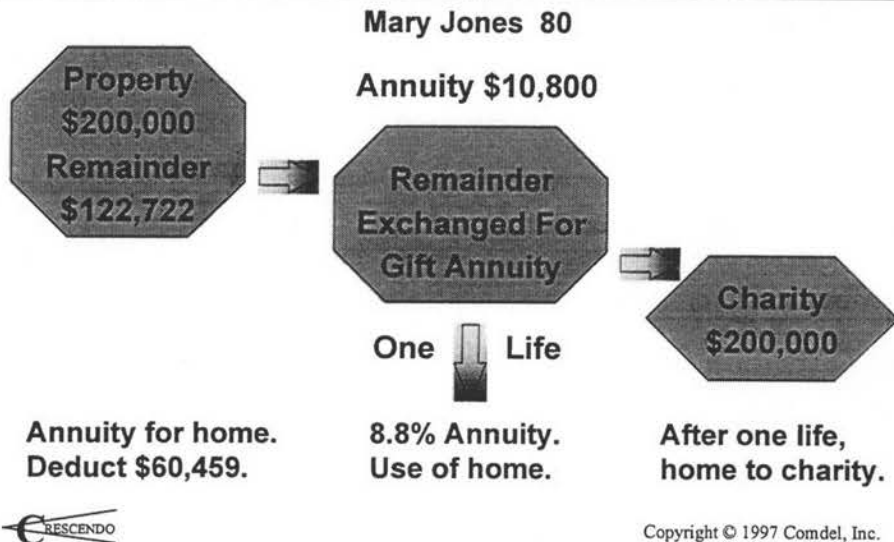
When individuals have the choice whether or not to start payments, such as the period between 59 ½ and 70 ½ for IRAs, the almost universal experience is that 90% or more of individuals will defer payments unless they genuinely need the funds. With those persons who set up the flexible annuities, it is quite likely that a significant percentage of them will defer payments to the later years of the projection

period. Indeed, some may defer to the point that they never take payments or they simply eventually decide to receive an additional charitable deduction by forgoing all further payments.

<b>FLEXIBLE DEFERRED GIFT ANNUITY -- PAYOUT RATES</b>							
<b>Pmt Age</b>	<b>Donor</b>	<b>John Jones</b>			<b>Payout Date</b>	<b>12/1/06</b>	
	<b>Annuitant</b>	<b>John Jones</b>			<b>Payout Age</b>	<b>64</b>	
	<b>Annuitant</b>	<b>Mary Jones</b>			<b>Earliest Payout Age</b>	<b>62</b>	
					<b>Latest Payout Age</b>	<b>93</b>	
	<b>PMT AGE2</b>	<b>1st PAY DATE</b>	<b>ANN RATE</b>	<b>ANNUITY</b>	<b>TAX FREE</b>	<b>GIFT AMT</b>	
62	61	12/1/04	8.899808	17,799.64	1,167.36	80,628	
63	62	12/1/05	9.749534	19,499.08	1,205.52	80,629	
64	63	12/1/06	10.7	21,400.00	1,246.15	80,629	
65	64	12/1/07	11.3	22,600.00	1,293.56	80,629	
66	65	12/1/08	12.2	24,400.00	1,347.59	80,629	
67	66	12/1/09	12.9	25,800.00	1,389.68	80,629	
68	67	12/1/10	13.9	27,800.00	1,441.69	80,629	
69	68	12/1/11	14.7	29,400.00	1,498.49	80,629	
70	69	12/1/12	15.8	31,600.00	1,566.86	80,629	
71	70	12/1/13	17.0	34,000.00	1,644.33	80,629	
72	71	12/1/14	18.0	36,000.00	1,707.86	80,629	
73	72	12/1/15	19.4	38,800.00	1,776.12	80,629	
74	73	12/1/16	20.8	41,600.00	1,863.53	80,629	
75	74	12/1/17	22.4	44,800.00	1,971.77	80,629	
76	75	12/1/18	24.1	48,200.00	2,062.00	80,629	
77	76	12/1/19	25.8	51,600.00	2,135.13	80,629	
78	77	12/1/20	27.8	55,600.00	2,260.25	80,629	
79	78	12/1/21	30.2	60,400.00	2,365.90	80,629	
80	79	12/1/22	32.4	64,800.00	2,530.39	80,629	
81	80	12/1/23	35.2	70,400.00	2,665.45	80,629	
82	81	12/1/24	37.8	75,600.00	2,809.08	80,629	
83	82	12/1/25	41.0	82,000.00	2,956.37	80,629	
84	83	12/1/26	44.5	89,000.00	3,159.46	80,629	
85	84	12/1/27	48.8	97,600.00	3,368.98	80,629	
86	85	12/1/28	52.8	105,600.00	3,581.85	80,629	
87	86	12/1/29	57.8	115,600.00	3,808.82	80,629	
88	87	12/1/30	63.2	126,400.00	3,981.86	80,629	
89	88	12/1/31	69.1	138,200.00	4,238.92	80,629	
90	89	12/1/32	75.4	150,800.00	4,568.00	80,629	
91	90	12/1/33	83.0	166,000.00	4,868.94	80,629	
92	91	12/1/34	90.4	180,800.00	5,099.90	80,629	
93	92	12/1/35	97.6	195,200.00	5,486.40	80,629	

## E. Gift Annuity For Remainder Interests

# Gift Annuity for Home



### 1. How does this concept work?

The gift annuity for remainder interest is a combination of two charitable agreements. If a person has a home or farm, it is permissible for them to give the remainder interest after their lifetime to a charity. For example, if a home is worth \$200,000 and the remainder interest is \$100,000, then a person could give the \$100,000 value by deed to a charity. When a person passes away, the charity would then own the home. The gift annuity for remainder interest adds one further development - the \$100,000 remainder interest is then exchanged for a gift annuity. With a typical gift annuity, there is approximately a \$50,000 charitable gift and the annuity contract value is approximately \$50,000.

### 2. Is this a gift concept?

The donor is making a gift of the portion of the remainder interest. The donor is also receiving the right to live in the home for his or her lifetime and receive an income stream. Some have also compared this to a combination of a life estate and a bargain sale. The donor is giving part of the remainder interest to the charity and receiving the bargain element, the gift annuity, for the balance of the remainder value.

### 3. What donor age group is appropriate for this plan?

This is a plan for senior friends. For the first contracts for a charity, single donors age 85 and above are the best candidates. From the standpoint of the donor, any person who desires to live in his home and receive an income and is willing to allow the charity eventually to receive the property is a candidate for the gift annuity for remainder interest.

### 4. How is the annuity calculated?

First, there is a calculation of the value of the remainder interest. This is done according to the regulations per Section 170 of the Code and is the same as if any other remainder in a home or a farm were being transferred. However, the full remainder is not transferred to the charity, but this remainder value is then used to create the gift annuity. For example, the remainder value of the \$200,000 home above is \$100,000. The \$100,000 amount is then used to create the both the payout and the charitable deduction for the gift annuity.

**5. What type of donors would be interested in this plan and why is this beneficial for the donor?**

If a donor is willing to eventually transfer their home or farm to a charity and would like to receive extra income during life, then this is the right plan. The donor receives a charitable income tax deduction, and resides in the home for his or her life and has the satisfaction of leaving a legacy to the charity.

**6. What if the donor needs to move to a retirement community or nursing home?**

The donor retains the life interest and would have the right to lease the home and receive income from the home. Alternatively, in some cases the donor may wish to jointly sell the home with the charity or basically be willing to give the balance of the income interest to the charity or transfer it for an additional gift annuity. Prior to creating a gift annuity for remainder interest, the charity should have discussions with the donor and donor's counsel regarding the plan to follow if this does become a desired alternative by the donor.

**II. Annuity valuation questions by the charity or administrator**

**A. One or two life current gift annuity**

**1. Should our Board follow the American Council On Gift Annuity rates?**

There are two very good reasons why perhaps 98% or 99% of charities do indeed follow the American Council On Gift Annuities rate. First, the ACGA rates are created so that there is a substantial gift residual for charity. This both benefits charities and increases the security of gift annuitants, since most charities retain this amount in their reserve fund. For those 1% or 2% of charities that pay higher than the specified rates, they are both reducing the total gifts to charity and increasing the potential risk to their gift annuitants.

In addition, with the passage of The Gift Annuity Antitrust Exemption Act in 1995, there is no restriction on charities paying the same rates. Since a gift annuity is intended to be in part a gift to a charitable organization, it is inappropriate for charities to compete for annuities in the same way that financial service companies compete. This is after all, a gift agreement and donors should desire to make a gift to the charity when purchasing a gift annuity.

**2. Should our Board set a maximum payout rate?**

Some Boards have set maximum rates such as 10% as the highest payout rates that will be permitted, even though the ACGA rates may have a maximum of 11% or 12%. While it is understandable that the Boards are reluctant to invade principal, setting a cap is generally an act of unnecessary conservatism on the part of the governing Board. While all gift annuities are expected to invade principal to some degree, the 11% and 12% gift annuities are created by quite senior persons. In the words of an actuary, there is an expected earlier maturity to the plan. Under the guidelines created by the actuary for the American Council On Gift Annuities, the rates at the upper ages are actually somewhat more favorable to charities even though they may exceed 10%. That is, the present value to the charity may be slightly greater with an 11% annuity than for a 10% annuity, given the difference in ages of the annuitants.

**3. Which is better for the charity, a 60-year-old annuitant with a 6.9% annuity or a 90-year-old annuitant with a 12.0% annuity?**

While experienced gift planners all know the answer to this question, there are some Board members who are not certain about this concept. Under the federal tables, the value to the charity of this gift annuity by the 60-year-old is 0.31 on the dollar where as the value to the charity of the 90-year-old is 0.58 on the dollar. Even though the 90-year-old is receiving almost double the annuity, the present value to the charity is far higher because the expected return multiple is much lower.



#### 4. Should we invest the annuity reserve in stocks or in bonds?

First, some states have specific requirements as to investments of annuity reserves. For instance, in California, 90% of the annuity reserve must be invested in government bonds or comparable investments. If one is required by state law to invest a specified amount, then this choice is not available. However, if the choice were available, it would make sense to invest the annuity reserves in a manner similar to long-term endowments. After all, the annuity reserve funds are long-term funds and the investment policy should be similar. With many long-term endowments today, the investment is 60% or even 70% equities in order to maximize long-term return.

#### 5. How do we portfolio balance in a state like California where 90% of the RCV (reasonable commensurate value) is typically invested in government bonds?

In California and other states that have specific requirements, it may be possible to net the exact same return that would typically be earned if the portfolio were large enough. While the portion that must be set aside for the specific reserve value must be invested in bonds, if the balance of the annuity reserve or annuity reserve plus endowment is sufficiently large, then the total return may be minimally affected. With respect just to the Annuity Reserve Fund, many organizations invest the balance of the Annuity Reserve Fund in equities and achieve perhaps a 40% equity- 60% bonds balance. However, if there is a large endowment, by balancing the total endowment, the Annuity Reserve Fund could be treated as the fixed portion of the total endowment and this investment is the case of some institutions would be in the range of 10% to 15% of the total endowment. Since both endowments would hold at least this percentage of bonds in any case, the portfolio balancing method can leave the institution with virtually the same return that they would have otherwise.

#### 6. Are current annuities better for charity than deferred annuities?

Since the charity is permitted to invest the funds for a deferred annuity, if the charity is able to achieve a rate of return comparable to or better than the assumed current rate for gift annuities (a net 6.25% in 1997) then it is likely that the deferred annuity will have greater economic benefit for the charity than a current annuity. Nevertheless, from the standpoint of the charity, the annuity that best fits the needs of the donor and produces a happy donor probably has the net best total impact. Donors who believe that the charity is placing their interest first will both make additional gifts to the charity and will encourage other friends to make gifts to the charity. Thus, a charity following its own self interest should be placing the donor first in reviewing the decision whether a particular donor should set up a current annuity or deferred annuity.

#### 7. What value should we use for our annual audits?

Since the auditors generally desire to value based upon the federal rules under Section 72, it is quite easy to revalue each year. Merely update the record with the gift date for the end of the calendar or fiscal year and run the deduction calculation with the Applicable Federal Rate for that month. The contract value as of that date is usually the desired number for the auditors.

### ***B. Deferred Annuity***

#### 1. Since the deferred annuities pay a high rate, are they good for the charities?

Under the rate effective law April 15, 1998, a donor age 40 can create a deferred annuity payable at age 70 and the payout rate will be 41.7%. While this seems to be a very high payout percentage rate, the charity adds 30 years to invest the funds. Assuming that under the rule of 72 the charity earns 8%, the funds would double every 9 years. If the annuity initially were funded with \$10,000, a charity would have approximately \$100,000 after 30 years. The \$4,170 annuity payable at that time is 41% of the initial \$10,000 but is only 4.17% of the probable amount held by the charity at that time. Thus, the deferred payment gift annuities are clearly very favorable for charities.

## 2. Are the payout rates too low or too high?

For a number of years, the deferred payout gift annuity rates followed very conservative assumptions and many felt that they were too low. However, with the rates in existence since March 1, 1997, it is the opinion of the author of this article that the deferred rates are now a fair representation of the rates that should be paid, at least in comparison to current gift annuity rates. If the current rate schedule is raised or lowered, the deferred rate schedule should be raised or lowered proportionately.

## 3. How should reserves for deferred annuities be invested?

Since the deferred annuity is likely to be even longer term than a current annuity, the strategy of investing for long-term growth is even more appropriate for deferred annuities. To the extent that state regulatory practices so permit, it will be appropriate to use the same equity-weighted portfolios that are now common in endowments.

## 4. Is there a limit to the length of deferral that a charity should accept for a deferred payment gift annuity?

Some charities have excepted deferral periods as long as 50 years. The annuity is a contract and a charity should not commit to fulfilling that contract unless they have confidence that the charitable organization is prepared to stand behind the contract and will be in existence for a very long time. Nevertheless, as long as the charity has stability and sufficient endowment, it seems appropriate to accept deferred annuities with fairly long periods of deferral. The annuity example here was created by a grandparent for a grandchild and is intended to be a retirement supplement for the grandchild.

### **C. College Annuity**

#### 1. A college annuity is supported only by a Private Letter Ruling. Should our organization offer a college annuity? Should we do so even if we are not a college, but rather a medical center, religious organization, social service organization or arts organization?

The college annuity was first approved in 1990 in a Private Letter Ruling and has been approved subsequently in Private Letter Rulings. Given the political climate in Washington and the obvious favorable political bias toward education in the Taxpayer Relief Act of 1997, there seems to be very minimal risk in offering the college annuity.

#### 2. The college annuity offers the individual an election of payment for life or payment for a term of years. What is the risk to the charity if the individual chooses payments for 70 or so years rather than payments for 4 years for college?

With the college annuity, there is a significant growth as would be true with any gift annuity. Since the payment from age 18 to perhaps age 88 involves a relatively low annuity payout amount, if the student did not elect the college distribution (an unlikely event but theoretically possible), then the charity could set aside sufficient reserves to fund the annuity at the lower payout level and allocate the balance as an immediate gift to the charity.

#### 3. Should a charity offer an open-ended option on the annuity? Would this be beneficial in enabling the donor to use the gift exclusion instead of having to report a gift and use a portion of the gift exemption?

Generally, for administrative and other reasons, the charity should offer only one option and that option should typically be a conversion to a fixed number of years. This is both simple and also protective of the goals of the donor. While it is theoretically possible to offer a lump sum conversion option and perhaps to thereby enable use of the annual exclusion, it seems unwise to do so. The donors generally prefer that the child will use the funds toward a college education or other educational objective and the best way of minimizing risk of misuse of funds is to pay the amounts either monthly or quarterly. Thus, it

appears that the best option to simplify administration for the charity and achieve the objectives of the donor is to select a fixed number of years such as 4 or 5 years for the conversion option and in the annuity contract to specify the exact dollar value that would be paid for life and the exact dollar value that would be payable for life and the exact dollar value that would be payable for the selected term of years. This method is commonly followed and does require the donor then to file a gift tax return for the value of the contract as of the date of creation.

#### 4. What is the value of a college annuity to the charity?

The college annuity has similar value to most deferred payment gift annuities. In all likelihood, the conversion will be made to the 4 or so year term payout and the college will typically receive the benefit within perhaps 15 to 20 years of creation of the annuity. This annuity payout will typically leave the college with from 2-4 times the initial funding amount even after making the payments.

#### 5. Is the college annuity the primary value of this plan?

No, in most cases the college annuity is not the primary reason to offer this agreement. For most estates, the college annuity is a relatively moderate or even small portion of the total plan. However, because of the value to the individual of seeing grandchildren attend college, it is frequently a very important part of the plan. Your author knows of one circumstance in which the college annuity was a \$100,000 amount in a \$12,000,000 estate. While the college annuity was not a huge tax issue, it was a preeminent importance to the grandparents and the plan was not closed until the college annuity arrangements had been completed. While the lead trusts in this plan involve several millions of dollars of gifts to charity, the key part of the plan in the view of the grandparents was the college annuity. Thus, it is essential to offer the college annuity if possible, realizing that other much larger gifts will probably accompany this plan.

### ***D. Flexible Gift Annuity***

#### 1. Should we rely on the Private Letter Ruling?

While a Private Letter Ruling is not a precedent, so long as the valuation principles are carefully followed, it is quite likely that this plan prevents very minimal legal federal tax risks. With the college annuity and the flexible annuity, the service has had no objection to individuals with qualified annuities changing the timing on their income payments. The only requirement has logically been that the contract value of any payment stream must be the same.

#### 2. How many years should be offered with the range of payouts?

It appears to the advantage of the charity to offer a fairly large range of years. One particular program offers 32 years as an option. The reason for offering a fairly broad range of years is that some donors will look at the significant increases available in the latter years and will year after year defer receiving payments. This deferral is clearly to the economic benefit of the charity.

#### 3. Will donors understand the flexible annuity concept?

It will be important to give the donors a clear picture of the exact payout option for each year. In addition, it will be important to determine the date by which a decision must be made in order for payments to start in a particular year. Since donors all across the nation now are buying commercial annuities with somewhat similar flexible payout characteristics, this should not be a major challenge. Nevertheless, it is always important with any gift agreement that there is full disclosure and that donors are encouraged to discuss the transactions with their qualified professional advisors.

#### 4. Are there potential state regulatory issues?

Yes, several states have begun to review the flexible annuity and, since it is a new concept, may not have yet ruled on the concept. While there is no intrinsic reason that a state that permits deferred annuities should object to the concept, it may be appropriate to obtain approval from state regulatory agencies in those states that regulate gift annuities prior to issuing a flexible annuity.

## **E. Gift Annuity For Remainder Interest**

### **1. What is the donor profile from the first agreements of the charity?**

This is a plan viewed by the charity as acquisition of real estate at very reasonable cost. Typically, the charity is buying real estate for approximately one-third to one-half of the cost that would be applicable to any other entity. Nevertheless, it is a plan that should be commenced with very senior donors. Perhaps the first five agreements should be individuals 85 and above and the subsequent agreements could be individuals 75 and over.

### **2. Are there risks in real estate? Can one reduce risks?**

Clearly, there are always risks in any investment and certainly risks in real estate. The primary means for reducing risks are to make certain that the appraised valuations of property are accurate and to initially involve senior donors in the program. Because the probable holding period is shorter for senior donors, there is an earlier maturity and will probably be assets that can be placed in the endowment period. Like any real estate, the other method for reducing risk is to diversify. If there are senior friends in the initial portion of the program and a sizable endowment can be built up and a significant number of individuals can be involved in the program, the risk can be substantially reduced.

### **3. Do you need an M.I.T.? That is, should the charity require an agreement on maintenance, insurance and taxes?**

With either a gift of remainder interest or a gift annuity for remainder interest, it is appropriate to have an M.I.T. agreement. The life tenant resides on the property and thus is responsible for the maintenance, the insurance and the taxes. In a few cases where the charity needed to feel comfortable that certain repairs could be made or that a fund was set aside for those repairs, the charity actually purchased for cash a portion of the remainder interest and that amount was used for repairs. For example, with a home valued at \$400,000 with a remainder value of \$200,000, a charity issued a gift annuity based on \$180,000 and paid \$20,000 outright to the individual. A \$20,000 fund was then used for current and future repairs.

### **4. Are there rollover provisions for this plan?**

There are indeed rollover provisions and it would be useful to discuss these rollover provisions prior to the funding of a plan. If an individual does desire to move to a retirement community or nursing home, then it is possible to transfer the remaining life interest for another gift annuity, to sell it for cash or to give it to the charity.

### **5. How critical is the valuation of the property?**

Very important. The remainder value, charitable deduction and gift annuity are all based on the appraised value. The charity must have good confidence that this is a quality appraisal. Fortunately, with the computerized sale reports available in virtually all urban areas now, it is much easier to make comparisons and evaluate the quality of the appraisal.

### **6. What is the potential internal rate of return? How does it compare to the rate of return for our endowment?**

This is a crucial question. The charity is in effect purchasing real estate. It might be compared to a zero coupon real estate bond. The charity is going to be paying the annuity and giving up interest on funds that otherwise would be in the endowment of the charity. By calculating the cost of the annuity and the projected lost interest, the charity can determine its out of pocket cost by the probable expectancy of the individual. By then estimating the probable net after sales cost benefit from the home and comparing it to the investments, then internal rate of return can be calculated. For individuals 85 and above, the internal rate of return will frequently be in the low to mid 20s. For younger persons, the rate of return will be lower. On a purely economic basis, this projected rate of return should be compared to the estimated rate of return for the overall endowment of the charity to determine whether this gift should be excepted.

## 7. Are we going to use the property for our charitable purpose?

If the charity is going to actually make use of the property, then the acquisition for the gift annuity is favorable in virtually every circumstance. Quite a few charities have prospective friends in homes that surround the campus of the charity. If it would be desired to acquire these homes for future expansion, then the charity can acquire them now with gift annuities for remainder interest at approximately one-third to one-half of current value or acquire later from the estate at what typically are highly inflated prices. Some charities have acquired property for perhaps one-fifth now of the cost at a later date. In these circumstances, the cost benefit analysis is virtually unnecessary. Almost any business manager looking at the transaction will realize that property that can be acquired through this method that will be used by the charity is a wonderful bargain.

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## SETTING FINANCIAL GOALS FOR PLANNED GIVING PROGRAMS

Presented by Marc Carmichael

### I. How to measure the success of a planned giving program

Success in planned giving could be measured in many ways -- how many total gifts are secured each year, how many personal visits with prospects take place, number of seminars, mailings, etc. At some point, however, some questions have to be asked: "How much are we taking in relative to what we are spending on planned giving? Is our planned giving program cost effective? Can we justify the program from a dollars-spent vs. dollars-raised standpoint?"

Relate what you raise to what you spend. With immediate gifts, fund raisers often talk about how much it should cost to raise a dollar. Twenty cents of expense to produce \$1.00 seems a reasonable standard, although a survey conducted by the Lilly Endowment shows the average college can raise \$1.00 for 16 cents. Is it feasible (and reasonable) to apply a cost-of-fund-raising percentage to planned giving? The answer should be yes, at least for a planned giving program that has been in place for many years. A start-up program probably should be evaluated over three to five years, with costs and gift dollars averaged over that time period. A case can be made for doing a longer-range evaluation for a mature program, as well, to allow for the ups and downs of the economy. For the sake of simplicity, we'll evaluate a hypothetical "mature" program based on the costs and results of a single year and use 20% as the gauge of success.

### How do you "count" planned gifts for the purpose of goal-setting?

Figuring the costs of a planned giving program is easy enough (add up salaries of planned giving staff, travel, marketing, training, etc.). But calculating gift results requires hard decisions on how to "count" gifts. (We're not talking about FASB rules here, although you could use FASB guidelines if you wanted to do so.) If you spend \$100,000 and employ a 20% fund-raising-cost percentage, then you should bring in \$500,000 -- in current dollars. With planned giving, of course, many gifts won't mature for 10, 20 years or longer. And some gifts, such as bequests, might be revoked before they mature.

We suggest a basic breakdown between "new gifts" and "matured gifts" (cash that comes in during the year). In a few cases a new gift may also be a matured gift. Many new gifts -- deferred gifts -- will need to be discounted because of the "time value of money" and, in the case of bequests and revocable trusts, for the possibility of revocation. Here are suggested guidelines:

Outright gifts (securities, cash, real estate and life insurance cash values and premiums): Count 100%. Technically, these qualify both as new gifts and matured gifts, but you can't count them twice!

Charitable remainder trusts and pooled income fund gifts: Count the remainder interest value of new gifts (the gift deduction amount); count 100% of proceeds from matured CRTs that were not counted as "new gifts" in previous years, 0% for any matured gifts that were counted in prior years.

Charitable gift annuities: Count IRS gift deduction value as a new gift (you can consider this amount as an outright gift, unless your organization reserves 100% of all gift annuity funds until the annuitant dies). Count 0% for "matured" gift annuities if your organization does reserve all CGA funds and gift was counted in prior year.

Bequests and revocable trust gifts: Count each bequest and revocable trust expectancy as 25 cents on the dollar, to reflect both the deferral period and the possibility of revocation. If you don't know the dollar amount of an expectancy, use the average bequest received by your organization in past years and multiply by 25%. Count matured bequests 100% if they arrived unannounced; count 0% if you had them in your expectancy file.

Other deferred gifts (remainder interests in homes/farms, charitable lead trusts, etc.): Count IRS gift deduction value; count matured gifts 100% if they come in "over the transom," 0% if they were counted previously.

This system can and should be adapted to fit your particular planned giving office. The key to any system's integrity is that gifts not be double counted as expectancies and, later, as matured gifts. An obvious example would be a charitable remainder trust that a donor sets up in January and then dies in June. It's unreasonable to count both the deduction value and the distribution of trust corpus.

The above system for counting gifts is not intended to satisfy your auditors and it may or may not be appropriate for other purposes such as donor recognition clubs. It's reasonable to count gifts differently for different purposes and this system's only purpose is to answer the question: "How are we doing in planned giving?" Here is how this system would apply to a hypothetical program:

**CHICAGO HOME FOR UNWED GRANDMOTHERS  
1997 PLANNED GIVING PROGRAM**

(Budget: \$100,000, average past individual bequest, \$16,000)

NEW GIFTS/EXPECTANCIES

<u>Type of Gift</u>	<u>Number of Gifts</u>	<u>Gross Amount</u>	<u>Average Discount</u>	<u>Dollars Counted</u>
Outright	5	\$100,000	0%	\$100,000
Charitable Remainder Trusts	3	500,000	50%	250,000
Pooled Income Fund	1	20,000	50%	10,000
Gift Annuities	10	150,000	50%	75,000
Bequests (expectancies)	12	192,000	25%	48,000
Other	0	0		0
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Total	31	\$962,000		\$483,000

MATURED GIFTS

<u>Type of Gift</u>	<u>Number of Gifts</u>	<u>Gross Amount</u>	<u>Counted Previously</u>	<u>Dollars Counted</u>
Outright	5*	\$100,000	\$100,000	\$ 0
Charitable Remainder Trusts	2	200,000	100,000	100,000
Pooled Income Fund	1	45,000	45,000	0
Gift Annuities	10*	75,000	75,000	0
Bequests	6	96,000	24,000	72,000
Other	0	0		0
<hr style="border-top: 1px dashed black;"/>				
Total	24	\$ 516,000	\$ 344,000	\$ 172,000

\* New gift that also counts as matured

Total new and matured gifts: 41

Total dollar count for year:     \$483,000 (new)  
   172,000 (matured)

\$655,000 in planned gifts at present value

Fund raising percentage =     \$100,000     = 15.27%  
   655,000

Based on a 20% percentage for fund raising costs, or even the Lilly study's 16% average, The Chicago Home for Unwed Grandmothers seems to have a successful program, at least for the money it is spending. What do you do with the results of this kind of evaluation? If the results are favorable, the numbers may make a good case for expanding the planned giving program. If the program is not cost effective, perhaps some changes should be made -- including setting future goals based on a cost-effective program. And that brings us to our next topic.

II. How to set a cost-effective dollar goal for the planned giving program

Everyone needs goals, both in personal and professional endeavors. Goal setting may seem impractical, however, in the imprecise world of planned giving, where the actions taken today may not bear visible fruit during the planned giving officer's tenure, and donor cultivation stretches over many months or years. And what dangers may lurk in setting specific goals if so much guesswork is involved? "I have enough pressures," the planned giving officer may say, "without giving my boss hard numbers by which to judge my performance." Nonetheless, setting annual dollar goals for the planned giving program is important.

The goals of a program can be based simply on the total gift amount that is necessary for a cost-

effective program. You can start with the budget for your planned giving program and include all of your costs, including salary, travel expenses, promotional materials, clerical and administrative costs, training, consultation charges, etc. (If the planned giving officer devotes only a portion of his/her time to planned giving, pro-rate the salary accordingly). After calculating your costs, settle upon an appropriate fund-raising percentage. How much, in other words, will it cost to raise a dollar? Twenty cents? Fifteen cents? Ten? (The recent funded by the Lilly Endowment indicated the average fund raising cost percentage for 51 colleges and universities was 16%).

Costs should then be capitalized by the fund-raising percentage (divide your costs by the percentage you selected). For example, if budgeted costs are \$100,000 and you are raising \$1.00 @ 20 cents, you should be raising \$500,000 a year in today's dollars ( $\$100,000/.20 = \$500,000$ ).

Next, determine the "mix" of planned gifts that will be solicited -- outright gifts, gifts in trust, bequests, etc., and how much value you will attach to each kind of gift. You should adjust deferred gifts to reflect the period of deferral and adjust bequests to reflect both deferral and the percentage of retention. Obviously, no adjustment is needed for outright gifts. As a rule of thumb, a gift in trust will have a present value of about 50% of the amount transferred. The same percentage could be used for gift annuities and pooled income funds. A bequest will have a present value of about 25% of the bequests for which you have dollar figures (pick out an "average" bequest amount that isn't skewed by "mega" bequests you may have received). The following is a hypothetical application of the foregoing concepts.

COST-EFFECTIVE DOLLAR GOALS	<u>Present Value (Value In Today's Dollars</u>	<u>Gross Value Of Contributions</u>
Estimated cost of program:	\$100,000	
Capitalized value to reflect fund-raising cost of 20%:	\$500,000	
Amount to be raised in present value dollars:	\$500,000	
Outright gifts will be 25% of planned gift "mix," requiring this amount:	\$125,000	\$125,000
Trust gifts will be 25% of overall goal, requiring this amount (discounted value of 50%):	\$125,000	\$250,000
Bequests will make up half of the overall goal, requiring this amount (discounted value of 25%):	\$250,000	\$1 million
Total to be raised:	\$500,000	\$1,375,000

If you work for an institution that is initiating a planned giving program, you should spread your goals over a three- to five-year time frame to reflect start-up time. For example, if the total amount to be raised in three years is \$3 million (gross value), you could set your goals as follows:

Goal in Year One = 20% of three-year total	\$ 600,000
Goal in Year Two = 30% of three-year total	\$ 900,000
Goal in Year Three = 50% of three year total	\$1,500,000

These goals may not match up with mathematical precision to eventual results, but they do focus the fundraiser's attention and provide objectives to work toward. You should track yearly progress, of course, and consider fine-tuning where some of your assumptions do not prove out (perhaps your bequest revenue turns out to be 75% of your planned gift "mix," for example, not 50%).

### III. The Action Plan

You need an action plan, of course, to meet your goals. The action plan is a listing of the steps that must be taken to reach the established goals. Typically the action plan would set forth the number of gifts and the size of gifts needed to reach the goal; the number of prospects that reasonably must be cultivated to achieve the goal; a plan for obtaining the needed prospects through referrals, seminars, direct mail, etc. It would include a reasonable plan for approaching and cultivating prospects, providing the gift tools that are considered necessary to reach the goal and whatever other activities are essential to the success of the plan.

Assuming the need to close 40 gifts each year to reach the goal:

- A. How many prospects need to be called upon (personal visitation)? Perhaps one-fourth will actually make a gift. Someone must personally call on 160 prospects (three a week)..
- B. To get 160 appointments to call on prospects, how many identified prospects are necessary? Approximately two to three times the number of appointments made, so you will need about 400 identified prospects.
- C. How many "suspects" are necessary to find 400 identified prospects? If a direct mail program is used, assume 2% to 3% of the list will respond during the year, so you need a mailing list of about 16,000 (if direct mail is your only source for leads).

### Conclusion

Nothing in the foregoing discussion, obviously, was handed down from Mt. Sinai. The purpose simply is to establish a logical, orderly procedure for deciding what you do in planned giving -- and how you are going to do it. Do you tack these goals to your office door? Maybe -- if you're the boss. Perhaps not, if you are the humble planned giving officer. Any disclosure requires prior education of all concerned as to why the goals were formulated -- and that the exact results cannot be guaranteed.

DOLLAR GOAL WORKSHEET

COST OF PROGRAM

Staff Salaries	_____
Travel	_____
Promotion	_____
Training	_____
Administrative	_____
Consulting	_____
Other	_____
 Total costs	 _____

DOLLAR GOALS

FUND RAISING PERCENTAGE  
(COST TO RAISE \$1.00) \_\_\_\_\_ %

DOLLAR GOAL IN PRESENT VALUE  
(total costs divided by fund  
raising percentage) \$ \_\_\_\_\_

GIFTS TO BE CLOSED	NUMBER OF GIFTS	AVERAGE AMOUNT	GROSS VALUE	PRESENT VALUE %	TOTAL AT PRESENT VALUE
Bequests	_____	_____	_____	_____ (25%?)	\$ _____
Outright Gifts (stocks, cash, etc.)	_____	_____	_____	_____ (100%)	_____
Gift Annuities	_____	_____	_____	_____ (50%?)	_____
Charitable Remainder Trusts	_____	_____	_____	_____ (50%?)	_____
Pooled Income Funds	_____	_____	_____	_____ (50%?)	_____
Other deferred gifts (remainder interests in homes/farms, lead trusts, etc.)	_____	_____	_____	_____ (50%?)	_____
 TOTAL TO BE RAISED	 _____		 _____		 \$ _____

ACTION PLAN WORKSHEET

NUMBER OF GIFTS  
TO BE RAISED

1. \_\_\_\_\_

NUMBER PERSONAL  
VISITS NEEDED

Percent visited  
that make gift

2. \_\_\_\_\_ (25%?)

Total appointments  
Needed

3. \_\_\_\_\_ (line 1 divided by line 2)

NUMBER OF IDENTIFIED  
PROSPECTS NEEDED TO  
SECURE NUMBER OF  
APPOINTMENTS ON LINE 3

4. \_\_\_\_\_ (Two or three times number of  
appointments needed)

NUMBER OF "SUSPECTS"  
NEEDED TO FIND NUMBER  
OF IDENTIFIED PROSPECTS  
(LINE 4)

5. \_\_\_\_\_ (For example, if direct mail is your main prospecting  
tool, use a 2% or 3% response rate and divide line 4 by  
that percent. You can adjust the number on Line 4 for  
the number of prospects that are developed outside of  
direct mail, e.g., referrals.)

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# CHARITABLE GIFT ADMINISTRATION IN THE 21st CENTURY

By Steven R. Bone, J.D., CLU

## Introduction

Just as the discovery by Copernicus that the earth is a relatively small rock in orbit around the sun revolutionized the way humans think about themselves and their place in the universe, so too will the evolving *Social Capital* concept forever change the way donors perceive their place and relative importance in the solar system of immediate and planned charitable giving. The effects of these changed perceptions when coupled with new technology will profoundly affect both the charitable gift planning and gift administration processes.

It is my purpose today *first* to explore the forces of enlightenment and change that are unleashing a paradigm shift in traditional approaches to planned giving. *Second*, I will attempt to predict what this radical transformation will mean for those of us who will be called upon to administer 21st century charitable gifts. *Third*, I will express my opinions concerning how best to cope with and prepare for this anticipated transformation.

I cannot begin to take credit for developing the concepts and identifying the trends upon which I will be reporting and commenting. Many of these have come together through the research and superb synthesis, critical thinking and creativity of my mentor and employer, Paul Brooks. I can only attempt to confirm them in part, through my fourteen years of personal experience as a technician and participant in the planned giving community. Any opinions I express will be strictly my own and they do not necessarily reflect the views or official policies of my employer, Renaissance Inc.

## When Planets Collide

Whenever two planets collide, one or both is bound to be torn asunder. Neither will ever be the same again. A similar cataclysm occurs when two significantly different cultures come to occupy a common area and are forced to establish a new order in which homeostasis can again be achieved. Such collisions of heavy mass and conflicting cultures is exactly what has been happening in the planned giving realm since the "orbits" of the financial services

and charitable development “worlds” started to converge in the 1980’s and continue to grow closer as we speak.

You have probably heard that “Men are from Mars and Women are from Venus.” That metaphor could also be applied *in general* to financial services professionals (the “Martians”) and the planned giving specialists employed by charities (the “Venusians”). Let’s consider some traditional *stereotypes* that are sometimes used to distinguish the citizens of these two very different “worlds.”

Financial professionals from Mars are accused on Venus of proposing charitable giving as a means to an end that has very little to do with altruism and Social Capital utilization. Martians are viewed by Venusians as “planned giving dabblers” whose primary purpose in recommending charitable gifts is to encourage the purchase of Martian trusts, investments and life insurance by appealing to the donor’s selfish desires to avoid taxes and maximize an estate for heirs. Venusians believe that on Mars, the charitable gift is viewed as a necessary evil that merely facilitates non-charitable personal ends.

Conversely, planned giving professionals from Venus view the charitable gift as the treasure they are seeking and expect it to come “from the donor’s heart.” Helping donors to avoid taxes and make sure their heirs don’t get shortchanged is merely a necessary evil with which most Venusians wish they did not have to deal. Generally, Venusians impugn the motives of anyone who makes or encourages the making of a charitable gift without true “donative intent.” Even worse are those who give only when there is a significant *quid pro quo* for doing so. Martians view this apparent Venusian preoccupation with the need for purity in a donor’s charitable giving motivations as a bit disingenuous, having never seen a charity turn down a gift, whether large or small, made by the Martians’ allegedly selfish, greedy clients.

Martians typically pursue their ends by “crunching” the donor’s hard, cold financial numbers; whereas, the Venusians pursue theirs by carefully crafting psychological appeals using a low-tech soft touch that generates positive values and encourages altruistic acts of generosity. Capitalist concepts are near and dear to the Martians; whereas socialist concepts invoke warm feelings on Venus. Consequently, it is a “given” that the Martian approach will appeal to the donor’s selfishness and greed; rather than to the donor’s sense of altruism and Venusian charitable intentions.

Stereotypical *similarities* exist, too. The mistrust evidenced between Martians and Venusians is usually shared because neither is ever quite sure of the purity of the other’s motives when the topic of charitable giving is being discussed. In truth, both Martians and Venusians share a common “bottom line” motivator: *they need to get paid for their time and effort*. The Martian financial planner is counting on receiving fees and commissions and the Venusian

development officer needs to justify his or her salary and other expenditures to the charity's chief operating officer. Thus, there is great pressure on professionals from both planets to get their clients and prospects to, "Show Them The Money!"

Martians and Venusians both share the conviction that the donor's available financial resources are limited and it is their respective duty to secure for themselves and/or *their* worthy causes the largest possible share of the donor's wealth. It is this belief in Social Capital *scarcity* that makes the clash between Martians and Venusians all the more intense and competitive.

Frequently, the government is cited by inhabitants of both worlds as the donor's primary external enemy. As such, the donor's defenses are best bolstered by enlisting their respective professional assistance. Martians and Venusians both fear that the other (or the government) will walk away with too many of the donors' scarce financial resources. Consequently, each strives for "maximum control" over the donor and his or her Social Capital in an attempt to ensure its "rightful" final disposition.

Unfortunately for donors, there are zealots from both planets who pursue their prospects with hardball, hard-sell tactics. The zealots from both planets are always sure *they* know what's best for their clients' money and property. As in most human endeavors, it is the zealots who create the headlines that shape public opinion and give life to colorful stereotypes like these.

*What a clash! What a contest! What a show!* And it is into this titanic collision between competing professional heavyweights and their cultures that the bewildered donor steps. For a donor, it must be like standing on Earth and watching Mars and Venus collide in the heavens. What are donors to think? What are they doing about it? Running for cover . . . or taking advantage of the chaos?

Other very interested observers are the chief operating officers of Venusian charities. What are they to think when their development directors come home with various "tales from the front lines"? What are they to do when Martian competitors appear to be winning too many skirmishes for donor control?

### **Witness The Dawning of the Age of "Donor-Centered Philanthropy"**

First let's consider where modern *donors* think *they* fit into this unfolding drama. Today's donors are becoming enlightened and emboldened as a result of the competition between the Martians and Venusians. They are rapidly losing

their passivity and mere spectator status. No longer are they content to “orbit” around financial planners, money managers, lawyers and development directors who have been trying for years to capture and “mine” them like asteroids of gold. Rather, they are coming to understand that all of these “advisors” are really in orbit *around them!* What a difference to gift advisors and administrators this change in perception will make as even more donors come to appreciate that their wealth and intention to control it, like a superior gravitational force, can be used to realign *their* advisors and capture *them* in orbit. Martians and Venusians who are aware of this trend have a name for it: “*Donor-Centered Philanthropy.*”

For several years, Martian financial services professionals trained in *economic* capitalism have been attempting to convince donors that what works for controlling their “economic” capital will also work for controlling their financial “Social Capital.” And donors are becoming more savvy than ever in controlling the former as they take responsibility for investing their own 401(k) retirement accounts and must enlist professional help to walk them through the increasingly complex federal income and estate tax maze. *So what are the planned giving ramifications of this increasing donor sophistication regarding economic capital control?*

Let’s first define some key terms. *Social capital* theory holds that each person is a creator and user of money and time for personal economic and “social good” purposes. The monetary component used for social purposes is referred to as “financial Social Capital.” It comes in two forms: “*government directed,*” and “*self-directed*” Social Capital. The *government directed* variety is represented by what we pay in taxes. The *self-directed* form is represented by the financial resources we voluntarily give to charity. *All of my further references to “Social Capital” will mean “financial” Social Capital that is directed by individuals rather than the government - unless I specify otherwise.*

Our Martian friends have been taking an active roll in helping donors expand their self-directed Social Capital at the expense of the government-directed variety. As a consequence, many donors are beginning to think of themselves as *Social Capitalists* when it comes to managing whatever dollars they have that *must* be distributed either to charity or to the government.

It follows that “*Social Capitalists*” are persons who believe that they have the power and right to control and manage their own financial Social Capital just as they are managing and controlling their own personal *economic* capital. Many of the same tools used to measure, manage and allocate personal economic capital are proving useful to manage Social Capital. As more and more Social Capitalists come to realize that they *can* have a great deal of control over the “dollars they cannot keep” - that they don’t *have* to be involuntary socialists - they are seeking and demanding the knowledge, tools and technical assistance required to help them become *their own* effective Social Capital managers. It is

this awareness coupled with the availability of new technology, that is fueling the "donor-centered philanthropy" movement.

You don't have to take my word alone that "donor-centered philanthropy" has "massive gravity" on its side. Did you see the article concerning Fidelity Investment's Charitable *Gift Fund* in the February 12, 1998 Wall Street Journal entitled "*You Don't Have to be a Rockefeller to Set Up Your Own Foundation*"? There we discover that in the last five years, over \$1.5 billion dollars have been contributed to this controversial charitable trust by over 11,000 Social Capitalists. Some have boasted that this makes Fidelity's Charitable Gift Fund one of the fastest growing charities in America.

What is its appeal? The short answer is the extensive degree of *donor control* over Social Capital that this novel type of charity imparts. The positive testimonials appearing in the *Wall Street Journal* article tell it all. For example, contributors admit to loving such features as the lack of any legal fees to set up an account and very low gift administration expenses, the fact that contributions are being managed by some of the best funds managers in the country, the ease by which they can designate which charities are to get distributions and control distribution timing, and the wonder of receiving a periodic statement that reports on their individual endowment's investment performance. Think what you may about the purity of this charitable institution, its legality, motives and sales practices. It has been a resounding "hit" primarily with "closet" Social Capitalists emerging from the swelling ranks of middle and upper income Americans. They cannot yet afford the luxury of their own private foundations and charitable trusts, but they nevertheless wish to control their Social Capital and hold all of its custodians and distributors accountable.

From our vantage point in Indiana, we also have seen a significant increase in donor interest in community foundations offering "donor advised funds." While the Lilly Foundation has done much to stimulate this interest, I interpret the public's positive response to Lilly's matching community foundation grants as marketplace demand and support for greater *donor control* over Social Capital.

The existence of a trend toward greater donor involvement and control in charitable gift administration was prominently noted by Dorothy S. Ridings, President and CEO, the Council on Foundations in her 1997 Annual Conference Plenary Address at the Council on Foundations Annual Conference in Honolulu, Hawaii, May 5, 1997. Ms. Ridings noted the following six relevant trends and predictions from the extensive feedback she received in her 1996-1997 travels around the country and various surveys:

(1) Dorothy said that Community foundations are ". . . going to be bigger. Lots bigger, even more than most people are projecting. We will be bigger not

*only through growth of existing assets but, more importantly, through new additions to the field."*

**My Commentary:** Community foundations are going to be a formidable competitor for Social Capital because they are gearing up to offer greater donor control and gift sprinkling flexibility than traditional charities with narrower focuses. Donor-advised funds make the donor a much more active participant in the grant making process and this is a benefit donors are seeking in order to give greater significance to their lives. To the extent community foundations succeed in placing themselves "in orbit" around the donor, rather than *vice versa*, they stand to gain Social Capital "market share" because the adoption of a donor-centered approach will be less threatening and much more empowering to the "hands-on" donor-investors of the 21st century.

Enlightened community foundations and other "intermediary charitable institutions" are not only in the vanguard of the donor-centered philanthropy movement, they are also trying to maneuver into the *closest orbits* around the donors. The closer they orbit, the more control they must concede to the donor. However, the more control they concede, the more likely they are to snag the lion's share of the Social Capital that the donor wishes to launch out to other orbiting charities.

What is interesting about this concession of control is that it can only go so far before the conceding institution's "orbit" starts to "decay" and the "gravity" of the donor pulls the charity down to a fiery "death" in the donor's "atmosphere." This is merely a metaphorical way of saying that too much donor control dooms the tax-exempt status of the intermediary institution . . . and therein lies the genesis of an interesting problem for traditional charities with narrower focuses.

Notwithstanding the marketing hype about increased donor-control, intermediary charities will lose their tax exempt status unless they generally make all *final* decisions with respect to where "donor-advised" funds will ultimately go. Donors who make gifts to them are *in fact* parting with the absolute *final say* over which other orbiting charities will get to use the intermediary charity's Social Capital. To the extent the intermediary charities take this mandate seriously, as they all should, the *other charities* who are to be the ultimate recipients of the Social Capital entrusted by donors to intermediary charities, will find themselves *more out of control than ever before!* Not only will the non-intermediary charities have to court donors, but also court the intermediary charities to which donors will be "launching" much of their self-directed Social Capital. If this model of our evolving philanthropic "solar system" really takes hold, non-intermediary charities may need to revisit and adjust their strategies and business plans.



(2) Dorothy said, "There will be more targeted grantmaking, more targeted funds, more personal interest and involvement by donors where foundations have living donors or their designees."

**My Commentary:** Social Capitalists have a growing concern regarding how their Social Capital will be spent by their charitable beneficiaries. Their charitable interests are being defined with greater acuity with the help of enlightened philanthropic planners and the availability of a vast amount of online information concerning charities. Examples of the later include the World Wide Web sites of the *National Charities Information Bureau*,<sup>1</sup> the *Philanthropic Advisory Service* of the *Council of Better Business Bureaus*<sup>2</sup> and the *Internet Non-Profit Center*.<sup>3</sup>

Donors today are increasingly more likely to designate specific uses for their planned gifts. Furthermore, their expectations are great that their charitable beneficiaries will honor all instructions and restrictions. We see this every day with respect to charitable remainder trust bequests.

Today's Social Capitalists also want and expect feedback concerning *how* their endowments are performing and *for what* the income is being used, coupled with some ability to hold "their" charitable custodians accountable. These demands for increased accountability will give a competitive edge to charities who install state-of-the art "gift management software" to improve their operating efficiencies and make sure a donor's specific instructions don't fall through the cracks.

(3) Dorothy said, "You [will] see the field of philanthropy as becoming more professional."

**My Commentary:** Donors are requiring increasingly higher levels of competence and cooperation among their chosen financial and charitable gift planners. A professional, cooperative "team effort" that places the donor's best interests at the forefront of all planning activities is expected. After all, it is the donor's Social Capital with which the professional advisors are "playing." We are seeing gift planning team members who don't know what they are doing and cannot carry their weight being "fired" by donors regularly. Lawsuits against incompetent charitable planners are becoming more prevalent and some, e.g. Jay Steenhuisen of World Vision, are predicting this type of litigation is about to intensify.

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<sup>1</sup> For information on the Internet, go to <http://www.give.org>

<sup>2</sup> For information on the Internet, go to <http://www.bbb.org/reports/charity.html>

<sup>3</sup> For information on the Internet, go to <http://www.nonprofits.org/gallery.html>

Recognizing a need for a standard of competence for Social Capital planners, the National Association of Philanthropic Planners (NAPP)<sup>4</sup> started testing its members for their technical proficiency with respect to charitable remainder trust planning in 1996 and granting a certification to those who could pass the test. This is but a small step in the direction of a nationally-recognized certification program for Social Capital and planned giving specialists, the need for which the market is likely to soon demand.

Also, donors who are interested in educating themselves about Social Capital and planned giving so they will be in a better position to hold their Social Capital planners accountable for the competence of the latter will find a growing wealth of Social Capital and planned giving *technical* information at their fingertips on the Internet.

(4) Dorothy said, “. . . we will be more open and accountable. You know we will have to be, and an overwhelming number of you say we want and need to be. Trust and accountability are showing up as major concerns among all our publics, as we’ve been told by several opinion surveys, and even absent any additional governmental oversight, you are convinced that addressing those concerns is important for us.”

**My Commentary:** Donors will no longer tolerate poor investment performance for their split-interest gifts and charitable endowments. Charitable trusts and charities that don’t do a good job of accurately reporting what is happening with their assets, income and expenses will be shunned in favor of those who do. The Internet is already proving to be a potent new tool in disseminating information about charities and the extent to which they are being good stewards of the Social Capital they manage and distribute.

Competition from Social Capital gift administrators with financial services roots who are willing to make full disclosures and provide accurate Social Capital performance reports will force charities and others to open up and do likewise. Increased competition and better technology will expose institutional trustees who have been negligent and wasteful in their gift administrative practices and responsibilities, subjecting them to accountability and liability for the damages caused by their negligence. The United Way and New Era scandals are still on the minds of many donors, and one of the best and fastest ways to regain their trust will be via open and honest Social Capital performance reporting.

(5) Dorothy said, “*The field will become more competitive. . . . there is widespread understanding among community foundations, for example, that increasing competition for donor attention is here to stay, that there is great*

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<sup>4</sup> This organization was formerly known as the *National Alliance of Renaissance Associates*.

*need to refine and strengthen how community foundations market their distinctive features – the things that make them attractive choices for donors as vehicles for giving. There will be an increasing number of options for how donors “do” their philanthropy – options we don’t even envision today – resulting in a lot more entrepreneurial thinking in the field.”*

**My Commentary:** The key words here are “competition for donor attention.” There is nothing like competition to make the “object competed for” come to appreciate its value. Donors are no exception. It is *their* Social Capital that the Martians and Venusians covet and it is becoming increasingly apparent to them that they can control who will get it. Thus, the competitors who do the best job of convincing their Social Capitalist customers the former are the most efficient, profitable, open and accountable, custodians, investors, distributors and users of Social Capital will succeed in capturing the most of it.

The rise in popularity of Fidelity’s Charitable Gift Fund and the proliferation of community foundations is only the start, as competition for Social Capital heats up. Intermediary charitable institutions of all types, including supporting organizations and private non-operating foundations will proliferate as Martians continue to tout their benefits. Expect more old-line, single-interest charities to offer “donor-advised funds” to become more competitive with community foundations and the Fidelity’s of the world. Slowly but surely, all of this competition will place the Social Capitalist upon a pedestal around which all development, financial, legal and accounting Social Capital advisors and distributors will orbit.

(6) Dorothy said, *“We will be more diverse, and yes, more inclusive in our composition and our practices. Dramatically changing demographics will drive much of that. So will the potential influx of new donors resulting from that intergenerational transfer of wealth. We have an intriguing challenge in how to identify those donors both before and after the transfer takes place, donors who will not typically be coming from positions of tremendous wealth.”*

**My Commentary:** Traditional *Venusian* notions of who is a top prospective donor are being challenged. Success is coming early in life to many of the technological geniuses of our time and it is not uncommon for these *nouveau riche* and their equally successful associates to have no family histories of significant charitable giving. Some Social Capital competitors are going to begin teaching the next generation of young and hopeful “Bill Gates” about the joys and benefits of self-directing their Social Capital *early* - expecting to earn their respect, loyalty and charitable gifts for years to come. It will not pay to wait until they are 65, graying, and featured on the front page of Fortune magazine before cultivating their favor. Long before then, others will have already placed themselves “in a closer orbit.”

The following sage advice on this point was offered by Jay Steenhuisen, World Vision's National Director of Planned Giving at the recent 1998 Renaissance National Conference on Social Capital:

*"Our best donors do not come off our donor list. Charities are not viewed by these folks as 'best qualified' to solve their economic and tax problems."*

Unless the Venusians "get wise" about this soon, the Martians are going to have the upper hand with this new breed of donor. I submit that the best way to discover these folks is to *team up* with other professional advisors who are currently helping them manage their economic capital and start "team-teaching" them how best to define and manage their Social Capital!

The appeal, ascendance and success of donor-centered philanthropy is also verified by the experiences of Renaissance Inc.<sup>5</sup> We caught the charitable remainder trust "wave" just as it was beginning to swell in 1986 and have ridden high in its crest for the past 11 years. During that period, we have assisted in the creation and administration of over 4,000 *new* inter vivos CRTs that now contain over \$2 billion in assets. Many settlors of these trusts were "off the radar screens" of most charities because they didn't fit the donor profile for which most development directors were looking. Some of the secrets of our success in expanding the CRT market *from the donor's perspective* include the following:

- (1) We take the donor's existing professional advisors as we find them and try our best to work cooperatively on the donor's hand-picked team.
- (2) One version of our "unbundled" administrative services and compliance assistance have empowered the donor to serve as his or her own trustee, and retain as much control as the law will allow.
- (3) *Our* administration policies place very few restrictions on who can serve as investment managers or where such managers must invest trust corpus, enabling donor-trustees to maintain any existing, highly-regarded, money-management relationships.
- (4) We are totally non-judgmental regarding which public charities or private foundations the settlors wish to designate as beneficiaries. We encourage settlors to discuss all gifts with their intended charitable beneficiaries; however, we faithfully honor all settlor requests for privacy and anonymity.

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<sup>5</sup> For information on the Internet, go to <http://www.reninc.com>

- (5) Our specialized gift accounting, tax reporting and compliance services are considered to be objective because we are not controlled by any investment manager.
- (6) We provide to trustees useful financial and other trust information they need to hold other trust planning and investment management team members accountable for the contributions of the latter to the investment and administrative effort.
- (7) We are effectively and efficiently creating and implementing new software and technologies to provide faster, more effective customer service to all members of the donor service team.

What entities like Fidelity's Charitable Gift Fund, community foundations, and Renaissance Inc. all have in common are unique attributes that make them catalysts for paradigm changes in the way planned charitable gifts are made, administered and used. They are hybrid organizations born out of the chaos that is resulting from the inevitable collision between the financial services community of Mars and the development community of Venus. Their very existence challenges the status quo, points the way to vast new opportunities for service and Social Capital expansion, and suggests new ways to strengthen, improve, grow and protect our country's vitally important non-profit sector.

### **Donor-Centered Philanthropy Sets the Stage for 21st Century Giving & Gift Administration**

Here is what my prior examples, experience and arguments should tell us about the Social Capital management needs and desires of typical, enlightened, twenty-first century Social Capitalists:

- (1) they expect their professional advisors, money managers and charities to all be competent and work together to simultaneously assure that their financial needs and those of all interested parties, including their family, will be met by any planning that is done;
- (2) they are into controlling their Social Capital with many of the same tools they use to control their economic capital;
- (3) they wish to select and hold accountable the charities to whom their Social Capital will be supplied and are warming considerably to Martian suggestions that they establish donor-advised funds, supporting organizations and private non-operating foundations;

- (4) they wish to select and hold accountable the money managers responsible for growing and preserving their Social Capital endowments;
- (5) they expect to be courted and romanced for their Social Capital by money managers and charities alike, no longer content to be “passive, compliant “bodies” merely “orbiting” around either;
- (6) many intensely desire privacy (or even anonymity) with respect to which charities will ultimately receive their Social Capital reserves. To this end, they desire to retain the ability to withhold future Social Capital distributions from former charitable beneficiaries in whom they have lost interest or faith; and
- (7) they continue to appreciate and derive charitable motivation from various tax incentives and want professional help in making the most of these.

Are any of these Social Capitalist attributes upsetting to you either as a Martian or Venusian? I would be very surprised if there is *not* something on the list that *each* of you find objectionable, probably starting with the very first item: *the requirement that all professional advisors must work together on a team.* How on Earth are you going to do that when you are *on* Mars or Venus and, through most appearances, you are colliding head-on with denizens of the other planet in a spirit of chaos and competition?

## The Enlightened Path for Worlds In Collision

Here is what I believe Martians and Venusians must do to engineer an amiable and mutually beneficial donor-centered partnership:

**FIRST:** The Martians and Venusians must come to recognize that the satisfaction of their respective needs by Earth-based Social Capitalists is *not* a “zero-sum” game in which one must win and the other must lose. If they both do their best job for the donor, there should be *more than enough* capital to satisfy them both - provided that they all work together to offset the gravitational pull of the sun, i.e. the federal government. It will be much more difficult for the government to eliminate *non-government-directed* Social Capital, e.g. by imposing a flat tax with no incentives for charitable giving, and/or stripping charities of their tax-exempt status, if Mars, Earth and Venus are weak and divided, than if they are strong and united. Thus, *all* must use their combined gravity to pull against the sun, rather than against each other.

There are two keys to making this “united we stand, divided we fall” strategy work. The first is the employment of new “technology” by both Martians and Venusians that will help them to convince donors that the Social Capital

"wells" of the latter are much deeper than anyone originally believed. If there is little or no scarcity of Social Capital, then neither the Martians nor the Venusians need fear not getting their respective "fair shares" when it comes time for their services to be compensated or Social Capital needs to be satisfied. "Co-opetition" and sanity can rule the day once the Social Capital scarcity issue is resolved.

Am I suggesting that the supply of "Social Capital" may be endless? Not exactly. However, I believe our reserves are much greater than most people think. Twenty-five years ago, you may recall scary scientific predictions that planet Earth would run out of oil by the year 2000. Fortunately those predictions were very wrong, thanks to better exploration methods and new technology that enables oil to be recovered from deeper inside the earth than anyone thought possible in 1975.

Like oil, our financial Social Capital reserves also are much deeper and larger than most people think. We have only skimmed the surface in finding them so far. However, the "depth" of the majority of these reserves will make them more difficult to recover. Plumbing the depths of a Social Capitalist to identify *all* sources of Social Capital requires a skill few have demonstrated and technologies that are only now being developed for this unique purpose. I believe the leading technology to accomplish this task is something called "*Values Based Estate Planning*<sup>TM</sup>," - the brainchild of Scott Fithian of Legacy Advisory Associates, Inc., Needham, MA.<sup>6</sup>

Values Based Estate Planning<sup>TM</sup> differs from the traditional tax-avoidance driven models by acknowledging that: (a) values govern all behavior and relationships; (b) values regarding wealth guide one's estate planning decisions; and (c) most people have not taken time to ascertain their values and apply them to their estate and financial plans. The ascertainment and application of a family's values to their wealth planning is absolutely essential to the creation of a rational, productive and gratifying plan. Values Based Estate Planning<sup>TM</sup> requires the following of the client:

- A thorough understanding of the Social Capital concept
- An understanding of the "planning values pyramid"
- The creation of a written, well-defined family financial philosophy
- Quantification of what it means to be "financially independent"
- The establishment of an appropriate family legacy
- The creation and maximization of a Social Capital legacy
- The building of a professional team to effect the plan

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<sup>6</sup> Values Based Estate Planning is a registered trademark of Legacy Advisory Associates, Inc., Needham, MA.

This technology helps to quantify a donor's unique Social Capital reserves, creates an irrefutable "road map" of the donor's charitable objectives and delivers a personal "mission statement" for Social Capital utilization. It promises to expand the donor's perception of his Social Capital to include personal assets and resources not heretofore earmarked for charitable purposes, thus minimizing the "scarcity" problem noted previously.

Most successful development directors and financial professionals already possess the basic skill set necessary to use this technology effectively. Nevertheless, mastery will take commitment, training and practice. The sooner both classes of advisors embrace this technology and learn how to use it, the lower the risk for a hard and painful collision between Mars and Venus. Training schools are now being set up to teach this new technology.<sup>7</sup>

The second key to achieving homeostasis between Mars and Venus is understanding that the enlightened Social Capitalist will want his professional advisors to be *both* in a tight orbit *around him*, and *also* in harmonious orbits *with respect to each other*. Without question, most donors need assistance from *both* economic and Social Capital planners to become the "whole economic persons" they are striving to be. Most people struggle to fully-comprehend all of the tax and economic dimensions of their wealth, *let alone* the emotional and spiritual aspects which will ultimately determine how their wealth will be utilized. Once they understand the complexity of this subject and need to get it straightened out in their minds, most will be willing to compensate professionals from both planets according to their educational efforts - but only *if* everyone can agree to work together on a *harmonious* team to help the donors attain their goals.

For such a spirit of teamwork to develop, there must be mutual trust<sup>8</sup> and respect among the cooperating Martians and Venusians. Such feelings will come about only if all planning team members are competent in their respective specialties and are jointly committed to solving *the donor's* unique financial and philanthropic goals and objectives *as their primary objective*. If any advisor on the team is less than competent or more "self-centered" than "donor-centered," the planets will collide and the results will not be pleasant.

Perhaps the best way to avoid such unpleasantness is to begin to build teams of professional advisors from Mars and Venus who *already have* personal trust and respect for each other's unique skills, competence, and personal motivations. Team members from Mars might include a financial planner or

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<sup>7</sup> e.g. The Renaissance Inc. training school has been re-engineered to incorporate Values Based Estate Planning™ methodologies. For training school information on the Internet, go to <http://www.reninc.com>.

<sup>8</sup> For an excellent treatise on the importance of "trust" in this setting, see the best-selling book entitled "Trust, the Social Virtues and the Creation of Prosperity" by Francis Fukuyama, Simon & Schuster, 1995.



insurance agent, stock broker, attorney and CPA. Members from Venus might include an independent charitable gift consultant or the development directors from the donor's favorite charities. All should be committed to a Values Based Estate Planning™ approach that will take both the tax and economic variables as well as the donor's values, philanthropic aspirations and spiritual needs into full account.

**SECOND:** The Martians and Venusians will have to recognize and use the best of what each has to offer and merge these high-quality attributes into the products, services and worthy causes they jointly serve up to their Social Capitalist clients. To a large degree, what is "best" in a system where all advisors "orbit" the donor will be a function of the donor's expectations and how well they are being satisfied.

There can be little doubt that the invasion of Venusian "charitable gift space" by Martian financial service invaders has been changing the expectations of Social Capitalists with respect to how Social Capital *should be* quantified, invested, tracked and reported. This is the case because economic capital techniques, management tools, and even investments are increasingly being "retrofitted" for popular use in the Social Capital sector. How successful and even "legal" or appropriate some of these innovations will prove to be remains to be determined. Nevertheless, we can be assured that they will continue to evolve. Here are several examples of evolving Social Capital technologies with primarily "Martian" roots:

(1) Values Based Estate Planning™ is an updated, expanded, Social Capital version of the life insurance industry's "capital needs" analysis. It combines Martian financial principals with Venusian psychological and values-based ones.

(2) Charitable gift planning software<sup>9</sup> incorporates financial cash flow models and other financial analytical tools to quantify a donor's financial Social Capital and hypothecate its growth, given various investment types and investment performance assumptions.

(3) Fidelity's Charitable Gift Fund "accounts" are strikingly similar to money market accounts against which the donor can write Social Capital "checks" advising Fidelity to which charities funds in an account should be disbursed. Some community foundations offering "donor advised" funds "check in" with similar, though perhaps less conspicuous, features.

(4) Fidelity's Charitable Gift Fund account holders are given *both* a choice of four specific funds into which their contributions will be invested, and the

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<sup>9</sup> e.g. PhilanthroTec's Charitable Scenario. For information on the Internet go to <http://www.ptec.com>.

right to rebalance their investment selections from time to time. Some charities are also permitting donors to give "advice" concerning how and with whom their contributed Social Capital will be invested.

(5) Fidelity's Charitable Gift Fund reports to account holders their donor-advised account balances just as if they were personal mutual funds. Renaissance Inc. will soon introduce and offer for a fee a similar accounting and reporting service to *any* charities or community foundations that offer donor-advised funds.

(6) Earlier this year, Renaissance Inc. introduced the capability for the trustees and money managers of the charitable remainder trusts it administers to go on-line via the Internet and track their CRT investments and latest trust accounting data. An ever increasing amount of charitable gift account portfolio data is now being fed electronically to Renaissance Inc. via various money managers and financial data providers. These electronic feeds enable the daily updating of many Renaissance-administered CRT and CLT financial records. We believe active managers of CRT portfolios will appreciate our efforts to compress the time it takes to generate up-to-date account information and deliver such information over the Internet on a daily and confidential basis.

(7) Taking a page out of the book for streamlining the establishment of qualified corporate retirement plans, Renaissance Inc. attorneys have developed a charitable trust *custom document drafting* and *trust funding consulting* service solely for estate planning attorneys who desire help in preparing and funding customized charitable remainder and charitable lead trust documents for their clients. This highly specialized, high capacity, fee based service is designed for attorneys, most of whom draft and help fund very few CRTs and CLTs during the course of a year and cannot afford to specialize in this area. It is now available to any attorney who is representing a donor and wishes to purchase it.<sup>10</sup> Consulting services are also available to attorneys who desire assistance with designing their own CRT and CLT forms.

(8) Using specially designed software, some money managers are getting much more savvy in designing and managing CRT portfolios to continuously balance the remaindermen's desire for corpus growth with the income recipient's changing needs for current or deferred income. This Martian innovation should have great appeal for CRT investment managers on *all* planets.

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<sup>10</sup> For more information about these services, please contact the Director of Legal Support Services, Renaissance Inc. at (800) 843-0050.

(9) Some commercial annuity and REIT financial product innovators have begun to manufacture products specifically for the Social Capital market. More are expected to jump on this bandwagon as the Social Capital industry develops.

Not to be outdone, Venusian technicians have also been studying Social Capital and are making their own contributions to emerging Social Capital technologies. For example:

(1) Sophisticated software is available to charities to automate general and gift accounting functions as well as donor tracking and communications. Some well-known software providers include Blackbaud<sup>11</sup> and Institutional Memory, Inc.<sup>12</sup> Their tools help to automate the non-profit accounting and development efforts and keep the flow of both financial and non-financial Social Capital coming the charity's way. Some of them can also be useful in generating feedback to donors concerning how their Social Capital is being recognized and used by the organization.

Institutional Memory, Inc.'s GiftedMemory™ is an intuitive prospect management software system designed to organize, track, and manage major gift donors, volunteers, and staff. Its function is to increase fundraising productivity by designing successful fundraising strategies and by streamlining the process. It claims to improve prospect research; provide on-line research profiles; aid with solicitation planning and the identification of relationships; track prospects, staff and volunteers; increase productivity; enhance management capabilities; improve communications; and develop a computerized 'institutional memory' regarding current and prospective donors that will outlive the tenure of any staff members.

(2) Also available from companies like Blackbaud is software for project, grant and endowment management that can be used to allocate income from a common investment pool to various projects, grants and endowments for which separate accountings are required.

From these innovators and their technological innovations, some more controversial than others, we are witnessing the birth of a new *Social Capital services industry*, not unlike the personal financial services industry that has been maturing over the last century. Regardless whether you like or can yet appreciate the new technologies that are being tested in this nascent industry, their increasing acceptance and approval by Martians, Venusians and donors is likely to produce ever greater demand for their ultimate utilization by all Social Capital advisors and managers.

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<sup>11</sup> For information on the Internet, go to <http://www.blackbaud.com>.

<sup>12</sup> For information on the Internet, go to <http://www.giftedmemory.com>.

**THIRD:** With the orbits of Mars and Venus converging, homeostasis must again be achieved in the Social Capital “solar system.” What is needed to orchestrate a “friendly” and mutually beneficial partnership between Martians and Venusians are chaordic™<sup>13</sup> “orbits” around earth-based Social Capitalists and co-opetive agreements among all “orbiting bodies.” *What’s that again?* Here is a translation of this 21st century “techno-babble” and my summary and conclusion to this presentation:

(1) A certain degree of chaos now reigns on both Mars and Venus that is exacerbated even further when Martians and Venusians mix and compete in the same “space.” Mars is a chaotic place because the professional advisors who occupy it, i.e. the financial planners, insurance agents, investment brokers, accountants, lawyers, etc., oftentimes compete against each other to control their Social Capitalist clients for the advisors’ self-interest. This advisor “quest for control” and self-interest often leads to chaos around the Social Capitalist who must contend with conflicting advisor egos, insecurities and hidden agendas as part of the price to be paid for getting his or her needs met. Throw a few Venusians into the mix and the chaos factor increases dramatically. Not only do Venusians quasi-compete with Martians, they are known to compete head-on with each other. They, too, come to the Social Capitalist with self-serving agendas. So here we are, awash in an apparently chaotic system in which everyone is selfishly pursuing his own interests. *Is there any hope?*

Anyone who has studied “capitalism” knows that it works so well precisely because it allows all participants in the system to pursue freely their individual self-interest.<sup>14</sup> One would expect such a system to collapse in utter chaos, but miraculously it does not. Free and **open** markets in which all participants are pursuing their self-interest with “rational, utility maximizing behavior” have proven to be the most efficient allocators of scarce resources and the surest route to wealth and capital maximization for *all* participants.

I believe that what works for maximizing and efficiently utilizing one’s personal economic capital in a free and open capitalistic system should work equally as well for maximizing and efficiently utilizing one’s Social Capital. Thus, Martians and Venusians can “agree to disagree” between and amongst themselves and pursue their own competing self-interests to the betterment of donors and everyone in society; but, *only* if they are able to do so in a totally “free and open” Social Capital marketplace.

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<sup>13</sup> This term was coined by Dee W. Hock, founder and CEO Emeritus of VISA USA and VISA International and refers to any self-organizing, adaptive, nonlinear, complex system that is simultaneously orderly and chaotic. It has been trademarked by The Chaordic Alliance. See Dee W. Hock, *The Chaordic Organization: Out of Control and Into Order*, World Business Academy Perspectives, Vol. 9. No. 1, 1995.

<sup>14</sup> See, e.g. Adam Smith’s classical economic treatise, *Wealth of the Nations*.

My mentor, Paul Brooks, would define such an open market as a "neutral" one in which *any* Social Capitalist, *any* professional advisor, *any* charity, and *any* investment advisor can come together to freely and safely trade in their goods, services, information and Social Capital with *anyone* who needs and wants them. Attempting to determine how such an open *marketplace* should be designed and constructed - and then attempting to "build" it - is part of what Renaissance Inc. is about. We believe these are goals worthy of our time and effort because only in such a marketplace can Adam Smith's "invisible hand" work its magic and create order in the Social Capital solar system out of its apparently chaotic and self-centered components.

(2) The Social Capitalists who are worth courting are getting increasingly more sophisticated and demanding of their professional advisors and charitable beneficiaries. They are coming to expect us to orbit around them, rather than vice versa.

a. To meet their Social Capital *planning* needs and expectations, and expand our reserves of Social Capital, we will all have to embrace technologies like Values Based Estate Planning™ that attempt to marry together the financial, tax and altruistic elements of Social Capital planning in terms the Social Capitalist can understand and feel comfortable acting upon.

b. To address their *control* issues, we must not assume that all Social Capitalists have similar ones. "Donor-centered" philanthropy will not always be synonymous with "donor-controlled" philanthropy. Donor-centered philanthropy focuses on what is truly best for a given Social Capitalist *from that person's viewpoint*. Consequently, "total control" is not always what will be considered best *or even desirable* for a given individual.

For example, an elderly donor who no longer has the energy and mental ability to personally manage his Social Capital may be very comfortable giving up "control" if he can be reasonably certain that his appointed Social Capital custodians will be competent in their services and accountable to him and his plan. For this person, "control" will be an unnecessary means to the ends of "accountability" and "appropriateness" so long as these ends can be assured by truly unselfish, "donor-centered," professional advisors and charities whom the donor can trust.

Contrast this person's control needs with those of a successful, "type-A," 50-something entrepreneur who is convinced that he is the master of his universe and achieved his exalted status by controlling everything he touches as tightly as possible. For this breed of Social

Capitalist, control is *not only* a means to the ends of accountability and appropriateness, it may even be an “end” in itself. Donor centered philanthropy will probably feel like the “donor *controlled*” variety when dealing with a prospect like this. *But here is the point.* Professional advisors and charities who adhere to donor-centered philanthropy will place themselves “in orbit” around any type of Social Capitalist and attempt to meet that person’s needs *first* . . . honestly, unselfishly, competently, thoroughly and always within the bounds of the law.

c. To meet their *gift administration* needs and expectations, we will be expected to provide fast, reliable, electronic feedback to them and their Social Capital investment managers concerning how self-directed, financial Social Capital is being invested, spent, and distributed for charitable purposes. The Internet and software tools like those under development at Renaissance Inc. can be expected to play an increasingly important role in the collection, management and timely dissemination of financial Social Capital information to donors and others who desire and need to have it.

(3) The Social Capitalists are going to require both Martians and Venusians to *cooperate on a team* that is dedicated first to solving the donor’s Social Capital problems. For this to happen between two groups with such different cultures and a history of quasi-competition and mistrust, a new way of relating will have to occur. Something now being called “*co-opetition*” will need to replace “competition.”

“Co-opetition” is a seemingly unnatural marriage between “competition” and “cooperation.” It describes a way of relating among competitors necessitated by market forces that are demanding changes too great for any one of them to tackle alone. For example, rapid technological advances and the staggering cost of implementing them are forcing alliances between former competitors like Apple and Microsoft, IBM and Motorola. Such “unholy” alliances and even mergers are occurring between intense competitors in the fields of finance, health care, pharmaceuticals, telecommunications, national defense . . . and others.

*When is “co-opetition” a good idea?* Technology consultant, Sam Albert of Scarsdale, New York noted in a February 12, 1998 *Investors Business Daily* interview that co-opetition makes sense when: (a) there is a need to reduce research and development costs to improve margins; (b) there is a need to catch up in the market or define a new market, but you don’t have the resources to do it alone; and/or (c) when there is a need to establish standards that can benefit the entire industry. Co-opetition makes sense in the nascent Social Capital services industry because “going alone” to develop the types of technologies now in demand for managing Social Capital will be cost prohibitive for most

competitors from either Mars or Venus. Technological standards are also needed that can benefit the entire industry.

Consider that if charities and community foundations are going to compete for the control of Social Capital against Martian heavyweights like Fidelity and Vanguard, they are going to need access to the same kinds of technologies that are making Fidelity's Charitable Gift Fund so popular. Joint-ventures with different Martians who can supply similar technology and the know-how to use it will make sense.

If financial information about Social Capital and various types of Social Capital accounts is to be available and useful to donors and their industry advisors, a common *electronic infrastructure* must be constructed to both process and carry this type of information. The standardization of this infrastructure, something we are calling the "*Social Capital Network™*," is essential if it is to serve *all* co-opetive participants in the Social Capital services industry.<sup>15</sup> Think of it like an "open" interstate highway system that permits the rapid and free flow of *all* Social Capital goods and services (and information about the same) to be provided *by* anyone *to* anyone. It might also be characterized as the "neural backbone" or "circulatory system" of the *open* and *neutral* Social Capital marketplace, the need for which I mentioned earlier.

The need to implement and use new Social Capital technologies and information standards *alone* will not lead to *productive* co-opetition in the Social Capital Network. *All* Social Capital service providers will also have to commit to the concept of donor-centered philanthropy if co-opetition is to work.

Financial planners from Mars have been learning over the past decade that most of their wealthy clients feel more comfortable accepting traditional financial and estate planning services from them if the cost of these services is unbundled from the cost of any investments or insurance the planner is also selling. Only if planning services are divorced from any product sales and separate fees are charged for the former can the client feel assured of getting the unbiased blueprint for his or her financial plan that he wants. This has been unsettling for many Martians. However, those who have been willing to place their sales commissions "at risk" in this fashion have earned the trust of their clients and will, in most cases, be rewarded with a product purchase, too.

Similarly, if development directors are to participate in co-opetive planning teams with the donor's other "orbiting advisors," they will need to loosen up on their "control expectations" during the planning process and try to assist the donor develop his or her charitable options, *objectively*. Development directors (and their C.O.O.s) who customarily insist on receiving "the whole

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<sup>15</sup> The Social Capital Network™ is a registered trademark of Renaissance Inc., Carmel, Indiana.

enchilada" as the price to be paid for their services and participation are going to struggle with this. But in the world of donor-centered philanthropy, donors are not going to accept self-serving advisors from *either* planet sitting at their planning tables. *Any* advisors to be admitted to the planning process in its formative stages will thus be required to "*check their self-interest at the door*" as the price of admission and trust the donor to be fair with all who cooperate and provide value during the process. Charities who refuse to play their cards this way will continue to find themselves "left in the dark" about many planned gifts established for their benefit until it is time for them to be distributed, and such gifts are likely to be smaller than they otherwise might have been.

The same kind of customer thinking has also fueled the growth of "third party" trust administrators in both the qualified retirement plan and charitable remainder trust arenas. In the former, many qualified plan trustees feel more comfortable buying plan administration services from a third party administrator who does not also sell investments to the trust. In the latter, Renaissance Inc. has capitalized on the desire of many CRT trustmakers to have someone other than their trusts' money managers or charitable remaindermen keep the trust accounting records and report about trust investment performance. The fact that the thousands of CRT trustmakers whose trustees we serve have chosen to pay us for what we do even when they could obtain trust administrative services "free of charge" from any number of worthy charitable remaindermen says a great deal about demand in the marketplace for objectivity.

(4) Co-opetive teams of financial advisors, development directors, attorneys, accountants, and gift administrators all using standardized elements of the Social Capital Network infrastructure and *their respective specialized knowledge and skills* will help to "tame" the young and chaotic Social Capital Services industry and enable all of its participants to maximize their value to each other, and ultimately, their respective "profits." On the bottom line, enlightened Social Capitalists will not tolerate self-serving dissension among their orbiting advisors because to do so will ultimately invite defeat for the whole team.

Scientific evidence suggests that when ancient worlds have collided in our solar system, about all that remains is an asteroid belt of lifeless, worthless little planetoids randomly circling the sun. Nothing in the history books says that the same ignoble end could not befall our unique non-profit sector if its impending, head-on collision with Mars results in something other than a co-opetive partnership. Only the government stands to win big if this impact continues to be a hard, destructive one. Whether we are Martians or Venusians, our challenge is to create a Chaordic™ and co-optive marriage that will enable each of us to serve our common Social Capitalist clients to the best of our unique abilities. United we stand, divided we fall. *Which way is it going to be?* The future of philanthropy and Social Capital in America is in your hands.



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## Principled Decision-making in Gift Planning

Albert Anderson

Ethics is more an art than a science. Nonetheless, there are time-honored means for making ethical decisions--decisions that if adequately prepared for, can lead to reasonably justifiable actions. While that may be all we can expect, it is far superior to expediency, and quite enough to enable us to be thoughtful and proficient in the resolution of ethical matters.

The attached "Elements of Ethical Decision-making in Not-for-Profit Organizations" represents some of the more important distinctions and steps to keep in mind as one approaches an ethical issue. Perhaps the first thing to note is that no one begins in a vacuum. We already come equipped with a moral awareness, however unexamined or inadequate, by virtue of background and experience; and we have some sense of our own self-worth and destiny. In fact our moral instincts are often rather perceptive and even accurate, as evidenced by the feeling so many of us share when something doesn't "smell" right.

However, one's moral sense of smell falls well short of ethics. Ethics is *principled* thought and action--a premise that will go a long way toward resolving issues of right and wrong, just and unjust, good and bad. Only well-intended thought and action based on ethical principles can extricate one from the morass of relativism, which left unchallenged makes every morally-related disposition or judgment valid, however strange or contrary it is to one's own view.

So, how do we take ethically principled action? By deciding on--and doing--the right thing. But what is "right"? The concept is ambiguous, so it's important to distinguish between "doing things right," which means taking the most effective, efficient action, or employing the best management practices; and "doing the right thing," which means being ethical, that is, fair, honest, good for one's word, etc. The distinction is important because many people, as they try to determine whether some disagreeable situation they are experiencing is an ethical matter, make the mistake of confusing right practice with moral right. That does not overlook the fact, moreover, that ethical lapses regularly occur in our organizations as a result of poor management, or from inattention to a miserable working environment that does little or nothing to prevent unethical behavior. But that is a topic for another occasion.

Ethically adequate decision-making is not only principled, it is justifiable. As the "Elements" I have attached indicate, it is the final requirement in a three-step decision-making process. We begin by examining the characteristic moral tension or discomfort we initially have, to decide if indeed an ethical issue is at stake. We judge the right or wrong of it, and then we consider a course of action, that is, what "ought" to be done (the language of ethics).

At this point we will find we are faced with one of *two types of ethical decision-making*:

(1) The one type is to decide whether and where to "draw the lines"--perhaps the most enduring metaphor we use (going back thousands of years) for being ethical. It represents the very common experience we face in having to decide how much is too much, or too little. Drawing lines is often the decisive action we take to mark the "limits" to which one is willing to go, when one has (as we say) had enough. But essentially it is the effort to lessen the potential for abuse, by taking a stand or steering a path that is neither excessive nor insufficient in addressing an ethical matter.

(2) The other type of ethical decision-making is having to decide between two or more competing or conflicting values, each of which suggests an apparently moral good. This often means prioritizing one over the other, and thus requires a higher, more fundamental standard for resolving the conflict, namely, employing one of the *ethical frameworks* noted in the “Elements,” most likely either consequentialism (a benefits-based rationale) or formalism (a duty-based rationale), to justify the choice.

Whichever the basic type of the problem, the question is: what makes the action we decide on, ethically right? The answer lies in how well we justify it. The model for ethical justification described in the “Elements” requires three thought-demanding steps: deciding on the right course of action, by identifying and applying the moral principle(s) that support(s) what one has in mind; and being prepared to ultimately employ a comprehensive ethical framework: either consequentialism or formalism.

At this point, rather than to continue with what probably strikes you as Ethics 101, let’s see how some of the elements of ethical decision-making apply to matters of philanthropy, specifically, matters with which planned giving officers are eminently familiar. I confess at the start that I have been unable to keep up with the increasingly sophisticated instruments and tax law changes that daily challenge you; so I will understand if you are not as passionate about ethical issues as I may appear to be. But I do think philanthropy has a right to expect some proficiency in, if not passion for ethical matters, from all of us-- proficiency that approaches the mastery we seek in planned giving. Professionalism would seem to require that much.

There are many potentially morally-compromising situations characteristic of, but not wholly unique to planned giving. They can occur, for example, in the marriage of charitable gift-seeking with marketing, as when we vigorously promote the tax advantages of the various planned giving instruments or suggest ways by which donors can best *conserve* their wealth even as they consider a major gift to charity.

However, planned giving officers may be more vulnerable than most fund-raising professionals and practitioners when it comes to “undue influence”--which represents a whole class of unethical behavior going well beyond the legal meaning of the phrase. Ethics, as you know, occupies a realm often distinct from, and certainly more far-reaching than law. (It may not be exaggeration to note that ethics is one of the best things planned giving officers have going for them: they may be good at soliciting charitable will bequests, but unless they are lawyers, not very good at defending themselves in court against unhappy heirs.)

I suspect that flirting with undue influence on a prospect stems from the nature of the fund-raising sector in which planned giving officers work. Given the fact that officers regularly spend their time cultivating deferred gifts that only in an indefinite future will go to the bottom fund-raising line, they are under greater pressure than other fund-raisers to make things happen, to be compelling mainly to elderly prospects, to be persuasive for the charities they represent, and to do so both legally and ethically.

These conditions are ripe for exploiting the ignorance, the sensitivities, and especially the anxieties of prospects regarding planned giving--prospects who are concerned, for example, that they will have enough to live on, or to cover the costs of possibly years in a nursing home. They ask themselves: Who will take care of me? Who really cares whether I live or die? To whom should I leave what I have; do they really need it; and will they be responsible with it? Just what kind of legacy should I leave?

Anticipating these very personal concerns, we find ourselves engaged in promoting the sometimes questionable, often fear- and guilt-inducing “messages” that permeate much of our literature. In effect these messages say, for example: “If you don’t make a will, the state will do it for you;” or, “Make the most of the assets you have worked so hard to accumulate, through plans designed to maximize your loved ones’ inheritance;” or, “A charitable gift will reduce your taxes; don’t give your savings to the government where who knows how it will be wasted;” or “Life has been good to you; give something back (in effect, you owe it);” or, “A generous gift offers naming

opportunities, and we'd like to recognize your philanthropy;" or "I understand your reluctance to leave your estate to certain family members you dislike; one alternative you might consider is to place it in a trust to help others (that is, us)." These are powerful *incentives* to make a gift, or at least to do some financial planning; but the question is whether or not they elicit the right *motives*.

Perhaps I've been uncharitable (pardon the pun) in conveying these pejorative messages. But the central issue for us is donative intent, or better, *charitable motivation*. It happens to be the first and most fundamental of the Model Standards of Practice for Charitable Gift Planners. It is entitled "Primacy of Philanthropic Motivation," and it says: "The principal basis for making a charitable gift should be the desire on the part of the donor to support the work of charitable institutions." As I understand this, the donor may have other desires, but the primary desire should be to be charitable--and, it seems to follow, that the task of the charitable gift planner is to promote and elicit the charitable motive. It is what I have called the "governing motive."

What does it take to satisfy the notion of charitable intent? Intent takes many forms. Broadly speaking, the idea captures the purpose, designation, or restriction assigned by the donor to the gift. However, intent is a two-edged sword: if the donee organization fails to satisfy the donor's intent, it has committed a breach of trust and possibly the law. I offer two examples in which the donor's intent is clear, but the donee's intent may be to exploit, confuse, or deceive the donor--which is unethical. (They happen to be examples of "drawing lines;" however, the ultimate frameworks that might be used to justify one's decision could be seen as "conflicting or competing ethical values.")

*Case 1:* The development officer of a not-for-profit is under increasing pressure from the organization's executive director and the board to raise operating funds. So the officer, who also works in planned giving, visits with one of her elderly prospects about making a special unrestricted contribution. However, it is clear the prospect really prefers adding to the organization's endowment, and agrees to make a gift with that in mind. The officer and executive director decide to place the gift into quasi-endowment (where the organization can draw on it for operating needs); and they subsequently thank the donor for the gift to the organization's general endowment (which holds both pure and quasi-endowment).

Now, one could argue that both the donor's and the organization's intentions have been "satisfied"--but only in a climate of deception. The officer failed, or intentionally chose not to explain to the donor the difference between pure endowment and quasi-endowment. However, the organization has the new source of operating revenue it needs; and both the officer and her superior have chosen to fudge the designation with impunity.

Why is this ethically wrong? Because the action represents a breach of ethical principles such as trust, truth-telling, and accountability (note these principles in the attached "Elements"). But why should I be guided by such principles? Basically, as we noted above, there are two kinds of ethical rationale or general guidelines I might employ, one of which (if I am ethically consistent) I will try always to live by: consequentialism or formalism.

Consequentialism is "benefits-based ethics." As a consequentialist, I would determine that a course of action is ethically right by weighing its likely beneficial outcomes against the potential harm that could result for the donor and the organization. The consequentialist holds that generally, experience shows that telling the truth (and other behavioral guidelines such as maintaining trust, carrying out one's responsibilities, etc.) is the right thing to do, because it usually results in more good than harm, for most people. Thus, deception is unethical, unless there are very compelling contrary considerations.

Formalism, on the other hand, is "duty- or responsibility-based ethics." As a formalist I would try to imagine if deception, this or any kind, ever makes sense; that is, whether it should be my duty or fundamental responsibility to deceive, in a moral world that all should inhabit.

Reasoning that deception (or breaking a trust, or avoiding one's responsibilities, etc.) would be logically self-defeating as a moral rule of life, because it would make mutual understanding impossible, I conclude that it is unethical, and justifiably so.

*Case II:* The development office of a marginally healthy, nonprofit social services center responds to a devastating flood in its community, by appealing for contributions to aid in flood relief. Receipts from a wide region are overwhelming. Sometime afterward, an enterprising journalist does an article on the center's splendid response, and reveals that the organization's operating expense during the crisis approached 50% of contributed funds. Some are outraged, thinking that surely most of what they contributed went to help the flood victims. Indeed, some expenditures went to pay off pre-flood center indebtedness. The center director, in turn, argued that expense was not excessive under the circumstances, that credit for necessary goods and services would not have been available without paying off previous debt, and that the net value of the aid went well beyond financial considerations.

Were charitable intentions met? The same ethical principles--trust, truth-telling, accountability--seem to be at stake. The practitioner who looks to what would benefit most people, as well as the one who considers what is every person's duty, would each argue the case according to their own fundamental framework for justifying what is ethical and unethical.

Moving from the general notion of intent to *charitable motivation*, which may be less vague for planned giving purposes, consider two major kinds of motivated donors:

(1) The donor who habitually gives to church, United Way, Boy Scouts, alma mater, other charitable causes; who shares her/his financial means simply because they feel it's the right thing to do, charity for its own sake, and fully trusting the charitable organization to be responsible about the gift's use. This is the kind of donor who would give even without tax deductions, buildings to be named, or public recognition (e.g. the biblical story of the widow's mite).

For this donor, giving is a matter of conscience, unconditional, intrinsically good. It represents the purest motivation for giving; it is "beneficence," the disposition to give, for its own sake. Aristotle contends it is an integral part of one's character development as well as a community good, because it maximizes, brings out the best in human well-being. It is central to the ideals of altruism and philanthropy.

Given the plethora of public information available about how to manage one's money, this donor is most likely aware that contributions can result in added desirable effects such as public recognition, tax reduction, prudent estate planning, etc. But the donor's giving is not *governed*, not *principally motivated* by such considerations; it is motivated above all by a need to be generous, charitable--which is quite different from:

(2) The donor for whom giving is informed by various potentially good outcomes, some of which serve one's interests better than others; and who therefore is persuaded or influenced by what might be financially prudent, politically correct, or good for business--in addition to being good for charity. This donor is trying to maximize certain interests, one's own or those of others, with the prospect of achieving good results.

Here is the issue: Confusing these kinds of charitable thinking has become commonplace in fund-raising today, with the result that we will find ourselves begging the question or jumping to conclusions about what we feel is ethically appropriate--*before* we are sufficiently clear about what we mean in the Model Standards when we affirm that the primary desire we seek to elicit in the donor is charity. Let me suggest how the confusion typically comes about:



Today we find ourselves immersed in a fund-raising climate that favors the second kind of charitable thinking (Donor (2) above), where the encouragement to be charitable is accompanied by a mixture of potentially advantageous and beneficial outcomes. For the donor who is presented with charity as one among other benefits

of giving, planning to facilitate choices is uppermost. To put it bluntly, the ends--granted one of which is to achieve some measure of altruism--justify the means directed by the donor's intentions, which may include enhancing one's public image, managing one's assets, and the like.

However, this context will suggest strongly that the Model Standard about charitable motivation has little point, and should be revised or removed considering two well-known arguments:

(a) There is no such thing as "dirty money," once it is washed by a good cause, Michael Milken and Mother Teresa (who took millions from the murderous Haitian dictator, Duvalier) notwithstanding. As an outcome, there is no harm in this, it is said; on the contrary, a lot of good can come about. Whether or not such money is given with charity foremost in mind is not important, this argument goes. It's the gift, not the thought (or the effort to salve conscience), that counts. Charity is served--all of which leads to a supporting argument:

(b) To consider a donor's motives is absurd. Most actions proceed, it is assumed, with a mixture of motives, and there is no way in principle for someone other than the donor to sort them out. That is true even when the gift derives from assets accumulated illegally or at the cost of countless human lives. (However, like Harvard's former President Bok, some may hedge this point: It may be not be prudent to take a gift from a known felon, they say; but normally it would be silly if not impossible to investigate the background of every donor!)

Clearly, these arguments tend to be very persuasive in today's largely "incentive-based" fund-raising climate. It's true, there may be no such thing as a "pure motive." But that possibility hardly rules out the idea of a "governing motive" that serves to prioritize one's reasons for action. Again, the fact that we don't know the donor's motives, ulterior or not, doesn't make motivation any less important to us. If charitable motivation is important, then we as planned giving officers are obligated to promulgate, promote, and elicit it.

Of course tax laws enacted to support qualified nonprofit causes have contributed to the incentive-based climate in which we work. However, they are a mixed blessing. By offering to reduce one's taxes they provide an incentive to support efforts whose value to the public good clearly justifies their tax-exempt status. Imperfect as they are, and difficult to enforce, they also offer ample opportunity for abuse through loopholes that amount to tax-avoidance.

The distinction between *incentives* to give and the *motivation* to give may be critical. Proceeding from the objective to maximize good outcomes, as in Donor type (2), we will be tempted to provide the donor with the various incentives to give, focusing on what the donor and others get out of the giving; rather than to remember that from another perspective--such as that of Donor type (1)--giving is simply the right thing to do. Admittedly a more idealistic perspective, giving in this case is charitably motivated when it is done for its own sake, unconditionally, though not blind to its consequences, to the degree they are foreseen.

In short, this perspective--a high, but hardly unreachable standard--proceeds from the assumption that beneficence, a dominant ethical principle for philanthropy, adds mainly intangible, not tangible value to the donor's life. As agents of philanthropy, we offer the donor *a qualitatively different asset* in exchange for their generosity. And thus we have the responsibility not only to raise funds, but to *educate about beneficence*; that is, to distinguish between the incentives or influences we bring to bear on the donor, and the charitable motivation we are committed to elicit from the donor.

Thus, to hold in our Model Standards that charitable motivation is primary, the “governing” force in charitable giving, we embody one of the *key ethical principles* that promulgate philanthropic ideals such as voluntary beneficence and altruism. In fact, Model Standard I derives its ethical strength not only from the principle of charitable motivation, but also from related principles such as beneficence (the disposition to give) and public good (the scope of philanthropy). Moreover, all such principles are held to be valid in their own right, representing *prima facie* ethical obligations. That is, they are fundamental responsibilities we as ethical practitioners are duty-bound to carry out, unless we are presented with extraordinary circumstances that may compel us to take what we regard as a prudent, but not necessarily moral, alternative course of action.

In short, the aim of the donative or charitable motivation Standard is to set the ethical tone at the outset, to establish the highest, most demanding norms, *anchored in ethical principles and justifying frameworks that govern our motives with the desire to be charitable prior to any other consideration*. If our job is to serve the purposes of philanthropy, then we should fix without distraction or detour on promoting the kind of nonprofit beneficence we represent.

Perhaps some final comments about choosing a comprehensive ethical framework, whether it is benefits-based (consequentialism) or duty-based (formalism). There are other frameworks on which one might fall back to justify my ethical behavior. However, these two doubtless represent the most influential positions we are likely to take with some consistency. Both hold that charity or beneficence is an ethical principle: the difference lies in how they are justified. We choose the one that is most compelling, based on what our knowledge of the human condition seems to demand.

A benefits-based perspective is the most pervasive in American culture, and thus the line of least difficulty for most. It appeals to the day-to-day kind of thinking we do to organize and anticipate the future; it is results-oriented, has strong utilitarian appeal represented, for example, by the strategies we typically adopt to achieve our goals and objectives. A duty-based view accords best with a strong, intuitive sense of personal character development, doing for others, justice in an unjust world, and the like: it reflects an ideal image of a moral society that one believes could and should be embraced by every person, everywhere, in every time.

A benefits-based perspective on charity is not unlike that of the discerning consumer looking to satisfy one or more desires presumed to be beneficial and cost-effective. A duty-based perspective on charity, as I said, measures our interests against the highest, but not unachievable standards or principles one might imagine.

Neither the benefits-based nor the duty-based perspective will do all one might expect of it. Life is more complex than any comprehensive theory of ethics. However, it may be that a duty- or responsibility-based view leaves one with less confusion than a benefits-based view in many ethical situations, for example, conflicts of interest, especially *quid pro quo* arrangements. As a duty- or responsibility-based ethicist one expects to benefit the nonprofit’s mission, but not, as in benefits-based ethics, to maximize an array of self-interests in the process. Duty-based ethics also purports to take action that is good for every individual, not just for the majority--and it probably helps to “draw the line” between not-for-profit and for-profit efforts to raise funds.

If we had time, we could easily segue from the Charitable Motivation Standard into another Model Standard issue that continues to be debated in planned giving circles. That issue is *compensation*. There is a reason the standard on charitable motivation is fundamental: if motivation is irrelevant, and the end (gift) is what counts, then the differences in ways we choose to be compensated are the more stark for ethical purposes.

The Model Standard on Compensation urges those of us in the nonprofit sector to conduct our work as salaried persons, not on a commission or fee basis. Commission- or fee-based compensation, characteristic of for-profit consultants or firms, offers at least two major advantages: to the organization, which benefits from funding it could not raise by itself, except with the help of a privately-paid professional; and to the fee-based professional, for

whom the prospect of financial reward based on sales becomes a powerful incentive.

Of course this arrangement also has attendant potential for conflict of interest, as the Standard points out. The size or accumulation of gifts we as planned giving officers solicit should have no direct bearing on the compensation we receive for the job that the charitable institution hired us to do. Ironically, working on commission is basically a benefits-based strategy that threatens to diminish the Charitable Motivation Standard, along with the principle of beneficence on which philanthropy is based, in favor of entrepreneurial reward.

No single segment of nonprofit fund-raising has made a greater impact on philanthropy in the last decade than planned giving. The ethical responsibility that fact carries with it for professional conduct is enormous. Ethical decision-making is not rocket science, but it can and must provide adequate proficiency to enable us to do the right thing. Above all it's the *principle* that counts.

Attachment:

*Elements of Ethical Decision-making  
in Not-for-Profit Organizations*

[Albert Anderson, from *Ethics for Fundraisers*]

*Moral Awareness:*

- + Rooted in upbringing, accepted behavior, personal values, self-interest, conscience;
- + Unexamined sense, feeling, or opinion of what is right and wrong, good and bad, just and unjust.
  - + affecting me (egoism), and
  - + affecting others (altruism);
- + Presupposes some concept of self-worth, of the human condition, and of individual capacity based on
  - + self-realization (secular), or
  - + other-worldly assistance (religious);
- + Assumes a basic climate of trust; in philanthropy, relationships
  - + affecting clients, constituents, and
  - + affecting colleagues, organizations.

*Ethically Adequate Decision-making:*

- + *Examine* the initial tension or discomfort one has about a situation
  - + to determine the ethical issue (if there is one).
  - + by establishing the facts.
- + *Propose* a course of action, what ought or ought not to be done, recognizing
  - + two kinds of decision-making:
    - + Drawing lines (to avoid inadequate or abusive action).
    - + Choosing from competing or conflicting values.
- + *Justify* a course of ethical action (below).

*A Model of Ethical Justification:*

- + *Judge* that a certain actual or proposed action is right or wrong based on moral awareness and examination of the facts (above).
- + *Apply* the moral principle that seems to support the judgment and suggests an appropriate (principled) course of action.
- + *Employ* a comprehensive ethical framework to justify one's choice of principled action.

*Principled Action in Philanthropy:*

- + Principles are forces or spheres of enduring ethical influence in the form of concepts we mentally explore for application to a morally puzzling issue. Each can be transformed into a normative statement, e.g. honesty = one ought always to be forthcoming, tell the truth.
- + In philanthropy there are three dominant forces or spheres of influence supported by other principles (logically related, but no less important):

- + *Beneficence*

A dominant principle. this acknowledges a primary ethical virtue central to philanthropy, the responsibility to share one's surplus assets to further human well-being. Subject like planets to this principle's orbit are:

- + *The public good*

which the mission of every worthy not-for-profit cause is intended to serve; and.

- + *Charitable intent*

which reflects the governing motive on which philanthropic activity rests, to include both fund-raising and fund-giving.

- + *Respect*

Another dominant ethical principle for practitioners, this embraces the fundamental dignity and worth we accord every human being. It attracts to its sphere of influence three additional principles:

- + *Individual autonomy*

the right of every able person, uncoerced, to make their own choices, secure their own well-being, and determine their own destiny;

- + *Personal privacy*

which recognizes the sanctity and confidentiality of one's personal, family, and non-public business or financial affairs; and.

- + *Protection from harm*

which urges that no action be taken that could be harmful to oneself or others.

- + *Trust*

The third dominant ethical principle, trust represents the fundamental relationship among not-for-profit practitioners and the constituents and general public they serve. Philanthropy would disappear without it, as would the ground of every relationship between persons. Accordingly, this principle attracts several others:

- + *Truth-telling*  
the obligation to be honest and forthright, to convey information as fully and accurately as possible, avoiding deceptive or misleading information;
- + *Promise-keeping*  
which acknowledges the commitments entailed by mutual understandings, agreements, and contractual arrangements;
- + *Accountability*  
the responsibility one assumes for performing, or failing to perform, the legitimate assignments or expectations of others;
- + *Fairness*  
the capacity and willingness to deal justly, equitably, and objectively with others, avoiding preferential, arbitrary, or prejudicial actions; and,
- + *Fidelity of purpose*  
which recognizes the necessity for dedication to the mission and aims of philanthropy, the organization, and one's profession.

*Comprehensive Ethical Frameworks:*

- + *Consequentialism (benefits-based ethics):*
  - + Action is ethical that results in greater benefit than harm, for most people.
- + *Formalism (duty-based ethics):*
  - + Action is ethical that accords with what is intrinsically and rationally obligatory for all, independently of balancing outcomes.

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**Upright Down South: Planned Giving According to Congress,  
Treasury, IRS and the Courts**

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## Upright Down South: Planned Giving According to Congress, Treasury, IRS and the Courts

[Author's note: many portions of this paper are written in the present tense because they constitute commentary and reporting written at the time the events described were occurring.]

### IRS Proposes New Type of CRT, NIMCRUT Restrictions and More

On April 17th, with tax season barely behind it, the Internal Revenue Service issued its long-promised proposed regulations on a variety of charitable remainder trust issues. Each of the provisions in the new proposed regulations is described in detail below, and this summary is followed by a discussion of some important issues raised therein.

#### Overview

The regulations are probably helpful on balance, although some purveyors of financially motivated charitable remainder trusts may find some of the new restrictions troublesome. Most important by far for most planners is the official acceptance of a new type of trust, the "flip unitrust," which will provide a constructive solution for the ever-present problem of the trust that is funded with real estate or other illiquid property. Now, a trust that conforms to the conditions prescribed by IRS may have the advantages of a net income charitable remainder unitrust while its income stream is limited by unmarketable or illiquid property, but be free of the net income limitation when it finally manages to sell that property.

Several new restrictions limit the use of net income charitable remainder unitrusts to manipulate the flow of income to trust beneficiaries. Henceforth, when a self-trusteed unitrust is funded with "unmarketable assets" (defined as anything other than cash, cash equivalents, or marketable securities), the trustee would be required to obtain a qualified appraisal from a qualified appraiser in accordance with the rules governing charitable contributions. Existing trusts would apparently be unaffected, except that this issue will probably be examined more closely in the future.

In recent years, some planners have attempted to make use of the net income limitation by allocating capital gain to the "income" of a net income unitrust. Under the proposed regulations, only gains accruing after the property is transferred to the trust may be allocated thusly. This change would apply to gains from sales or exchanges taking place after April 18, 1997, even for existing trusts.

Another NIMCRUT issue, although not directly addressed in these proposed regulations, is the subject of a "request for comments." This is the situation where a net income charitable remainder unitrust is used to take advantage of the timing differences between the receipt of trust income under local trust law and taxable income for federal income tax purposes. The IRS gave two examples of this technique. The first is the widely-touted use of a trust funded with an interest in a partnership controlled by the trustee, donor, beneficiaries, or related parties to hold income-producing investments. The interested party is thus able to control when the trust receives the earnings from its partnership interest and, accordingly, when the unitrust recipient will receive distributions from the trust. The second is the familiar use of a deferred annuity contract to permit the interested party to control trust distributions. The IRS and the Treasury Department are studying this issue, and public comments are requested. In the meantime, private letter rulings will not be issued on the qualification of NIMCRUTs to be used in this fashion.

Other issues are also addressed in the proposed regulations. The technical basis upon which the "accelerated charitable remainder trust" ploy was based would be eliminated. Such trusts made distributions for a given year after the close of the year for which the distribution was due. Under the proposed regulations, payments would be required to be made before the end of the year in question. An exception would continue to permit net

income unitrusts (which could not fit the accelerated charitable remainder trust mold) to make distributions after the close of the year. This change would take effect immediately, for taxable years ending after April 18, 1997, and the IRS also announced that it would continue to challenge the purported tax consequences of accelerated charitable remainder trusts as announced in Notice 94-78.

*Other proposed changes would make it clear that the four-tier system for taxing charitable remainder trust beneficiaries applies to all charitable remainder trusts, including net income unitrusts, and block the attempted use of NIMCRUTs to avoid the application of Code section 2702 valuation principles, picking up on the invitation extended by Congress in the Small Business Job Protection Act of 1996.*

#### "Flip Unitrusts"

By far the most important aspect of the proposed regulations is the decision of IRS to allow planners to use a new type of charitable remainder trust \_ the flip unitrust \_ for certain illiquid contributions. Trusts of this sort, which start out as net income unitrusts but shed their net income limitation subsequently when the initial trust asset is sold by the trustee, have been employed by some practitioners in the past. These pioneers believed that the concept of flip trusts was clearly allowable under prior law. Unfortunately the Internal Revenue Service did not agree with this view, and ruled in Private Letter Ruling No. 9506015 that such a trust was not authorized under the Internal Revenue Code. The view of IRS at that time was that a charitable remainder trust may be either an annuity trust or a unitrust, and if the latter it may or may not have a net income limitation, but under no circumstances may it change from one method to another. Since a flip unitrust purports to make such a change (from a net income unitrust to a "straight" unitrust, it is not authorized.

Now, in these proposed regulations, the IRS has changed its mind, telling planners that some flip trusts may be used, but only those with four basic characteristics:

(1) The trust must have substantially all (i.e., at least 90 percent) of its assets in the form of "unmarketable assets" at either one of two times \_ after the initial contribution or after any subsequent contribution prior to the "flip." Marketable assets are broadly defined as any assets other than cash, cash equivalents, or marketable securities. The definition of marketable securities for this purpose is in Code Sec. 731(c).

(2) Under the governing instrument, the flip (i.e., the change to a straight unitrust) will be triggered by the earlier of two events is \_

(A) The sale or exchange of a specified asset or group of assets that was contributed to the trust upon its creation; or

(B) The sale or exchange of unmarketable assets if, immediately after the sale or exchange, the fair market value of any remaining unmarketable assets is fifty percent or less of the total fair market value of the trust's assets.

The IRS explains that this approach is required because the original legislative history of the charitable remainder unitrust provision states specifically that the trustee may not have discretion over the method used to determine the unitrust amount. (See H.R. Conf. Rept. No. 782, 91st Cong., 1st Sess. 296 (1969), 1969-3 C.B. 644, 655.)

(3) The unitrust must switch exclusively to the fixed percentage method for calculating all remaining unitrust amounts payable to any income beneficiary at the beginning of the first taxable year following the year in which the triggering event described in the immediately preceding paragraph.

(4) Any makeup amount remaining (i.e., remaining from the time when the unitrust was a net income unitrust) is forfeited, because the fixed percentage method does not provide for a makeup amount.

This rule would be effective for trusts created on or after the date the final regulations on this subject are eventually published in the Federal Register. However, trusts created before or after that date with a nonqualifying flip provision could be amended or reformed to comply. A trust could not be reformed or amended to add a flip provision if it failed to include a flip provision.

Note: These effective date rules fail to address specifically the obvious issue of whether a qualifying trust may be created now, prior to adoption of final regulations, with a flip provision in the form required by these proposed regulations. Odd as it may seem, the rules apparently do not contemplate permitting such a trust to qualify. Unless the Internal Revenue Service issues a clarification on this issue, some cautious planners may decide not to rely upon the new flip trust authority until the final regulations are eventually issued. A strict reading of the effective date provision suggests that one could literally comply by preparing a trust which deliberately violates one of the requirements in the proposed regulations (e.g., by using triggering standards that differ from the triggering language described in paragraph (2) above), then amending the trust to include the required language at a later date. That would be questionable practice, however, since it would involve intentional creation of a nonqualifying trust. Perhaps this is part of what the IRS had in mind when it invited comments on "the least burdensome methods of changing the terms of a trust's governing instrument." Despite this, discussions with knowledgeable Internal Revenue Service people reveal that the IRS did not intend to withhold the benefits of the flip unitrust until the regulations are finalized. After all, as one IRS spokesman noted, it would be silly to allow one to amend a defective trust formed while the regulations are pending, but preclude a trust formed the same day with exactly the same wording as the reformed document from qualifying. The final regulations will probably include a clarification of this.

### **Unmarketable Assets**

An obscure provision in the legislative history of Code Sec. 664 indicates that a charitable contribution deduction will be denied for a donor's transfer of hard-to-value assets (such as real estate or an interest in a closely-held business) to a charitable remainder unitrust unless there is an independent trustee responsible for valuing the assets each year. See H.R. Rept. No. 413, 91st Cong. 1st Sess. 60 (1969), 1969-3 C.B. 200, 239. Neither the statute nor the regulations repeats this rule and, the IRS says in the preamble to the proposed regulations, many practitioners have asked whether it is necessary to have an independent trustee value unmarketable assets in a charitable remainder unitrust.

In effect the proposed regulations answer this question "yes but there is another way." If a charitable remainder unitrust holds unmarketable assets and the trustee is not independent, there is still a way for the trust to continue qualifying \_ the trustee may obtain a qualified appraisal from a qualified appraiser, as those terms are defined in Treas. Regs. Sec. 1.170A-13.

Several points are worth noting here. First, the proposed regulations expand this principle without acknowledging that they are doing so. The cited provision in the legislative history refers not to unmarketable assets but rather to hard-to-value assets. The latter would be more limited in any event, but the proposed regulations expand the category of unmarketable securities to include anything other than cash, cash equivalents and marketable securities. Thus, many types of assets that are not regarded as hard-to-value may nevertheless require the use of a qualified appraisal.

The new rule may fall heaviest on self-trusted charitable remainder unitrusts that have heretofore relied upon the hard-to-value principle and provided for the appointment of an independent trustee with duties limited to valuation. The proposed regulations do not specify whether this approach will continue to be appropriate, but in any event the trust would probably not contemplate the new definition of "unmarketable" property. The proposed regulations do indicate that "a trust whose governing instrument requires that an independent trustee value the trust's unmarketable assets" may be amended or reformed to accommodate the qualified appraisal approach. This may be some comfort, but what about the common case where the independent trustee is called

in not for unmarketable assets but for hard-to-value assets? Will reformation or amendment be recognized in such cases? Perhaps, but the IRS would do well to clarify its views on this subject.

### **Anti-Accelerated Charitable Remainder Unitrust Rule**

The existing regulations (Treas. Regs. Secs. 1.664-2(a)(1)(i) and 1.664-3(a)(1)(i) permit the trustee of a charitable remainder trust to pay the annuity or unitrust amount within a reasonable time after the close of the taxable year to which they relate. This, it is said, was intended as an administrative convenience for trustees.

While such a delay might be needed by the trustee of a net income unitrust to determine just how much income the trust realized for a given year, this is not the case with a straight unitrust or an annuity trust, for which the amount distributable for any year is fixed and determinable. Moreover, the permissible delay has been the subject of abuse by some trustees, especially those of trusts designed to serve as accelerated charitable remainder unitrusts which IRS views as improperly converting capital gain income to nontaxable distributions.

To prevent such abuses the proposed regulations provide, for years ending after April 18, 1997, that all charitable remainder trusts except net income unitrusts must make their distributions before the close of the taxable year for which the distribution is due. It is suggested that this will not require any modification of trusts' governing instruments, since a trustee will normally be authorized to make distributions within the permitted time, and thereby avoid disqualification. As discussed below, however, there will be problems for some trusts.

Although this provision effectively pulls the plug on accelerated charitable remainder unitrusts, the IRS states that it will continue to challenge such trusts as it outlined in Notice 94-78.

The proposed rule works well for a plain vanilla unitrust that has its valuation date near the beginning of the year and makes regular payments thereafter, whether monthly, quarterly or annually, at the end of the stated period. Such a trust may make its required payment a bit early if necessary, without requiring any modification of the trust instrument. What trusts may expect problems then? Any trusts that vary from this model may have difficulty complying with the proposed distribution requirement. For example, some trusts are drafted, in an effort to maximize the donor's deduction, with the valuation date on the first business day of the year and the distribution to occur on the anniversary of the valuation day. Such a trust cannot literally comply with its governing instrument under the proposed regulations unless some change is permitted.

Other trusts may be able to comply, at least theoretically, but face inherent practical problems that make literal compliance appear unlikely. Consider a trust that uses an average of values on more than one date during the year, as permitted by the regulations, or evaluation date that occurs at the end of the taxable year.

Likewise, a trust that receives a contribution at or near the end of the year, a very common situation, will necessarily have difficulty computing the amount of the required distribution in time for a year-end payment. For example, if December 31 is a business day, a contribution of publicly traded stock on that day cannot be valued until after the close of business, and it will probably be January 1 or 2 before the December 31 closing prices are widely available. In this situation, the proposed new rule is not feasible.

The IRS has been made aware of these problems and it is likely that some of these will be included in the final regulations. One suggestion is that trusts have in all events at least 65 days after the contribution is made to calculate and make its distribution for that period. Another thought is to permit all affected trusts to select a new valuation date during the first year after the regulations take effect, just as they were permitted to change their tax law years when Congress required all trusts to adopt a calendar year. Planners who find themselves facing difficulties under this rule are urged to notify the Internal Revenue Service and suggest appropriate relief.

## **Allocation of Capital Gain to Trust Income**

The proposed regulations didn't go as far as many had feared in restricting the ability of a NIMCRUT to characterize capital gain as income. Given the unusual nature of such a rule, many trust and estate lawyers anticipated a blanket prohibition on allocations of capital gain to income. Many will be surprised to learn that the legislative history of Code Sec. 664 states that "the determination of what constitutes trust income is to be made under the applicable local law and, thus, is not to include items such as capital gains which must be allocated to the trust principal." [Senate Dept. No. 552, 91st Cong. 1st. Sess. (1969) at p. 89.] So the IRS has been fairly cooperative in this area. The fact that the IRS only sought to prevent trusts from using pre-contribution capital gain in this fashion may be viewed as legitimizing allocations of post-contribution gain to trust income.

The Internal Revenue Service warns that, while the prohibition in the proposed regulations would take effect for sales and exchanges of property after April 18, 1997, it will challenge attempts to allocate pre-contribution gains arising before that date to trust income under general principles as being fundamentally inconsistent with applicable local law. Is this correct? The result may vary from one state to another, but in general the IRS is probably correct as a matter of general fiduciary law. Certainly the legislative history quoted above suggests that Congress held this view.

For example, consider a trust funded with property which costs the donor \$1,000, but is now worth \$10,000. The trustee has received \$10,000, notwithstanding the tax rule that says the trust takes the donor's basis. If the trust sells the property for \$9,500, the trust has lost \$500, even though a gain of \$8,500 results for tax purposes. For the same reasons, it is logical to say that any gain resulting from a sale in excess of \$10,000 may be trust income, but not so gain resulting from sale at a lesser figure.

The capital gain unitrust may be less important after these regulations anyway, for two reasons. First, the flip unitrust authorized under the proposed regs will serve many of the same purposes where a donor funds the trust with illiquid, non-income producing property. Second, the IRS' invitation for comments on the use of income exception charitable remainder unitrusts funded with assets which produce income the timing of which is subject to the donor's control poses an additional problem (as discussed below). Although the allocation of capital gain to income is not listed in the request for comment, the statement on the issue provided by IRS would include this device:

"The IRS and Treasury are studying whether investing the assets of an income exception CRUT to take advantage of the timing difference between the receipt of trust income and income for federal tax purposes causes the trust to fail to function exclusively as a charitable remainder trust."

This request may have a chilling effect on the use of such devices, including the unitrust that allocates capital gain to income.

Note that the issue of whether a NIMCRUT's deficiency account must be treated as a liability for valuation purposes (as held in several private letter rulings, including LR 9511007) was not addressed in the proposed regulation. Thus, presumably, the IRS position on this issue continues at least for ruling purposes.

### **Request for Comments on NIMCRUTs Holding "Certain Investments"**

Many planners view the request for comments on the NIMCRUT issues described above as an indication that the IRS is opposed to such use of the charitable remainder trust, and believe that the IRS actually plans announce in the end that it is taking an adverse position on this issue. While this could certainly be the eventual outcome, it is important to keep the present developments in context. The Internal Revenue Service does not say in these proposed regulations anything more than that it is studying the issue with a view to "drafting future guidance on this issue."

Rev. Proc. 97-23, issued simultaneously with the proposed regs, indicates that rulings will no longer be issued

on two very specific NIMCRUT issues \_ use of a partnership or a deferred annuity contract to take advantage of the difference between trust income and income for federal income tax purposes for the benefit of the unitrust specifically. This in itself is less broad than the subject matter on which comments are requested.

A bold planner may decide to press forward with such arrangements now, in the hope that any guidance eventually issued by IRS will probably not be retroactive. While such eventual guidance is likely to be prospective (like the various provisions in these proposed regulations that tighten existing rules), less aggressive planners are likely to hold back until the issue is resolved. By then, of course, it may be too late, but who can express surprise that those who are willing to take a calculated risk may get benefits that are denied to the weak and cautious. All-in-all, the combination of this request for comments and the self-dealing analysis presented by IRS in this year's CPE text give the cautious planner much reason to abstain from aggressive NIMCRUT strategies under current conditions.

### **A Final Thought**

The proposed regulations were an outgrowth of several bar association projects designed to convince the Internal Revenue Service that it should lighten up on some of its pronouncements and issue public guidance (as opposed to private letter rulings, which may not be relied upon as precedent). In particular, representatives of the American Bar Association and the California Bar Association submitted suggestions to IRS.

The final product does advance both of these goals, and gift planners should welcome the new rules on balance, especially if some of the operating problems are resolved in the final regulations.

### **Charitable Remainder Trust Payout Limitations**

A surprising addition to the Senate bill would change the limitation on charitable remainder trust payouts from the present minimum of 5% to a figure "not less than 5% nor more than 50%." This was added as a revenue raising measure. Cynics would note, however, that the principal target of this provision (the accelerated charitable remainder unitrust) would already be struck dead for years ending after April 18, 1997 by the proposed CRT regulations issued in April. Those regulations include a requirement that most charitable remainder trusts make their payout to noncharitable beneficiaries prior to the end of the taxable year. Both the year-end payout required by the regulations and the 50% limitation required under the Senate bill would make accelerated charitable remainder unitrusts impossible. If the 50% maximum passes Congress, perhaps IRS could rely upon that provision and withdraw its proposed regulation, thereby alleviating many problems that arise under the regulation for charitable remainder trusts administrators and trustees.

Other pending provisions would also affect the work of gift planners. Despite a major drive to repeal the estate and gift taxes, as widely reported in the press, Congress appears unlikely to take such action in the immediate future. However, all potentially viable bills now pending do include major estate tax relief. These bills would gradually increase the tax-exempt amount from the present \$600,000 to \$1,000,000 or \$1,200,000 over a period of years. Business interests would receive special benefits, varying from an added \$1 million exemption in some versions to liberalized estate tax payment provisions in others. Commentators have speculated that the repeal of the estate tax would adversely affect charities by discouraging (or providing less encouragement to) a charitable bequest. Perhaps the same effect could follow from any changes that lower the estate tax burden on certain estates or remove estates from the taxable category, but this effect has not been discussed.

All the pending bills include some form of capital gain tax cuts as well, and these would similarly appear to reduce incentives for some charitable gifts, such as charitable remainder trusts transfers motivated by capital gains tax savings.

### **Tender Offer Stock Contributed Too Late**

*Michael Ferguson v. Commissioner*, 108 T.C. No. 14. (April 28, 1997). In an important case for gift planners,

the Tax Court held that charitable contributions of stock made immediately before the corporation was acquired in a tender offer produced capital gain taxable to the donors. The case may challenge long-held notions of how late is too late for a contribution under these circumstances.

As with all cases of this type, the facts are of paramount importance. The Ferguson family owned nearly 20% of the stock of American Health Companies, Inc. ("AHC"), a diet and vitamin franchise company. A director of AHC contacted an investment banking house about a possible sale of the company, and several offers were received. On July 28, 1988, AHC entered into a merger agreement with CDI Holding, Inc., contemplating a tender offer by a CDI subsidiary at \$22.50 per share and a subsequent merger. The AHC Board of Directors (with the Fergusons abstaining) approved this agreement, determined that \$22.50 was a fair price, and recommended acceptance by the shareholders. The obligation of AHC to effect the merger was subject to various conditions, including approval by a majority of AHC shareholders and tender of 85% of the shares. The CDI subsidiary could waive the 85% minimum tender condition, and under the applicable law, the CDI subsidiary could force the remaining shareholders to go through with the deal if the CDE subsidiary acquired a majority of the stock pursuant to the tender offer.

The tender offer was made on August 3, 1988, conditioned on the CDI subsidiary acquiring 85% of the AHC stock (although, as noted, this condition could be waived). Also, if any material adverse changes affected AHC, the offerer could terminate or amend its offer. Originally, the tender offer was to expire on August 30, 1988, but this was extended to September 9, 1988 when a fire totally destroyed the AHC factory on August 25, 1988. [These dates may seem tedious, but they are important in the context.]

A Securities and Exchange Commission filing of 8/22/88 signed by Michael Ferguson stated that the Fergusons had advised CDI that they would tender their stock, that Sybil Ferguson would become President and sign a 3-year contract, and that Roger Ferguson would have the consulting contract with the same term.

Michael Ferguson signed a "donation-in-kind record" on August 15, 1988 indicating his intention to donate 30,000 AHC shares to his church and the next day his Merrill Lynch broker helped him open a new brokerage account and place 391,651 shares into it. Because of a legend on the shares restricting transfer, Merrill Lynch wouldn't transfer the shares without the advice of its legal department, a process expected to take "upwards of two weeks." Michael formed a charitable foundation on August 26, 1988. On September 8, 1988, the broker arranged the actual transfer from Michael's account to accounts for the church and the foundation, and Michael signed an authorization for the transfer on September 9. The church gave him a receipt indicating a September 9, 1988 donation date, and an SEC form filed later also showed that the transfer was made on September 9. Roger and Sybil Ferguson made their transfers to similar donees under precisely the same circumstances.

The AHC shareholders tendered their stock through August and September 1988. The proportions tendered reached 50% on August 31 and reached 95.2% on September 9, 1988. On September 12, the CDI subsidiary accepted the tendered stock and on September 13 it purchased the shares. Thereafter, on October 12, 1988, the directors of the buyer corporation adopted a resolution to merge the two companies and the merger occurred on October 14.

The question, of course, was whether the donors were taxable on the gain in the stock transferred to the charities. The IRS claimed that the July 28 merger agreement coupled with the August 3 tender offer, was the functional equivalent of a shareholder note approving the sale, and that the capital gain accrued then and the charitable gifts occurred thereafter. The donors claimed that their gifts were made when they gave irrevocable instructions to the Merrill Lynch broker. At that time, they said, the donee charities were not obligated to go through with the transaction and could not be compelled to tender the donated stock.

The Tax Court reviewed the facts and the applicable case law in great detail and concluded that:

"The reality and substance of the events surrounding the merger agreement, the tender offer, and the gifts to the Charities indicate that the stock of AHC was converted from an interest in a viable corporation to a fixed right-to-receive cash prior to the date of the gift.



Therefore, petitioners are taxable on the gain in the stock transferred to the Charities under the anticipatory assignment of income doctrine."

This was the essence of the Court's analysis. Even though there were contingencies present (such as the donors' right to withdraw their shares from the transaction and the 85% minimum tender condition), these were mere formalities in light of the fact that a majority of the stock was tendered and the purchasing company could force the donors or the donee charities to go through with the sale by August 31, 1988, when 52% of the stock had already been tendered.

The Court further found that the transfers to the charities were not completed until September 9, 1988, when the letters of authorization were signed. This was also the date on the donees' receipts, and was the day they named as the transfer date on reports to the SEC. The broker's actions with respect to the stock were taken on behalf of the donors, as their agent, and not as the donee charities' agent. The foundation donees weren't even formed until August 26, and so could not have received contributions before that date as claimed by the donors.

Thus, the gifts were not completed until after the date that the donors' right to receive the sales price had become effective. So the unhappy [or unlucky] donors were required to pay tax on the gain arising on the contributed shares.

*This case should be required reading for gift planners facing a pre-sale contribution transaction. It is most important for what it did not say. There is no one event or condition that provides an easy-to-apply test for when a contribution will be too late to shift the tax burden from the donor to the donee. Rather, this depends upon a realistic view of all the facts. Some planners have heretofore taken a simplistic approach to this issue whereby a contribution is regarded as timely so long as the property to be contributed is not subject to a binding obligation. The Ferguson case teaches us that it just isn't that simple.*

#### **House Proposes 10% Minimum Charitable Share Rule for CRTs**

As Congressional staffers and members of both taxwriting committees began work in conference to finalize the 1997 tax legislation (with Administration representatives from Treasury playing key roles), provisions from either the House bill or the Senate bill stood a chance of becoming law. As charitable gift planners were soon to learn, provisions that were in neither bill could become law as well. The Senate bill included a provision which would limit the payout of a charitable remainder trust. Instead of the present not-less-than-five-percent payout limitation, that bill would make the limitation "not less than five nor more than 50%." This would eliminate the accelerated charitable remainder trust of which much has been written in these pages

Recently, the staffs of the House and the Senate have been meeting to try to achieve agreement on the minor, non-political tax provisions that appear in one version or another of the pending legislation. In response to the Senate's five-to-fifty percent rule described above, the House staff proposed to accept that rule with an additional limitation whereby the value of the charitable share in a qualifying CRT could not be less than 10% of the value of the trust's assets.

This would provide another basis for precluding accelerated charitable remainder trusts from qualifying, but it would do much more than that. Trusts which run for the lives of a number of individuals, or which have very young lifetime beneficiaries, or which have high payouts (but well below 50%) would also be eliminated. Many financially motivated charitable remainder trusts would not qualify and many, perhaps most, of the trusts regarded by critical observers as aggressive or abusive would be eliminated.

*This change is not yet law, nor is it even close to enactment. It simply represents a position proposed by staff members in the legislative process. However, it would mark a serious change in the approach of the law to charitable remainder trusts. Would it, if eventually enacted, be a destructive or disruptive influence? Perhaps for some planners, but it could also place all charitable planning on a higher plane.*

## **Enough Already! -- Donor's Third Airplane Appraiser Rejected**

*Charles Doyle v. U.S.*, 80 AFTR 2d, Par. 97-5023 (U.S. District Court for the District of Minnesota, 6/3/97). Charles Doyle donated a "replica airplane" to the planned Upper Midwest Museum of Transportation in 1991 and claimed a deduction for \$175,000 based upon an appraisal by his friend, Randall Sohn. The case ended up in court, and the IRS appraiser, Guy Cane, valued the contribution at only \$45,000.

In the pretrial discovery process, Mr. Doyle identified (several days after the deadline) one John Scott as his expert witness; Mr. Scott's appraisal report, which was filed nearly two months late, set the value at \$500,000. The pretrial discovery period ended March 7, 1997, and on April 14, 1997, Mr. Doyle identified yet another expert (Louis F. Casey) who would apparently support an even higher value.

In this decision, the Court rejected Mr. Doyle's attempt to have this third expert enter the proceedings. Doyle gave no compelling reason for turning to Mr. Casey, and if he was allowed to change appraisers again (1) Mr. Doyle would have to attack his own witnesses, and (2) the litigation would be delayed, as the IRS would have to be given more time for discovery. As the Court said, "A party must not be permitted to constantly change its position with respect to a critical fact at issue."

What's the moral? -- Find a good expert, early on, preferably before the return is filed, and stick with him or her.

## **Congress Passes Tax Bill!**

In the face of heated and passionate wrangling, Congress surprised everyone by completing work on the epic 1997 Tax Bill. The so-called Taxpayer Relief Act of 1997 passed both Houses of Congress in a week and was signed into law by President Clinton on August 5. The President's line-item veto period expired August 12, so the legislative process has now been completed.

Despite all the political discussion concerning the complexity of our tax law, and the pledges of so many legislators to simplify the Internal Revenue Code, the new law is more complicated than ever. The 1997 Act itself is huge, containing more than 800 provisions. As such, it is the largest piece of tax legislation since 1986.

The Act contains something for everyone. It includes capital gains tax cuts, estate tax relief, education incentives, new individual retirement account options, and a host of other changes.

Several items are of considerable interest to charitable gift planners. First, and most important, there are two new restrictions applicable to newly-created charitable remainder trusts. The first of these, applicable to trusts created (or additional contributions made) after June 18, 1997, imposes a new 50% maximum payout limitation (in addition to the familiar 5% minimum payout rule). This is aimed at stamping out the accelerated charitable remainder trust, of which so much has been written and said. The other change, reported initially in our last issue, imposes a minimum charitable benefit rule for charitable remainder trust transfers after July 28, 1997. Under the new rule, a trust will not be qualified if the value of the charitable remainder interest at the time of the transfer to the trust is less than 10% of the net fair market value of the property contributed to the trust. This will require a re-examination of some basic understandings concerning the ways in which charitable remainder trusts may be used to minimize capital gains taxes. Especially hard hit will be trusts with large payouts (even if well below the new 50% limit) and those that have young beneficiaries or several beneficiaries.

Some gift planners will be glad to learn that the provision allowing a full fair market value deduction for contributions of publicly traded stock to private foundations, which expired on May 31 of this year, is extended for 13 months, to June 30, 1998.

These changes and many others are described in detail later in this paper.

## **IRS: We Changed Our Mind**

In several recent private letter rulings, the Internal Revenue Service has announced a change of position in two areas, both involving charitable remainder trusts.

### **Enforceable Pledges**

When a charitable remainder trust discharges an obligation for a donor or other disqualified person, this can be a prohibited act of self-dealing. In several rulings, however, the Internal Revenue Service had held that this would not be true where a charitable remainder trust is used to pay off a donor's legally binding enforceable pledge to a charity. In LR 9703020, one such ruling was revoked, and LR 9714010 followed suit soon thereafter. Moreover, the IRS had earlier announced its new, adverse position on this issue in the fiscal year 1997 Continuing Professional Education Text.

Note: The self-dealing rules should not apply if the donor can establish that the pledge was satisfied by the contribution of the remainder interest to the donee, rather than a transfer from the trust. Alternatively, it may be advisable simply to avoid even the appearance of a binding pledge, if that is possible.

### **Distributions to Grantor Trusts**

In three rulings last year (LR 9619042, 9619043 and 9619044), the IRS appeared to moderate its historical position on the question of whether a charitable remainder trust may make its distributions to a grantor trust for the benefit of the individual beneficiaries. Recently, in LR 9710008, 9710009, and 9710010, the IRS modified these holdings. Now, upon further reflection, the IRS says that a trust recipient may be used in this fashion only where the individual beneficiary is incompetent.

### **Farm Produces FMV Deduction**

**LR 9728016.** Donors (husband and wife) proposed to transfer a 120-acre farm, (including a two-acre dwelling parcel) to a trust that is a supporting organization for a local historical and cultural organization. The donors will retain an easement permitting limited development of a portion of a farm. In addition, cousins of the donors will have the right to live on the farm for life; the will of the mother of the donor-husband left the farm to the donors subject to the cousins' life occupancy right.

The IRS held that the transfer of the farm will be a deductible contribution for income tax and gift tax purposes. The amount of the donor's charitable deduction is the value of the farm, less the easement retained by the donors.

*The cousins' life estate was not discussed. Presumably the donors never owned this anyway, so it would not affect the contribution.*

### **New Tax Bill Affects Charitable Planning**

#### **Introduction**

The highlight of the 1997 tax legislation signed into law by President Clinton on August 5 is, unfortunately, complexity. Despite the widespread campaign rhetoric calling for a simpler, fairer, etc. tax law, the new bill is a highly complicated piece of legislation that will add many pages to the Code and create many headaches for tax practitioners.

This bill is an old-style tax bill; an anachronism loaded with goodies for many different taxpayer groups. It has been designated the "Taxpayer Relief Act of 1997" for political reasons since it was important to Congress that this be the public perception of the Act. The Act contains a number of provisions that will directly and indirectly affect our work as charitable gift planners. Two of these, representing the first new charitable remainder trust qualification changes since 1969, have received

much early attention. These are the imposition of a 50% maximum payout for charitable remainder trusts and a new 10% minimum charitable share requirement. There are, however, many more provisions to learn and apply, and what follows is an attempt to give planners a working knowledge of these provisions

### **The 10% Solution**

The biggest change by far is the new requirement that all charitable remainder trusts created after the effective dates described below have a minimum charitable benefit equal to 10% of the value of the trust's assets. Thus, the underlying theory is that the considerable benefits available for charitable remainder trusts, and their donors and beneficiaries, should be available only if a minimum share (i.e., 10% under the new rule) of the trust is devoted to charitable purposes.

Many are asking, "Where did this new rule come from?" As previously stated, the Senate version of the 1997 tax bill included the 50% upper limit on payouts (described below). When the House bill and the Senate bill went to the Conference Committee, the House conferees proposed to accept that 50% rule with one additional change \_ the 10% minimum requirement for the charitable share. The Senate conferees accepted this change and now it is a part of our Internal Revenue Code.

What about the usual hearings and opportunity to comment? This new provision was added in the Conference Committee, which does not hold public hearings, so the provision essentially came into the law without any advance warning to the interested public. While this is not an ideal situation, there is ample precedent for Congress legislating in this fashion. Moreover, because both the House and the Senate passed identical versions of the Conference Committee-approved bill, there is no technical constitutional argument against the validity of the provision.

As previously stated, these two charitable remainder trust provisions (the 50% maximum payout and the 10% minimum charitable share) are included in the revenue-raising portion of the bill. Thus, they were deemed to have the effect of increasing government tax revenues and making possible some of the other tax-reducing measures contained in the bill. Studies by the Joint Committee on Taxation indicate that the new rules are estimated to bring in \$6 million per year, but there is room to doubt those figures since much of the added revenue arises from the effect of eliminating the much-maligned accelerated charitable remainder trust; the proposed regulations released by the IRS in April of this year would already make it impossible to create such trusts in the future, and would eliminate the tax effectiveness of existing trusts as well.

How does the new rule work? For openers, separate rules are provided for charitable remainder annuity trusts and charitable remainder unitrusts. In the case of annuity trusts, the rule is rather simple. New Code Section 664(d)(1)(D) simply requires that the value (determined under the IRS Rate-of-the-Month Tables) of the remainder interest in the trust be at least 10% of the initial fair market value of the all property placed in the trust. Charitable remainder annuity trusts are not permitted to receive additional contributions after they are first created, so their situation is simple. The rule is applied only once to annuity trusts, when the trust is created, and the 10% charitable share must be present at that time.

In the case of unitrusts, however, a somewhat more complicated rule applies. For unitrusts, the test applies separately for each contribution of property to the trust. New Code Sec. 664(d)(2)(D) provides that "with respect to each contribution of property to the trust," the value determined under the rate-of-the-month tables of the remainder interest in the newly-contributed property be at least 10% of the net fair market value of such property as of the date the property is contributed to the trust.

Because unitrusts are permitted to receive additional contributions, the application of the rule is more complicated than in the case of annuity trusts. Because the unitrust rule is applicable to each contribution, an amount contributed now to a trust with a small (under-10%) charitable remainder

share created prior to the effective date for the new law cannot be enhanced with a subsequent contribution. Likewise, if there should be wild swings in the IRS charitable actuarial rate applicable under Code Sec. 7520, the affect could be to render a second contribution unqualified even though an earlier contribution met the 10% test.

Note that the 10% requirement is based upon the value of the charitable share and not the donor's deduction. Thus, a trust may qualify even if the donor's deduction is well below 10% (e.g., if the deduction is limited to the donor's basis in contributed property).

### **Saving the Trust That Flunks the New Test**

If a charitable remainder trust created by an uninformed donor is qualified in all respects except that it flunks the new 10% minimum charitable share test, the Code now gives the donor a choice. The trust may either be "declared null and void ab initio," or, for donors who dislike such excessively Latin results, the trust may be reformed to meet the 10% test, either by reducing the payout or the duration of the trust or both to the extent necessary to satisfy the new requirements.

This reformation must be undertaken in timely fashion, in accordance with the previously existing rules in Code Sec. 2055(e)(3)(C)(iii); thus, the reformation must be commenced within 90 days of the due date for the estate tax return or trust tax return in question. (Thus, both testamentary and inter vivos trusts may be reformed.) In addition, the usual 5% variance limit, requiring that the charitable share in the trust as reformed not vary more than 5% one way or the other from that in the trust as originally created, is specifically made inapplicable.

Should the donor choose the "null and void ab initio" approach, the Code now provides that (1) there will be no deduction allowed for creating the trust, and (2) any transactions entered into by the trust prior to its being declared void (such as a sale of trust property) will be treated as entered into by the transferor, and thus must be accounted for on the donor's tax returns.

If an additional contribution is made to a qualifying charitable remainder unitrust, but the additional contribution fails to qualify under the new 10% minimum charitable share rule, the additional contribution is treated as a transfer to a separate trust, under explanatory regulations to be issued at some future date. Presumably this means that the separate trust will then have the null and void ab initio or reformation options described above.

### **Effective Dates**

The new 10% minimum share rule is generally applicable to transfers in trusts made after July 28, 1997. A special rule is provided for some decedents who created a charitable remainder trust under the terms of a will or other testamentary instrument executed on or before July 28, 1997. This relief is available if the decedent either (1) dies before January 1, 1999, without having republished his or her will or amended it by codicil or otherwise, or (2) if the decedent was under a mental disability to change the disposition of his or her property on July 28, 1997, and did not regain competence to dispose of the property before the date of death.

### **Discussion**

One question we might ask is how did Congress select 10% as the magic figure. Actually, there is considerable authority for applying a more stringent 5% test. Under basic tax principle, 5% is often used as a threshold test for determining whether or not there is any substantiality to a claimed position. Congress apparently chose 10% in order to provide a somewhat more generous test to mitigate any adverse impact on charitable giving and charitable institutions.

The new test will probably be more significant in its application to charitable remainder unitrusts

rather than charitable remainder annuity trusts. The previously existing 5% exhaustion test for charitable remainder annuity trusts (in Rev. Rul. 77-374) will often hit annuity trusts with a small charitable share, even if that share is well in excess of 10%.

The practical implications of the new 10% test are discussed later in this paper.

### **50% Maximum Payout**

Although it is overshadowed by the 10% minimum share rule described above, the Act makes another important change to for charitable remainder trusts qualifications. The definitions of both the charitable remainder annuity trust and the charitable remainder unitrust (Code Secs. 664(d)(1)(A) and 664(d)(2)(A)), are both amended by changing the payout restriction from "not less than 5%" to "not less than 5% nor more than 50%." This change is applicable to transfers in trust after June 18, 1997.

The obvious target of this provision is the accelerated charitable remainder trust. This form of trust typically utilized an 80% payout in an effort to secure significant capital gains tax savings/avoidance for its donor. By limiting the payout to 50%, future accelerated charitable remainder trusts in the classic form would be prohibited. Note, however, that a 50% payout is considerable, and would still allow trusts to secure significant advantages for donors while qualifying. More on this later when we discuss the practical implications of the bill.

### **Gift Tax Return Not Required for Charitable Transfers**

The new law clarifies a point that not many people were aware of anyway. Under the new law, effective with transfers after August 5, 1997 (the date of the enactment), gift tax returns will no longer be required for charitable transfers.

Many planners didn't know that gift tax returns were required in any event. However, an important point to note is that this relief in the 1997 Act applies only to transfers that are wholly charitable. Most split-interest transfers, such as transfers to a charitable remainder trust or pooled income fund, are not affected and will continue to require gift tax returns.

Thus the new exception will primarily benefit outright charitable transfers. One other new category of transfers excused from filing returns consists of contributions of qualified easements in real property described in Code Sec. 2522(d). Except for such easements, the new exception applies where (1) the donor transfers his/her entire interest in the property transferred, and (2) no other interest in the property is (or has previously been) transferred to a noncharitable donee.

### **Estate Tax Relief for Land Subject to a Conservation Easement**

The conservation easement has long been used as a means of preserving park land, forest land, and other important open-space properties. The Taxpayer Relief Act of 1997 introduces a new benefit for land subject to a qualified conservation easement. Effective for estates of decedents dying after December 31, 1997, a partial estate tax exclusion is granted for land subject to a qualified conservation easement. To take advantage of the new rule, the decedent's executor must make an irrevocable election on the estate tax return to use the provision added as new Code Sec. 2031(c). If the election is made, the gross estate for tax purposes is determined by excluding the "applicable percentage" of land subject to an easement, up to a maximum of \$100,000 for 1998, increasing \$100,000 per year until it reaches \$500,000 for transfers in 2002 or thereafter. The "applicable percentage" for this purpose is 40% reduced by two percentage points for each percentage by which the value of the easement is less than 30% of the total value of the land.

There are, as you might expect, several catches to this benefit. First, the land in question must be located either (1) within 25 miles of a metropolitan area, (2) within 25 miles of a national park or wilderness area, or (3) within 10 miles of an Urban National Forest. The land must be owned by the

decedent or a member of his or her family at all times during the 3-year period ending with the decedent's death. The conservation easement may be placed on the land by the decedent, a member of his or her family, the executor of his or her estate, or the trustee of a trust which includes the land in question. The exclusion is not available to the extent the land is debt-financed property. Also, if the donor retains any development right in conveying the qualified conservation easement, the benefit of the new exclusion is scaled down or eliminated.

The 1997 law also clarifies several other easement issues. Most importantly, the Internal Revenue Service had often taken the position that where farm land has been valued using the special use valuation provisions of the Code (Code Sec. 2032A), the conveyance of a qualified conservation easement over such farm land would be considered a "disposition" which would cause a recapture of some of the tax benefits obtained from special valuation.

Under the 1997 law, the special use provisions are amended to make it clear that the transfer of a qualified conservation contribution as defined in Code Sec. 170(h) by gift or otherwise will not be deemed a disposition for purposes of special use valuation recapture. Another, even more obscure rule, is enacted to cover the situation where surface rights and mineral rights have been separated and a qualified conservation contribution is made.

### **Combination CRT/ESOP**

A special rule is provided whereby the owner of a corporation may create a charitable remainder trust, funded with an interest in the corporation, where the remainder interest in the CRT is payable not to a charity but rather to an Employee Stock Ownership Plan ("ESOP"). This is a limited purpose rule, however, and will not be generally applicable. It has been reported as designed to eliminate estate taxes on a trust created by a "billionaire philanthropist" who died in 1988 and wanted to leave his stock in a closely-held corporation to the employees of the corporation.

There are a number of restrictions, among which is a requirement that the ESOP be in existence on August 1, 1996, and that the securities in question previously passed from a decedent dying before January 1, 1999, to a qualified charitable remainder trust.

Despite its limited application, this rule may be very useful where the circumstances are such that it can apply to a given donor.

### **Donations of Computer Equipment to Schools**

The new law doesn't change the basic rule that gifts of inventory are deductible only to the extent of the donor's tax basis in the property. However, an additional exception to this rule is created. Under new Code Sec. 170(e)(6), gifts by corporations of computer technology or equipment to qualified elementary or secondary schools will, under limited circumstances, qualify for a deduction equal to the smaller of the donor's basis plus half the appreciation or two times the donor's basis. These new rules parallel the rules in Code Sec. 170(e)(3) for gifts by corporations of inventory for the care of the ill, the needy or infants. The amendment applies to taxable years beginning after 1997, but is not available for contributions in taxable years beginning after 1999.

### **Generation-Skipping Tax Change**

The generation-skipping tax problem described in the Planners' Forum column in the January 1995 issue is solved by the new legislation.

In general the generation-skipping transfer tax applies to all transfers from a grandparent to a grandchild. A special rule is provided whereby if a parent's will provides for the transfer to a child, but the child predeceases the parent and the transfer goes to that child's child (i.e., a grandchild)

instead, the generation-skipping tax is not applicable. Under prior law, this so-called predeceased parent exception was not applicable in the case of collateral relatives, such as nieces and nephews. This change remedies that omission. Thus, where an individual with no children provides for a transfer to her niece, but because that niece is not living the transfer goes to the child of the niece, the generation-skipping tax will now be inapplicable.

A number of charitable organizations had expressed support for enactment of this provision because of its applicability to charitable lead trusts, which often involve the sort of distant generational planning for which such considerations are important.

### **Payments to Nonprofit Organizations**

For some time, there have been disputes between nonprofit organizations and donors on the one hand, and the Internal Revenue Service on the other regarding the characterization of certain payments. For example, corporate payments for sponsorship of events, shows, etc., might be treated as a contribution, and hence not subject to the unrelated business income tax, by the nonprofit recipient of the payment. The IRS sometimes took the position, however, that such payments amounted instead to advertising income, to which the unrelated business income tax applied.

The 1997 law provides a safe-harbor exception whereby the tax on unrelated business income will not be applicable to certain "qualified sponsorship payments." A qualified sponsorship payment for this purpose is a payment made by any person engaged in a trade or business "with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of such person's trade or business" in connection with the activities of the donee organization. Payments for advertising the payor's products or services do not qualify; likewise, payments the amount of which is contingent upon the level of attendance at sponsored events, broadcast ratings, etc., are ineligible.

This rule is applicable to payments solicited or received after December 31, 1997.

### **Estate and Gift Tax Changes**

The 1997 Act makes several changes designed to ease the impact of estate and gift taxes, particularly on family-owned businesses and farms. First, beginning in 1998, the unified estate and gift tax credit will begin to increase annually, reaching a maximum of \$1 million in the year 2006. The increases are gradual however -- the 1998 level is only \$625,000.

In addition, beginning in 1999, the \$10,000 annual gift tax exclusion, the \$1 million generation-skipping transfer tax exemption, and several other specialized dollar limitations will all be indexed annually to reflect inflation. These provisions apply to the estates of taxpayers dying after and to gifts made after, December 31, 1997.

Also, under a very complex provision (new Code Sec. 2033A), executors of estates will be able to elect special estate tax treatment for highly-restricted "family-owned business interests" beginning in 1998. Under the complicated set of rules applicable to the new exclusion, these interests must comprised more than 50% of a decedent's estate, and must pass to qualified heirs (generally family members who "materially participate" in the business) under rules paralleling those applicable for purposes of special use valuation.

The special family-owned business provision limits the combined value of this new credit and the increasing unified credit to a total of \$1.3 million. Thus, the amount of this new exclusion that will be available each year will decrease in value year by year as the unified credit increases during the 1998-2006 phase-up period. In 1998, the new family-owned business provision will exclude up to \$675,000 of value in qualified family-owned business interests from a decedent's taxable estate (i.e.,



\$1.3 million minus the \$625,000 unified credit available for transfers in 1998).

It is worth noting that some estate planning bar groups have taken the position that because this provision is so complicated as to offer benefits that may prove to be illusory, it should be repealed.

### **Pension Excise Taxes**

The 1997 Act repeals both of the 15% excise taxes that had previously been applicable to IRA and pension plan assets. The former tax on excess distributions (which had been suspended for 1997-1999) is repealed, effective for distributions received after December 31, 1996. The tax on excess accumulations (sometimes referred to as the "success tax") is likewise repealed in the case of estates of decedents dying after December 31, 1996.

### **Individual Retirement Accounts**

The 1997 Act creates a new type of individual retirement account beginning in 1998. This category is called a "Roth IRA" in honor of Senator William Roth of Delaware, who championed its enactment. Contributions to Roth IRAs will not be deductible, and distributions from the account will not be subject to income tax. Earnings on the account will be taxable only if and when there are distributions that are not "qualified" distributions. A qualified distribution for this purpose is a distribution made after the taxpayer attains age 59 1/2, made to a beneficiary after the taxpayer's death, made because the taxpayer is disabled, or used by a first-time homebuyer to acquire a principal residence.

Annual contributions to the Roth IRAs will be limited to \$2,000, less the taxpayer's deductible IRA contributions. Unlike deductible IRAs, there will be no prohibition on making contributions after attaining age 70 1/2. The \$2,000 limit is phased out as adjusted gross income increases from \$150,000 to \$160,000 for married couples filing jointly (\$95,000 to \$110,000 in the case of single filers).

Another new type of IRA -- the "Education Individual Retirement Account" -- may distribute funds tax free for payment of qualified higher education expenses of beneficiaries. Contributions of up to \$500 per year are permitted, until the beneficiary reaches age 18, and this limit is phased out as the contributor's income exceeds \$95,000 (\$150,000 on a joint return).

### **Capital Gains**

The Act makes a number of important changes in capital gains. For individuals, the maximum tax rate on net capital gains occurring after May 6, 1997 will be reduced to a maximum rate of 20% for sales after May 6, 1997 (if the property had been held for more than 18 months by the time of sale). In the case of property sold between May 6, 1997 and July 29, 1997, this 20% rate will be available if the property had been held for more than 12 months (rather than 18).

A maximum rate of 18% applies for sales of property acquired after December 31, 2000 that had been held for more than 5 years at the time of the sale. A 25% maximum rate applies for real estate depreciation recapture treated as capital gain. Moreover, the current 28% maximum capital gain rate will continue to apply to sales of collectibles, sales before May 7, 1997, and sales after July 28, 1997 of property held for more than one year but not more than 18 months.

Special rules apply to capital gain arising from the sale of a principal residence. Under the 1997 Act, taxpayers may exclude up to \$250,000 of gain (\$500,000 for married couples filing jointly) realized on the sale or exchange of a principal residence after May 6, 1997. Unlike the "one-time" exclusion available under prior law, this exclusion will be allowed each time a taxpayer sells or exchanges a principal residence, although it can generally not be claimed more often than once every two years. Also, unlike prior law, the taxpayer is not required to reinvest sales proceeds in a new residence to

claim the exclusion or to be have attained any particular age. To be eligible, the residence must have been owned and used as the taxpayer's principal residence for a combined period of at least two years out of the five years preceding the sale or exchange. The taxpayer must recognize gain to the extent of any depreciation allowable with respect to the rental or business use of such principal residence for period after May 6, 1997. The old "rollover" provision and the old one-time exclusion for residence sales by taxpayers over 55 years of age are repealed.

### What Does It All Mean?

#### The 50% Maximum Payout And 10% Minimum Charitable Share Rules

The 50% maximum payout rule is unlikely to pose problems for many planners, except in some odd and extreme situations. Much more significant is the 10% minimum charitable share rule, although its importance is probably overstated. Most of the complaints about this new restriction seem to come from investment-and-financial-oriented advisors who are disappointed to see this limit placed upon the tax benefits available from a charitable remainder trust. Charitable organizations seem generally pleased with the new requirement, even though they may logically expect to lose out on some trusts under the 10% limitation, at least in theory. Perhaps this breakdown of reactions is understandable when we consider that, for every less-than-10% charitable CRT that is lost, the charitable beneficiary will by definition lose less than 10% of the benefits involved. The donor loses 90% of the benefits, so perhaps we should expect to see donors' representatives most upset by the new rule.

But, just how badly will aggressive planners be hit by the 10% rule? Surprisingly, some fairly aggressive trusts can still be created under the new regime. For example, using the 7.60% IRS charitable actuarial rate for August 1997 and a single payout at year-end, the following charitable remainder unitrusts would still qualify:

- 50% payout for 3 years
- 18% payout for the lives of two  
73-year-olds
- 20% payout for the life of a 62-year-old

Each of these would seem to offer considerable benefits to their donors — enough so that the charitable remainder trust as a planned gift device will probably not fall off the planning map.

True, some trusts (and some donors) will be unable to qualify under the new rule. In the weeks during which the House-Senate Conference Committee was meeting on this issue, the American Institute of Certified Public Accountants filed a statement in opposition to this 10% rule. One of the points the AICPA made in an effort to show how harmful the 10% proposal would be was the fact that (using the 8.0% actuarial rate for July), the new rule would make it impossible for a 24-year-old to set up a single life charitable remainder unitrust. [Poor baby!] Congress was unconvinced, and your editors are too. After all, what institution would issue a charitable gift annuity to a donor of this age? Or permit him or her to participate in its pooled income fund?

True, not all of the affected trusts will be as extreme. In the case of charitable remainder annuity trusts, as noted earlier, the previously existing (and still applicable) 5% probability test already knocks out many, if not most, of the trusts for which the charitable share is less than 10%. With unitrusts, however, the results of the new rule will not be limited to donors in their 20's. Especially with two-life trusts, persons of early middle age can be affected dramatically. Here are some examples of two-life charitable remainder unitrusts that fail the 10% test (based upon the August actuarial rate of 7.6%, as before):

Spouses' Ages      34, 32    42, 40    48, 46    52, 50

Payout Rate	5%	6%	7%	8%
Parent & Child Ages	49, 24	57, 32	63, 38	67, 42
Payout Rate	5%	6%	7%	8%

See Exhibit A, below, for more examples of the consequences of the 10% rule.

What, if anything, is gained under the new rule? With the new 10% limitation in place, charities may breath a bit easier in the knowledge that most of the trusts the IRS has viewed as abusive will now be banished. This means that charitable remainder trusts will be less attractive to the sort of high-flying promoters who place little emphasis on the charitable part of a charitable remainder trust. Congress, having stepped in with the 10% rule, will not be likely to revisit the issue, and the mild aroma of tax abuse will probably subside.

Lest we forget, in some ways we may be lucky to have this rule set at 10%; some commentators had suggested a much higher standard \_ as high as 35% in one recent article. Ten percent seems like a level the charitable world can live with even if some planners argue that 10% is just too much charity for them.

### Capital Gains Tax Cuts

An important factor for donors and potential donors is the amount of tax they will save with their gift. Just as higher tax rates make the charitable deduction more valuable, higher capital gains tax rates make a donor more receptive to a charitable gift that will avoid those taxes. The lowering of the maximum capital gains tax rate from 28% to 20% is a significant drop, and logic suggests that this will provide some disincentive for charitable gifts. In the past, however, that logic has not always been borne out. Indeed, perhaps the lower tax has been so long in coming that its arrival will unlock charitable gifts as well as sales of capital gain property.

The complexity of the new capital gain structure will pose some problems for charitable remainder trusts and their trustees. The present four-tier structure for taxing charitable remainder trusts distributions may have to be adjusted to accommodate the varying types of capital gain possible under the new tax law. For example, if a charitable remainder trust has gains of both the new 20% variety and the old 28% variety, will the 28% variety be deemed distributed before the 20% variety? If so, this would perpetuate the easy-to-remember "WIFO" or Worst-Income-First-Out principle. Only time will tell how the IRS approaches this.

The more liberal treatment of capital gains suggests that beneficiaries will now be even more likely to prefer capital gain distributions from charitable remainder trusts over ordinary income distributions. As a result, trustees may find themselves pressured to produce capital gains rather than ordinary income as a result.

### Other Changes

The new individual retirement arrangement ("IRA") options and the repeal of the excise taxes on excess distributions and excess accumulations will affect the alternatives available to potential donors. The considerations that formerly led many donors to pass such retirement assets through a charitable remainder trust available may still carry the day, but the planning factors to be taken into account are different now, and planners will have to adapt their marketing strategies.

The estate tax changes could cut both ways. A higher unified credit and the new exclusion for family-owned businesses may discourage some charitable gifts in the short run. This could be more than offset, however, as individuals whose estates are large enough to encounter a potential estate tax burden visit their tax advisors to review their estate plans. It is this process that often causes a donor

to realize the beneficial effects of various charitable transfers.

Private foundation contributions of appreciated publicly traded stock are safe again, at least until June 30, 1998. Given the recent run up in the stock market, it is likely that many potential donors will decide to form foundations soon, rather than wait until the full fair market value deduction rule is ready to expire again next year.

### Conclusion

While the net impact of all these changes is not yet clear, and won't be sorted out for some time, one thing (or maybe two) can be stated with assurance. Charitable gift planners have a lot of new information to absorb before they set out to help donors cope with the new law. And, year-end planning for 1997 is going to be more interesting than usual.

### Exhibit A

#### Examples of consequences of 10% minimum charitable share rule

##### Assumptions:

7520 rate                    7.60%  
 Payments per year        1  
 Months delay in full year 12

##### Charitable Remainder Unitrusts:

Unitrust rate:	5.00%	6.00%	7.00%	8.00%				
One-life unitrust factors:								
Age of life beneficiary	21	20	30	29	36	35	40	39
Unitrust remainder factor	10.18%	9.81%	10.30%	9.84%	10.40%	9.86%	10.20%	9.63%
Two-life unitrust factors:								
Age of older spouse	36	34	44	42	50	48	54	52
Age of younger spouse (2 years younger)	34	32	42	40	48	46	52	50
Unitrust remainder factor	10.89%	9.94%	10.97%	9.86%	11.16%	9.91%	10.87%	9.55%
For parent and child:								
Age of parent	50	49	58	57	64	63	68	67
Age of child (25 years younger)	25	24	33	32	39	38	43	42
Unitrust remainder factor	10.15%	9.72%	10.12%	9.60%	10.27%	9.69%	10.03%	9.41%

##### Assumptions:

7520 rate                    7.60%  
 Payments per year        1  
 Months delay in full year 12

##### Charitable Remainder Annuity Trusts:

Annuity as percent of initial value:	7.60%	8.00%	8.40%	8.80%				
One-life annuity trust factors:								
Age of life beneficiary	39	38	45	44	50	49	54	53
Annuity trust remainder factor	10.55%	9.98%	10.14%	9.34%	10.34%	9.33%	10.66%	9.45%
Probability of exhausting annuity trust	0.00%	0.00%	29.87%	33.02%	40.61%	43.69%	45.13%	46.10%
Status of 5% test	pass	pass	fail	fail	fail	fail	fail	fail
Two-life annuity trust factors:								
For spouses:								
Age of older spouse	52	51	58	57	62	61	65	64
Age of younger spouse (2 years younger)	50	49	56	55	60	59	63	62
Annuity trust remainder factor	10.64%	9.99%	10.86%	9.94%	10.77%	9.61%	10.48%	9.11%
Probability of exhausting annuity trust	0.00%	0.00%	6.67%	8.91%	18.75%	22.41%	26.22%	32.46%
Status of 5% test	pass	pass	fail	fail	fail	fail	fail	fail
For parent and child:								
Age of parent	67	66	73	72	77	76	81	80
Age of child (25 years younger)	42	41	48	47	52	51	56	55
Annuity trust remainder factor	10.43%	9.80%	10.41%	9.53%	10.02%	8.93%	10.73%	9.42%
Probability of exhausting annuity trust	0.00%	0.00%	20.80%	23.73%	34.35%	37.53%	39.02%	42.18%
Status of 5% test	pass	pass	fail	fail	fail	fail	fail	fail

Thanks to Pam H. Schneider, Esq., and Daniel R. Ross, Esq., of Philadelphia for these examples.

### 12 Months Is Still Long-Term for Charitable Contributions

The new capital gain rules may bring relief for investors, but they also cause confusion for many taxpayers. In short, despite the various capital gains revisions, 12 months (one year, to be precise) is still the required holding period for full fair market value deductions for charitable contributions of capital gain property.

In simpler times, we had just one tax rate for long-term capital gains and another for ordinary income. The Taxpayer Relief Act of 1997 brought this area to new heights of complication. Now, gains from the sale of assets held for more than 18 months are taxed at a new maximum rate of 20%. The old 28% top rate still applies to gains from assets held more than 12 but less than 18 months or from collectibles. And if the asset is held for more than 5 years, even lower rates will apply (eventually).

Where does this leave charitable gift planners today? Code Sec. 170(e)(1) still says what it always did - the amount of a charitable contribution of property otherwise taken into account is to be reduced by "the amount of gain which would not have been long-term capital gain" if the donor had sold the property instead of contributing it. And eighteen months is now the required holding period for the much-touted new 20% maximum rate. This left many planners in doubt as to how it all fit together. Does a donor now have to hold appreciated property for a minimum 18-month period before a full fair market value deduction will arise upon contributing it? No, the old one-year holding period still applies for this purpose.

Here's how it works. Note that the term "long-term capital gain" quoted above from Code Sec. 170(e)(1) is the key concept. To the extent the sale of a property would produce "long-term capital gain," a contribution of the same property will likewise produce a deduction equal to the value of the property. The definition of this key phrase in Code Sec. 1222(3) as gain from the sale or exchange of a capital asset held for more than 1 year was not changed by the 1997 legislation. So the rules haven't changed in this respect, despite the flurry of capital gains legislation.

I received a number of calls on this one, and have confirmed the foregoing discussion with knowledgeable sources on Capitol Hill. The deck may have been shuffled, but this rule hasn't changed.

### **Congress Makes Mistakes**

The new 1997 Tax Law has been in place for only a month, and already some glitches have come to light. One charitable contribution provision is in this category. We told you last month about new Code Sec. 170(e)(6), allowing corporations an enhanced deduction for certain charitable contributions of computer technology and equipment for elementary or secondary school purposes. The new rules are complex, and will apply to a relatively limited class of donors in any event, but that is no surprise. The question, how long will this new rule be available?

The 1997 Act, as signed by President Clinton on August 4, is clear on this point. The provision takes effect for contributions made in taxable years beginning after 1997 (according to Sec. 224(b) of the Act) and new Code Sec. 170(3)(6)(F) says it shall not apply to any contribution made during any taxable year beginning after 1999. That's a two-year window. The problem is that, when the lawmakers described the provision in the Conference Committee Report, they said it would be effective for taxable years beginning after 1997 and before 2001. That's three years.

What happens when Congress says one thing and describes another? Well, the Internal Revenue Code is the governing law, so for now the two-year window would seem to be the governing law. However, the Joint Committee on Taxation is working up a list of all the various mistakes it has located, and this will be on the list for correction in the next tax bill passed by Congress.

So, this tax odyssey may expire in 2001 after all, if corrective legislation is passed by then.

### **But Wait, There's More**

The foregoing discussion of important provisions should not overshadow other important provisions of The 1997 legislation. Charitable gift planners working with the new law should keep the following additional items in mind.

**Charitable Mileage** - For taxable years beginning after 1997, the standard mileage rate for computing the charitable deduction allowable for use of a passenger automobile in the course of performing volunteer work for a charitable organization increases from 12 cents per mile to 14 cents per mile. This is the first change in this rate since 1984. The rate is still set by Congress, and is specifically listed in the Internal Revenue Code (Code Sec. 170(i)). By contrast, the comparable rate for business use of a car is determined administratively by IRS; that rate is considerably higher (31 cents per mile for 1997), to reflect depreciation, which is not allowable for charitable usage.

Note that the Senate version of the 1997 Act would have been a bit more generous \_ a rate of 15 cents per mile, which would have been indexed for post-1998 inflation.

**Conservation Easements** - In our last issue we described the complicated new estate tax exclusion for land upon which a conservation easement has been placed. The same portion of the 1997 amended Code Sec. 170(h)(5)(B)(iii) to modify the rules governing allowance of a charitable deduction for certain conservation easements. Under that provision, the charitable deduction is allowable for income tax and estate tax purposes

to taxpayers making a contribution of a permanent conservation easement on property even though a mineral interest has been retained and surface mining is possible, but only if the probability of surface mining is "so remote as to be negligible." Prior law allows a deduction in such cases when the mineral interests were separated from the land prior to June 13, 1976. The new law allows a charitable deduction to be taken regardless of when the mineral interests were separated.

**Charitable Contributions of Large Partnerships** - The 1997 Act allows certain partnerships with over 100 partners to elect a simplified system of taxation. Under the "simplified system," various tax computations and elections are taken into account at the partnership level, rather than the partner level. As part of this system, the treatment of charitable contributions by these electing partnerships is changed. In general, contributions made by a partnership are considered made pro rata by the partners and are taken into account by the partners on their personal income tax return. Under the new system, the charitable contribution deduction is allowed instead at the partnership level, and is taken into account in determining partnership taxable income. The charitable deductions of an electing large partnership will be subject to the limitations that apply to corporate donors (such as the 10%-of-taxable-income limitation).

**CRT Cannot Be An ESBT** - The Small Business Job Protection Act of 1996 created a new type of trust - the "Electing Small Business Trust" or "ESBT." Although that Act also allowed Section 501(c)(3) organizations to be S corp shareholders for the first time, it seemed clear that a charitable remainder trust could not be an electing small business trust, since any trust exempt from income tax was specifically excluded. The Taxpayer Relief Act of 1997 now eliminates any small doubt that may have existed on this point by providing expressly in Code Sec. 1361(e)(1)(A)(iii) that a charitable remainder annuity trust or charitable remainder unitrust may not qualify. (Thanks for that "relief.")

#### **Son Cannot Deduct Deceased Father's Contribution Carryovers**

*Dieter Stussy v Commissioner*, T.C. Memo 1997-293. Jan Stussy died in 1990. Before his death, he amended his revocable trust twice to leave various assets to the Jan Stussy Foundation. Contemporaneously with one of these amendments, he also signed an agreement giving the Foundation the exclusive right to use four rooms in his residence. About three months later, Jan Stussy died and left the bulk of the property in his trust, including his residence, to his son Dieter. When the estate filed Jan's 1990 income tax return, it claimed a charitable contribution deduction of approximately \$263,000 based upon the transfer of the rooms to the Foundation.

Subsequently, Dieter claimed a carryover of this deduction on his own income tax returns for 1992 and 1993, on grounds Jan's trust became a split-interest trust after the 1990 amendments, so that (under his view) the tax benefit of the trust's charitable contribution passed through to him as residuary beneficiary of the trust.

Sorry, said the Tax Court, it doesn't work that way. To claim a charitable contribution deduction, one must make a contribution. Here, the contribution was not made by Dieter, but rather by his father. One taxpayer (even a surviving spouse) may not deduct another taxpayer's contribution carryovers.

#### **Can CRT Be Valued on the Basis of Beneficiaries Actual Life Expectancy?**

Another pending case involves an issue of significant interest to charitable gift planners. A decedent's will created a charitable remainder trust for the benefit of her stepson, who was at the time suffering of a fatal and incurable condition. Fifteen months later (6 months after the estate tax return was filed) the stepson died. The estate thereupon filed an amended estate tax return using the stepson's actual life term to compute the value of the charitable remainder interest in lieu of the expectancy reflected in the IRS actuarial tables. This amended return included an affidavit of the stepson's attending physician, which stated that on the decedent's date of death the stepson's condition was "fatal, incurable and in an advanced state" and that he had "six months or less to live." This latter statement would bring into play an exception to the general rule whereby the actual expectancy may be used instead of the actuarial life expectancy under the IRS tables in valuing the charitable remainder interest. The IRS disagreed and the estate brought the action for a refund of the estate tax paid.

(Estate of Llewellyn Burchell, Chase Manhattan Bank, Executor v United States, U.S. District Court for S.D. NY Docket No. 96 CIV 6757 (BSJ)).

### **Estate's Payment of Decedent's Pledge is Deductible**

**LR 9718031.** D pledged \$250,000 to a state university to be used as matching funds for construction of a new building. A memorandum signed in May 1994 provided for payments to be made from time-to-time, with the total to be paid no later than December 31, 1999. The state legislature appropriated funds for the project in 1994, contingent upon the university's raising a stated amount of private funds, and construction began in late 1995. D died in early 1996, before making any payments on his pledge. The university filed a claim against the estate for this \$250,000 on June 26, 1996, and in a subsequent report to the State Finance Department, the university reported contractual agreements for the full amount of private funding required for the building project. The IRS held that the payment of this \$250,000 pledged by the estate was deductible as a claim against the estate under Code Sec. 2053(a)(3) [NOT as a charitable deduction]. The Memorandum of Agreement specified that the purpose of the pledge was to assist with the cost of the building in question, and the university demonstrated reliance on the pledge by commencing construction before D paid his pledge. Under the applicable state law, this was sufficient to convert this pledge into a claim enforceable against the estate.

*Oddly, the IRS never discussed a regulation that seems to be aimed specifically at this sort of situation. Treasury Reg. Sec. 20.2053-5(b) states that a pledge evidenced by a note "or otherwise" is deductible only to the extent that "it would have constituted an allowable [charitable] deduction under Sec. 2055 ... if it had been a bequest." D's pledge seems to fit squarely within this rule, but this was not discussed in the ruling. The binding nature of the claim under state law is generally regarded as a more difficult issue, and the quoted regulation provision provides an easier standard to meet.*

### **Where the Ten Percent CRT Rule Came From**

Any gift planner who fails to attend the National Conference on Planned Giving feels that he or she has missed something important, and the recent Tenth Anniversary Conference in New Orleans was no exception. A striking example of this came at the annual Tax Update Luncheon, where attendees were treated to something rare indeed - a behind-the-scenes view of how an important new piece of charitable tax legislation came into being.

A special guest, Tim Hanford, Tax Counsel to the House Ways and Means Committee, provided these insights. Many observers had attributed the new ten percent minimum charitable share for charitable remainder trusts to Congressional concerns over the accelerated charitable remainder trust, which enabled a taxpayer to recoup 96 percent of the value of a highly-appreciated asset under the guise of a charitable gift, paying capital gains tax on only a small portion (16 percent) thereof. According to Tim, these abusive vehicles were only a contributing factor.

### **The Telephone Rings**

Hanford described the real provocation as a telephone call he received from a person complaining about the all-or-nothing tax treatment of a CRT that receives unrelated business taxable income. The caller suggested that the law should be changed to make it clear that only the UBTI itself, and not all of the income of the trust, should be subject to tax under these circumstances. Asked about the situation he faced the caller described a long-term CRT, funded with stock of a family business, that eventually distributed its assets to a family foundation. The stated purpose of this arrangement was to effect a largely tax-free transfer of the family business. It was clear that the benefit to charity would be delayed by many years, and even then would likely be limited to distributions from the foundation primarily consisting of income earned on the funds received from the trust.



This got Hanford to thinking that the rules for CRTs as they then existed seemed to permit or even encourage uses of charitable gift vehicles for non-charitable purposes. Over time, he saw a number of articles in tax journals that confirmed the impression that charitable remainder trusts in particular were commonly used for tax and financial purposes that had no relationship to the sort of concerns for charity that had led Congress to provide tax incentives for charitable giving in the first place. Reviewing postings on Gift-PL, the NCPG e-mail distribution center, further supported this impression.

### **In Congress - 1997**

When the 1997 tax legislation started to move through Congress, Hanford raised this point with Ways and Means Committee members, but there was no opportunity to act as the bill went forward in the House. That opportunity came later when the House version and the Senate version went to a House-Senate Conference Committee for compromise and assembly of a final bill. The Senate bill had included a fifty-percent maximum CRT payout as a device to stop the accelerated CRT. In the give-and-take of the conference, the House proposed to accept the Senate's fifty-percent rule if the Senate would agree to the ten-percent minimum charitable share. The deal was made, and the final bill included both provisions.

Hanford noted that the ten percent test was considered to be the best overall compromise between the intention to limit noncharitable uses of CRTs and concerns for truly charitable transfers. The legislators were indeed aware that this would affect gifts by younger individuals, but this was not viewed as a sufficient reason to retain existing law. He acknowledged the lack of the usual hearings and public comment, and expressed the view that such input would not have been sufficient to derail enactment of the ten percent rule. And finally, he confirmed that there is no sympathy on Capitol Hill for repealing this new requirement.

### **Where Do We Go From Here?**

Tim Hanford's presentation made one thing perfectly clear. Congressional members and staff are just like us. They read the same professional journals, newspapers and other publications, so they see the same articles and advertisements, including those that highlight uses, misuses, and "creative applications" of charitable vehicles. The story of the caller urging a change in the UBTI rule of CRTs shows how a single encounter can affect the entire charitable sector. And Tim's final comment \_ that he would be watching Gift-PL and otherwise monitoring our work as gift planners - should not be forgotten. Although this sounded like a threat to some, the truth is that the world is always watching, and we should always govern ourselves accordingly.

### **IRS Approves Flexible Start Deferred Gift Annuity**

Who says there's nothing new under the sun? At the NCPG session in New Orleans, Seattle planned giving consultant Frank Minton described a recent private letter ruling approving a new form of deferred charitable gift annuity. The ruling has since been released as **LR 9743054**. The unique feature of this annuity is an optional starting date for the annuity stream. The 50-year-old donor in the ruling was entitled to elect the commencement date for his annuity when he reached age 55, or at any time thereafter. The annuity agreement included a table specifying the amount of the annuity receivable at various beginning ages.

Thus, as would any deferred annuity, the longer this donor delays the start of the annuity payments, the larger the payments will be when they finally do start. The difference with this new plan is that the starting date and the amount the annuitant will receive are not fixed at the outset. Instead, the annuitant retains the right to choose the starting date later; only when that date is eventually selected will the amount of the annuity payment be fixed.

The donor's income tax charitable deduction will be based upon the earliest possible starting date he or she may elect. Although a delay in the starting date normally increases the deduction, LR 9743054 requires that the deduction be based upon the largest possible annuity the donor could choose.

*One can see how this new annuity plan will fit a number of donor situations. For one, it will allow for most of the advantages of the so "build-up NIMCRUT" with none of the risks and uncertainties the latter brings. And this could be an attractive option for the much-discussed young donor (i.e., in his or her early twenties or younger) who finds that the new 10% minimum charitable share rule makes it impossible for him or her to create a lifetime charitable remainder trust.*

*Organizations interested in establishing a plan based upon this new format may contact Frank Minton at Planned Giving Services (206) 329-8144 (or e-mail at PlanGiv@aol.com).*

## **IRS Relents on CRT Distribution Proposal**

The Internal Revenue Service has backed off on one of the most controversial provisions of the proposed regulations issued last April. The announcement came in Notice 97-68 issued just four days before the IRS hearings on the CRT proposed regulations (see next item).

Of all the topics in the proposed regulations, the one prompting the most response was a proposal that virtually all charitable remainder trusts (except net income charitable remainder unitrusts) be required to make the required payments of unitrust amounts or annuity payments before the close of the taxable years to which the payment is related. The new rule would have applied to taxable years ending after April 18, 1997. Thus, for 1997, most charitable remainder trusts would have been required to make their 1997 distribution by December 31, 1997. Many organizations had called for IRS action to relieve this burden before year-end, since it is clear that there will be no formal action on the proposed regulations by year-end.

After receiving "a significant number of comments expressing concern that the proposed timing amendments will place a significant burden on many trusts that are not engaging in abuses," the IRS has now announced that for taxable year 1997 it will not require certain charitable remainder trusts to make distributions by year-end. The trusts that are excused from the proposed new distribution requirement are the following:

1. A charitable remainder annuity trust providing for an annuity payment of 15% or less of the initial fair market value of the property placed in the trust.
2. A charitable remainder unitrust under which the annual unitrust distribution is 15% or less,  
or
3. A charitable remainder annuity trust or unitrust from which all amounts distributed for 1997 are characterized in the beneficiaries' hands as income (of any sort) and not as trust corpus.

The Internal Revenue Service and the Treasury Department will continue to consider the comments submitted on the proposed regulations before deciding whether to adopt an amended version of the proposed regulations as final regulations.

## **Bi-Coastal Hearing On CRT Proposed Regs**

On November 18, the IRS heard comments from the interested public on the proposed charitable remainder trust regulations released April 18, 1997. Responses from witnesses in California (via television) and Washington D.C. were generally complimentary, especially since the release of Notice 97-68 just a few days earlier. That Notice (described in the preceding item, above) headed off complaints from most witnesses about the proposal to require that most charitable remainder trust distributions be made by the close of the year to which they relate. This would have been unduly burdensome, these witnesses were prepared to say, but the IRS headed them off with Notice 97-68 indicating that only high-percentage-payout to trusts would be required to comply.

Other witness comments included the following:

In addition, in a recent speech, Kenneth J. Kies, Chief of Staff of the Joint Committee on Taxation, urged tax-exempt organizations to consider carefully how basic tax reform proposals would affect them. Noting that the Clinton White House has made a "significant shift" in its willingness to reach consensus with Congress on tax reform proposals, he stated that the White House is giving serious consideration to the inclusion of tax reform proposals in the President's State of the Union Address next January. This could be particularly important to the exempt organization community because many flat tax and other tax reform proposals might eliminate the charitable contribution deduction. Other alternative tax systems could even eliminate the concept of exempt organizations altogether, or redefine the field.

### **Donor Lacks Standing to Enforce Restricted Charitable Gift**

*Carl J. Herzog Foundation, Inc., v University of Bridgeport*, Connecticut Supreme Court, SC 15526 (August 26, 1997). This non-tax case has profound implications for planners who help donors arrange support for specific programs and projects. The Carl J. Herzog Foundation ("the Foundation") offered a matching grant to the University of Bridgeport to provide "need-based merit scholarship aid to disadvantaged students for medical related education." Initially, the University raised \$250,000 under this program, which the Foundation matched to provide scholarships to nursing students. Subsequently, the University closed its nursing school and the Foundation sought to have the \$250,000 in matching grant funds segregated from the University's general funds and reestablished in accordance with the original gift purpose.

In a three-to-two decision, the Connecticut Supreme Court held that the donor did not have standing to bring this suit. Under the Connecticut Uniform Management of Institutional Funds Act, only the State Attorney General is authorized to enforce charitable gifts for a stated purpose.

In a dissenting opinion, two justices viewed the majority opinion as permitting a donee to "double-cross" a donor with impunity unless the Attorney General steps in. "I fail to see why Connecticut, the home of so many respected schools that would honor their promises, should endorse such sharp practices and create a climate in this state that would have a chilling effect on gifts to its educational institutions," said the dissent.

Subsequently, in an op-ed piece in the Wall Street Journal of September 10, 1997, Yale history professor Frank M. Turner suggested that this case "strikes a severe blow" to the atmosphere of trust that should exist between Universities and their donors. In Mr. Turner's opinion:

"Some institutions may be tempted to believe the only good donor is a thoroughly docile one - best of all, a dead one with neither estate lawyers nor family concerned about the fate of the funds. But in fact, universities benefit from donor restrictions as well as gifts. The donation of unrestricted funds often simply pours money into a black hole, owing to a lack of either external regulation or internal institutional discipline."

### **IRS Wins a Big One**

*United Cancer Council, Inc. v Commissioner* 109 T.C. No. 17 (12/2/97). Normally we do not report on exempt organization cases unless they directly involve a charitable giving issue. This case, however, presents an indirect charitable issue that could prove to be very important for some gift planners. The organization in question, United Cancer Council (UCC), was created in 1963 to support a number of local cancer agencies nationwide. In 1984, faced with a decline in membership dues, UCC turned to a new fundraising approach through a contract with Watson & Hughey, Co. (W&H), a professional fundraising firm. This initial contract had a 5-year term and provided fees to W&H for each fundraising letter mailed. W&H advanced all expenses and receive co-ownership of the UCC mailing list.

Although the facts surrounding W&H's conduct of sweepstakes fundraising mailings on behalf of UCC are complicated, the net result was to raise \$28,763,287 in contributions to UCC over the 5-year period, incurring \$26,523,917 in expenses over the same period. UCC's annual budget had never exceeded \$50,000 prior to the W&H contract. The net fundraising revenue for UCC over the 5-year period was about \$2.25 million, and

W&H fees totaled just over \$4 million plus another \$3.9 million paid to a division of W&H for mailing lists rentals. On these facts, the Tax Court found that (1) W&H was a "private shareholder or individual" for purposes of Section 501(c)(3), and (2) UCC's net earnings inured to the benefit of W&H. Accordingly, it upheld the revocation of UCC's exemption under Section 501(c)(3), retroactive to the starting date for the 1984 contract.

This case, involving an unusual and extreme situation, would seem at first glance to hold little in the way of significant implications for charitable gift planners. However, on closer examination of this lengthy opinion, that impression fades. First, the Tax Court held that W&H became an insider subject to the inurement prohibition as a result of the control granted it under an arm's length negotiated contract. Second, the compensation paid openly and presumably voluntarily to W&H violated that prohibition and, ultimately, cost UCC its exemption.

*This decision is the Tax Court's first major case in many years on inurement under Section 501(c)(3), and will certainly receive a lot of attention, including IRS attention. Increasingly, gift planners are offered plans that create various unconventional relationships between the donor and the donee charity. If such relationships involve large amounts of money with much smaller benefit to the putative "donee" the IRS (and ultimately, courts as well) will no doubt turn to the UCC case for guidance. On this score, the Tax Court noted that "the \$2-1/4 million (that UCC received) is so small in comparison to the amounts of contributions, of W&H compensation, of postage and shipping costs, of printing and publication costs, and of mailing list rental costs, as to be almost an incidental product of the fundraising campaign."*

*The UCC case is must reading for anyone called upon to evaluate such plans.*

### **Supreme Court Sends Back Holding Against Charities in Texas Gift Annuity Case**

In several prior issues we have discussed the epic lawsuit in U.S. District Court in Texas against a number of charitable defendants. In the April 1997 issue of CGPNews we described the decision of the U.S. Court of Appeals for the Fifth Circuit assessing a \$15,000 penalty against the charities for filing a "frivolous appeal." That decision held that the attempt by Congress to end this suit via the Charitable Gift Annuity Antitrust Relief Act of 1995 did not accomplish its stated objective of ending the Texas litigation. Congress subsequently passed a broadened statute that was signed by President Clinton on July 3, 1997. Meanwhile, the charities appealed the adverse ruling of the Fifth Circuit to the Supreme Court.

On December 8, in a one-sentence order issued on behalf of all nine justices, the Supreme Court vacated the Fifth Circuit opinion and remanded the case to the Fifth Circuit "for further consideration in light of the Charitable Donation Antitrust Immunity Act of 1997, Pub. L. No. 105-26, 111 Stat. 241 (1997)."

*Yogi Berra could have been referring to this litigation when he said, "It ain't over till it's over."*

### **Sale of Easement is Partly a Gift**

*Charles H. Browning, Jr. v Commissioner*, 109 T.C. No. 16 (11/25/97). Howard County, Maryland, has an active program of farmland protection through purchases of development rights from landowners. By selling development rights to the county, the landowner restricts the use of his/her property. The vehicle used for this purpose is a conservation easement that has the characteristics of a "qualified conservation contribution" as defined in Code Sec. 170(h). To obtain a charitable deduction, however, the donor must make a "contribution." Under the Howard County program, the landowner receives a payment, and this would negate any contribution unless the amount paid for the easement is less than the easement's value. If the value of the easement is more than the amount received, the landowner has made a bargain sale, and is entitled to a deduction for the gift elements in the sale. Thus, the critical issue is valuation.

Mr. and Mrs. Browning own a 52-acre farm that has been in her family for six generations. In 1990 they

conveyed to Howard County an easement restricting development of the land, and received in exchange installment payments that will total \$309,000 over a 30-year period (plus interest). Based upon appraisals concluding that the land was worth \$771,600 before the easement and \$173,052 thereafter, the Brownings claimed a deduction for the approximate difference, \$598,500, less the \$309,000 payments from the County for a net deduction of \$289,500. The IRS disallowed the deduction on grounds the Brownings had not shown that the fair market value of the easement exceeded the amount they received from the sale. Specifically, the IRS contended that the payment the Brownings received was in line with what the county generally paid for easements, and that the record of such comparable sales was sufficient to fix the value of this easement. Since there is a substantial record of easement sales in Howard County, the IRS argued, the usual before-and-after appraisal technique is unnecessary and inapplicable.

The Tax Court rejected the IRS view, and, based upon its review of the appraisals, allowed the Brownings a deduction of \$209,000 (instead of the \$289,000 they claimed). Under the regulations governing easement contributions (Reg. Sec. 1.170A-14(h)(3)(i)) the before-and-after appraisal technique is to be used if there is "no substantial record of market-place sales." The sales under the Howard County program are not determinative of value because that is an inhibited market: those sales are not "market-place" sales and the price paid by the county is not a "fair" market value, said the Court.

One contention raised by the IRS (and roundly rejected by the Tax Court) was especially significant for charitable gift planners. The IRS argued that the value of the charitable deduction (presumably the resulting tax saving) must be subtracted from the fair market value of the easement to determine the value of any gift to the county. The Court rejected this out of hand, pointing out that Reg. Sec. 1.170A-1(c)(1) states specifically that the amount of a charitable contribution of property is the fair market value of the property.

#### **How to Contribute Rule 144 Stock to a Private Foundation**

**LR 9746050.** As a general matter, a contribution of property to a private foundation produces a deduction that is limited to the donor's tax basis in the property. This general rule is inapplicable to a gift of qualified appreciated stock (QAS) under the off-again, on-again rule that was most recently extended in the 1997 Act. A contribution of such stock will produce a fair market value deduction for the donor.

Qualified appreciated stock is stock for which market quotations on an established securities market are available (and conforming to a few other technical rules not involved here). Where shares of a given corporation are under a restriction, and cannot be readily sold or transferred, they are usually viewed as different from shares of the same corporation that are traded on an exchange. If this is so, they cannot be QAS. This ruling provides a guidebook to donors who would like to contribute such stock to a private foundation.

**[WARNING: TECHNICAL STUFF AHEAD. Don't try this at home without carefully reading the ruling and the applicable law, and/or consulting competent securities counsel.]**

The donor in **LR 9746050** contributed to his private foundation stock in a New York Stock Exchange company. This stock had been received a month earlier in a merger and under SEC Rul. 144, the donor could not sell or dispose of any stock in the corporation in question unless either (1) it is subject to an effective registration statement under the Securities Act of 1937, or (2) pursuant to an exemption. The contributed stock would have been freely transferable on the New York Stock Exchange if it had been registered, but it was not registered. The parties proceeded instead under the exemption in SEC Rule 145.

In order to make the stock fully transferable in the foundation's hands, the donor agreed with the foundation that for as long as the foundation held the stock, neither he, his estate, his trusts or trust beneficiary, or any other successors and interests would make any transfers of the company's shares except under the terms of the agreement with the foundation. Those terms precluded transfers at any time at which such stock, when aggregated with the largest number of shares owned by the foundation in the preceding three months exceeded 1% of the corporation's stock outstanding. Under this agreement and SEC Rules 144 and 145, the foundation could sell its stock on the New York Stock Exchange at any time.

Under these circumstances, the contributed stock was considered listed and available for the donee foundation to sell, so that it fit the QAS definition. The stock was also a capital asset, and did not amount to more than 10% of the corporation's outstanding stock nor violate related prohibitions. Last, IRS concluded, this stock was QAS and the donor could claim a deduction for a contribution to the foundation equal to the full value of the stock.

### **Surgeons Cut Off (and Deduct) Two Divisions**

**LR 9747040.** A partnership consists of several prominent surgeons engaged in hand surgery and microsurgery. Its members proposed to contribute the partnership's orthotics (brace-making and fitting) division and its physical therapy division to a medical research organization (MRO). The MRO works with surgeons and hospitals in designing, implementing and managing clinical and laboratory research programs in hand and microsurgery. It has provided training to over 800 surgeons who practice around the world. The 9 directors of the MRO include 4 of the 8 partners in the donor partnership. The MRO indicated that fulfillment of its exempt purposes requires research and development in the additional areas of post-surgical physical therapy and the development of orthotics and bracing. The donor partnership's divisions are independent of the partnership, although they are not independent legal entities; together these divisions have 20 employees.

The donor partnership proposes to contribute the two divisions to the MRO through a memorandum of gift. The contribution will consist of the assets of these divisions, including employees, equipment, cash and good will. The MRO will assume no liabilities and will accept no property subject to liabilities in connection with the contribution.

The IRS held that the contribution would be deductible by the partnership. However, the amount of the contribution may be reduced under Code Sec. 170(e)(1). That is, the deduction will be offset by the amount of any ordinary income or short-term capital gain that would have resulted had the partnership sold the division instead of contributing it, and by the gain element in any tangible personal property whose use by the MRO is unrelated to its exempt purposes.

### **Other Rulings**

**LRs 9734015 through 9734019.** A charitable remainder unitrust is about to receive a bequest of a majority interest in 2 corporations. The trustee and beneficiary of the trust is a shareholder, director and CEO of one of these corporations. In addition, that person and another individual holding similar positions with the other corporation are both co-executors of the estate from which the stock interest will pass to the charitable remainder unitrust. The IRS held that a merger of the two corporations will not constitute a direct or indirect act of self-dealing. Although self-dealing might otherwise be found to occur, this transaction qualifies under a special exception in Code Sec. 4941(a)(2)(F) permitting certain mergers and other corporate transactions.

**LR 9734020.** Mrs. D created a private foundation and in 1995 died leaving a trust and a will, both providing for transfers to the foundation. Several of her family members brought suit contesting Mrs. D's will and seeking to remove her executor. Now this litigation is to be settled, with a part of the foundation's share going instead to family members with costs to be paid by Mrs. D's estate, the executor's fee to be limited, and various other steps to be taken. The settlement is contingent upon the foundation's obtaining a favorable ruling from IRS. The IRS approved, holding that the foundation's exemption under Code Sec. 501(c)(3) will not be adversely affected and the settlement will not violate the self-dealing rules.

The self-dealing result is provided under Reg. Sec. 53.4941(d)-1(b)(3), governing transactions during the administration of an estate.

### **Why the 10% CRT Rule? Congress Explains**

After each major tax act, the staff of the Joint Committee on Taxation prepares a "General Explanation" of the

Act, popularly known as the Blue Book. The Blue Book on the Taxpayer Relief Act of 1997 was just released. In that work, the following explanation is given for the rule imposed by the 1997 Act requiring that a qualifying charitable remainder trust have at least a 10% charitable share:

"In addition, the Congress was concerned that certain charitable remainder trusts had been created primarily to obtain the tax benefit of the trust's exemption from income tax under Sec. 664(c) and not to provide for charity. The Congress was aware that many charitable remainder trusts where the actuarial value of the charitable remainder interest at the time of creation is insignificant. The Congress believed that requiring that the actuarial value of the charitable remainder interest be at least 10% of any transfers to the trust will insure that any benefit from the creation of charitable remainder trusts be available only where there is a significant benefit to charity."

### **The Pooled Income Fund Gift and the Gift Annuity: Which is Appropriate?**

**By Douglas E. White**

For several years now, many charities throughout the United States have experienced decreasing activity in their pooled income funds. In large part, this is because donors and charities have seen pooled income funds pay less and less over the last decade with little or no growth. Balanced funds that regularly produced incomes of 8% and 9% in the 1980s now produce yields of approximately 4% to 5%, and many even less than that. Growth oriented funds produce even less. Disappointing results - or results that are perceived as disappointing - have led to less and less marketing of funds, fewer gifts, and an overall sense that this form of planned gift is not very attractive to many donors.

At the same time, charities have seen an increase in gift annuities. The primary observation that many development professionals make is that gift annuity rates are high relative to current pooled income fund yields - the American Council on Gift Annuities (ACGA) recommends payouts of up to 12% for annuitants 90 years old and older - with a significant part of the annual annuity returned tax-free; this, in contrast to the all-ordinary income from a pooled income fund that is most likely to pay less income. Also, the income tax deduction using similar payout assumptions is often higher for a gift annuity, especially for younger donors. In addition, the administrative costs associated with a gift annuity program are usually less expensive than those of a pooled income fund.

It would be easy to conclude that pooled income funds are less attractive than gift annuities, that for those charities that want to market life-income vehicles that encourage smaller gifts than those used to establish charitable trusts the lowly pooled income fund should be abandoned.

But that would be a mistake. The gift annuity and the pooled income fund are two entirely different and distinct gift vehicles, and the one should not be confused with the other. Just because the current income from a pooled income fund is less than an annuity does not make the pooled income fund inferior. Each gift has its advantages, and each should be employed in the most appropriate situations. In dealing with donors, charities need to keep in mind that gift annuities are more appropriate for older individuals than younger ones, and that investment strategies for a pooled income fund need to reflect the ages of the fund's income beneficiaries. Also, in analyzing the gifts from a multi-year perspective, charities need to better convey to donors the benefits and differences of each type of gift. The characteristics of each are very different depending on whether they are seen only from the perspective of the year the gift is made or whether they are seen from a person's expected lifetime.

### **What Affects Pooled Income Fund Payouts?**

The reason pooled income funds seem to be less popular today than they were in the early and mid-1980s is simple: they don't generate as much income as they used to. Income levels from bonds have fallen dramatically during the past 15 years. Many pooled income funds - indeed, many planned giving programs - were born in the mid-1980s. Planned giving professionals who were back then introduced to the way life-income gifts work

had to deal with an historical aberration: high interest rates. Neither before nor since then have interest rates been so high. Because a pooled income fund pays only its net income changes in interest rates directly affect fund distributions. At its current yield of approximately 6% (as of this writing, the yield is actually less), the yield on the 30-year Treasury bond is less than half of what it was in 1982. Because its duration is the longest, the 30-year Treasury bond pays the most of any obligation issued by the federal government. Of course, pooled income funds can have investment grade corporate bonds or even junk bonds that pay more income, but the 30-year bond is a benchmark for long-term interest rates. Weighting a fund with high-income corporate or municipal bonds is not a good answer to the problem. In general, the more a corporate or municipal bond pays, the lower its rating, which means additional risk.

Furthermore, many funds have a portion of their assets invested in equities, or stocks. Although we have seen a dramatic rise in the stock market over the past few years, this does not mean that incomes from stocks in pooled income funds have increased proportionately. In fact, as a percentage of a stock's value, the dividend rates of many companies, especially those found in the Standard & Poor's index of 500 of the nation's largest companies, have actually fallen. Dividend rates of between 0.5% and 2.0% are not uncommon. As a generator of income in a pooled income fund, the stocks of large companies do not have much effect. Thus, pooled income funds are experiencing two problems at once: Low incomes from bond funds and even lower incomes from equity funds. While bond yields have fallen below what they were in the mid-1980s, pooled income funds with a bond, or income, orientation continue to pay more than equity-oriented funds.

Low income levels have led charities to try to solve the income problem by inadvertently creating another problem: They have turned supposedly balanced pooled income funds into income-oriented funds. Since the mid-1980s, the value of many balanced funds (for purposes of this article we mean those with approximately 55% equities and 45% bonds) increased by approximately 100% while the income-per-share stayed about the same. During that same time, bond-oriented funds (those with approximately 15% invested in equities and 85% in bonds) did not grow at all in value while their incomes dropped significantly.

The problem is that while the balanced funds, those with a slight majority of their assets in equities, saw a large increase in value, their incomes have risen only a small amount. And income is, for many donors, the defining measurement of success in a pooled income fund. Many charities, seeing income from their balanced funds stagnate in dollar terms and drop in percentage terms even though principal values significantly increased, shifted the fund's asset mix to include more bonds. They have chased income. While this move increased income levels for the short term, because bonds do not generally appreciate in value, the value of the fund - and its income - will not rise over time. For elderly income beneficiaries this may not be a problem - which is why elderly people ought to be in funds that are income oriented - but for many younger people, those under 75, the strategy to move a pooled income fund to bonds may be a big mistake. As a result of this shift, many funds that are labeled "balanced" are no longer actually balanced. They will not provide the growth in principal (and therefore, potentially, in income) one would expect from a balanced fund. There is also a danger that the pool's investment mix no longer matches the objective described in the pool's charter language, which often speaks to some expected growth in principal. In many cases, from an investment perspective, the balanced pool is now indistinguishable from an income-oriented pool.

### **The Age Of The Beneficiary Is Key**

This leads to the question of who should be a pooled income fund beneficiary. The answer depends in large part on the investment objective of the fund. Putting a 55- or 60-year-old in an income-oriented fund is generally unwise: Little growth can be expected while the income and the ultimate gift value will drop against inflation. The 55-year-old should ideally be placed in a growth or balanced fund because, even though the current income is lower than that generated by a bond-oriented fund, the income will most probably grow more quickly.

Charities need policies that guide income beneficiaries of certain age groups to pooled income funds with appropriate investment objectives. Ideally, charities with enough donors should have three funds. Below is a chart of suggested age ranges that correlate with the three broad pooled income fund investment objectives:



Donor Ages:	Type of Fund	Approximate Asset Mix (Stock/Bond in %)
Under 60	Growth	70/30
60-75	Balanced	55/45
75 and above	Income-Oriented	15/85

Ideally, pooled income funds should also be structured to age with their donor pool. When the bulk of the donors in the fund reach an age break, the fund should shift its investment emphasis. For example, when the bulk of the donors in the growth fund reach their early to mid 60s, the fund should shift to a balanced investment objective. Then, when they reach their mid to late 70s, another shift should be made, this time to an income-oriented objective. Charities should try to link the ages of income beneficiaries with the investment objective of the fund to which the donor makes a gift. Taking care to align beneficiaries, based on their ages, with the appropriate fund balances the income and growth needs of the beneficiaries and reduces the volatility of the income as beneficiaries age.

An extension of this thinking is that since an income-oriented fund will not grow much during the lifetime of the most appropriately aged beneficiaries, people in their mid-70s and older who make a life-income gift would probably prefer the higher income provided by a gift annuity. Even the most bond-oriented pooled income fund will generally not pay as much current income as a gift annuity.

### Gift Annuity Payouts

The gift annuity's flat dollar payout is not dependent on the income generated by its investment. In fact, the IRS prohibits annuity payments from being based on how, or even whether, the gift asset is invested. The annuity's security is based on the assets of the charity. Although most programs of any size create their own pools of gift annuity assets, either in their endowments or separately, annuity payments are secured by more than those pools. This is a fundamental difference between gift annuities and all other life-income gifts. Also as with commercial annuities, a gift annuity payment is assumed to provide some return of principal. This means that the contrast with a pooled income fund payment, the difference is even more stark: all income from a pooled income fund is taxed at ordinary rates. Therefore, donors know, at the time of the gift, not only the amount of annual payout they will receive for the rest of their lives, but also how it will be taxed.

### The Right Age For Gift Annuitants

Determining the right age for gift annuity donors is simpler than for pooled income fund donors. Because of the inflation erosion of a flat dollar income, only elderly donors - generally 75 and older - should make gift annuity gifts. From an actuarial perspective the inflation erosion of a flat income will not affect this group of people very much. As noted earlier, donors in their late 70s and older probably would not make a gift to the pooled income fund because it will pay less than a gift annuity with little opportunity for growth, and may see their already comparatively lower incomes decrease if interest rates fall.

The chart below shows the following information for a \$10,000 cash gift by a 77-year-old person to establish a gift annuity and a gift to an income-oriented pooled income fund: initial income, deduction, and the expected nominal and inflation-adjusted income at the end of 11 years (about the life expectancy of a 77 year old person).

	Pooled Income Fund	Gift Annuity
Payout in %	5.0%	8.8%
Initial payout in dollars	\$ 500	\$ 880
Deduction	\$6,122	\$4,530
Expected annual		

income in 11 yrs.	\$ 558	\$ 880
Inflation-adjusted income in 11 yrs.	\$ 403	\$ 636

(The following assumptions have been made: the pooled income fund's highest rate of return during the last three years is 6%; its growth is 1%; the Charitable Mid-Term Federal Rate used in calculating the gift annuity's deduction is 7.2%; and inflation is 3%.)

Clearly, the gift annuity wins the income contest. To make the comparison even worse for the elderly pooled income fund donor, over half the payout from the gift annuity is tax-free until the end of the person's life expectancy, while all of the income from a pooled income fund is taxed at ordinary rates. The slightly higher deduction from the pooled income fund gift in this example generally is not a persuasive factor. Even though the percentage of erosion of the initial income is higher for the annuitant (28% for the gift annuity versus 20% for the pooled income fund) it is not so severe as to provide less than the payment from the pooled income fund. For a 77-year-old who will receive income for life, the gift annuity is superior to even a pooled income fund with a bond orientation.

But for younger people this is not true. For a 60 year old, for example, because a flat or constant annuity payment loses its purchasing power, a gift annuity is significantly less appealing than a properly structured pooled income fund gift. A 60-year old with the same \$10,000 gift should almost always make a gift to a pooled income fund with a growth orientation initially. Furthermore, even though few funds have been designed with this in mind, the fund ideally should mature with its donor pool; that is, become more income oriented over time. In the chart below, the fund changes investment objectives over a 25-year period, the approximate life expectancy of a 60 year old person. For the first five years it is a growth fund, for the next 15 years it is a balanced fund and for the final five years it is an income-oriented fund. During that same time, of course, the nominal income from the gift annuity remains constant.

	Pooled Income Fund	Gift Annuity
Payout in %	3.0%	6.9%
Initial payout in dollars	\$ 300	\$ 690
Deduction	\$ 4,914	\$ 3,240
Expected annual income in 25 yrs.	\$ 1,066	\$ 690
Inflation-adjusted income in 25 yrs.	\$ 509	\$ 330

(The following assumptions have been made: the pooled income fund's highest rate of return during the last three years is 4%; its appreciation is assumed to be 5% for 5 years, 3% for 15 years and 1% for the remaining 5 years; the Charitable Mid-Term Federal Rate used for the gift annuity is 7.2%; and inflation is 3%.)

One key observation is that the inflation-adjusted payout from the pooled income fund is actually higher than the initial payout. This is due to the combination of built-in nominal income growth and extra growth in the early years of the fund. If the fund began with and maintained a balanced investment objective over the entire 25-year period, the inflation-adjusted income in the final year would be lower than shown, but the income in the early years would be more. Nevertheless, the total income and the final year's income from the pooled income fund that is invested for growth will be superior to the gift annuity for the younger donor.

### Distinct Audiences

Pooled income funds and gift annuities serve different purposes. They are often grouped together from a marketing perspective because each generally accepts gifts of smaller sizes than are appropriate for charitable remainder trusts. But that is their only similarity. Broadly, properly structured pooled income funds best serve

a younger audience of donors while gift annuities serve an older audience. If young donors make gifts to a pooled income fund, that fund should be invested to include a growth component.

The problem lies mainly in understanding the complexities of a pooled income fund; gift annuities are relatively easy to understand, even though too many development professionals ignore the erosion of the purchasing power of a flat annuity income. The pooled income fund is more complex because its income is based on investment strategies that change with each charity and each fund. The only way to compare the benefits of the two forms of gifts is to analyze not only the immediate income that is generated, but also the investment strategies of the fund and the life expectancies of the income beneficiaries.

### **The IRS Speaks on Deferred Annuities, But What Did It Say?**

Since at least 1996, the IRS has cast a suspicious eye on the use of limited partnership units and the use of variable and/or deferred annuities in charitable remainder trusts to artificially control the distribution of income to the income beneficiary of a NIMCRUT. In fact, such "abusive manipulations" were the primary target of action for the IRS in its fiscal year 1997 business plan in the charitable remainder trust area.

In Rev. Proc. 97-23, amplifying Rev. Proc. 97-3, the IRS indicated that it was studying the issue of annuities and limited partnership interests in NIMCRUTs, and that it would issue no further rulings on these types of transactions until the study was complete. Simultaneously, in the CRT proposed regulations issued April 18, 1997, the IRS asked for public comment on this issue.

Now, in an as yet unpublished Tax Advice Memorandum, the IRS has ruled on a NIMCRUT containing a deferred annuity. Already, much is being made of the ruling, which was favorable for the taxpayer. However, the ruling, while welcomed, may mean less than it first appears.

The facts of the ruling involved an individual who put a portion of his shares in his closely-held business in a NIMCRUT. Later, the business was sold, and the trust received cash proceeds of the sale of its stock. Realizing that a five-year noncompetition provision would give the trustor all of the income that he would need for that period of time, deferred annuities were purchased to postpone the receipt of income from the trust by the trustor until the five-year noncompetition period ended.

Originally, the trustee of the trust was the trustor's nephew. When the annuity contracts were purchased, a lawyer trusted by the parties had become trustee and in fact signed the applications for purchase of the deferred annuities. After the purchase of the annuities, the nephew became trustee again.

The IRS examined two issues: application of the self-dealing rules, and the issue of income deferral. Obviously, the primary issue of concern was the self-dealing issue.

The IRS noted that the trustor, as a disqualified person, is entitled to receive the income interest from the trust. Consequently, the IRS stated it was difficult to argue that the disqualified person received an inappropriate benefit by deferring the income interest, particularly where Sec. 664 permitted the deferral. Specifically, the ruling states that "accordingly, these uses (the use of the income on a deferred basis for the trustor) must be permitted under the income exception of Section 4947(a)(2)(A) unless the disqualified person controls the investment decision and uses this control to unreasonably affect the charitable remainder beneficiaries' interest."

Further, the IRS states that "since charitable remainder trusts by their intrinsic nature provide for the continuous use by the disqualified person of the entire trust corpus, we conclude that the presence of an unreasonable effect on the charitable remainder interest distinguishes a permissible use of trust assets from an impermissible use."

The ruling goes on to state that "in addition to failing to show harm to the charitable remainder interest, the facts of this case do not clearly show control by the disqualified person. The trust represented that an

independent attorney/trustee signed the contract to purchase the deferred annuity policies. Moreover, even if we conclude that the nephew, as trustee, purchased the deferred annuity policies, the facts are insufficient to demonstrate that the trustor usurped control from the trustee or that he could compel or influence the trustee to purchase the deferred annuity policies in question. Instead, the trustee merely took into consideration the particular financial needs of the trustor before investing the proceeds in the sale of the trust assets."

Finally, with regard to what is "income" for trust purposes, the IRS notes that Section 643(b) constitutes the definition of income under Reg. Sec. 1.664-3(a)(1)(b)(i). That section provides that for Section 664 purposes, among others, the term income, when not preceded by the words taxable, distributable net, undistributable net, or gross means the amount of income of the estate or trust for the taxable year determined by the terms of the governing instrument and applicable local law. Here, the trust's governing instrument uses the definition of income under Sec. 643(b) to define income. Therefore, the applicable state law defines the trust's income. The applicable state law, which is a version of the Uniform Principal and Income Act, appears ambiguous as to whether a trust's right to receive money is income to the trust whether characterized as principal or income. However, the IRS held that the implications from the relevant sections of state law that define income and principal indicate that the trust does not receive either until the trust actually receives possession of money or other property. Consequently, the trust's right to receive either the cash value or the surrender value of the contract does not create trust accounting income under Sec. 643(b) of the Code.

This case is good news for people using variable and/or deferred annuities in NIMCRUTs. The question is how much relief does this letter ruling indicate? First, we note that a Technical Advice Memorandum (TAM), like a letter ruling, is nonprecedential. Furthermore, in Rev. Proc. 97-23, the IRS specifically said that its moratorium on rulings with regard to annuities and limited partnership units in NIMCRUTs would not apply to TAMs which must be issued to agents in the field seeking guidance on such complex issues. Furthermore, the italicized portions of the ruling above indicate that this ruling may very well be limited to its facts. The ruling notes that the facts of the case do not clearly show control by the disqualified person. Consequently, it could clearly be argued that where control by the disqualified person is clearly shown, the self-dealing application implied by the IRS over the past two years could well be found. Furthermore, the ruling has as its central premise that an independent trustee sign the contract to purchase the deferred annuity policies and for that matter performed other duties that could otherwise invoke self-dealing. It is clearly implied that the lack of an independent trustee, or the lack of other clear evidence showing that the trustor did not usurp control from the trustee or that the trustor could compel or influence the trustee to purchase the deferred annuity policies in question was critical to the ruling. Consequently, this ruling indicates that an independent trustee such as the attorney here or a charity may be required if the parties are to avoid the self-dealing stigma that the IRS has dangled over such transactions for over two years.

Obviously, this ruling does give some indication that flexibility may be employed by the IRS in dealing with manipulation where that manipulation is not extreme and where it is reasonable under the circumstances and where the facts do not belie an independent trustee acting with regard to the annuities or limited partnership interests or portray clear independence on the part of the trustee in some other fashion from the trustor. All of these may be very difficult to show in many cases, and the findings of the IRS in this TAM may very well still be mooted by the IRS in its ultimate statement on these issues following the completion of the ongoing examination of the use of annuities and limited partnership units in NIMCRUT.





# STATE REGULATIONS OF GIFT ANNUITIES

## FILING AND REPORTING REQUIREMENTS FOR CHARITABLE GIFT ANNUITIES IN ALL 50 STATES

As Reported by the State Regulations Committee,  
American Council on Gift Annuities

Effective: 8-1-98

*Presented by*

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**STATE REGULATIONS REPORT  
of the  
STATE REGULATIONS COMMITTEE  
of the  
AMERICAN COUNCIL ON GIFT ANNUITIES**

**SUMMARY OF CHARITABLE GIFT ANNUITY (CGA) STATE  
REGULATIONS**

**As of APRIL 20, 1998**

<b>I</b>	CGAs are <b><u>REGULATED. Permit issued/regulated</u></b> by State Insurance Dept. AR CA* HI MD* NJ NY ND* OR* WA* WI	(10)
<b>II</b>	State Law <b><u>provides for CONDITIONAL EXEMPTION from regulation</u></b> of CGAs AL* AZ* CO* FL* ID* IL KS MN* MO* PA* SD TX* VA*	(13)
<b>III</b>	State Law grants <b><u>BLANKET EXEMPTION from regulation</u></b> of CGAs. IN KY LA MA ME MI NE OH SC UT	(10)
<b>IV</b>	State Law <b><u>does NOT specifically address CGAs</u></b> in its state insurance/securities laws. AK CT DE DC GA IA MS MT NV NH NM NC OK RI TN VT WV WY	(18)
----- Total		(51)

- Notes: \* - 15 states require State Specific Disclosure Statement in annuity agreements
- All - Federal Law (Public Law 104-62) also requires charity to supply a Gift Annuity Disclosure Statement to all annuitants in Fund and to all prospective donors prior to their making their first annuity gift (Effective 3-7-96). This is separate from state mandated disclosure language required in gift annuity agreements of some (presently 15) states.

**IA- CGAs are Regulated (10 States)**

State	Years in Operation	Board Resolution	Disclosure Statement	Reserve Required	Annual Filing (f)	Investment Limitations	State Code Section Nos.
AR	5	Yes		Yes (d)	Yes	Less strict	23-63-201(d)
CA	10	Yes	(5)	Yes (e)	Yes	Strict	11520-11524
HI	10 (a)			Yes	Yes		431: I - 204
MD	10 (b)		Yes	Yes	Yes	Less Strict	487
NJ	10	Yes	(4)	Yes (d)	Yes (h)	Strict	17B:17-13.1
NY	10	Yes	(4) (6)	Yes (d)	Yes (g)	Most Strict	1110
ND			(1) (5)	Yes	Yes		26.1-34.1
OR	20 (c)		Yes (1) (2)(5)	Yes	Yes		731.704-724
WA	3		(1)(2)(3)(5)	Yes	Yes		48.38
WI	10		(1)	Yes (d)	Yes	Less Strict	615.03 - .15



Notes:

- (a) - In Hawaii and \$5 million in assets in the state. Pending legislation allows assets to be in or outside of Hawaii if assets total \$10 million.
- (b) - In MD, charity must have "physical presence" in state (excluding fund raising). Periodic seminars in homes of MD residents would qualify.

**IA- CGAs are Regulated (10 States) Notes continued**

- (c) - In OR and if non-profit is a certain type of charity (See OR Permit Application paperwork for categories that qualify). OR now allows both Immediate and Deferred Payment Gift Annuities as of 12-01-95.
- (d) - Rules apply to Reserves for all annuitants in all states (the entire Reserve Account).
- (e) - For CA annuitants only: California wants separate Trust Account for CA annuities. For "foreign" (outside of CA) charities, trust account for CA annuitants may be outside of California. Law changed 1994, effective 1-1-98.

**IA- CGAs are Regulated - - (Notes - Continued)**

- (f) - Charity report activity of annuity fund within 60-90 days of the end of calendar or fiscal year (varies by state). NY is 60 days. In most other states, Annual Report is due in 90 days.
- (g) - Charity to report fund activity by March 1 for Calendar Year report.
- (h) - Charity to report fund activity by April 1 for Calendar Year report.
- (1) - Age of annuitant(s) must be shown in agreement.
- (2) - Agreements must be sequentially numbered (show in upper right corner). [Suggested for all gift annuity agreements.]
- (3) - Corrective action required if age or sex if annuitant is wrong.
- (4) - NY Insurance Law: Prohibits real estate to be accepted for a gift annuity.

NJ Insurance Dept.: Does not allow charity to invest in or hold real estate in Gift Annuity Fund.

- (5) - Reasonable Commensurate Value must be shown in body of agreement (same size type as agreement).
- (6) - Contract is governed by the laws of the state of residence of annuitants; except that NY law will prevail if that state has laws less restrictive than NY. (Consider adding similar wording to all agreements where domicile of charity and state of residence of annuitant(s) both claim jurisdiction, that the most restrictive rules will govern the administration of the gift annuity agreement.)

**IB - CGAs are Regulated**

**Fees Payable to State**

State	Minimum Reserve Required	Reserves Reduced by Reinsurance	Initial Filing	Annual Filing	Per New Agreement
AR	\$ 100,000	Yes			
CA	\$ 100,000	Yes	\$ 2,880	\$ 92	\$ 60 (10)
HI					
MD	\$ 100,000	Yes			
NJ	\$ 100,000 ( 7 )	Yes			
NY	\$ 100,000 ( 8 )	( 9 )			
ND			\$ 100		
OR	\$ 100,000		\$ 250	\$ 50	
WA	\$ 100,000		\$ 25	\$ 25	\$ 5
WI	\$ 100,000	Yes	\$ 200	\$ 50	

Notes:

- All - Special Permit/Certificate of Authority needed by charity and issued by state. Annual Report of Activity of Gift Annuity Fund to be filed with all states (except for ND). Charity must file Gift Annuity Rates and Forms of Gift Annuity Agreements with the State.
- ( 7 ) - \$100,000 plus actuarially calculated Reserve for all gifts, including 10% Excess Reserve.
- ( 8 ) - NY Law requires charity to file for Permit once Required Reserve (including 10% Excess) totals \$80,000 or more. Minimum Reserve to be maintained is \$100,000.
- ( 9 ) - Charity may reinsure any annuity gift over the Required Reserve of \$100,000, but only by using a "treaty" (negotiated) agreement with an insurance company licensed in NY.

**IB - States are Regulated (Notes Continued)**

- (10) - Fee for first 10 new agreements per quarter. Additional new agreements per quarter are discounted in stages down to \$30 each for more than 40 new agreements. Charity must submit copies of new agreements to CA Insurance Dept.

**II - Conditional Exemption from Regulation** Exemption automatic except for note (k).

State	Years in Operation	Board Resolution	Disclosure in Agreement (r)	Reserve Required	Notice to State	Available Assets	Date Rules In Effect
AL		No	Yes		Yes ( i )		
AZ		No	Yes				04-09-97 (o)
CO	3	No	Yes				
FL	5	No	Yes	Yes	Yes ( k )	\$ 100,000	05-15-96 (n)
ID	3	No	Yes (q)		Yes ( k )	\$ 100,000	
IL	20 (j)	No	Yes			\$2 Million (j)	
KS		No	Yes		Yes ( i )		07-07-95 (p)
MN	3	No	Yes		Yes ( i )	\$ 300,000	1996
MO	3	No	Yes		Yes ( k )	\$ 100,000	
PA	3	No	Yes (l)	Yes		\$ 100,000	12-16-96
SD	5	No	Yes (m)				
TX	3	No	Yes		Yes ( k )	\$ 100,000	09-01-95
VA	3	No	Yes			\$ 100,000	03-31-96

Notes:

- ( i ) - Exemption granted by state's Securities Department.
- ( j ) - Requirements are waived if annuity agreements are reinsured.
- ( k ) - Contact states for forms and instructions (see following pages). Notice must be filed concurrent with writing first annuity.
- ( l ) - Charity must also comply with PA charitable solicitation law. Requires addition of 3/4 page of extra wording in Agreement, including date of incorporation and name of officer from whom annuitant can obtain charity's financial data. Donor must sign agreement.
- ( m ) - - Exemption applies only to South Dakota charities. "Foreign" corporations. (Charities outside of ND do not qualify.) Charity must supply copies of annuity marketing materials.
- ( n ) - FL no longer issues permits. Annual Report of Annuity Fund activity is required after initial notice is given to Florida Insurance Dept.
- ( o ) - Exempt only if state mandated wording placed in agreement. See Arizona Statute Section 20-118.

- (p) - Exempt if KS Securities Laws Section 17-1261 and 17-1262 are met.
- (q) - Provision is in State Law for fine of \$1,000 per agreement for non-compliance.
- (r) - The agreement must be signed by donor and charity. May become a universal requirement among all states with advent of possible passage of Model Act. Donor must sign Disclosure Statement. May be handled by including Disclosure Statement in agreement and having donor sign the annuity agreement.

### III - Blanket Statutory Exemption from CGA Regulation (10 states)

IN KY LA MA ME (s) MI (u) NE (t) OH (u) SC (s) UT

Notes:

- (s) - Must have been in continuous operation for five (5) years.
- (t) - Must have been in continuous operation for three (3) years.  
Sect. 59-1801 to 1803, NE Law. (Effective 3-26-96.)
- (u) - Exemptions are administrative and not statutory.

### IV - State Law is silent on definition and regulation of CGAs (18 states)

AK CT(v) DC DE GA(w) IA(x) MS MT NV NH NM NC OK RI TN VT WV WY

### IV - State Law is silent on definition and regulation of CGAs (18 states) Notes

- Notes - If state law does NOT define a "charitable gift annuity" and either specifically exempt it from regulation or describe how it is to be regulated, the state regulators would be hard pressed to prove that rules for "commercial" annuities also apply. Some states take the position that gift annuities are the same as commercial annuities, and claim jurisdiction over charity.

(v)	CT	- State legislature may soon consider passing legislation to regulate or to exempt gift annuities from regulation. Legislature may hold off until NAIC final draft of its suggested Model Act is completed and approved.
(w)	GA	- statute does not specifically mention gift annuities, but they are believed to be regarded as securities, for which a limited exemption may be possible.
(x)	IA	- Securities Bureau previously granted exemption as a security. That jurisdiction was rescinded under administrative rule, due to federal passage of Philanthropy Protection Act of 1995. Insurance Dept. has not yet decided whether it wants to regulate.

### V - Summary of recent Gift Annuity regulatory changes by year

1995	-	CO IL MD OR TX
1996	-	FL MN MO NE PA VA
1997	-	AZ IA
1998	-	CA ND

## VI - Possible Changes Pending in State Legislatures.. (as of 04-20-1998)

- CT - Possible new legislation, regulating or exempting annuities. Legislature may wait until it sees final version of NAIC suggested Model Act for Gift Annuities due late in 1998.
- HI - Charities may be outside of HI if they have \$10 million in assets in or outside of HI. Change pending in State Legislature. Has passed House and is pending in the (HI) Senate (as of 4-20-98).
- IA - While Securities Bureau has removed itself from jurisdiction, (as of 7-8-97), due to passage of Philanthropy Protection Act of 1995 (Public Law 104-62), the Iowa Insurance Dept. is still reviewing the possibility that they might want to claim regulatory jurisdiction as insurance.
- ND - Presently issues Permits (as of 4-20-98), but is reviewing status in light of the Philanthropy Protection Act of 1995 (Public Law 104-62).

## VII - State Regulations Committee

### State Regulations Committee of the American Council on Gift Annuities

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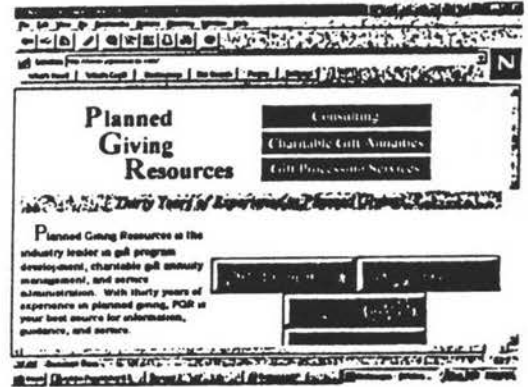
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## WEB SITES FOR GIFT PLANNERS

■ **Planned Giving Resources** is a World Wide Web site containing a free database of state regulations governing charitable gift annuities. Visitors can select a state to check what rules apply for gift annuities in that particular jurisdiction. The site also has a list of sources in each state that can provide more information, along with the latest state regulatory information, contacts for permits, and exemption notices. The site is administered by James B. Potter, a planned giving consultant in Alexandria, Virginia. Planned Giving Resources can be found on the web at [www.pgresources.com](http://www.pgresources.com).



Contact Names for NOTIFICATION to State Insurance Dept.  
that  
Non-Profit will issue Charitable Gift Annuity Agreements

State	Contact	Address	Phone - Fax
Florida *	Jan H. Hamilton	Insurance Examiner Bureau of Specialty Insurers Division of Insurer Services 200 E. Gaines Street Tallahassee, FL 32399-3144	(850) 922-3144, ext. 2446 (850) 488-0313 (fax)
Idaho *	Carol Anderson	Idaho Dept. of Insurance 700 West State Street P.O. Box 83720 Boise, ID 83720-0043	(208) 334-4309 (208) 334-4398
Missouri *	Cindy Moore	Missouri Dept. of Insurance P.O. Box 690 Jefferson City, MO 65102	(373) 751-4362
Texas **	Jackie Robinson	Texas Dept. of Insurance 333 Guadalupe Street P.O. Box 149104 Austin, TX 78714-0104	(512) 305-7270

Notes:

- \* FL and MO provide forms for charity to use in Notification.
- \*\* TX requires notification by letter containing specific information. Copy of draft letter acceptable to TX enclosed with TX information. ID requires notification by letter containing information specified in copy of MO Insurance Law (enclosed).

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Note also...

Notification to State Insurance Dept. is NOT required by CO, PA and VA, but minimum criteria by charity must be met and specific (state mandated) wording added to gift annuity agreements to be exempt from registration as a commercial insurance company.

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NOTE: Please send updates and additions to: James B. Potter, P.O. Box 8300, Alexandria, VA 22306-8300. Or, call (703) 799-8300, Fax 703-799-8318  
E-mail: jimbpotter@aol.com. Web Site: <http://www.pgrresources.com>

## SAMPLE GIFT ANNUITY DISCLOSURE STATEMENT/LETTER

The Philanthropy Protection Act of 1995 requires the charity to notify all existing donors to a Gift Annuity Fund and then (after 3-6-96), to notify all prospective donors to the Fund at the time of the solicitation, using a letter or pamphlet format that provides information similar to the following:

"Dear \_\_\_\_\_:

Thank you for your recent contribution to (name of charity) for a charitable gift annuity. Per the gift annuity agreement, guaranteed payments in the amount of (state amount and frequency of payments) will be paid to (state name(s) of annuitants) for life. If you want to provide a generic statement for the distribution to all gift annuity donors instead of a letter to each individually, the second sentence of this paragraph could read as follows: *Per the gift annuity agreement, guaranteed payments of the amount indicated will be made to named annuitants for life.*)

These payments are a general obligation of our organization, and they are backed by all of our assets. At (indicate date) our total invested funds exceeded \$\_\_\_\_\_ (indicate book or market value), and they are invested (describe the general types of investments held by the organization, such as stocks, bonds money market funds, and federal obligations, but do not list assets by name.) (If you offer gift annuities in states that require maintenance of a segregated reserve fund, you should add the following sentence to this paragraph: *We also maintain a gift annuity reserve fund valued at more than \$\_\_\_\_\_ that is invested in accordance with the laws of the states in which we offer gift annuities.*)

The (name of charity) was established in (indicate date). Responsibility for governing the organization is vested in a Board of \_\_\_\_\_ comprised of \_\_\_\_\_ persons, who are (describe manner of selection).

Common investment funds managed by our organization are exempt from registration requirements of the federal securities laws, pursuant to the exemption for collective investment funds and similar funds maintained by charitable organizations under the Philanthropy Protection Act of 1995 (P.L. 104-62). Information in this letter is provided to you in accordance with the requirements of that Act.

We would be pleased to provide any additional information at your request.

Sincerely yours,"

.....  
Note: The above Disclosure Letter assumes that the gift annuity has already been created. In the financial illustration or proposal letter given to the donor prior to making the gift, we recommend language such as the following be included:

"With a gift annuity, you simultaneously make a charitable gift and provide guaranteed payments for life to yourself and/or another person. The fact that you are making a charitable gift may entitle you to income, gift and estate tax deductions.

"However, because a charitable gift is involved, the annuity rates offered by (name of charity) are lower than those available through commercial annuities offered by insurance companies and other financial institutions."  
.....

The Philanthropy Protection Act of 1995 (Public Law 104-62) requires that ALL participants in a charity's Gift Annuity Fund be notified (once) after 12-8-1995 and by 3-7-1996 with a Disclosure Statement similar to the above draft letter.

Also, all new prospective donors to the Charity's Gift Annuity Fund be provided with disclosure information like the above, once prior to their making the gift.

# Charitable Gift Annuities Model Act

The National Association of Insurance Commissioners (NAIC) is working on a draft of suggested wording for a Uniform Code for Gift Annuities that each state legislature would be asked to pass, so that the regulation of charitable gift annuities and the public charities that issue them would have a standardized approach to such regulation. The draft shown below is the version (as of 03/98) that is presently being reviewed by the Insurance Commissioners in all 50 states and the District of Columbia. The NAIC is expected to approve some version of this draft legislation at its meeting in mid June, 1998. It is contemplated that some edits may be made before adoption of the final wording. The NAIC committee that worked on this draft was only given the responsibility of drafting regulatory language to submit to the state legislatures. See also the next section for a draft of a Charitable Gift Annuity Exemption Act, so state legislatures will have a choice to pass either regulatory legislation or exemption legislation. The NAIC suggested uniform regulatory legislation draft follows:

Draft: 3/17/98 Adopted by the Life Insurance (A) Committee of NAIC

- Section 1. Scope
- Section 2. Definitions
- Section 3. Certificate of Authority
- Section 4. Surplus and Reserves
- Section 5. Investments
- Section 6. Annual Reports
- Section 7. Examination
- Section 8. Filing of Contracts
- Section 9. Disclosure
- Section 10. Other Applicable Code Provisions
- Section 11. Severability
- Section 12. Effective Date

## **Section 1. Scope**

This Act applies to Charitable gift annuities issued by charitable organizations as herein defined and shall be known as the Charitable Gift Annuity Act.

## **Section 2. Definitions**

- A. (1) "Charitable gift annuity" means a transfer of cash or other property by a donor to a charitable organization in return for an annuity payable over one or two lives, under which the actuarial value of the annuity is less than the value of the cash or other property transferred and the difference in value constitutes a charitable deduction for federal tax purposes.

(2) "Charitable gift annuity" does not include a charitable remainder trust or a charitable lead trust or other similar arrangement where the charitable organization does not issue an annuity and incur a financial obligation to guarantee annuity payments.

B. "Charitable organization" means an entity described by:

(1) Section 501(c)(3) Internal Revenue Code of 1986 [26 U.S.C. Section 501(c)(3)1; or

(2) Section 170(c), Internal Revenue Code of 1986 [26 U.S.C. Section 170(c)]

### **Section 3. Certificate of Authority**

A. A charitable Organization shall not receive a transfer of property, conditioned upon its agreement to pay an annuity to the donor or other annuitant unless and until it has obtained from the commissioner a certificate of authority to issue gift annuities.

B. A charitable organization shall file with the commissioner its application for a certificate of authority. The application shall be in a form prescribed and furnished by the commissioner and shall be verified by two (2) of the applicant's officers. The application shall include or be accompanied by such proof as the commissioner may reasonably require that the applicant is qualified Under this Act. At the time the application is filed, the applicant shall pay to the commissioner the applicable filing fees as specified in [insert citation].

C. If after such investigation as the commissioner deems advisable, the commissioner finds that the applicants in sound financial condition and is otherwise qualified, the commissioner shall issue to the applicant a certificate of authority. If the commissioner does not so find, the commissioner shall deny issuance of the certificate of authority and notify the applicant in writing stating the reasons for denial.

D. The certificate of authority of a charitable organization issued under this act shall continue until suspended or revoked by the commissioner or terminated by the organization subject to continuance each year by payment on or before March 1, of the continuance fee of \$ [insert amount] and filing of the annual report.

E. A person acting on behalf of a charitable organization to solicit the transfers of property in exchange for annuity payments shall not be required to be licensed; however the person shall be authorized in writing by the charitable organization to act on its behalf. The charitable organization shall keep a file of current written authorizations.

### **Section 4. Surplus and Reserves**

A. A charitable organization authorized by this Act shall maintain a segregated account for its charitable gift annuities. The assets of the account are not liable for any debts of the charitable organization other than those incurred pursuant to the issuance of charitable gift annuities. The assets of the account shall at least equal in the -sum of the reserves on its outstanding annuities plus a surplus of ten percent (10%) of the reserves.

B. 1. Reserves on the outstanding snnuities shall not be less than reserves calculated using:

a. The Commissioner's Annuity Reserve Valuation Method as defined in [insert citation to the state standard valuation law];



b. Any mortality table permitted under (insert citation to the state standard valuation law) to be used in determining the minimum standard for the valuation of individual annuities issued during the same calendar year as the charitable gift annuity; and

c. An interest rate 100 basis points less than the maximum interest rate permitted under [insert citation to the state standard. An interest rate 100 basis points less than the maximum interest rate permitted under [insert citation to the state standard calendar year as the charitable gift annuity.

2. In determining the reserves, a deduction shall be made for any portion of the annuity risk that is reinsured by an authorized insurer or reinsurer. For this purpose, and annuity contract purchased from an authorized insurer or reinsurer by the charitable organization is considered to be "annuity risk reinsured."

C. The general assets of the charitable organization shall be liable for annuity agreements to the extent that the segregated account is inadequate.

### **Section 5. Investments**

The segregated assets shall be invested in the same manner and subject to the same investment laws applicable to domestic life insurers in [insert section].

### **Section 6. Annual Reports**

A. A charitable organization authorized under this Act shall annually file a report verified by at least two (2) principal officers with the commissioner covering the preceding fiscal year. The report is due ninety (90) days after the close of the charity's fiscal year or at a later date approved by the commissioner.

B. The report shall be on forms prescribed by the commissioner and shall include:

1. A financial statement of the organization, including its balance sheet and receipts and disbursements for the preceding year;

2. Any material changes in information;

3. The number of gift annuity contracts issued during the year, the number of gift annuity contracts as of the end of the year and the number of gift annuity contracts that terminated during the year;

4. The amount of annuity payments made during the year and the amounts transferred from the segregated account to the general account during the year; and

5. Other information relating to the performance of the charitable gift annuity segment of the charitable organization necessary to enable the commissioner to:

(a) Issue certificates of authority;

(b) Ascertain maintenance of records;

(c) Evaluate solvency;

(d) Respond to consumer complaints;

and

(e) Conduct hearings to determine compliance with this Act.

C. A copy of a report containing the information required in Subsection B that has been filed in the state of domicile of the charitable organization will be deemed to satisfy the requirement of this section. The commissioner shall have the authority to request additional information.

## **Section 7. Examination**

Whenever the commissioner determines it to be expedient, the commissioner may make or cause to be made an examination of the assets and liabilities and other affairs of the charitable organization as they pertain to annuity agreements entered into pursuant this Act. The commissioner shall keep information obtained in the course of examinations confidential until the examination is completed. The reasonable expenses insured for an examination shall be paid by the charitable organization.

## **Section 8. Filing of Contracts**

A. An authorized charitable organization shall file for information with the commissioner a copy of each form of agreement that it proposes to issue to donors in exchange for property transferred to the organization. (Within [insert number] days the commissioner shall approve or disapprove the proposed agreement forms and shall notify the charitable organization as soon as practicable.)

[Drafting Note: Insert bracketed material in prior approval states.]

B. Each annuity agreement form shall include the following information:

1. The value of the property transferred;
2. The amount of the annuity to be paid to the donor or other annuitant;
3. The manner in which and the intervals at which payment is to be made;
4. The age and sex of the person(s) during whose lives payments are to be made;
5. The reasonable value as of the date of the agreement of the benefits created; and
6. The date that payments are to begin.

## **Section 9. Disclosure**

A. Before accepting the property transferred in exchange for the annuity agreement, the organization shall obtain a signed statement from a prospective donor acknowledging the following terms of the agreement:

1. The value of the property transferred;
2. The amount of the periodic annuity benefits to be paid;
3. The manner in which and the intervals at which payment is to be made;
4. The reasonable value of the agreement and the benefits created; and
5. The date that payments are to begin.

B. In addition to the above disclosure, the charitable organization shall obtain a signed statement from a prospective donor acknowledging that he or she has been informed that payments made under a charitable gift annuity are backed solely by the full faith and credit of the organization and are not insured or guaranteed by an insurance company or backed in any way by the State of [insert state].

C. The requirements of Subsection A and B may be satisfied by an acknowledgement that is part of the annuity agreement that is signed by the donor.

## **Section 10. Other Applicable Code Provisions**

These provisions of the insurance code apply to the transactions covered by this Act:

- A. [insert citation to receivership law];
- B. [insert citation to laws on hazardous financial condition];
- C. [insert citation to laws governing unfair trade practices]; and
- D. [insert citation to laws governing investments].

### **Section 11. Severability**

If any provision of this Act or the application of the provision to any circumstances is held invalid, the remainder of the Act or the application of the provision to other circumstances shall not be affected.

### **Section 12. Effective Date**

This Act shall become effective [insert date] and shall apply to charitable gift annuity agreements entered into on or after the effective date.

© 1998 National Association of Insurance Commissioners 03/17/98 Draft

# **GIFT ANNUITIES SIMPLIFIED MODEL ACT**

## **(Draft)**

Since the National Association of Insurance Commissioners (NAIC) working group ("Life Insurance (A) Committee") was given the charge to draft only legislation wording that would standardize the regulation of Charitable Gift Annuities, a Task Force of nine persons comprised of volunteers from the American Council on Gift Annuities (ACGA), the National Society of Fund Raising Executives (NSFRE), and the National Committee on Planned Giving (NCPG), has drafted suggested wording for a Simplified Model Act. The Task Force suggested draft legislation as follows:

Draft as of 5-05-98

### **CHARITABLE GIFT ANNUITIES**

Section 1. Definitions

Section 2. Exemption from Insurance Laws

Section 3. Notice to Donor

Section 4. Notice to Insurance Dept.

Section 5. Effect of Failure to Provide Notice

Section 6. Not Unfair or Deceptive Trade Practice

#### **Section 1. Definitions**

Sec.1 In this Article:

1) "Charitable gift annuity" means a transfer of cash or other property by a donor to a charitable organization in return for an annuity payable over one or two lives, under which the actuarial value of the annuity is less than the value of the cash or other property transferred and the difference in value constitutes a charitable deduction for federal tax purposes.

(2) "Charitable organization" means an entity described by:

- (A) Section 501(c)(3) Internal Revenue Code of 1986 [26 U.S.C. Section 501(c)(3)]; or
- (B) Section 170(c), Internal Revenue Code of 1986[26 U.S.C. Section 170(c)].

(3) "Qualified charitable gift annuity" means a charitable gift annuity described by Section 501(m)(5), Internal Revenue Code of 1986 (26 U.S.C. Section 501(m)(5), and Section 514(c)(5), Internal Revenue Code of 1986 (26 U.S.C. Section 514(c)(5)), that is issued by a charitable organization that on the date of the annuity agreement:

- (A) has either
  - (i) an unrestricted fund balance, consisting of assets in excess of liabilities, of not less than \$300,000, or
  - (ii) unencumbered assets in it Gift Annuity Fund of not less than \$300,000; and

(B) has been in continuous operation for at least three years or is a successor or affiliate of a charitable organization that has been in continuous operation for at least three years.

## **Section 2. Not Insurance**

(1) The issuance of a qualified charitable gift annuity does not constitute engaging in a business of insurance in this state.

(2) A charitable gift annuity issued before (insert effective date of this statute), is a qualified charitable gift annuity for purposes of this article and the issuance of that charitable gift annuity does not constitute engaging in the business of insurance in this state.

## **Section 3. Notice to Donor**

(1) When entering into an agreement for a qualified charitable gift annuity, the charitable organization shall disclose to the donor in writing in the annuity agreement that a qualified charitable gift annuity is not insurance under the laws of this state and is not subject to regulation by the department or protected by a guaranty association affiliated with the department.

(2) The notice provisions required by this section must be in a separate paragraph in a print size no smaller than that employed in the annuity agreement generally.

## **Section 4. Notice to Department**

(1) A charitable organization that issues qualified charitable gift annuities shall notify the Department's annuities division in writing by the later of 90 days after the effective date of this Act or the date on which it enters into the organization's first qualified charitable gift annuity agreement. The notice must:

(A) be signed by an officer or director of the organization;

(B) identify the organization; and

(C) certify that:

(i) the organization is a charitable organization; and

(ii) The annuities issued by the organization are qualified charitable gift annuities.

(2) The organization shall not be required to submit additional information except to determine appropriate penalties that may be applicable under Section 5 of this article.

## **Section 5. Effect of Failure to Provide Notice**

The failure of a charitable organization to comply with the notice requirements imposed under Sections 3 or 4 of this article does not prevent a charitable gift annuity that otherwise meets the requirements of this article from constituting a qualified charitable gift annuity. However, the commissioner may enforce performance of the requirements of Sections 3 and 4 of this article by sending a letter by certified mail, return receipt requested, demanding that the charitable organization comply with the requirements of Sections 3 and 4 of this article.

## **Section 6. Not Unfair or Deceptive Trade Practice**

The issuance of a qualified charitable gift annuity does not constitute a violation of (include applicable reference to state Business and Commerce Code or the equivalent.)

"5/5/98 Simplified Model Act suggested by the American Council on Gift Annuities (ACGA)"

# NAIC Executive Committee Action

*June 22, 1998*

This is a summary of what Therese Vaughan relayed to me today. She is the Insurance Commissioner of the State of Iowa, Chair of the NAIC committee concerned with annuities (the "A Committee"), and a member of the NAIC Executive Committee.

The Executive Committee at its meeting in Boston on June 22 took this action:

1. Referred the model regulatory act back to the A committee with instructions to address certain issues including calculation of required reserves. I asked her if the investment of gift annuity reserves could also be reconsidered by the A committee, and she said that it could.
2. Instructed the A Committee to draft a streamlined regulatory act that could be presented as an alternative to more full-blown regulation. (We have been referring to this as a "model exemption statute," but, as I noted earlier, Ms. Vaughan and her colleagues are not comfortable with the word "exemption," and they prefer that it be called a "simplified" or "streamlined" regulatory act.) We previously submitted to her the draft of such an act, but the one eventually adopted by the A Committee could be somewhat more restrictive than what we submitted.

Here is the process that will be followed: Ms. Vaughan will reconstitute the Annuities Working Group and appoint a new chair to replace Jerry Fickes, who is retiring this summer. That group will consider these two items and present their drafts and recommendations to the A Committee. Then the A Committee will take action and submit their recommendations once again to the NAIC Executive Committee. Although the Commissioners meet quarterly, it is unlikely that this matter will be ready for consideration by the Executive Committee before March of next year.

In the meantime we can continue to be part of the process and make our views known. Ms. Vaughan will inform me when a new chair is appointed to the Annuities Working Group. We can then communicate with that person, and subsequently with Ms. Vaughan.

It is very good news that the model regulatory act was not adopted and circulated by itself to the various states, for that could have stimulated increased state regulations. It is also very good news that the A Committee has been instructed to develop a model act for simplified regulation such as we now have in many states.

Thanks to all of you who contacted Ms. Vaughan and other commissioners. You were heard, and you have made a difference. From the beginning, the Annuities Working Group under Jerry Fickes' leadership, and then Ms. Vaughan, have been willing to listen to our concerns and work with us. I suggest that you now write a letter to her expressing appreciation for her cooperation with the charitable community. Her address is:

Therese M. Vaughan  
Commissioner  
Iowa Insurance Division  
Lucas State Office Building, 6th Floor  
Des Moines, Iowa 50319

Report submitted by:

Frank Minton  
[PlanGiv@aol.com](mailto:PlanGiv@aol.com)  
Member, State Regulations Committee  
American Council on Gift Annuities







1. On December 1, you receive a call from Bill, who tells you that he and his wife want to establish a charitable gift annuity just for his wife's life. You ask Bill what amount and what type of asset the couple plan to use to fund the annuity. Bill says, "We're going to use some stock I bought in 1996. It has a great deal of appreciation on it." Bill and his wife Wanda live in Illinois, a non-community property state.

Based on the information presented, what two questions should be asked of Bill at this point in order, possibly, to try to help him and Wanda obtain the greatest capital gain tax advantage in creating the annuity?

Notes: (1) The top federal capital gain tax rate for stock held more than 18 months is 20 percent. The top federal capital gain tax rate for stock held more than 12 but not more than 18 months is 28 percent. (2) If an individual uses appreciated stock to establish a gift annuity just for another person, the individual must report all the gain thereby realized under the bargain rules up-front; the gain cannot be *spread*. (3) Husbands and wives can make unlimited gifts to one another free of federal gift and estate taxes, because of the unlimited gift and estate tax marital deductions.

2. This case is a *mess*...but a real-world sort of mess. Also the sort of case one might encounter on a contracts exam in law school.

Twelve months ago, you sent a one-life gift annuity "proposal" to Dora, then aged 70 to the nearest whole year. The proposal was, really, a "plain vanilla" *illustration* of how a \$10,000 *cash*-funded gift annuity would work for Dora. The illustration was based on the then recommended payment rate of 7.7 percent.

Now you receive in the mail a stock certificate and signed stock power from Dora, together with a cover letter stating that she wants to establish a gift annuity "per your previous offer." The stock, which is *very* highly appreciated, is worth about \$32,000.

- a. Does the sending of the stock, stock power and cover letter by Dora constitute an acceptance of an offer made by your organization, so as to form a contract? (Gift annuity agreements are, after all, *contracts*. Contracts are formed, in general, by *offer and acceptance*.)
- b. Based on the facts presented, has *Dora* made an offer to enter in a gift annuity agreement? Would it make a difference if you knew that Dora had previously established one or more gift annuities with appreciated stock? Or if you knew she had never set up a gift annuity before?

- c. In the case of a gift annuity, can there be a completed gift before the date the gift annuity contract is formed? Why is this question important here?

- 3. ABC Charity has its offices in the State of New York, a state that regulates charitable gift annuities. ABC offers gift annuities in almost all states, including 10 states that regulate gift annuities in one way or another.

ABC has an old legal opinion that it need only comply with New York's regulations, because ABC's annuity agreements state that they are governed by the laws of the State of New York.

- a. Does Missouri, for example, have the power (i.e., the constitutional power) to regulate ABC's gift annuity business carried on within its borders?

- b. Does the governing law provision of ABC's gift annuity agreements negate this power?

- 4. Wife wants to use stock that is her own separate property to establish a gift annuity that will make payments just to her for her life and then to her husband Hal, if he survives her, for his life. The stock is worth about \$84,000.

Questions: Does it make sense from a tax planning standpoint for Wife to reserve the power, exercisable by will, to revoke Hal's right to receive the annuity payments? Why? From a tax planning perspective, would it make better sense for Wife to establish a *joint and survivor* annuity agreement for herself and her husband?

Note: Section 2523(f)(6) of the Internal Revenue Code provides:

In the case of a joint and survivor annuity where only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die--

(A) the donee spouse's interest shall [qualify for the gift tax marital deduction]....

5. Sam, aged 72, proposes this plan to your organization: He will give \$100,000 in cash to your organization, with the proviso that if he dies within 2 years of making the gift, your organization will make gift annuity payments to his wife, Alice, commencing as of the date of Sam's death. The annual annuity amount will be the amount Alice would receive under a regular, 2-year deferred payment gift annuity agreement.

Is such an arrangement OK from a federal tax standpoint? Would it allow Sam to claim a federal income tax charitable deduction? Letter Ruling 8213093.

6. With Case #5 in mind, consider this situation: Lucy, aged 79, wants to set up a life income gift plan for the benefit of her son, Fred, aged 51, who is somewhat mentally retarded. Fred is in very good health and is expected to live a normal life span.

Lucy is prepared to fund her gift arrangement with a quite substantial amount of money. She wants to keep down the gift and estate taxes that will be imposed with respect to Fred's income interest(s). She has told you that although she wants to provide Fred with income now and continuing for as long as she lives, her main concern is providing Fred with a source of income following her demise.

Your organization, of course, has a natural interest in receiving a benefit from Lucy's gift arrangement sooner rather than later.

Any thoughts on how to design a gift plan that possibly may meet both Lucy's and your organization's objectives?

7. Actual case: Names and facts changed to protect the innocent. Hugh, aged 78, agrees to establish, and *firmly* intends to establish, a gift annuity using 100 shares of Microsoft and 100 shares of Intel stock. The annuity will make joint and survivor payments to Hugh and his wife Marlene. Hugh has a *very low* cost basis in both his Microsoft and his Intel shares. The shares are his own separate property.

Unfortunately, Hugh's broker is slow in getting the stock transferred. He manages to get the 100 shares of Microsoft transferred to your organization, but before the Intel stock is transferred, Hugh dies.

Marlene wants to go forward with the gift annuity. She is the sole beneficiary under Hugh's will.

Questions: How should this situation be handled? How will this situation play out from a federal tax standpoint?

8. Actual case: Names and facts changed to protect the innocent. Molly, aged 80, works with development officer Kate to establish a gift annuity. Letters are exchanged, and Kate provides Molly with several computer-generated gift illustrations.

At year's end, Molly has \$240,000 worth of highly appreciated stock transferred to Kate's organization to establish the gift annuity.

Kate's organization promptly sells the stock.

In January, Kate receives an angry call from Molly, who says that she is furious. "Why?" Kate asks. Molly tells Kate that she has just met with her accountant, who told her that her federal income tax charitable deduction for creating the gift annuity would be limited to 30 percent of her adjusted gross income. Molly then states, correctly, that none of the correspondence or gift illustrations, nor the 1-page disclosure statement Kate provided, mentioned that Molly's charitable deduction would be subject to limitations. Molly says she thought she'd be able to take her deduction fully for the year she created the annuity.

Molly then says that she feels she is the victim of a misrepresentation, that she has contacted a lawyer, and that she may very well sue Kate's organization.

Questions: Does Molly have a legitimate complaint? What is the best way, probably, for Kate's organization to deal with this situation?

9. Actual case: Names and facts changed to protect the innocent. Sarah, aged 48, calls to tell you that her mother's health is in steep decline; that Sarah holds her mother's general durable power of attorney; and that her mother wants Sarah to use a substantial amount of the mother's assets to establish a gift annuity for two of the mother's long-time friends (aged 72 and 68).

What questions do you want to ask Sarah? How should this situation be handled?

10. A commonly encountered variation on Case #7. Donor firmly intends to establish one gift annuity using *two* different assets -- let's say, Intel stock and Microsoft stock. Donor's broker transfers the Intel stock, which is highly appreciated, to your organization but delays transferring the Microsoft stock.

On the day the Intel stock is transferred to your organization's account, Intel starts to plummet.

Your business office wants to sell it.

- a. At this point in time, is the gift annuity established?

- b. If not, who owns the Intel stock?

Donor didn't intend to give your organization the Intel stock outright, so the fact that your organization has the stock does not establish that your organization owns the Intel stock. Your organization comes to own the Intel stock only when the donor's intention -- which is to establish one gift annuity with the two different stocks -- is carried out on the donor's part.

- c. If the donor owns the Intel stock at this point, what are the tax consequences if your organization now sells the Intel stock?

- d. What is, arguably, the best way to deal with this situation?

11. Problem for discussion. ABC Charity wants to develop a policy and procedure for dealing with stock-funded gift annuities.

- a. One of the issues faced by ABC is when to value stock for purposes of determining the annuity payments -- the date the stock is sent (mailed, wired DTC) or the date the stock is received. What are the pros and cons of these dates?

- b. Another issue faced by ABC arises in situations when the donor wants to receive the gift annuity agreement before sending her stock. ABC cannot fill in the annuity payment amount in the agreement without knowing the value to use for the stock. Any suggestions for how to deal with this situation?
12. One last situation for discussion. XYZ Charity has a policy of using the amount it nets from selling stock to determine the annual annuity payment due the donor who uses the stock to establish a gift annuity.

Is there anything wrong with this policy from a federal tax standpoint?

Note: Once again, it is important to keep in mind that a gift annuity is a contract. Until the contract is formed, the donor's gift is incomplete.







# **23rd Conference on Gift Annuities**

April 14 - 16, 1998

Atlanta, Georgia

***PLANNING  
STRATEGIES UNDER  
THE 1997 TAX ACT***

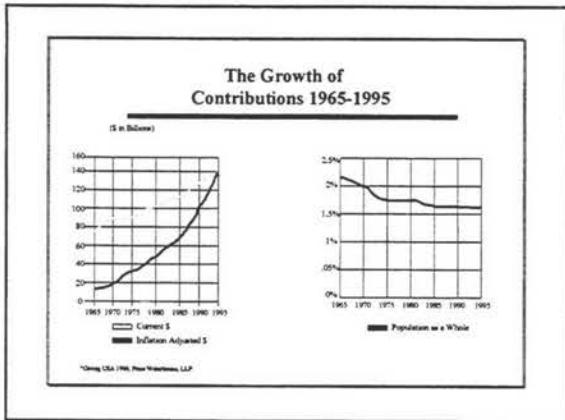
Emanuel J. Kallina, II, Esq.

Kallina & Ackerman

Baltimore, MD 21212

**SECTION I**

***IMPACTS OF TAX  
RESTRUCTURING ON  
CHARITABLE GIVING***




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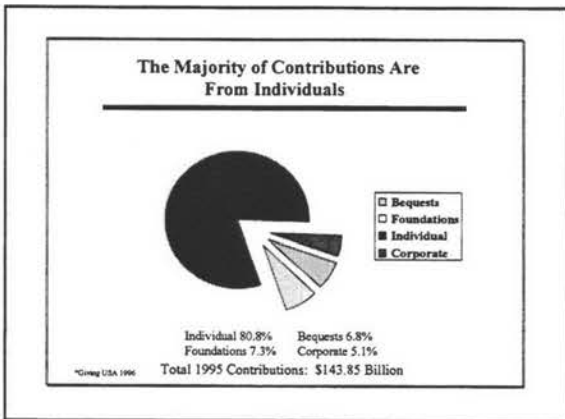
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### Realities for Charitable Tax Restructuring

- ☛ 73% do not itemize
- ☛ 94% with income over \$100,000 itemize
- ☛ 91% with incomes less than \$30,000 do not itemize

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**Realities for Charitable  
Tax Restructuring**

- ☛ "good" vs. "bad" charities
- ☛ commercialism by charities
- ☛ perceived abuses of tax exemption

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**Realities for Charitable  
Tax Restructuring**

- ☛ prior reductions of charitable deduction (3% floor)
- ☛ taxation of charities (S stock)

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**History of Charitable  
Deduction**

1913: Federal income tax enacted

1917: First charitable deduction allows taxpayers to deduct up to 15% of income (coincides with tax rate increase to pay for World War I)

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**History of Charitable  
Deduction**

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**1924:** *Revenue Act of 1924* allows 100% deduction for those who contribute more than 90% of their income

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**History of Charitable  
Deduction**

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**1969:** *Tax Reform Act of 1969* replaces 15%/100% limits with 50% limit for gifts of cash and 30% for appreciated property (current law)

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**History of Charitable  
Deduction**

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**1981-1985:** *Economic Recovery Tax Act of 1981* allows nonitemizers to claim limited deductions (expired in 1985)

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*"This country cannot abandon or impoverish the great structure of private charity and education that has been one of the most notable achievements of American civilization. Therefore, with every additional dollar the government finds it necessary to take in taxation it becomes increasingly necessary to accept the principle of leaving untaxed that part of every citizen's income which he may give voluntarily to the public good."\**

\*Frederick Democrat Senator from New Hampshire Henry F. Wilson speaking in favor of the first charitable deduction in 1917 (The Washington Post, August 25, 1917).

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### **Impact of the Charitable Deduction**

- 27% of households itemize
- those households that itemize make more than 68% of charitable gifts
- in 1995, those who claimed a charitable deduction gave 29% of their income compared to 1.4% for those who did not deduct
- for households with income over \$75,000, itemizers gave 3.0% while nonitemizers gave 0.8%

\*Giving and Volunteering, 1996

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### **Economic Elasticity of Charitable Giving**

- a 10% increase in personal income leads to a 2% to 3% increase in amount of giving

\*Price Waterhouse LLP

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- Economic Elasticity of Charitable Giving**
  - a 10% increase in the after tax cost of giving leads to:
    - a 14.8% decrease in the amount of giving
    - a 4.2% decrease in the likelihood of giving

\*Price Waterhouse LLP

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- Economic Elasticity of Charitable Giving**
  - overall a 10% increase in the cost of giving leads to a 19% decrease in giving

\*Price Waterhouse LLP

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Estimated giving by individuals, estates, and corporations totaled \$120.2 billion in 1996. According to analysis done by the Working Group on Tax Restructuring, total giving in 1996 would have been.....

**\$37.5 billion lower (31% decrease), if the Flat Tax had been in effect**

\*Price Waterhouse LLP

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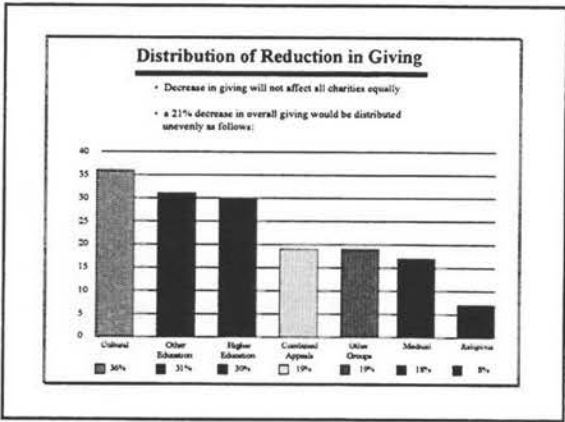
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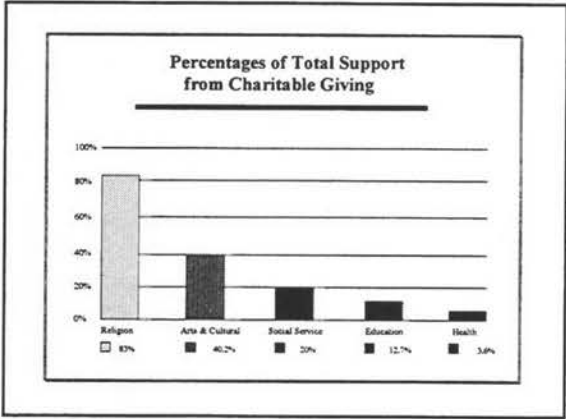
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### CONCLUSIONS

- ① The charitable deduction might be politically difficult to defend because deductions primarily benefit the wealthy
- ② Changes in the tax law that increase the cost of charitable giving will primarily affect wealthier individuals who will react by adjusting their giving
- ③ The poor, the needy and all other beneficiaries of charities will be most directly affected

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**Tax Reform Proposals Overview**

The charitable deduction is only one aspect of potential impact on charities:

FLAT TAX	NATIONAL SALES TAX	USA TAX
Representative Armer	Representatives Schaefer and Tauzin	Senators Nunn and Doinoff
<b>Individual Tax</b>		
flat rate tax on cash wages and other compensation (standard) deduction makes first \$3,400 tax free for family of four	no income tax, but value added tax on sales (special refunds based upon family property or income level)	income tax at progressive rates on income less non-additions to savings (allowance makes first \$16,400 tax free)
eliminates deduction	<b>Charitable Deduction</b> no deduction but contributions not taxed	deduction reduces savings deduction
same as current law	<b>Qualifying for Tax Exemption</b> excludes sports and provision of security to animals and children	excludes social welfare, certain education, child care, public safety and sports

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**The National Committee on  
Planned Giving position  
statement:**

*"The charitable sector promotes and ensures the well-being and vitality of the nation. Reduction in tax incentives will produce catastrophic consequences for the public by crippling the charitable sector."*

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**SECTION II**

***USING VARIABLE  
ANNUITIES IN CHARITABLE  
REMAINDER UNITRUSTS***

***POWERPOINT  
PRESENTATION -  
SPIGOT TRUSTS***

## ***SPIGOT TRUSTS***

NIMCRUTS ARE ALIVE & WELL!

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### **Spigot Trusts - IRS Concerns**

- “We know you are taking advantage of us [the Government], we just don’t know how you’re doing it.”

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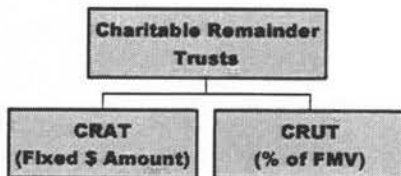
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## **CHARITABLE REMAINDER TRUSTS**



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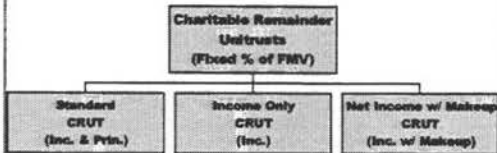
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## CHARITABLE REMAINDER TRUSTS




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## TAXABLE INCOME VERSUS FIDUCIARY INCOME

- Fair Market Value = \$100
- Payout Rate = 7%
- Interest Earned = \$ 5

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### INCOME = \$5

	INCOME	PRINCIPAL	IOU ACCOUNT
SCRUT	5	2	0
IOCRUT	5	0	0
NIMCRUT	5	0	2

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**TAXABLE INCOME VERSUS  
FIDUCIARY INCOME**

- LAND
- FAIR MARKET VALUE = \$100
- 5 YEARS LATER, \$150
- TAXABLE INCOME?
- FIDUCIARY INCOME?

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**TAXABLE INCOME VERSUS  
FIDUCIARY INCOME**

- ZERO COUPON BOND
- FAIR MARKET VALUE = \$60
- 5 YEARS LATER, \$100
- TAXABLE INCOME?
- FIDUCIARY INCOME?

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**TAXABLE INCOME VERSUS  
FIDUCIARY INCOME**

- OTHER ASSETS:
  - COMMON TRUST FUND
  - VARIABLE ANNUITY
  - LIFE INSURANCE
  - PARTNERSHIP

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**Spigot Trusts -  
IRS Concerns**

- Self-Dealing
  - “If it’s good for the donor, it must be self-dealing (because what is good for the donor is bad for the government).”

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**Spigot Trusts -  
IRS Concerns**

- Invalid CRT from the outset
  - Benefits to the donor
    - gift of appreciated assets, tax-free
    - sale of assets, tax-free
    - tax deduction for part of gift

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**Spigot Trusts -  
IRS Concerns**

- Invalid CRT from the outset
  - Benefits to the donor
    - tax-free accumulation
    - income when you need it
    - estate and gift tax exclusion

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**Spigot Trusts -  
IRS Concerns**

- Invalid CRT from the outset
  - In other words, benefits to the donor are too great, so the whole thing must be illegal!

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**Spigot Trusts -  
TAM**

- Role of TAMs in IRS hierarchy
  - PLRs for one donor
  - TAM is opinion of National Office, requested by local

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**Spigot Trusts -  
TAM**

- FACTS:
  - Agents wanted to save money
  - 1990 - 8% NIMCRUT created
    - no special language in trust
    - not an approved insurance company

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**Spigot Trusts -**  
**TAM**

• **FACTS:**

- Closely held stock gifted in 1990
- Independent Special Trustee ("IST") - the only precaution taken
- Stock sold in 1991

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**Spigot Trusts -**  
**TAM**

• **FACTS:**

- Stock reinvested in 2 Annuities on life of H & W
- H & W as Annuitants & not the Trust!!
- Annuity payments delayed to age 80
- 1997 - H & W assigned all rights to CRT (Note: K&A came into the case in 1997)

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #1:**

- "Did naming H & W as annuitants constitute an act of self-dealing?"

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**Spigot Trusts -**  
**TAM**

- Legal Issue #1: Self-dealing with H & W as annuitants
  - Was there a property right?
  - Was there a transfer of property rights to Disqualified Person?
  - Did a Disqualified Person receive a benefit?

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**Spigot Trusts -**  
**TAM**

- Legal Issue #1: Self-dealing for H & W as annuitants
  - Yes, a property right
  - Yes, a transfer to disqualified person
  - But, *NOT* self-dealing because H & W never received anything (no "current benefit" received)

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**Spigot Trusts -**  
**TAM**

- Legal Issue #2:
  - Did the purchase of an annuity constitute an act of self-dealing?

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Purchase of Annuity as Self-Dealing - *Further Facts* cited by TAM:**

- Closely held stock
- 5 year employment agreement & non-compete = no need for income
- attorney (nephew) acted as IST

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Purchase of Annuity as Self-Dealing - *Further Facts* cited by TAM:**

- attorney resigned after sale of closely held stock & purchase of annuities
- H (who was the donor & income beneficiary) became sole successor trustee from 1/15/92 to Present

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Did the IST manipulate the assets of the CRT for the personal benefit of H, "by furthering his [H's] income, retirement & tax planning goals"?**

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Question:**

- "There was a concern that the transaction as a whole; the purchase of a deferred annuity, the failure to make withdrawals from the annuity policies, and the intention to subsequently make unitrust payments to [H] under the make-up provisions of the Trust; could be construed as an act of self-dealing under section 4941(d)(1)(E)...

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Conclusion:**

- "[I]t is difficult to argue that the disqualified person receives an inappropriate benefit by deferring the income interest, particularly where such deferral is permitted under section 664 of the Code."

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Conclusion:**

- "Inherently, any investment decision regarding the trust assets that increases or decreases the amount of payout of this income interest is a use for the benefit of the disqualified person."

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Conclusion:**

- "Accordingly, these uses must be permitted under the income exception of 4947(a)(2)(A) unless the disqualified person controls the investment decision and uses this control to unreasonably affect the charitable remainder beneficiary's interest."

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Conclusion:**

- "Since charitable remainder trusts by their intrinsic nature provide for a continuous use by the disqualified person of the entire corpus, we conclude that the presence of an unreasonable affect on the charitable remainder interest distinguishes a permissible use of trust assets from an impermissible use."

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Conclusion:**

- "In addition to failing to show harm to the charitable remainder interest, the facts of this case do not clearly show control by the disqualified person."

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #2 - Conclusion:**

- "...the facts are insufficient to demonstrate that [H] usurped control from the trustee....  
Instead, the trustee merely took into consideration the particular financial needs of [H] before reinvesting the proceeds from the sale of the trust assets."

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #3:**

- Did the failure to withdraw income from the deferred annuity contracts constitute self-dealing?

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**Spigot Trusts -**  
**TAM**

• **Legal Issue #3: Failure to Withdraw**

- District Office argued that the NIMCRUT had income because it had the right to receive cash

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**Spigot Trusts -**  
**TAM**

- Legal Issue #3: Failure to Withdraw
  - According to the National Office, the NIMCRUT's requirement to pay out a fixed percentage of "income" refers to "fiduciary income," as that term is defined under state law.

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**Spigot Trusts -**  
**TAM**

- Legal Issue #3: Failure to Withdraw
  - "The applicable state law, the Uniform Principal and Income Act of [X], appears ambiguous on whether a trust's right to receive money is income to the trust..."

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**Spigot Trusts -**  
**TAM**

- Legal Issue #3: Failure to Withdraw
  - "The implication from the sections that define income and principal, however, is that a trust does not realize either [income or principal] until the trust actually receives possession of money or other property."

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**Spigot Trusts -**  
**TAM**

- Legal Issue #3: Failure to Withdraw
  - Conclusion: "Therefore, the Trust's right to receive either the cash value or the surrender value of the contracts does not create trust accounting income under section 643(b) of the Code."

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**Spigot Trusts -**  
**TAM**

- Where do we go from here?!
  - Is an IST required?
  - Is damage to the charitable remainder the key?
  - How about other assets inside of NIMCRUTs, such as Partnerships?

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**Spigot Trusts -**  
**TAM**

- Where do we go from here?!
  - What happens if the trust instrument does not define fiduciary income? Are we to assume that the Revised Uniform and Uniform Principal & Income Acts of the various states per se allow the deferral of income unless there is cash?!

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**Spigot Trusts -**  
**TAM**

- Where do we go from here?!
  - Let us assume that, without cash, there is no fiduciary principal or income. If the trust instrument is silent and fails to **QUANTIFY** fiduciary income, does that mean that the appreciation in value of the annuity is allocable to fiduciary income?

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**Spigot Trusts -**  
**TAM**

- Where do we go from here?!
  - What will happen under the Proposed Regulations?
    - When issued, will these Regs be proposed or final?
    - Will they follow the approach of the TAM?
    - Will they clarify issues created by the TAM or those not addressed by the TAM?

FILED UNDER 9901 TAM PLATINUM

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***MEMORANDUM ON  
SELF-DEALING***

## MEMORANDUM ON SELF-DEALING

### Issue #1 - Blind Application of the Self-Dealing Rules Under Code Section 4941(d)(1)(E)

A private foundation (“Private Foundation”) and a charitable remainder trust (“CRT”) are not the same statutory creatures. To name a few distinctions, a Private Foundation is created pursuant to Sections 501(c)(3) and 509 of the Internal Revenue Code of 1986, as amended (“Code”), while a CRT is created under Code Section 664. A Private Foundation requires pre-approval from the IRS pursuant to Form 1023 - Application for Tax-Exempt Status, while a CRT requires no pre-approval process. The tax reporting requirements for each entity are different, and the term of existence of each entity is different. The term for a CRT is statutorily established and any violation of that term will invalidate the qualification of the CRT. A Private Foundation, on the other hand, may have an indefinite term of existence.

*Lastly, and most significantly, a Private Foundation is established solely for the benefit of charitable beneficiaries, but a CRT is established for the benefit of both non-charitable beneficiaries and charitable beneficiaries. Whereas with a Private Foundation, no net earnings of a charity can inure to the benefit of a private person, with a CRT, net earnings must statutorily be paid to a private person.*

Although forms of a Private Foundation and a CRT were already in existence, these common law creatures were enacted into the tax law in 1969 to address different abuses. For instance, a Private Foundation was an entity which would make current distributions solely for the benefit of charity. If a Private Foundation invested its assets solely for growth, it would make no current distributions to fulfill its charitable purpose and thus would subvert the primary purpose for existing. For this reason, laws were passed on minimum distribution requirements under Code Section 4942. Likewise, a donor is entitled to take tax deductions for a contribution to a Private Foundation, but the Private Foundation could divert those monies for impermissible purposes, such as, political contributions or for a low interest loan to a disqualified person, as defined in Code Section 4946 (“Disqualified Person”), *See*, H.R. Rept. No. 91-413 (Part 1), 1st Session, 1969-3 200. Consequently, Code Sections 4945 and 4941 were enacted to prevent these types of abuses.

With respect to a CRT, Congress wanted to assure that split-interest trusts would be established for the benefit of *both* charitable and non-charitable interests. Prior to 1969, donors to such trusts were taking charitable deductions for contributions which were not reflective of the actual benefit flowing to charity. In addition, rights to invade the corpus of such a trust or a contingent charitable remainder interest in such trusts were deemed by Congress to be detrimental to the charitable remainderman, *See*, General Explanation of the Tax Reform Act of 1969, as explained by the Joint Committee on Taxation relating to Code Section 664, p. 87. For these reasons, Congress passed Code Section 664.

It is clear that Congress, by enacting Code Section 664, created a vehicle which provides personal financial benefits to a Disqualified Person, as well as an anticipated and reasonably ascertainable benefit to charity. Disqualified Person's are specifically entitled to the personal financial benefits of a CRT as an incentive to make a charitable gift.

Without question, Private Foundations and CRTs serve different functions and were created for different purposes. Chapter 42 contains certain excise taxes which were enacted to apply solely to a Private Foundation ("Private Foundation Excise Taxes"). In 1969, Congress also determined to apply the Private Foundation Excise Taxes to a CRT, See, Code Section 4947(a)(2); however, Congress did not blindly apply the Private Foundation Excise Taxes to a CRT. For instance, while Code Sections 4941 (self-dealing) and 4945 (taxable expenditures) generally apply to a CRT, Code Section 4943 (excess business holdings) and 4944 (jeopardy investments) apply to a CRT in only very limited circumstances, See, Code Section 4947(b)(3)(B).

More specifically, Congress did not blindly apply Code Section 4941 to a CRT. Instead, Congress recognized that the self-dealing rules could not logically apply to the amounts payable under the terms of a CRT to its non-charitable income beneficiaries, See, Code Section 4947(a)(2)(A), Treas. Reg. Section 53.4947-1(c)(2) and Revenue Ruling 72-395, 1972 - 2 CB 340.

Accordingly, Code Section 4941(d)(1)(E) cannot be blindly applied to a CRT. As opposed to specifically delineating certain acts of self-dealing, Code Section 4941(d)(1)(E) provides that any transfer or use of the assets or income of the Private Foundation *for the benefit of a disqualified person* is an act of self-dealing. If this Section is blindly applied to a CRT, the trustee would be prohibited from investing the assets of the CRT for the benefit of the income beneficiary, because the trust's assets would be "transferred or used for the benefit of a Disqualified Person". As stated above, however, Code Section 4947(a)(2)(A) specifically excludes the payments to be made to the income beneficiaries of a CRT from the self-dealing rules generally. An intellectual catch-22 arises - the only means by which a trustee can make a permissible payment to the CRT income beneficiaries is by an investment of the trust's assets, which will under a blind application of Code Section 4941(d)(1)(E) result in an act of self-dealing.

Confusion regarding the application of Code Section 4941(d)(1)(E) to a CRT is surfacing, because the Regulations under Code Sections 4941, 4947 and 664 do not recognize the inherent distinctions between a Private Foundation and a CRT and provide no guidance or interpretation with respect to such distinction. What is clear is that a Disqualified Person to a Private Foundation can receive no impermissible personal financial gain. It is also clear that a CRT was created, in part, to specifically provide a direct personal financial gain to a non-charitable beneficiary, who ordinarily is a Disqualified Person. For instance, a donor to a CRT ("Donor") is entitled to contribute an appreciated asset and reap the direct financial benefits of the reinvestment of the full before-tax sales proceeds. At that point, the CRT trustee must exercise

its fiduciary duty and reinvest the sales proceeds taking into account the special needs of the income beneficiaries. Thus, the CRT was created to provide the income beneficiaries with personal financial planning benefits. These benefits, as well as the up-front charitable income tax deduction, are the very incentives which Congress contemplated in promoting charitable giving and were a “trade-off” for the remainder irrevocably passing to charity.

In this regard, the most significant difference highlighted above between a Private Foundation and a CRT is the differing interests and character of their beneficiaries. One of the best ways to analyze the substantive nature of this distinction is to consider state trust and fiduciary law.

Although a trustee of a CRT is under a similar fiduciary duty as a trustee of a Private Foundation, it must additionally take into account the fact that the character and rights of the beneficiaries are different. The interests of both the non-charitable income beneficiary and the charitable remainder beneficiary, as described in the CRT governing instrument, must be considered. In this regard and under black letter trust law, a trustee is under an affirmative duty to the successive beneficiaries to act with due regard to their respective interests and owes them a fiduciary obligation of loyalty and competence, See, Section 232 of the Restatement of Trusts (Third) (1992) (“Restatement”). In addition, the income beneficiary is entitled to have information regarding the trustee’s investments and other activities of the trust, See, A.W. Scott & W.F. Fratcher, The Law of Trusts (4th Ed.) (“Scott’s”), Sections 170, 174 and 173. The trustee, therefore, is fully accountable to the beneficiaries.

These general concepts pervade the analysis under Sections 232 and 227 of the Restatement. While a trustee is not free to pursue income to such an extent that the remainder value is depleted, it also cannot invest the assets of the trust entirely for capital appreciation at the expense of income, See, Scott’s, Section 232 and Restatement, Section 232. Section 232 of the Restatement specifically states,

“In short, trustees have a duty of impartiality with respect to the diverse beneficial interests they serve. Thus, a trustee has a duty to seek to balance the income and principal elements of total investment return. This balance is to be achieved in a manner that is fair to all beneficiaries as a reflection of the trust’s purposes, terms, and obligations and in light of the circumstances of the trust *and the relevant circumstances of its beneficiaries.*” [Italics Added]

Section 232 of the Restatement, comment I, specifically addresses the requirement of impartiality and income productivity, which in this context means, productivity of trust accounting income. This comment, and specifically Illustration 18, acknowledge the trustee’s obligation to take into account the particular needs and desires of its beneficiaries. The relevant facts and conclusion of Illustration 18 are provided below.

A trust was designed to pay its net income to a surviving spouse for life with remainder

thereafter to pass to the then living issue of the surviving spouse and the deceased spouse. The duty of impartiality requires that the trustee make the trust estate, as a whole, productive of income in the trust accounting sense. The surviving spouse consents to or encourages an underproductive investment strategy by the trustee. It is determined that the duty of impartiality is not breached, if the trustee pursues an investment portfolio which produces an unreasonably low yield overall with an excessive emphasis on growth. This conclusion is reached, because the only beneficiary, who could be adversely affected by such an investment program, has effectively consented to the underproductive portfolio.

If the trustee engages in a different investment program in Illustration 18, it will be liable to the beneficiary for a breach of its fiduciary duty and subject itself to personal liability for such breach. The trustee must take the personal needs of the income beneficiary into account in investing the trust's assets, because the only means by which the trustee can meet those needs (and not violate its fiduciary duty) is with a properly structured investment program. It is also interesting to note that Illustration 18 emphasizes the fact that the income beneficiary could consent to a certain investment program, which is potentially detrimental to such beneficiary, if such beneficiary is the only one to be adversely affected by such decision.

For all of these reasons, the IRS can't blindly apply Code Section 4941(d)(1)(E) to a CRT. The distinctions between the Private Foundation and the CRT are too obvious and significant to ignore. Of foremost significance, the CRT has a non-charitable income beneficiary that will receive financial benefits from the CRT. The provision for such benefits, for investment of trust assets and for timing the payout of economic benefit to the income beneficiaries, cannot correspondingly constitute an act of self-dealing. Accordingly, Code Section 4941(d)(1)(E) must be analyzed in the context of the unique characteristics of a CRT and the state fiduciary laws which guide the conduct of the trustee in meeting the needs of the CRT beneficiaries.

#### Issue #2 - CRT's Acquisition of a Deferred Annuity Contract and Code Section 4941(d)(1)(E)

Code Section 4941, Treasury Regulation Section 53.4941(d)-2(f)(1) and Revenue Ruling 74-600, 1974-2 C.B. 385, all consistently hold that a *benefit* must inure to a Disqualified Person in order for an act of self-dealing to occur under Code Section 4941(d)(1)(E). In analyzing the acts of self-dealing described in that Section, the Regulations provide some examples. Among other things, the examples include a Private Foundation's payment of any taxes imposed on a disqualified person under Chapter 42 of the Code; a Private Foundation's purchase or sale of stock or securities in an attempt to manipulate the price of the stock or other securities to the advantage of a Disqualified Person; a Private Foundation's indemnification or guarantee of a Disqualified Person's loan; and in certain cases, a Private Foundation's grant or other payment in satisfaction of a legal obligation of a Disqualified Person.

In the context of a Private Foundation, it is clear that a direct financial gain is received by

a Disqualified Person in each example in the Regulations. However, other examples in these Regulations acknowledge that certain incidental or tenuous benefits received by a Disqualified Person are excluded from the definition of self-dealing, such as in Example 1 (in which a Private Foundation makes a grant to a City for the purpose of improving a particular neighborhood and a corporation, which is a substantial contributor to the Private Foundation, is located in that particular community) and in Example 2 (in which a corporation, which is a substantial contributor to a Private Foundation, establishes a scholarship program to award grants to the corporation's employees). Based upon these Regulations, the Disqualified Person must receive an impermissible benefit.

The facts in Revenue Ruling 74-600 are so distinct from this case that it is simply inapplicable. In that Ruling, a Private Foundation owned a painting which was displayed in the home of a Disqualified Person. Thus, the Disqualified Person was presently enjoying the paintings. In many CRT cases, the Donor makes a contribution to a CRT, and the trustee reinvests the sales proceeds. The Disqualified Persons only have the enjoyment of the statutorily-permitted unitrust payments, properly taken in context with their personal financial planning needs. In the Ruling, however, the Disqualified Person is receiving an impermissible benefit that borders on a "sham", because the Disqualified Person effectively retains the sole means of enjoying the paintings, while providing an incidental benefit to the public.

In the context of a CRT's acquisition of a deferred annuity contract (Annuity Contract"), the interest of the charitable remainderman is not impaired, and Donors are entitled to a charitable deduction which will be at least commensurate with the ultimate benefit anticipated to be received by charity, *See*, NCPG Position Paper, beginning on page 5 for an analysis regarding an income exception CRUT holding certain investments. In addition, the Disqualified Persons are receiving only the benefits which they are statutorily entitled to receive. Therefore, a CRT's acquisition of an Annuity Contract does not provide the Disqualified Persons with any financial gain, which is a clear requirement under the Self-Dealing Regulations.

However, it appears that the IRS is grappling with the question whether a CRT's acquisition of an Annuity Contract provides the Disqualified Persons with some other type of impermissible benefit, i.e., that the Annuity Contract was purchased primarily to meet the Disqualified Person's personal financial planning needs. This assumption is based upon the fact that the Disqualified Persons will be receiving payments from another source for a period of years and won't need the unitrust payments during that time period. By investing in an Annuity Contract, the trustee can, in concept, invest the CRT's assets in a fashion to generate capital appreciation for such period and then make distributions to the Disqualified Persons when their projected income needs change, *See*, NCPG Position Paper, beginning on page 5 for an analysis regarding an income exception CRUT holding certain investments.

The difficulty in grappling with the self-dealing implications in such a case is probably due to the inherent conflict between the Regulations under Code Section 4941(d)(1)(E) which require the receipt of an impermissible benefit by the Disqualified Persons and the explicit



financial benefits granted to the Disqualified Persons, as income beneficiaries of a CRT. This difficulty also highlights the significant confusion caused by attempting to blindly apply that Code Section in the case of an acquisition by a CRT of an Annuity Contract.

In this regard, the IRS cannot bifurcate the state law fiduciary duties of the CRT trustee and the permissible benefits provided to the Disqualified Persons as income beneficiaries of a CRT from the application of Code Section 4941(d)(1)(E). It is clear that the Code provides tax incentives which entitle the income beneficiaries of a CRT, to personal financial planning benefits. In addition, state law requires a CRT trustee to invest its assets taking into account the personal financial planning needs of the Disqualified Persons.

To summarize these arguments in one sentence, an attempt to blindly apply Code Section 4941(d)(1)(E) to the acquisition of an Annuity Contract by a CRT ignores the spirit and intent of the law, as evidenced by its legislative history, and the inherent distinctions between a Private Foundation and a CRT, and forces the CRT trustee to violate its unambiguous fiduciary duty owed to its income beneficiaries.

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***INTERNAL REVENUE  
SERVICE***

***TECHNICAL ADVICE  
MEMORANDUM***

INTERNAL REVENUE SERVICE  
TECHNICAL ADVICE MEMORANDUM

LEGEND:

A = Donor  
B = Trustee  
C = Independent Trustee  
R = Life Insurance Company  
T = Tax Planning Consultant  
V = Company  
X = Charitable Remainder Unitrust

m = Sales Price for Company Stock  
n = Redemption Price for Company Stock  
o = Investment in Each Annuity Contract

ISSUES

1. Does the purchase of the deferred annuity policies from R constitute acts of self-dealing when the named annuitants are disqualified persons?
2. Would the purchase of the annuity policies jeopardize the Trust's qualification as a charitable remainder unitrust under section 664 for federal income tax purposes?
3. Would the annuity's withdrawal provision, described hereafter, result in income to the Trust, X, within the meaning of section 643(b).

FACTS

X is a charitable remainder unitrust which was intended to qualify under section 664 of the Internal Revenue Code. X was created by A by a trust instrument dated June 25, 1990. The trust instrument provides that the Trustee shall pay to A, and upon A's death, to A's wife, a unitrust amount equal to the lesser of (1) the trust income for the year or (2) eight percent of the aggregate fair market value of the trust assets for the year. The Trust instrument includes a make-up provisions so that for any year that the unitrust payment is less than eight percent, the shortfall for prior years may be made-up in subsequent years when trust income exceeds eight percent. B is the trustee of X and is also the nephew of A.

Upon the death of the survivor of A or A's wife, the trust shall terminate and the balance of trust assets are to be distributed to designated charities.

In December, 1991, X entered into a contract to purchase two deferred annuity contracts from R, a commercial life insurance company. In one policy A is named the annuitant and in the other policy A's wife is named the annuitant. In other respects the two policies are identical. X is the owner of the policy and is beneficiary of the policies should either annuitant fail to reach the maturity date of the policies which is age 80. As a result of the endorsement of the two policies in 1997, the Trust, X, became the annuitant. Additional information relating to the policies is discussed hereafter in greater detail.

## LAW AND ANALYSIS

### A. Self-dealing Issue:

Section 4947(a)(2) provides, in part, that in the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522, .. section 4941 (relating to taxes on self-dealing, section 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), section 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and section 4945 (relating to taxes on taxable expenditures) shall apply as if such trust were a private foundation.

Section 4941 imposes an excise tax on acts of self-dealing between a disqualified person, as defined in Section 4946, and a private foundation.

Section 4941(d)(1) in general defines the term "self-dealing," in part, to include any direct or indirect--

(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.

Section 4946 defines the term "disqualified person", in part, to include a person (with respect to a private foundation) who is --

- (A) a substantial contributor to the foundation,
- (B) a foundation manager,

Under Sections 4946(a)(2) and 507(d)(2) a "substantial contributor" is defined as a person who contributes over \$5000 and such amount is more than 2 percent of the total contributions, or in the case of a trust, also the creator of the trust.

Section 4946(b) defines "foundation manager" to include an officer, director, or trustee of the foundation.

Section 53.4941(d)-2(f)(1) of the Excise Tax Regulations provides, in part, that the purchase or sale of stock or securities by a private foundation shall be an act of self-dealing if such purchase or sale is made in an attempt to manipulate the price of stock or other securities to the advantage of a disqualified person.

The Request for Technical Advice asks us to determine whether the purchase of the deferred annuity naming the donor and his wife as annuitants constitute acts of self-dealing under section 4941 of the Code.

In analyzing an issue of self-dealing under section 4941(d)(1)(E) of the Code, the Service has focused on three elements. Is a property right created? Is there a transfer of such property right to a disqualified person? Does the disqualified person receive a benefit from the receipt of such property right?

It is the view of the Service that a valid contract right constitutes an enforceable property interest. Michtom v. United States, 573 F.2d 58, 63 (Ct. Cl., 1978). Thus, the donor's rights under the annuity contract constitute a property interest.

It has been the Service view that the prohibition against transferring or using foundation assets to disqualified persons was intended to be extremely broad. The range of transactions described under 4941(d)(1)(E) would also include transactions described under sections 4941(d)(1)(A), (B), (C), (D), or (F). Here, the property interest (the annuity right in the contract) was transferred to the donor and the donor's wife who are disqualified persons under section 4946 of the Code.

The final element for consideration is whether the receipt of the right to the annuity under the contract by the Donor or his wife confers a benefit on the Donor. Certainly there is a potential benefit to the donor. If the donor and his wife reach age 80 the contract will be annuitized and the donor and his wife have the potential to receive all the payments to be made under the contract. This would leave the charitable remainder interest with nothing.

However, the annuity rights in the contracts are contingent on several factors. The donor and his wife must survive to age 80 to receive annuity payments. Further, assuming that X is the owner of the policy, the right of the named annuitants can be defeated by the policy owner's rights to a partial withdrawal from the policy or the surrender of the policy in exchange for the cash value of the policy. Additionally, the owner may defeat the benefit to the named annuitants by changing the maturity date; the date when the annuity payments are to begin. The partial withdrawals and surrender of the policy are subject to some restrictions and penalties for early surrender. A change of the maturity date does require written notice to the company.

Nevertheless, the owner of the policy does have the power to preempt the annuity by taking such actions.

The Service has found an act of self-dealing under section 4941(d)(1)(E) only in the case where the disqualified person has received a current benefit. In Rev. Rul. 74-600, 1974-2 C.B. 385, the Service held that self-dealing occurred under section 4941(d)(1)(E) when paintings owned by a private foundation were allowed to be placed in the residence of a disqualified person. In Rev. Rul. 77-160, 1977-1 C.B. 351, the Service held that the dues paid to a church on behalf of a disqualified person in order to allow such person to retain his membership in the church was an act of self-dealing.

In summary, it is our position that the donor receives no present value from the contract right to receive annuity payments. We do not believe that the annuity right could be currently assigned by the donor and his wife to a third party for any significant value. The donor and his wife have recently assigned their interest in the policy as named annuitants to X. Thus, the problem is resolved for future years.

An analogy in this case may also be made to an incomplete gift for purposes of the federal gift tax. In Rev. Rul. 79-243, 1979-2 C.B. 343, the Service held that the donor made an incomplete gift to his wife of an income interest in trust by virtue of the fact that the donor retained the right to revoke the gift by will. The facts of the ruling provide that the donor created a charitable remainder trust qualifying under section 664 of the Code. The donor was to receive the unitrust amount for his life, and upon the donor's death, the wife was to receive the income interest for her life. However, the donor, in the trust instrument, reserved the right to revoke the wife's secondary interest in the unitrust amount. Authority for the Service position was based on Section 25.2511-2(c) of the Gift Tax Regulations. Part of such Regulations provide as follows:

Thus, if an estate for life is transferred but, by an exercise of a power, the estate may be terminated or cut down by the donor to one of less value, and without restriction upon the extent to which the estate may be so cut down, the transfer constitutes an incomplete gift.

To the extent that X has retained the right by contract to terminate or reduce the annuity right received by the donor and his wife, the transfer of the annuity right is not a completed transfer.

Our office has carefully considered another theory for asserting that an act of self-dealing under section 4941 has occurred with respect to the purchase of the deferred annuity contracts and the failure of the trust to withdraw income from the deferred annuity contracts. The following facts are relevant to the consideration of this additional ground for asserting an act of self-dealing:

At the time X was created by A, it was funded with 86 shares of stock of V, a business previously owned and managed by A. On March 7, 1997, A transferred an additional 7 shares of V to X. Consequently, X held 93 of 94 outstanding shares of V.

In the Summer of 1991, A became aware of a third party's offer to purchase V. In September or October of 1991, the trustee of X became aware of the proposal for the purchase of V, which included payment to A for a five year period pursuant to an employment agreement and noncompetition agreement. Since A's income would be provided for a five year period without the need for income from X, A and the trustee had discussions with T, a tax planning consultant, about the possibility of investing X's assets in deferred annuities. Based on T's recommendations, the trustee believed investing in deferred annuities was a solid choice in light of other investment alternatives available and the flexibility it offered the trustee to defer trust income until A's employment agreement and noncompetition payments ceased.

Consequently, in December 1991, X entered into a contract to purchase two deferred annuity policies from R, a commercial life insurance company. On January 15, 1992, the following three events occurred more or less contemporaneously: (1) substantially all the assets of V were sold to an unrelated purchaser for m; (2) X's stock holdings in V were redeemed for n, which X deposited into its account; and (3) X wrote two identical checks for o for each of the annuities purchased. The representatives for the Trust made the following representations: (1) C, an attorney who is trusted by A and B, served as the sole trustee of X from the time after the stock sale was contributed to X until before the sale of such stock to the unrelated purchaser; and (2) soon after the annuity contracts were acquired by X, C resigned as trustee and B again became the trustee. In fact, C signed as trustee on the contract to purchase the two deferred annuity policies.

Both annuity policies designated X as owner and beneficiary. As stated above, one policy named A as annuitant and one policy named A's wife as annuitant. In order to eliminate the possibility of any annuity payment being made directly to A or his wife (a potential self-dealing problem) an endorsement to each deferred annuity policy was executed, in 1997, by R and X effective as of the policy date of each annuity contract. The trustee of X signed the endorsement, which apparently represents the assignment of interest of A and his wife in the policy as annuitants to X.

We have examined the transaction with the intention of ascertaining whether B, acting in concert with A on an ongoing basis, manipulated the assets of X for the personal benefit of A, by furthering his income, retirement and tax planning goals. There was a concern that the entire transaction taken as a whole; the purchase of a deferred annuity, the failure to make withdrawals from the annuity policies, and the intention to subsequently make unitrust payments to A under

the “make-up” provision of the Trust; could be construed as an act of self-dealing under section 4941(d)(1)(E) of the Code by virtue of the authority provided by section 53.4941(d)-2(f)(1) of the Regulations.

In as much as A, a disqualified person, is entitled to receive the income interest from the trust, it is difficult to argue that the disqualified person receives an inappropriate benefit by deferring the income interest, particularly where such deferral is permitted under section 664 of the Code. The underlying problem is that the income beneficiary interest is in itself a use for the benefit of the disqualified person of the assets of the trust. Inherently, any investment decision regarding the trust assets that increases or decreases the amount of payout of this income interest is a use for the benefit of the disqualified person (assuming the disqualified person does not object). Section 4947(a)(2)(A) provides that section 4941 will not apply to any amounts payable under the terms of the trust to the income beneficiary. The amounts of income deferred by the investment decision in this case were payable to the income beneficiary under the terms of Trust X. Accordingly, these uses must be permitted under the income exception of section 4947(a)(2)(A) unless the disqualified person controls the investment decision and uses this control to unreasonably affect the charitable remainder beneficiary’s interest.

While section 53.4941(d)-1(a) of the regulations provides that it is immaterial whether the transaction results in a benefit or a detriment to the private foundation, the regulation is incompatible with section 4947(a)(2)(A) because, as discussed above, any investment decision regarding trust assets that results in an increase or decrease in the unitrust amount will inescapably constitute an attempted use for the benefit of the disqualified person. Therefore, rather than focusing on whether the deferral of income is a use of trust assets, the relevant question is whether the deferral of income is a permitted use. Since charitable remainder trusts by their intrinsic nature provide for a continuous use by the disqualified person of the entire trust corpus, we conclude that the presence of an unreasonable affect on the charitable remainder interest distinguishes a permissible use of trust assets from an impermissible use.

In addition to failing to show harm to the charitable remainder interest, the facts of this case do not clearly show control by the disqualified person. X represented that an independent attorney/trustee signed the contract to purchase the deferred annuity policies. Moreover, even if we conclude that B, as trustee, purchased the deferred annuity policies, the facts are insufficient to demonstrate that A usurped control from the trustee or that he could compel or influence the trustee to purchase the deferred annuity policies in question. Instead, the trustee merely took into consideration the particular financial needs of A before reinvesting the proceeds from the sale of the trust assets.

B. Purchase of the Annuity and Qualification under Section 664:



The purchase of the deferred annuity contracts does not adversely affect the trust's qualification as a charitable remainder unitrust under section 664 of the Code and the current regulations thereunder.

C. Trust Accounting Income Issue:

Under the terms of the annuity contracts, the Trustee, as owner of the contracts, can withdraw up to 10 percent of the "cash value" of each contract at the beginning of each year. The cash value equals the premiums paid, less deductions, plus accumulated interest earned. The Trustee may also surrender the contracts and receive the "surrender value" of each contract. The surrender value equals the cash value minus any applicable surrender charge. In the request for technical advice, it is argued that the Trust, a NIMCRUT, had income from the contracts because of the rights to receive the cash value and surrender value of the contracts.

Under section 664(d)(2)(A), the unitrust amount is generally a fixed percentage (which is not less than 5 percent) of the net fair market value of the trust's assets valued annually. Under section 664(d)(3), however, the governing instrument may instead provide that the unitrust amount is (A) the amount of the trust income if such amount is less than the amount determined by the fixed percentage of the value of the trust's assets; and (B) any amount of trust income that is in excess of the amount required to be distributed based on the fixed percentage, to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the required amounts based on the fixed percentage of the fair market value of the trust's assets.

Section 1.664-3(a)(1)(b)(1) provides that the amount of trust income for a NIMCRUT is the amount of trust income as defined in section 643(b) and the applicable regulations. Section 643(b) provides that, for section 664 purposes, among others, the terms "income," when not preceded by the words "taxable," "distributable net," "undistributed net," or "gross" means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. The Trust's governing instrument uses the definition of income under section 643(b) to define income. Therefore, the applicable state law defines the Trust's income.

The applicable state law, the Uniform Principal and Income Act of State, appears ambiguous on whether a trust's right to receive money is income to the trust, whether characterized as principal or income. The implication from the sections that define income and principal, however, is that a trust does not realize either until the trust actually receives possession of money or other property. See XXX Code Ann. Section XXXXX and section XXXX (1991). Therefore, the Trust's right to receive either the cash value or the surrender value of the contracts does not create trust accounting income under section 643(b) of the Code.

## CONCLUSION

1. The purchase of the deferred annuity policies, based on the particular facts of this case as described in the preceding paragraphs, does not constitute an act of self-dealing under section 4941 of the Code.

2. The purchase of the deferred annuity contracts does not adversely affect X's qualification as a charitable remainder trust under section 664 of the Code and the current regulations thereunder for federal income tax purposes.

3. X's right to receive either the cash value or the surrender value of the contracts does not create trust accounting income under section 643(b) of the Code.

A copy of this technical advice memorandum is to be given to the organization. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

- END -





CREATIVE GIFTS OF REAL ESTATE  
Real Cases, Real Gifts

Presented by Paul L Harkess  
Mayo Foundation for Medical Education and Research

- Disclaimer: This is not a technical discourse but a practical primer
- Announcement: All the cases in this presentation are based on real events. The names have been changed and in some cases the locations of the events have been altered to protect the presenter.
- Assumption: You have been offered gifts of real estate (if a development officer) or you have had clients who considered giving real estate to charity and many of you have completed gifts funded with real estate
- Declaration: **Real estate** is not a gift or a gift vehicle; real estate is an *asset* used to fund a gift

**A CASE IN POINT:**

Ron and Violet Jones are long-time supporters of a charity in the community where they have lived for over 40 years. The mortgage was paid off ten years ago and the three-bedroom home has become a little too much for them to manage. A year and a half ago, they applied for entrance to The Willows, a lovely retirement community in another state, where some of their friends had moved previously.

The Joneses were put on a waiting list and told that when the new section of The Willows was completed, they would receive notice of the date when they could move in. They would also be billed at that time for the \$60,000 entrance fee and initial payments on their new two-bedroom townhouse in The Willows. Mr. and Mrs. Jones knew that the \$100,000 current market value of their home would give them sufficient funds to make their move.

When the long-awaited notice arrived, they received it with mixed feelings. Delighted that their new home would be ready in just a few weeks, they also wondered how they could sell their home in time to have the commitment fee ready for The Willows.

Option One:	The Joneses put their home on the market and sell it for	\$100,000
	Less: Costs of sale (legal, transfer, inspections, commission)	(8,000)
	Net proceeds to the Joneses	\$ 92,000
Option Two:	Bargain sale to charity for	\$ 60,000
	Plus: tax savings from \$40,000 charitable deduction	14,400
	Total proceeds from transaction	\$ 74,400
Financial cost of Gift Plan:		\$ 17,600

Benefits to the Joneses of Bargain Sale Gift:

- 1) Prompt realization of equity needed to complete retirement home plan
- 2) Avoidance of hassles of home sale
- 3) Satisfaction of making charitable gift to a meaningful cause

This case illustrates the emphasis on meeting donor needs first, with tax considerations showing up as only a reduction in "cost" of the gift rather than a determining factor. In fact, Anderson University found in a survey conducted after their successful installment bargain sale program that the primary reasons for donors giving their homes to Anderson under the program were avoiding the hassle of the sales process and desire to do something important for the university.

At Prudential Real Estate Gifts, we put together this list of ten scenarios showing donor needs being met:

#### WHY DONORS CONSIDER GIFTS OF REAL ESTATE

- 1) Donors interested in eliminating the burden of the sale process
- 2) Donors interested in making a life style move to a smaller home, in the same or different community
- 3) Donors needing an income stream of cash to purchase retirement property or pay indebtedness
- 4) Donor physically unable to maintain property, moving in with family or long term care facility
- 5) Donor owns second home that donor and/or family no longer use
- 6) Donor purchased property as an investment and now wants to be relieved of management burden
- 7) Donor purchased property as an investment and now wants to cash in on recognized appreciation
- 8) Donor purchased property for retirement and makes decision not to utilize
- 9) Donor inherited property and has no intention of using it
- 10) Potential tax benefits received from donating appreciated property

#### The Role of Charitable Intent

There are many reasons why an individual may be interested in giving real estate to charity. Paramount in each case, however, is the donor's desire to make a gift to the charity of choice. Rarely is the best gift made without charitable donative intent.

How do you determine charitable intent?

One way: the "ten second" test. Ask the potential donor what he/she wants your charity to do with the proceeds from the gift. Even if the person answers "do what is most needed by your organization," that indicates they have given some thought to the charitable aspect of the gift. If the person takes more than ten seconds to answer, that person is more likely an *investor* than a donor.

You will find that investors will take a lot of your time --- and rarely complete a gift. If investment value is their primary concern, they will find better options elsewhere.

Where do you find donors with real estate to give and one of the "problems" described above?

Areas of the country where real estate is "hot" -- or is it?  
variations in a statistical Standard Metropolitan Area (SMA)  
talking owners into charitable inclination

Your own donor base -- research tools, such as CD Investnet's Real Estate Program  
helps you prioritize  
your own donors are inclined to help your organization

**Types of Real Estate** that may be used for charitable gifts

Real estate makes up 35-50% of the asset base of Americans

Commercial real estate - highest values, highest risk

Residential property - good value when marketable, minimizing risk

Land in its various forms – raw land, undeveloped land for commercial development, residential development property, farm land

**THREE TYPES OF RISK** in handling gifts of real estate

Financial Risk	Costs of holding property Liability for claims
Market Risk	General economic conditions Competing properties
Environmental Risk	Probability of risk varies with type of property Assessment of environmental risk Phase I & II assessments Transaction screens

**Three Phases** in handling gifts of real estate

Evaluation Phase

Acceptance Phase

Disposition Phase

**A CASE WITH MORE THAN ONE POINT:**

Doctor Dick owns a one-acre residential lot in a desirable community in southern California, the last vacant lot in a community that was built out over the last ten years. All services are in place (street, sidewalks, sewers, utilities, etc.). The property is a flat corner lot in an otherwise hilly area. Minimum lot size in this community is  $\frac{3}{4}$  acre. Doctor Dick was one of the first to buy when the development was laid out, paying \$25,000 for his lot fifteen years ago.

Now 72 years old, he has been a patient at the medical center where he did his residency many years before that and has been a regular donor, a member of the \$1,000/year giving club. Four years ago, he suggested to a medical center development officer a gift of the lot to a unitrust paying him income for life. He said he estimated the value of the property at \$800,000. After some discussion, he turned away.

Two years later, he contacted the medical center again. The development officer walked the property with Doctor Dick who submitted an appraisal of \$925,000. Medical center ordered its own appraisal which came in at \$625,000.

Clearly there were errors in at least one of the appraisals. Doctor Dick's appraiser turned out to be more accurate but credibility of medical center was damaged. Doctor Dick backed away.

Part Two:

Last year, donor submitted a new appraisal at \$1,100,000. Medical center obtained new appraisal at \$950,000. While value was no longer a concern, Doctor Dick continued to negotiate every point of the terms of his planned gift.

Part Three:

After agreeing on a gift value of about one million dollars, donor said he only wanted to give 80% of the property value to medical center. Medical center agreed to be trustee of the CRT even though it would receive less than the full value of the property.

### **Valuation of Real Property**

*Market value* is defined by the USPAP (a professional appraisers society) as "the most probable price in terms of money which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably, and assuming the price is not affected by undue stimulus."

*Appraisal value* will vary depending on the purpose of the appraisal: to determine a selling price, highest and best use, replacement value for insurance, taxable value in an estate, deduction value for a charitable gift. Value is usually determined by one of three methods: cost method, market approach, income approach. An appraisal may or may not take into account the marketability of the property.

Partial interests in a property are usually reduced in value. The whole *is* worth more than the sum of its parts. The IRS, some courts and legal advisors believe that the value of a fractional interest must be discounted to recognize various negative factors including the difficulty of selling such a partial interest, potential disputes among co-owners and the expense of partitioning the property. The late Dave Donaldson wrote in his manual on Tax Aspects of Charitable Giving that the discount in the case of real estate, however, "should be considerably less than the discount applied to a minority stock interest, at least in jurisdictions that permit tenants in common to bring an action to sell the property and partition the proceeds. Unlike the minority shareholder, the holder of a partial interest in real estate has a mechanism for readily obtaining his or her share of the value of the property. Thus the discount should simply reflect the cost and delay associated with exercising that mechanism."

### **JUST IN CASE:**

Mrs. Bee called charity about its gift annuity program. She had a second home with a fair market value of \$85,000. A widow, she and her husband had purchased the home many years ago for \$30,000. She read the charity's brochure on charitable gift annuities which gave examples of ACGA rates paid to donors of various ages. Mrs. Bee was 89 years old when she called, three months before her next birthday. Would she get as much as a 12% return from her gift of the real estate in exchange for a gift annuity?



The answer to her question is yes and no. A charity which has adopted the ACGA rates has agreed to pay *no more than* the recommended rates to annuitants of a given age. The ACGA rate is applied to the amount the charity receives from the donor. When the gift property is real estate, it is prudent for the charity to estimate the expected value *after expenses* of sale and apply the ACGA rate to that value to determine the amount of the annual payment to the annuitant. The *effective rate* of return will be lower than the ACGA rate (nothing wrong with that) and remember the gift annuity contract states the *amount* of the annual payment that you have agreed to pay the annuitant, not an annual rate.

For example, if we assume that direct costs, including broker's commission, legal fees and carrying costs, of selling Mrs. Bee's property are \$15,000, the annuity will be 12% (for a 90-year-old) of \$70,000 or \$8,400. This amount is 9.88% of the \$85,000 appraised value of the house.

NOTE: In the case of a unitrust, you are only obligated to pay X% of the value in the trust as valued annually – or if you are using the net income or “flip trust” the lesser of that percentage or the actual income earned by the trust. In a straight unitrust, the initial unitrust amount will be based on the appraised value of the property so you will have a potentially higher unitrust amount the first year than you will after you have sold the property and charged the carrying costs and expenses of the sale to the trust. One alternative is to have the donor fund the trust with cash or securities, in addition to the real estate, in an amount equal to the first year's payments and the anticipated real estate expenses. Otherwise, the net income unitrust limits the maximum amount that the trust must pay until income is being earned by the trust. The advent of the “flip trust” is the best of all worlds.

In any event, be sure to alert the donor that after the sale and reinvestment of the proceeds, the anticipated unitrust amount is X% of the actual value left in the trust, not X% of the appraised value of the property.

#### **A CASE WHOSE POINT IS WELL TAKEN:**

Dr. Henry Adams and his wife deeded their home in Cambridge (Massachusetts) to medical school to fund a unitrust. The property was appraised at \$425,000 by independent appraisal and inspections were done to determine that the 150-year-old house was in sound condition. The snow that covered the property hid something that Dr. and Mrs. Adams had long forgotten about. When they purchased the house twenty-five years earlier, they had replaced the worn-out oil-burning furnace with a natural gas heating system. The old furnace had been hauled away and the oil tank drained.

Documents were drawn for the deed and the charitable remainder trust and reviewed by attorneys for the donor and the school and a closing date set for the gift transfer. Five days before the closing, after a mid-December thaw, a representative of the school was walking by the property and noticed a black spot in the remaining snow at one corner of the property. Further investigation disclosed the old oil tank, now rusted through, leaking a small amount of oil.

Resolution: A prompt analysis of the tank revealed a very small amount of oil had remained trapped in the tank. An estimate for removal of the tank and clean up of the contaminated soil was obtained. The school reached agreement with Dr. and Mrs. Adams to split the cost of cleanup which could not be scheduled prior to closing the gift. Attorneys for the school drew up a binding agreement which became one more document to be signed at the closing of the gift, and Dr. and Mrs. Adams gave the school a check for their half of the cleanup.

The old buried tank might have passed unnoticed in the school's subsequent sale of the home and was determined to be of little consequence. A more thorough environmental assessment review might have revealed the tank earlier on in the process. The American Society for Testing and Materials (ASTM) developed a questionnaire called the "Initial Transaction Screen" to permit owners or potential purchasers of real estate to assess the likelihood of environmental contamination of a property based on past and present uses and the appearance of various features. For gift properties, the receiving charity can complete the screen or, preferably, have it done by an environmental expert. Of course, if the transaction screen produces evidence of possible environmental damage, a Phase I review may be called for. Transaction screens are typically sufficient for residential properties. Phase I and Phase II assessments are more appropriate for commercial properties and open land.

Environmental risk is real but discovery of contaminants need not always prove fatal to the gift.

#### **A POINTED CASE:**

A noted research institution was offered a California estate property which included a home designed by a noted architect, a carriage house, large swimming pool with heaters and cabanas and two acres of lawns adorned with sculpture. A full environmental assessment of the property revealed the presence of two underground oil tanks, one for the main house and one for the pool heaters, and an extensive underground piping system connecting them. At least one of the connecting pipes was broken and had leaked oil into the surrounding soil. Recovery of the tanks and pipes and clean up of the contaminated soil would do damage to the lawns and landscaping and there was uncertainty about the extent of the spread of the contamination.

The property was offered to fund a unitrust. Negotiations for terms of the trust also included discussion of the need to remedy the environmental hazard which would prevent sale of the property or severely reduce its value from the appraisal which was completed prior to the environmental assessment. As the end of the calendar/tax year approached, the donor offered to provide an escrow of \$50,000 to cover the costs of clean-up, accept responsibility for costs in excess of that amount and hold the trust harmless from further cost with respect to the restoration of the grounds. The institution accepted this offer and the property was transferred to the trust.

Removal of the tanks was commenced soon after the closing. The presence of the machinery and the holes in the ground delayed marketing of the property for sale for over three months, adding to the carrying cost of the trust. During this time, however, it was discovered that the State of California has a fund which provides assistance to homeowners for remediation of environmental problems. Further investigation confirmed that the trust could apply for reimbursement of the costs of remediation from this state fund. A large share of the cleanup cost was paid by the State of California and the unused part of the donor's escrowed fund was returned to him.

Several other states have also set up assistance funds for property owners faced with environmental problems. Some are better funded than others, some are more efficient, some are very restrictive in their application but if faced with this issue, it bears research into the applicable state program.

In this case, the charity agreed to act as trustee of the charitable remainder trust, believing itself to be protected by the donor's escrowed funds and "hold harmless" clause. In the end, they had even greater protection from the state environmental fund. Others have argued that charities should insist on the appointment of an independent trustee for the trust until after the property is sold, thus keeping the charity out of the chain of title. It was believed that an independent trustee was necessary for the purpose of doing the annual unitrust valuation of "hard-to-value" property.

Last fall the IRS proposed regulations that permit a "qualified appraiser" to provide an annual appraisal of the property which would be acceptable to establish the annual valuation for the unitrust. Under these rules, the donor could serve as initial trustee with the independent appraiser providing the annual valuation and the charity would become successor trustee only after the property is sold. The donor would then be the only party on the title (first as owner, then as trustee) when the real estate is sold out of the trust and would bear full responsibility for any environmental problem discovered while the property is in the trust or subsequently.

A final case brings us back to the initial point of meeting the donor's objectives.

### **A POIGNANT CASE:**

Nelson Denver's first response to a planned giving mailing from an east coast institution, was a question written on a post card "Do you ever get to San Francisco?" His second response included filling out a questionnaire in which he identified himself as 78 years old, married and interested in a charitable remainder trust that would pay income to himself as sole beneficiary. The funding asset would be a 38-unit apartment building in central San Francisco worth about \$4.5 million. A trip from the east coast to San Francisco was scheduled expeditiously.

The meeting took place at Mr. Denver's home and he gave the charity's representative a tour of the home. When they got to his office on the second floor, Mr. Denver introduced his accountant. He had Mr. Denver's personal balance sheet showing total assets in excess of \$10 million, a market analysis of the property prepared three months earlier by a local real estate agent, indicating a market value of \$4.7-5.3 million, operating statements for the building showing an annual net income of \$325,000 and full occupancy of the building with 3-year leases, an offer for purchase of the apartment building for \$4,750,000, and a copy of a pre-nuptial agreement with his present wife, indicating that they maintained separate assets.

While the accountant spent quite a bit of time discussing the financial details with the planned giving officer, the key moments came in talking with Mr. Denver. While he enjoyed a good income from the apartment building, he was tired of the hassles that managing such a property entailed. Although he had good tenants, the collection of rents, maintenance of the well-kept building, potential liability claims, etc. were becoming too much for him. When asked what he wanted the institution to do with the final distribution of the funds, he quietly indicated that he wanted to create a professorship in the name of his first wife.

The accountant argued that there was no way he could take the full charitable deduction allowed on a 7% unitrust over the next six years, given the 30% of AGI annual limitation. He suggested a gradual distribution of partial interests in the property over several years.

Result: Notwithstanding the entreaties of the accountant, Nelson Denver made the gift: 20% (\$1 million) was transferred as an outright gift on December 30 that year to fund the professorship, 80% (\$4 million) was transferred on January 3 to fund the charitable remainder unitrust. The accountant was right: there was no way Mr. Denver could use the entire charitable deduction. But that was not his goal. He honored the memory of his first wife, avoided the hassles of property ownership and maintained his level of income.

(The charity received five offers on the property and sold it three months later to the ones who made the original offer to Mr. Denver. The selling price was \$5,200,000.)

## **MYTHS About Gifts of Real Estate**

**Myth 1:** Charities should avoid gifts of real estate like the plague

**Truth:** Properly managed, these gifts can be very productive; why avoid 1/3 of the assets your donor can use to make a gift?

**Myth 2:** You can eliminate risk in taking gifts of real estate

**Truth:** No one can eliminate the three risks in real estate gifts but with due diligence and evaluation, risk can be minimized

**Myth 3:** Charities should always seek to have tenants in the property to defray carrying costs

**Truth:** Tenants create additional problems and potential costs, liabilities and unwanted lawsuits; tenants also make marketing and sale of the property more difficult

**Myth 4:** The income tax deduction is the greatest tax motivation of donors in giving real property

**Truth:** The greatest motivation for donors is charitable intent and meeting other personal needs; to the extent that tax considerations motivate the gift, the avoidance or partial avoidance of capital gain typically outweighs the charitable deduction

**Myth 5:** Charity may not negotiate the potential sale of the property with interested parties until after the gift is made

**Truth:** It is beneficial to charities and may be helpful to donors in confirming the real market value of gift property to have "offers in the wings."

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# What's Wrong With This Gift?

BY EDWARD J. MCBRIDE

One fine day you, as the PGO of your university, get a call from a person previously unknown to you. It quickly becomes apparent that this person has done some reading about charitable remainder trusts and is interested in hearing what you can tell him about them. After you take down pertinent information and arrange a visit with him and his wife, you hang up the phone and immediately check their names on the school's database. Just as you suspected: no record.

You run the numbers based on their suggested value and given birthdates, and at the appointed time you meet with them. They seem mildly interested and cordially thank you for your time. They see you to the door with a vague promise of "We'll let you know." You go back to the office thinking "scratch this one."

Come late November, they call to say they want to set up a NIMCRUT before year's end, funding it with a fully paid-for duplex. You nervously glance at the calendar, your grateful phone voice betraying your concerns about timing. Both units have tenants, but both leases expire in the spring.

Being the over-achiever you are, you spring into action. You help the donors locate an appraiser (it appraises at \$135,000); you do your Phase I environmental audit; you review

copies of the leases; you order a title report.

The property does have one small problem: a water line leak that developed over the winter and will need some extensive backhoe work to fix, including the removal of part of the patio slab. It's too wet now to do this and the donors orally agree to pay for the costs in the spring, when the repairs can be made.

You tell the prospects on more than one occasion that they need to confer with their own lawyer. You include this admonition in a letter.

On December 29 you close the gift. The donors tell you they see no need to have an attorney review the gift documents or represent them at the closing.

The donor husband offers to continue on as property manager until the building sells. You enter into a short management agreement outlining his duties and setting his compensation at 7 percent of rents collected, plus a \$25 fee for new leases.

A couple of times in your discussion, you ask the donors how they would want your organization to use the gift. They frankly haven't given this much thought. And they still haven't decided by the time the gift closes.

The duplex is marketed and the following summer sells for \$128,000.

## SO, WHAT'S WRONG WITH THIS GIFT

Well, is there *anything* wrong with this gift? Let's break it down.

1. Some people might argue that there is no donative intent, that the donors have no prior relationship or interest in your college other than utilizing it for a "tax dodge." So? Must we as the PGOs first put our prospects through some kind of philanthropic litmus test before we move forward? Prospects with a prior history may be less likely to complain or find fault with our trusteeship, but that alone shouldn't prevent us from seriously considering the gift . . . and begin building a positive long-term relationship.
2. Is it too late in the year to complete the gift? That depends on how quickly the appraiser can do his or her job, and whether or not you can do your due diligence in qualifying the property for acceptance. Just because there's only a month left to do all this should not be grounds for turning it down.
3. The leases expire in the spring. What then? What if you haven't sold the duplex yet and you don't get new renters? You have a potential cash flow problem, don't you? Should that eventuality deter the gift? Only if your organization wants absolute, iron-clad deals that carry no risk. In that case, you'd better abolish any further acceptance of real estate gifts.
4. But what if there's no cash flow and taxes and other expenses come due? This should be a topic of discussion with the donors up front, before the gift. Share with them the pitfalls of a CRT "borrowing" money to pay expenses. But do you try to get a binding, signed obligation from the donors that they'll cover such expenses through additional gifts if necessary? Only if you're trying your best to estrange them.
5. The water leak. Again, an iron-clad enforceable signed contract to ensure the donors follow through on their promise? Well, that might be nice, but do you *really* need it? If, come spring they have a change of heart, the expenses will be paid out of cash flow and consequently their unitrust payments may be affected.

*Continued on page 6*

Being the  
over-achiever you  
are, you spring  
into action.

Ed McBride has been director of gift planning at the University of Idaho. Prior to entering the planned giving world eight years ago, he was in private law practice for 16 years. He is currently president of the Inland Northwest Planned Giving Council in Spokane, and is a member of the Membership and Nominating Committees of the NCPG.

### SO, WHAT'S WRONG WITH THIS GIFT *Continued from page 5*

6. No attorney? O-o-o-h that's risky. Or is it? Again, how far do we have to go to protect our own backside? So far that we alienate demonstrably capable, mature, obviously sane donors? In addition to oral and written admonitions, we should include a clause in the CRT instrument by which the donors acknowledge in writing our recommendation that they seek independent counsel.

7. Oh, but wait, the donors offer to manage the duplex. That's self-dealing, isn't it, prohibited by Code 4941? Well, take a look at 4941(d)(2)(D): As long as the personal services are reasonable and necessary to carry out the exempt purposes of the trust, it is not self-dealing if the compensation is not excessive.

8. The property sells for less than the appraisal. It's within two years of the date of gift, so your charity must file IRS Form 8282. Does this make the gift "wrong"? No, but it means that the donors' claims for a higher deduction may be questioned by the IRS and they may have to adjust the deduction.

9. The donors don't know how they want the gift to be used. There's no legal requirement that this be spelled out prior to the gift. In fact, it gives you an opportunity to stay in touch with them — aside from periodic trust payments — to discuss funding ideas.

Rarely is a planned gift the "perfect" gift. If you wait for the ones to come along that pose no risks and no dispute, you'll do more waiting than you will completing gift plans.

*Note: The above article is intended for educational and discussion purposes and should not be considered authoritative in making specific applications. Since space restrictions permit only a brief treatment, additional or more complete solutions may exist. Readers who discover erroneous or missing elements are invited to submit these in a Letter to the Editor.*

## POLICY ON GIFTS OF REAL PROPERTY

Before acceptance, all offered gifts of real property must be reviewed using the following requirements:

- A. Conduct interview with donor regarding their intention for use of gift (i.e. life income vehicle, outright, expectations for Mayo's use of the property) and complete real property disclosure checklist. Forward information to Treasury Services for review and approval to proceed with gift discussions.
- B. Donor must obtain a qualified appraisal in compliance with IRS regulations. This appraisal will perform these functions:
  - Assist IGO's in structuring the gift plan (if not an outright gift)
  - Give the accounting staff and auditors a reasonable value at which to carry the asset on MFMER books;
  - Assist with the establishment of asking price for the property.
- C. Donor must give permission to use Abstract of Title. MFMER shall order and pay for title insurance prior to commitment of gift.
- D. Donor must give permission to conduct environmental audit of property. MFMER shall employ and pay for an independent consultant to conduct an environmental audit.
- E. Donor may be asked to pay carrying costs while MFMER holds property.
- F. Trusts funded with real estate: The donor shall be advised that for the purposes of estimating future income beneficiary payments, the agreed upon appraised value will be reduced by 20%. This allowance provides for the cost of managing and disposing of real property.

Properties with mortgages will not be accepted except:

- A. With an independent appraisal (approved by MFMER).
- B. If the mortgage amounts to 50 percent or less of the value established by the appraisal.
- C. Donor must be advised of potential complications and tax liability and advised to seek tax counsel prior to proceeding with gift.
- D. Mortgaged property will not be accepted for charitable remainder trusts.

Gifts of commercial properties and businesses will be evaluated not only on the basis of property tax and mortgage liabilities, but also taking into consideration that:

- A. MFMER may have to pay income tax on unrelated business income.
- B. MFMER, as a non-profit corporation, receives no tax benefit from depreciation.

Other considerations:

- A. Donor shall be advised that MFMER may elect to seek an additional, independent appraisal on any gifts of property.
- B. The property will be listed at the appraised value with broker(s) in the area in which the property is located.
- C. MFMER should be willing to wait a reasonable period (one year) of time to receive an offer in this range.
- D. If, because of high taxes, sizable mortgage, or other circumstances in which MFMER is unwilling to hold the property for a reasonable period and will be forced to cash out as quickly as possible, the prospective donor will be so informed.



## Mayo Foundation for Medical Education and Research Real Estate Checklist

**Donor Name:**

**Donor Address:**

**Phone:**

**Additional Information:**

Attachments Required	Attachments That MAY Be Required
<p>Development Officer:</p> <p><input type="checkbox"/> Donors Appraisal</p> <p><input type="checkbox"/> Copies of deeds or contracts</p> <p><input type="checkbox"/> Property tax information</p> <p><input type="checkbox"/> Debt Information</p> <p>Treasury Services:</p> <p><input type="checkbox"/> Title Insurance Policy</p> <p><input type="checkbox"/> Phase I</p> <p><input type="checkbox"/> Appraisal</p>	<p><input type="checkbox"/> Survey</p> <p><input type="checkbox"/> Income and Expense Info.</p> <p><input type="checkbox"/> Amortization Schedule</p> <p><input type="checkbox"/> Depreciation Schedule</p>

**I. Property Address:**

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Land Area (acres or sq. ft)

Building Area (sq. ft.)

Date of Construction

Type of Property:

- |                                       |  |
|---------------------------------------|--|
| <input type="checkbox"/> Residential  | <input type="checkbox"/> Commercial/Industrial |
| <input type="checkbox"/> Agricultural | <input type="checkbox"/> Recreational          |

Replacement Cost of Building

Current Property Insurance

Coverage (Name of Carrier and Limits)

Date of Acquisition/Form of Acquisition

Current Cost Basis (Includes Improvements)

Principal Balance of Mortgage

Current Fair Market Value (Estimate)

Term of Remaining Mortgage

Assessed Value for Real Estate Taxes

Fiscal Tax Year

Real Estate Taxes

\_\_\_\_\_

\_\_\_\_\_

Land Value	_____	Building Value	_____
Most Recent	_____	Appraised	_____
Appraisal Date	_____	Value	_____
Appraiser	_____		
Occupancy Status After Transfer of Title to Charity:			
Vacant (building has no personal property, no occupant)			_____
Unoccupied (building has personal property, no occupants)			_____
Occupied (building has personal property with occupants)			_____

Please indicate by checking "YES" your awareness of any condition or problem which may affect the title or marketability of the property. Use Section VIII to provide addition information.

**II. Title/Zoning**

	YES	NO
A. Title	_____	_____
B. Restrictions or Easements	_____	_____
C. Zoning Variances, Violations or Special Permits	_____	_____
D. Zoning violations	_____	_____
E. Survey	_____	_____
F. Any Zoning or Title Changes (under consideration or discussion)	_____	_____
G. Mineral or Water Rights (describe)	_____	_____

**III. Building**

	YES	NO
A. Foundation/Slab	_____	_____
B. Basement Water/Dampness/Sump Pump	_____	_____
C. Roof Leaks	_____	_____
D. General Structural	_____	_____
E. UFFI (formaldehyde insulation)	_____	_____
F. Asbestos	_____	_____
G. Lead or Lead Paint	_____	_____
H. Termites/Ants/Pests	_____	_____
I. Wood/Coal Stove	_____	_____
J. Swimming Pool	_____	_____
K. Radon	_____	_____
L. Building Systems	_____	_____
1. Plumbing	_____	_____
2. Electrical	_____	_____

- |                     |       |       |
|---------------------|-------|-------|
| 3. Heating          | _____ | _____ |
| 4. Air Conditioning | _____ | _____ |
| 5. Hot Water        | _____ | _____ |
| 6. Water Supply     | _____ | _____ |
| 7. Sewage; type     | _____ | _____ |
| 8. Other Fixtures   | _____ | _____ |

**IV. Rental/Condominium/Cooperative**

**YES**

**NO**

- |   |       |       |
|---|-------|-------|
| A. Rent Control                                   | _____ | _____ |
| B. Tenants  | _____ | _____ |
| 1. Leases   | _____ | _____ |
| 2. Rental Arrears                                 | _____ | _____ |
| 3. Last Month's Rent or Security Deposit Disputes | _____ | _____ |
| C. Common Area or Association Fees in Arrears     | _____ | _____ |
| D. Building or Sanitary Code Violations           | _____ | _____ |
| E. Operating/Capital Budget                       | _____ | _____ |

**V. Environmental (Use Section VII for description of all "YES" answers)**

**YES**

**NO**

- |  |       |       |
|--|-------|-------|
| A. History of Property   |       |       |
| 1. Property has prior or current use of industrial, commercial, agricultural, manufacturing waste disposal or other non-residential purposes | _____ | _____ |
| B. Condition of Property   |       |       |
| 1. Stressed or denuded vegetation or unusual barren areas  | _____ | _____ |
| 2. Discoloration, oil sheens or foul/unusual odors in water  | _____ | _____ |
| 3. Storage drums   | _____ | _____ |
| 4. Above or underground storage tanks; vent or filler pipes  | _____ | _____ |
| 5. Evidence of oil or other chemicals in soil  | _____ | _____ |
| 6. Evidence of PCB's   | _____ | _____ |
| 7. Evidence of toxic air emissions   | _____ | _____ |
| C. Adjacent Properties   |       |       |
| 1. Properties adjacent to subject have conditions requiring "YES" answer to any questions in (A) and (B) above                               | _____ | _____ |
| D. Flood Plain/Wetland/Drainage  | _____ | _____ |

E. Endangered Plants or Wildlife	_____	_____
<b>VI. General</b>	<b>YES</b>	<b>NO</b>

Are you aware of any other information concerning any part of the land or buildings which might affect the decisions of a buyer to buy or affect value of property or affect use by buyer?

\_\_\_\_\_

**VII. Property Maintenance Budget**

To hold this property as an asset, the following income and expenses are anticipated:

A. Income:	Annual \$
1. Rent	_____
2. Other	_____
<b>Total Income</b>	_____

B. Expenses:	
1. Real Estate Taxes	_____
First Payment Due _____ Date _____	
Second Pmt. Due _____ Date _____	
2. Utilities	
Gas	_____
Oil	_____
Electric	_____
Water/Sewer	_____
Other	_____
3. Services	
Caretaker/Property Manager	_____
Landscaping	_____
Heating/Cooling Service Contract	_____
Snow Removal	_____
Pool Services	_____
Common Area Charge (Condominium)	_____
Security	_____
Other	_____
4. Maintenance/Repairs	_____
5. Insurance	_____
<b>TOTAL EXPENSES</b>	_____
<b>NET INCOME (LOSS)</b>	_____

**VIII. Additional Information on Sections II through VII:**

**IX. Acknowledgements**

Owner(s) hereby acknowledge that the information set forth above is true and accurate to the best of my (our) knowledge.

Owner	_____	Date	_____
Owner	_____	Date	_____
Prepared By	_____	Date	_____
Development Officer	_____	Date	_____









**PROBLEM SOLVING WITH CHARITABLE GIFT ANNUITIES**

**Presented by**

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**PROBLEM SOLVING  
WITH CHARITABLE GIFT ANNUITIES**

**David Wheeler Newman**

- I. Introduction
  - A. Non-Trust Charitable Giving Technique
  - B. Attraction to Donors
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    - 2. Security
  - C. Attraction to Charities
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- II. General Tax Rules - Donor
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  - B. IRC §72
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    - 4. Annuitants Who Live Too Long
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- III. General Tax Rules - Charity
  - A. IRC §514(c)(5)
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    - 1. Exception for Charitable Gift Annuities
- IV. Appreciated Property
  - A. Bargain Sale
  - B. Timing
- V. Encumbered Property
  - A. Consequences to Donor
    - 1. Timing
    - 2. CRT Alternative
  - B. Consequences to Charity
    - 1. TAM 9431001
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- VI. Deferred Annuities
  - A. General
  - B. Tuition Annuity Plan
    - 1. Tax Consequences to Annuitant
    - 2. Tax Consequences to Charity
  - C. DCGA Retirement Plan Supplement

D. Elective Starting Date DCGA

1. IRC § 514(c)(5)
2. PLR 907071
3. Tax Consequences to the Donor

VII. Gift Annuity Funded with Remainder in Personal Residence

A. General

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**PROBLEM SOLVING  
WITH CHARITABLE GIFT ANNUITIES**

David Wheeler Newman

**I. Introduction**

**A. Non-Trust Charitable Giving Technique.**

Creative charitable gift planning often focuses on charitable remainder trusts and charitable lead trusts while overlooking non-trust charitable giving techniques. These non-trust techniques include a gift of a remainder interest in a personal residence or farm, a donor advised fund, a donor directed fund and a charitable gift annuity.

**B. Attraction to Donors.**

A charitable gift annuity (CGA) is often preferred by a donor over charitable giving vehicles utilizing a trust, such as a pooled income fund or charitable remainder trust, for various reasons including:

1. **Simplicity.** The donor doesn't need to read through a long and complicated trust agreement. A CGA is usually documented with a very short (1 or 2 page) contract.
2. **Security.** Unlike a trust, where the life income beneficiary depends on the assets of the trust and the yield generated from those assets for payment of the income stream, a CGA represents a direct obligation of a charitable institution which the donor knows and trusts.
  - (a) A CGA pays the income beneficiary a fixed annual amount. The annuitant need not be concerned with the investment results obtained by the charity.
  - (b) Unlike a trust, where the principal may be exhausted if the income distribution exceeds the yield derived from trust assets, an annuitant is not concerned that the annuity will terminate earlier than planned.

### C. **Attraction to Charities.**

The popularity of CGAs has increased over the past 10 years in part because they are also very popular with charities. Reasons for this popularity include:

1. **Meeting donor needs.** One reason charities like CGAs is because their donors like them.
2. **Lower unit cost.** Charities have found that it is very expensive to develop and document a charitable remainder trust. For this reason, trusts are often reserved for larger life income gifts. At one time it was thought that the demand for smaller life income charitable gifts could be filled by pooled income funds. However, inept management of pooled income funds by some sponsoring charities, and the disappointing yields from those funds which resulted, has caused the pooled income fund to become less attractive as a vehicle for smaller life income gifts, with a corresponding increase in the popularity of CGAs.

### D. **Mechanics**

A CGA is established by an *inter vivos* or testamentary transfer of assets to a charitable organization. In exchange, the charity issues an annuity contract specifying the payments to be made to the donor or other designated annuitant or annuitants. CGA payments are normally made monthly or quarterly. The amount of the payment is determined actuarially based on the age of the annuitant(s). While some charities undertake the actuarial analysis to create their own CGA rate tables, the majority of charities have traditionally used the recommended rates established through actuarial analysis performed by the American Council on Gift Annuities. In January, 1997, the Council announced new recommended rates, effective March 1, 1997.

### E. **State Regulation**

Many states regulate the issuance of gift annuities to their residents. For example, in California a charitable organization must obtain a certificate of authority to act as a grants and annuities society before issuing CGAs.<sup>1</sup>

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<sup>1</sup> California Insurance Code §§ 11520 to 11524.

## II. General Tax Rules - Donor

- A. **IRC §170** The charitable contribution income tax deduction is calculated by subtracting the value of the CGA from the value of the property transferred to the charity. The value of the annuity is based on the IRC §7520 interest rate in effect for the month of the gift and the life expectancy of the annuitant(s). These life expectancies are taken from tables in the Treasury Regulations at §1.72-9. The two factors are combined in IRS Publication 1457, Alpha Volume, which contains factors which, when multiplied by the annual annuity, will yield the value of the annuity.
- B. **IRC §72** The same rules applicable to commercial annuities to determine the portion of each annuity payment that an annuitant must include in his or her income also apply to CGAs. Gross income does not include that part of any amount received as an annuity which bears the same ratio to such amount as the investment in the contract bears to the expected return. This ratio is referred to as the exclusion ratio.
1. **Investment in the Contract.** The value of cash or other property transferred to the charity in return for the CGA, less the amount deductible as a charitable contribution (as calculated above) is the investment in the contract.
  2. **Expected Return.** The expected return is the amount payable under the annuity each year multiplied by the life expectancy of the annuitant from the tables in Treas. Reg. §72-9, equal to the total of all payments which the annuitant will receive if the annuitant lives to his or her exact life expectancy.

**Example One:** Tom is 76 years old when he transfers \$10,000 to Charity in July 1995 in exchange for an annual annuity of \$860. Using an IRC §7520 CMFR of 7.6%, and Publication 1457, we determine that the applicable factor is 6.325 which, when multiplied by the annuity amount, results in a present value of Tom's annuity of \$5,439. The charitable deduction is the amount transferred, \$10,000, less this amount, or \$4,561. The tables in Treas. Reg. §72-9 tell us that Tom has a present life expectancy of 11.9 years. The Expected Return from the Annuity is this figure, adjusted to 11.8 for annual payments as required by the Regulations, multiplied by the annual annuity amount of \$860; or \$10,148. The exclusion ratio is the ratio of the investment in the contract of \$5,439 to the expected return of \$10,148, or 53.6%. Of

the \$860 Tom receives each year, 53.6%, or \$461, will be excluded from his gross income during his life expectancy. The balance is taxable each year as ordinary income.

3. **Software.** These calculations are thankfully performed with commercially available computer software, which are generally very accurate.
4. **Annuitants Who Live Too Long.** The total amount excludable from income over the life of the annuity may not exceed the original investment in the contract.<sup>2</sup> An annuitant who lives longer than his or her life expectancy at the time the annuity was issued may no longer exclude any portion of the annuity from gross income -- the entire annuity payment is taxable as ordinary income after he or she has excluded the total investment in the contract.
5. **Annuitants Who Don't Live Long Enough.** If payments under the annuity terminate with the death of the annuitant, and any portion of the investment in the contract has not been excluded because the annuitant did not live to his or her life expectancy, the unrecovered balance is a deduction on the final income tax return of the annuitant.<sup>3</sup>

### C. Transfer Taxes

1. **Gift Tax.** If annuity payments are to be made to anyone other than the donor or his or her spouse, the annuity interest is a taxable gift. If there is only one annuitant, and annuity payments begin immediately, the gift should be eligible for the annual \$10,000 exclusion,<sup>4</sup> although this result is not entirely free from doubt.<sup>5</sup> A deferred annuity won't qualify for the annual exclusion because it is a future interest.<sup>6</sup>

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<sup>2</sup> IRC §72(b)(2)

<sup>3</sup> IRC §72(b)(3).

<sup>4</sup> PLR 8637084

<sup>5</sup> Estate of Miriam Kolker, 80 TC 58 (1983).

<sup>6</sup> IRC §2503(b)



- (a) If a donor creates a two-life annuity, with payments to herself for life and then to a survivor for life, the value of the survivor's interest will not qualify for the annual exclusion because it is a future interest.<sup>7</sup> The donor can avoid creating a taxable gift by retaining in the gift instrument the right to revoke the survivor's interest.<sup>8</sup> Note that, unlike a charitable remainder trust, the donor may retain the right to revoke exercisable during the donor's life or at death through his will, not only the latter. A taxable gift results in any year the right to revoke is not exercised by the donor and the annuitant receives annuity payments.
- (b) If two donors create an annuity for their joint lives, each is making a gift to the other of his or her share of the survivor interest and should retain the right to revoke to avoid gift tax.

2. **Estate Tax.** If a donor creates a one-life CGA for his own benefit, no amount is included in her gross estate. If the annuity is created during the life of the donor for another individual, no amount is included in the gross estate of the donor unless she reserved the right to revoke the interest of the annuitant, in which case the amount included in her gross estate will be the value of the annuity payments remaining at the donor's death.

- (a) An annuitant's interest in a CGA created in the donor's will is included in the donor's taxable estate.
- (b) Any estate tax attributable to the annuity is allowed as an income tax deduction to the annuitant.<sup>9</sup>

3. **Marital Deduction.** If a donor creates a CGA to benefit his or her spouse, the type of annuity will determine the availability of a gift or estate tax marital deduction.

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<sup>7</sup> IRC §2503(b)  
<sup>8</sup> Treas. Reg. §2511-2(c)  
<sup>9</sup> IRC §691(c)

- (a) A CGA created solely for the spouse will qualify for the gift or estate tax marital deduction.<sup>10</sup>
- (b) If an individual establishes a joint and survivor annuity with his or her separate property, naming the spouse as survivor annuitant, the interest of the non-donor spouse in the annuity automatically qualifies for a marital gift tax deduction under the QTIP rules unless the donor elects not to take the marital deduction.<sup>11</sup> Similarly, if there was no current gift when the joint and survivor annuity was created because the donor retained the right to revoke the survivor interest of the spouse, the interest of the spouse passing through the donor's estate will automatically qualify for marital deduction under the QTIP rules unless the administrator of the decedent's estate elects not to claim the deduction.<sup>12</sup>
- (c) If, instead of a joint and survivor annuity the donor creates successive interests in the annuity for herself and her spouse, the marital gift tax deduction will be jeopardized. For example, assume the wife uses her separate property to establish a CGA making payments to her for life, and then to her husband for life. The gift to the husband will not qualify for the gift tax marital deduction because the husband has not been given the immediate right to receive income.<sup>13</sup> To avoid this result, the wife should retain the right, exercisable by will, to revoke the husband's right to receive annuity payments. If she does not exercise this right, the interest of the husband will qualify for the estate tax marital deduction.<sup>14</sup>

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<sup>10</sup> Treas. Reg. §§ 2056(b)-1(g), Example 3; 2523(b)-1(b)(6)(iii).

<sup>11</sup> IRS §2523(f)(6).

<sup>12</sup> IRC §2056(b)(7)(C).

<sup>13</sup> Treas. Reg. §25.2523(f)-1(c)(2).

<sup>14</sup> Treas. Reg. §2056(b)-1(g).

### III. General Tax Rules - Charity

- A. **IRC §514(c)(5).** One variety of unrelated business tangible income is debt financed income arising from acquisition indebtedness.<sup>15</sup> The annuity obligation from the charity to the annuitant is a form of debt. Issues concerning encumbered property, discussed in V below, must be considered. In addition, for it not to be considered acquisition indebtedness, the annuity must meet the following criteria contained in IRC §514(c)(5):
1. The value of the annuity must be less than 90% of the value of the property received by the charity.
  2. The annuity must be payable over the life of one or two individuals living at the time of the gift.
  3. The annuity does not guarantee a minimum amount of payments or specify a maximum amount of payments.
  4. The annuity does not provide for adjustment of payments based on income received by the charity from the transferred property or any other property.
- B. **IRC §501(m).** A charity otherwise exempt from tax under IRC §501(c)(3) can lose its tax exemption if a substantial part of its activities consists of providing commercial-type insurance. Even if the insurance activity is not substantial in relation to the overall activities of the charity, providing commercial-type insurance generates UBTI, with the charity taxed under the rules applicable to insurance companies.<sup>16</sup>
1. **Exception for Charitable Gift Annuities.** For purposes of IRC §501(m), commercial-type insurance does not include charitable gift annuities, defined in IRC § 501(m)(5) to be an annuity if a portion of the amount paid for the annuity qualifies as a charitable deduction and the annuity is described in IRC §514(c)(5). For this reason, most CGAs meet the four criteria in IRC §514(c)(5) described above.

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<sup>15</sup> IRC §514.

<sup>16</sup> IRC §501(m)

#### IV. Appreciated Property

- A. **Bargain Sale.** A CGA funded with appreciated property is analyzed as a bargain sale for purposes of calculating gain to the donor. The basis in the property must be allocated proportionately between the sale element of the transaction (the value of the annuity) and the gift element (the value of the property in excess of the annuity value).<sup>17</sup> The basis of the property allocated to the annuity is determined as follows:

$$\frac{\text{FMV of Annuity}}{\text{FMV of Property}} \times \text{Adjusted Basis} = \text{Bargain Sale Basis}$$

- B. **Timing.** The general rule is that the bargain sale gain is recognized in full in the year the gift annuity is created. The gain may be spread over the life of the donor, but only if the annuity is nonassignable (or may only be assigned to the charity issuing it), and if the donor is the only annuitant, or the donor and a designated survivor annuitant or annuitants are the only annuitants.<sup>18</sup>

**Example Two:** Billy, age 65, funds a CGA payable for his life with publicly traded stock with a market value of \$100,000 and a basis of \$20,000. The charity agrees to pay Billy \$7,200 per year, resulting in an annuity with a present value of \$61,956. Using the bargain sale rules, the portion of Billy's stock basis allocated to the sale portion of the transaction is 61.956% of \$20,000, or \$12,392. The difference between this and the value of the annuity, or \$49,564, is the amount of capital gain that will be reportable over Billy's life expectancy of 19.9 years. Billy's exclusion ratio, calculated as above, is 43.2%, meaning that 56.8% of each annual payment of \$7,200, or \$4,090, will be taxable as ordinary income. Of the 43.2%, or \$3,110, that is not ordinary income, the gain of \$49,564 divided by Billy's life expectancy of 19.9 years, or \$2,488, will be long term capital gain and the remainder, \$622, will be tax free recovery of his basis in the stock.

If the donor of a CGA funded with appreciated property dies before all the capital gain is recognized, or if the donor relinquishes to the charity at any time his right to receive payments under the CGA, no further

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<sup>17</sup> IRC §1011(b)

<sup>18</sup> Treas. Reg. § 1011-2(a)(4)

capital gain will be recognized. If a donor funds a two life CGA with her separate appreciated property, but dies before the entire capital gain is recognized, the unreported gain is reported by the surviving annuitant.<sup>19</sup>

**Example Three:** Billy uses the same stock to fund a CGA for his life, followed by the life of his brother Jimmy, age 70, as survivor. The charity agrees to pay to Billy, and then to Jimmy, \$6,900 per year, resulting in an annuity with a present value of \$68,156. The bargain sale ratio for allocating Billy's stock basis is 68.16%, resulting in \$13,632 of his basis being allocated to the sales portion of the transaction. The resulting capital gain of \$54,525 must still be reported over Billy's life expectancy of 19.9 years. The exclusion ratio (for both Billy and, if he survives him, Jimmy) will be 42.9%, meaning that 57.1% of each annual payment of \$6,900, or 3,939, will be taxable as ordinary income. Treatment of the 42.9% that is not ordinary income is different for Billy and Jimmy. For Billy, the capital gain of \$54,524 is divided by his life expectancy of 19.9 years, so that \$2,737 is long-term capital gain each year, with the remaining \$223 a tax-free recovery of Billy's basis in the stock. For Jimmy, the entire 42.9%, or \$2,960, is tax-free if Billy lives to his life expectancy of 19.9 years to recognize the entire capital gain. If Billy dies before all gain is recognized, Jimmy will recognize capital gain at \$2,737 every year until the entire capital gain is recognized.

## V. Encumbered Property

- A. **Consequences to Donor.** As noted in IV above, a CGA funded with appreciated property is a bargain sale transaction in which the donor will recognize capital gain. If the property is transferred to charity subject to an encumbrance -- such as a mortgage -- the amount of the encumbrance will be included in the amount realized for purposes of calculating the donor's capital gain.<sup>20</sup>
1. **Timing.** Note that unlike other gain in the property, the portion of the capital gain attributable to the debt on the property cannot be stretched out and reported over the life expectancy of the donor, even if the requirements of Treas. Reg. § 1011-2(a)(4) are met, since the donor is deemed to be relieved of the obligation --

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<sup>19</sup> Treas. Reg. §1.1011-2(a)(4)(iii)(b)

<sup>20</sup> Treas. Reg. § 11011-(2)(a)(3).

and therefore to receive this portion of the bargain sale consideration -- at the time of the transfer.

2. **CRT Alternative.** Even with the recognition of capital gain attributable to the encumbrance on the property, funding a CGA with encumbered property may be an attractive alternative to a charitable remainder trust, since a trust funded with encumbered property may not be able to qualify as a CRT.<sup>21</sup>

**Example Four:** Pablo, age 70, plans to fund a CGA with an apartment building with a market value of \$500,000 and a basis of \$200,000. The charity will take the property subject to a mortgage of \$50,000. The charity agrees to pay Pablo \$31,050 per year, based on the equity in the property of \$450,000, resulting in an annuity with a present value of \$216,043 (see appendix for calculation). In applying the bargain sale rules, the value of the annuity must be added to the outstanding principal balance of the debt to begin with a total amount realized in the bargain sale of \$266,043. This results in allocation of basis as follows:

A/R \$266,043 divided by FMV \$500,000	= 53.2%
52% of basis	= \$200,000
Bargain sale basis	= \$106,400

This bargain sale basis must then be reallocated between the debt and the annuity components of the consideration received by Pablo:

Debt \$50,000 divided by A/R \$266,043	= 18.8%
18.8% of bargain sale basis \$106,400	
equals basis (debt)	\$20,003
\$106,400 minus \$20,003	= basis (annuity) \$86,397.

In the year of the transfer, Pablo will recognize the capital gain resulting from the transfer of property subject to debt:

A/R (debt)	\$50,000
Minus basis (debt)	<u>\$20,003</u>
Equals capital gain (debt)	\$29,997

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<sup>21</sup> PLR 9015049

Pablo will receive a charitable contribution deduction in the year of the gift of \$233,957. Pablo's exclusion ratio is 44.9%. Of each annual payment of \$31,050, \$13,941 will be something other than ordinary income. With this amount the capital gain recognized which is attributable to the CGA is calculated as follows:

A/R (annuity)	\$216,043
Bargain sale basis (annuity)	(\$86,397)
Capital gain (annuity)	\$129,646
divided by Annuitant's life expectancy	16 years
Equals annual capital gain	\$8,103

Of each annual payment received by Pablo during his life expectancy:

Ordinary income	\$17,109
Capital gain	\$ 8,103
Non-taxable	<u>\$ 5,838</u>
	\$31,050

**B. Consequences to Charity.** When a charity plans to issue a CGA in exchange for encumbered property, the debt must be analyzed for tax purposes like other types of debt used to acquire property. The analysis must include the possibility that the debt will be acquisition indebtedness giving rise to debt financed income from the operation or sale of the property.<sup>22</sup>

- 1. TAM 9431001.** Although it is not entirely free from doubt (and is contrary to the result widely assumed), this Technical Advice Memorandum suggests that the charity could be taxed on a sale of the property even if the property is sold immediately after the transfer to charity with no appreciation in value following the gift.
- 2. Seasoned Debt.** IRC § 514(c)(2)(B) provides an important exception to the definition of acquisition indebtedness that would otherwise expose the charity to tax liability on income from the operation or sale of encumbered property. If the exception applies, the encumbrance won't be acquisition indebtedness for ten years following receipt of the property by the charity. To qualify, the charity must not formally assume the debt -- it may

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<sup>22</sup>

IRC §914.

only receive the property subject to the debt. In addition, for gifts during life:

- (a) the debt must have been placed on the property more than five years before the gift, and
- (b) the property must have been owned by the donor for more than five years.

## VI. Deferred Annuities

- A. **General.** The starting date for annuity payments may be deferred into the future. Doing so will increase the charitable deduction, and allow the CGA to address a broader range of donor planning objectives.

**Example Five.** Bruno, age 50, received in January of this year a bonus from his employer of \$100,000 in recognition of his outstanding performance last year. He has no current need for additional income, but would like to provide increased income for retirement at age 65, while making a gift to his *alma mater*. The college agrees to pay Bruno an annual annuity of \$16,300 beginning at age 65, in exchange for a contribution of \$100,000. Bruno will be entitled to claim a charitable deduction this year of \$59,473.

- B. **Tuition Annuity Plan.** The deferred charitable gift annuity DCGA has recently been used by educational institutions as part of a tuition annuity program. The donor funds a DCGA designating the donor or a child or grandchild as the annuitant, with payments deferred until the child reaches, for example, age 18. The annuitant has the right to sell the annuity for installment payments over a fixed number of years. The parties anticipate that these installment payments will be used to pay tuition at the school sponsoring the plan, but this is not contractually required.

**Example Six:** Ron wants to plan for the college education of his granddaughter, now age 5. The planned giving officer at the university, Bruce, tells Ron about the tuition annuity plan sponsored by the university which is funded with deferred gift annuities. The idea is appealing to Ron, since he has also been looking for a way to fund his reunion pledge to the university in a way that fits in with his other financial planning objectives.

Bruce suggests that Ron initially purchase a DCGA for Kate that will start payments when she is age 19 and could be expected to be in her



first year of higher education. The special annuity contract used by the university in its tuition plan allows the annuitant the option of selling -- or commuting -- the annuity at any time before payments begin. The formula for commutation is that the university will compute the discounted present value of the annuity payments at the date the sale is to take place, using a 6% discount rate. The university will then pay this amount with interest at 6% in four equal annual installments. Ron and Bruce determine that, with \$10,000, Ron can fund a DCGA that will pay Kate \$1,220 per year for life, beginning at age 19 (see Appendix for calculations). Bruce explains that at age 19, Kate will have a life expectancy of 63 years and that the discounted present value of the right to receive \$1,220 per year for 63 years is \$19,816. If this amount is paid by the university to Kate with interest at 6% in four equal annual installments, she will receive \$5,719 per year. And Ron will be making a deductible gift to his *alma mater* of \$4,233, which will make him look pretty good in front of his classmates at the reunion.

1. **Tax Consequences to Annuitant.** If the annuitant sells the annuity for the installment payout before the starting date of the annuity, the annuitant is taxed on the difference between the amount received and the investment in the contract. If the sale occurs after the annuity starting date, all proceeds of sale are taxable.<sup>23</sup> If the sale occurs before the starting date of the annuity payments, the annuitant will be allowed tax-free recovery of the investment in the contract. For example, in Kate's case, the investment in the contract of \$5,767 is recovered over the four year commuted payment period, so that \$1,442 of each payment of \$5,719 will be tax free.
2. **Tax Consequences to Charity.** For a charity issuing gift annuities to avoid UBTI, the annuities must meet the requirements of IRC § 514(c)(5), one of which is that the annuity may not guarantee a minimum number of payments. But the IRS ruled in PLR 9042043 that the option to commute the annuity into four installments does not alter the fact that the primary obligation under the annuity is for the life of the annuitant, and that the annuity contract used in the tuition annuity plan accordingly did not run afoul of this requirement.<sup>24</sup>

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<sup>23</sup> IRC § 72(e).

<sup>24</sup> See also GCM 39826

- C. **DCGA Retirement Plan Supplement.** It is a basic principal of financial planning that the best way to save for a future financial objective, such as retirement, is to initiate a methodical system of savings and investment. The DCGA can be the basis for a retirement savings plan for charitably inclined individuals. The DCGA compares favorably with other types of retirement savings, when one takes into account the limits on contributions (and deductibility of contributions) to IRAs and the limitations to amounts that can be contributed to other retirement plans, including employer-sponsored 401(k) plans.

**Example Seven.** Betsy is the planned giving officer for a non-profit hospital system. She has taken on the task of developing planned gifts from members of the hospital medical staff. A common complaint from the doctors is that one of their primary financial planning objectives is to provide for a secure retirement. They find it difficult to set aside enough to provide the income they will need at retirement if they are forced to save with after-tax dollars. This is exactly what they are told by many of their financial advisors, for example, if a doctor's pension plan is overfunded. Betsy designs a DCGA retirement supplement plan based on annual contributions. Each year's contribution to the plan would be used to buy a DCGA from the hospital. Each DCGA will provide payments to begin when the participating doctor reaches retirement age. She comes up with a plan that can be easily presented to the entire medical staff, in which the majority of contributions are tax deductible. To illustrate, Dr. Jane is a successful surgeon, age 45. She has learned that you can no longer make deductible contributions to her retirement plan or IRA, yet she would like to continue to set aside funds for retirement at age 65. Betsy proposes to establish a 5 year plan (which may be extended at Dr. Jane's option) to methodically set aside funds used to purchase DCGAs which will be payable over Dr. Jane's retirement years. Dr. Jane feels she can afford to commit to set aside \$25,000 per year for each of the next five years. Betsy prepares the following illustration for Dr. Jane and her financial advisor:

### DCGA RETIREMENT PLAN SUPPLEMENT

YEAR	CONTRIBUTION	DEDUCTION	RETIREMENT INCOME
One	\$25,000	\$15,818	\$5,450
Two	\$25,000	\$15,625	\$5,150
Three	\$25,000	\$15,462	\$4,850
Four	\$25,000	\$15,276	\$4,575
Five	\$25,000	\$15,060	\$4,325
TOTAL	\$125,000	\$77,241	\$24,350

Betsy has shown Dr. Jane a system for setting aside \$125,000 toward retirement, over a period of 5 years, the majority of which will be tax deductible. If this system is followed, Dr. Jane will create for herself retirement income of \$24,359 per year, payable during her life and backed by the full financial strength of the hospital system. Dr. Jane is impressed, but she wants to know how the DCGA retirement plan supplement compares with setting the same amount aside each year in a traditional savings and investment plan. She wants to start the plan right away when Betsy tells her she would need to earn 6.8% after tax on her investments -- 11.2% before tax -- to achieve the same retirement income, and with the DCGA retirement plan supplement, the account is protected from Dr. Jane's creditors as it accumulates.

- D. **Elective Starting Date DCGA.**<sup>25</sup> One problem with saving for retirement is that when funds are being set aside years in advance, most people don't know exactly when they will end up wanting to retire. While example Seven demonstrates the financial benefits of using a DCGA as a retirement plan supplement, it would be even better if the donor annuitant could retain the right to elect the commencement date of the payments under the annuity contract. The added feature of an elective starting date adds tremendous flexibility to the DCGA being used as retirement plan supplement.

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<sup>25</sup> The author wishes to express his appreciation to Frank Minton, with whom he worked in analyzing this type of DCGA.

1. **IRC § 514(c)(5).** As noted in section IIIA above, a charitable gift annuity must meet all four criteria contained in IRC § 514(c)(5). A DCGA with an elective starting date will meet all four criteria since it will continue to be payable over the life of one individual living at the time of the gift, as required -- the only difference in this case is that the point in that person's life when payments commence may be elected at a later date. To meet the other requirements of IRC section 514(c)(5), it is important that the annuity payments be fixed in the annuity contract for any payment starting date which the annuitant might elect.
2. **PLR 901071.** A DCGA with an elective starting date is similar to the gift annuity contract at issue in Private Letter Ruling 9017071, which was issued to spouses for their joint lives, with a commencement date deferred until a future date. That annuity contract provided that if one spouse died prior to the starting date specified in the annuity contract, the surviving spouse could elect to receive reduced annuity payments, commencing prior to the specified starting date. Adjusting the annuity payment based on the commencement date was necessary to preserve the actuarial equivalence of the annuity contract. The IRS ruled that, because of the actuarial equivalence, the DCGA was qualified.
3. **Tax Consequences to the Donor.** As with other charitable gift annuities, the donor will be entitled to deduct the difference between the value of the property transferred to the charity and the value of the annuity contract received in return. The only difference in this situation is that, if this calculation yields a lower deduction at some ages than at others, the donor must accept the lower deduction, since the gift is reduced by the maximum value which the annuity contract could have, determined by the starting date elected.

**Example Eight:** Betsy develops a program to offer DCGAs with an elective starting date to members of the medical staff and other hospital donors. Her first prospective donor is Mark, age 50, who would like to fund a DCGA with \$25,000 to supplement his retirement income. He finds the elective starting date attractive since he doesn't know when he will decide to retire. Betsy develops the following table to include in Mark's annuity contract:

Payment Age	Annuity	Deduction
55	1,787.31	12,364.29
56	1,966.16	12,364.29
57	2,166.14	12,364.29
58	2,390.16	12,364.29
59	2,641.80	12,364.29
60	2,925.00	12,364.29
61	3,125.00	12,830.31
62	3,325.00	13,350.20
63	3,575.00	13,754.12
64	3,850.00	14,150.70
65	4,075.00	14,737.11
66	4,375.00	15,177.25
67	4,700.00	15,618.33
68	5,050.00	16,063.52
69	5,425.00	16,515.84
70	5,825.00	16,976.06
71	6,250.00	17,443.75
72	6,725.00	17,890.33
73	7,300.00	18,278.89
74	7,825.00	18,753.30
75	8,500.00	19,143.50
76	9,225.00	19,542.49
77	10,000.00	19,948.00
78	10,850.00	20,347.52
79	11,750.00	20,751.20
80	12,725.00	21,148.14

For example, for a DCGA funded with \$25,000, should Mark elect to begin receiving annuity payments at age 55, the annual annuity payable to him for his life would be \$1,787.31. If, on the other hand, Mark elects

to have the starting date of his annuity delayed to age 70, his annual annuity payment will be \$5,825. This table, used to determine the amount of the annuity based on the starting date elected by the annuitant, has been designed to ensure that the donor will not receive a charitable contribution income tax deduction larger than that to which he would have been entitled based on the provision in the annuity contract for payments to begin at age 60. The table indicates the charitable contribution income tax deduction for each annuity payment shown on the table, based on the annuitant's age at the starting date. Thus, the deduction based on the January 1997 CMFR for a contribution of \$25,000 by someone aged 50, in exchange for an annuity of \$2,925 per year, payable by the charity commencing at age 60, is \$12,364.29. This is identical to the deduction that the donor would be entitled to receive if the annuity amount was instead \$1,787.31 commencing at age 55. (Note that the charitable deduction to which the donor would be entitled, based on a contribution of \$25,000 for annuities of the amount shown on the table commencing at age 61 or older would actually be greater than the deduction for payments beginning at age 60 of \$12,364.29. For example, the deduction for an annuity in the amount of \$5,825 per year commencing at age 70 would be \$16,976.06. However, the donor will be restricted to claiming the lowest deduction based on the commencement ages and annuity amounts reflected in the table, that is \$12,364.29, since this reflects the charitable gift less the maximum possible noncharitable value of the annuity.)

## VII. Gift Annuity Funded with Remainder in Personal Residence

- A. **General.** For many donors, a personal residence is the principal asset in their estate, making a gift of a remainder interest in a personal interest, following a life estate retained by the donor, a charitable gift vehicle which should be explored. But many of those same donors require income to live on, and they need to tap into the equity they have built in the residence to meet both objectives. As more than one gift planning guru has pointed out, you can't live in your unitrust -- meaning that if the residence is used to fund a charitable remainder unitrust, the donor may not continue to live in it due to the prohibition on self-dealing. Even if the donor could live in a residence held by a unitrust, the unitrust is deriving no income from the equity in the residence which can be used to pay the donor or other income beneficiary of the trust. A CGA funded with a remainder interest in the personal residence should be considered in this situation.

**Example Nine.** Homer, age 70, has lived in his beautiful lake-front home for decades. While he is grateful for the fact that it has increased in value over the years to \$250,000, he is dismayed by his inability to tap the value of this asset to provide badly needed income any way other than to sell the house he wants to live in until he dies, or to borrow against it and risk losing the house *and* running out of money. He reviews his situation with Joe, the planned giving officer at the college, who suggests he consider a CGA funded with a remainder interest in the home. Joe explains that by giving the college a remainder interest following his life estate, Homer will be able to live in his house for the rest of his life. The college is willing to issue an annuity to Homer based on the value of the remainder interest. To determine the results to Homer, the first step is to calculate the value of a remainder interest in the property following a life estate for someone age 70 (see calculations in Appendix) which, for a home valued at \$250,000 is \$92,375. Then Joe determines the annual annuity that could be issued for this gift, using the annuity tables developed by the college, to be \$7,113 per year.

This is a terrific result for Homer, since he gets to remain in his house and derive income from his eventual gift to his *alma mater*. Before the college can offer this gift program to its donors, however, several *caveats* must be considered. First, the college is spending liquid assets from sources other than the very illiquid asset it receives from Homer. Is the investment committee willing to pay out dollars from the endowment today, with the knowledge it may be fifteen or twenty years before the life estate in the residence is completed and the college is free to sell the property? Second, does state law allow an annuity to be issued by a charity in exchange for a remainder interest in real property? If it does, do annuity reserve requirements mandate other college assets -- like bonds -- be placed in the reserve account to back Homer's annuity? Third, as with remainders where no CGA is issued, the college and Homer must consider and document issues common to other

co-ownership situations, such as who pays to insure and maintain the property, and what are the rights of the other party if the party with the obligation fails to perform? Finally, all the normal concerns with gifts of real estate apply.

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## MARKETING SOPHISTICATED GIFT PLANS

### ESSENTIAL ELEMENTS

Define the *audience* or *audiences*.

Determine the *messages* for each audience.

Determine one or more appropriate *marketing strategies* for each audience.

*Saturation Marketing* — Broad scale information and motivational materials to expose all publics to planned gift development. Generally characterized as *reactive marketing*.

*Segmented Marketing* — Breaks the public down into segments that meet certain planned gift prospect criteria. Members of these segments are exposed to more direct and consistent information and assistance. Since many may qualify themselves by requesting more information and counsel, generally characterized as *co-active marketing*.

*Impact Marketing* — Identification of individuals who are known to meet certain planned gift prospect criteria. These individuals are exposed to individualized, direct and personal development efforts. Generally characterized as *proactive marketing*.

### CHARITABLE GIFT ANNUITIES

#### AUDIENCES

##### Immediate Payment Gift Annuities

1. 75+ year old donors who could afford to make an outright gift, but are concerned about future income needs and want something they can "count on."
2. Donors who want a fixed income and like the simplicity of the charitable gift annuity agreement and reporting.
3. Donors who want a fixed income, but have a modest amount to contribute (not enough for a charitable remainder annuity trust).
4. Donors who want a nominal income they can "count on" and budget for.
5. Donors who want to name an older individual as the annuitant as a way of providing financial assistance (gift tax implications possible) and like the simplicity of the charitable gift annuity.
6. Donors who simply want to replace a fixed income (such as income from a Certificate of Deposit) and make a future charitable contribution at the same time.
7. Donors with low-yield appreciated assets who want higher current income without incurring long-term capital gains taxes.

## Deferred Payment Gift Annuities

1. Donors who want to provide a family member, employee, or friend with retirement income.
2. Donors who want to use one or more deferred payment gift annuities as a source of retirement income.

## MESSAGES

1. You can make a significant future gift to us and maintain or even increase your lifetime income at the same time.
2. You can convert highly appreciated, but low-yield assets, to higher income without owing capital gains tax.
3. You can supplement a loved one's, employee's or friend's income knowing that you've made a significant future gift to us at the same time.
4. You can supplement your own retirement income, benefit from tax savings now, and make a significant future gift to us at the same time.
5. You can name an older person to receive the lifetime income while claiming a much larger income tax charitable deduction than if you were the income recipient.

## MARKETING STRATEGIES

### Saturation Marketing

1. Include brief case studies (how a charitable gift annuity helped real or hypothetical individuals solve a financial problem or concern) or teaser articles ("did you know you can...") in organization newsletters, on web pages.
2. Include stories about charitable gift donors (why we made this gift) in annual reports.

### Segmented Marketing

1. Direct mail pieces/series on charitable gift annuities to older individuals of solvent, but modest means.
2. Direct mail pieces/series on deferred payment charitable gift annuities to individuals in their 40's and 50's about using deferred payment charitable gift annuities as retirement supplement plans.
3. Direct mail pieces/series on immediate and deferred payment charitable gift annuities to members of planned giving societies, bequest donors, etc.

### Impact Marketing

1. Include donor-specific illustrations when meeting with older individuals of solvent, but modest means.
2. Hold small group informational meetings for older individuals.

3. Include donor-specific retirement supplement illustrations when meeting with individuals in their 40's and 50's.
4. Hold small group informational meetings on charitable planning to supplement retirement income for individuals in their 40's and 50's.

## **POOLED INCOME FUNDS**

### **AUDIENCES**

1. Donor(s) wants a variable, market-driven income but either does not have or does not want to contribute enough to create a charitable remainder unitrust.
2. Donor(s) wants a variable, market-driven income but does not want the cost or complexity of creating a charitable remainder unitrust.
3. Younger donors who do not want to make an outright gift, want to keep some income for life, and want a variable, market-driven income. May be the only way younger donors can make a "major gift" to a campaign while keeping a lifetime income.
4. Donor(s) want to provide a family member or long-time employee with some additional lifetime or retirement income with hope of keeping up with inflation.
5. Donor(s) with highly appreciated, but low-yield assets and want to increase their income without paying capital gains taxes on the profit if they sold the assets.

### **MESSAGES**

1. You can make a significant future gift to us and receive a market-driven yield for the rest of your life at the same time.
2. You can convert highly appreciated, but low-yield assets, to higher income without owing capital gains tax.
3. You can provide a loved one, employee or friend with a variable lifetime income knowing that you've made a significant future gift to us at the same time.
4. You can make a gift now which may be worth much more to us by the time we receive it due to market growth while you receive a variable lifetime income.
5. You can name an older person to receive the lifetime income while claiming a much larger income tax charitable deduction than if you were the income recipient.

## MARKETING STRATEGIES

### Saturation Marketing

1. Include brief case studies (how a gift to a pooled income fund helped real or hypothetical individuals solve a financial problem or concern) or teaser articles ("did you know you can...") in organization newsletters, on web pages.
2. Include stories about pooled income fund donors (why we made this gift) in annual reports.

### Segmented Marketing

1. Direct mail pieces/series on gifts to the pooled income fund with charts on estimated charitable value at different ages of life income beneficiaries to individuals age 50+ with investments in the stock market. (Purchase data on stock ownership in a geographic area or certain donor profiles).
2. Include information about gifts to the pooled income fund at meetings of donors age 50+ , members of planned giving societies, bequest donors.
3. Direct mail pieces/series on gifts to the pooled income fund with charts on estimated charitable value at different ages of life income beneficiaries to members of planned giving societies, bequest donors.

### Impact Marketing

1. Include donor-specific illustrations when meeting with age 50+ individuals.
2. Include information about gifts to pooled income funds in small group meetings on financial planning and charitable giving, planning for retirement, etc.

## CHARITABLE REMAINDER TRUSTS

### AUDIENCES

#### Annuity Trusts (Fixed Income):

1. 75+ year old donors who could afford to make an outright gift, but are concerned about future income needs and want something they can "count on."
2. Donors who want a life income plan where all the income will be tax-exempt interest; may fund initially with cash or municipal bond holdings. Normally are either highly compensated or have a large amount of taxable income from other sources.
3. Donors who want a nominal income they can "count on" and budget for; charitable gift annuities not available or the donor does not trust the charity and wants a Trustee to manage the process; or donors who want to retain the right to change the charitable remaindermen.
4. Donors who want income they can "count on" and want the larger immediate income tax deduction generated by the CRAT as opposed to the charitable remainder unitrust.

Especially attractive if the donor names older parents as the trust's income beneficiary(ies) to assist in their support (gift tax implications possible).

5. Donors who simply want to replace a fixed income (such as income from a Certificate of Deposit) and make a future charitable contribution at the same time.
6. Donors with low-yield appreciated assets who want higher current income without incurring long-term capital gains taxes. Typically a large, one-time transfer to fund the trust.

Unitrusts (Variable, Market-Driven Income):

1. Younger (50's/60's) donors who could afford to make an outright gift, but are concerned about future income needs and want something that can keep up with inflation.
2. Donors with low-yield appreciated assets who want higher current income without incurring long-term capital gains taxes. Typically fund the trust with a large transfer, but like the idea that additional assets can be added during lifetime, or can be "poured over" from the estate of the first spouse to die for additional income for the surviving spouse without management responsibilities.
3. Older donors who want a variable, market-driven income.
4. Donors who want a higher payout rate than economically feasible at present (net-income unitrust or net-income unitrust with make-up provision).
5. Donors who want a variable, market-driven income, but want to preserve the trust corpus for the charitable remaindermen (net-income unitrust).
6. Donors who want to fund a charitable remainder trust with an asset not currently producing an income ("flip" unitrust, net-income unitrust, or net-income unitrust with make-up provision to give the Trustee time to produce income for distribution; avoids distribution of the corpus when no income has been earned.)
7. Donors who still enjoy the excitement of stock and bond market deviations and have higher risk tolerance.
8. Donors who want to assist with a "younger" (60s) parent's support but want a variable, market-driven income for the parent.
9. Donors who want to "defer" the income until later (around the time of retirement).

MESSAGES

1. You can create a plan which will provide you with a fixed or variable income for life or a set number of years and make future gifts to one or more charities and you can name the Trustee (even yourself) to manage the plan.
2. You can convert highly appreciated, but low-yield assets, to higher income without owing capital gains tax and taking the charitable income tax deduction now.
3. You can provide a loved one, employee or friend with a fixed or variable income for

life or a set number of years knowing that you've made a significant future gift to one or more charities at the same time.

4. You can create a plan which will provide children, grandchildren, or any younger persons with income for a set number of years to provide funds for education, to start a business, to build a home, knowing that at a set point in the future the assets will be given to the charities you named.
5. You can create a plan by making an initial contribution and periodically make additional contributions of money or securities during your lifetime to gradually increase your lifetime income.
6. You can create a plan with the goal of deferring income until some point in the future, like retirement.
7. You can create a plan now and at your death add assets from your estate to increase income for your survivors.
8. If you are planning to sell a closely-held business, you can contribute some or all of your shares to a charitable remainder trust and receive more lifetime income than if you sold all your shares and invested the after-tax proceeds because the trust doesn't pay capital gains taxes.
9. You can create a plan and name an older person to receive the lifetime income while claiming a much larger income tax charitable deduction than if you were the income recipient.

## MARKETING STRATEGIES

### Saturation Marketing

1. Include brief case studies (how a charitable remainder trust helped real or hypothetical individuals solve a financial problem or concern) or teaser articles ("did you know you can...") in organization newsletters, on web pages.
2. Include stories about charitable remainder trust donors (why we made this gift) in annual reports.

### Segmented Marketing

1. Direct mail pieces/series on charitable remainder trusts to individuals who have expressed an interest in life income plans.
2. Provide information about charitable remainder trusts to members of planned giving societies, bequest donors.
3. Direct mail pieces/series on charitable remainder trusts to individuals in their 40s and 50s interested in retirement planning.
4. Direct mail pieces/series on charitable remainder trusts to individuals with holdings in closely held businesses.



5. Direct mail pieces/series on testamentary charitable remainder trusts for spouses and term of years trusts for children funded with retirement plan assets to individuals suspected of having significant retirement plan assets.

#### Impact Marketing

1. Include representative illustrations when meeting with individuals with highly appreciated assets, individuals in their 40's and 50's, and owners of closely-held businesses.
2. Include information about charitable remainder trusts in small group meetings on financial planning and charitable giving, planning for retirement, etc.
3. Hold small group informational meetings for owners of closely-held businesses hosted by their friends/peers.
4. Hold small group informational meetings for individuals known to have significant retirement plan assets hosted by their friends/peers.

### **CHARITABLE LEAD TRUSTS (NON-REVERSIONARY, NON-GRANTOR DONE FOR GIFT AND ESTATE TAX SAVINGS)**

#### AUDIENCES

##### Lifetime Charitable Lead Trust Donor Profiles

1. Donors with assets expected to greatly appreciate between now and death of donor.
2. Donors who want to see the impact of the annual distributions to charity from the trust.
3. Donors who want to finalize a charitable plan which will make significant charitable contributions to one or more charities.

##### Testamentary Charitable Lead Trusts

1. Individuals with very high net worth, facing confiscatory federal estate taxes.
2. Individuals who want to leverage the \$1 million per grandparent generation-skipping transfer tax exemption and set up lead trusts with remainder to grandchildren or great-nieces/nephews to avoid the second generation federal estate taxation in the parents' estates.
3. Single individuals with estates over \$625,000 who want to eliminate as much estate tax as possible, make a gift to charity, and maximize what the family will ultimately retain.

#### MESSAGES

1. You can create a plan which will provide one or more charities with a fixed or variable income for the duration of your life and your spouse's or for a set number of years and have the assets returned to your children and maybe even your grandchildren with little to no estate tax on the transfer back to your family.

2. You can dramatically reduce the amount of gift or estate tax due on a substantial transfer to your children or heirs by first “loaning” some assets to a charitable trust.
3. You can “freeze” the value of an asset for estate tax purposes by placing it in a special charitable trust which pays income to one or more qualified charities before transferring the asset to your family or heirs.
4. You can accelerate part of your children's inheritance and substantially reduce gift tax on that part of the inheritance by providing one or more charities with a fixed or variable income for a term of years before the transfer to your children.
5. If you want to pass part of your estate directly to your grandchildren without owing the penalty tax known as “generation skipping transfer tax” and greatly reducing gift or estate tax by making distributions to them from a trust which has first provided one or more charities with a variable income for the rest of your life, or a term of years after your death.

## MARKETING STRATEGIES

### Saturation Marketing

1. Include brief case studies (how a lead trust helped real or hypothetical individuals solve a financial problem or concern) or teaser articles (“did you know you can...”) in organization newsletters, on web pages.
2. Include stories about charitable lead trust donors (why we made this gift) in annual reports.

### Segmented Marketing

1. Direct mail pieces/series on charitable remainder trusts to high net worth individuals and couples; individuals likely to receive substantial inheritances; individuals with rapidly appreciating assets, such as real estate, investment portfolios, some closely held businesses.
2. Provide information about charitable lead trusts to members of planned giving societies, bequest donors.

### Impact Marketing

1. Include representative illustrations when meeting with high-net worth individuals and couples, individuals known to be beneficiaries of substantial estates, and individuals with rapidly appreciating assets, and the professional advisors to these individuals.
2. Include information about charitable lead trusts in small group meetings on estate planning for high net worth individuals.

### Presented by:

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REGISTRANTS



# Registrants for the 23rd Conference on Gift Annuities

April 14-16, 1998

Atlanta, Ga.

Name	Organization	City, State
Mary Margaret Abood	Bank of America	Chicago, IL
Jan S. Adams	Mellon Private Capital Management	Boston, MA
Morris Adams	Ridge Area ARC Foundation	Avon Park, FL
John C. Adamson	Second Presbyterian Church	Memphis, TN
Paul Glenn Alexander	Baptist Health Care Foundation	Montgomery, AL
Vernon L. Alger	Seventh-day Adventists - Lake Union Conf.	Berrien Springs, MI
Edwin Allen, Jr.	Lexington Theological Seminary	Lexington, KY
Michael W. Anderson	Kansas Univ. Endowment Assn.	Lawrence, KS
Paul A. Anderson	Far East Broadcasting Company	La Mirada, CA
Albert B. Anderson, Ph.D.	College Misericordia	Dallas, PA
Dianne P. Ansley	University of the South	Sewanee, TN
Xenon U. Antone	General Board of Global Ministries	New York, NY
Lynn E. Archer	Arthritis Foundation	Atlanta, GA
Wayne W. Archer	University of Texas Foundation	Tyler, TX
Dr. John Jerry Armstrong	Dayton Christian Schools, Inc.	Dayton, OH
Kris S. Arnzen	Resonate, Inc.	Cincinnati, OH
Sidney L. Arroyo	Covenant House New Orleans	New Orleans, LA
Mary Kay Artress	Seventh-day Adventists - Southern Union Conf.	Decatur, GA
JoAnn L. Avery	The Salvation Army	Atlanta, GA
Barbara Bagley	Resource Development, Inc.	Springfield, MO
Robert J. Bailey	Reformed Theological Seminary	Jackson, MS
Steven J. Baker	Barnabas Foundation	Grand Rapids, MI
Joan V. Banaszak	St. Jude Children's Res. Hosp.	St. Petersburg, FL
Marianne Barker	Oregon State University	Corvallis, OR
Amy F. Barnwell	Fidelity Investments	Boston, MA
Paul Barrus	Laubach Literacy	Syracuse, NY
Josh Samuel Bartholomew	Samaritan's Purse	Boone, NC
C. Ann Barton	Sun Trust Bank, Chattanooga	Chattanooga, TN
Donna Barwick	Lefkoff, Duncan, Miller et al	Atlanta, GA
Kenneth L. Bath	Knox College	Galesburg, IL
Barbara Bauer	Deborah Hospital Foundation	Browns Mills, NJ
Shirley Bayne	Amnesty International USA	New York, NY
Susan P. Beacham	Bank of America	Chicago, IL
Barbara Bear	Converse & Associates	Memphis, TN
Ronald D. Beck	Western Kentucky University	Bowling Green, KY
Eric G. Beckman	Moody Bible Institute	Chicago, IL
Marvin E. Beckman	Moody Bible Institute	Chicago, IL
Jerry Bedford	Heifer International Foundation	Little Rock, AR
Don D. Behning	Iowa State Univ. Foundation	Ames, IA
Perry Bell	United Methodist Foundation	Springfield, IL
Michael W. Bennett	Willamette University	Salem, OR
Kathleen P. Berger	University of Dayton	Dayton, OH
Brian P. Berrigan	The Jesuits New Orleans Province	Metairie, LA
Karen E. Bertroch	Union Gospel Mission	Seattle, WA
Barbara J. Bibbee	General Board of Global Ministries	Middleburg Hts., OH
Andrew R. Biebl	Biebl, Ranweiler, Christiansen, et al	New Ulm, MN
Bruce Bigelow	Hood College	Frederick, MD
Thomas Billitteri	Chronicle of Philanthropy	Washington, DC
Sister Kathy Bilskie	Sisters of St. Benedict	Ferdinand, IN
John B. Bingham	Sungard Trust Systems	Charlotte, NC
Roger L. Bisson	Missionaries of Africa	Washington, DC
B. Lee Black	New Mexico Baptist Foundation	Albuquerque, NM
Timothy K. Blankenship	The Gideons International	Nashville, TN
Brent Blanner	R & R Newkirk	Willow Springs, IL

Name	Organization	City, State
Ingrid M. Blanton	Colonial Williamsburg Foundation	Williamsburg, VA
Denise M. Blew	Lehigh University	Bethlehem, PA
Michal L. Bobryk, JDLLM	Phoenix Charter Oak Trust Company	Hartford, CT
Charles H. Bolton	Capital Management Center	Ft. Walton Beach, FL
Steve Bone, Esq.	Renaissance, Inc.	Carmel, IN
Charmaine Boone	Foster's Home for Children	Stephenville, TX
Eugene L. Boone	Foster's Home for Children	Stephenville, TX
Sandra Borischak	Epilepsy Foundation	Landover, MD
Catherine M. Bowling	Assoc. for the Preservation of Civil War Sites	Hagerstown, MD
Kimberly J. Bowman	St. Olaf College	Northfield, MN
Arthur Meyer Boyd	Friends Committee of National Legislation	Washington, DC
Carolyn L. Branch	Westark College	Fort Smith, AR
David A. Brawley	State Street Global Advisors	Boston, MA
Marco Brehm	Covenant House	New York, NY
Robert J. Brennan	The Humane Society of the United States	Washington, DC
Patricia S. Brent	Lahey Hitchcock Clinic	Burlington, MA
Robert T. Bridges	Asbury Theological Seminary	Wilmore, KY
Eva M. Brightup	Friends University	Wichita, KS
Arthur M. Brink, Jr.	Fletcher Allen Health Care	Burlington, VT
Eugene W. Brockemeyer	First Christian Church Fdn., Inc.	Lincoln, NE
Rachel P. Brophy	California State University, Long Beach	Long Beach, CA
Ken Brouwer	Wycliffe Bible Translators	Huntington Beach, CA
Barbara Norris Brown	Hope Hospice	Fort Myers, FL
David W. Brown	Alexander Haas Martin & Partners	Atlanta, GA
Eileen J. Brown	Children International	Kansas City, MO
Elizabeth A.S. Brown	Moody Bible Institute	Chicago, IL
Gail A. Brown	Coral Ridge Ministries Media, Inc.	Ft. Lauderdale, FL
James Patrick Brown	Marianist Mission	Dayton, OH
Ronald A. Brown	Princeton University	Princeton, NJ
Tommy R. Brown	Palmer Home for Children	Columbus, MS
Clyde Eugene Brueland	David and Margaret Home, Inc.	La Verne, CA
L. Conrad Bryner	Deseret Trust Company	Salt Lake City, UT
Heidrun M. Buehner	Lutheran Church-Missouri Synod Foundation	St. Louis, MO
Jan Bunyard	University of Alabama at Birmingham	Birmingham, AL
Linda L. Burr	CARE, Inc.	Oakland, CA
Janice Burrill	Wells Fargo Bank/Charitable Mgt. Group	Los Angeles, CA
Tommye Burrough	In Touch Foundation	Atlanta, GA
Jean P. Bursley	General Board of Global Ministries	Half Moon Bay, CA
Marite M. Butners	Providence Health System	Seattle, WA
Harvey J. Byram	Southwest Estate Services, Inc.	Burleson, TX
Janis Cable	Resource Development, Inc.	Plano, TX
Margaret E. Caldwell	Fidelity Investments	Chicago, IL
O. Richard Caldwell	Seventh-day Adventists - General Conf.	Silver Springs, MD
Samuel D. Caldwell	Wilmington Friends School	Wilmington, DE
W. Gerald Caldwell, Jr.	Resource Advisory Services, Inc.	Dallas, TX
L. Curtis Calihan	National Community Foundation	Brentwood, TN
Margaret D. Cammuse	Southern Baptist Foundation	Nashville, TN
Eric Campbell	Arthritis Foundation	Chanhassen, MN
Louis Canosa	Seventh-day Adventists - Carolina Conf.	Candler, NC
Lisa A. Cantone	Haggett, Longobardi & Co., LLC.	Glastonbury, CT
Gregory B. Capin	Capin Crouse LLP	Greenwood, IN
Ray M. Caraway	United Methodist Foundation	Baton Rouge, LA
Jeffrey A. Carlisle	Sungard Trust Systems	Atlanta, GA
Arthur Carlson	Seventh-day Adventists - Carolina Conf.	Fletcher, NC
Charles B. Carlton	North Alabama United Methodist Fdn, Inc.	Birmingham, AL
Philip L. Carman	Rotary Foundation	Evanston, IL
Marc L. Carmichael	R & R Newkirk	Willow Springs, IL
Wilma Carmichael	R & R Newkirk	Willow Springs, IL

Name	Organization	City, State
Craig A. Carter	Advent Christian Village	Dowling Park, FL
G. Tom Carter	Seventh-day Adventists - General Conf.	Silver Spring, MD
Brian S. Casey	Iowa State Univ. Foundation	Ames, IA
Judith C. Cash	University of Virginia	Charlottesville, VA
Howard B. Castle	Wesleyan Church Corporation	Indianapolis, IN
Brigidine Castro	Rutgers University Foundation	New Brunswick, NJ
Gordon M. Caswell	Baylor Health Care System Foundation	Dallas, TX
Marilee Cater	HCJB World Radio	Colorado Springs, CO
Gary W. Caton	International Missions	Reading, PA
George E. Cawthon	University of Florida Foundation, Inc.	Gainesville, FL
Bren H. Chambers	Back to the Bible	Lincoln, NE
Gerald A. Chapman	Seventh-day Adventists - Rocky Mtn. Conf.	Denver, CO
Lain R. Chappell	Focus on the Family	Colorado Springs, CO
Sally Cheney	Laubach Literacy	Syracuse, NY
Sorrell E. Chesin	SUNY at Albany	Albany, NY
William L. Childs, Jr.	Tennessee Baptist Foundation	Brentwood, TN
Kristine Christlieb	Christlieb Advancement	Trophy Club, TX
Jim J. Chroust	CMH Foundation	Wilmington, OH
James B. Church	Loma Linda University	Loma Linda, CA
Mary Michelle Churchwell	New Mexico Baptist Foundation	Albuquerque, NM
Sandra Ciallella	Scripps Foundation for Medicine & Science	La Jolla, CA
John F. Ciskanik	Christendom College	Front Royal, VA
Dennis P. Clark	Masonic Charity Foundation of CT	Wallingford, CT
Dortha F.M. Coakley	American Diabetes Association	Alexandria, VA
Donald G. Coates	Catholic Charities USA	Alexandria, VA
Robert L. Coffman	Anderson University	Anderson, IN
James E. Connell	James E. Connell & Associates	Lebanon, PA
Julia S. Constantino	Saint Louis Priory School	St. Louis, MO
Phil Converse	Converse & Associates	Memphis, TN
Joe L. Cope	Abilene Christian University	Abilene, TX
Terrence C. Corkerton	Ohio Wesleyan University	Delaware, OH
Valerie Cornelius	Christian Community Foundation	Woodland Park, CO
Fr. Joseph Costa, I.M.C.	Consolata Missionaries	Somerset, NJ
William A. Couchenour	Olivet Nazarene University	Kankakee, IL
Cynthia I. Court	Arthritis Foundation	Crofton, MD
Dr. John Crooch	Oklahoma United Methodist Foundation, Inc.	Oklahoma City, OK
Stewart J. Crook	Georgia State University	Atlanta, GA
Robert E. Crosby	Crosby Associates	Lancaster, PA
Margaret A. Cuccinello	Jesuit Seminary and Mission Bureau	New York, NY
Thomas W. Cullinan	University System of Maryland	Adelphi, MD
Barbara A. Culver	Resonate, Inc.	Cincinnati, OH
Max W. Custer, Jr.	Watchtower Bible and Tract Society	Patterson, NY
Sandra M. D'Ambrosio	Fox Chase Cancer Center	Philadelphia, PA
Elaine D'Amours	Mount Holyoke College	South Hadley, MA
Don J. Dady	Legacy Marketing Group	Petaluma, CA
Susan Dame Greene	Bipster International, LLC	Falls Church, VA
Lillian Budd Darden	Wesley Woods Center on Aging	Atlanta, GA
W. Robert Daum	Seventh-day Adventists - Pacific Union Conf.	Westlake Village, CA
Alesia M. Davenport, CEP	American Heart Association	St. Petersburg, FL
David M. Davies	International Bible Society	Colorado Springs, CO
Arthur E. Davis	The Stewardship Foundation	Harrisburg, PA
Bobby R. Davis	Boyd-Buchanan School	Chattanooga, TN
Daniel L. Davis	Seventh-day Adventists - Allegheny E. Conf.	Pine Forge, PA
Larry L. Davis	Seventh-day Adventists - Southern Union Conf.	Decatur, GA
Stan Davis	Samford University	Birmingham, AL
Bernard J. Davisson, II	Johns Hopkins Institutions	Baltimore, MD
Judith M. Dawson	Punahou School	Honolulu, HI
Dennis R. Day	St. Norbert College	DePere, WI

Name	Organization	City, State
Ethel M. Dean	Presbyterian Homes of NJ Fdn.	Princeton, NJ
Laura Hansen Dean	Laura Hansen Dean & Associates	Indianapolis, IN
William A. Deaton	Associate Reformed Presbyterian Fdn.	Charlotte, NC
Frank A. Deen	Seventh-day Adventists - Assoc. of CO	Denver, CO
Eugene P. Degitz	Princeton Theological Seminary	Princeton, NJ
Art DeHoogh, CFRE	Mennonite Board of Missions of Kansas City	Hesston, KS
Jeanne L. Deiger	Sungard Trust Systems	Atlanta, GA
Victoria A. DellaSperanza	Elderhostel	Boston, MA
William P. DeMoranville	Arthritis Foundation	Atlanta, GA
Kenneth J. DeVries	WMU Foundation	Kalamazoo, MI
Ann W. Dibble	Georgia Tech Foundation	Atlanta, GA
Maryellen Dickey	Lehigh University	Bethlehem, PA
John Dickson	American Heart Association	Los Angeles, CA
Doris E. Dieter	American Foundation for the Blind	New York, NY
John W. Dixon	Fiduciary Trust Co., Int'l	New York, NY
Frederick J. Dixon, Jr.	Acts, Inc.	West Point, PA
Ernest Dobkins	Seventh-day Adventists - No. Calif. Conf.	Pleasant Hill, CA
Edward P. Dolan	Columban Fathers	St. Columbans, NE
E. Michael Donegan	Denver 200	Denver, CO
Richard A. Dorn	Miami Jewish Home & Hospital	Miami, FL
Jessica Michelle Dotson	New Mexico Baptist Foundation	Albuquerque, NM
Lon P. Dufek	Crescendo Software	Camarillo, CA
Richard P. Dugan	Missionary Church Investment Foundation	Fort Wayne, IN
Mary S. Duncan	Georgia Tech Foundation	Atlanta, GA
William Lloyd Duncan	Addolorata Villa Foundation	Wheeling, IL
Marlene F. Dunford	United Way of Summit County	Akron, OH
Tod Eastlake	Assemblies of God Foundation	Springfield, MO
Gregory W. Edwards	The Nature Conservancy	Charlottesville, VA
Margaret M. Edwards	Birmingham-Southern College	Birmingham, AL
Susan J. Ehart	The Principia School and College	St. Louis, MO
Ben H. Engbrecht	North American Baptist Seminary	Sioux Falls, SD
Richard K. Ensminger	American Institute for Cancer Research	Washington, DC
Mary Ann Esber	Ohio State University	Columbus, OH
Ellen G. Estes	Estes Associates	Woodbridge, CT
Frank W. Estes	Yale-New Haven Hospital	New Haven, CT
Zachary J. Etienne	Saint Meinrad Archabbey	St. Meinrad, IN
William W. Evans	Free Will Baptist Foundation	Antioch, TN
Gary R. Faircloth	Starr Commonwealth	Albion, MI
Stephen C. Falk	Henry Ford Health System	Detroit, MI
Martha A. Farrington	Hoag Hospital Foundation	Newport Beach, CA
Carole Fenstermacher	University Buffalo	Buffalo, NY
Linda M. Fischler	Fox Chase Cancer Center	Philadelphia, PA
Joy Fisher	University of Idaho	Moscow, ID
Linda R. FitzPatrick	Mellon Private Capital Management	Boston, MA
Kenneth P. Flanigan	Evangelical Alliance Mission	Carol Stream, IL
Melitta Fleck	Gray Cary Ware & Freidenrich	San Diego, CA
Wyatt H. Folds, Jr.	Reformed Theological Seminary	Maitland, FL
Catherine H. Forrester	SC Coastal Conservation League	Charleston, SC
Colin T. Foster	The Salvation Army	West Nyack, NY
Charles A. Fowlie	Preachers' Aid Society of N.E.	Northboro, MA
Glen A. Fradenburg	American Family Association, Inc.	Tupelo, MS
Jackie W. Franey	American Heart Association - National Center	Dallas, TX
Beattie Friday	Woodruff Arts Center	Atlanta, GA
Kenneth C. Frisch	Bowling Green State University	Bowling Green, OH
Al W. Frost	Lutheran Child & Family Services	River Forest, IL
Susan A. Frost	Clarke School for the Deaf	Northampton, MA
George M. Furlong, Jr.	Baptist Health Care Foundation	Pensacola, FL
David L. Gadberry	City of Hope National Medical Center	Los Angeles, CA



Name	Organization	City, State
Mark P. Gadson	Phoenix Charter Oak Trust Company	Hartford, CT
George Gahr	Christian Homes	Lincoln, IL
Karen Miller Gamble, Esq.	Morehouse College	Atlanta, GA
Louise M. Gantt	South Carolina Episcopal Home	West Columbia, SC
Donna Garner	The Salvation Army	Atlanta, GA
Dan T. Garrett	Abilene Christian University	Abilene, TX
Patricia H. Gately	Oblate Missions	San Antonio, TX
Susan D. Gathings	Loma Linda University	Loma Linda, CA
Steve Gegen	Friends University	Wichita, KS
Robert Jay Getz	Getz Development Group	Newaygo, MI
Gene Gibba	Valley Health System	Hemet, CA
Doris L. Gidney	General Board of Global Ministries	Arden, NC
Karen Gilbert	Catholic Charities	Chicago, IL
Nick Giles	Georgia Sheriff's Youth Homes Inc.	Stockbridge, GA
Francis C. Gillette	Northwest College Foundation	Powell, WY
David L. Gines	Brenau University	Gainesville, GA
William C. Gingrich	North American Baptist Conference	Oakbrook Terrace, IL
Mary Louise Gist	Children's Hospital Medical Center	Cincinnati, OH
Bob Golberg	Amherst H. Wilder Foundation	Saint Paul, MN
Joel Goober	State Street Global Advisors	Boston, MA
Gordon Gordon	Carnegie Mellon University	Pittsburgh, PA
Robert A. Gordon	San Antonio Hospital Foundation	Upland, CA
Charles Gordy	Tufts University	Somerville, MA
R. Louis Graner	Scottish Rite Children's Medical Center	Atlanta, GA
Thomas M. Gray	Columbia University	New York, NY
Hudson S. Green	Marietta College	Marietta, OH
Thomas Edward Griffith	Society of the Divine Word	Techny, IL
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Sister Rose Guercio	Maryknoll Sisters	Maryknoll, NY
James E. Gumpert	Arthritis Foundation	Aurora, CO
Gerry C. Gunnin	Presbyterian Healthcare Foundation	Dallas, TX
Victor J. Gunst	North American Baptist Conference	Oakbrook Terrace, IL
Lance W. Gurel	Arkansas Tech Endowment & Trust Fund	Russellville, AR
Suzanne Guss	University of Louisville	University of Louisville, LA
Julius P. Gwin	Mission to the World	Atlanta, GA
Lyn T. Habercom	Maryville College	Maryville, TN
Bill Haggstrom, CFRE	The Salvation Army - Indiana Division	Indianapolis, IN
David S. Hallum	New Life Corp. of America	Brentwood, TN
H.P. Hamlin	Georgia Sheriff's Youth Homes Inc.	Stockbridge, GA
Jackie D. Hancock, Jr.	Wellmont Health System Foundations	Kingsport, TN
William C. Hankins	Seventh-day Adventists - Southern Union Conf.	Decatur, GA
Annette Hanks	Wells Fargo Bank/Charitable Mgt. Group	Los Angeles, CA
Paul Harkess	Mayo Foundation	Rochester, MN
James K. Hasson, Jr.	Sutherland, Asbill & Brennan	Atlanta, GA
David H. Hatfield	The Salvation Army	St. Louis, MO
Lawrence V. Hawkins	SDA- Christian Record Serv.	Lincoln, NE
Bill Hay	Seventh-day Adventists - Rocky Mtn. Conf.	Denver, CO
Ted E. Hayden	SMA Fathers	Dedham, MA
Dwight M. Heaney	Lutheran Social Services of the South, Inc.	Austin, TX
Roger W. Heinrich	Seventh-day Adventists - SE Calif Conf.	Colton, CA
John N. Helgeson	The Webb Schools	Claremont, CA
Rev. William Helwig	Wisconsin United Methodist Foundation, Inc.	Sun Prairie, WI
Chuck Henle	Moody Bible Institute	Chicago, IL
Jerry W. Henry	Brenau University	Gainesville, GA
Lloyd W. Herbener	Christian Home Assoc. - Children's Square	Council Bluffs, IA
Robey Franklin Herrick	Assemblies of God	Macon, GA
Lisa Herzner	PhilanthroTek, Inc.	Matthews, NC
Gary S. Hickle	Yellowstone Boys & Girls Ranch Fdn.	Billings, MT

Name	Organization	City, State
Zoe M. Hicks, Esq.	-----	Atlanta, GA
K. Milton Higgins	California Baptist Foundation	Fresno, CA
Peggy J. Hilden	Physicians Committee for Resp. Medicine	San Francisco, CA
James M. Hillman	Three Angels Broadcasting Network, Inc.	West Frankfort, IL
Ken Hodge	Renaissance, Inc.	Carmel, IN
Nancy B. Hodge	Mayo Fdn. for Medical Educ. & Research	Jacksonville, FL
Daniel G. Hoebeke	Alzheimer's Association	Chicago, IL
Leland F. Hoffman, Jr.	PhilanthroTek, Inc.	Matthews, NC
Ernest A. Holladay	Ohio State University	Columbus, OH
David D. Holland	Holland Financial Group, Inc.	Ormond Beach, FL
James R. Hoobler	Ohio State University	Columbus, OH
Michael R. Horst	Denison University	Granville, OH
Linda K. Hostetter	National Benevolent Association	St. Louis, MO
Richard W. Houston	Christian Community Foundation	Woodland Park, CO
Edward E. Howard	The Children's Home of Easton	Easton, PA
Thomas D. Hughes	Memorial Mission Healthcare Fdn., Inc.	Asheville, NC
Deborah C. Hull	Cleveland Botanical Garden	Cleveland, OH
Chase S. Hunt	Princeton Theological Seminary	Princeton, NJ
James Huntley	Toledo Museum of Art	Toledo, OH
James C. Huska	WELS Foundation, Inc.	Milwaukee, WI
Arthur C. Hyland	American Institute for Cancer Research	Washington, DC
Robert G. Ingold	Southwest Baptist University	Bolivar, MO
S. Patrick Ingram	University of Virginia	Charlottesville, VA
Angelina B. Jackson	AAL Capital	Montgomery, AL
Clay Jackson	The Principia School and College	St. Louis, MO
Jackson F. Jackson	Samford University	Birmingham, AL
John B. Jacobs	American Baptist Foundation	Valley Forge, PA
J. Lance Jacobson	Mayo Clinic	Rochester, MN
George C. Jacques	Baptist Foundation of Arizona	Phoenix, AZ
Richard A. James	Loma Linda University	Loma Linda, CA
Judith S. Janssen	AAL Capital	Appleton, WI
Heidi Jark	Valparaiso University	Valparaiso, IN
Catherine Jay	Church of the Nazarene	Kansas City, MO
Coy H. Jeans, Jr.	North Carolina Baptist Foundation	Marion, NC
Nancy Jeffers	Robert F. Sharpe and Co., Inc.	Memphis, TN
Robert D. Jenkins	DePauw University	Greencastle, IN
Jessica W. Jennings	Christian Brothers Investment Services, Inc.	New York, NY
Richard D. Jennings	State Street Global Advisors	Boston, MA
Andrew Jensen	Paragon Foundation	Alhambra, CA
Kenneth D. Johns	Braille Institute of America	Los Angeles, CA
Becky A. Johnson	Southern Baptist Foundation	Nashville, TN
Michael A. Johnson	Arthritis Foundation	Richmond, IN
Richard W. Johnson	Lee Bernard Co.	Palm Springs, CA
Tanya Howe Johnson	National Committee on Planned Giving	Indianapolis, IN
Hollis E. Johnson, III	Southern Baptist Foundation	Nashville, TN
Steve Johnston	Florida Baptist Family Ministries	Lakeland, FL
Donald W. Joiner	Planned Giving Resource Center	Nashville, TN
Catherine S. Jones	Ministers & Missionaries Benefit Board	New York, NY
Crystal Annette Jones	Moore Regional Hospital Foundation	Pinehurst, NC
Leigh A. Jones	Berea College	Berea, KY
Timothy A. Jones	University of Colorado Foundation, Inc.	Boulder, CO
Beverly Judge	American Council on Gift Annuities	New York, NY
Ann Jungmeyer	Rice University	Houston, TX
Bill Junk	Oklahoma United Methodist Foundation, Inc.	Oklahoma City, OK
Eloise B. Kaeck	Kishwaukee Health Foundation	Dekalb, IL
Emanuel Kallina, II	Kallina & Ackerman	Baltimore, MD
Daniel G. Karslake	The Riverside Church	New York, NY
Jill M. Kawano	Punahou School	Honolulu, HI

Name	Organization	City, State
David W. Keister	FMB Trust Company	Baltimore, MD
Elizabeth A. Keitel	Planned Giving Consultant	Hamden, CT
Philip W. Kell	California Baptist Foundation	Fresno, CA
Marvin Lewis Kelley	University of Cincinnati Foundation	Cincinnati, OH
Robert H. Kelley	S.V.D. Funds	Techny, IL
Cam Morin Kelly	Smith College	Northampton, MA
W. Fred Kendall	Belmont University	Nashville, TN
Joan C. Kenna	Vassar College	Poughkeepsie, NY
Betty Kercher	Buffalo Bill Historical Center	Cody, WY
Gloria Kermeen	American Council on Gift Annuities	Indianapolis, IN
Muriel Keshner	Rutgers University Foundation	New Brunswick, NJ
Miles B. Kessler	American Numismatic Assoc.	Colorado Springs, CO
Gary W. Kidwell	Christian Church Foundation, Inc.	Indianapolis, IN
Robb Kiker	Piedmont College	Demorest, GA
Cheryl B. King	Fidelity Investments	San Francisco, CA
Dr. George B. King	Baptist Foundation of Alabama	Montgomery, AL
Wayne A. King	OMS International Inc.	Greenwood, IN
Robert L. Kinzel, Jr.	Hendrix College	Conway, AR
Richard C. Kleckner	Aurora University	Aurora, IL
Daniel W. Klein	Texas Presbyterian Foundation	Dallas, TX
Jeff Klein	Jewish Community Foundation	Cherry Hill, NJ
Timothy David Klingveil	Trans World Radio	Cary, NC
Richard P. Knoedler	Moody Bible Institute	Chicago, IL
Edward C. Knox, CFRE	The Salvation Army	Hazleton, PA
Gretchen S. Koch	Archdiocese of Washington	Washington, DC
Virginia Blair Kontny	ALSAC/St. Jude Children's Research Hospital	Orange, CA
C. Alan Korthals	Kaspick & Company	Boston, MA
Peter C. Kote, J.D.	California State University, Long Beach	Long Beach, CA
Sister Anne Krause, SP	Sisters of Providence	St. Mary-of-the-Woods, IN
Dale W. Kreher	Columban Fathers	St. Columbans, NE
Paul E. Krouse	University of North Florida	Jacksonville, FL
J. Douglas Lambert	Bible Literature International	Columbus, OH
Joseph L. Langenderfer	The Catholic Foundation	New Orleans, LA
Bonnie Lapole	The Salvation Army	Atlanta, GA
Lindsay L. Lapole	The Salvation Army	Atlanta, GA
Kenneth C. Larson	Wheaton College (Illinois)	Wheaton, IL
Anita Laterro	Riverside Methodist Hospital Fdn.	unknown, XX
Robert M. Lavin	Hospital Sisters Health System	Springfield, IL
Debra Lawrence	First Church of Christ, Scientist	Boston, MA
Sara Lawrence	Mount Holyoke College	So. Hadley, MA
Cyndi Layne	Young-Preston Associates, Inc.	Cloverdale, VA
Nancy Leanes	Wheaton College	Norton, MA
Frederick H. Leasure	United Methodist Foundation of W. Pa.	Pittsburgh, PA
Jose A. LeGrand	Seventh-day Adventists - Florida Conf.	Winter Park, FL
Richard Michael Lehman	Eastern Mennonite Missions	Salunga, PA
Edward F. Leonard, III, Ph.D.	Georgia College & State Univ. Foundation	Milledgeville, GA
Betty J. Letzig	General Board of Global Ministries	New York, NY
Carol J. Lewis	The Salvation Army	Omaha, NE
H. Kenwood Lewis	Northwestern Memorial Foundation	Chicago, IL
Stephen P. Link	Lehigh University	Bethlehem, PA
Patricia Castillo Linn	California State University Foundation	Long Beach, CA
J. Frederick Lintner	The Culver Academies	Culver, IN
Hardy M. Lister	Falcons Landing	Sterling, VA
Greg Lober	Resource Development, Inc.	Springfield, MO
Thomas Lockerby	PG Calc Incorporated	Cambridge, MA
Lee W. Logan	Erskine College	Due West, SC
James J. Loscheider	The Christian & Missionary Alliance	Colorado Springs, CO
Bruce R. Lott	Christian Church Homes of Kentucky	Louisville, KY

Name	Organization	City, State
Norm Lotz	Covenant House	New York, NY
Harry R. Lovell	Illinois Wesleyan Univeristy	Bloomington, IL
Daniel A. Luessenhop	Society of the Little Flower	Darien, IL
Bettie B. Lusk	General Board of Global Ministries	Goodyear, AZ
Donald A. Lusk	General Board of Global Ministries	Goodyear, AZ
Peggy S. Luy	Millikin University	Decatur, IL
Jeffrey A. Lydenberg	Cleveland Clinic Foundation	Cleveland, OH
Carolyn Lynn	Church of the Nazarene	Kansas City, MO
Barbara D. Mack	Claretian Missionaries/St. Jude League	Chicago, IL
Sandy Macnab	Alexander Macnab & Co.	Chicago, IL
Bob Magee	Trust Imaging Systems, Inc.	Malvern, PA
Olga R. Maldonado	Texas Methodist Foundation	Austin, TX
Betsy A. Mangone	Mangone & Co.	Lakewood, CO
Barlow Mann	Robert F. Sharpe and Co., Inc.	Memphis, TN
Julia Manning	Reliance Trust Company	Atlanta, GA
Nancy E. Maraldo	Pentera, Inc.	Indianapolis, IN
Ray Markham	Jesuits of the Missouri Province	St. Louis, MO
Vonda J. Marrow	Kentucky Wesleyan College	Owensboro, KY
Nancy F. Marshall	Peninsula United Methodist Homes, Inc.	Wilmington, DE
Bill E. Martin	Omaha Home for Boys	Omaha, NE
William Martin	College of St. Catherine	St. Paul, MN
Elizabeth L. Mathieu	Neuberger & Berman Trust Company	New York, NY
A. Ruth Matthews	Arthritis Foundation	Atlanta, GA
Elizabeth E. Matthews	Western Adventist Foundation	Westlake Village, CA
J. David Mays	College of William and Mary	Williamsburg, VA
Thomas J. McCarron	California State University Foundation	Long Beach, CA
Mary Frances McCarthy	St. Mary's Hospital Development Fdn.	Grand Junction, CO
William P. McCarthy	Kelly Ryan Financial	Sarasota, FL
Ned McCarty	First Church of Christ, Scientist	Boston, MA
Maureen A. McCawley	Province of Our Lady of Consolation, Inc.	Mt. St. Francis, IN
Blanche D. McCloskey	National Wildlife Federation	Vienna, VA
G. Harold McCue	Trevecca Nazarene University	Nashville, TN
Jeffrey A. McCuen	Sungard Trust Systems	Atlanta, GA
Robert A. McCumber	Seventh-day Adventists - Assoc. of CO	Denver, CO
Timothy J. McDowell	Comboni Missionaries	Cincinnati, OH
Bo McElroy	Robert F. Sharpe and Co., Inc.	Memphis, TN
W. Douglas McGaughey	Memorial Hermann Health Care System Fdn.	Houston, TX
Sister Patricia Ann McGuire	Sisters of St. Benedict	Ferdinand, IN
Chris M. McGurn	Mercantile Bank & Trust Co.	Baltimore, MD
Patrick H. McHugh	Capuchin Province of St. Mary	White Plains, NY
Clif McIntire	Paine Webber Philanthropic Services Group	Charlotte, NC
Joe McIntosh	Southern Baptist Convention Annuity Board	Dallas, TX
H. Joseph McKane	Aurora University	Aurora, IL
Patrick J. McKenna	Georgia Tech Foundation	Atlanta, GA
Richard K. McLaughlin	Rogue Valley Manor Foundation	Medford, OR
Richard J. McMillen	Water Street Rescue Mission	Lancaster, PA
William H. McMullen, Jr.	-----	Charlotte, NC
Bronnie F. McNabb, Jr.	United Methodist Foundation of W. NC	Charlotte, NC
Todd Mekelburg	Union College	Lincoln, NE
Philip E. Melberg	National Rifle Association	Fairfax, VA
Jim Menton	American Cancer Society	Atlanta, GA
T. Edward Mercer	University of Texas - Pan American	Edinburg, TX
Anthony J. Meyer	Greenville Hospital System Fdn.	Greenville, SC
Keith Meyering	Sunset Association	Jenison, MI
Shelby R. Miller	Northfield Mount Hermon School	Northfield, MA
Bryant Millsaps	Tennessee Baptist Children's Homes, Inc.	Brentwood, TN
Frank D. Minton	Planned Giving Services	Seattle, WA
Mike Mitchell	First United Methodist Church - Tulsa, Okla.	Tulsa, OK

Name	Organization	City, State
Delmar R. Mohler	Moody Bible Institute	Chicago, IL
Charles E. Molloy	CARE, Inc.	Atlanta, GA
Patricia M. Moloney	Dominican Sisters - St. Mary of the Springs	Columbus, OH
Vickie Monday	Seventh-day Adventists - Florida Conf.	Winter Park, FL
Dr. Leon M. Moody	Dublin Christian Academy	Dublin, NH
Ed Moore	Sunny Glen Children's Home	San Benito, TX
Phyllis Moore	Sunny Glen Children's Home	San Benito, TX
Rachel F. Moore	Smith College	Northampton, MA
W. David Moore	Arkansas Baptist Foundation	Little Rock, AR
Barb Morgan	Punahou School	Honolulu, HI
Heather K. Morgan	American Institute for Cancer Research	Washington, DC
Denita J. Morin	Arthritis Foundation	Atlanta, GA
Susan E. Moritz	Wesley Retirement Services	Des Moines, IA
William F. Moroney	Missionaries of Africa	Washington, DC
Robert L. Morrissey	Indian Hills Community College Fdn.	Ottumwa, IA
William F. Mosconi	Rutgers University Foundation	New Brunswick, NJ
Patricia Neild Moulton	San Diego State University	San Diego, CA
Michael Mudry	Hay/Huggins Company, Inc.	Wayne, PA
Richard J. Mulder	Barnabas Foundation	Orland Park, IL
Robert W. Muldoon, Jr.	Piedmont College	Demorest, GA
Lee Mulligan	Thoms Health Services Fdn.	Asheville, NC
James A. Mullin	Catholic Community Foundation	St. Paul, MN
Ronald P. Munger	The Nature Conservancy	San Francisco, CA
Larry G. Murphy	Southern Baptist Convention Annuity Board	Dallas, TX
Charles R. Murray	The Seeing Eye	Morristown, NJ
Gifford G. Myers	Northwestern Foundation	Saint Paul, MN
Keith A. Napolitano	Bethesda Lutheran Homes & Services, Inc.	Watertown, WI
Richard Nassau	Jewish Federation of Greater Philadelphia	Philadelphia, PA
Aletha C. Nee	Seventh-day Adventists - Florida Conf.	Winter Park, FL
David Neely	Mount Hermon Association	Mount Hermon, CA
William A. Neill	Ripon College	Ripon, WI
A. Gordon Nelson	Christian Blind Mission Int'l	Stouffville, ON
David Wheeler Newman	Mitchell, Silberberg & Knupp	Los Angeles, CA
Debbie Newsom	Converse & Associates	Memphis, TN
Stephen H. Nickel	Back to the Bible	Lincoln, NE
John B. Nickels	Bethesda Lutheran Homes & Services, Inc.	Watertown, WI
Kirby Nickerson	Advent Christian Village	Dowling Park, FL
David H. Nienas	Claremont School of Theology	Claremont, CA
William G. Nolan	Birmingham-Southern College	Birmingham, AL
Marie Noriega	Wells Fargo Bank/Charitable Mgt. Group	Los Angeles, CA
Peter M. Norman	Episcopal Retirement Homes	Cincinnati, OH
Bruce Nortell	North Central College	Naperville, IL
Olive Norvell	New Life Corp. of America	Brentwood, TN
William P. O'Connor	Missionary Oblates	Belleville, IL
Charles F. O'Dell, Jr.	Southwestern Adventist University	Keene, TX
Larry W. O'Neal	University of Alabama - Huntington	Huntsville, AL
Michael J. Occhipinti	Saddleback Memorial Foundation	Laguna Hills, CA
Keith M. Oelke	University of Georgia	Athens, GA
Jon A. Oien	Augustana College	Sioux Falls, SD
Sergio M. Oliver	First Union	McLean, VA
John D. Ordway	UCC Pension Boards (Ret.)	Naples, FL
Addison Ore	Paralyzed Veterans of America	Greensboro, NC
Cynthia Ott	Friars of the Atonement, Inc.	Garrison, NY
Victor L. Ottenlips	The Redemptorists	Liguori, MO
William S. Overby	North Carolina Baptist Foundation	Cary, NC
Ronald E. Ovitt	Central Baptist Children's Home	Lake Villa, IL
Bruce Owens	Mission to the World	Atlanta, GA
Cecil Jim Owens	Seventh-day Adventists - No. Calif. Conf.	Pleasant Hill, CA

Name	Organization	City, State
Debra G. Palmer-Seiler	Children`s Hospital and Regional Med. Ctr.	Seattle, WA
Mike R. Parham	Freed-Hardeman University	Henderson, TN
Roger K. Parolini	Aurora University	Aurora, IL
Barbara J. Parrott	Seventh-day Adventists - Rocky Mtn. Conf.	Denver, CO
D. Smith Patterson	Wofford College	Spartanburg, SC
John A. Patterson	Oklahoma Baptist University	Shawnee, OK
Robert L. Patterson	Seventh-day Adventists - Col. Union Conf.	Columbia, MD
Ronald W. Paulson	Trinity Western University Fdn. U.S.	Lynden, WA
Lynn J. Pauquette	Parsons Child and Family Center	Albany, NY
Lisa Townsend Payne	Foundation for Owensboro Mercy	Owensboro, KY
Lori J. Payne	Sun Trust Bank, Chattanooga	Chattanooga, TN
Robert S. Peach	Ashrae Foundation	Atlanta, GA
Robert C. Peper	L.S.S. Foundation - Paragon	Alhambra, CA
Shirley Anne Peppers	Harvard University	Los Angeles, CA
Nancy L. Perazelli	Drake University	Des Moines, IA
Lorena Perez	In Touch Foundation	Atlanta, GA
Susan J. Perkins	College of Staten Island	Staten Island, NY
Doloras A. Perrone	Shriners Hospital for Children	Tampa, FL
Eric H. Petersen	Moral Re-Armament, Inc.,	Fort Myers Beach, FL
Nancy Peterson	Providence Health System	Seattle, WA
Robert J.B. Petmecky	In Touch Foundation	Atlanta, GA
Gary Pforzheimer	PG Calc Incorporated	Cambridge, MA
Brian J. Piecuch	Christian Blind Mission Int'l	Greenville, SC
Marianne Piepenburg	Southern Methodist University	Dallas, TX
Mark D. Pitman	Brethren Foundation	Elgin, IL
Tui D. Pitman	Seventh-day Adventists - Gulf States Conf.	Montgomery, AL
James B. Potter	Planned Giving Resources	Alexandria, VA
Floyd H. Powell	Seventh-day Adventists - Florida Conf.	Apopka, FL
John G. Power	-----	Los Angeles, CA
Charles F. Preuss	Back to the Bible	Lincoln, NE
Sarah Fish Preyer	Duke University	Durham, NC
Patricia A. Price	CARE, Inc.	New York, NY
Wayne R. Price	Lutheran Church-Missouri Synod Foundation	St. Louis, MO
Daniel G. Pritchard	Mercy Home for Boys and Girls	Chicago, IL
James Bradley Purcell	Union Theological Seminary	Richmond, VA
Eric A. Putman	Leadership Institute	Arlington, VA
Raymond Quetchenbach	SVD Funds	Techny, IL
Ellen Rakatansky	PG Calc Incorporated	Cambridge, MA
Richard E. Ralston	Ayn Rand Institute	Marina del Rey, CA
Dr. Donald Ratajczak	Georgia State University	Atlanta, GA
Patricia A. Rawa	Catholic Church Extension Soc. of the USA	Chicago, IL
Carla Maxwell Ray	Morehouse College	Atlanta, GA
Marla R. Ray	St. Edward`s University	Austin, TX
Stan Reaves	Georgia Sheriff`s Youth Homes Inc.	Stockbridge, GA
Michael D. Redmond	Friars of the Atonement, Inc.	Garrison, NY
Steve L. Reed	Arkansas Children`s Hospital Fnd.	Little Rock, AR
R. Dean Rees	Holt International Children`s Services	Eugene, OR
Dale L. Regier	Mennonite Brethren Foundation	Hillsboro, KS
Bob F. Reiber	Seventh-day Adventists	Simi Valley, CA
Marian M. Reiber	Seventh-day Adventists - General Conf.	Simi Valley, CA
Paul L. Reidinger	John Knox Village of Florida, Inc.	Pompano Beach, FL
Eugene T. Remmers	Seventh-day Adventists - GA Cumb. Assoc.	Calhoun, GA
Benjamin J. Rhodes	Illinois Wesleyan University	Bloomington, IL
James A. Rhodes	Pennsylvania State University	University Park, PA
Janet Ribble	The Salvation Army	Southfield, MI
Rodney Jay Ribble	Arthritis Foundation	San Antonio, TX
Lynette Davis Rice	General Board of Global Ministries	Libertyville, IL
Louis W. Rice, III	University of Illinois Foundation	Urbana, IL

Name	Organization	City, State
Harold D. Richardson	Southern Baptist Convention Annuity Board	Dallas, TX
Tamara S. Richwine	Cornerstone Management, Inc.	Norcross, GA
Dave Ricks	American Cancer Society - California Div.	San Diego, CA
Sally Ridgway	The Gladney Fund	Fort Worth, TX
Heather E. Rindels	Henry Ford Health System	Detroit, MI
Alberta L. Rivera	Montana State University Found., Inc.	Bozeman, MT
Andrew W. Rivers	Friars of the Atonement, Inc.	Garrison, NY
Donna J. Roberts	Seventh-day Adventists - Florida Conf.	Winter Park, FL
Ed Roberts	The Salvation Army	Wichita, KS
Nancy Roberts	American Council on Gift Annuities	Dallas, TX
Tal Roberts	American Council on Gift Annuities	Dallas, TX
Beverly S. Robinson	Oakwood College	Huntsville, AL
Theodore Y. Rodgers, IV	Northern Baptist Theological Seminary	Lombard, IL
Jennifer Elizabeth Rogers	National Wildlife Federation	Vienna, VA
Glenn R. Rohrbach	Baptist Mid-Missions	Cleveland, OH
Geri Rose	Natural Resources Defense Council, Inc.	New York, NY
Sheilah B. Rostow	Fleet Bank	Hartford, CT
J.C. Jim Ruching, III	New Life Corp. of America	Brentwood, TN
Nanette J. Rudolf	Holy Cross Hospital	Ft. Lauderdale, FL
Cindy A. Rudolph	Cedars Home for Children	Lincoln, NE
Bethel M. Ruest	Mayo Foundation	Rochester, MN
David Wyatt Russell	Millsaps College	Jackson, MS
Joan E. Russell	Three Angels Broadcasting Network, Inc.	West Frankfort, IL
Thomas B. Russell	USMA - Association of Graduates	West Point, NY
Rev. Dorland R. Russett	NY/CT Foundation of the UMC, Inc.	White Plains, NY
Andrew W. Russo	Charitable Trust Administration Co.	Cleveland, OH
Constantino Salios	North American Baptist Conference	Oakbrook Terrace, IL
Ronald W. Salyer	United Methodist Church Foundation, Inc.	Cicero, NY
Marlon J. Sandlin	MAF Foundation	Redlands, CA
Scott Saunders	David Lipscomb University	Nashville, TN
Frances Saus	Berry College	Rome, GA
Ed Savage	Sacred Heart League	Walls, MS
James Sawtell	Seventh-day Adventists - Carolina Conf.	Charlotte, NC
David H. Schaeffer	American Cancer Society	Atlanta, GA
Alois Schmitt	Capuchin Province of St. Mary	New York, NY
Paul H. Schmitt	St. Olaf College	Northfield, MN
David W. Schneider	Twin Towers Retirement Community	Cincinnati, OH
Raymond C. Schneider	American Baptist Homes Foundation	Santa Barbara, CA
Steven L. Schoen	Southwest Missouri State University	Springfield, MO
G. Roger Schoenhals	Planned Giving Today	Edmonds, WA
Jonathan R. Schoenhals	Planned Giving Today	Edmonds, WA
A. David Scholder	National Multiple Sclerosis Society	Los Angeles, CA
Thomas P. Scholler	Archdiocese of Detroit	Detroit, MI
Clinton A. Schroeder	Gray, Plant, Mooty, Mooty & Bennett	Minneapolis, MN
Ardis Schultz	Crescendo Software	Camarillo, CA
Karon Schultz	Anderson University	Anderson, IN
A. Charles Schultz, Esq.	Crescendo Software	Camarillo, CA
Jack Schwab	Holt International Children's Services	Eugene, OR
William John Schwartz	Northwood University	Midland, MI
John C. Scibek	Marine Biological Laboratory	Woods Hole, MA
Linda M. Scott	Baptist/South Miami Hospital Fdn.	Miami, FL
Robert C. Seal	Seventh-day Adventists - Florida Conf.	Winter Park, FL
Spencer F. Sealy	American Cancer Society	Atlanta, GA
Eric Seckers	Charitable Trust Administration Co.	Cleveland, OH
Mark R. Seeley	Reformed Theological Seminary	Charlotte, NC
John P. Sentovich	Diocese of Rockford	Rockford, IL
Sidney J. Shearin	Shearin Consulting Services	Irvine, CA
William E. Sheehan, Jr.	Santa Clara University	Santa Clara, CA

Name	Organization	City, State
Robert W. Shelby	Billy Graham Evangelistic Assoc.	Minneapolis, MN
Mike Sheppard	National Community Foundation	Brentwood, TN
Dennis E. Sheridan, ChFC	Starr Commonwealth	Albion, MI
Gary L. Shetler	Mennonite Foundation	Goshen, IN
Ellen Shugart	Arthritis Foundation	Wethersfield, CT
Mary Ann Sides	North Carolina Baptist Foundation	Cary, NC
Ronald E. Simers	Billy Graham Evangelistic Assoc.	Minneapolis, MN
Stephen E. Simmons	Boy Scouts of America	Nassau, DE
Terry L. Simmons	Thompson & Knight, P.C.	Dallas, TX
Larry Simonson	Christian Homes	Lincoln, IL
Gary L. Skaggs	Northwest Nazarene College	Nampa, ID
Michael W. Skaggs	Northern Rockies Cancer Center	Billings, MT
Thomas D. Skinner	Biblical Theological Seminary	Hatfield, PA
William L. Slaughter, Jr.	Synovus Trust Company	Columbus, GA
David Slover	Children's Medical Center of Dallas	Dallas, TX
Eric M. Smith	Missionary Church Investment Foundation	Fort Wayne, IN
Gordon E. Smith	Ministers & Missionaries Benefit Board	New York, NY
James R. Smith	Missouri Baptist Foundation	Jefferson City, MO
Kenneth E. Smith	William Taylor Foundation	Upland, IN
Mark H. Smith	Covenant House Florida	Ft. Lauderdale, FL
Melinda A. Smith	Boys & Girls Clubs of America	Atlanta, GA
Scott D. Smith	Colby College	Waterville, ME
Susan Smith	Christian Community Foundation	Woodland Park, CO
Tom A. Smith	Board of Church Extension	Anderson, IN
Wayne C. Smith	Swiss Village, Inc.	Berne, IN
Paul G. Smith, Jr.	Southern Adventist University	Collegedale, TN
Winton C. Smith, Jr.	Winton Smith & Associates	Memphis, TN
Jeffrey T. Snell	Boys & Girls Clubs of Greater Milwaukee	Milwaukee, WI
James C. Soft	Yellowstone Boys & Girls Ranch Fdn.	Billings, MT
W. Peter Sommerfeld	Oregon Health Sciences Foundation	Portland, OR
Edward Sommers	Middlebury College	Middlebury, VT
Orville Les Speer	Seventh-day Adventists - GA Cumb. Assoc.	Calhoun, GA
Kathy Sperlak	R & R Newkirk	Willow Springs, IL
Mary Ellen Spiegel, CFP	Archdiocese of New York	New York, NY
Virginia G. Spradlin	Christian Church Foundation, Inc.	Indianapolis, IN
Linda P. Spuck	Water Street Rescue Mission	Lancaster, PA
Douglas C. Staats	Grace to You	Valencia, CA
Robert W. Stafford	Northcrest, Inc.	Ames, IA
Gary L. Stambaugh	Bible Literature International	Columbus, OH
Alfred N. Steele	The Christian & Missionary Alliance	Colorado Springs, CO
Jeffrey E. Steele	Philanthropy Planning Center Inc.	New York, NY
Timothy A. Stephenson	The Christian & Missionary Alliance	Colorado Springs, CO
Lynn Steuve	The Salvation Army	Atlanta, GA
Douglas B. Stewart	Arthritis Foundation	Atlanta, GA
Donald G. Stoner	United Church of Christ	Cleveland, OH
Gary E. Stoops	St. John's University	Collegeville, MN
Lowell V. Stortz	Leonard, Street and Deinard	Minneapolis, MN
James L. Stott	Catholic Church Extension Soc. of the USA	Chicago, IL
Charles Ann Strickland	Alton Ochsner Medical Fdn.	Metairie, LA
Linda Stringer	Southern Poverty Law Center	Montgomery, AL
Valerie Strong	Billy Graham Evangelistic Assoc.	Minneapolis, MN
Edward Stucky	Swiss Village, Inc.	Berne, IN
Lynn D. Stuhr	AAL Capital	Appleton, WI
Floyd I. Stumbo	The Children's Home Foundation	Lubbock, TX
Gregory J. Sullwold	The Salvation Army	West Nyack, NY
Jennifer Swenson	Renaissance, Inc.	Carmel, IN
Roger Syrja	Bob Jones Univ. Museum & Gallery, Inc.	Greenville, SC
LaVand Syverson	MAF Foundation	Redlands, CA



Name	Organization	City, State
John A. Tapia	General Board of Global Ministries	New York, NY
Charles J. Taylor	United Methodist Foundation	Houston, TX
Earl Taylor	Omaha Community Foundation	Omaha, NE
Peter C. Taylor	Morton Plant Mease Foundation	Clearwater, FL
Conrad Teitell	Cummings & Lockwood	Stamford, CT
Eugene Tempel	Center on Philanthropy	Indianapolis, IN
Charles W. Thomas, Jr.	Delco Blind/Sight Center	Chester, PA
Dr. Jerry W. Thomason	Hannibal LaGrange College	Hannibal, MO
Don E. Thompson	Southern Methodist University	Dallas, TX
John Charles Thompson	Arthritis Foundation	Chattanooga, TN
Stanley B. Thompson	Free Methodist Foundation	Spring Arbor, MI
Jonathan Tidd, Esq.	-----	West Simsbury, CT
LeRoy W. Tilt, III	East End Memorial Foundation	Birmingham, AL
Kathy Toborg	Kirkwood Community College	Cedar Rapids, IA
Eugene Torres	Seventh-day Adventists - Florida Conf.	Clermont, FL
Gregory K. Traucht	United Methodist Church - West Ohio	Worthington, OH
David Earl Treadwell	Prison Fellowship Ministries	Reston, VA
Catherine G. Trzeciak	University of Pittsburgh	Pittsburgh, PA
Andrew C. Tuecke	Emmaus Bible College	Dubuque, IA
Alden B. Tueller	Utah Valley State College	Orem, UT
Margaret Ann Tungseth	Concordia College	Moorhead, MN
Thomas R. Tupper	Deaconess Foundation	St. Louis, MO
Robert B. Turner	Seattle University	Seattle, WA
Charles Ray Tyler, Jr.	Cornerstone Management, Inc.	Norcross, GA
Jeff Underwood	First Church of Christ, Scientist	Boston, MA
Laurie W. Valentine	Kentucky Baptist Foundation	Louisville, KY
Tonny P. van der Leeden	City of Hope National Medical Center	Los Angeles, CA
Angela Inis Vaughan	Sun Trust Bank	Atlanta, GA
Dina Vaz	Amnesty International USA	New York, NY
Rev. Douglas F. Verdin	NY/CT Foundation of the UMC, Inc.	White Plains, NY
Leslie E. Vidra	Indiana University Foundation	Bloomington, IN
Joyce R. Viets	Arthritis Foundation	Santa Barbara, CA
Judith A. Voigt	Venice Foundation	Venice, FL
Thomas Wahhab	SMA Fathers	Dedham, MA
Charles A. Walker	Muskingum College	New Concord, OH
Sam Walls	Baptist Health Foundation	Little Rock, AR
Philip R. Walters	Arthritis Foundation	Longwood, FL
Dana E. Ward	The Nature Conservancy	Arlington, VA
Kathryn L. Ward	American Institute for Cancer Research	Washington, DC
M. Clay Warf	North Carolina Baptist Foundation	Cary, NC
Melinda M. Warren	Baptist Foundation of Oklahoma	Oklahoma City, OK
Douglas A. Weaver	Pentera, Inc.	Indianapolis, IN
Monte J. Weaver	Second Presbyterian Church	Memphis, TN
Monica R. Webb	Georgia College & State Univ. Foundation	Milledgeville, GA
James A. Weinmann	Catholic Foundation of Oklahoma	Oklahoma City, OK
Steven J. Weissman	LA Gay & Lesbian Center	Los Angeles, CA
Michael S. Welling	Arthritis Foundation	Antelope, CA
Malcolm B. Wernik	Presbyterian Homes of NJ Fdn.	Princeton, NJ
Harold West	Meredith College	Raleigh, NC
Leonard Westphal	Three Angels Broadcasting Network, Inc.	Loma Linda, CA
Stephen M. Whisler	Southwest Baptist University	Bolivar, MO
Benjamin T. White	Alston & Bird	Atlanta, GA
Johnathon Y. White	GEFA First Colony Life	Lynchburg, VA
Charles N. White, Jr.	Sigma Phi Epsilon Foundation	Richmond, VA
Stephen R. Whited	Piedmont College	Demorest, GA
Jon C. Wiebe	Mennonite Brethren Foundation	Hillsboro, KS
Daniel D. Wiersum	Bethel College & Seminary	St. Paul, MN
Hugh M. Williams	Lighthouse International	New York, NY

Name	Organization	City, State
James S. Williams	Western University of Health Sciences	Pomona, CA
Paul J. Williams	Moody Bible Institute	Tempe, AZ
Ed. H. Williford	French Camp Academy	French Camp, MS
McDonald Willis	Magnolia Manor	Americus, GA
David H. Wills	Focus on the Family	Colorado Springs, CO
Eugene L. Wilson	American Leprosy Missions	Greenville, SC
Janie Y. Wilson	State Street Global Advisors	Boston, MA
Jeffrey K. Wilson	Andrews University	Berrien Springs, MI
Suzanne Wolfson	Bipster International, LLC	Falls Church, VA
Sue C. Woodard	Michigan State University	East Lansing, MI
David Woods	Billy Graham Evangelistic Assoc.	Minneapolis, MN
Vicki J. Woodward	Rush - Presbyterian - St. Luke's Medical Ctr.	Chicago, IL
Lynne Tsing-lin Wu	Children's Hospital Foundation	Cincinnati, OH
Robert H. Wuillamey	Catholic Medical Mission Board	New York, NY
Scott Wynant	Assemblies of God Foundation	Springfield, MO
Ronald E. Wyrick	Juniata College	Huntingdon, PA
Christine Yelle	PG Calc Incorporated	Cambridge, MA
Kevin York	Boys & Girls Town of Missouri	St. Louis, MO
Charles H. Young	Seventh-day Adventists - GA Cumb. Assoc.	Calhoun, GA
Glenn Young-Preston	Young-Preston Associates, Inc.	Cloverdale, VA
Paul J. Youngdale, Jr.	University of Texas Foundation	Austin, TX
Tonia Marie Younger	PNC Bank, NA	Cincinnati, OH
Margaret N. Zabo	Mellon Private Capital Management	Pittsburgh, PA
Gloria J. Zarifis	Society of the Little Flower	Darien, IL
Rebecca S. Zimmer	National Benevolent Association	St. Louis, MO
Sister Joan Zlogar, S.P.	Sisters of Providence	St. Mary-of-the-Woods, IN
Dale Zschoche	University of Dubuque	Dubuque, IA
Kelly J. Zuniga	University of Houston	Houston, TX







