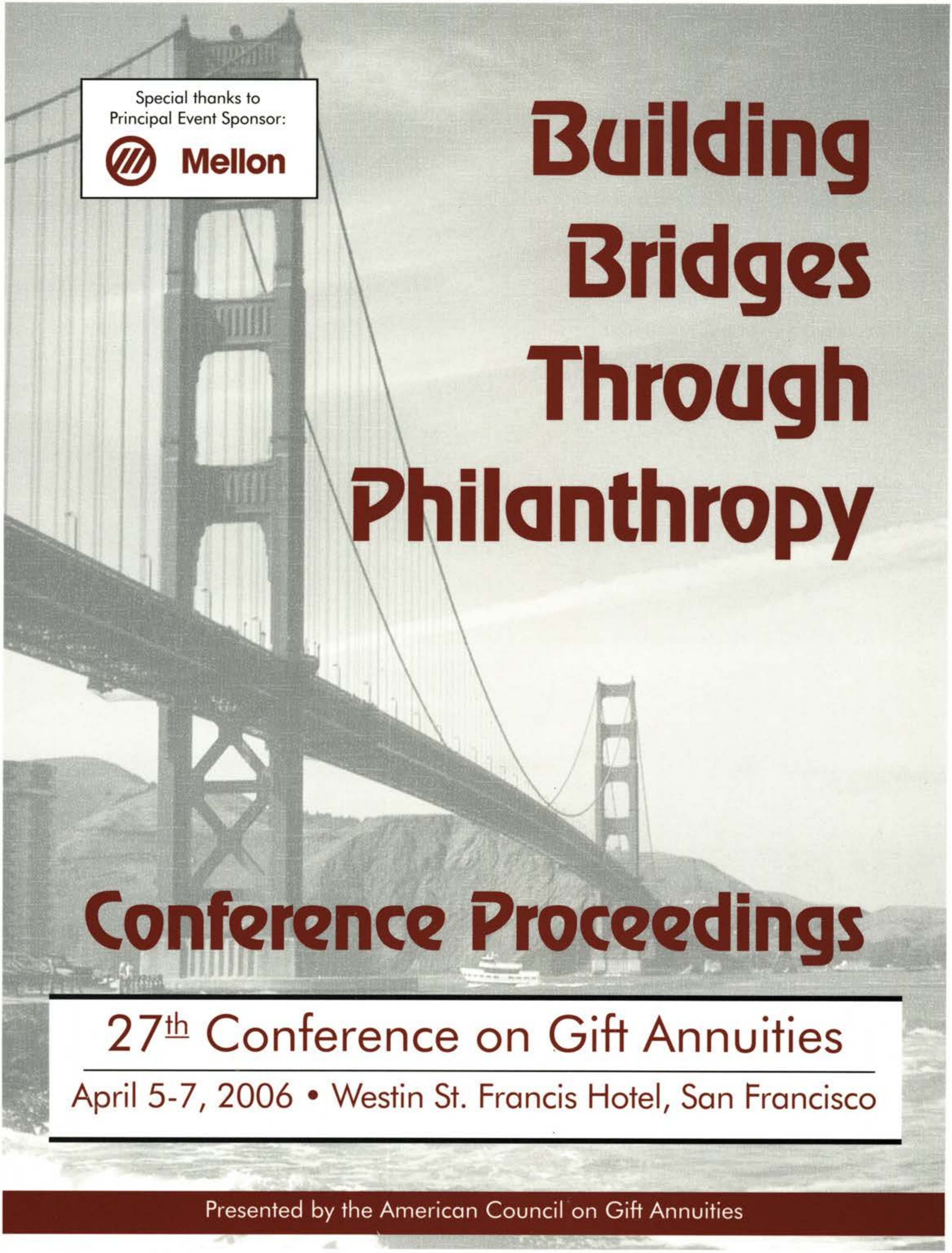

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Conference Proceedings

27th Conference on Gift Annuities

April 5-7, 2006 • Westin St. Francis Hotel, San Francisco

Presented by the American Council on Gift Annuities

American Council on Gift Annuities thanks...

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Principal Event Sponsor of the 27th Conference on Gift Annuities

To Our Participants:

Please refer to the Conference Program for a complete agenda, including room assignments. The program also includes a diagram of the exhibit hall with a list of exhibitors.

The views expressed in these papers are those of the authors and do not necessarily reflect the opinions of ACGA, its staff, or its board members. ACGA does not guarantee the accuracy of the authors' comments and none of the material in these proceedings should be construed as legal advice. Readers are urged to consult their own legal counsel regarding any information found herein. Permission to reprint an individual paper must be secured from the author of that paper.

Neither ACGA nor the Westin St. Francis Hotel are responsible for lost or stolen conference proceedings. Replacement cost for the conference proceedings is $60.

Statement from Frank Minton, ACGA Board Chair

The American Council on Gift Annuities thanks you for attending the 27th Conference on Gift Annuities. Since 1927, ACGA has worked side-by-side with charities across the country. Together, our efforts have steered the evolution of charitable gift planning and responsible philanthropy.

We encourage and appreciate your participation in these efforts. After the last conference in 2004, charities throughout the country showed their support by making contributions toward the retirement of debt resulting from the Texas lawsuit. We are truly grateful for the vote of confidence shown by these organizations, and by others whose encouragement sustained us through those gloomy days.

Also in 2004, charities throughout the country participated in the 2004 Survey of Charitable Gift Annuities. Since 1994, our survey reports have helped charities evaluate their gift annuity programs and establish policies with regard to their programs. The reports also provide supporting data to some charities as they explore the possibility of starting new programs.

In 2005, we turned our focus to providing web-based services to our sponsors and the general public. Our sponsors now have exclusive access to a section of our web site in which they can download the report from the 2004 survey, as well as a detailed report on ACGA suggested gift annuity rates, selected papers from past conference proceedings and more. Potential donors now have access to information about charitable gift annuities, including lists of sponsoring charities with links to their web sites. Our state regulations pages have been updated to a more uniform format. And, we've launched the ACGA Virtual Exhibit Hall, which will give our visitors an opportunity to learn about the products and services offered by the for-profit sector.

Our plans for the future include a study of issues to explore before starting a gift annuity program. This study is part of our ongoing effort to promote responsible philanthropy. As always, our focus is to provide actuarially sound gift annuity rate recommendations.

Just over ten years ago, the 22nd Conference on Gift Annuities was held in San Francisco. While this conference boasted our best attendance ever, the atmosphere was grim as the Texas lawsuit threatened ACGA and charities throughout the country. Those days are long behind us, and San Francisco greets us again. Thank you for joining us.

Frank Minton, ACGA Chair

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Education Agenda

Wednesday, April 5 • Schedule

8:00 am – 7:00 pm .... **Registration Open**
9:00 am – 3:00 pm .... **Fundamentals of Planned Giving**
3:15 – 5:00 pm .... **Symposium**
5:30 – 6:30 pm .... **Reception/Gathering in Exhibit Hall**
6:30 – 8:30 pm .... **Opening Dinner**

Keynote Address
Richard B. Hoey, Mellon Financial Corporation

Fundamentals of Planned Giving

Everything You Could Possibly Ask About a Successful Planned Giving Program
Pamela J. Davidson • Davidson Gift Design, Bloomington, IN
James E. Gillespie • CommonWealth, Indianapolis, IN

This is the best investment of time you'll spend if you want basic information on virtually any aspect of establishing or running a successful planned giving program. We will address how to start a planned giving program, how to assess if your organization is ready and what you may need to remedy first. We will offer a primer on the concepts (that are not technical) behind top vehicles you should use, many involving little or no administration at your charity. Why donors consider making planned gifts will be covered, highlighting donor benefits from and popular current uses of charitable gift options.

Symposium

Analyzing Gift Annuity Risks
George Atwood • Yale University, New Haven, CT
Bryan Clontz • Charitable Solutions, LLC, Atlanta, GA

This highly interactive session will cover various risks associated with gift annuity programs. The presenters will focus on the critical and practical risk management, generally, with a specific discussion of investment and longevity risks. The latest gift annuity research will be examined in light of some of the biggest mistakes charities can make and how appropriate policies can be designed to limit future problems.

Keynote Address

Outlook for the Economy and Financial Markets
Richard B. Hoey • Chief Economist, Mellon Financial Corporation, New York, NY

Our keynote address will review the outlook for the global economy, demographics, currencies, oil, U.S. economy, fiscal policy, monetary policy, short-term yields, long-term yields, profits and the equity markets.

Thursday, April 6 • Schedule

7:30 am – 5:30 pm .... **Registration Open**
7:30 – 8:30 am .... **Continental Breakfast in Exhibit Hall**
8:30 – 9:45 am .... **Morning Breakouts**
9:45 – 10:15 am .... **Refreshment Break in Exhibit Hall**
10:15 – 11:30 am .... **Repeat Morning Breakouts**
11:45 am .... **Chair's Luncheon**

Chair's Address
Frank Minton, Planned Giving Services

Gift Annuity Rates Update
Cam Kelly, ACGA Rates Committee Chair

1:30 – 2:45 pm .... **Afternoon Breakouts**
2:45 – 3:15 pm .... **Refreshment Break in Exhibit Hall**
3:15 – 4:30 pm .... **Repeat Afternoon Breakouts**
4:30 – 5:30 pm .... **Reception in Exhibit Hall**

Thursday Morning Breakouts

Track I:
The Fundamentals of a Successful Gift Annuity Program
Betsy A. Mangone • The Denver Foundation, Denver, CO

This presentation will explore the critical elements of a solid and successful charitable gift annuity program. The key points of the discussion will include the issues involved and the answers to questions such as: What should your gift annuity program policies look like? How will you identify prospective donors? How will you market your program? How will you administer your program? How creative should you be with your gift annuity program? How will you steward your donors?

Track I & II:
Marketing Bequests: 1865 – 2006
Lindsay L. Lapole, III • The Salvation Army, Atlanta, GA

Building your bequest program is the foundation of everything else you do. Learn how it leads to win-win solutions, life-long relationships, additional gifts and referrals. Learn the basics from a bequest program that began in 1865, and lives today. Market your bequest program from the "A's" to the "Z's."

Marketing Planned Gifts
Michael Kateman • University of Missouri – Columbia, Columbia, MO

Learn how top fundraisers market planned gifts, how they capture or recapture the attention of their prospects and how they identify new prospects. Following this review of the top ten percent of the Chronicle of Philanthropy's Philanthropy 400, review how to develop more productive marketing plans and move beyond traditional planned giving marketing strategies.

Education Agenda

Thursday Morning Breakouts, con't.

Track II:

Real Estate - Bridging a Gap in Your Fundraising
Paul L. Harkess • Mayo Foundation, Rochester, MN

Are real estate gifts a riddle wrapped in a mystery inside an enigma? Or can they be a source of valuable new gifts for your organization? Real estate is the primary asset owned by most Americans and an investment asset for many. It can be the giftable asset of choice for outright, endowment, life income and bequest gifts. For charities and financial planners, these gifts can be a headache yet produce very satisfying results for all parties. This session will provide an overview of evaluation, acceptance and administration of gifts of real estate and present alternative methods of achieving success in accepting gifts of real estate.

Track II & III:

Building a Stronger Gift Planning Program
Marjorie Houston • Wheaton College, Norton, MA

Building relationships among gift planners, donors, and the CFO is challenging. Using the NCPG Valuation Standards for Charitable Planned Gifts as a way to address the concerns is one tool available to us for evaluating our program and addressing issues raised by our CFO and the marketplace.

Track III:

Investing Charitable Gift Annuity Assets
Scott Kaspick • Kaspick & Company, Redwood Shores, CA
David A. Libengood • Kaspick & Company, Boston, MA

This session will examine the investment of charitable gift annuities in today's complex economic and regulatory environments. We will address a number of key issues: choosing a strategic asset allocation for the gift annuity pool, implementing the investment strategy given the constraints imposed by state departments of insurance, understanding the risks, establishing efficient custody account structures that meet regulatory requirements, and assessing the implications for investment and gift acceptance policies.

UMIFA, Endowment, Donor Advised Funds and Gift Annuities: No Place But San Francisco!
Terry Simmons • Thompson & Knight LLP, Dallas, TX

The Uniform Management of Institutional Funds Act governs the management of distributions from endowment funds in 47 states, and is currently being re-written by the Commissioners on Uniform State Laws. It can be a confusing set of rules, and can become particularly confusing when gift annuities, restricted and unrestricted, become involved. This session will focus primarily on UMIFA, how it works, and how it interacts with the rules (and institutional policies) governing gift annuities. Time will also be given to the use of donor advised funds, particularly by charities other than community foundations that have begun to employ them in fundraising. What are the key rules of donor advised funds, and have we crossed a regulatory line in how they are currently utilized?

Thursday Morning Breakouts, con't.

Track IV

State Regulation of Charitable Gift Annuities
Edith Matulka • Planned Giving Services, Seattle, WA
James B. Potter • Planned Giving Resources, Baker, LA

This presentation will cover the manner in which states regulate issuance of gift annuities, recent statutory and enforcement changes, and the issues that charities should consider in determining in which state they will offer gift annuities.

Thursday Afternoon Breakouts

Track I:

Charitable Remainder Trust Basics
David T. Leibell • Cummings & Lockwood, Stanford, CT

This presentation will be an overview of the rules governing charitable remainder trusts with an emphasis on practical advice regarding when and which kind of charitable remainder trust is appropriate, along with planning opportunities and pitfalls to watch out for.

Comparing Life Income Plans
Elizabeth A.S. Brown • Moody Bible Institute, Chicago, IL

This presentation will explore the unique characteristics of various life income plans, including the charitable gift annuity, pooled income fund, charitable remainder unitrust and annuity trust. We will also look at how revocable trusts and irrevocable discretionary trusts can be used as alternatives to classic charitable vehicles. We will cover tax and non-tax considerations, and examine these plans from both the donor's and the charity's perspective, with a goal of equipping listeners with tools to determine which plan is best in a given set of circumstances.

Track II:

Advanced Planning with Deferred Gift Annuities
David Wheeler Newman • Mitchell Silberberg & Knupp, LLP, Los Angeles, CA

The portion of all gift annuities that have a deferred starting date has increased over the last few years as planners explore the ability to use deferred charitable gift annuities (DCGAs) to coordinate donors' philanthropic interests with their financial planning objectives. This presentation will focus on this type of planning, and will discuss the ins and outs of flexible start date annuities and annuities with commutation clauses built in that can be used as tuition annuities, as well as the use of DCGAs for retirement savings to supplement IRAs and other types of retirement savings plans.

Education Agenda

Thursday Afternoon Breakouts, con't

Track II & III:
Evaluating Planned Gifts – Case Studies
André R. Donikian • Pentera, Inc., Indianapolis, IN

This session will examine a series of actual case studies and recent developments and explore their gift planning implications.

Track III:
Investing to Maximize Remainder Values
Paula B. Blacher • U.S. Trust Planned Giving Services Group, Los Angeles, CA
Michael C. Scholtz • U.S. Trust, Greensboro, NC

Charities that run their own life income programs do so with the intention of ultimately realizing a significant financial return for their efforts. The odds of maximizing the value of a charity's remainder interest in a life income gift can be increased through the establishment of, and adherence to, a set of realistic, written gift acceptance policies. In addition, the investment strategies employed by the charity or its investment manager will play a very significant role in the long-term financial success of a life income program. This session will focus on these issues, focusing on topics like gift acceptance policies, differences between investing endowment assets and planned gifts, volatility and time-horizon, investment projections and active risk budgeting.

Asset Allocation in CRTs: Time Horizon, Payout, Risk
Charles B. Gordy • Bank of New York, West Paterson, NJ

This presentation will examine the importance of asset allocation in meeting donor and institutional expectations for payouts and remainder values. Time horizon, percentage payout and risk tolerance contribute to the decision making process in choosing an appropriate allocation and will be discussed in the course of the presentation.

Track IV:
Ethics in Planned Giving
Jonathan G. Tidd • Attorney, West Simsbury, CT

This session will consider a number and variety of gift planning situations in which arise intertwined ethical and legal issues. This is a session for the experienced gift planner.

Update on Tax Legislation Affecting Charities & Charitable Giving
Jonathan Selib • U.S. Senate Committee on Finance, Washington, DC

Straight from the Democratic Tax Counsel for the United States Senate Committee on Finance, get an insider's view of the factors driving legislation crucial to charities and philanthropy.

Friday, April 7 • Schedule

7:30 am – 1:30 pm .... **Registration Open**
7:30 – 8:30 am .... **Continental Breakfast in Exhibit Hall**
8:30 – 9:45 am .... **Morning Breakouts**
9:45 – 10:15 am .... **Refreshment Break in Exhibit Hall**
10:15 – 11:30 am .... **Repeat Morning Breakouts**
11:45 am .... **Closing Luncheon**
Conrad Teitell
Cummings & Lockwood, Old Greenwich, CT

Friday Morning Breakouts

Track I & II:
Stewardship: Listen with your Eyes
Dyan Sublett • Natural History Museum of Los Angeles, Los Angeles, CA

How well do we understand our donors? Do we know what it will take to get each one to say yes? Through stories that illustrate successful – and surprising – work in education, culture and social change, we'll learn about the language of philanthropy and our role in partnering for powerful outcomes.

Track II:
A Time for All Seasons: The Charitable Lead Trust
Emil Kallina • Kallina & Associates, LLC, Towson, MD

This session will present an overview of the structure and benefits of a Charitable Lead Trust (CLT), the mathematics of computing the present value of the income and remainder interests, the use of discounts with CLTs, and "tax neutral CLTs." The presentation will end with case studies of CLTs and how they solve specific problems, such as sheltering large amounts of ordinary income, dealing with Promissory Notes, removing assets from corporate solution, transferring the family business to the next generation, and financing municipal improvements, all with very favorable tax consequences to the donors, and substantial gifts to charity.

Looking the Gift Horse in the Mouth: Drafting and Using Gift Acceptance Policies and Procedures
Robert E. Harding • Gray, Plant, Mooty, Mooty & Bennett, P.A., Minneapolis, MN

A well-crafted set of gift acceptance policies and procedures can go a long way toward avoiding problem gifts, keeping donors and beneficiaries happy, and maximizing the benefit of gifts to the donee institution. This session will cover policies regarding: acceptable types of gifts, criteria for accepting particular gifts, gift restrictions, gift acceptance decision-making procedures, use of legal counsel and handling of expenses.

Education Agenda

Friday Morning Breakouts, con't

Track II & III:
Paradigm Shifts in Planned Giving
Cynthia Krause • Wilson & Krause, Dallas, TX

Capital gains taxes have been reduced. The estate tax exemption will continue to dramatically increase or may be eliminated. These facts, plus the changes in our nation's mindset and the maturing of a global economy are current realities. The framework that created and nurtured the growth of the planned giving industry in the 1990s is rapidly imploding, causing a paradigm shift in our industry. This presentation will identify and interpret the challenges these realities raise and will offer solutions for success gleaned from interviews with some of the most outstanding planned giving operations in the country, presented and analyzed through the experienced eyes of a national planned giving consultant.

Track III:
Bequest Administration: Using Detective Skills to Avoid Problems in Probate
Joseph O. Bull • The Ohio State University, Columbus, OH
Eugenia Maish • The Ohio State University, Columbus, OH

This presentation will provide an overview of the probate administration process of a donor's estate. Case histories will be used to illustrate both how this process works in real life and when a planned giving officer needs to become more involved in the estate process to protect his/her organization's interests.

Track III:
Reimagining Reinsurance
Tom Cullinan • Tom Cullinan Charitable Giving Counsel, Inc., Elkhorn, NE

Many charities that participated in past historic bull markets have found that the performance of their gift annuity reserve is magic no longer. Today, volatility in the equity and interest rate markets adds even more risk, and those who in the past rejected reinsurance out-of-hand now have good reason to reevaluate those decisions given the onset of heightened fiduciary responsibility. If a well-managed gift annuity program is key to your organization's development – and future – and whether your organization reinsures or not, hear an experienced gift planning specialist with no vested interest in reinsurance reveal a potential competitive advantage for you.

Specialized Learning Tracks

Choose sessions designed to meet your needs:

Track I – Fundamentals
Track II – Advanced Planned Giving
Track III – Financial, Investment & Administrative Issues
Track IV – Issues and Trends in Gift Planning

Friday Morning Breakouts, con't

Track IV:
eMarketing of Planned Gifts
A. Charles Schultz • Cresendo Interactive, Camarillo, CA

eMarketing of planned gifts has arrived in 2006. Charities large and small will raise millions in planned gifts this year. Over 65% of affluent seniors now use e-mail and surf the web. By 2010, over 60% of gift marketing will be electronic. Successful gift planners will understand how to use effective eMarketing. Senior-friendly web site design principles, acquisition of e-mail addresses, electronic education and motivation are keys to future planned gifts. Certified ePhilanthropy Master Trainer (ePMT) Charles Schultz will show the path to raising major eGifts.

Making the Transition from Current to Planned Gifts
Robert F. Sharpe Jr. • The Sharpe Group, Memphis, Tennessee

With the G.I. Generation rapidly passing from the scene and the rapid aging of much of the rest of the American donor population, it is more important than ever to effectively manage the transition from outright gifts to those that are made in light of long-range financial plans. This session will examine the typical lifecycle of a donor and offer practical advice on ways to maximize current giving while also helping donors plan what may be their gift of a lifetime.

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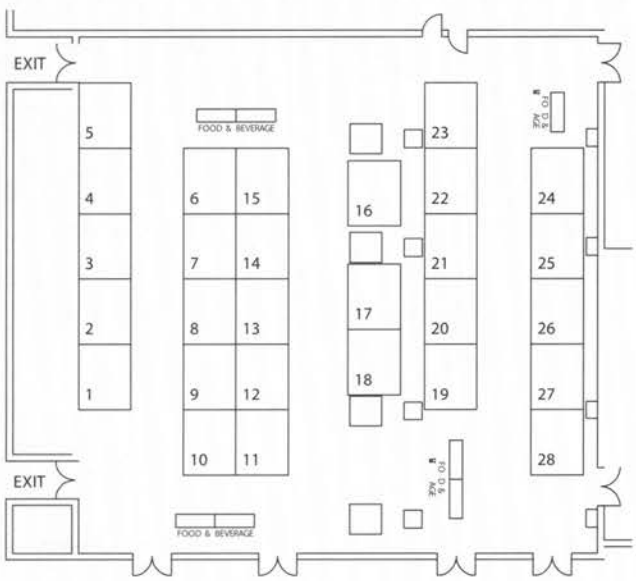

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The Bank of New York .... Booth 19
West Paterson, NJ

BIPSTER LLC .... Booth 8
Salem, MA

Charitable Solutions, LLC .... Booth 25
Marietta, GA

Exhibitors, con't.

Charitable Trust Administration Company .... Booth 3
Cleveland, OH

Crescendo Interactive, Inc. .... Booth 17-18
Camarillo, CA

Kaspick & Company .... Booth 12
Boston, MA

LG&G Group LLC .... Booth 23
Branchville, NJ

Mellon Financial Corporation .... Booth 11
Boston, MA

Mercantile Bank & Trust Co. .... Booth 14
Baltimore, MD

Merrill Lynch Center for Philanthropy & Nonprofit Management .... Booth 5
Newport Beach, CA

Mutual of Omaha .... Booth 13
Omaha, NE

National Committee on Planned Giving .... Booth 4
Indianapolis, IN

Northern Trust .... Booth 10
Chicago, IL

Pentera, Inc. .... Booth 26
Indianapolis, IN

PG Calc Incorporated .... Booth 27-28
Cambridge, MA

Planned Giving Today .... Booth 1
Edmonds, WA

R&R Newkirk .... Booth 9
Willow Springs, IL

RuffaloCODY .... Booth 7
Cedar Rapids, IA

The Sharpe Group .... Booth 15
Memphis, TN

State Street Global Advisors .... Booth 21
Boston, MA

The Stelter Company .... Booth 20
Des Moines, IA

TIAA-CREF Trust Company, FSB .... Booth 16
St. Louis, MO

US Bank Charitable Services Group .... Booth 6
Portland, OR

Wachovia Center for Planned Giving .... Booth 2
Winstom-Salem, NC

Wells Fargo Charitable Management Group .... Booth 24
Minneapolis, MN

Conference Faculty

Conference Chair

Laurie W. Valentine has been Trust Counsel and Chief Operating Officer of the Kentucky Baptist Foundation since 1994. She is admitted to the practice of law in Florida and Kentucky. Prior to joining the Foundation, she was in private practice in Florida, specializing in estate planning, charitable gift planning, business succession planning, probate and guardianship law. Valentine has spoken on a variety of ethics, tax, charitable gift planning, estate planning and incapacity planning topics at seminars sponsored by The Florida Bar, National Business Institute, Louisville Bar Association and Kentuckiana Planned Giving Council. She has also written articles and chapters on estate planning, estate administration, estate and gift taxes and legal ethics for a variety of legal publications. Valentine has been involved in various professional and community activities including past service on the Board of the Suncoast Ronald McDonald House, St. Petersburg, Florida, and the Planned Giving Committee of St. Anthony's Healthcare Foundation, as well as president of the Kentucky Planned Giving Council. She currently serves on the Board of Directors of the American Council on Gift Annuities and the Board of the Kentuckiana Planned Giving Council.

Keynote Speaker

Richard B. Hoey is chief economist and senior vice president of Mellon Financial Corporation, as well as chief economist and chief investment strategist of The Dreyfus Corporation. Hoey is responsible for monitoring all aspects of the economic environment for Mellon and Dreyfus including the U.S. economy, the global economy and currencies. He also serves as a principal spokesman for Mellon and Dreyfus on economic and investment issues. Previously, Hoey spent nearly two decades as a chief economist, portfolio strategist and a member of both the investment policy and stock selection committees of a number of leading investment firms. He graduated from Yale College where he earned a B.A. degree in politics and economics in 1965 and from New York University Graduate School of Business Administration where he earned an M.B.A. in investments in 1967.

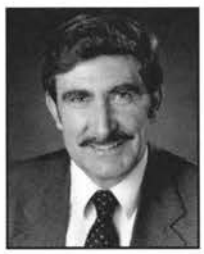
27th Conference on Gift Annuities

Building Bridges Through Philanthropy

April 5-7, 2006 • San Francisco, CA

Plenary Speakers

Cam Kelly currently serves as the Director of Major Gifts and Gift Planning at her alma mater, Smith College, in Northampton, Massachusetts. She has held the position of director of planned gifts & bequests since 1991, and assumed responsibility for the major gifts unit as well in the Fall of 2005. Prior to joining Smith's Advancement Office she was an investment advisor and portfolio manager with a small investment management firm in Boston. She earned an A.B. degree from Smith College in mathematics, and she is a Chartered Financial Analyst. Kelly has served on the board of the American Council on Gift Annuities since 1994, and currently chairs its Rates Committee. She is a member of the Editorial Advisory Board of Planned Giving Today, and has served on the board of the Planned Giving Group of New England. Kelly is also a board member for the Hampshire Regional YMCA in Northampton, chairing that board from 2002-2004.



Frank Minton, current ACGA Chair, is president of Planned Giving Services, a division of PG Calc Incorporated, of Seattle, Washington, a planned giving consulting firm serving clients in the U.S. and Canada. Before entering consulting in January 1991, he spent ten and one-half years with the University of Washington, where he served as Director of Planned Giving and Executive Director of Development. He received M.A. and Ph.D. degrees from the University of Chicago. Dr. Minton has served both as conference chair and president of the National Committee on Planned Giving. In 1992 he received NCPG's Distinguished Service Award, and he currently serves on its Ethics Committee. He has also received a CASE (Council for the Advancement and Support of Education) Distinguished Service Award, the David Donaldson Distinguished Service Award from the Planned Giving Group of New England, and he was the first recipient of the Outstanding Development Officer Award from the Northwest Development Officers Association.

Conrad Teitell is an estate-planning principal in the Connecticut and Florida based law firm of Cummings & Lockwood, resident in the Stamford, Connecticut office, and chairs the firm's Charitable Planning Group. He is an adjunct visiting professor at the University of Miami Law School and is also director of the Philanthropy Tax Institute. Teitell writes the monthly newsletter, *Taxwise Giving.* He is listed in *The Best Lawyers in America* and is the recipient of the American Law Institute/American Bar Association's Harrison Tweed Award for Special Merit in Continuing Legal Education. Teitell is a recipient of the National Committee on Planned Giving's Distinguished Service Award, serves as counsel to the ACGA and has spoken at every ACGA conference since 1968.

Conference Faculty

Symposium Panelists

George Atwood directs the Trust and Estates group of the Yale Investments Office, responsible for the investment and administration of a portfolio of charitable trusts, annuities, estates and illiquid special assets having a value of in excess of $300 million. He joined Yale in 1988. Atwood earned a B.A. in economics from Tufts University, an MBA from Yale, and is a Chartered Financial Analyst.

Bryan K. Clontz is President of Charitable Solutions, LLC, specializing in non-cash asset receipt and liquidation, gift annuity reinsurance brokerage and gift annuity risk management consulting. Previously, he served as the vice president of advancement at The Community Foundation for Greater Atlanta and the director of planned giving at the national office of Boys & Girls Clubs of America. Clontz received a BSBA from the College of Charleston, a MS in Risk Management and Insurance from Georgia State University and a MS in Financial Services from the American College. For the last six years, he has served as a graduate adjunct professor of personal financial planning and life insurance in the Department of Risk Management and Insurance at Georgia State University. He serves on the Editorial Board of the Planned Giving Design Center, the Advisory Board for the American College's Chartered Advisor in Philanthropy designation and the ACGA Rates Committee.

Fundamentals of Planned Giving Speakers

Pamela Jones Davidson is President of Davidson Gift Design in Bloomington, Indiana, a consulting firm specializing in gift planning, planned giving program design and implementation, and training. Before forming her own company in 1999, she was a charitable gift planner and consultant for three years with Laura Hansen Dean and Associates, Indianapolis, Indiana. From 1985 through 1996, she was with Indiana University Foundation, leaving that organization as its Executive Director of Planned Giving and Associate Counsel. Davidson received her undergraduate degree from Indiana University in 1975, and graduated *magna cum laude* from the Indiana University School of Law at Indianapolis in 1979. Davidson was the 1999 President of the National Committee on Planned Giving. She is on the Editorial Board of the Planned Giving Design Center, and recently became faculty of The College of William and Mary's National Planned Giving Institute. She is a past board member and past treasurer of the Indiana Chapter of the National Society of Fund Raising Executives (now AFP), and a past board member and president of the Planned Giving Group of Indiana.

Fundamentals of Planned Giving Speakers

James E. Gillespie is president of CommonWealth, an Indianapolis, Indiana firm that provides comprehensive counsel in the area of planned gift development programs, specializing in training, mentoring and professional development. Previously, he was chief operating officer of the consulting division of Renaissance Inc. in Indianapolis. Gillespie was a professional development officer for Junior Achievement and the Indianapolis Symphony Orchestra. He is a lead faculty member of The Fund Raising School, a unit of Indiana University's Center on Philanthropy. Gillespie served on the board of directors of the National Committee on Planned Giving and was NCPG's conference chair in 2001.

Breakout Session Speakers

Paula B. Blacher is Senior Vice President – Investments for U.S. Trust's Planned Giving Services Group. She advises and consults on investment issues such as asset allocation and implementation to the Group's national institutional client base. Prior to joining U.S. Trust, she worked at Wells Fargo as Senior Philanthropic Portfolio Manager for the Charitable Management Group. She holds an Executive Masters of Business Administration from the Peter F. Drucker Graduate Management Center, Claremont Graduate University, and has achieved Chartered Financial Analyst and Certified Investment Management Analyst professional designations. Blacher sits on executive boards of Women at Work and the Pasadena City College Foundation, is a member of the National Committee on Planned Giving, California Institute of Technology Associates, and the CFA Society of Los Angeles.

Elizabeth A.S. Brown is an attorney and Certified Public Accountant, and serves as assistant general counsel of The Moody Bible Institute of Chicago. Prior to joining Moody in 1983, she was an associate attorney with McDermott, Will & Emery in Chicago. At Moody, Brown assists donors with estate planning matters, and otherwise provides legal support for Moody's planned giving function. During her tenure at Moody, Brown has also served as treasurer and manager of the Investment Department. Brown serves as treasurer on the board of directors of the American Council on Gift Annuities.

Conference Faculty

Breakout Session Speakers

Joseph O. Bull serves as Director of Planned Giving at The Ohio State University, which granted him a Bachelor of Science, *summa cum laude*, in 1981 as well as a Master of Arts and Juris Doctor in 1985. He began his university advancement career as Assistant Director of Planned Giving at Duke University in 1985, and he served North Carolina State University in various gift-planning capacities. He returned to his alma mater as Director of the Campaign for Alumni House in 1991 and assumed his current position in 1994. Bull was the 2005 chair of the board of directors of the National Committee on Planned Giving. Additionally, he serves as a member of the Editorial Advisory Board for *Planned Giving Today,* the Editorial Board of the web-based *Planned Giving Design Center* and as a faculty member for The Academy of Gift Planning. He is a former member of the boards of directors of the American Council on Gift Annuities and Charitable Accord, as well as a past president of the Central Ohio and North Carolina Planned Giving Councils.

Tom Cullinan is a consultant to national and regional charitable organizations, as well as a writer and teacher of charitable estate planning principles and techniques. He earned degrees in business and law from the University of Nebraska-Lincoln and holds education certificates from the Indiana University Center on Philanthropy, the Philanthropy Tax Institute and Rice University. Cullinan currently serves on the board of the National Committee on Planned Giving and is a sponsor of the American Council on Gift Annuities. He is a member of the editorial advisory board for *Planned Giving Today* and is a member of the national board of consultants for its sister publication, *Planned Giving Mentor.*

André R. Donikian is president and editor in chief of Pentera, Inc., a comprehensive planned giving publishing and consulting company in Indianapolis, Indiana. Donikian has served as advisor to more than 300 charities and educational institutions throughout the United States. He is a nationally recognized attorney and consultant in the field and presents seminars on all aspects of planned giving. Donikian has served on the board of the National Committee on Planned Giving and the board of advisors of Union College. He is a founder and former board member of the Planned Giving Group of Indiana.

Breakout Session Speakers

Charles B. Gordy, II is the Managing Director of the Bank of New York's Planned Giving Services Division, which manages planned giving programs for non-profits across the country. Gordy has served as the director of planned giving at Yale University, at Tufts University, and at The Wilderness Society. He recently completed a 3-year term as a board member of the National Committee on Planned Giving, was a member of its Executive Committee, and chaired its Audit Committee. He was recently elected to the board of the American Council on Gift Annuities, and to the board of the Planned Giving Group of Greater New York. He has served as a board member and officer of the Planned Giving Group of New England. He received his B.A. in English and in Government from Colby College in 1981, and his Juris Doctor from George Washington University Law School in 1986, with a focus on business and tax law.

Robert E. Harding is a principal with the Gray Plant Mooty law firm in Minneapolis. For most of his 22 years of practice he has focused exclusively on charitable gift planning. Mr. Harding represents colleges, universities, national church bodies, health care systems and other nonprofit organizations in developing and implementing planned gifts. He speaks regularly at regional and national conferences on planned giving. Mr. Harding received undergraduate and graduate degrees in philosophy from Harvard University and a law degree from the University of Minnesota where he was an editor of the Law Review and a member of the Order of the Coif.

Paul Harkess has worked with major and planned giving donors for over 26 years, facilitating contributions to Union College, Harvard Medical School and the Cleveland Clinic Foundation. He was also instrumental in establishing and promoting the for-profit firm, Prudential Real Estate Gifts, to assist charities in valuing, accepting and selling gifts of real estate. Since July 1996 he has served the Mayo Clinic as a development officer, specializing in planned giving and major and principal gifts. Harkess is on the board of trustees of his local community foundation, the Rochester Area Foundation. He is a member of the Minnesota Planned Giving Council and the Saranac Group.

Conference Faculty

Breakout Session Speakers

Marjorie Houston is director of gift planning services at Wheaton College, a small liberal arts college in Massachusetts. Before going to Wheaton, she was director of gift planning for Brown University in Rhode Island. She is past president of the Planned Giving Group of New England, Planned Giving Council of Rhode Island and Canaras Group. She is a past member of the Board of Directors for the National Committee on Planned Giving. Houston is on the editorial advisory committee for *The Journal of Gift Planning* and is a frequent speaker at regional and national conferences, such as NCPG's National Conference on Planned Giving, ACGA's Conference on Gift Annuities and the CASE Advanced Planned Giving Institute.

Emanuel J. Kallina, II focuses his law practice on estate and charitable planning for high net worth individuals and representing a number of charities on an ongoing basis. He also practices extensively in the related fields of business law, securities law, corporate tax law, partnerships, real estate, and insurance. He is a founder of CharitblePlanning.Com, a co-founder of the Planned Giving Design Center, a former member of the board of directors of the National Committee on Planned Giving, a co-founder of the Chesapeake Planned Giving Council, and chairman of the board and president of The James Foundation. On behalf of NCPG as Government Relations chairman for 5 years and also on behalf of clients, Kallina has testified frequently before the IRS and currently works with the staff of the various Congressional committees regarding charitable legislation.

J. Scott Kaspick has over 20 years of experience managing planned gift and endowment assets. As Associate Treasurer of Stanford University and a member of the University's endowment management team (1983-1989), he developed and implemented both the investment approach and the systems for managing Stanford's then $150 million planned giving program. In 1989, he founded Kaspick & Company to provide asset management, trust administration, and policy consulting for planned gift assets. Kaspick has been a speaker at national and regional conferences, addressing financial issues relating to planned giving. He has a BA in Economics from California State University, Sacramento, and an MBA from Stanford University.

Breakout Session Speakers

Michael Kateman is executive director for arts development and planning at the University of Missouri-Columbia. He was formerly director of gift planning and endowments at MU. His diverse marketing, public relations and fundraising background includes healthcare, the arts, human services and higher education. He is a nationally recognized speaker on marketing and advertising planned giving techniques. He is a former instructor at the University of Missouri-Columbia School of Journalism and past presenter for NCPG, NACUBO, AHP, AFP, The Big 12 Development Conference and planned giving conferences coast to coast. He served as NCPG education chair for two years. Kateman is a graduate of the University of Missouri-Columbia, with an MA from the School of Journalism and a BS in Business Administration - Marketing. He attended the Universidad Iberoamericana in Mexico City.

Cynthia Wilson Krause is president of Wilson & Krause, a philanthropic advisory services firm located in Dallas, Texas. She is currently on the faculty of The College of William & Mary National Planned Giving Institute and is a member of the Editorial Board of the *Planned Giving Design Center*. She is a former member of the board of directors and past conference chair for the National Committee on Planned Giving, past president of the North Texas chapter of NCPG, and a former member of the editorial advisory boards of the publications *Planned Giving Today* and *Planned Giving Mentor*. She is a graduate of Baylor University School of Law.

Lindsay L. Lapole, III has been the territorial planned giving director of The Salvation Army, Southern Territory since 1986. He had previously served as a planned giving director in the Kentucky/Tennessee and Florida divisions of The Salvation Army and in fundraising and volunteer management with the Boy Scouts of America. Lapole is a past director of the Georgia Chapter of the Association of Fundraising Professionals and is a past board member and president of the Georgia Planned Giving Council. He serves as chairman of the National Planned Giving Consultants Committee of The Salvation Army. Lapole serves as secretary of the board of the American Council on Gift Annuities and was chair of the 26th Conference on Gift Annuities.

Conference Faculty

Breakout Session Speakers

David T. Leibell is a principal in the Stamford, Connecticut office of Cummings & Lockwood LLC, practicing in the Private Clients Group and Charitable Planning Group. Prior to joining Cummings & Lockwood, David worked in the financial services industry for several years, specializing in the financial aspects of estate planning. Leibell received a B.A. from Trinity College, a J.D. from the Fordham Law School and an LL.M. in taxation from New York University. He is a frequent lecturer to lawyer and nonlawyer audiences throughout the United States and has authored many articles on charitable, estate and tax planning. Leibell serves as the 2005 Chairperson of the Philanthropy Committee for Trusts & Estates Magazine.

David A. Libengood is a relationship manager with Kaspick & Company, LLC in Boston, Massachusetts. He provides consulting services to institutional clients on gift planning, investment, and program management issues. Prior to joining Kaspick & Company in 2001, he managed the gifts and endowments program at The First Church of Christ, Scientist. He earned his MBA from the University of Michigan, is a Certified Trust and Financial Advisor (CTFA), and has served as President of the Planned Giving Group of New England.

Eugenia M. Maish is a Development Officer in Planned Giving for The Ohio State University, focusing on trust, estate and life insurance gift administration. A practicing paralegal since 1999, she previously worked in private laws firms in the probate, real estate and estate planning arenas. Maish has written articles and training manuals on probate, real estate, special needs advocacy, mediation, domestic violence, and medical education. A former board member of the Paralegal Association of Central Ohio and the Capital University Law School's Paralegal Advisory Board and Alumni Board, she is now a member of the Central Ohio Planned Giving Council and the Ohio State Bar Association. Maish holds a Bachelors from Wake Forest University, a Masters from Miami University, and a paralegal certificate from Capital University Law School.

Breakout Session Speakers

Betsy A. Mangone is vice president of the Philanthropic Services Group for The Denver Foundation. She has been in the major gift and planned giving field since 1982. She served as vice president of the University of Colorado Foundation and from 1996 to 2004 she was president of Mangone & Co., a charitable gift consulting firm which provided major gift and planned giving services for over 100 national and international clients. Mangone serves as vice chair of the American Council on Gift Annuities and is a past president of the National Committee on Planned Giving. She is a member of the editorial advisory committee for *the Journal of Gift Planning* and a member of the Planned Giving Design Center's Editorial Advisory Board. Mangone has served on the board of directors of Ronald McDonald House, Rocky Mountain PBS, Kempe Children's Foundation, The Women's Foundation of Colorado and Bootstraps, Inc. She is a member of the Denver Estate Planning Council.

Edith (Edie) Matulka has been with Planned Giving Services in Seattle, Washington since 1997, where she has primary responsibility for assisting charities in complying with state regulations for issuance of gift annuities. She is the lead author of certain chapters of *Charitable Gift Annuities: The Complete Resource Manual.* In addition to the practice of law, her background includes work in government, public and nonprofit settings. Matulka serves on the State Regulations Committee of the American Council on Gift Annuities.

David Wheeler Newman chairs the Charitable Sector Practice Group at the Los Angeles law firm of Mitchell Silberberg & Knupp LLP. For over twenty years he has advised charitable organizations and their donors on the legal and tax aspects of planned giving. Newman is a former member of the board of the National Committee on Planned Giving, where he served as an officer and member of its executive committee.

Conference Faculty

Breakout Session Speakers

James B. Potter was a planned giving executive for 20 years with two national charities, the Presbyterian Church (USA) Foundation and the American Lung Association. After five years of part-time consulting work, he became a full-time consultant in 1990, and is currently president of Planned Giving Resources in Baker, Louisiana. He has served on the board of the American Council on Gift Annuities since 1974 and has chaired their State Regulations Committee since 1989. Potter was awarded the 1999 Distinguished Service Award by the National Capital Gift Planning Council (then called the Planned Giving Study Group of Washington, DC).

A. Charles Schultz is a California attorney who specializes in charitable giving and estate planning. He is president of Crescendo Interactive, Inc. and is the principal author of the Crescendo Planned Giving Software and GiftLegacy Pro eMarketing System. He is producer and moderator for the *GiftLaw* satellite teleconferences and is editor for the *GiftLaw.com* charitable tax planning web site, the *GiftLaw Pro* quarterly charitable tax service and writes the weekly *GiftLaw* and *GiftLegacy* eNewsletters. Shultz received his law degree from the University of Michigan, with further tax specialization training at Washington University in St. Louis. He serves on the board of the Ventura County Community Foundation and Christian Foundation of the West.

Jonathan Selib is a Democratic Tax Counsel on the U.S. Senate Finance Committee. His responsibilities include advising Ranking Member, Senator Max Baucus and Finance Committee Democrats on legislation involving Tax Exempt Organizations, Estate and Gift Taxation, taxation of bonds, the Earned Income Tax Credit, Internet and Technology Tax, Taxation of Indian Tribes, and Tax Litigation. Prior to attending law school, Mr. Selib taught 5th and 6th grade special education in Oakland, California and wrote direct mail for the U.S. Fund for UNICEF. He has also worked on a number of political campaigns. Mr. Selib graduated with honors in History from Trinity College (CT), where he received the Furgeson Memorial Prize in History and the John Curtis Underwood Memorial Prize in Poetry. He received his J.D. from American University, Washington College of Law, where he served as Articles Editor on the American University International Law Review.

Breakout Session Speakers

Robert F. Sharpe, Jr. is President of The Sharpe Group. He has over 25 years of nonprofit fund development experience. He is an honors graduate of Vanderbilt University and Cornell Law School. In past years, he practiced law with a major law firm specializing in income, estate, and gift taxation and corporate planning. Prior to his legal experience, he served as a development officer for a liberal arts college. He has authored many articles and other publications covering numerous gift planning topics. Sharpe is a frequent speaker for gatherings including NCPG's National Conference on Planned Giving, the American Bankers Association Trust Asset Management Conference, the Association of Fundraising Professionals (AFP) National Conference, the International Fundraising Congress, the Association for Healthcare Philanthropy Advanced Planned Giving Institute, Council for Advancement and Support of Education (CASE) National Conference, CASE Advanced Planned Giving Conference, the O.M.I. Non-Profit Tax Conference, and others. He is an active volunteer and has served as a board member of a number of arts, educational, and civic organizations.

Michael C. Sholtz is responsible for the coordination of consulting, administrative, investment management, and tax services delivered to institutional clients of US Trust Company, N.A. in Greensboro, North Carolina. Sholtz has spoken extensively on issues dealing with planned giving and has presented at numerous national and regional conferences and events. Before joining U.S. Trust in 2001, he served for almost seven years as Director of Planned Giving for Duke University in Durham, North Carolina. Sholtz is a member of the North Carolina, Delaware, and Pennsylvania Bars and is a Board Certified Specialist in Estate Planning and Probate Law in North Carolina. He is a member of the Duke Estate Planning Council and a former President of the North Carolina Planned Giving Council. Sholtz received his B.A. from Yale University, M.B.A. from University of Miami, J.D. from Duke Law School, and LL.M. (Taxation) from Villanova Law School.

27th Conference on Gift Annuities

Building Bridges Through Philanthropy

April 5-7, 2006 • San Francisco, CA

Conference Faculty

Breakout Session Speakers

Terry Simmons is a senior partner in the Dallas-based 400-lawyer law firm of Thompson & Knight L.L.P. where he has a national practice in charitable gift planning, exempt organizations law and estate planning. He represents individual clients, exempt organizations and for-profit entities in complex domestic and international transactions involving nonprofit/for-profit interaction. He represents clients in the formation and representation of private foundations as well as supporting organizations and all other public charities in all aspects of exempt organization operations. He serves on numerous nonprofit boards and is a prolific writer in his practice areas, and is co-editor and co-publisher of *Charitable Gift Planning News*, a national newsletter covering tax and legal developments in the planned giving and exempt organizations fields. Simmons holds a BBA degree from Baylor University, a J.D. degree from Baylor University School of Law, and an LL.M (Master of Laws) degree in Taxation from Southern Methodist University School of Law. He is listed in *The Best Lawyers in America*, 2005-2006 (Trusts and Estates) and is listed among the *Texas Super Lawyers* by *Texas Monthly Magazine*.

Dyan Sublett is senior vice president for advancement at the Natural History Museum of Los Angeles County. Previously, she was senior vice president for institutional advancement at Art Center College of Design in Pasadena, California and senior development director at the University of California, Los Angeles. She holds an undergraduate degree from Indiana University and a Master of Fine Arts from the University of Massachusetts. Sublett co-founded the Women and Philanthropy Program at the University of California, Los Angeles, which has served as a model for nonprofits nationwide. She is a contributing writer to the book *Women as Donors, Women as Philanthropists*, and is a consultant with educational, environmental and social change organizations.

Jonathan G. Tidd is a West Simsbury, Connecticut attorney whose practice is limited to advising charitable organizations on gift planning issues. He is a member of the Connecticut, Illinois, Indiana and New York Bars. He 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.

Model Standards of Practice for the Charitable Gift Planner

Adopted and subscribed to by the American Council on Gift Annuities and the National Committee on Planned Giving, May 7, 1991.

PREAMBLE

The purpose of this statement is to encourage responsible gift planning by urging the adoption of the following Standards of Practice by all individuals who work in the charitable gift planning process, gift planning officers, fund raising consultants, attorneys, accountants, financial planners, life insurance agents and other financial services professionals (collectively referred to hereafter as "Gift Planners"), and by the institutions that these persons represent.

This statement recognizes that the solicitation, planning and administration of a charitable gift is a complex process involving philanthropic, personal, financial, and tax considerations, and as such often involves professionals from various disciplines whose goals should include working together to structure a gift that achieves a fair and proper balance between the interests of the donor and the purposes of the charitable institution.

I. PRIMACY OF PHILANTHROPIC MOTIVATION

The principal basis for making a charitable gift should be a desire on the part of the donor to support the work of charitable institutions.

II. EXPLANATION OF TAX IMPLICATIONS

Congress has provided tax incentives for charitable giving, and the emphasis in this statement on philanthropic motivation in no way minimizes the necessity and appropriateness of a full and accurate explanation by the Gift Planner of those incentives and their implications.

III. FULL DISCLOSURE

It is essential to the gift planning process that the role and relationships of all parties involved, including how and by whom each is compensated, be fully disclosed to the donor. A Gift Planner shall not act or purport to act as a representative of any charity without the express knowledge and approval of the charity, and shall not, while employed by the charity, act or purport to act as a representative of the donor, without the express consent of both the charity and the donor.

IV. COMPENSATION

Compensation paid to Gift Planners shall be reasonable and proportionate to the services provided. Payment of finders fees, commissions or other fees by a donee organization to an independent Gift Planner as a condition for the delivery of a gift are never appropriate. Such payments lead to abusive practices and may violate certain state and federal regulations. Likewise, commission-based compensation for Gift Planners who are employed by a charitable institution is never appropriate.

V. COMPETENCE AND PROFESSIONALISM

The Gift Planner should strive to achieve and maintain a high degree of competence in his or her chosen area, and shall advise donors only in areas in which he or she is professionally qualified. It is a hallmark of professionalism for Gift Planners that they realize when they have reached the limits of their knowledge and expertise, and as a result, should include other professionals in the process. Such relationships should be characterized by courtesy, tact and mutual respect.

VI. CONSULTATION WITH INDEPENDENT ADVISORS

A Gift Planner acting on behalf of a charity shall in all cases strongly encourage the donor to discuss the proposed gift with competent independent legal and tax advisors of the donor's choice.

VII. CONSULTATION WITH CHARITIES

Although Gift Planners frequently and properly counsel donors concerning specific charitable gifts without the prior knowledge or approval of the donee organization, the Gift Planners, in order to insure that the gift will accomplish the donor's objectives, should encourage the donor, early in the gift planning process, to discuss the proposed gift with the charity to whom the gift is to be made. In cases where the donor desires anonymity, the Gift Planners shall endeavor, on behalf of the undisclosed donor, to obtain the charity's input in the gift planning process.

VIII. DESCRIPTION AND REPRESENTATION OF GIFT

The Gift Planner shall make every effort to assure that the donor receives a full description and an accurate representation of all aspects of any proposed charitable gift plan. The consequences for the charity, the donor and, where applicable, the donor's family, should be apparent, and the assumptions underlying any financial illustrations should be realistic.

IX. FULL COMPLIANCE

A Gift Planner shall fully comply with and shall encourage other parties in the gift planning process to fully comply with both the letter and spirit of all applicable federal and state laws and regulations.

X. PUBLIC TRUST

Gift Planners shall, in all dealings with donors, institutions and other professionals, act with fairness, honesty, integrity and openness. Except for compensation received for services, the terms of which have been disclosed to the donor, they shall have no vested interest that could result in personal gain.

Analyzing Gift Annuity Risks

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I. Risks and the Continuum

Risk is simply the likelihood that actual outcomes are worse than expected. Risks can further be measured quantitatively to determine which risks are rational vs. irrational. The best example is people who fear flying because of the dangers, so they drive instead. When, in fact, their risks of driving are exponentially greater than flying. Risk management is a process of understanding both the likelihood (frequency) of an event and the severity. Then the risk may be retained, reduced, transferred or avoided.

It is also interesting to note that the only two types of gifts where charities can lose more than the original gift are gift annuities and non-cash assets gifts (e.g., real estate, partnerships, etc.). For the purposes of our presentation, we will focus on charity specific risks (default or exhaustion because of poor investments or long-lived donors) vs. donor specific risks (default from charity, purchasing power risk, etc.). Bryan will cover the more analytical and theoretical issues, while George will cover the more qualitative and practical considerations.

During this presentation, we would suggest visualizing a continuum from 1-10 (with 1 being the most risk averse and 10 being the most risk tolerant) and consider where your charity falls.

II. The Top 10 Charitable Gift Annuity Risks to Avoid
(Reprinted with Permission from Planned Giving Today – Nov. 2004, Bryan Clontz)

After performing dozens of risk audits on charitable gift annuity pools from 25-1500 annuitants, I have become increasingly troubled by how charities are managing gift annuity risks. The majority of these pools, regardless of the size, have at least one firecracker, hand grenade and/or nuclear bomb that could do varying degrees of damage to the pool or charity. How can you avoid the risk? Stay out of these top 10 charitable gift annuity traps.

1. Using Money Currently

Spending current money from charitable gift annuities has always been the cardinal sin of gift annuity management, yet charities still do it. Although, the equity returns of the '80s and '90s allowed these policies, the whipsaw effect of 2000-2002 has pulled many of these pools underwater – to the point at which the present value of assets is less than the present value of liabilities.

Using conservative ACGA assumptions, a new gift annuity has a 5-15% probability of exhaustion. And for every 5% the charity uses up-front, the exhaustion probability increases by 4-8% to a total of 35-45% at 20% up-front.

A number of charities, typically community or religious foundations, charge an additional yearly administrative fee of 1% or so. On a present value basis, this would be similar to taking between 8-10% immediately if the donor has a 15-year life expectancy.

2. **Granting Rate Exceptions**

Similar to taking money currently, rate exceptions are a de facto way of taking the same risk but giving up the benefit. By providing the donor with a higher income than ACGA rates, they are guaranteeing a larger life income and therefore have a larger liability and a smaller surplus.

3. **Calling a CGA Pool a "Pool"**

Calling any gift annuity pool a "pool" is incorrect for actuarial purposes. First, to benefit from any statistical prediction relative to the law of large numbers, statisticians and actuaries usually like to see homogenous pools of 1,000 lives or greater. Having pools of less than 250 annuitants therefore provides extreme variations in mortality experience. Said simply, charities have no way of predicting when donors will die.

Second, true pools use gains from early deaths to off-set losses from later deaths. Charities almost always carve out the pro-rata reserve at the donor's death and use the money at that time for unrestricted or restricted purposes. This means that all the actuarial "winners" are pulled out early and are not typically available to back all the actuarial "losers" left in the pool. Further, if the gift is restricted to a purpose as many gifts are, this does not provide for any flexibility should a group of annuities exhaust. In essence, restricted gift annuities are stand-alone pools (this is frequently the situation in the community foundation or university setting). This would not be the case if a large unrestricted endowment has been Board-approved to back gift annuity liabilities.

Third, actuaries like to see very large pools of risks that are equal size and have come in equally over a long period of time. They do not like to see 40 annuitants with an average gift size of $35,000, but with a range of $10,000-$2.6 million that all came in since 1999. This lends itself to investment timing and annuity concentration risk.

4. **Thinking FASB Liabilities Are Reality**

Many charities use their FASB liability reports to assess their pools. The flaw in this analysis is that FASB allows charities to choose the 1990 life expectancy table or the Annuity 2000 table, as well as a reasonable discount rate. In my research, about 65-75% of charities are choosing the 1990 table and a discount rate of 7%. By simply adjusting the assumptions to the Annuity 2000 table plus a gender-specific 1.5 years and using a 6% discount rate, charities will find that their asset-to-liability percentage will likely decrease between 15-20%.

So a charity that shows a surplus of 15% (or 115% assets to liabilities), may actually have a negative surplus of 5% (or 95% assets to liabilities). This is because the 1990 life expectancy table is understating realistic gift annuitant life expectancies between 3-5 years. This does not include a reduction of 2-5% for the volatility of investment returns rather than using a constant discount rate.

While FASB and state reserve requirements may allow some flexibility in assumptions, it is critically important to re-model the pool based on more realistic expectations.

5. Investing Too Aggressively in Equities and Not Matching Assets to Liabilities

As more states adopt the prudent investment standard for gift annuity reserves, charities are thinking about increasing their equity exposures.

After reviewing current gift annuity investment allocations, Don Behan, Ph.D., a former Georgia State University actuarial professor and current Senior Research Fellow and consulting actuary said, "A charity that invests more than the gift portion in equity without locking in guaranteed fixed payments to meet the payout liability is speculating." In essence, following this logic, charities should never invest more than the current charitable deduction percentage in equities.

Interestingly, the largest five annuity companies have an average of only 2.8% in equities. The remainder is in fixed income investments that precisely match the expected cash flows. Rather than following this precise approach, charities typically use the same allocation as the endowment even though the endowment has a perpetual time horizon and no liability, and gift annuities have a 12-15 year average time horizon with a 60-70% contractual liability on day one. Further, charities are not adjusting the allocation to better match the pool liability (if the average life expectancy of a pool is seven years, then that should have a different allocation than a pool with an average life expectancy of 18 years). This would assume the size of all the gifts would be equal, but what if they are not? Does your charity put a 50 year-old $1.3 million deferred annuity into the same allocation as an 85 year-old $10,000 annuity?

6. Relying on History to Project the Future

Of course no one knows for sure, but most of today's market observers aren't calling for equity returns of the '80s and '90s. With fixed income returns near all-time lows, most financial modeling has become much more conservative than even three or four years ago. And while recent ACGA studies have shown very high residual balances, these reserves benefited from the longest, largest and most consistent bull run in history.

Mathematically, the most harm is done when early losses are successive and withdrawals are being made at the same time. Years 2000 through 2002 would be a perfect example. As has been mentioned, a balanced allocation had a 5% exhaustion probability at the beginning of 2002 and a 20% exhaustion probability at the end of 2002. In fact, our research shows that gift annuities written between 1998-2002 have between 20-45% exhaustion probabilities if they were allocated 45-65% in equities. And this assumes that people will not continue to live longer than the Annuity 2000 table.

7. Not Self-Insuring "Large" Annuities Representing Concentrated Risk
Charities with smaller pools, restricted gifts, a low risk tolerance or with low surplus continue to write large annuities relative to their pool. If a $10,000 gift annuity were to run out of money, it may not cause organizational harm. If a $1 million gift annuity were to run out of money, it could be devastating. In some cases, 5% of the annuities represent 70-80% of the assets. This concentration risk is further exacerbated with older donors. At age 75, the longevity risk – the risk the donor lives past life expectancy - becomes much greater than investment risk – the risk that returns don't match assumptions consistently.

Charities should perform some statistical analysis to determine which annuities are large – typically defined as those annuities more than two or three standard deviations from the mean. Then limit the downside while maximizing life expectancy values. Reinsurance, or purchasing a single premium immediate annuity to back some or all of the gift, can be employed to shift the investment and longevity risk to the insurance company.

Although reinsurance continues to be misunderstood in the charitable arena and is either overused, reinsuring everything, or underused, reinsuring nothing, prudent applications of reinsurance can dramatically reduce concentration risk. In fact, it is precisely what life insurance and property/casualty insurance companies do when their risk is too concentrated. In earlier research, we found the charity would have a larger life expectancy balance by reinsuring and then reinvesting the surplus 100% in equity in about 75% of the cases if they invested less than 60% in equity in their self-insured gift annuity pool.

8. Not Having a Written Risk Management Plan that Matches Risk Tolerance
Before the first gift annuity is offered, charities should set policies to match their risk tolerance based on how much they could afford to lose at different probability levels. They should decide on a risk retention limit – how much they are comfortable self-insuring, a risk reduction limit – the point at which they might try to reduce the ACGA rate, and a risk transfer limit – the point at which they purchase an immediate annuity to back the liability (often called reinsurance). This decision process is identical to the decision a consumer makes when choosing a deductible (self-insurance), a co-insurance percentage (risk reduction) and a stop-loss limit (risk transfer). For example, after reviewing various ending balance scenarios, a charity might decide that the risk for them becomes too great at $250,000 and therefore will be reduced for gift annuities between $250,000-$400,000. Over that point, they may choose to transfer the risk through reinsurance as the risk on that particular annuity is too great. Charities with a large healthy pool, or a charity with a large unrestricted endowment available to back annuity liabilities, or a charity with high risk tolerance should have a very high risk retention limit such that they may only need to reduce or reinsure risk in 2-5% of the cases. When the converse is true, it might be prudent to reduce or reinsure risk in as much as 33% or more of the cases. The key is to collar the downside loss based on the pool's attributes and the charity's risk tolerance.

9. Not Reviewing the CGA Pool on a Periodic Basis

One year or one annuity can change everything. In addition, as the pool becomes healthier, risk retention limits can be increased, allocations can be tweaked to better match new liabilities, and reserves can be released to meet donative intent. Or, if the pool becomes weaker, risk retention limits can be decreased, allocations can change as appropriate and reserves can be retained for the benefit of the pool. Finally, because risk itself is not static, the charity should also reassess its risk tolerance every few years..

10. Charities Thinking That They Are Smarter Than Life Insurance Companies

From a strictly financial perspective, gift annuities are nothing more than commercial immediate life only annuities that are priced 25-40% too high. This "overcharge" represents the charitable gift. While the surplus provides the charity with a strong buffer, it can be eroded very quickly through mismanagement, poor investment returns, poor investment timing and long-lived donors.

Life insurance companies do not take money currently; do not make rate exceptions beyond a point that pricing actuaries have deemed prudent; have pools of millions of annuitants; have life insurance pools which are negatively correlated with annuity pools; have teams of actuaries setting rates, monitoring surpluses and asset/liability matching strategies; reinsure blocks of risks that exceed retention thresholds and review the pools constantly. This should not be construed as advice to transfer all the gift annuity assets to insurance companies, only that many of the same best practices should be followed.

Conclusion

The period of 2000-2002 was the perfect storm for gift annuity pools. Unfortunately, the damage will not be repaired anytime soon. As most charities are guilty of at least six or seven of these mistakes, they should perform a deeper analysis of their gift annuity pool to better identify risks, develop risk management and investment policies based on the pool's composition and the charity's risk tolerance, and periodically review the pool to make necessary changes. Alternatively, the other option is to just cross your fingers and hope for the best.
(end of article)

III. Recent Mortality Studies and Investment Experience

A recently-released study conducting by Don Behan, Ph.D., and Bryan Clontz, CFP,,*Mortality of Beneficiaries of Charitable Gift Annuities*, was just posted on the Society of Actuaries web site and will be published in the North American Actuarial Journal in the spring of 2006.

The key findings were:

- CGA donors are living between 1-5 years longer than the Annuity 2000 Table;

- there are mortality differences between different sub-types of charities – religious vs. healthcare for example;
- there was a very strong select and ultimate mortality pattern that accounted for much of the longevity disparity between our findings and the Annuity 2000 Table.

As it relates to investment experience the following table assumes that:

- 55% Fixed, 40% Equity and 5% Cash Allocation
- Annual returns assumed Vanguard Intermediate Bond Fund, Vanguard Total Stock Index and Vanguard Prime Money Market Fund (less a 75 basis point investment and administration expense)

Year	Actual Net Return	+/- vs ACGA Assumed 5%
1996	9.2	+4.2
1997	16.7	+11.7
1998	13.5	+8.5
1999	9.7	+4.7
2000	1.2	-3.8
2001	0.2	-4.8
2002	-2.1	-7.1
2003	15.5	+10.5
2004	4.8	-0.2
2005	3.7	-1.4

IV. The Yale CGA Experience

Yale's experience with gift annuities has been quite positive, and we can attribute much of the success to following many of the points and avoiding the mistakes mentioned here.

The First Yale Annuity

The annuity program at Yale is currently sound, but it actually began with a deal that would make any organization's business officers cringe. On December 19, 1831, Yale entered into an agreement to pay a $1,000 life annuity, a generous sum at the time, to the painter John Trumbull, age 75, in exchange for eight original paintings of subjects from the American Revolution. At the time there was no certainty that these canvases would be worth what they are today. Yale's total revenue and expenses in 1831 were just over $20,000. Furthermore, Yale also agreed to build a fire proof building at a cost of $4,000 to house the collection. John Trumbull died at age 87, far outliving his life expectancy. This annuity is a poster child for poor risk management;

a large concentrated mortality risk, an illiquid undiversified and non- income producing asset as a reserve, a large annuity representing over 5% of annual revenues and expenses. This would be equivalent to an annuity of $85 million against Yale's current operating budget. Interestingly, Trumbull was not a Yale graduate, he was a Harvard alumnus, which may explain why he chose to make this deal with Yale. Fortunately, the donated asset has proven quite valuable, and Yale has survived. Our modern annuity program seeks to avoid the many obvious risks associated with the Trumbull annuity.

The Current Program

The Yale program presently consists of 962 contracts having a face value of $43 million, and annual payments totaling $3.8 million. The reserve pool has a market value of $93 million. The FASB liabilities are calculated at approximately $24 million (using the Annuity 2000 table). We are in the very fortunate position of being well over funded and can attribute this to several factors:

1. Extraordinary investment performance of our reserve pool has been the main contributor to success, allowing the program to "outrun" the liability. Reserves are invested with the Endowment; a highly successful and diverse pool comprised of domestic equity, foreign equity, absolute return, private equity, real assets, and fixed income. Strength begets strength in a virtuous cycle which allows pools with excess reserves to be invested more freely for potentially greater returns. Future success in investing is not taken for granted, and we maintain conservative assumptions looking forward.

2. A conservative annuity rate schedule limits overall liabilities and strengthens the pool. Rates at Yale are set based upon a minimum 40% charitable deduction and are typically slightly below the suggested AGCA rates. This policy also has the effect of discouraging "rate shoppers" thereby ensuring that annuity gifts represent charitable intent rather than a financial product. A close working relationship between the business office and the development office results in few if any exceptions to rate policy.

3. All gift assets are held in reserve until the annuity terminates. In gift proposals, it is made clear to donors that the designated program or project will not receive funding until the annuity terminates. This logical 'consequence' to the donor of choosing a planned gift over an outright gift often results in reconsideration of an outright gift. The policy also provides incentive for the early termination/assignment of the annuity.

Concentration of Risk and Charitable Intent

Despite a reasonably large annuity population, the annuity pool has not always been highly diverse. Until several years ago, one exceptional donor represented over 40% of the pool liability and reserves. An outlier in the population, these 28 annuities representing over $42 million, were treated separately in all internal reporting and management decisions. Needless to say, this elderly donor had a close relationship with the university and strong charitable intent. The annuity arrangement was interesting in that every few months, after accumulating payments, funds were again donated in exchange for yet another annuity. Both he and Yale understood that the University was the central focus of his overall estate plan, and the passing of assets back and forth through the many annuity gifts served to cement the relationship. While it does not appear on the balance sheet and does not necessarily give comfort to auditors, the known level of this donor's charitable intent was a central factor in accepting and managing the concentrated risk represented by these annuity contracts. Yale ultimately received the entire estate and the donor ranks among the most generous benefactors in Yale's history.

While reasonably large in absolute terms, and annuities are a small part of Yale's overall financial picture. Against a backdrop of a $1.7 billion operating budget and a $15 billion endowment, $3.8 million in annual payments or a $24 million total liability is manageable. Yale is the enviable position of having a well-funded pool and risks are manageable within the context of the overall financial position of the organization.

V. Practical Advice for Large and Small Shops

From a practical perspective, the following points can be added to those above:

1. Avoid "rate shoppers" and keep the program charitable. True charitable intent serves to de-emphasize the financial product nature of an annuity arrangement and reduces true risk to the organization. With few exceptions, the University's annuity donors are deeply committed to the best interests of the institution. Donor's to Yale often care as much or more about the charitable residual value as their own annuity check.

After a flat year of endowment returns, I have actually had donors call me, concerned that there might not be enough left for Yale to fund their intended scholarship. While annuities are legal binding contracts, be sure you are dealing with those that are doing it for your benefit as much as their own. A pool of very charitable donors is good insurance should your reserves become dangerously low.

2. Reduce investment costs. Over paid investment managers are a sure way to under perform in your investments. It is a fact that most active investment managers under perform the market indices, and investors pay for that privilege. Low cost, passive index funds or exchange traded funds (ETFs) are very efficient and are accessible by even the smallest investors. Reducing investment costs equates to better returns. Adding 0.5% to 1% of increasedl investment return is very significant.

3. Diversify your equity investments. Holding the S&P500 is not diversification. REITs, small cap, emerging markets, foreign stock, and foreign bonds, can be coupled together to improve performance without adding significantly to overall portfolio risk. Much has been written on this topic so we will spare the details here. Getting this right can dramatically improve the performance of pool investments.

4. Ask for gifts of the income. This is the easiest way to improve the mortality experience in your pool, and nobody has to die. Donors' circumstances often change as they get older. Donors often no longer need the income. Most annuitants do not realize how easy it is to assign their income nor are they aware of the additional tax deduction that an assignment will yield. Remind them often. Donors with strong charitable intent will respond to these appeals.

5. Resist pressure to offer higher rates or make exceptions to policies. As business managers, be sure to educate your development staff thoroughly about the real economics behind annuities and all planned gifts. Development staff should have incentive to negotiate and close "quality" planned gifts. Too often, development goals are based on the face value of planned gifts. Ask donors if they would accept a lower rate. It is common sense that if most annuity rates are at or below the rate of expected return on reserves, longevity risk is reduced as the liability can be outpaced by earnings. Be especially wary of issuing longer-term annuities where payout rate might exceed expected returns.

VI. Summary and Conclusion

We sincerely hope that while analyzing gift annuity risks can seem a daunting and complex task, that you don't lose the forest for the trees – CGAs are wonderful gifts for both the donor and the donee. It remains, however, critically important to establish and follow clear risk management policies and procedures as well as implementing effective monitoring systems to insure reality will meet expectations. As we now know that donors are living longer than expected, and the last six years have provided us with a difficult investment education, we hope this presentation will be useful in providing a necessary CGA pool "check-up."

VII. Additional Resources

Five additional articles on this topic are:

B. Clontz and M. Newton, "An Analysis of Commercial Insurance as an Alternative Gift Annuity Financing Option," The Journal of Gift Planning, 1st Quarter 1998.

B. Clontz and D. Behan, "Optimizing Charitable Gift Annuity Risk Management: Collaring the Bear and the Grim Reaper", The Journal of Gift Planning, 1st Quarter 2004.

F. Minton, "Maximizing the Benefits of Your CGA Program", Planned Giving Design Center.

B. Clontz and D. Behan, "Optimizing Charitable Gift Annuity Risk Management Part II: Reinsurance Revisited" 2nd Quarter 2005.

D. Behan and B. Clontz, "CGA Mortality Study" research paper for the Society of Actuaries [expected publication in the North American Actuarial Journal in Spring 2006].

Yale Endowment annual report:
http://www.yale.edu/investments/Endowment_Update.pdf

Analyzing Gift Annuity Risks

Bryan Clontz
President, Charitable Solutions, LLC

George Atwood
Yale University Trusts and Estates

Agenda

- CGA Market Overview
- Risk Management 101
- CGA Risk Management
- New CGA Mortality Study
- Investment vs. Longevity Risk
- Exhaustion Frequency and Severity
- The Yale CGA Experience
- Practical Advice for Large and Small Shops

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Charitable Gift Annuity Market Overview

- Estimated $15-20 Billion in CGAs
- Average Age 78
- Average Gift $60,000 (Doubled Since 1999)
- Most Popular Form of Life-Income Gift
- Average Residuums
  76% (1994)
  96% (1999)
  65% (2004)

3

Risk Management 101

- Actual Outcomes Worse Than Expected
- Event Frequency, Event Severity
- Risk Management Strategies
  Retain Risk (Total Assumption or Deductible)
  Reduce Risk (Stop Smoking)
  Transfer Risk (Insurance or Contract)
  Avoid Risk (Eliminate Activity)

4

CGA Risk Management

- Charity CGA Risks: Investment Returns and Timing, Longevity, Rate, Concentration, Restricted Funds, Administrative/Policy
- Top Ten CGA Mistakes

1. Using Money Currently
2. Granting Rate Exceptions
3. Thinking a "Pool" is a Pool
4. Thinking FASB Liabilities are Reality
5. No Asset-Liability Matching on Investments
6. Relying on History to Project the Future
7. Self-Insuring Large Concentrated Risk
8. No Written Risk Management Plan Matching Risk Tolerance
9. No Periodic CGA Pool Review
10. Charities Thinking They are Smarter than Insurance Companies

Recent CGA Mortality Research

- Clontz-Behan CGA Mortality Study for the Society of Actuaries – 35,000+ CGAs from 27 Charities

Sample Case:	77 Year-Old Female/$100K 7.4% CGA/6% Discount Rate	
1990 IRS Table	11.1 Years	$55,828 Liability
Annuity 2000	12.7 Years	$64,490 Liability
ACGA-LE	14.0 Years	$68,782 Liability
Clontz-Behan	14.8 Years	$71,267 Liability

Income Tax Deduction Overstated by 38-40%

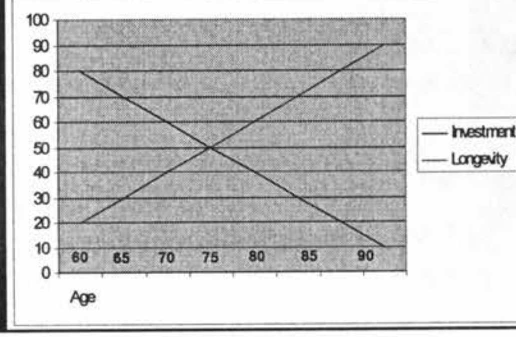
Liability Understated by 27-30% over 1990 – 11-13% over 2000

Donors are living 1-5 years beyond Annuity 2000

Recent Investment Experience vs. ACGA Rate Assumptions

Year	Actual Net Return	ACGA Assumed 5%
1996	9.2	+4.2
1997	16.7	+11.7
1998	13.5	+8.5
1999	9.7	+4.7
2000	1.2	-3.8
2001	.2	-4.8
2002	-2.1	-7.1
2003	15.5	+10.5
2004	4.8	-.2
2005	3.65	-1.35

Investment vs. Longevity Risk by Age



Exhaustion Frequency and Severity

- 1998-2002: 20-45% Exhaustion Probability for all CGAs
  *Assumed 6/30/03 Market Values, 60% Equity Allocation, ACGA-Assumed Life Expectancies and Historic Future Returns
- 6-12% Exhaustion Probability for New CGAs
- Of the CGAs that Exhaust, the average "loss" on original gift is 10-15%
- Lowest Risk – Young Male with Deferred Annuity
- Highest Risk – 90 Year Old Female

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The Yale CGA Experience

Yale's First Annuity Gift,
John Trumbull 1831

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The Yale CGA Experience

Current Status; A Well Funded Pool:

- 962 Contracts
- $43 million Face Value
- $3.8 million Annuity
- $93 million Market Value
- $24 million Liability

Attribution of Success:

1. Extraordinary Investment Results
2. Conservative Rates
3. Maintain Reserves

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The Yale CGA Experience

Charitable Intent May be a Factor in Accepting a Non Diversified Annuity Risk

12

Practical Advice for Large and Small Shops

- **Keep the Focus on Charitable Intent**
  - Avoid the rate shoppers
- **Reduce investment costs**
- **Diversify investments**
- **Ask for Gifts of Income**
- **Resist Pressure to Make Policy Exceptions**

13

The Fundamentals of a Successful Charitable Gift Annuity Program

Presented by

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The Fundamentals of a Successful Charitable Gift Annuity Program

Betsy A. Mangone

Introduction

Rewards and Risks

Bequests, charitable remainder trusts and charitable gift annuities are all taproots of philanthropy in our country. If bequests form the largest segment of planned gifts, charitable gift annuities are not too far behind in popularity. And it is interesting to note that gift annuities are hardly the new kid on the block. In fact, they have been around for a long, long time—over a hundred twenty-five years.

Popular With Donors

There are good reasons that charitable gift annuities are popular. First, they provide multiple benefits for donors:

- A gift to the charity of the donor's choice
- A charitable gift annuity contract is easy to understand and complete
- An income to the donor/donor's spouse
- Charitable gift annuities offer, relative to other 'investments,' a competitive rate of return
- An income tax charitable deduction
- Typically some tax free income
- Often a method of actually increasing income to the donor
- A method of providing increased income to an employee or relative.

Popular With Charities

Similarly, there are good reasons that charitable gift annuities are popular with charities:

- The charitable gift annuity contract is easy to understand and create
- The charitable gift annuity is easy to explain to donors and their advisors
- Charitable gift annuities are sought after by donors and donors even expect charities to have a gift annuity program
- A charitable gift annuity program will promote long-term relationships with important donors
- A gift annuity program will assist with strategic planning because it is a gift of a future interest.

Risk and Reward
During our lifetimes, we tend to seek out concepts and activities that offer balanced results. We are not afraid to take some risk if the reward seems in proportion to the risk. Our approach to charitable giving is no different. As donors, if there is a way we can support the mission of our favorite charitable organization while receiving tax benefits and income payments to ourselves—great. As charities, if there is a way we can offer donors tax-advantaged and income producing charitable vehicles as incentives to support us—great!

Charitable gift annuities however, do carry a component of risk for the charity that other charitable giving methods do not. This is because the agreed upon income payment from the charity to the donor is a legal and financial *obligation* on the books of the charity. Therefore whether we are considering starting a charitable gift annuity program, or in the midst of operating a charitable gift annuity program, we must be aware of the risks of the program—as well as the rewards.

Before we begin the discussion of how to start a gift annuity program, let's take one last look at how we are defining a charitable gift annuity—for it is this definition that spells out very clearly both the risks and rewards of a charitable gift annuity program.

Definition
A charitable gift annuity is a contractual agreement between one or two donors (typically husband and wife) and a charity. The donor(s) transfers assets as a gift to the charity and in return, the charity *promises* (read "is obligated") to pay a fixed-income payment to the donor(s).

It is the *promised income* that makes the gift so attractive to donors. It is the *anticipated residuum (gift)* after the donor's lifetime that makes the gift so attractive to charities.

This presentation is focused on providing the internal structure and external activities that will enable donors and charities to successfully utilize the charitable gift annuity to its fullest potential.

Starting a Charitable Gift Annuity Program-Internal Structure

1. The Importance of Stability

Financial
There are certain characteristics that point to a successful gift annuity program. Here are some important financial questions your prospective donors may be asking the following questions.

- What is your investment history?
- Do you have an investment committee or some group charged with overseeing your investments?
- Do you have an endowment?
- Have you been successful at hitting financial targets?
- What is your history of fiduciary responsibilities and performance?
- What is your history of financial stewardship?
- Do you have an investment policy?

Options
Review you organization's situation and discuss how to establish an investment policy (or update your current one) with colleagues, volunteers and board members who are investment oriented, banks or planned giving consultants.

Ability to Deal with Complexity
Many states have start-up registration and on-going reporting requirements for charities issuing gift annuities. These requirements can include the length of existence for your organization, a minimum unrestricted financial surplus or reserve, and annual reporting requirements. These requirements form a *minimum* list of financial and reporting necessities when determining whether or not to issue gift annuities.

Here is a brief check list to assist you and your colleagues to determine whether or not your organization is financially prepared to issue charitable gift annuities, and willing and able to work within the complexities involved.

- Determine which states in which you are interested in issuing gift annuities and then obtain a list of any special financial, registration and/ or reporting requirements for those states. The website for the American Council has this information at www.acga-web.org.

- Once you have the information from each state determine whether or not your organization satisfies the minimum requirements. This may limit the geographic area in which you decide to issue gift annuities.

- A gift annuity program will generate future income and likely little or no current income for some years. So, with the cost of marketing, issuing agreements and making the annuity payments, there will be immediate costs with no offsetting income in the early years. Your cost will be in staff time investment and administrative fees, and generally some outside legal fees.

Some states require that a separate annuity reserve fund be created and that the initial gift amount be placed into this investment account. Payments to annuitants can come from this account, but care must be taken that there are sufficient investment returns to assist in making the payments. Some charities place only a portion of the initial gift into the reserve account, but beginning programs have no history on which to base investment return.

Caution is important. A few annuitants who live significantly longer than their actuarial life expectancies can result in continuing annuity payments that use up a major portion of the initial gift and the income from it. One large gift that is a major percentage of the amount of annuities issued can create a financial problem if the annuitant lives a long time.

Options

Contact established gift annuity programs, talk with knowledgeable colleagues, discuss with a planned giving consulting company or ask one of the large planned giving software vendors for assistance. Also, visit AGCA's website at www.acga-web.org.

Mission

Before you embark upon a successful charitable gift annuity program, your organization must have a strategic mission that focuses on perpetual issues that transcend generations of donors. Here are some important mission related questions your prospective donors may be asking:

- Are you successfully addressing your mission? Because a charitable gift annuity represents a long-term investment in your organization by a donor, they are going to want to know that you are committed to accomplishing your mission. After all, it is the mission that is attracting the donor in the first place.

- Is your mission long-term? Again, this gift is establishing a long- term relationship between you and the donor, and the donor will want to feel comfortable that your cause will be as appropriate tomorrow as it is today.

- Your donor will want to know your plans are visionary enough to attract new generations, perhaps the original donor's children, as the years go by.

- How long have you been in existence? It will be difficult for your program to attract long-term donors if you have been in existence for five or less years. In fact, some state laws will prohibit you from offering gift annuities until you have been in existence for some years.

- Is there a lot of staff turnover? This is an important question because unreasonable staff turnover implies possible organizational stress and donors prefer organizations that both attract and retain top talent.

Donor Pool

Successful gift annuity programs rely on a traditional donor and prospective donor base model that has been developed through an annual fund program and a major gifts program. On the other hand, sometimes a gift annuity program will attract new donors having no history of an interest in your organization prior to the initiation of the program.

The reason new prospective donors with no history with you may be interested is because of the relatively high income available with a gift annuity. Thus, the donor interest can be largely financial in some cases.

And here are some *practical* questions you should be asking about your donor and prospective donor pool:

- How many annual donors do you have?
- How many major donors do you have?
- How many of your donors are 60+ in age?
- How many have incomes or asset bases that can support a major gift?
- How many may be interested in discussing a retirement income?

Here are some suggestions for *good* prospects.

- Current donors of 60+
- Prospective donors of 60+
- Donors/prospective donors interested in discussing retirement opportunities
- Board members
- Volunteers
- Faculty (e.g. of universities and medical centers)
- Members (e.g. of cultural arts organizations)

Should you contact professional advisors about the program? Why may they not be interested?

2. The Importance of Culture and Governance

Your Team

It is important to consider the capability of your team to invest and administer a life-income gift program. This is particularly true in the instance of deferred gifts. Here are some points to consider and discuss.

- Is your current team experienced?
- How much time will the program require?
- Do you have adequate staff?
- Will you offer training opportunities?
- Are you able to work collaboratively with the financial professionals in your organization?
- Does your supervisor understand the deferred revenue nature of a charitable gift annuity program?
- Should you seek the services of a parent corporation or community foundation?
- Do you have gift acceptance policies that discuss life-income gifts?
- Do you have the capability of performing gift annuity calculations?
- Can you keep abreast of changing Applied Federal Rate?
- Can you keep abreast of changing regulations and legislation?

Options
Explore the multiple training opportunities advertised in professional publications; contact the National Committee on Planned Giving; consult ACGA's website at www.acga-web.org*; contact the planned giving literature and software companies; contact planned giving consultants and/or knowledgeable colleagues.*

Your Board
It is critical for your board to specifically endorse the charitable gift annuity program. This is true for two reasons: 1) every charitable gift annuity on your books represents a financial obligation for the organization; 2) it is important to explain the nature of the exact benefit of each gift annuity in order to manage expectations. In general, before embarking on any life-income gift program, the board needs to understand the deferred nature of planned gifts and the difference between present and future value.

Additionally, the board must create an investment and administrative policy that provides both risk management and a reasonable return. Risk exposure is managed by:

- Limiting the ages of donor annuitants
- Following reasonable payout rates
- Limiting the assets accepted for a charitable gift annuity
- Limiting the geographic area where gift annuities will be issued.

The board needs to consider where annuities will be issued (different states have different reserve requirements) and what assets might be accepted. For example, if illiquid assets such as real estate and limited partnerships are accepted as a funding asset for a gift annuity, where is the income to the donor going to come from? If there is no income from the asset, then money from the organization must be used.

Typically, boards decide on one of the following three methods of investment policy relative to making income payments to donors:

- Invest the entire gift amount and make the income payments to the donor from the investment earnings

- Invest an amount equal to the present value of the future income stream to the donor and spend the balance

- Spend the entire gift amount and make payments to the donor from other sources.

A beginning program will likely exclude all such gifts of illiquid assets.

Here are some questions to think about relative to your board's receptivity to a gift annuity program:

- Is your board interested in and knowledgeable about fundraising?

- Do you have a financially savvy board that can endorse gift acceptance policies in general? Gift acceptance policies are important for several reasons:

    1. They establish the conditions under which all gifts, including gift annuities, will be accepted.

    2. They ensure that all donors are being treated equally.

    3. They ensure that the board understands and has endorsed the gifts that the charity will accept.

    4. They provide a roadmap and security for development officers.

- Does the board understand both the fiduciary and deferred nature of planned gifts like charitable gift annuities?

- Does the board support long-term financial and program goals?

- Have members of the board made planned gifts?

Policy
Here is a sample charitable gift annuity acceptance policy

1. The Charitable Gift Annuity

    a. Description

    The charitable gift annuity is a contract between *The Charity* and the donor. *The Charity* agrees to pay the donor (legal and/or other person named by the donor) a lifetime annuity in return for a gift of cash, securities, or other property. The payment may continue for the life of a second individual, such as a spouse. The annual payment is a fixed sum, the amount of which is based on the size of the gift and the number and ages of the beneficiaries.

    Rates of return under a charitable gift annuity are lower than the rates offered by commercial insurance companies so that a significant residuum will remain for *The Charity*. Written notice of this fact will be documented for the donor in two documents. First, the donor will be notified in writing during the gift negotiation stage. Second, the gift annuity contract cover letter will also contain this disclosure information for the donor.

    Gift annuities issued in [insert state of Donor's residence] shall comply with [insert state of Donor's residence] state law and meet the disclosure requirements under the Philanthropy Protection Act of 1995.

    b. Guidelines

    1) The preliminary minimum amount for an annuity agreement is $10,000.00.

    2) For new contracts, *The Charity* will be guided, although not bound, by the suggested rates recommended by the American Council on Gift Annuities.

    3) Agreements shall be limited to two lives, and ordinarily the minimum age for the annuitants shall be 60 for immediate annuities and 50, with the initial payment at 60, for deferred annuities. Exceptions may be made subject to the prior approval of the Board.

4) Gift annuities may be managed by *The Charity,* and *The Charity* may employ agents and advisors to assist with the administration and investment of gift annuity assets.

5) Gift annuities must meet individual state laws governing gift annuities in each state.

6) *The Charity* prefers to provide quarterly payments to gift annuity donors.

Reinsurance

It is possible to minimize risk by re-insuring the charitable residuum of gift annuities through a contract with a life insurance company. A portion of the initial gift is used to purchase insurance. Typically the charity "sells" the policy to an insurer for a percentage of the total value. The insurance company then has the obligation to cover the payments to the donor. The charity invests the money they receive for the policy and this becomes the charitable gift. When reinsuring gift annuities, careful attention should be given to the balance between risk and reward because the value of the gift can be significantly diminished. However, the investment risk has also been reduced. Care must be taken that the state insurance commissioner allows this and that your organization is not required to also maintain a reserve account. If this is the case, then your organization could have more money tied up in reinsurance and reserve than has been received.

The costs of reinsurance fluctuates with interest rates and generally requires 60-85% of the contribution, depending on the ages of the annuitants and interest rates.[i]

Administrative Costs

The annual administrative costs are assumed to be 100 basis points per year. This figure includes investments and custodial fees, the costs of making payments and filing federal tax forms, and the costs of submitting reports in regulated states. The 100 basis points do not include marketing costs which are generally included in the overall development budget.[ii]

Starting a Charitable Gift Annuity Program-External Structure

Marketing

The effort you devote to marketing your charitable gift annuity program will be directly related to the success of the program.

Where to Market
Where do you begin? You begin with a list of the available methods of reaching your prospective gift annuity donors. It is smart to think of the *existing* methods of communication you have with your constituents. If you are already marketing your bequest program and/or your legacy society, you already have the beginnings of your charitable gift annuity marketing program because you can utilize the same delivery vehicles.

- Your website—offering both donors and professional advisors the option to complete their own gift annuity calculations, as well as an in-depth definition of charitable gift annuities and example stories.

- Organizational newsletters and magazines. Consider using the same space and similar message repeatedly. Use personal testimonials from current gift annuitants whenever possible.

- Personal letters to current and prospective donors. You can send these out as an *announcement* of the new gift annuity program, or as *a reminder* of this charitable vehicle you offer.

- Brochures. A simple trifold with pictures and a brief explanation of the advantages of a current and deferred charitable gift annuity. The decision is whether to provide a chart illustrating the payout rates according to ages. The advantage is that there is a better chance the reader will relate to one of the payout rates listed, but the disadvantage is that if there are large financial market swings and you decide—or ACGA decides—to make a change in the payout rates, your marketing brochure is outdated.

- Post cards. Large post cards are the marketing rage. They are typically colorful and very easy to read. No attempt is made to provide lengthy explanations of the gift annuity; the intent is to entice the reader to contact you for additional information.

- Radio. Many organizations discuss the advantages of a charitable gift annuity on short radio ads on stations whose audience may make good gift annuity prospects, for example, local public radio.

- Newspapers. While most planned giving programs would not consider advertising charitable remainder trusts or bequests in a newspaper, charitable gift annuities offer a good reason to consider such mass ads. Because they are in many respects, a financial instrument, offering a way to obtain a secure life-time income, newspaper readers not closely tied to a particular charity can be interested. Thus the Pomona and Salvation Army ads in The Wall Street Journal and other publications.

What to Market

The inclination is to market the 'sizzle'...the respectively high income available from the gift annuities. Indeed, many charities take this approach. The fact is that charitable gift annuities represent a life-long relationship between your donor and your institution. Repeated experience has taught us that a gift made in the absence of charitable intent is often, in the long run, a problematic gift for one reason or another. On the other hand, a gift annuity from someone not having a relationship is still a gift you otherwise may not have received. Sometimes there is an opportunity to get to know a gift annuitant unfamiliar with your organization and successfully garner ongoing support.

- Market the available income, but be sure your charitable message is prominently displayed.

Disclaimer

Be sure that you put the following or a similar message at the bottom of any of your written marketing communications:

> *"The above information is not intended to be tax or legal advice. We urge you to seek the advice of your professional advisors."*

The Checks to Your Donors

You have two major options when considering how to send the income payments (whether direct deposit notices or an actual check) to your donors: 1) your organization can do it under your own letterhead; or 2) you can ask the administrator of your gift annuity program to do it (likely a bank). If at all possible, you will want to send the notice of a direct deposit or the actual check to the donor under your name. It is a wonderful opportunity to continually market your program.

Conclusion

For established institutions with a comprehensive donor base, experienced board and staff and an established planned giving program, charitable gift annuities comprise a significant component of the total fundraising assets. For those less established organizations, with a smaller donor base, newer board and staff and a newer development program, charitable gift annuities can still provide an excellent fund for the future. In fact, charities not offering a charitable gift annuity program may actually lose those donors who are interested specifically in creating a gift annuity. To be knowledgeable about all the risks and rewards is the key to a safe and solid program.

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[i] 2004 Survey of Charitable Gift Annuities; American Council on Gift Annuities

[ii] Explanation of the ACGA Gift Annuity Rates, Effective July 1,2004

MARKETING BEQUESTS FROM

"A" TO "Z"

1865 - 2006

LINDSAY L. LAPOLE, III
TERRITORIAL PLANNED GIVING DIRECTOR
THE SALVATION ARMY, USA SOUTHERN TERRITORY
ATLANTA, GA

I. MOTIVATION FOR MARKETING BEQUESTS

Universal Need:

A primary motivation for choosing to market bequest, from the charities perspective, is that it meets a universal need. Our culture and tradition teach us that "everyone needs a will". Financial institutions, attorneys, and all manner of advisors remind us that "we need a will". The message is clear, "Without a will, we are not Okay!" Therefore, much of the motivation to move forward is already instilled in individuals before we enter the picture. Most people accept this evaluation and are pleased for someone to give them a "wills kit". Because that is not what we offer, our marketing must be carefully presented and we must have staff prepared to explain what we do and offer their services for the process.

Leads to Long Term Relationships:

The development of a will and estate plan requires a great deal of personal interaction. We gather and a significant body of personal information about our prospects, their families and their financial affairs. We are often aware of feelings and attitudes that the person may not have shared with any one else. The joys and hurts, accomplishments and disappointments of a lifetime come tumbling out as they figuratively face a blank piece of paper that will become their estate plan.

I would define an estate plan as follows:

> **"Your estate plan is a written record that conveys your property, responsibilities, values, and beliefs, in an orderly and thoughtful way to those you trust and wish to honor."**

As we make the determination that bequests will become a part of your planned giving program, you must be prepared for the implications of long term relationships. Throughout this paper the term "estate planning" is used instead of "will" for the offer of our marketing. We should be careful to not perpetuate the interchangeable use of "will" and "estate planning". If the goal of your bequest program is to close the gift by will for its own sake, and "will wording" can be provided by support staff, much of what I say here will be irrelevant. However, estate planning guidance can provide a valuable service to your donors that will commit them to you and your organization permanently.

Requires Constant Nurture:

One of the misguided motivations for many organizations to enter the bequest area of gift development is to generate quick and easy gifts for their organization. They become disappointed and disillusioned when those gifts do not materialize. Gate keepers, ill health, family members or a myriad of other factors often "take" or use up "their" gift. Therefore the wise organization will enter bequest marketing with the intention of building a nurturing environment. This environment will help assure that the gift will still be there 20 to 25 years from now when the donor passes away. Because most staff will not be in place that long, there needs to be an organizational commitment to permanently nurture these gifts.

Nurture leads to other gifts:

The nurture of the person required to maintain the good health of the bequest commitment creates an environment in which the will is not viewed as the end in itself. Rather, the bequest commitment, placed within the comprehensive estate plan, becomes a stepping stone to other opportunities to generate support for the organization by being of service to the donor. Constant changes in family, financial and income needs may make it wise on the donor's part to create an irrevocable income generating gift with some of the estate assets. Good quality bequest commitments become the best prospecting tool you have for additional gifts by Charitable Remainder Trusts, Charitable Gift Annuities and Pooled Income Fund.

Other Gifts Lead to Referrals:

Satisfied donors, like satisfied customers, refer others to us for the same caring approach to this very emotionally charged process of estate planning. It is unrealistic to expect board members and friends of the organization to make **meaningful** referrals if they have not yet made a personal commitment. Just as the wise development professional would not recruit a major gifts campaign chairperson who had not or would not make a major gift personally, we should not fool ourselves into thinking that referrals made by those who have not made a personal commitment will be worthwhile. Your satisfied donors, much more than recruited board or committee members, will lead to an effective referral program

II PREPAREDNESS FOR MARKETING BEQUESTS

Long Term Investment:

We have already spoken of some of the rational for a long term commitment. The leadership of the organization must be prepared to view this as an investment in the future of the organization. I have had the opportunity to meet with the leaders of several national organizations who are asking the question, "How can we start a planned giving program and get money into the national budget this year?" Unfortunately there is no positive answer to that question. Successful organizations see the "expense" of their planned giving program as an investment. Beginning a bequest program that the organization is unwilling to nurture and allow to mature is a waste of money and energy. It will also lead to disgruntled supporters and that will impact other areas of support.

How long will you last?

What is the life expectancy of your organization? Will you go out of business without your next United Way allocation? Are the books balanced and overall health of the organization good? What is the public perception of the organizations health and welfare? **Will your organization last longer than your donors?** A planned giving program begun with bequest marketing is not the answer to these issues. Donors, like sailors, are not excited about taking a trip on a leaky boat!

Identify your Market:

Before beginning the bequest program the target market will need to be identified. A demographic profile will need to be identified with marketing materials prepared and targeted at that group. Our history has been that people die within about 6- 7 years of preparing their last will. Research by Robert Sharp indicates that death occurs about 5-6 years following the preparation of the last will. So the question becomes, "How many long term donors do you have that are 5-7 years from death (actuarially). That will help the organizational leadership determine how realistic an income stream is from a bequest program in the 5-7 year time frame. Remember, the longer the time from commitment to fulfillment, the higher the "financial investmen" in nurturing the gift.

Should you find a much younger donor base, it may be that Deferred Gift Annuities, College Annuities, or Pooled Income Funds for additional retirement planning will be the best target marketing alternative for your organization. Be careful in recommending a bequest program, which may appear to be the easiest and least "risky" fix, when it will, I fact, require the longest term commitment to maturity. Money in Gift Annuities and Pooled Funds may not be yours to spend right now, but it is yours and is not subject to "change" risk.

Are the legalities handled?

In 1865 the founder of The Salvation Army, General William Booth solicited gifts by will to his "new" organization. And he provided the methodology for providing for those gifts. Every week since then, prospects have called The Salvation Army to ask if we could accept gifts by will. We can and do for 141 years.

The question for any organization is, "Can we accept gifts by will?" Are the legalities in place? Who signs the receipt and release? Where will the money be physically delivered? Will you accept "gifts in kind" from estates? How and by whom will the money be allocated? Are allocation policies in place? Will "donor designations" be honored even after the donor and their family members have died?

You have all heard about the $1.6 billion gift from Joan Kroc to the Salvation Army. That is the exciting part! What you do not know is that The Army leadership met and evaluated the operational and investment implications of that gift for almost four months before agreeing to accept it.

Trained to Engage

The development staff of the organization must have the training to engage the donor in the process. Otherwise your bequest program becomes a clerical function of providing wording for inclusion in the will for the gift to your organization.

Time to Nurture

The development department, or at least an appropriate number of staff members, must be provided the dedicated time to carry out this development and nurturing function. Almost any other development function is more exciting than making appointments on the phone to meet with someone about their estate plan. Therefore, staff members must have this function as a major part of their time, job description, goals and annual evaluation. Otherwise the "bequest marketing" effort will be wasted.

Capability to "Finish the Drill"

Football Coach Mark Richt, of the University of Georgia, has challenged his teams, since coming to Georgia, to "Finish the Drill". He means that from spring practice to the bowl game, they are to focus all their energies on finishing what they begin.

The organization desiring to begin bequest marketing, must be prepared to "finish the drill" and not leave themselves and their donors disappointed because of a lack of follow through on commitments made but not kept.

II. THE HIERARCHY OF MARKETING BEQUESTS

Building Spheres of Influence Around Donors

The least expensive and most productive way to market bequest is through building "spheres of influence" around donors. From pre-existing list of individuals, donors would identify supporters whom they feel comfortable contacting or inviting to a personal presentation regarding bequests and planned giving. These events are hosted by the donor and many times at a location of their choosing, usually their home or club.

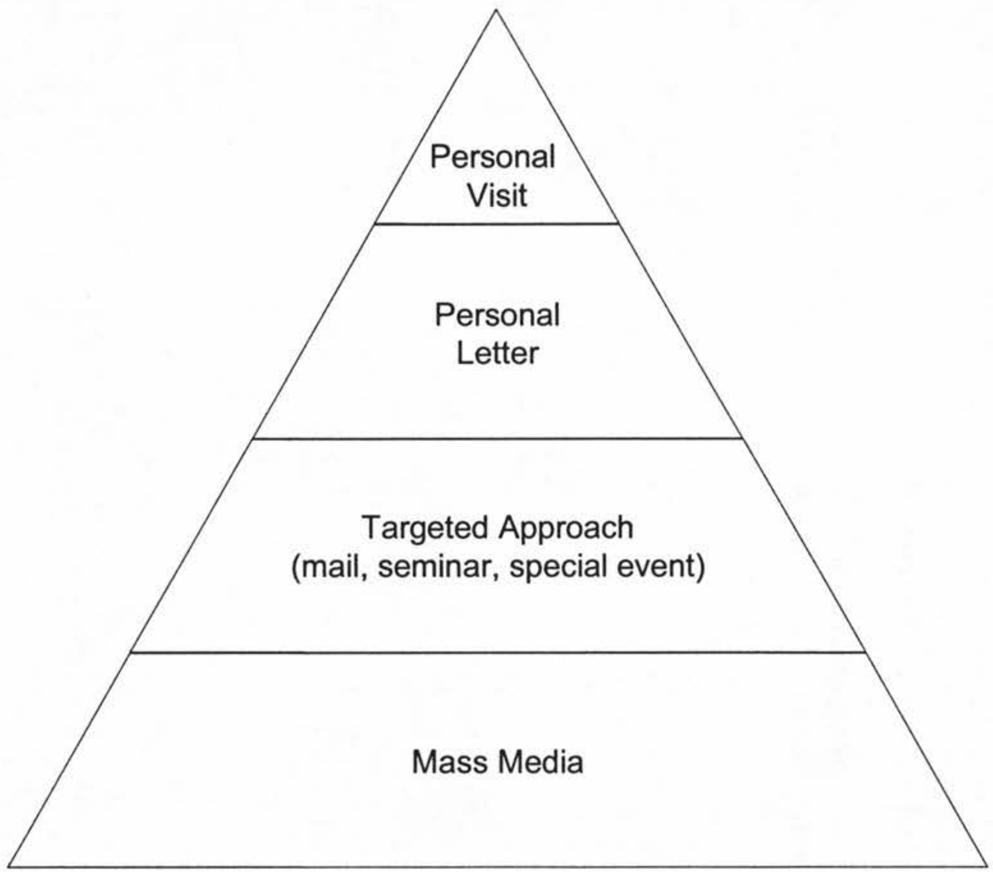
Many organizations seek to build their bequest program around "the board". But in most cases the board was not recruited originally to commit to remembering the organization in their estate plan. Making a gift through your estate plan involves a wide range of issues that may not be on the table for consideration by your board members. They may have family, personal and business situations that preclude them being bequest donors.

Therefore we would do well to focus on those who have made commitments through their wills or other planned gifts, just as we would focus on previous or willing donors in a traditional fund raising campaign. Many seem to forget that planned giving is fund raising and the same principals apply:

1. People give to people, not to causes. (Not development people—the "People" your organization serves!)
2. Big gifts come when the right person asks the right person for the right amount at the right time.
3. Well trained, motivated volunteers can raise more money than staff.

The use of this approach presumes that you have bequest donors who are willing to assist in this way. That may be a future dream for you, but a worthy one none the less.

Hierarchy of Marketing



Referrals from Donors

There is a similar approach that may be more useful is receiving referrals from your existing donors. This would involve them in going with you or calling to make an appointment for you to make contact with a new prospect. In the referral process your donor transfers some of their credibility with the prospect to you. They stand up for you and say that you, your cause and your way of doing business is worthy of consideration.

Seminars

Will or Estate planning seminars are one of the traditional ways of promoting gifts through estate planning. This is an area that many feel may has passed its prime because of all the seminars conducted by financial and insurance professionals. Another "garden variety" seminar is probably not the answer.

The successful program will allow the attendees to experience something of benefit. Health organizations have tied seminars to presentations on senior health issues. A fashion show, concert or private tour of a program facility may also add to the attraction of the seminar. Many colleges and universities add the Estate Planning Seminar as a part of the Alumni Weekend or Homecoming. Creativity is the watchword for those seeking to use this technique.

Seminars do not have to be expensive affairs. Many national speakers are available and there is significant expensive involved it that type presentation. However, well prepared attorneys, CPA's and bank trust officers, working with the Planned Giving director can develop a very effective presentation. Many of these programs draw good audiences, especially if the attorney is well known in the community as an expert that people want to hear. However you decide to carry out your seminar endeavor, it should be an integral part of your annual marketing plan at some level.

Newsletters

Newsletters fall into several different categories. First there is the free standing newsletter used just to communicate bequest, estate planning and planned giving information. This is usually purchased from a vendor and mailed to existing annual donors and friends of the organization. While some organizations may chose to write their own brochures, because of costs, there is benefit in materials purchased from some vendors.

Most people look at color, design and personalization when choosing a vendor and newsletter. While those are important, they pale by comparison to a key factor that some people overlook because most vendors do not discuss or sell it. A newsletter must be legally accurate and it must represent the image of your organization. Without verifying these two characteristic's you should be very weary of using any newsletter. Almost correct is not good enough! Many vendors of planned giving materials are unwilling to spend the money for legal review. In this case cheaper may not be better!

Chose a vendor that has lawyers on staff or available for consistent legal review. You will also want to assure that your newsletters reflect your organizational policies and procedures. This may require additional expense for this type personalization. Otherwise you may find your newsletter making offers that do not reflect your organizational operations.

The second type of newsletter often used in bequest marketing is the organizational newsletter with a bequest article and offer. This approach provided the planned giving director the opportunity to deliver the message without much of the planning, design, coordination and expense. It also keeps planned giving as an integrated part of the organizational culture.

Many times local units of national or regional organizations use a local newsletter to promote local events and awareness. These are excellent and low cost places to place an article or advertisement for your bequest program. Coordination through the local unit can also incorporate them into the organization commitment as they reap the benefits of the bequest allocation.

<u>Advertising</u>

When considering "advertising" your bequest program two more questions must be answered in addition to the ones raised above.

1. What is the capacity of the development staff to process the response?
2. What is the capability of the staff to qualify the leads?
3. What time commitment is available to conduct telephone follow-up?

This past fall we introduced the Dixie Carter Legacy of Love television spots in our territory (the fifteen southeastern states and DC). We anticipated a maximum of 5000 leads. As the spots began to run, the Terry Schivo situation hit the evening news every day. We were in the middle of news advertising an estate planning guide on the four major networks. We received over 15,742 responses in five weeks. Even with our 31 professional staff persons and sixteen divisional support staff, we were ill prepared to meet our goal for handling the response in the timely manner. We had to reorder materials three times as we struggled to meet the demand.

Before deciding that "advertising" is a marketing technique you will use, the cost must be carefully counted and the message must fit the mission of your organization. Trained staff must be in place and have the commitment and time to follow –up on the responses. Written fulfillment of the offer to each lead should take place within 48 hours of its receipt. Phone contact to each respondent should begin within two weeks and be completed before the individual forgets the reason for their original response. Techniques for the written follow-up, phone qualifying toward an appointment and gift development exceed the scope of this document. However, an ill conceived bequest marketing promotion without these elements being in place could lead to very negative donor relationship situations for your organization.

Letterhead

One of the most basic bequest marketing tools is the use of a phrase like, "Remember __________in your will" on your organizational letterhead. While this seems like an easy way to generate leads, the issues discussed above must have been dealt with and resolved. While we all anticipate a reasonable response, we may find ourselves facing a very large and complex bequest without the structure in place to handle it. What would you really do with a $5,000,000 gift designation for a building, program or function that did not currently exist and was marginally outside your mission? Who says "yes" or who says "no" to Mr. or Ms. Big Bucks?

E-marketing

The wave of the future is upon us…maybe! There are those who see e-marketing as the long awaited answer to all matters related to prospect identification and cultivation. There is no doubt that e-marketing has a place in prospect identification for some prospect bases for some organizations. We have generated leads and closed gifts that had our various web sites as their "source of lead".

The distinction between "source of lead" and "closing the gift" is one of philosophy and organizational structure. Our belief is that, for the long term goals of the prospect are to be met, personal interaction is essential. Again, if we are providing language to an unknown prospect for their attorney to include our organization in their will, a well trained support staff person can handle that.

During this past winter we initiated a direct mail promotion to 86,000 of our internal prospects. We split the list exactly in half. One half received the opportunity to respond by phone, web and mail. The other half were given the option of responding only by phone and web. The analysis of our responses is contained in Fig. 2. Those responding by mail alone almost doubled the respondents who were only given the phone and web option. This test makes it clear to us that we need to make the "snail mail" option always available to those we wish to reach.

That should not be interpreted as valid for all organizations. You need to test various methods and techniques. Find through your personal research, the techniques your prospects will respond to. Consultants, vendors and other organizations can make suggestions, based on their experiences and biases, but the only true proof of what will work for your organization is that which you prove for yourself. And by the way, it will change next year and you will have to try new methods.

BKV

The Salvation Army
Total Wills Responses
10/1/05-12/11/05

	BRE Version - Leads						Non-BRE Version - Leads					Combined Total			
Market	# Mailed	Phone	Web	Mail	BRE Total	Response Rate	# Mailed	Phone	Web	Non-BRE Total	Response Rate	Total Mailed	Total Leads	Total Response Rate	
AOK	5,367	1	1	34	36	0.67%	5,366	3	5	8	0.15%	**10,733**	**44**	**0.41%**	**AOK**
FL	5,696	10	1	49	60	1.05%	5,695	17	9	26	0.46%	**11,391**	**86**	**0.75%**	**FL**
GA	5,691	0	0	5	5	0.09%	5,691	4	3	7	0.12%	**11,382**	**12**	**0.11%**	**GA**
KY/TN	5,390	2	0	11	13	0.24%	5,390	5	2	7	0.13%	**10,780**	**20**	**0.19%**	**KY/TN**
MD/WV	5,416	3	0	13	16	0.30%	5,415	4	4	8	0.15%	**10,831**	**24**	**0.22%**	**MD/WV**
NCV	5,132	3	0	3	6	0.12%	5,132	4	4	8	0.16%	**10,264**	**14**	**0.14%**	**NCV**
NC/SC	5,500	2	0	5	7	0.13%	5,499	0	2	2	0.04%	**10,999**	**9**	**0.08%**	**NC/SC**
TX	5,335	1	0	11	12	0.22%	5,335	2	4	6	0.11%	**10,670**	**18**	**0.17%**	**TX**
CA	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1	1	N/A	**N/A**	**1**	**N/A**	**CA**
AZ	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	1	1	N/A	**N/A**	**1**	**N/A**	
NJ	N/A	N/A	1	N/A	1	N/A	N/A	N/A	N/A	N/A	N/A	**N/A**	**1**	**N/A**	
TOTALS	**43,527**	**22**	**3**	**131**	**156**	**0.36%**	**43,523**	**39**	**35**	**74**	**0.17%**	**87,050**	**230**	**0.26%**	

CLOSING THE GIFT

Decision Making Process

Once a lead is generated and the appointment obtained, the bequest marketing process becomes one of working through a decision making process with the prospect. The prospect is figuratively facing a blank piece of paper, which will eventually become their Will. The steps in between require them to make significant decisions about how they feel about individuals and property and decisions related to who will receive what.

Being prepared to work through this process with the prospect will leave you many options in suggesting gifting alternatives beyond the simple bequest in the Will. It can obviously lead to testamentary planning, including Charitable Remainder Trusts, Pooled Income Funds, and Charitable Gift Annuities. These gifts are generally tied to meeting specific family needs, which are much less likely to be overturned. The individual who is receiving significant life income would have a much more difficult time challenging the Will in the courts.

Driven by Their Values and Attitudes

This decision making process is driven by the prospect's values and attitudes. These attitudes are well in place before you arrive, and it becomes our responsibility to understand the motivation of the individual. The more we understand the value structure that is motivating them to make the decisions they are making, the better position we are in to suggest alternatives for their consideration.

Cannot Be Changed

It is not our responsibility to change their decisions, but rather to understand them. The prospects who demands that you to promise to go to court to keep her sister from inheriting part of her estate is not looking for a lifetime of anger and hurt to be changed by a development officer in her living room. She is asking your organization to make a commitment based on her values and attitudes.

The father that is going to disinherit his daughter and granddaughter because of who is daughter married, is not interested in you changing that situation. He is interested in knowing whether you will accept his estate gift and use it for your charitable purposes. On a more positive note, the donor who comes forward without family or other obligations and simply wants to leave their entire estate to you to "buy into the good you are doing", does not need to be given a four-color brochure helping them understand what that mission is. They have made a determination already based on observing the good works of your organization, and fancy salesmanship and a stack of brochures can at best overwhelm them and confuse the issues, and at worst, lose the gift.

Must Be Understood and Responded To

Understanding the decision making process is one that we simply understand and respond to. Many times the most difficult thing is not saying "yes", but knowing when to say "no". An effort to change a person's lifelong held values or attitudinal structure, in favor of making them fit our preconceived gift solution will lead to a very disgruntled donor, and a gift that ultimately is beyond nurture. We must always remember that we are making commitments on behalf of our organization that we undoubtedly will not be present to fulfill. Therefore, the commitments and promises that we make and the gifts that we accept on behalf of our organization must be in the best long term interest of the organization and in its long term ability to fulfill. You must always ask the question, "If I accept this gift, who will carry out the terms and conditions of the gift when it becomes available?"

How Does Your Proposal Meet their Need?

In order to be successful in this process, the proposal that you make to them must clearly meet their needs, goals, and objectives. Or, to state it in another way, it must fulfill their need to fix something, avoid something, or accomplish something. For them to be able to fix, avoid, or accomplish, we must clearly understand what it is they are attempting to do. Our task, therefore, must put arms and legs on their desire to meet a specific need in their community or world.

Involve The Family and Advisors…Now or Later!

The family and advisors of your prospect will be involved in the estate planning process - either now or later. All these individuals have their own goals and objectives for the use of your prospect's estate. Generally, that will not include large, charitable gifts that remove the estate either from their personal avarice or commission base.

Therefore, the wise gift planner will involve these people and determine in advance what their goals and objectives may be. In creating a gift proposal that meets those goals and objectives as well, they assure the long term health of their gift and satisfaction of their prospect. This means that, as appropriate and with the agreement of the prospect, these other individuals are very often brought into the gift planning process as early as the first or second appointment. Our estate planning or bequest marketing then opens itself to meeting broad based needs that everyone understands in advance. This sometimes makes the selection of gift type or the administration of the gift more challenging, but it also creates a much better environment for the long term health and security of the gift for the charitable organization.

NURTURING THE GIFT

Plan on 25 Years

It is worthwhile for organizations to think of bequests as pledges. Pledges that are made now that will not pay off for 20-25 years. As stated earlier in this paper, you therefore must build a plan of carefully nurturing the donor, the family, and their advisors to assure that as much of the gift as possible is still there when it is time to be used by the organization.

Define the Methods You Will Use

There are many methods available for this nurturing process - Christmas cards, birthday cards, annual visits, inclusion of the person in organizational events - are all ways that you can stay in touch with the individual. Address changes that come to your attention should automatically indicate some sort of change in lifestyle, and therefore trigger an immediate personal visit with the individual. I say immediate because the difference in three or four months in certain stages of life can make a dramatic difference in whether your prospect still recognizes you and is able to communicate effectively with you and those responsible for their care, and know that you are a trusted part of their inner circle of associates who needs to be communicated with and kept advised of their condition.

Be Consistent

Once you determine the techniques that you will use, you need to follow through consistently and build those techniques into the time schedule and into the budget. As the donor base becomes larger, this may require additional staff and the reduction in work territories so that the staff has the opportunity to maintain appropriate and consistent relationships with existing donors, as well as having the time to generate new gifts. We are not in the "relationship" business per se; we are in the business of generating bottom line, long term results for our organizations through the process of effective relationship building. That is a significant difference, and one that unfortunately is missed by many in the development field.

Be Diligent

As already stated, we must be diligent to not just process the change of address or phone number, but to be aware of the fact that this probably indicates a change in lifestyle and something that should require a personal visit and follow-up. Make sure that when changing addresses, banks where payments are to be made on life income agreements, and those types of transactions that you are well documenting the appropriate legal authority for people to take action on behalf of your prospect.

Nurture is not really a mechanical process. While we need to put it on our calendar, at its most basic expression, it is a matter of maintaining strong interpersonal relationships with that person. They must know that we care about them, that we stand in their behest in the decisions they have made; not just to protect what they want to give to our organization, but to assure that decisions they made while they were capable of decision making, are carried out in those times when they are not capable. Our diligence and our presence as a part of their lives and the knowledge of their family and advisors to our presence in their lives, will assure that their desires are carried out.

Be Patient

We say to our new staff that bequest development is a marathon not a sprint. It is not a sprint to the next quarter's production report or the next organizational annual report. It is a matter of long term development, and the process that makes a quarterly report work is volume not impatience with a particular individual or situation. The person who has 75 active prospects working toward gift closure does not have to concern themselves with the one gift that must close in order for them to "be successful" in the eyes of their supervisors and organization. Just as the prospect will make decisions based on their values and attitudes, they will do it in a time that is comfortable for them, and that may not be the time schedule that works for us. Volume is our friend, and large numbers of individuals that we can be consistently working with is an important part of this process.

Our experience over the last 30 years is that we have been able to allocate approximately 86% of all gifts that have been committed to The Salvation Army. That includes those that fall through the cracks, those that never were, and those that are for a lesser (or greater) amount than originally intended.

MEASURING SUCCESS

How much do you allocate to Your Mission?

The true measure of our success in planned giving is very simply, "How much does the organization have to spend for programs, services, and mission fulfillment at the end of the day?" How much of your organization's operating budget comes from income from legacies and bequests? It is easy to say 86% of what of we generate through gift expectancies in The Salvation Army is eventually allocated. It is much more helpful to the organization, however, to know that over the last 30 years, $782,508,143 has been added to the operating budget in reserve funds to meet the organizational needs.

By that, the organization knows that the investments it has made over the last 30 years have reaped appropriate returns, and by that, the organizational leadership is in a position to continue the process of investing in the future.

How to Succeed in Planned Giving Without Really Trying

An Overview of Marketing Planned Gifts

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What are the market trends?

In 1998 I began studying the planned giving practices of leading fundraisers in the United States. My sample was the top 10 percent of the *Chronicle of Philanthropy's* Philanthropy 400. Over the years, I've updated and added to the data I collected. Even though there is some movement in the top 10 percent each year, statistically, there has been no significant change in the data the past few years.

I've learned that nearly three-quarters of those I surveyed have a formal planned giving marketing plan and that for 32 percent of them, their planned giving marketing budget is program driven. That's good news when you look at how much of total giving is made up of planned gifts – 50 percent.

What is being marketed?

Wills and Bequests, Charitable Gift Annuities and Charitable Remainder Trusts are the most widely marketed planned giving techniques among the top fundraisers. These are the easiest techniques to market because they're straightforward and easy to explain. More challenging techniques to market include:

- Retirement Plan Assets
- Real Estate
- Charitable Lead Trusts
- Pooled Income Funds
- Life Insurance
- Securities
- Closely held Stock
- Estate Design
- Tangible Personal Property
- Charitable Reverse Mortgage
- Deferred Charitable Gift Annuity
- Donor Advised Fund
- Life Estates

According to *Giving USA 2005*, bequest giving in 2004 is estimated at $19.8 billion, which is 8 percent of all giving in the US. Bequest income is vital to most charities – especially for their endowments. At MU it's estimated that close to 95 percent of all bequest gifts are endowed. Encouraging bequest giving may have the greatest payoff of all marketing efforts.

The most obvious example of the changing attitude of donors is the proliferation of donor advised funds. I believe we soon will see more and more marketing of donor advised funds by charities, not just companies that mange the funds.

What are the tactics?

The methodology of top fundraisers to communicate planned giving opportunities and benefits include traditional tactics and some new ones. For example, 87 percent use newsletters and 84 percent make personal visits – quite traditional. However, change is happening when you consider 84 percent use web sites and 77 percent use advertising.

Newsletters not only provide an education of planned giving tools to a constituency, they also provide semi-qualified prospects through the direct response piece. Most organizations can expect between a 0.5 percent to a 1.5 percent response rate. Although this may seem low, it only takes one gift to potentially pay for the newsletter program.

Web-based marketing

The Internet is becoming more important in daily communication. According to a 2001 study by Mediamark Resources (MRI), 43 percent of people of ages 55-64 are surfing the Web, and a recent study by the University of California at Los Angeles reports that 30 percent of people age 65 and older are on the Internet regularly. Since these are the age groups most often targeted for planned giving marketing materials, it seems crucial for organizations to have some type of planned giving message on the Web. But as Marc Carmichael of R&R Newkirk points out, 100 percent of these age groups have a mailing address. Internet marketing cannot stand alone.

It pays to advertise

Advertising is a creative, non-intrusive way to deliver a message. For it to be effective, however, there must be repetition and consistency of message. Using a "constituent-based" media mix (an organization's communication tools) can often be cost effective and definitely provide a targeted audience. The most popular constituent-based media are

- Newsletters
- Magazines
- Newspapers
- Event Programs
- Buck slips
- Radio
- Television

In addition to constituent-based media, many organizations use mass media.

The most-often-advertised planned giving techniques are wills and bequests, charitable remainder trusts and charitable gift annuities.

The benefits of advertising, according to the survey, are

- Awareness and education of planned giving techniques
- Name recognition and visibility of the organization
- Broadening of the market and generation prospect leads
- Involvement and motivation donors
- Securing of gift.

Telemarketing is not just for the annual fund anymore

I want to briefly touch on something relatively new in planned giving: telemarketing. A consortium of five PBS television stations did a bequest cultivation program with Gift Planning Direct. The objective was to identify new bequests to their stations. The program consisted of direct mail and telephone follow up. They started with 12,299 prospects, had 2,623 prospects participate in the program and uncovered 366 new commitments.

Six Federations of the United Jewish Communities also hired Gift Planning Direct to conduct a bequest cultivation campaign for their endowment program. They had a response rate of 18.04 percent from their 8,196 prospects and uncovered 161 new commitments. These commitments open the door for stewardship through Planned Giving Recognition Societies, which can ultimately lead to outright endowment gifts.

Organizing and executing a Planned Giving Marketing Plan

A Basic Marketing Outline
(Adapted from *Blueprint for Marketing* by Susan E. Frost. Used with permission.)

I. Executive Summary
   a. Organization History
   b. The Market
   c. The Plan

II. Mission Statement

III. Situation Analysis
   a. Internal Analysis
      i. Resources
      ii. Strengths and Weaknesses
      iii. Current Donor Base

b. External Analysis
    i. Current and Past Donor Survey
    ii. Prospective Donor Survey
    iii. Gift Trends

IV. Marketing Objectives
    a. Target Markets
    b. New Markets
    c. Market Segmentation

V. Marketing Strategies

VI. Marketing Tactics

VII. Timetable

VIII. Measurement

IX. Budget

The Small Planned Giving Marketing Plan -- $5,000

With a limited budget it's important to segment your market more as the number of people reached will be fewer than with larger budgets. Usually an organization will want to target older, consistent donors with the planned giving messages. The amount these patrons have given in the past is only a slight indicator of their interest and capability in giving. The material used in the plan should reach both the lay audiences as well as the allied professionals, if possible.

Materials to Produce:

1. A semi-annual to quarterly newsletter
    a. On this budget the newsletter will be personalized on the front and back, but it may not be able to feature a personalized donor profile.
    b. There should be a direct response piece for the prospect to return and a follow-up booklet or brochure.
    c. Cost for approximately 1,000 pieces = $3200.
2. A library of inexpensive brochures covering the planned giving techniques offered by the organization
    a. The brochures should be customized for the organization.
    b. Cost for approximately 1,000 pieces = $600.

3. A "buckslip" with bequest message and legal name of organization to be included in gift receipts, other mailings and at appropriate special events
    a. Cost for approximately 1,000 pieces = $100.
4. Planned giving articles to be published in the organization's constituent publication
    a. These articles may be purchased to help ensure that "full and fair disclosure" is provided as required by securities law.
    b. Cost for semi-annual articles = $300.
5. An annual Estate Planning Seminar for donor prospects
    a. Host the event on site and utilize volunteer allied professionals to minimize costs.
    b. Cost for invitations, refreshments = $500.
6. A static, informational planned giving Web page added to the organization's Web site
    a. List ways of giving to the charity.
    b. Suggest language for wills and living trusts.
    c. Show how to contact a planned giving officer.
    d. Cost for design = $200.
7. A select allied professional mailing
    a. Include cover letter with "Federal Tax Pocket Guides for Advisers and Planners."
    b. Cost for 100 pieces = $100.

The Medium Planned Giving Marketing Budget - $25,000

This sized budget allows an opportunity to broaden the market beyond current donors to prospects and suspects. Frequency of delivered messages can be increased. Also, it is easier to justify a higher degree of customization as a means of better connecting with the prospects through testimonials and anecdotes.

Materials to Produce:

1. A quarterly customized planned giving newsletter
    a. The newsletter will feature donor profiles and messages distinct to the charity. There should be a direct-response piece for the prospect to return and a follow-up booklet or brochure.
    b. Cost for approximately 5,000 pieces = $10,000.
2. A library of brochures covering the planned giving techniques offered by the organization
    a. The brochures should be personalized with the name of the organization.
    b. They may be used on personal calls or for telephone follow up.
    c. Cost for approximately 2,500 pieces = $1,500.
3. A "buckslip" with bequest message and legal name of organization to be included in gift receipts, other mailings and at appropriate special events
    a. Cost for approximately 5,000 pieces = $500.
4. Planned giving articles to be published in the organization's constituent publications
    a. These articles may be purchased to help ensure that "full and fair disclosure" is provided as required by securities law.
    b. Cost for quarterly articles = $600.
5. Semi-annual Donor Seminars
    a. Host the event on site and utilize volunteer allied professionals to minimize costs.
    b. Incorporate topics that have been featured in newsletter.
    c. Cost for invitations, refreshments = $1,000.
6. A professionally designed and maintained planned giving Web page added to the organization's Web site.
    a. Post the quarterly newsletter.
    b. List ways of giving to the charity.
    c. Provide suggested language for wills and living trusts.
    d. Post gift annuity rates.

e. Provide instructions on how to contact a planned giving officer.

f. Cost for design/maintenance = $2,000.

7. An Allied Professional targeted mailing
   a. Include cover letter with "Federal Tax Pocket Guides for Advisers and Planners."
   b. Cost for 500 pieces = $400.
8. An Allied Professional monthly newsletter
   a. Include cover letter with first mailing.
   b. Cost for 500 pieces = $2,500.
9. A Targeted Donor Mailing
   a. Segment by audience or topic.
   b. Include brochure.
   c. Include direct-response piece.
   d. Cost for 1,000 pieces = $1,500.
10. Heritage Society mailings
    a. Include quarterly personalized update on charity.
    b. Offer a birthday greeting with premium.
    c. Cost for 1,000 = $2,000.
11. Heritage Society Event
    a. Cost for invitations, refreshments, etc. = $3,000.

The Large Planned Giving Marketing Budget - $50,000

As additional funding is made available for marketing, frequency of message must be a priority. Broadening the market to reach more prospects is also important. As staffing allows, trying new tactics to connect with the audience is possible. However, consistency of message must be the overriding factor in the growth of the plan. A higher degree of customization can tie an expanding program together.

Materials to Produce:

1. A quarterly, customized planned giving newsletter
   a. The newsletter will feature donor profiles and messages distinct to the charity. There should be a direct-response piece for the prospect to return and a follow-up booklet or brochure.

    b. Cost for approximately 10,000 pieces = $15,500.

2. A library of brochures covering the planned giving techniques offered by the organization
    a. The brochures should be customized for the organization.
    b. The content provides a quick, easy read.
    c. Brochures may be used on personal calls or for telephone follow up.
    d. Cost for approximately 5,000 pieces = $3,000.
3. Customized Ways of Giving Booklets
    a. These booklets should be customized for the organization.
    b. The content provides more detail than do the brochures on each planned giving technique offered by the organization.
    c. They may be used on personal calls, for telephone follow up or as a response piece to specific targeted mailings.
    d. Cost for approximately 3,500 pieces = $6,500.
4. A "buckslip" with bequest message and legal name of organization to be included in gift receipts, other mailings and at appropriate special events
    a. Cost for approximately 10,000 pieces = $1,000.
5. Planned giving articles to be published in the organization's constituent publications
    a. These articles may be purchased to help ensure that "full and fair disclosure" is provided as required by securities law.
    b. Cost for monthly articles = $1,800.
6. Quarterly Donor Seminars
    a. Host the event on site and utilize volunteer allied professionals to minimize costs.
    b. Incorporate topics that have been featured in newsletter.
    c. Cost for invitations, refreshments = $2,000.
7. A professionally designed and maintained planned giving Web page added to the organization's Web site
    a. Post the quarterly newsletter.
    b. List ways of giving to the charity.

c. Provide suggested language for wills and living trusts.

d. Post gift annuity rates.

e. Provide instructions on how to contact a planned giving officer.

f. Cost for design/maintenance = $2,000.

8. An Allied Professional targeted mailing

a. Include cover letter with "Federal Tax Pocket Guides for Advisers and Planners."

b. Cost for 1,500 pieces = $1,000.

9. An Allied Professional monthly newsletter

a. Include cover letter with first mailing.

b. Cost for 1,000 pieces = $6,000.

10. Semi-Annual Targeted Donor Mailing

a. Segment by audience or topic.

b. Include brochure.

c. Include direct response piece

d. Cost for 2,000 pieces = $3,000.

11. Quarterly Targeted E-Mail Messages

a. E-Mail "blaster" service provided by outside vendor.

b. Select constituency carefully.

c. "Urge to action" - Web site link.

d. Topics to include gift announcements, donor testimonials, update on charity.

e. Cost = $2,000.

12. Heritage Society mailings

a. Include quarterly personalized update on charity.

b. Offer birthday greeting with premium.

c. Cost for 1,000 = $2,000.

13. Heritage Society Event

a. Cost for invitations, refreshments =$4,000.

Evaluations & Expectations

The key to finding success with any marketing plan is consistent and frequent communication.

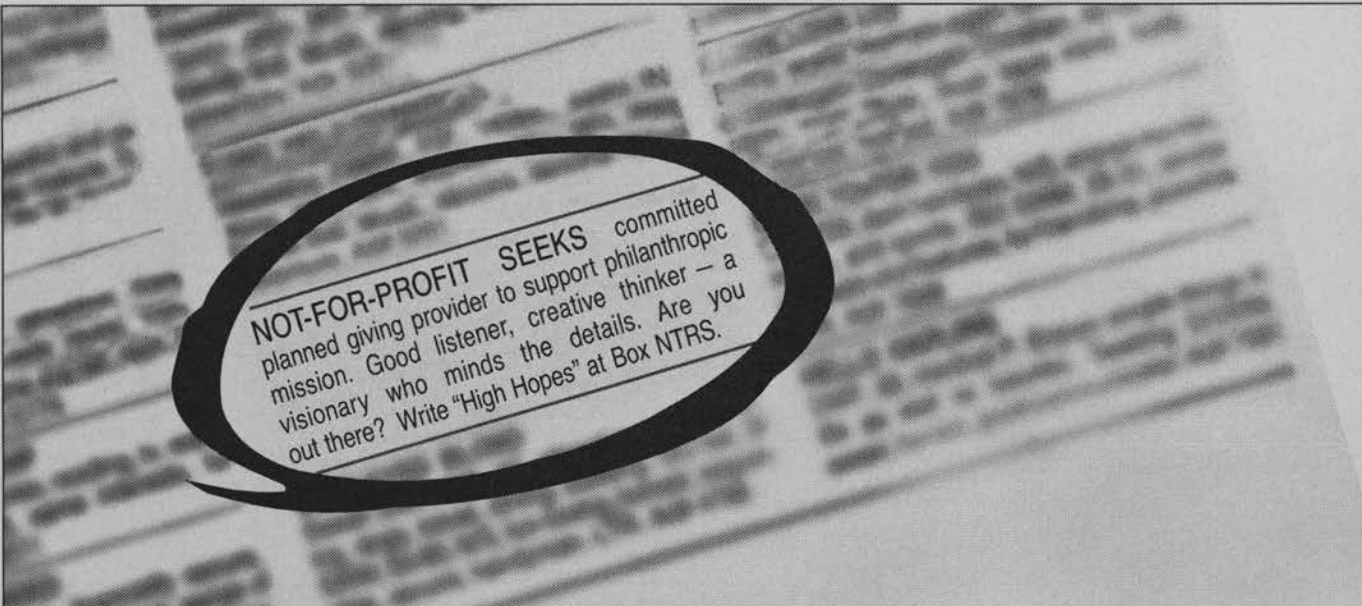
As we evaluate our program and review our expectations, two items seem to stand out:

1. Never, never, ever, ever abandon your will and bequest program.
2. Stewardship…stewardship…stewardship.

Stewardship, in and of itself, is a powerful marketing tool to enhance giving to endowments. At MU our administrative stewardship program for endowments and planned gifts provide the basis for assessing and cultivating the next gift. Each year our director of endowments and planned gift administration sends an annual report on individual endowments, which includes the rate of return on the endowment pool with a cover letter. Over the past seven years this mailing has averaged $700K annually in additional endowment gifts. This is the basis for a marketing strategy for current donors.

Conclusion

Marketing is a building process. Success won't arrive overnight because it takes time to build a strong foundation. Based on best practices from peer institutions and our own successes, the cornerstone of our foundation may surprise us.


NOT-FOR-PROFIT SEEKS committed planned giving provider to support philanthropic mission. Good listener, creative thinker — a visionary who minds the details. Are you out there? Write "High Hopes" at Box NTRS.

Building Bridges Through Philanthropy
27th Conference on Gift Annuities • April 5-7, 2006

Real Estate – Bridging a Gap in Your Fundraising

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Real Estate – Bridging a Gap in Your Fundraising

Disclaimers

This is not a technical approach to esoteric fundraising techniques (no FLPs, LLCs, etc.).

This is intended to provide basic information and inspiration on the value of gifts of real estate to charities of all sizes.

Types of gifts that donors may make to charities:

Charitable Gifts

- Outright gift
- Bargain sale
- Income – producing gifts
  - Installment bargain sale
  - Gift annuity
  - Charitable remainder annuity trust (CRAT)
  - Charitable remainder unitrust (CRUT, NIMCRUT, Flip Trust)
  - Pooled income fund
- Charitable lead trust
- Life estate in residence
- Bequest
- Life Insurance
- Non-qualified gifts
  - QTIP Trust
  - Revocable trust, Living Trust
  - Pour-over trust

Types of Real Estate

- Residential
- Commercial
- Agricultural
- Undeveloped land

Ownership of Real Estate

One estimate of wealth holdings in U.S. (2002):

Stocks	$12 trillion	22%
Bonds	11 trillion	20%
Cash and Equivalents	8 trillion	14%
Real Estate	24 trillion	44%

Government owned	5 trillion
Commercial	11 trillion
Residential	8 trillion

Why avoid one-third of the assets your prospects and donors own?

Why Donors Consider Gifts of Real Estate

These are the top scenarios that bring donors to charities with potential gifts of real estate. This list may not be totally inclusive but contains the most common gifting scenarios.

1. Donors interested in eliminating the burden of the sale process.
2. Donors interested in making life style move to a smaller home, perhaps in a different community.
3. Donors needing an income stream of cash to pay current indebtedness or purchase retirement property.
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 investment and now wants be relieved of management burden or negative cash flow.

7. Donor purchased property as investment and now wants to cash in on recognition of appreciation.

8. Donor purchased a property for retirement and makes decision not to utilize.

9. Donor inherited property and has no intent to use it.

10. Potential tax benefits received from donating appreciated property.

Charitable Intent

Investor vs. Donor

The "ten second" test

How gifts are funded with real estate

<u>Charitable Gifts:</u>

- Outright gift
- Bargain sale
- Income – producing gifts
  - Installment bargain sale
  - Gift annuity
  - Charitable remainder annuity trust (CRAT)
  - Charitable remainder unitrust (CRUT, NIMCRUT, Flip Trust)
  - Pooled income fund
- Charitable lead trust
- Life estate in residence
- Bequest
- Life Insurance
- Non-qualified gifts
  - QTIP Trust
  - Revocable trust, Living Trust
  - Pour-over trust

Risks associated with gifts of real estate

Environmental Risk

Degree of risk varies with type of property
Assessment of environmental risk
Phase I & II assessments
Transaction screens

Market Risk

General economic conditions
Competing properties

Financial Risk

Costs
Direct costs
Carrying costs
Opportunity costs
Liability claims

Management Risk

Difficulty varies with type of property
Exposure varies with type of gift

How charities minimize these risks

Gift Acceptance Policy

Evaluation of risk – Ten key questions

1. The Property
   What is the nature of the property? Is this a personal residence, vacation home, or held for investment? What type of property is it? (single family, duplex, undeveloped land, commercial) What is its zoning? Where is it located? (exact description and address) How old is the house/building? How is the title held?

2. Occupancy
   Is it owner-occupied or are there tenants currently in the property? Is it a personal residence or held for investment? If leased what is termination date, rent payment? (We will need a copy of the lease).

3. <u>Marketing History</u>
   Has it been listed for sale? If so, how recently? Is it currently on the market? When was it initially listed and current list price? Who is listing broker? Have you received any offers? Are you still in touch with any potential buyers? Have you made any counter offers?

4. <u>Permission to Access Property</u>
   How many our broker obtain access to the property to do an evaluation?

5. <u>Valuation</u>
   What do you think your home is worth? On what do you base that opinion? If on an appraisal – when was it done? For what purpose (e.g. – loan, tax assessor, fair market, listing).

6. <u>Mortgages, Encumbrances & Liens</u>
   Are there any outstanding mortgages? What are the balances? When was the property last refinances? Are there any other liens on the property? Are all taxes paid and current?

7. <u>Other Factors Affecting Value</u>
   Do you know any structural, environmental, zoning, or other factors which adversely affect the property or create a potential liability or difficulty in selling this property?

8. <u>Cost Basis</u>
   When did you purchase the property? What is your cost basis? (Initial price plus capital improvements less any depreciation)

9. <u>Gift Plan</u>
   What type of charitable gift is contemplated? How was this gift determined to be suitable for meeting your family's needs as well as your charitable objectives?

   Outright
   Bargain sale
   Gift annuity
   Life estate
   Charitable remainder trust

10. <u>Designation of Gift Proceeds</u>
    What do you want (charity) to do with the proceeds, when received by (charity)?

Donor as trustee

Third-party assistance

- Community Foundations (donor-advised funds)
- Dechomai Foundation / National Real Estate Foundation
- Realestatedonations.org
- Trust companies

How to evaluate and accept gifts of real estate - 19 Steps to complete!!

3 Phases for Gifts of Real Estate

- Gift evaluation phase
- Gift acceptance phase
- Gift disposition phase

Gift Evaluation Phase

1. Ask donor for copy of deed, title policy, survey, maps, photos, etc.
2. Schedule physical inspection of the property.
3. Request a Broker's Price Opinion (BPO) from a reputable broker.
4. Obtain approval of donor to proceed based on BPO or other evaluation.
5. Order formal appraisal from a qualified appraiser.
6. Order a title report to assure clear title.
7. Complete an environmental checklist (or obtain a Phase I review if necessary).
8. Obtain inspection report of structural, electrical, plumbing, heating, air conditioning and appliances.
9. Review appraisal and other reports to evaluate risk, repairs and hidden costs.
10. Reconcile differences between appraised value and the initial BPO value.
11. Submit your recommendation and supporting documents to Gift Acceptance Committee. If a bargain sale, obtain commitment from Treasurer's office to fund the bargain sale purchase price.

Gift Acceptance Phase

12. Advise donor of charity's decision, resolve concerns and set date to vacate.

13. Schedule "closing" and executed purchase agreement, etc. If a bargain sale, transfer purchase money funds to title company or closing agent.

Gift Disposition Phase

14. Schedule any needed repairs or improvements.

15. Execute listing agreement and develop marketing strategy to sell the property.

16. Execute home management agreement to care for property prior to sale.

17. Accept, reject or counter each purchase offer before it expires.

18. Execute final sales agreement and satisfy any contingencies.

19. Schedule closing and have sales proceeds remitted to charity.

YOU'RE DONE! Are you ready to do it again?

Three myths about gifts of real estate

Myth 1: Charities should avoid gifts of real estate like the plague

Truth: Properly managed, these gifts are very valuable; why avoid 1/3 of the assets your donors can use to make a gift?

Myth 2: The income tax deduction is the greatest motivation of donors in giving real property

Truth: The greatest motivation for donors is charitable intent along with meeting other personal needs; to the extent that tax planning motivates the gift, the avoidance or partial avoidance of capital gain often outweighs the charitable deduction

Myth 3: You can eliminate risk in taking gifts of real estate

Truth: No one can eliminate the four types of risk in real estate gifts but with proper evaluation and due diligence, risk can be minimized.

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Give & Take

April 2005

[Is Anybody Out There?] [Planning Matters] [Are You 'Missing']

Planning Matters

Real estate gifts have recently grown in popularity as property values have steadily risen while those of many other popular assets have widely fluctuated. In many areas of the country, a broad array of real estate classes have enjoyed double-digit returns over the last few years, though some analysts fear that overvalued property has created a "bubble" in real estate prices that could burst at some point in the future.

Despite these gains in value, many fund-raisers have relatively limited experience in dealing with gifts of real estate, and some charitable organizations' gift acceptance policies actually discourage such gifts. Understanding the pros and cons of real estate gifts can help you determine whether a particular gift makes sense for your donors or your charity. This month's "Planning Matters" column will address a few of the most commonly asked questions about gifts of real estate.

Question: What are the tax implications for gifts of real estate?

Answer: Generally speaking, gifts of appreciated real property held longer than one year will be deductible for income tax purposes at the full face value, up to 30% of the donor's adjusted gross income. Any excess deduction amount may be carried over for use in up to five additional years. If the property has been subject to accelerated depreciation, the contribution must be reduced by the amount of that depreciation.

Question: Is it necessary to have the real estate appraised before its acceptance?

Answer: If the gifted property is valued at more than $5,000, it is the donor's responsibility to obtain a qualified appraisal to substantiate the gift. This information is summarized on Side B of Form 8283. If the property is valued at more than $500,000, the full appraisal must be attached to the donor's ~~appraisal~~ return. In some cases, the charity may also wish to obtain its own appraisal.

Question: What about environmental issues?

Answer: Since the passage of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, the potential liability associated with a polluted site has had a chilling effect on gifts of real estate. In the wake of this legislation, some charities even began at this time to discourage gifts of real estate. Exercising due diligence before accepting the gift is the best way to identify potential problems. A title search or abstract may identify troublesome uses of the property. A Phase I or Phase II environmental assessment is commonly used to screen properties before acceptance. In recent years, a number of other strategies have evolved to avoid being listed in the chain of title. For example, a foundation or specialty charity may be used as an intermediary owner prior to sale.

Question: Can real estate be used to fund a life income or split interest gift?

Answer: While real property may be used for these types of gifts, each situation must be considered carefully. A farm or personal residence may be used to establish a qualified "life estate arrangement" where a donor gives property while retaining its use for life, but commercial property cannot be used for that purpose. Until recently, New York state regulations prohibited the acceptance of real estate to fund a charitable gift annuity. Even though this is now permissible, a charity should still consider whether it makes sense to fund gift annuities in this way. In some cases, a deferred gift annuity can provide time to liquidate the property. In the case of charitable remainder trusts, either a net income or "flip" unitrust is usually preferable to an annuity trust.

Question: What about "buyers in the wings" where there is a purchaser waiting?

Answer: Under no circumstances should there be a contract or legal obligation for the sale of appreciated real estate before the gift. In such cases, the tax rules would say that the donor had given the proceeds of the sale and there could be a capital gains liability. It is not unusual, though, to accept marketable real estate where several potentially interested buyers have been identified. If a charitable trust is the recipient of the property, care should be taken to avoid potential self-dealing issues if the potential purchaser is a family member or other affiliated party.

Question: How does the donor complete the gift of real estate?

Answer: If the charity has agreed to accept the property, the legal title should be conveyed by a deed to be filed in the county where the property is located. Care should be taken to make sure that there are no liens, mortgages, or encumbrances prior to accepting gifts of real estate. A warranty deed is preferred over other types of deeds, such as a quit claim deed.

Question: Can a donor give less than his or her entire interest in real estate, such as water rights or an easement?

Answer: Generally, a donor must give his or her entire interest in the property. However, there is a special exception for gifts of conservation easements. A donor can also deed an undivided interest in the entire property to charity. For example, the donor could give an organization a one-quarter or one-third interest in the property and then the charity could sell its interest or wait to receive its share of the proceeds after the entire property is sold.

Gift planners should review their internal gift policies, procedures, and checklists before encouraging gifts of real estate. It would obviously be counterproductive to market such gifts if they are prohibited by your gift acceptance policies.

If you are familiar with your policies, you can then endeavor to identify the appropriate prospect pool to which to market such gifts. Age, wealth, geographic proximity, and giving history are all factors to consider. Donors of certain professions may have a special interest in gifts of real estate. For example, real estate developers may donate an undivided interest in a property before its development, a farmer may leave a bequest of land or give it during lifetime, or a real estate investor might choose to give you an apartment complex or rental property. Persons with multiple residences might want to contribute one of them. It is important, however, that real estate not be considered "business inventory" held for sale as that could adversely impact tax benefits.

In today's complex fund-raising environment, gift planners must be more open to considering widely owned assets, such as real estate, and encourage interested donors to consider ways to use these assets to fulfill their charitable priorities. With fewer persons subject to federal estate taxes, gifts that provide current income tax deductions and reduce the expenses of taxes, insurance, and upkeep are likely to become more attractive to a growing segment of your donor population.

To learn more about how to promote gifts of real estate, attend one of Sharpe's popular seminars. See page 3 for more information and upcoming dates.

[Is Anybody Out There?] [**Planning Matters**] [Are You 'Missing']

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PLANNED GIVING TODAY®
THE PRACTICAL NEWSLETTER FOR GIFT-PLANNING PROFESSIONALS

JANUARY 2006
Volume XVII, Number 1

Tip of the Iceberg

BY K. GENE CHRISTIAN

Planned giving is a professional discipline few people imagined as a career option 15-20 years ago. According to their Web site, there are more than 11,000 people supporting the mission of the National Committee on Planned Giving — an organization that didn't exist 22 years ago. With that kind of explosive growth and interest, a logical person might conclude that it's time for a plateau or "correction" to occur. After all, the financial markets and real estate go through cycles, so why not planned giving?

Regardless of how the debate on IRA rollover reform or estate tax elimination goes in Washington, the sheer volume of data supporting the rising popularity of planned giving will continue to flood our professional landscape. Imagine an iceberg looming on the horizon just a few meters away from your boat. What you see is only a small portion of what truly exists below the surface.

So, too, it will be with planned giving. What we see and experience today will be only a small fraction of the reality that occurs during the next 30 years in this business. Consider the following facts on the next page.

Continued on page 2

Real Estate Gifts: Trends, Recent Experience, and Recommendations

BY DENNIS P. BIDWELL

As a practitioner involved for many years in helping charities attract and structure real estate gifts, I have accumulated abundant anecdotal information about such gifts. But I have found precious little hard data on trends and recent experience regarding real estate gifts.

My curiosity about the current state of real estate gifts was shared by the board of directors of the Planned Giving Group of New England. With input from PGGNE, I designed a survey on this topic for the group's 380 members. The survey was administered electronically over the summer of 2005, and I reported the results of that survey at the September 2005 meeting of the PGGNE membership. This article provides a similar report, along with recommendations in several areas based on my experience.

Studies indicate that more than $10 trillion of privately held real estate assets will change hands in the next 45 years. The enormous intergenerational transfer of privately held real estate wealth that is going on around us every day provides an enormous opportunity to attract substantial capital to the nonprofit sector. Yet, for most institutions, this remains a largely untapped opportunity. With from 30 to 40 percent of the nation's wealth locked up in real estate assets, most estimates place gifts of real estate at only 2 to 3 percent of total charitable giving.

More than anything else, my interest in conducting this survey was motivated by a desire to better understand how this gap has come to exist, what is being done at some institutions to close it, and what

Continued on page 8

THIS MONTH

73 percent reported receiving five or fewer inquiries per year.

Real Estate Gifts *Continued from page 1*

remain as obstacles to pursuing real estate gifts at other institutions.

Current Activity and Trends

The PGGNE survey results suggest that increased recent attention to the real estate gift opportunity, in professional journals and the popular press, has resulted in growing interest in real estate gifts.

Changes in attitude toward real estate gifts in recent years:

Have become more receptive	38%
Have become less receptive	5%
No change	56%

Furthermore, 40 percent of respondents said they actively market an interest in a variety of real estate gifts; 16 percent said they actively market an interest in only "simple" gifts of real estate (presumably outright gifts and bequests). Another 37 percent reported that they accept real estate gifts, but don't actively market their interest in such gifts, while only 3 percent reported that they absolutely don't accept real estate gifts.

Yet, even with increasing attention to attracting real estate gifts, 62 percent of respondents reported the value of their real estate gifts, was a percentage of total gifts, as 1 percent or less. Another 28 percent reported such gifts having a value of from 2 to 5 percent of total gifts. Only 10 percent of respondents — all of them colleges and universities — reported real estate gifts amounting to 6 percent or more of total gifts.

Similar patterns are seen in real estate gift inquiries, where 73 percent of respondents reported receiving five or fewer inquiries per year.

Significantly, those institutions reporting 10 or more real estate inquiries per year, 10 or more completed gifts per year, and reporting real estate gift values in excess of 6 percent of total gifts received all described themselves as actively marketing their interest in a variety of types of real estate gifts.

Note: Real estate gifts don't appear unless an institution's interest in such gifts is actively communicated. Furthermore, the larger the variety of real estate gift options presented, the greater the likely volume of completed real estate gifts.

Overcoming Institutional Obstacles

In the cases where an institution reported a reluctance to pursue real estate gifts, the survey sought to determine the reasons for that reluctance.

If reluctant to accept real estate gifts, why?

Liquidity risk concern	53%
Environmental risk concern	50%
Too time-consuming and complicated	50%
Reluctance in finance office	44%
No real estate staff experience	44%
Unfortunate previous experience	22%

Many of these responses are clearly related: Finance office reluctance is often related to a combination of environmental and liquidity risk concerns, which is often based on an unfortunate previous experience. And the time-consuming and complicated nature of some real estate gift transactions wouldn't necessarily be problematic if appropriate staff experience were in place, or if consultants with appropriate skills were used.

Fortunately, experience has shown ways that these obstacles can be overcome.

Liquidity risk can be managed by a thorough due diligence process that includes an institution's independent assessment of the marketability of the property, by early and thorough title work and other inspections, and by welcoming opportunities (except in the case of a charitable remainder trust) to identify a buyer ready to repurchase the property.

In fact, some charities use the ultimate protection against liquidity risk: making the gift transaction contingent on a sales contract with a subsequent buyer, sometimes with the closings happening simultaneously.

Environmental liability risk can be managed and controlled with policies that require a professional Phase I environmental assessment, perhaps with the use of appropriate indemnification language. Some nonprofits report increased use of real estate environmental liability insurance, while others have elected to set up a subsidiary organization to hold title to real estate, or to partner with a community foundation or some other entity for purposes of holding title.

Note: There are enough approaches to managing and controlling liquidity risk and environmental liability risk that the likely existence of such risks, in and of themselves, should not deter the careful pursuit of real estate gifts.

An approach to dealing with finance office wariness that has proved successful in some instances is involvement of the finance office in discussions that result in detailed policies and procedures for real estate gifts. The aim of such policies and procedures should be, on the one hand, to clarify the due diligence procedures that will address liquidity and environmental risk concerns, while at the same time communicating to the outside world the charity's interest in discussing real estate gift possibilities. Finance office wariness can also be overcome by selective use of consultants with real estate experience to fill in the gaps in the development office and the finance office staffing patterns.

Marketing and Donor Motivation

As noted, the survey clearly established a relationship between marketing effort and real estate gift success. The survey went on to seek information on the effectiveness of particular marketing approaches. The approaches rated most effective in generating real estate gift inquiries were: Personal visits to prospects identified through research (64 percent); publicizing real estate gifts from prominent friends of the organization (54 percent); and case studies in publications, etc. (43 percent). Rated considerably less effective were targeted mailings based on prospect research and seminars for professional advisors.

The survey also sought information on the motivations behind real estate gifts.

What most motivates real estate donors to give to your institution?

Availability of tax deductions	64%
Relief from the headaches of owning and managing real estate	62%
Charitable intent	60%

It is interesting to note that respondents rated each of these motivations of roughly equal importance. Of particular significance is the belief that many real estate donors are motivated by a desire to be unburdened of the worries and responsibilities of owning and managing real estate.

Note: This suggests that real estate gift marketing efforts would benefit by addressing aging constituents who may be feeling the burdens of real estate ownership and would be interested in learning of alternatives.

Policies and Procedures

Slightly more than 70 percent of survey respondents reported having written policies and procedures regarding real estate gifts. Among these respondents, 85 percent reported policies that require an appraisal at the donor's expense, and 56 percent asked prospects to complete a detailed questionnaire providing extensive information about the proposed real estate gift asset. Also, 59 percent reported using some form of gift-acceptance letter or memorandum of understanding to memorialize the structure and terms of the gift, and to lay out the responsibilities of the parties leading up to gift closing.

With regard to environmental assessments, 80 percent of respondents reported requiring a Phase I environmental assessment. Of these, 56 percent reported requiring the donor to cover the cost of such an assessment, while 24 percent reported that it was policy for the donee institution to cover such an expense.

Regarding title examinations, 76 percent of respondents reported requiring a title report of some sort, with 47 percent asking the donor prospect to pay for such title work, while 29 percent reported that the charity would pay for title work.

Note: Charities interested in appearing more welcoming to real estate gifts should consider offering to pay for environmental assessments and title work in the case of gift prospects that pass through preliminary screens of gift acceptability. After all, the purpose of such investigations is to protect the donee institution from exposure to risk. It is only in the case of a real estate appraisal that IRS regulations require the donor to pay.

Frequency of Use

The survey asked about the frequency of use of various types of real estate gifts.

With what frequency will your organization accept these types of real estate gifts?

Outright gift	85%
Bequest	75%
Charitable remainder trust	67%
Retained life estate	36%
Undivided/fractional interest	33%
Bargain sale	30%
Charitable gift annuity	19%
Charitable lead trust	15%
Retained life estate/CGA	9%

Continued on page 10

Finance office wariness can also be overcome by selective use of consultants.

Trench Tales

◆ *I was visiting a donor for the first time, an elderly woman who is a member of our legacy society. During the course of the visit, I learned that she had about four months' worth of checks — annuity checks, Social Security, etc. — in her purse that she had not deposited. Her neighbor who usually drives her to the bank had been injured, and so my donor had not been able to get to the bank in some time.*

Feeling nervous about the uncashed checks, I offered to give her a ride to the bank, which she happily accepted. Once we left the bank, she asked if we could go to the drug store next door, where she needed to get something. She proceeded to buy a huge bottle of cheap wine. On the way back to her house, she asked if I could stop at the liquor store. It would have been difficult to say no at that point, so I did, and she bought a pack of cigarettes. Needless to say, I was trying to do a good deed, and it ended up being more than I bargained for.

◆ *I had invited an elderly woman, one of my prize prospects, to attend a campus event. When I arrived to pick her up in my two-door car, I discovered she had invited her granddaughter to join us. As it turned out, having an extra person along saved the day.*

The older woman insisted on sitting in the back seat. No problem . . . that is, until we arrived, and she tried to get out. Mission impossible. Coming to the rescue, I took her hand and pulled forward. When that didn't work, the granddaughter got in beside her and pushed. After what seemed like a millennium, we were finally able to put together the winning combination of pushes and pulls to extricate her from the car. Going home, she sat in front.

Anecdotes are supplied by readers of *Planned Giving Today.* Do you have an interesting or amusing story related to your work as a charitable gift planner? Jot it down and send it in so we can pass it on (pgt@pgtoday.com). Names are withheld to protect the "guilty."

More and more institutions are seeking real estate gifts.

Real Estate Gifts *Continued from page 9*

The relative popularity of outright gifts, bequests, and real estate-funded charitable remainder trusts is not a surprise.

It is a surprise, however, to realize how underutilized retained life estates and bargain-sales are. Both are structures that can fit particular donor life planning and tax circumstances very well, if only they were offered as options. And in both cases, proven approaches exist for managing environmental liability, liquidity risk, and other risks. For example, 9 percent of respondents reported entering into bargain sale arrangements only when they could simultaneously close on the purchase and the sale of the property.

Even less frequently used is a charitable gift annuity funded with real estate, even when the option exists to defer payments for several years to allow for liquidation of the property. This is despite the fact that some respondents reported that many prospects are attracted to the relative simplicity of a CGA compared to a CRT. Only 5 percent of respondents reported using the technique of making a CGA contingent on being able to close on the sale of the gift property at the time that the CGA is finalized.

The institutions that reported the greatest success in attracting real estate gifts are the institutions that reported use of the greatest variety of gift structures.

Note: It is clear that one way to increase the volume of an institution's real estate gift activity is to broaden the menu of gift structures offered, and to employ creative problem solving regarding issues such as liquidity and environmental liability.

Conclusions

From this survey of PGGNE members, combined with personal experience, it can be concluded that:

- More and more institutions are deciding to seek real estate gifts, and are finding ways to overcome internal obstacles that have often hindered such efforts.
- The institutions that are successful in increasing real estate gift activity are likely to be institutions that actively market their interest in a wide range of real estate gift types.
- One marketing approach that may be particularly effective is to emphasize the ability of gift structures to relieve aging property owners of the burden of property ownership and management, while fulfilling their charitable objectives and addressing their tax-planning priorities.
- There are proven ways to start a successful real estate gifts program, or to upgrade an existing one, by emphasizing marketing, training, and development of appropriate policies and procedures. Selective use of the growing number of consultants with expertise in the real estate gifts field can also be helpful in such efforts. ◆

The PGGNE Survey

A survey instrument, developed in consultation with PGGNE's program committee, was electronically administered to 380 PGGNE members, using Zoomerang technology, with responses accepted between August 4 and August 31, 2005. The 73 responses, representing about a 20 percent response rate, closely followed PGGNE's membership composition: 63 percent educational institutions, 15 percent health care organizations, 5 percent religious institutions, 5 percent environmental organizations, 5 percent social service institutions, and 7 percent other.

Dennis P. Bidwell is principal of Bidwell Advisors, a consulting firm specializing in real estate gift planning for charities and individuals. He is a frequent speaker at gatherings of gift-planning professionals and professional advisors.
dbidwell@bidwelladvisors.com

MAYO FOUNDATION

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 Development Officer 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 Mayo Foundation books;
- Assist with the establishment of asking price for the property.

C. Donor must give permission to use Abstract of Title. Mayo Foundation shall order and pay for title insurance prior to commitment of gift.

D. Donor must give permission to conduct environmental audit of property. Mayo Foundation shall employ and pay for an independent consultant to conduct an environmental audit.

E. Donor may be asked to pay carrying costs while Mayo Foundation 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 Mayo Foundation).

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. Mayo Foundation may have to pay income tax on unrelated business income.

B. Mayo Foundation, as a non-profit corporation, receives no tax benefit from depreciation.

Other considerations:

A. Donor shall be advised that Mayo Foundation 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. Mayo Foundation 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 Mayo Foundation 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.

Devereux

The Devereux Real Estate Asset Legacy Foundation

Real Estate Acquisition Questionnaire

Gifts of Real Estate

Name of
Donor(s):____

1. Location of property:

2. Number of parcels and acreage:

3. Type of Property: ____ wooded; ____ open; ____ marshlands; ____ other

4. How long have you owned the property? What is the nature of ownership; i.e. joint tenancy, tenancy by the entirety, tenancy in common, etc.?

5. Current zoning of the property (list any zoning restrictions):

6. List improvements (type of building(s), condition, type & date of construction, # of floors):

7. Proximity to commercial activity (type, location, and distance):

8. Describe the previous use of the buildings/property:

9. If property is residential, to your knowledge how long has it been used for residential purposes?

10. Improvements:

_____ Municipal Sanitary Sewer Line

_____ Municipal Storm Sewer Line

_____ Municipal Water Line

_____ Electrical Power

_____ Telephone

11. Access:

_____ Frontage on Town/City road

_____ Frontage on unimproved road

_____ Right-of-way over existing private road

_____ Right-of-way unimproved

_____ Land locked property

12. Date of last appraisal: Date __________ Value $_______________________

13. Town/City assessed value $______________ at ______________% FMV

14. Date of last assessment: ___________________

15. Are there any unpaid taxes/attachments of the property? (If yes, please describe):

16. Is the property subject to mortgage? (If yes, please list current balance and date of borrowing including any subsequent borrowing after initial financing):

17. Current yearly operating expenses are:

Property Taxes	$_________ (inclusive of all tax liabilities)
Insurance	$_________
Electricity	$_________
Heat	$_________
Condominium/Homeowner Fees	$_________
Road Maintenance	$_________
Other	$_________

18. Has the property recently been offered for sale? __________. If yes, how long has it been on the market? __________.

19. Do you wish to reserve any rights to this property? __________. If yes, explain:

20. Right-of-ways or easements on the property:

21. Potential or pending legal actions or claims:

22. What is the type of current use and zoning of the adjoining property of the tract being considered as a gift to the Devereux Real Estate Asset Legacy Foundation? Please describe:

23. Does the land have potential for development? __________ Please explain:

24. Has the property been known or suspected to have been used as a dumping site, either legally or illegally, for disposal of solid or chemical waste? __________. If yes, explain:

25. Any evidence or suspicion of asbestos-containing material or lead paint in the building(s)? __________. If yes, please describe:

26. Are there any known or suspected above ground or underground storage tanks on or near the property including fuel oil, heating oil, or gasoline? __________. If yes, please describe including distance from property:

27. Other structures and/or improvements on property (e.g., swimming pools, ponds, playgrounds, railroad tracks, etc.):

28. Proximity to landfill:

29. Explain if any of the following apply: wetlands, ponds, waterways, lakes, gorges, caves, wells, or other natural hazards:

30. If The Devereux Real Estate Asset Legacy Foundation sells the property, do you wish the proceeds from the sale to be used in any particular way?

Prepared by____________________________________ Date ________________________
Donor

The Devereux Real Estate Asset Legacy Foundation is grateful that you are considering this generous gift. Please complete this form and return it to us with a copy of the most recent independent qualified appraisal, a copy of the deed, and any other pertinent information. Thank you for your assistance.

4/22/05

GRAY PLANT MOOTY

3400 City Center
33 South Sixth Street
Minneapolis, MN 55402-3796

612 343 2800
Fax: 612 333-0066
Web Site: www.gpmlaw.com

Consulting Office, Beijing China

Robert E. Harding
612 343-2869
robert.harding@gpmlaw.com

January 17, 2001

By Federal Express

Mr. David Doubleday
Mayo Clinic Scottsdale
13400 East Shea Boulevard
Scottsdale, Arizona 85259

Re: Implementing a Gift of a Residence with a Retained Life Estate

Dear Dave:

This letter summarizes our recent discussions about the steps Mayo Foundation and a donor should take in implementing a gift of a residence with a retained life estate. The steps are as follows:

i. Before the donor deeds the residence to Mayo subject to the life estate, Mayo should conduct the same type of environmental review of the property as it would in the case of an outright gift of real estate. The reason is that Mayo will enter the chain of title when the donor deeds the property to Mayo subject to the life estate, even though Mayo will not take possession of the property until the death of the life tenant.

ii. The donor's attorney should draft a deed of the property to Mayo subject to a life estate for the donor (and the donor's spouse, if appropriate). The deed should be delivered to Mayo and recorded.

iii. At the same time as the donor executes and delivers the deed, the donor and Mayo should enter into an agreement based on the attached sample Agreement of Life Tenant and Remainderman. That agreement is designed primarily to avoid misunderstandings between the donor and Mayo and to make the donor aware of his or her continuing responsibilities with respect to the property. For the most part, the

> agreement recites what would normally be the respective rights and responsibilities of the life tenant and remainderman in a parcel of real estate. Although the agreement may be legally enforceable, we have not attempted to determine its legal effect with respect to a gift of real estate located in a particular state.

If you have questions about these materials, please call.

Very truly yours,

GRAY, PLANT, MOOTY,
MOOTY & BENNETT, P.A.

By Bob Harding
Robert E. Harding

REH/wwr
Enclosure
cc w/enc. by mail: Wendy Wood
J. Lance Jacobson

GP:764066 v1
81681

AGREEMENT OF LIFE TENANT AND REMAINDERMAN

JOHN DONOR, of Anywhere, U.S.A. ("The Donor") and MAYO FOUNDATION, a Minnesota nonprofit corporation with headquarters located at Rochester, Minnesota ("the Foundation"), enter into this agreement on ______________ to confirm the respective rights and responsibilities of the Donor and the Foundation with respect to the Donor's ________________, _________________ residence ("the Premises"), the legal description of which is attached hereto as Exhibit A, which the Donor has this day transferred to the Foundation, reserving a life estate for himself for his life:

1. The Donor agrees that during the term of his life estate he will maintain the Premises in good order and condition and will undertake and pay the cost of normal maintenance, taxes, fuel, and required utilities. The Donor agrees that during the term of his life estate he will pay all real estate taxes assessed against the Premises and all special assessments.

2. Repairs and replacements to the Premises and improvements thereon, including the structural and non-structural parts thereof, roofs, fixtures, and replacements and the mechanical, electrical and plumbing systems, whether such repairs and replacement are foreseen or unforeseen, shall be made by the Donor at his cost. The Donor will make such repairs and replacements as would be made by a fee simple owner using the Premises as his residence. Capital improvements, additions and replacements, if any, and the plans and specifications therefor, shall be agreed upon in writing by the parties prior to their making.

3. The Donor shall insure the Premises and improvements thereon, with the Foundation as an additional named insured, against damage by fire or other hazard in such form and amount from time to time as would be carried by a fee simple owner using the Premises as his residence, except that the policy of suchinsurance shall include an extended coverage endorsement and an endorsement waiving the insurer's subrogation rights as against the Foundation. The Donor shall further obtain a policy of public liability insurance with the Foundation as an additional named insured and containing limits of liability not less than $100,000 for property damage, $300,000 for injury to person and $1,000,000 aggregate limitation. Each policy shall contain a 30-day cancellation clause.

4. In the event of loss or damage to the Premises by fire or other cause, the Donor, except as provided below, shall promptly repair or rebuild the Premises and improvements thereon at least to the extent of the proceeds received from insurance coverage. In the event, however, that the loss or damage is so substantial that the parties shall determine it to be economically unfeasible to repair or rebuild the Premises and the improvements thereon, the insurance proceeds shall be divided between the Donor and the Foundation in proportion to the actuarial value of their respective interests in the Premises immediately before that event which caused such loss or damage, such actuarial values to be determined by reference to United States Treasury Regulations Tables then in force for the valuation of life estates and remainders for federal tax purposes.

5. The Donor reserves the right to terminate and release his life estate in the Premises and to surrender absolute title and possession to the Foundation. The Donor authorizes and directs his personal representative to pay all taxes and municipal charges which may be a lien on the Premises at the time of his death. The duty of maintenance of the Premises by Donor shall cease as of date of delivery of possession of the Premises to the Foundation.

6. It is possible that the Donor and the Foundation will conclude at some point in the future, based on changed circumstances, that a sale of the Premises is desirable. If the Premises is sold, the Donor and the Foundation shall each be entitled to receive a pro rata share of the net sale proceeds based on the actuarial values of the Donor's remaining life estate and the Foundation's remainder interest at the time of the sale, determined by reference to United States Treasury Regulations Tables then in force for the valuation of life estates and remainders for federal tax purposes.

7. This Agreement may only be amended by an instrument in writing executed by both parties, and it shall be binding upon and inure to the benefit of the parties hereto and their respective successors, distributees, heirs, legal representatives and assigns.

IN WITNESS WHEREOF, the parties have duly executed this instrument at ____________________State of ________________, as of the date appearing in its heading.

____
JOHN DONOR
- As Donor -

MAYO FOUNDATION

By________________________________
Its_______________________________

STATE OF______________)
) ss.
COUNTY OF____________)

On this_____day of________, 20___, before me, a Notary Public within and for said County, personally appeared JOHN DONOR, to me known to be the person described in and who executed the foregoing instrument as Donor and acknowledged that he executed the same as his free act and deed.

____
Notary Public, ___________County, _______
My Commission Expires:

STATE OF______________)
) ss.
COUNTY OF____________)

On this _____ day of ____________, 20___, before me, a Notary Public within and for said County, personally appeared ___________________________, to me personally known, who, being by me duly sworn did say that he she is the ______________________________ of MAYO FOUNDATION, the corporation named in the foregoing instrument, and that said instrument was signed and sealed in behalf of said corporation by authority of its Board of _________________ and said _________________________________ acknowledged said instrument to be the free act and deed of said corporation.

____
Notary Public, ___________County, _______
My Commission Expires:

Faneg Co

President and Fellows of Harvard College
Trustee of the Hartman Charitable
Remainder Unitrust
Treasurer's Office
600 Atlantic Avenue
Boston, MA 02210-2203

Re: Carrying Costs

Gentlemen:

I have on this _______ day of ____________, 1988, created the Hartman Charitable Remainder Unitrust by contributing to it the property located at 591 County Road, Madison, Connecticut. I understand that, in keeping with your fiduciary duty, you may sell the property and reinvest the proceeds in order to diversify the assets of the trust into a more liquid and productive form of investment. However, I also understand that you may not be able to sell the property immediately and that the property may, in your hands as trustee, incur certain operating costs such as real estate taxes, insurance premiums, utility expenses and expenses for repair and maintenance. In order to prevent such operating expenses from becoming an indebtedness of the trust, and in order to induce you to serve as the trustee of the trust, I hereby irrevocably promise to make cash contributions to the trust upon your written request at such time and in such amounts as may be necessary to enable you, as trustee, promptly to pay any such operating costs as they may arise.

I understand that this is an enforceable obligation which is binding on me and my estate.

Very truly yours,

____
Frederick Hartman

Accepted and agreed

The President and Fellows of Harvard University as Trustee of the Hartman Charitable Remainder Unitrust

By: ______________________________

PrudentialRealEstateGifts

ILLUSTRATION OF COSTS AND NET GIFT TO CHARITY

Property valued at		$100,000	100.0%
Appraisal	525		
Inspections (general home, termite, radon)	560		
Septic and structural inspection, if required	Variable		
Survey, if required	Variable		
Title examination	300		
Realty transfer tax, recording fees	500		
Attorney's fees	500		
Initial costs and fees		2,385	2.4%
Net at Acquisition		97,615	97.6%
Costs and fees on sale (Updated inspections, tests, title insurance, legal fees, notary fees, etc.)		1,500	1.5 %
Broker's commission @ 6.%		6,000	6.0%
Net proceeds from sale		90,115	90.1%
Prudential management fee		3,000	3.0%
Net amount to charity		$ 87,115	87.1%

Additional carrying costs will be incurred by the charity until the property is sold. These include utilities, taxes, maintenance, repairs (as needed), insurance, property management, etc. which will reduce the amount distributed to the charity.

This illustration assumes property is sold at appraised value of $100,000. If property sells for less than this assumed value, this "resale loss" will reduce the net from sale, broker's commission, Prudential management fee and the net amount distributed to the charity.

ALL AMOUNTS IN THIS ILLUSTRATION ARE ESTIMATES ONLY FOR THE PURPOSE OF DISCUSSION. ACTUAL RESULTS WILL VARY DEPENDING ON THE SPECIFIC REQUIREMENTS AND MARKET FACTORS OF ANY GIVEN SITUATION.

Creative Ways of Dealing with Non-Cash Assets

Bryan Clontz, CFP
President, Charitable Solutions, LLC
bclontz@charitablesolutionsllc.com (404) 375-5496

Outright charitable gifts of non-cash assets will probably forever be the tax geek's dream and the charity's nightmare. From the donor's tax perspective, usually cash is the worst gift option, appreciated stock is usually next best and some form of wiggling, crawling (but hopefully not glowing) real estate might be the best. You have surely heard all the statistics: privately held non-cash assets represent approximately four to six times the entire value of the stock market, yet over 80 percent of these gifts are estimated to be initially declined by charities, and of those gifts accepted, they represent approximately two percent of all giving. What follows are suggestions on how to better position your charity to receive these assets either directly or indirectly with as little risk as possible.

Why Do Charities Frequently Decline Non-Cash Assets?
In general terms, non-cash assets include all forms of real estate, closely held C and S-Corp stock, limited partnerships, artwork and collectibles, and other assets. All of these have distinct and inherent risks. For real estate, the risks are more obvious: environmental issues, liquidation concerns, property management functions, etc. For limited partnerships, the risks might be more subtle: potential capital calls, ongoing UBIT liability, increased annual audit discussions, etc.

How to Establish a Non-Cash Risk Management Plan
For non-cash gifts, it is critically important to establish a risk management plan. I suggest viewing these gifts on a continuum from 1-10. My non-scientific legend is: 1 = cash gifts, 2 = publicly-traded appreciated securities, 3 = mutual fund gifts, 4 = closely held C-Corp stock, 5 = personal residence with no debt and strong marketing potential, 6 = limited partnership/LLCs/S-Corp stock, 7 = commercial or out-of-state residential real estate, 8 = any asset with potential liability (like poor marketing potential, existing mortgage, problem tenants or property), 9 = any asset with probable liability (like outstanding property problems, complex tax consequences or a complex marketing process for assets like tangible personal property), 10 = any asset with known liability (environmental issues, zoning issues or outstanding capital call).

Most charities are very comfortable going to a 3 or 4 on the continuum where some are willing to tread into deeper waters. Asking a fundraiser where the ideal placement would be will usually yield of response of a 7 to 8. Not surprisingly, asking the financial officer will usually place the charity around the 3 or 4 range. To establish a customized risk management plan – what risks to retain, reduce, transfer or avoid - it is important to understand how risk tolerant the charity is and what the loss possibilities might be. The next step is to determine if your charity wants to receive the gift directly or if you should refer the gift elsewhere and still try to receive some benefits.

How to Receive a Non-Cash Gift Directly
To receive any form of non-cash gift, it is critical to have well-drafted and approved gift acceptance policy and procedure manual that sets forth what assets will be accepted, in what form and in what way. This document should also describe various risk reduction strategies including, but not limited to, environmental appraisal, market assessments, site inspection, document review, formulating a gift acceptance committee, using a separate corporation/trust (typically a Type II supporting organization), legal counsel review, etc.

The benefits of receiving a non-cash gift directly include maximizing the gift value and having more donor relations and legal control. The costs of receiving a non-cash gift directly include identified and unidentified risks, staff time and associated direct and indirect expenses.

Even with the best of policies and procedures and risk reduction strategies, charities will not be able to capture all the non-cash asset opportunities that present themselves. Beyond the gift falling outside the charity's comfort zone, the most common reason for declining or losing non-cash assets is the lack of decision-making speed. Many donors will call on Monday and will want an answer by Thursday. This always seems to happen when each member of the gift acceptance committee is vacationing on different continents. When this occurs, rather than losing the entire gift, charities should be aware of other options.

How to Receive a Non-Cash Gift Indirectly Using Charitable Intermediaries

If your charity cannot accept the asset directly there are two primary ways to still get the gift using charitable intermediaries. These intermediaries come in two primary forms: community foundations (including local, state-wide, religious foundations or national donor advised funds) or non-cash pass-through charities.

Community foundations have long served an important role in accepting complex assets on behalf of other charities. Generally, they take on all the risks that have already been mentioned when accepting the gift, manage the assets and liquidate the property. The proceeds are then typically added to an endowed fund in the charity's name with the spending policy defining what income interest will be granted annually. In some cases, the community foundation will allow the proceeds to be deposited in a donor advised fund with the donor retaining the ability to advise or recommend future grants (these funds can be endowed – only allowing advice on the income, or non-endowed – allowing advice on the principal and income). Community foundations usually do not charge an up-front fee for this service if the asset will remain over time. This allows them to recoup some of their initial acquisition costs through an annual administrative fee.

New options have been developed in recent years that use a community foundation structure, but the mission is only to receive non-cash assets, manage them, liquidate them and then grant them back to the charity the donor was trying to give it to in the first place. The two foundations that serve this particular niche are the Dechomai Foundation, Inc. – www.dechomai.org (using Charitable Solutions, LLC as an administrator) and the National Real Estate Foundation, Inc. – www.nationalrealestatefoundation.org (using Chase Magnuson as a consultant). Both public charities assume all the risks (the referring charity is not in the chain of title), provide the tax acknowledgement to the donor and then immediately grant the net proceeds after liquidation as a donor advised fund grant. Fees generally range from 1 to 10 percent and are based on the asset size, overall complexity, contribution timing and liquidation difficulty. These organizations, depending on the group, may also provide other charitable consulting services to help charities receive non-cash gifts directly, non-cash gift annuities and serving as initial trustee on CRTs with illiquid assets.

This section is not intended to promote or endorse any particular vendor, structure or strategy, only to make planned giving practitioners aware of the various options available should they wish to explore non-cash receipt and liquidation alternatives.

Summary

Non-cash assets will continue to be an under-tapped but lucrative development strategy for charities. By understanding what assets are likely to be donated, developing a risk tolerance profile for an organization, plotting that profile on a risk continuum, developing sound gift acceptance policies and procedures with risk reduction strategies, and finally a policy about when and where to refer non-cash assets that are not conducive for direct receipt, a charity can maximize their non-cash asset success.

[Reprinted with permission from Planned Giving Today, February 2005]

Fact Sheet: Dechomai Foundation, Inc.

Determination Date: 501(c)3 public charity status on January 15, 2003

Structure: National donor advised fund based in Atlanta, GA

Mission: To accept complex non-cash assets, manage the assets during the holding period, liquidate the assets and then distribute 100% of the net proceeds based on the donor's recommendation.

Operating Support: The entire operating budget comes from fees charged on donor transactions. These fees range from 1-3 percent based on the donation's size, complexity, holding period and liability exposure.

Eligible Assets: Any form of real estate, closely-held stock, limited partnerships, LLC interests, artwork, foreign property or other miscellaneous capital assets.

Current and Recent Activity: Over the last 12 months, we have completed 13 gifts with a total value of $21.6 million. These assets include a financial exchange seat, a partial interest in a professional sports team, paintings auctioned at Sotheby's, and multiple gifts of real estate.

Past Activity: Our principals have completed over 175 non-cash asset transactions with a total value over 220 million. These activities occurred over the last 10 years at national, regional and local charities.

Board Structure/Role: The four-person Board reviews all due diligence reports; approves the donor advised fund agreement, fee, and memo of understanding; and then provides formal approval of the recommended grants.

Board Bios:
Mark A. Newton graduated from the University of Georgia where he majored in Risk Management and Insurance and a concentration in Estate Management. After graduation, Mark worked for one year with an insurance planning firm based in Atlanta. The following year, he founded Asbury Newton, Inc.

Before entering the structured settlement profession, Mark assisted affluent families and senior executives of leading public and private corporations with critical estate, insurance and cash flow planning. He has been quoted in national publications and has co-authored a study on annuities that was published nationally.

Greg Gryska graduated from the University of Alabama with a major in Insurance. He has worked for the past 22 years in various areas of the employee benefits and is currently the President of AddOnBenefits, Inc., an Atlanta-based employee benefits and plan design group. His company specializes in helping companies communicate the value of employee benefit plans to current and prospective employees.

Anne Paul Josey graduated from Mary Baldwin College in Staunton, Virginia with a bachelor's of Arts degree in French and Political Science. She also studied at the Institute of European Studies in Paris and the Williamsburg Development Institute in Virginia. Anne has worked in various positions in the non-profit sector including the American Heart Association, United Way of Metropolitan Atlanta and the Atlanta Ballet. She is currently the Executive Director of CLICK, a literacy program in Newnan, Georgia.

Charles E. Gearing graduated with a bachelor's degree in electrical engineering from Georgia Institute of Technology and then went on to earn master's and doctorate degrees from Purdue University. Charles pursued a career in higher education, serving in various academic and administrative roles at Auburn University, Purdue University, University of North Carolina, Middle East Technical University (Ankara, Turkey), Dartmouth University, State University of New York, Binghamton, before returning to Georgia Tech, where he served as Dean of the College of Management and Associate Vice-president for Development. In his latter role, Charles supervised a 45-member fund-raising staff during a highly successful $200 million capital campaign. He retired from Georgia Tech as Professor Emeritus in 1991.

After his retirement from Georgia Tech, Gearing served four years as director of stewardship development with The Cathedral of St. Philip in Atlanta. Since 1991, Gearing has served as a stewardship consultant with the Episcopal Church Center, and as a field representative of the Episcopal Church Foundation. In 1999 he was appointed as Director of Diocesan Programs for the Episcopal Church Foundation, and in that capacity he assists dioceses across the country in developing their planned giving programs. He is a co-author of the Foundation's manual, ***Funding Future Ministry**: A comprehensive guide for church leaders to encourage planned gifts in support of Christian ministries*, and has recently completed a companion manual, ***A Diocesan Gift Planning Program**: Guidelines for Success.*

Outside the Episcopal Church, Gearing has served in leadership and development roles in several non-profit organizations, such as Nicholas House, Jerusalem House, Memorial Society of Georgia, and the Alzheimer's Association (where he currently serves as Chairman of the Endowment Fund).

Staff Bios:
Bryan Clontz is President and Co-Founder of Charitable Solutions, LLC – a non-cash asset consulting firm. For the last decade, he served as Vice President of Advancement at The Community Foundation for Greater Atlanta, and was formerly Director of Planned Giving at the national office of Boys & Girls Clubs of America and Director of Planned Giving for the United Way of Metropolitan Atlanta.

He received a B.S.B.A from the College of Charleston, a M.S. in risk management and insurance from Georgia State University and a M.S. in Financial Services from the American College. Bryan has earned the certified financial planner designation (CFP™), and subsequently earned the chartered life underwriter (CLU), chartered financial consultant (ChFC), accredited estate planner (AEP) and chartered advisor in philanthropy (CAP) designations. For the last six years, he has served as a part-time graduate personal financial planning and life insurance instructor at Georgia State University. He has given more than 400 presentations on financial planning and planned giving topics and has co-authored a chapter in an international insurance textbook, has written more than a dozen articles in financial services and planned giving journals and a planned giving manual entitled Just Add Water which has sold more than 2,000 copies. Bryan also chaired the inaugural statewide Leave a Legacy Georgia! campaign. He has served as an expert witness related to charitable gift annuity default and reinsurance related to an Arizona charitable bankruptcy.

Bryan serves on the Editorial Board of the Planned Giving Design Center, on the Advisory Board of the American College's Chartered Advisor in Philanthropy (CAP) designation program and on the Rates Committee for the American Committee on Gift Annuities. He has served on the Board of the Georgia Planned Giving Council for six years, was an Increasing Philanthropy Committee member for the Southeastern Council on Foundations, co-authored the continuing legal education materials on Private and Public Foundations distributed in twelve states, and has served as a community foundation Advancement Network board member for three years.

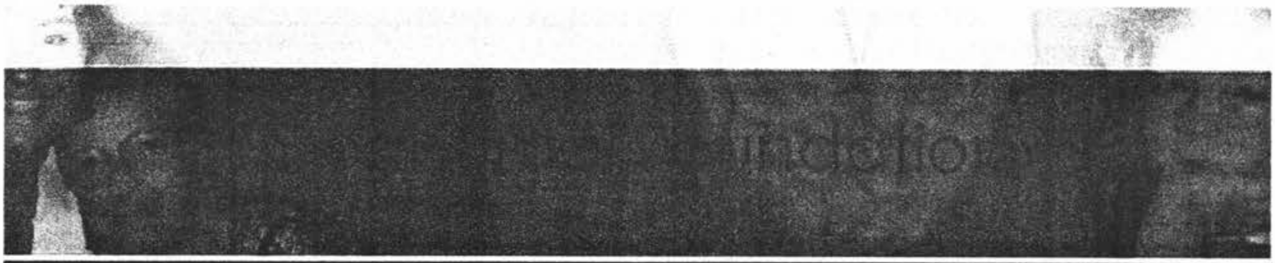
Mack Johnston, CFA serves as the CEO, Chief Operating Officer and Co-founder of Charitable Solutions, LLC. He previously served as Managing Director of DirectGiving, LLC, a wholly-owned subsidiary of Magner.Network. The company creates and manages private-labeled donor advised funds and charitable gift annuity programs. In his capacity as Managing Director, Mack was heavily involved in the design and implementation of the technological "front-end" of the Merrill Lynch Community Charitable Fund introduced by Merrill Lynch in early 2003.

Mack also provided various administrative services and acted as the Administrative Managing Director for the Pathway Foundation, Inc., a national donor advised fund that also provides financial services firms with a charitable gift annuity platform.

Mack has held a wide range of positions in the investment management arena. Before joining DirectGiving, he was the Managing Director of Administration for First Investment Advisors, First Union's (now Wachovia) private client investment subsidiary. He also served as the State Chief Investment Officer for Georgia and Tennessee for FIA in Atlanta, before assuming the Managing Director's duties in Charlotte, NC.

Mack also managed mutual funds for Bank South and other personal and institutional investment accounts at Citizens and Southern Investment Advisors. He began his career at Dean Witter in 1981 before moving to Atlanta in 1982 to join Charles Schwab & Company. He received the Chartered Financial Analyst (CFA) charter in 1987, a Master of Business Administration from Georgia State University in 1986, and a Bachelor of Science from the University of Alabama in 1981.

Contact Information:
Dechomai Foundation, Inc.
(404) 375-5496 – Bryan's Cell Phone
(770) 953-7708 – Charitable Solutions, LLC office
www.dechomai.org or www.charitablesolutionsllc.com



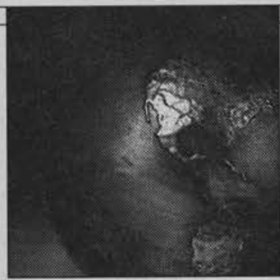
What We Do

The Dechomai Foundation's foremost reason for existence is to help other charitable institutions receive non-cash donations – donations that the charity might not otherwise be able to accept.

We manage the entire process – from receiving the non-cash asset to managing and liquidating the asset to finally granting the net proceeds to the charity recommended by the donor (almost always the originating charity).

We have extensive experience in accepting real estate (commercial and residential), many types limited partnerships, closely-held stock, restricted stock, S-Corp stock, life insurance, notes, seats on financial exchanges and other unusual assets – all subject to Board approval, of course.

A comprehensive description of the way a "typical" non-cash donation is handled can be found in the Non-cash Donation Work Flow Chart. While we pride ourselves in being capable of handling just about all types of non-cash donations, there are instances when our Board may decide to decline an asset.



Building a Stronger Gift Planning Program

Presented by

Marjorie A. Houston
Director, Gift Planning
Wheaton College
Norton, MA

Thursday, April 6, 2006

mhouston@wheatonma.edu

Building a Stronger Gift Planning Program

A Strategy for Building Relationships Among Gift Planners, Donors and the CFO

presented by
Marjorie A. Houston
Gift Planning Director
Wheaton College
April 6, 2006
ACGA Conference

Issues to Consider

- Institutional culture
- Division of services
- Communication mechanisms

Institutional Culture

- How are decisions made
- Who are the necessary players at the table
- Layers of decision-makers
- Codified policies and procedures
- Review process (gift not staff)

Division of Services

- Individual fundraising
- Annual fund
- Alumni relations
- Gift Administration
- Gift Planning
- Communications

Communication

- Internally among colleagues
- Training
- Marketing

How Do We Make Gift Planning Visible?

- Examining the program regularly
  - Keep good statistics ("In God We Trust, Everyone Else Bring Data")
  - Know the marketplace
  - Know the value of your program
- Developing a business plan

Components of a Business Plan

- External Environment
- Internal Assessment
- Action Plan

The External Environment

- Philanthropic environment – become resource or "educate the boss"
  - Role of for-profit sector in philanthropy
  - Needs and expectations of your donors
  - Define what generational transfer means to your institution
  - Uncertainty in future of estate tax
  - Financial outlook
  - Growing interest in creation of family philanthropy

Internal Assessment

- To make the case that time and resources should be put into Gift Planning it is important to assess the value of the program to the overall priorities of the institution…How?
  - SWOT analysis
  - Current year statistics
  - Past performance
  - Future expectations
  - Probabilities with change

SWOT Analysis

- In any analysis of a program it is important to show the people power and how the program intersects with other divisions in and out of advancement

Strengths

- **Positioning in a large institution is key-recognize where the strengths are but build on the weak points**
- **Examples**
  - **Committed advancement team**
  - **Engaged finance team**
  - **Involved communications team**
  - **Growth in annual fund**
  - **Stream of realized bequests**
  - **Strong annuity program**

Weaknesses

- **Define where the program does not meet the need**
- **Elements of:**
  - **Uncertainty in how gift planning integrates into overall development process**
  - **Uncertainty by major gift and principal gift officers on how to use gift planning**
  - **Gift planning is used infrequently in strategizing over a solicitation**
  - **Bequest/life income society not integrated as part of overall giving societies**
  - **Gift acceptance policies are not codified**

Opportunities

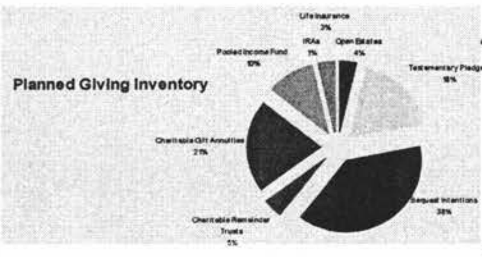
- What are they currently for your institution and do they make sense for the marketplace.
  - Examples:
    - Marketing to high net worth
    - Stewardship
    - Gift administration
    - Philanthropic vehicles
    - Bequest marketing
    - Technical expertise

Threats

- Well known issues:
  - Entrance of for-profit sector
  - Increased number of not-for-profits
  - Conservation (if not diminishment) of principal by donors in gift funds

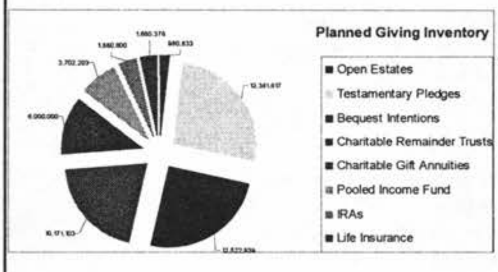
Examples of Analysis

Inventory (by percentage)of Donors by Gifts



Example of Analysis

Inventory of Gifts by Dollar



Good Valuations Lead to Good Policies

- Face value of a program versus future value versus present value – does it matter?
- Explaining why life income gifts have "current" value

Valuing Your Gifts – Analyzing the Gift Annuity Pool

- **Addressing immediate issues, e.g. decreasing FMV of gift annuity pool**
- **Testing the methodology**
- **What makes most sense in risk and volume**
- **Does the marketplace drive the annuity rates**

Execution of the Analysis

- **Formula for FV and what it means**
- **Role of PV in examination**
- **Benefits to analysis of future and present values**
- **Logic behind examining CGAs first**
- **Using the valuation formula for CRTS and PIFS – does it work the same?**

Example of Valuation Results

- **Examined a pool of 59 terminated annuities, grouped by donor fund**
- **Total initial gift value was $1,226,770**
- **Projected FV calculation of the pool was $733,097 (based on NCPG default investment rate)**
- **FMV of terminated pool was $1,023,948**

What the Numbers Actually Told Us

- Gifts exceeding 50% of initial gift had payouts between 6% and 7%
- Payouts between 8% and 10% that exceeded 50%, terminated at or near life expectancy
- Where gifts lost value, annuitants lived 4+ years beyond life expectancy and payouts were greater than 9%
- 95% of participants died between 1995 and 2000

Analysis of Current CGA Pool

- Examined pool of 175 one life CGA contracts
- One life pool initial gift value is $2,716,353
- Projected FV of pool is $1,428,558
- Current FMV of gifts is $2,911,486 (based on 6/30/03 audited numbers)
- Average LE of pool is 11.3 years

Analysis of Deferred Annuities

- Examined 24 deferred CGA contracts
- Initial gift value of pool is $823,951
- Projected FV of pool is $386,427
- PV of pool is $163,057
- Average LE of pool is 19.2 years
- (Did not test impact of changing portfolio mix on this group)

A Few Observations

- CGAs based on two lives have a FV less than 50% of initial gift value and average life expectancy is 15+ years
- Gifts established before 1995 have a FV exceeding 50%
- 7 individuals have lives 3+ years beyond life expectancy and rates exceed 10%; FV likely to be greater than terminated value
- Deferred annuities whose payouts are over 8.5%, FV is less than 50%
- If annuity rate had been dropped by .5%, gifts would average 34.6% increase in FV

How Can the Results Help Position Your Activity

- Determine where dollars are coming from versus where resources are being used
- Determine trends in giving in your donor base
- Determine if gift and institutional policies and procedures are generating best results
- While cash will always be king – data may be used to bolster your influence on gift policies and the value of your program

Develop Recommendations

Recommendations are a product of the results of SWOT analysis and valuation analysis and could consist of:

- Refocusing marketing program
- Plan to address younger donors
- Targeted messages to specific constituents
- Strong presence for bequest society
- Comprehensive training program
- Codified policies and procedures

All This Work and Now What?

- Develop a three-year plan with trends, projections and budget
- Share plan with colleagues to get feedback and buy-in
- Present to boss, VP, Executive Council, President

Big vs Small…is it really different?

- Access is different, can not hide behind protocol
- Budgets rule decisions but data gives relevance
- Creativity easier; autonomy greater
- Gift policies and internal procedures are more lax so better position to influence change
- Best practices remain the same:
  - Know the value of your program
  - Have a plan
  - Communicate the plan
  - Lead, Integrate, Serve

Lead Integrate Serve

- **Lead** others through training
- **Lead** others through creativity
- **Lead others through sharing of information**
- **Integrate** with other fundraising units
- **Integrate** in marketing program and prospect strategy
- **Integrate program by sharing information**
- **Serve** through strong technical expertise
- **Serve** through strong marketing program, production of leads
- **Serve through sharing of information**

From *The Journal of Gift Planning*®, by Marjorie A. Houston, ©2005, Volume 9, Number 1.

Marketing the Value of Charitable Gift Annuities:

A Strategy for Building Relationships Among Gift Planners, Donors and the CFO

Marjorie A. Houston

Foreword

I have had the opportunity to examine charitable gift annuity programs at two diverse institutions. My goal has been to understand the impact of the gift on the institution in relationship to how we use gift annuities, what annuity gifts ultimately fund at the institution and what the return is to the institution over time as compared to other investment returns.

Most recently, I undertook a study of our gift annuity program using the NCPG Valuation Standards for Charitable Planned Gifts as a way to address the concerns of our CFO about the decreasing fair market value of the gift annuity pool. We first evaluated the terminated pool by determining the projected future value of the gifts at inception and comparing those projections with the actual gifts realized. This helped us to validate the methodology for our CFO. We did not consider the present value, as this was a moot issue as a tool for comparison to actual realized value at termination. When evaluating the existing pool, we did both future value and present value calculations to assess the annuity pool for projected real dollars available in the future and their purchasing power. We found, as anticipated, that the present value calculation proved to be an excellent tool for the CFO to assess the true value of the annuity pool and counteract his initial reactions about the decrease in the annual value of the total pool and, therefore, the viability of the program. However, we also found that the future value, which projects the termination value, told us a great deal about our pool and the characteristics that may be unique to our own annuitants. We used this knowledge as a basis for formulating some of our gift policies and marketing materials.

This is an unusual approach to the NCPG Valuation Standards, but I offer it as an opportunity to think about how we use tools to evaluate our programs and what value those results might have for our donors' education. I encourage others to analyze their CGA pool using the NCPG Valuation Standards and assess what the results tell you about your program.

Introduction

The American Council on Gift Annuities (ACGA) completed a study in 2003 in which a great majority of charities reported positive returns from their terminated annuities. However, as a result of the biggest stock market run in history, the decade of the

Syllabus code: 4.01
Abstract: A careful analysis of a charitable gift annuity program, using formulas recommended in the NCPG Valuation Standards for Charitable Planned gifts, is a first step toward alleviating the chief financial officer's concerns about the viability of gift annuities and broadening the donors understanding of how gift annuities benefit your institution.

90s provided many of us with a false sense of security and an expectation that returns on investments would continue to outstrip the payouts. The downturn in the markets and the long term perspective of extended life expectancies bring those positive returns on future annuities into question.

No one can guarantee that every annuity will return a positive result, and the law of averages will assure that a certain percentage of annuitants will live beyond 100. Even if a charity earns a net total return of five percent over the life of an annuity, there probably will be no gift remainder if the annuitant lives beyond age 100. Because of these realities, a careful analysis of a charitable gift annuity (CGA) program is a good first step in alleviating the concerns of the chief financial officer (CFO) and broadening donors' understanding of how gift annuities benefit your institution.

Internal Analysis and Marketing

For most charitable organizations, the charitable gift annuity is the gift *du jour* and the backbone of the planned giving program. The generous rate structure is attractive to our donors in this low interest environment. For development officers, this means that we continue to market these gifts in myriad ways. While some large national organizations are using high profile celebrities to endorse gift annuities on public radio, and others are taking out ads in national newspapers, most of our organizations deliver the message through newsletters, publications and individually targeted mailings.

More and more, however, our marketing program for CGAs emphasizes the very thing that is making our CFOs concerned: high rates and longevity. How many times has a gift planner said jokingly that if a donor establishes a charitable gift annuity, it guarantees he or she will live a very long time? Our joke sends a chill up the spine of our financial officers!

The three-year bear market that began in March of 2000 and ended in 2003 drained many organizations' endowments, and the average charitable organization's investment pool during that period suffered a 2.3 percent loss. Despite the gains earned since then, the impact of that downturn left the financial officers grappling with the associated risks of managing a gift annuity program and the development officer with trying to explain the realities of a gift annuity contract.

Helping the CFO become comfortable with charitable gift annuities is important, particularly in today's environment. We need to address the concerns about return to the institution by "marketing" the positive effects of the gift. To do this, however, requires an analysis of the numbers and an interpretation of what we mean by a positive return. The analysis should result in a program that is viable to the finance office and recommendations for best practices to be adapted and marketed to our donors.

There has been much discussion in the past year about the importance of explaining the numbers by educating our internal constituencies. William Samers and Steven Meyers in "Planned Giving in the Big Picture: Talking About the Numbers to the People Who Count" (*The Journal of Gift Planning*, Vol. 8 No.1, 1st Quarter 2004, p. 11) developed the concept of Total Financial Resource Development (Total FRD). Total FRD is excellent for assessing the overall depth of the program while providing a snapshot of the program's strengths and weaknesses. For example, by comparing the number of donors against an estimate of the future dollars to be received in each gift category, we can adjust our marketing program to programs that are raising the most dollars, versus those that are having the most activity. I have used the Total FRD method to do a SWOT analysis for a report to the board of trustees highlighting precisely where we needed to change emphasis based on dollars raised. Using a method like this to count planned gifts gets the attention of stakeholders and produces conversation about direction of the gift planning program. However, when the finance office suggests that a gift annuity or charitable trust program's return is not matching expectations, a closer examination of the numbers becomes paramount.

Listening to Gift-PL: In July 2004, subscribers to NCPG's e-mail discussion forum, Gift-PL, offered some interesting commentaries on issuance of gift annuities in California, as a result of that state's 10 percent reserve requirement. At the heart of the conversation was the issue of how to alleviate the concern of CFOs over the potential that charitable gift annuities are a losing proposition. The questions raised are prescient, as they are being asked at many institutions: Is there any hard evidence of long range benefit by staying with ACGA rates? Are [you] reducing the payout rates, raising the age limit, or backing away from annuities all together?

Gift annuity programs are coming under increasing scrutiny by the finance and investment offices at many institutions. As the viability of the rate structure and the risks to the institution, associated with guaranteed income to the recipient, are being questioned, many CFOs are making assessments of gift annuity programs without understanding their role. Much is being written about the viability of the ACGA rate structure in today's investment environment, and individual state restrictions on issuance of annuities adds complexities that frustrate our financial colleagues. Couple this with the rosy returns of the mid-90s that skewed the finance department's expectations of the returns on gift annuities, and gift planners find that we are being questioned about rate structure, anticipated return, donor expectation and, at some charities, viability of issuing gift annuities at all.

Evaluating risks associated with establishing annuities, examining a viable rate structure for an organization and marketing the gift to prospects are important elements of assessing the value of a gift annuity program. However, the following questions should be considered when grappling with the nuances of any gift annuity program.

- Does the marketplace drive the annuities?
- What makes the most sense in risk and volume for the charity?
- What role do annuities play with donors?

Does the Marketplace Drive the Annuities?

State Street Global Advisors, in the winter 2004 edition of *Charitable Contributions* stated, "...we are getting more and more questions from the finance, investment, and accounting staffs about gift annuities and the associated risks of long term liabilities...We would contend that by simply paying at the lower rates, the new ACGA rates reduce the risk to an institution. However, whether the 50 percent residuum target will be achieved depends upon the asset allocation of the gift annuity fund." In an article titled "Optimizing Charitable Gift Annuity Risk Management," (*The Journal of Gift Planning*, Vol. 8, No. 1, 1st Quarter 2004. p. 5) Bryan K. Clontz and Donald F. Behan presented an in-depth analysis of managing annuity risk. They preface their assessment by stating that effective management of the longevity and investment risks has become critically important for both existing and future gift annuities. According to Clontz and Behan, "[I]t is highly likely that one-third or more of the gift annuities written during [this] time period [1998-2003] will run out of money, even if financial markets return to historical norms going forward." This assessment is not extreme, as many finance officers have been cautioning gift planning officers and investment committees about the same risks. In a July 16, 2004, posting to Gift-PL, Bryan Clontz said that he remained "concerned by what audits are uncovering in large and small pools alike as it relates to the levels of CGA risk. For small pools, pools with large annuities or pools with an abnormally high number of CGAs created in 1999-2002, we are finding that even if asset class returns resume to historical levels, many annuities will erode all principal and go negative."

One way to counterbalance this concern is to evaluate the historical return of terminated annuities against the expected return of the current pool. You can also examine the nuances of your constituency base—life expectancies, size of gifts, repeat customers and performance of one life versus two life annuities—and make valid recommendations for the program moving forward. From this assessment you can develop a marketing program that is geared toward your particular donor or prospect pool and your institution's expectations.

Risk and Volume—What Makes Sense?

In order to make a case for assessing the program, it is important to understand the role gift annuities play within your program and their value toward reaching institutional goals. It is often the discrepancy between the return of the gift in real dollars versus what it was intended to fund that causes the financial office to question the viability of the gift or rate structure. NCPG has provided an opportunity for us to assess the program through its valuation standards. When applied to the charitable gift annuity program, the standards provide a solid analysis of the returns and present those returns in a language that is understood by the CFO. This puts the gift planning officer in a good position to recommend direction for use of charitable gift annuity contracts within his or her institution.

One of the more interesting research items Clontz and Behan uncovered is that, of the top five multi-million dollar life insurance companies with the largest immediate annuity blocks of business, on average only three to five percent of the portfolio is allocated to equities. They strategically buy fixed income instruments to match the expected cash flow needs over life expectancies, using the benefit of the law of large numbers. Charities generally do not have the benefit of the law of large numbers. Clontz also comments that every charity with a sound CGA risk policy can comfortably offer CGAs. However, for charities that wrote large gift annuity contracts in 2000 or 2001 and are investing them in a 60 percent equity and 40 percent fixed portfolio, the exhaustion probability would be in the 65 to 75 percent range. Although this sampling is concentrated in two years and conceivably produces an anomaly, it does illustrate the level of risk an organization may face. While everyone seems to spend a great deal of time assessing minimum ages and minimum gift size, issues related to maximum sizes and cash flow match relative to donor and pool characteristics are by far greater risk factors.

Gift Annuity Basics

A charitable gift annuity is a simple contract between an individual and an institution, in which the institution promises to pay a fixed dollar amount annually for the life or lives of an individual(s) in exchange for a gift. However, charities are becoming increasingly concerned about the risks of gift annuity programs, and some are taking steps to reduce those risks. Risks being considered are the longevity of the gift annuity pool, rate of return, size of gift and number of beneficiaries, as well as state regulations governing CGAs. Charitable gift annuities are regulated by state law with some states requiring the charity to be registered in the state before an annuity can be issued to its residents and still others that set investment parameters or require setting aside a reserve account. Each charity must make its own determination on whether registration is necessary.

Uniform charitable gift annuity rates are recommended by the American Council on Gift Annuities and followed by most charities. On average, those rates may be expected to yield 50 percent of the contributed principal remaining on an annuitant's death. Why does the industry generally follow uniform rates? Historically, the industry belief is that charities should compete on merits of their missions, not on the basis of annuity rates offered. The rates recommended by ACGA are based on the Annuity 2000 mortality tables (female lives) with a one year setback. However, it is important in any analysis to test those assumptions against the realities of the program for each individual charity. Application of the NCPG valuation standards helps us do just that.

Effective July 1, 2003 the ACGA recommended that the industry offer lower maximum annuity rates. Although rate adjustment is voluntary, many charities institute recommended ACGA rate changes. The rates are reviewed and assessed based on long term economic indicators. Based on these indicators the ACGA makes a set of investment and administrative cost projections. The total return assumptions underlying the new rate structure are six percent and the annual expenses for investment of reserves and administration are one percent; making five percent the assumed net total rate of return for CGAs established since July 1, 2003.

The Charitable Gift Annuity Analysis

In order to judge the effectiveness of the gift annuity program, it is important to look at the value to the charity of such gifts over time. This is not the same as the IRS deduction calculation, which simply reflects the prevailing IRS discount rate in effect at the time of the gift and assumes that a gift is invested in mid-term Treasury bonds and earns the return set on the bond at the time of the gift. At many institutions, CGAs are invested with the endowment and are therefore exposed to a mix of investment vehicles and have the potential to do better than mid-term Treasury bonds over the long haul. At my institution, the investment portfolio for our CGA pool is 21 percent equities, 29 percent fixed income, and 50 percent marketable alternatives.

NCPG's Valuation Standards provide practical methods for projecting a gift's future value and the present value (i.e., present purchasing power) of that future gift. Since the NCPG standards are a methodology grounded in historical data that is understood and accepted by financial officers, the standards are particularly effective for analyzing gift annuities. They provide a strong tool for evaluating the rate structure against particular institutional needs.

In our study to determine a future value that reflects the potential growth over life expectancy, we used a formula that takes into account life expectancy, investment/earnings rate to determine the future value, the individual annuity payout and the present value. (Discussion of valuing gift annuities is included in NCPG's *Valuation Standards for Charitable Planned Gifts*, which is available in the Ethics & Standards section at www.ncpg.org.) In applying the valuation standards, organizations may use their own earnings rate over time to calculate the future value, or they may use a standard assumed earnings rate. We chose to use the ACGA assumed net return of five percent and the default discount rate provided in the NCPG valuation standards report.

Execution of the Analysis

For the business office to accept the analysis, validation is the key. The logic behind examining terminated annuity contracts is simple. If the projected future value holds up against the terminated value—in other words, if the default assumptions recommended by the NCPG valuation standards yield a projected future value that is at least equal to the actual terminated value—then the underlying assumptions can be substantiated.

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In order to arrive at a set of observations that could be applied to any analysis of the current gift annuity pool, we followed three steps. First, we undertook an analysis of a cross-section of the terminated CGA pool, and compared each annuity contract's actual terminated value to a projected future value based on the initial gift value, the payout rate, the life expectancy and the historical returns on the pool. Next we performed a similar examination of a cross-section of existing annuities. Results on terminated annuities were then contrasted with the anticipated return on existing annuities with similar parameters.

The Terminated Portfolio Speaks

We examined a portfolio of 59 terminated gifts and accepted the American Council on Gift Annuities assumption that achieving 50 percent of initial gift at termination should be the break-even point. The portfolio failed to achieve this goal on four of its terminated contracts. The two similarities among these four gifts were that each annuitant lived at least four years beyond life expectancy and each annuitant received a payout of over nine percent. The losses ranged from 7.5 percent to 103 percent of expected terminated value (50 percent of initial gift). In the sampling (see Exhibit 1) of the 29 gifts established between 1973 and 1997 and terminated between 1985 and 2002, 18 individuals outlived their life expectancies.

As previously noted, we applied the future value calculation to the terminated pool in order to validate the methodology before applying it to the current pool of annuities. Exhibit 2 shows that for terminated CGAs, the fair market value exceeded the projected future value and the ACGA assumed return.

[Exhibit 1: Sampling of Terminated Gifts]

Sampling of Terminated Gifts Analyzed

Date of Gift	Gift Amount	IRS life expectancy (LE) based on current tables	Difference between IRS expected and actual LE	Rate of Annuity	Annuity $ value (calculated)	Calculated FUTURE value (FV) of gift @ DOG	Sum of FV of gifts by fund	FMV of gift @ termination by fund #	Percent % gain/loss of actual FMV over FV	*50% original gift*	*Difference between FMV @ term & expected return (50%)*	*% gain / loss of FMV over expected return (50%)*	PV @ DOG
5/22/1985	$5,000.00	11.2	-6.04	8.90%	$445.00	$2,164.27	$5,187.10	$6,562.50	26.52%	$5,000.00	$1,562.50	31.25%	$1,307.85
5/22/1997	$5,000.00	5.30	0.07	11.70%	$585.00	$3,022.83							$2,381.75
6/3/1986	$30,000.00	8.9	-6.84	9.90%	$2,970.00	$14,012.94	$14,012.94	$11,654.49	-16.83%	$15,000.00	-$3,345.51	-22.30%	$9,390.68
11/30/1990	$10,000.00	6.90	-1.29	10.90%	$1,090.00	$5,277.03	$5,277.03	$6,232.39	18.10%	$5,000.00	$1,232.39	24.65%	$3,869.20
1/24/1986	$5,000.00	8.9	-1.17	9.90%	$495.00	$2,335.49	$2,335.49	$2,963.56	26.89%	$2,500.00	$463.56	18.54%	$1,565.11
12/17/1990	$30,000.00	8.90	1.09	9.90%	$2,970.00	$14,012.94	$14,012.94	$21,681.94	54.73%	$15,000.00	$6,681.94	44.55%	$9,390.68
12/3/1990	$10,000.00	10.00	-1.02	9.40%	$940.00	$4,465.73	$22,328.64	$43,960.43	96.88%	$25,000.00	$18,960.43	75.84%	$2,848.23
5/6/1991	$40,000.00	10.00	-0.59	9.40%	$3,760.00	$17,862.91							$11,392.93
8/17/1989	$10,000.00	6.90	-4.01	11.40%	$1,140.00	$4,876.78	$4,876.78	$5,464.99	12.06%	$5,000.00	$464.99	9.30%	$3,575.73
12/20/1994	$10,000.00	5.70	2.92	10.60%	$1,060.00	$6,409.02	$6,409.02	$11,222.27	75.10%	$5,000.00	$6,222.27	124.45%	$4,959.76
5/6/1996	$14,661.00	8.4		9.40%	$1,378.13	$8,125.36	$8,125.36	$19,332.41	137.93%	$7,330.50	$12,001.91	163.73%	$5,566.99
11/3/1983	$50,279.06	14.60	-2.90	8%	$4,022.32	$18,942.67	$18,942.67	$57,565.88	203.90%	$25,139.53	$32,426.35	128.99%	$9,823.78
7/28/1986	$10,250.00	11.2	-0.48	8.90%	$912.25	$4,436.75	$7,883.15	$19,211.04	143.70%	$10,125.00	$9,086.04	89.74%	$2,681.08
4/4/1984	$10,000.00	12.5	-1.49	8.90%	$890.00	$3,446.40							$1,964.35
10/22/1991	$5,000.00	6.1	-1.09	12.30%	$615.00	$2,469.46	$2,469.46	$2,775.77	12.40%	$2,500.00	$275.77	11.03%	$1,876.97
6/24/1993	$26,102.00	9.50	2.99	9.60%	$2,505.79	$11,942.52	$61,993.96	$139,044.37	124.29%	$57,369.75	$81,674.62	142.37%	$7,790.13
12/18/1995	$25,000.00	7.90	3.86	9.60%	$2,400.00	$14,183.92							$9,942.51
12/3/1997	$30,000.00	6.90	4.84	10.50%	$3,150.00	$16,791.69							$12,311.92
6/22/1999	$33,637.50	6.50	5.90	10.80%	$3,832.85	$19,075.84							$14,240.58
3/13/1980	$10,000.00	12.5	-5.49	7.10%	$710.00	$6,471.14	$11,142.12	$25,830.17	131.82%	$10,000.00	$15,830.17	158.30%	$3,688.37
2/24/1986	$10,000.00	8.9	-3.13	9.90%	$990.00	$4,670.98							$3,130.23
12/26/1991	$5,038.88	7.40	1.09	10.90%	$549.24	$2,453.43	$2,453.43	$4,171.85	70.04%	$2,519.44	$1,652.41	65.59%	$1,758.89
1/7/1987	$100,009.89	8.4	-7.45	10.20%	$10,201.01	$47,321.11	$47,321.11	$28,836.78	-39.06%	$50,004.95	-$21,168.17	-42.33%	$32,433.12
3/1/1994	$2,000.00	7.90	6.15	10.40%	$208.00	$984.23	$984.23	$1,946.02	97.72%	$1,000.00	$946.02	94.60%	$689.92
6/30/1979	$5,000.00	15.30	-6.43	6.90%	$345.00	$2,891.80	$7,357.52	$20,606.44	180.07%	$7,500.00	$13,106.44	174.75%	$1,453.22
11/26/1986	$10,000.00	10	-4.32	9.40%	$940.00	$4,465.73							$2,848.23
4/16/1979	$5,000.00	14.6	-7.95	7.10%	$355.00	$2,818.63	$2,818.63	$25,121.42	791.26%	$2,500.00	$22,621.42	904.86%	$1,461.76
8/9/1991	$3,000.00	4.70	-0.45	12%	$360.00	$1,917.51	$6,238.30	$13,273.55	112.78%	$4,000.00	$9,273.55	231.84%	$1,552.16
5/1/1973	$5,000.00	13.9	-9.54	5.70%	$285.00	$4,320.79							$2,312.45

Future Value calculation formula used as defined by NCPG Valuation Standards
FV = [($original gift) x (1.05)^Life expectancy] - [(Annuity) x {(1.05^LE - 1)/.05}] **(Expected Return for FV Formula 5%)**

Exhibit 2: Profile of Terminated Pool Results

	Fair Market Value at Termination	ACGA Assumed Return (50% of gift)	Projected Future Value at Date of Gift*
Total pool **	$1,023,948.39	$588,080.54	$733,097.84
Mean of total pool by fund	$31,998.39	$18,377.52	$20,595.54
Median of total pool by fund	$18,054.92	$7,415.25	$8,004.26

*based on NCPG default investment rate
** represents a sample of 59 annuities grouped by donor fund

As a whole, gifts that exceeded 50 percent of the initial gift had payouts between six percent and seven percent. Gifts that had higher payouts, between eight percent and 10 percent, and exceeded 50 percent of the expected return, terminated at or around the donor's expected life span. Without a doubt, investment returns of the 90s had a positive effect on portfolios of gifts that terminated in the mid to late 90s.

What the Current Data Tell Us

For a portfolio of 175 current gift annuity contracts, we calculated the future value of the gift as of the date of gift and compared the expected future value against the fair market value given to us by the finance office as determined by the college's independent auditors on June 30, 2003. Following are some of the assessments we were able to make regarding the health of the annuity program:

- Gifts made before the mid-90s were able to take advantage of exceptional market returns and grew more than historical returns used to determine future value.
- Annuities established before 1995 have been impacted by investment growth of the 90s and are currently at double or triple their initial intended value to the college: even taking into account predicted future liability, the future value of these gifts still is projected to be greater than 50 percent of original gift.
- Two-life gift annuities, regardless of investment return, have a calculated future value of less than 50 percent of original gift. Most two-life gift annuities have been established since the mid-90s.

Statistics on Examined Portfolio of Charitable Gift Annuities

Average age at DOG	78.67	
Average Life Expectancy (LE)	11.3	
Average annuity rate	8.96%	
Median annuity rate	8.7%	
Average annuity rate for 1 life	9.33%	
Median annuity rate for 1 life	9.4%	
Average annuity rate for 2 lives	7.67%	
Median annuity rate for two lives	7.5%	
Average income distribution	$2,004.15	
Average gift	$22,444.12	
Median gift	$10,000	
Average future value of gift	$11,225.77	(50%)
Median future value of gift	$5,600.07	(56%)

We examined deferred charitable gift annuity contracts separate from the immediate payout charitable gift annuities in order to assess the effect the life expectancy and larger payout had on the residuum. Since we observed, in both the terminated gift annuity contracts and the immediate payout gift annuity portfolio, that the higher payout and longer life expectancy had a dramatic effect on the residuum, we wanted to determine if the deferred period for investment would offset the higher rates and longer life expectancies.

For a portfolio of 24 deferred annuity contracts, we calculated the future value of the gift as of the date of gift and compared the expected future value against the fair market value given to us by the finance office as determined by the college's independent auditors on June 30, 2003. Most DCGAs were established in mid to late 90s, so they have not had the advantages of investment for long periods of time. However, in calculating the future value of the gifts, we perceived that the DCGA gift results are a function of the size of the income payout and the deferral period, and that the future value is less than 50 percent when payouts are over 8.5 percent. We did not test the impact of changing the portfolio mix on this group of contracts, but we did test dropping the deferral rate (the underlying rate at which the outright annuity is compounded during the deferral period). What we learned is that if deferral rates had been dropped .5 percent from the recommended rate, gifts would see an average of 34.6 percent increase in future value. We felt the impact of this was significant, since historically the deferred gift annuity contracts tend to be larger gifts than the immediate payout annuities.

Statistics on Examined Deferred Charitable Gift Annuity Portfolio

Average age at DOG	63.27
Median age	64.5
Average life expectancy (LE)	19.2 (determined from payment date)
Median annuity rate	8.10%
Average annuity rate	8.21%
Average gift	$34,331.60
Median gift	$30,356.24
Average future value%	50.85%
Average future value of gift	$16,101.59 (51.45% of initial gift)
Median future value of gift	$14,626.67 (49.61% of initial gift)

Recommendations

Remember, numbers sing—at least with the CFO! Following our analysis, the CFO engaged with gift planning in a conversation that took two tracks. First, as a result of the analysis, the CFO now has a better understanding of the underlying assumptions of a gift annuity and does not continue to measure the success of the program solely by the termination value of each gift or the annual FMV of the pool. Second, although not discussed in this article, the analysis led to a change in a number of finance practices that previously worked against the gift annuity program, such as the finance office's feeling that the college is obligated to make the initial gift value whole at termination of the contract.

Following are some recommendations from the study that may be beneficial as guidelines. Recommendations for any individual organization should be based on an analysis of its existing program.

Minimum gift levels for different age groups:

- Individuals age 45 to 54 may establish a DCGA for a minimum gift of $25,000
- A build-up gift can be made with a pledge of $25,000; first installment must be $10,000
- Individuals age 55 to 64 may establish a CGA for a minimum gift of $25,000
- Individuals age 55 to 64 may establish a DCGA for a minimum gift of $10,000
- Individuals age 65 and over may establish a CGA for a minimum gift of $10,000
- All annuity contracts, current and deferred, will be capped at nine percent.
- The annuity rate on all DCGA contracts will be dropped by .5 percent.
- The future value of the gift should be calculated before agreeing to establish a gift annuity.

- The future value of gifts to establish an endowed fund and funded through a CGA should equal the current publicized value for such a gift (e.g., future value to equal $100,000 to establish an endowed scholarship, not original gift value). While it may be a practice at some institutions to say that the present value of a life income gift should equal an endowment minimum, we found the future value to be a more easily attainable gift for the donor, and a concept that is more easily understood. We do, however, provide the present value for the donor.

- A donor may endow a gift through a series of CGAs over a five-year period; the cumulative estimated future value of the gift must equal the current publicized minimum for such a gift.

- If terminated value is less than endowed value as determined at time of gift, then contract language will allow for charity to direct the gift to a similar purpose.

- The ACGA rates will be used as a guide but may be adjusted to meet policy if future value of gift does not equal 50 percent.

- The policy and rates used to establish a gift annuity should be published annually.

- The Investment Committee of the Board of Trustees should endorse the NCPG Valuation Standards for Charitable Planned Gifts as the methodology for projecting the ultimate value of life income gifts.

Please note: Future value is used for projecting the future termination value of a gift annuity and comparing that against the 50 percent of residuum target. However, that is only half of what the NCPG Valuation Standards are recommending when it comes to valuing life income gifts. NCPG's Standards are based on calculating the present purchasing power of the gift after first determining projected future value. Our institution has chosen to emphasize future value as a means of p rojecting the nominal dollars that will be available in the future.

We did, in fact, calculate the present value in our study because we wanted to know the purchasing power of the gifts, and because it is a more accurate factor for the institution to use when looking at its long term plans. However, we found that the future value calculations were relevant in directing conversation with both the CFO and the donor about rate structure and about what the college could anticipate receiving in actual dollars at termination. We also found the future value to be a more donor-centric

method for "counting" the gift, rather than present value or face value, which have been used in the past.

External Message Determined from Internal Recommendations

Segmentation is a key component of a good marketing program, since not eve ry message is appropriate for eve ry group. Clearly, the message to our internal constituents—the finance office—stressed the viability of the program and its ability to meet the needs of the organization. How do we incorporate the results of the analysis into a coherent message for our donors?

As a result of the valuation analysis, some major trigger points we re identified that are pertinent to our particular donor base. The terminated portfolio analysis helped us evaluate the effect of payout and life expectancy on return. At a historically women's college, longevity is playing a key role in return on the gift. In addition, older women are comfortable with gift annuities and are willing to transfer large sums of money to establish a gift annuity with an expectation that their gift will build an endowment in their name for a particular purpose. Engagement in the long term objectives of the charity is important, and the marketing should match the realities as well as manage expectations of donors. How can we use the results from the valuation analysis to segment our market and our message?

We defined three methods for segmenting the pool and using the future value calculations as a guide for the message. Marketing materials, segmented the pool by these characteristics, among others:

- age, concentrating on those over 65, de-emphasizing the rate structure
- profession, stressing the retirement planning benefits of a DCGA
- level of gift, emphasizing building an endowment

Age Segmentation

In our analysis, a combination of longevity, portfolio mix and high payout contributed to low return (less than 50 pe rcent of original gift value). Since longevity (at least for now) is out of our control, and portfolio mix is determined by the Investment Committee, adjusting the rate structure becomes the most viable option for influencing return to the college on gift annuities. If we institute lower rates and cap rates, the incentive to give has to come from the mission. The basics of all good ma rketing are defining the need and appealing to the spirit. For older individuals this is especially true. Therefore, explaining that the rates are capped by stressing the future value of the gift to our organization helped our donors see beyond the income. How is this accomplished? A *Future Value Calculations for Charitable Gift Annuity* worksheet (Exhibit 3) is completed on each gift annuitant and shared with him or her. The form provides us an opportunity to discuss with the donor the impact of his or her gift in the future in real dollars. The future value also leads to discussion on the effect the gift will have on scholarship, faculty, library or any other area of interest. The conversation stays focused on the value of the gift rather than the income and on the goals and aspirations of both donor and charity.

Exhibit 3

Future Value Calculation for Charitable Gift Annuity

Date of Gift:

Amount of Gift:

Donor Name: **Donor Date of Birth:**

Beneficiary Name: **Bene Date of Birth:**

Age at Date of Gift: **Life Expectancy at Date of Gift:**
(If 2-life CGA use life expectancy for both lives)

ANNUITY RATE:
ANNUITY:
IRS RATE: **PGCALC CHARITABLE DEDUCTION:**

FUTURE VALUE OF GIFT $0.00

PRESENT VALUE: $0.00

Future Value calculation: *[($ original Gift) x (1.05)^Life expectancy] - [(Annuity) x ((1.05^LE - 1)/.05)]*
Present Value calculation: *Future Value / (1+ IRS rate)^Life expectancy*

Again, please note, this is a ve ry different conversation than talking about the present value of a gift. We are not t rying to have our donors understand the buying power of their gifts, just what the gift may potentially realize in real dollars.

Professional Segmentation

The *Future Value Calculation for Deferred Charitable Gift Annuity* worksheet (Exhibit 4) is used with younger donors in a manner similar to that used with the immediate payment gift annuity. However, the focus of the conversation is quite different. For our younger donors, primarily those in professional positions such as law, accounting or medicine, emphasizing the planning aspects is the key. However, the analysis of our two-life deferred population indicated to us that the future value potentially may not equal the break-even point. Consequently, our marketing materials follow the recommendation to offer deferred annuities on single lives only. Where do we place the emphasis? Just as IRAs are touted as individual retirement funds, we emphasize the individual planning opportunities with deferred charitable gift annuities, as well as the anticipated value of the future gift.

The future value also leads to discussion on the effect the gift will have on scholarship, faculty, libra ry or any other area of interest. The conversation stays focused on the value of the gift rather than the income and on the goals and aspirations of both donor and charity.

Exhibit 4

Future Value Calculation for Deferred Charitable Gift Annuity

Date of Gift:		
Amount of Gift:		
Donor Name:		**Donor Date of Birth:**
Beneficiary Name:		**Bene Date of Birth:**
1st Payment Date:		
Age at Date of Gift:		**ANNUITY RATE:**
Elapsed Time from Gift Date to 1st Payment date:		**ANNUITY:**
Life Expectancy from 1st Payment date: ***(If 2-life DCGA use life expectancy for both lives)***		**IRS RATE:**
FUTURE VALUE @ 1st Payment	$0.00	**PGCALC CHARITABLE DEDUCTION:**
FUTURE VALUE OF GIFT	$0.00	
PRESENT VALUE:	$0.00	

Steps to Calculate Valuation for DCGA

Future Value calculation @ 1st Payment:	*($ original Gift) x (1.05)^Life expectancy*
Future Value calculation @ end of Life Expectancy:	*[(Gift adj.) x (1.05)^Life expectancy] - [(Annuity) x ((1.05^LE - 1)/.05)]* *Gift adj is the result of step 1: Future Value calc @ 1st payment*
Present Value calculation:	*Future Value / (1+ IRS rate)^Life expectancy*

Endowment Segmentation

Another segment of the population to consider is individuals who want to build toward an endowment but still could benefit from the income. Many individuals use life income gifts to establish an endowed fund upon termination. Unlike a pooled fund or trust, where growth is expected to follow the gift, the structure of the annuity only expects 50 percent of the gift to remain. However, to recognize anticipated growth over time, the future value becomes a viable predictor of what the gift may be worth in the future. As a result of the valuation, the conversation with the donor becomes more realistic regarding the size of his or her gift in real dollars. In other words, if a fund today is endowed for $100,000, then, if funded with an annuity, the future value of the annuity must equal $100,000. We do not expect the purchasing power to equal $100,000, because this might make the initial gift prohibitively high. However, since we are recognizing a donor for the estimated future value of the gift, the calculation provides a catalyst to have an in-depth conversation about the size of the initial gift in order to reach the goal. This helps put the charity on a stronger financial footing, and manages the donor's and family's expectations.

Conclusion

A number of recommendations have come from this analysis, but the biggest positive result is the ongoing conversation with the CFO about the whole gift planning program and the role of the finance office in the program's success. Regardless of whether the administration is handled in-house or externally, the finance office has a stake in the gift annuity program and a responsibility to understand its impact on the charity. The gift planning office has a stake in learning how to engage finance officers in conversation by presenting data to which they can relate. Building on the strength of that relationship and a mutual interest in securing the best gift for the charity, the gift planning office can craft best practices and marketing materials that enhance the program. The surprising factor in all of this is that, for the most part, donors want to know what their gift means to the institution and how it will make a difference.

I would like to acknowledge the work of NCPG Valuation Task Force for devising and making available the Valuation Standards for Charitable Planned Gifts, Scott Lumpkin, Associate Vice Chancellor, University of Denver, for his insight and strategic thinking regarding the article's content; and Alyson Blais, Assistant Director for Gift Planning at Wheaton College, who did all the calculations on the CGA pool and populated the spreadsheet used for our analysis.

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Investing Charitable Gift Annuity Assets

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Investing Charitable Gift Annuity Assets

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Agenda

In scope

a) Regulatory environment as it pertains to investing gift annuity assets
b) Financial risks to the charity
c) Basic portfolio design and execution for gift annuity assets
d) Assessing your investment decision
e) What it all means for best practice policies and procedures

Out of scope

a) Regulations not having to do with investments
b) Legal and regulatory risks
c) Risks to the annuitants
d) Reinsurance issues and possibilities

Context For Understanding Investment Issues

Assumptions behind the ACGA rate tables

a) 50% residuum target in nominal dollars (not inflation-adjusted)
b) Expected contract horizons are determined using Annuity 2000 tables, and further assuming all donors are female, with a 1.5 year age set-back
c) 1% management / administration expenses
d) Portfolio allocation of 45% equities, 55% bonds, and 5% cash
e) 6% annual total return before fees or 5% after fees

Regulatory environment as it pertains to investing gift annuity assets

a) Unregulated states (state law is silent or exempts charities from registering)
b) States that require reserve accounts
c) States that impose investment restrictions on reserve accounts
   i) California and Florida – Maximum of 50% of reserve in equity investments
   ii) Wisconsin – Maximum of 20%
d) Recent evolution toward more investment flexibility
   NY – Now applies a prudent investor standard, in place of a cap on equities
   NJ and AR – Have also moved to prudent investor standard
   CA – Now caps equities in the reserve account at 50%, up from 10%

RISKS FACED BY CHARITIES OFFERING GIFT ANNUITIES

Risks should be assessed within the context of the individual institution

a) The total size of the gift annuity program relative to the charity's unrestricted assets
b) Financial health of the charity
c) Risk profile of the charity
d) Age of the program

Risks *outside* of the charity's control

a) Mortality risk — donors live longer than expected based on mortality tables
b) Market risk — charity does not achieve the long-term expected return, or experiences a prolonged market downtown (particularly at the start of a contract)

Risks *within* the charity's control

a) Rate risk — charity issues gift annuities at rates higher than ACGA rates
b) Spending risk — charity spends a portion of the gift before termination
c) Funding risk — funding assets do not sell right away (e.g., real estate) or sell for less than the gift value
d) Size risk — charity writes very large gift annuities
e) Concentration risk — a disproportionate amount of the dollar payments from the gift annuity program are made to one annuitant, or a few annuitants
f) Fee risk — charity pays too much for the management of its program

Other risks

a) Start-up risk — charity has a relatively new planned giving program that did not experience the 90's bull market
b) Regulatory risk — charity is constrained in its investment strategy by regulators
c) Prior misfortune risk — poor policy decisions and/or unsuccessful investment strategies of predecessors put the program assets at risk today

Implications of these risks

a) Contracts run dry and the charity must make payments from some other source
b) Residuary amount does not meet the intended gift purpose

Assessing Your Institution's Risk

To understand the primary risks in your portfolio of gift annuity contracts, begin by collecting data about each contract

a) Gift amount
b) Gift date
c) Current market value (assumes gift annuity pool is unitized)
d) Annual payment
e) Payment frequency
f) If deferred, the date of the first payment
g) Horizon (genders and dates of birth)
h) Annuity 2000 liabilities
i) Designated use of contract residual amounts

Research the following about your program

a) Current investment strategy and long-term expected returns
b) Prior gift acceptance and investment policies
c) Prior years' investment performance

Do some basic calculations

a) Calculate the pool's effective payout rate and the weighted average horizon and compare to ACGA rates
b) Calculate the Annuity 2000 liability for each contract; compare to its market value
c) Roll up the liability/market value comparison to your entire program
d) Examine the concentration of annuitants (in terms of annual payments)
e) Identify any underwater contracts (contracts where there are no assets left)

INVESTMENT PLANNING STEPS

Basic investment planning steps are similar to endowment or planned gift portfolios

a) Review the investment objectives
b) Understand the primary risks
c) Establish a long-term asset allocation policy, paying close attention to diversification
d) Determine market style exposure (value vs. growth, active vs. passive)
e) Select investment managers
f) Rebalance the portfolio regularly
g) Codify the investment objectives and policies in a written document
h) Revisit policy decisions regularly and whenever you consider a large new contract

"Stress" your investment decision and look at the results

a) Reduce assumed investment returns
b) Lengthen mortality assumptions
c) Focus on the largest contracts, and the underwater contracts
d) Look closely at the contracts written in 1998-2000, near the peak of the market
e) Determine the extent of the charity's exposure by subjecting "suspect" contracts to downside risk analysis
f) Consider Monte Carlo simulations to frame probabilities for discussion with senior staff and trustees

Portfolio execution best practices

a) Unitize your portfolio of contracts
b) Put in place an efficient custody structure, given state regulations
c) Promptly sell donors' donated securities
d) Have in place a disciplined rebalancing policy
e) Pay low (reasonable) fees
f) Tightly manage cash

What Are the Policy Implications?

Some best practices

a) Develop a written policy statement for your gift annuity program
   - Minimum ages for gift annuities (current and deferred)
   - Maximum gift amounts
   - Acceptable funding assets
   - Gift acceptance decision-making process
b) Follow ACGA rates
c) Do not spend any of the donated assets prior to termination
d) Develop acceptance policies and analytical approaches for dealing with gifts of illiquid assets (e.g., real estate) or don't accept them
e) Determine a maximum liability per annuitant
f) Determine a maximum program liability
g) Develop a policy for dealing with underwater contracts *before* you have any (or at least well in advance of their market values going negative)
h) Involve your senior staff and the trustee investment committee in a periodic review of the program

Remediation efforts for underwater contracts

a) Make payments from operating funds
b) Make payments from total gift annuity program assets (but be aware of the impact on other contracts including ones with restricted purpose residual interests)
c) Set aside residual distributions from terminated unrestricted contracts
d) Impose a "tax" on all terminating contracts
e) Impose an annual "tax" on all contracts in the pool to fund a reserve
f) Ask the donor to give up his/her income interest

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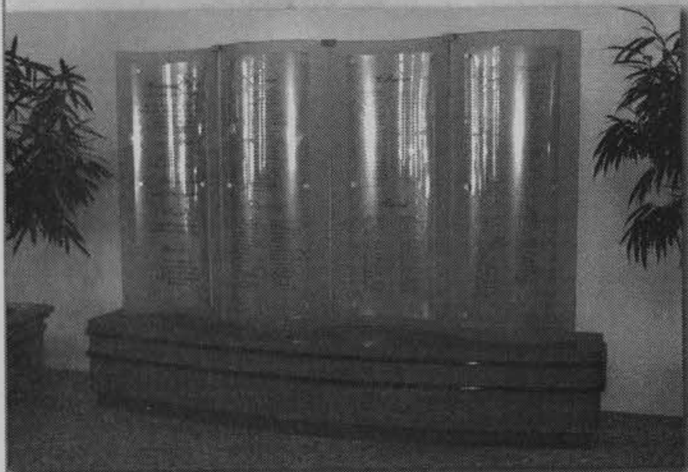
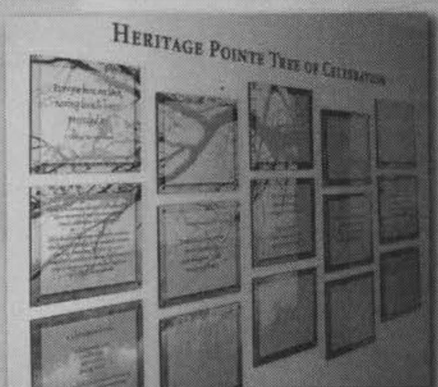
DONOR RECOGNITION SYSTEMS



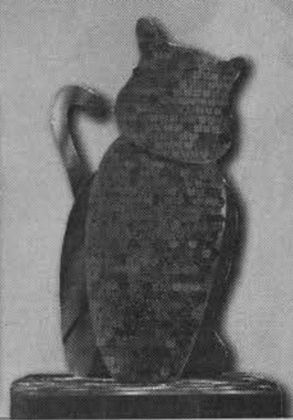
- **Healthcare Institutions**
- **Education Agencies**
- **Community Organizations**
- **Humane Societies**

Successful systems:

- Exist in harmony with the architecture and interior design of the institution
- Convey the characteristics and personality of the organization
- Consider the regional community and its history
- Ensure that historic recognition is preserved and integrated
- Provide a lasting positive impression
- Create a sense of pride for both the organization and the donor
- Encourage donors to give at their highest possible level
- Allow for future expansion
- Are easily updateable and affordable



Donor recognition wall for Opportunity Village, Las Vegas, NV; (1) Cumulative display and (2) Tree of Celebration for Heritage Pointe, Mission Viejo, CA; Donor recognition wall for Good Samaritan Children's Therapy Unit, Puyallup, WA; Cat display where donor names are inscribed on individual pet tags for San Diego Humane Society and SPCA, San Diego, CA



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UMIFA, Endowment, Donor Advised Funds and Gift Annuities: No Place but San Francisco

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INTRODUCTION

The following questions were assigned for discussion during this session (and, since they were assigned, we will discuss them!):

1. What is UMIFA?

2. How does UMIFA relate to endowments?

3. Can a distribution be made from an endowment if the market value of the endowment dips below the endowment's date-of-contribution value?

4. Under UMIFA, what is a "restricted" fund and what is an "unrestricted" fund, and what is the role of the development officer in determining a donor's intent in this regard?

5. Is a charity in violation of UMIFA if it takes money from annuities for restricted purposes to make payments on another annuity that has run dry?

6. Does a charity violate UMIFA if it utilizes its gift annuities and operates its gift annuity fund like a pooled income fund?

7. What are the issues surrounding donor advised funds established by charities other than community foundations?

Association of Governing Boards of Universities and Colleges

PUBLIC POLICY PAPER SERIES No. 03-1

The Uniform Management of Institutional Funds Act and Its Meaning for Colleges and Universities

By Terry L. Simmons

Executive Summary

For endowment managers in higher education, the ability to maximize growth while maintaining current distributions is a best-of-both-worlds scenario. Current law allows an institutional board to invest an endowment fund for long-term growth while preserving its ability to make current distributions in support of the programs that the donor intended to benefit at the time the endowment fund was created. The model law that permits this is called the Uniform Management of Institutional Funds Act ("UMIFA"), versions of which are in effect in 46 states and the District of Columbia.

UMIFA's central concept is that of "historic dollar value." This value is the sum of (1) the fair market value of an endowment fund at the time of creation, (2) the fair market value of any later gifts made to the endowment fund, and (3) any additions of endowment fund appreciation to historic dollar value that the donor directs the institutional board to make upon creation of the endowment fund.

UMIFA allows a board to spend the amount by which the fair market value of an endowment fund exceeds historic dollar value in a given year. Of course, the board is bound by a standard of conduct that usually dictates that it withhold some of an endowment fund's appreciation to offset inflationary effects and to smooth the volatility of distributions that may be caused by market fluctuation.

UMIFA's standard of conduct imposes a duty of ordinary business care and prudence that applies to investment and distribution decisions. It is similar to the broad standard that most states impose on corporate board members, though less stringent than the standard typically imposed on trustees, particularly with respect to investment decisions. In fact, UMIFA gives the board broad investment authority and broad authority to delegate investment and management responsibilities to paid professionals.

UMIFA allows donors final say in most instances. If a donor's gift instrument speaks to a particular issue, its terms will almost always trump the terms of UMIFA. UMIFA also allows donors to end their restrictions for any reason and a court to nullify restrictions that have become outdated or illegal.

Traditionally, most endowment funds have provided that the principal of each fund was to be maintained in perpetuity, with only the net income being utilized. Over the past several decades, this arrangement basically served the goals of donors and met the needs of universities and other endowed nonprofit organizations. Over time, however, the ability to use only state-law-defined income—traditionally meaning interest, dividends, and rent—began to warp the investment policies of institutions. Because they needed current funds for operations, institutions would weight endowments toward fixed-income securities for the higher current return necessary to meet current operating needs, at the cost of whatever future growth in the fund a heavier weighting toward equity investments would have produced.

While the terms of the gift instrument could have made the growth in the funds available to the institution, gift documents seldom were drafted that way. In time, it became clear to institutional leadership, legal scholars, and political leaders that the law should be changed in this area to accommodate total-return investing and to make endowment funds serve the institutional needs for both current income and long-term growth in the value of endowment funds. Out of those conversations and deliberations came the decision to draft a proposed uniform law to accomplish these goals.

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The Association of Governing Boards of Universities and Colleges is a national nonprofit education association whose primary membership consists of governing boards of public and independent colleges and universities, professional schools, and seminaries and theological schools. AGB membership also comprises the boards of foundations affiliated with public colleges and universities, boards of statewide higher education coordination and planning agencies, advisory boards of institutions or campuses within multi-campus or statewide systems, and governing boards of independent K-12 schools. AGB serves 35,000 individuals affiliated with 1,800 campuses in the United States and abroad.

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While this is an important subject during any economic climate, it is critically important in a deep bear market such as the one that began in 2000. For while the uniform law governing endowment funds provides the mechanism by which endowment funds can be used to fund current needs, that same mechanism greatly affects how much the value of endowment funds rises over time. This is the flashpoint that has many colleges and universities at a point of economic distress. Hence, understanding the uniform law becomes all the more important to board members of all colleges and universities and public institution-related foundations.

What UMIFA Does. The Uniform Management of Institutional Funds Act ("UMIFA") was promulgated by the National Conference of Commissioners on Uniform State Laws in 1972 for consideration and ultimate adoption by the states. (For access to its full text and related documents, see the box on page 8.) UMIFA was intended to provide greater certainty in the administration of permanent endowment funds and to permit investment for long-term growth while preserving the ability of colleges, universities, or affiliated foundations to make short-term distributions. (In this paper, the term "governing board" refers to boards that govern a college or university or an affiliated foundation, depending on which entity under UMIFA is the "institution" for purposes of implementing investment decisions on behalf of a given endowment fund.)

Until the mid-1960s, colleges and universities typically were content to invest permanent endowment funds for current income, limiting spending to a portion of dividends, interest, rents, and royalties earned. There was much uncertainty surrounding proper endowment fund administration because it was unclear the extent to which state-law and common-law trust principles applied to institutions holding endowment funds. Nonprofit corporation acts, general corporate statutes, and trust codes did not specifically address the investment and use of these funds. Although permanent endowment funds do not involve private trust concepts of an income beneficiary and remainder beneficiary, a state's trust code often was assumed to apply to permanent endowment funds.

During this period of uncertainty about the extent to which state-law and common-law rules governed endowment funds, many institutions maintained a policy of spending only income. Harvard University, however, took the position that appreciation was distributable. Harvard's large endowment-fund gains and commensurate distributions sparked substantial interest in total-return investing, but most institutions were counseled to maintain their policy of spending only income.

Then, in the late 1960s and early 1970s, the Ford Foundation, concerned that endowment funds were not generating the maximum return, commissioned a study that found that many institutions were

Some Key Definitions Under UMIFA

Under UMIFA, the following familiar terms are defined roughly as follows:

Institution: An incorporated or unincorporated organization organized and operated exclusively for educational, religious, charitable, or other eleemosynary purposes or a governmental organization to the extent that it holds funds exclusively for any of these purposes.

While the definition of "institution" is very broad under UMIFA, its application varies among the states. In some states, UMIFA applies only to educational institutions and/or institutions organized to support educational institutions. In Indiana, only institutions of higher education, nonreligious institutions with at least $10 million in endowment funds, and community trusts or community foundations are subject to UMIFA. In Texas, UMIFA does not apply to private foundations unless chartered for the benefit of a college or university.

In this paper, the term "institution" means the university, college, or affiliated foundation managing the endowment fund, rather than the broader definition given to that word in UMIFA, unless otherwise clearly indicated.

Institutional fund: A fund held by an institution for its exclusive use, benefit, or purposes. This does not mean that institutional funds are only those funds held by the beneficiary institution for its own use. Funds held by an institution for its own purposes are also institutional funds. Therefore, a fund held by an institution whose purposes are to support educational institutions is an institutional fund even though the fund is not literally held for the institution's benefit or use.

A fund held by a noninstitutional trustee, such as a trust company, for the benefit of an institution is not an institutional fund. Likewise, a fund held by an institution for the benefit of a noninstitutional beneficiary (for example, a unitrust or annuity trust) is not an institutional fund. Of course, payments from a unitrust or annuity trust during the trust term or upon termination may become or be directed into an institutional fund.

It also is possible for a fund to be so separate and distinct from the institution holding the fund that the fund may itself be an institution. The characterization of the institution holding the fund in such a case would largely be irrelevant. (This latter structure is largely unused and untested given that case law is undeveloped and that UMIFA's drafters provided little commentary on the issue.)

Endowment fund: An institutional fund not wholly expendable by the institution under the terms of the gift instrument. A gift instrument may create a partial endowment fund, restricting expenditure of a portion of the gift and freeing the remainder of the gift from these restrictions.

Significantly, a fund that restricts distributions to a particular class of beneficiaries but that does not restrict the level of distributions is not an endowment fund. Additionally, a fund can be an endowment fund if the gift instrument does not restrict spending in perpetuity but instead restricts spending for a specified time period, after which the spending restrictions are lifted.

It is fairly certain that an institution cannot create an endowment fund unilaterally under UMIFA. Only the terms of the donor's gift instrument can impose the spending restrictions necessary to create an endowment fund. This does not mean an institution is prohibited from setting aside funds in a manner similar to an endowment fund. The restrictions on these "quasi-endowment funds" could be lifted at any time either by resolution of the governing board or amendment of the institution's organizational documents.

Governing board: The body responsible for the oversight of an institution. In this paper, the term "governing board" applies to the governing board of a private or public college or university or affiliated foundation.

Gift instrument: The document pursuant to which property is transferred to or held by an institution or institutional fund. A gift instrument may take the form of a will, deed, grant, conveyance, agreement, memorandum, writing, or other governing document. Even statements in marketing and solicitation literature that lead to a contribution to an endowment fund may be treated as part of the gift instrument.

investing endowment funds too conservatively. The institutions were forgoing capital gains (which were assumed to become part of the permanent endowment) by favoring current income. UMIFA gave institutions the power to invest under a more liberal prudent-person rule, investing for total return and distributing both realized and unrealized gain. After UMIFA's enactment, colleges and universities and their affiliated foundations, for the most part, have been released from the traditional structures of income and principal allocation and now may enjoy the benefits of total-return investing.

UMIFA's primary goal is to free institutions from income-allocation concerns. Endowments often were "underproductive" of capital gains, resulting in too little growth in the endowment so as to enhance current distributions (sometimes described as overproductive of income), resulting in sufficient current distributions but allowing the value of the underlying endowment assets to be eroded by inflation over time. UMIFA seeks to enable institutions to invest without concern for these issues, focusing instead on the best investment strategy and distribution policy for the overall health, both long term and short term, of the institution.

Since it was drafted 30 years ago, UMIFA has been modified by state legislatures to fit their own particular political and legal environments. The requirements of a given state's UMIFA statute must be clearly understood by board members and their chief executives as they make important investment, spending, and asset-allocation decisions. Board members must establish common investment and distribution practices and procedures in the context of a clear understanding of the specific state framework of UMIFA.

UMIFA has been adopted by the District of Columbia and every state but three (Alaska, Arizona, and Pennsylvania). Florida enacted UMIFA but repealed it, effective January 7, 2003.

UMIFA's Basic Contents. The heart of UMIFA is found in its authorization of the appropriation of net realized and unrealized appreciation. UMIFA provides as follows:

> *The governing board may appropriate for expenditure for the uses and purposes for which an endowment fund is established so much of the net appreciation, realized and unrealized, in the fair value of the assets of an endowment fund over the historic dollar value of the fund as is prudent under the standard established by [UMIFA].*

"Historic dollar value" is the aggregate fair market value of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the fund at the time it is made, and (3) each accumulation made *pursuant to a direction in the applicable gift instrument* at the time the accumulation is added to the fund. The determination of historic dollar value made in good faith by the governing board is conclusive.

Accounting entries recording realization of gains or losses to the fund have no effect on historic dollar value. Additionally, an endowment fund's sale and/or purchase of assets do not increase or decrease historic dollar value.

An inflation reserve, market fluctuation reserve, or other reserve unilaterally created by the institution does not increase historic dollar value. Only an instruction in the gift instrument can do so. An institution can voluntarily maintain certain reserves, but unless the reserve requirement is set forth in the applicable gift instrument, such a reserve cannot increase historic dollar value. Most institutional boards do not use formal reserve accounts. Instead, they typically create informal inflation and market fluctuation reserves by establishing distribution levels between 4 percent and 7 percent of an endowment fund's average value over the previous 24 to 60 months, thereby distributing less than the endowment fund's anticipated long-term annual rate of return at a relatively steady distribution level.

UMIFA implements a critical rule of construction for gift instruments. If a gift instrument provides that only an institution may use the "income" of the fund, UMIFA directs that such a provision does not impose a restriction on the expenditure of the net appreciation of the fund. It is possible for a donor to restrict distributions to income (typically dividends, interest, rent, and royalties). To accomplish this, however, the applicable gift instrument must indicate the donor's intent that net appreciation not be expended. Some states also require the gift instrument to specifically identify and opt out of the UMIFA provisions authorizing distribution of appreciation. Notably, this rule of construction applies retroactively to *all* gift instruments, allowing institutions to adopt a total-return investing/spending policy for all of their endowment funds.

With the written consent of the donor, an institution may release, in whole or in part, a restriction imposed by the applicable gift instrument on the use or investment of an institutional fund. This provision does not allow the donor to amend the gift instrument or add restrictions. Additionally, in some states, only those restrictions that will not result in the fund losing its characterization as an endowment fund may be released. Oddly, while donors can *release* endowment-fund restrictions, they generally cannot *enforce* endowment-fund restrictions. Only a state's attorney general may do so. (See pages 9-12.)

Assume an institution or foundation received a $100,000 endowment gift in 1998. The applicable gift instrument restricts expenditures to income only. If the endowment fund's fair market value in 2000 were $110,000, the institution or foundation would be permitted to distribute up to $10,000 from the endowment fund.

Now assume that the donor made an additional gift of $50,000 in 2000. In 2002, the endowment fund's fair market value would be $160,000. In this situation, the institution or foundation also could distribute up to $10,000. The endowment fund's historic dollar value was increased by $50,000 by the additional gift made in 2000, causing the endowment fund's historic dollar value to increase to $150,000.

Next, consider a situation in which the applicable gift instrument for the aforementioned 1998 endowment gift directs that 50 percent of the gift must be held in perpetuity and that distributions are limited to income. Only the portion of a gift subject to restrictions is an endowment fund. The remainder of the gift is not governed by UMIFA. Additionally, the restriction to income placed on the restricted portion of the gift is insufficiently explicit to prohibit distributions of realized and unrealized gain. In this instance, the institution or foundation has received an endowment gift with a historic dollar value of $50,000 and an unrestricted gift of $50,000.

The board, whether a governing board of a private college or university, of a public college or university, or of a university-related foundation, is not subject to the limitations imposed on a trustee by a state's trust code. Instead, subject to limitations in the applicable gift instrument or in state laws other than those that govern trustee investments, the governing board may invest in real or personal property, mortgages, stocks, bonds, debentures, and other securities, interests in associations, partnerships, or individuals, and obligations of any government, regardless of whether a particular asset produces a current return.

Boards also may retain property contributed by a donor and may pool part or all of an endowment fund into a common fund maintained by the institution. (Aggregation is permissible for investment purposes only, not for purposes of aggregating historic dollar value to justify distributions from individual endowment funds that are below historic dollar value.) Finally, the board may invest the endowment-fund assets in any other pooled or common fund, including shares in regulated investment companies, mutual funds, common trust funds, investment partnerships, real estate investment trusts, or similar organizations where investments are commingled and investment decisions are made by parties other than the institutional board.

n most states, UMIFA is the controlling governing statute with regard to management of endowment funds, absent a contrary provision in the gift document.

Assume further that the donor makes the same $100,000 gift in 1998, restricting only $50,000 to endowment, but that the donor also restricts expenditures from the entire gift to be used for scholarships for art students. It might appear that restricting distributions to art students has caused the entire gift to become an endowment fund. But this is not the case. UMIFA does not apply simply because of a restriction limiting expenditures to scholarships for art students. UMIFA applies when limitations are placed on spending amounts, not recipients. Beneficiary restrictions are a matter of contract law and are not addressed by UMIFA, which is primarily focused on responsible investing and spending. Therefore, only $50,000 of the gift is an endowment fund governed by UMIFA.

It is clear that an endowment fund's assets can be used to pay for the cost of administering the endowment fund. Trust rules allocating costs to income and principal, however, do not apply in the endowment fund context. Instead, those costs absorbed by an endowment fund will simply reduce the fair market value of the endowment fund. This in turn will reduce the amount properly distributable from the endowment fund because the amount by which the endowment fund's fair market value exceeds its historic dollar value will be reduced.

Board Obligations. Section Four of UMIFA gives the institutional board broad investment authority.

Section Five of UMIFA specifies a series of groups to which the institutional board may delegate investment management. These include committees, officers, agents (including investment counsel), or employees of the institution or of the endowment fund.

For board members carrying out their fiduciary responsibilities, the standard of care to which each board member is subject depends on individual state law. However, the prevalent standard is the standard of ordinary business care and prudence. (Some states still employ a greater standard of care than ordinary business care.)

With regard to investments, the institutional board has an obligation to monitor investment activity and results continuously, to reevaluate investment policies periodically, (including asset allocation and related issues), and to establish the terms and manner in which endowment assets will be utilized for current obligations. In making the decision as to the current use of assets, the board has an obligation to take into consideration both the long-term and the short-term needs of the institution. Before the implementation of UMIFA, the latter process was rather straightforward. Generally, the gift instrument was the controlling document, and only income, as conventionally defined by state-law trust-accounting concepts, was available to support current obligations. The principal, on the other hand, ordinarily could not be invaded.

Nowadays, however, UMIFA as adopted in most states is the controlling governing statute with regard to management of endowment funds, absent a contrary provision in the gift document. (Some states have made the locally adopted UMIFA voluntary.) Consequently, institutional boards now may appropriate the increase in value over historic dollar value for each fund. But note that the ability to appropriate growth in the value of an endowment fund over historic dollar value and the decision whether to do so or not are not the same thing. One of the duties of an institutional board is to make a decision as to the portion of an endowment fund that will be used for current operations. It can determine the spending rate of the entire endowment and of individual endowment funds on a fund-to-fund basis. Again, ordinary business care and prudence governs this choice.

Because many institutions have thousands of endowment funds, the decision typically is made on a global basis. Specifically, an institution will implement a spending or distribution policy that will be employed across the board, subject to the floor of historical dollar value. In making such decisions, the board must carry out its fiduciary responsibilities according to the standard of care provided for in the relevant state statutes. Again, most typically, this is a standard of ordinary business care and prudence.

UMIFA establishes a flexible and pragmatic standard of conduct for institutional boards. In appropriating appreciation, making and retaining investments, and delegating investment management, board members must exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. They must consider both the long-term and short-term needs of the institution in carrying out its purposes, its present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. The standards imposed by UMIFA are more similar to corporate governance standards, applicable to for-profit and nonprofit corporations, than to fiduciary duties imposed on trustees of trusts.

UMIFA has been enacted only in the last decade in many states, and where a choice is present, many institutions have been slow to adopt it. UMIFA is easier to apply when the market is steadily appreciating in value. But when the value of an endowment fund suddenly falls below historic dollar value, the institution finds itself reconsidering its investment mix. Because UMIFA was implemented to permit and encourage total-return investing, it seems clear the drafters of the model law expected institutional boards to operate with a bias toward the long-term good of the institution. This is particularly important for institutions supporting educational endeavors, given that hikes in education costs continue to outpace inflation.

The institutional board should ensure that the value of an endowment fund is not eroded by inflation over time and may wish to smooth the effect of market volatility on distribution levels. Annually distributing a percentage of the value of an endowment fund that is less than its anticipated long-term annual growth rate operates to offset or eliminate erosion of the fund by inflation.

Additionally, determining endowment-fund value by using the average value of the endowment fund over a certain time period helps to smooth fluctuations in distribution levels caused by market volatility. A shorter averaging period will create greater fluctuations in distribution levels, while a longer averaging period will create smaller fluctuations in distribution levels. A shorter averaging period, however, will cause distributions to reflect a significant market downturn much sooner. This may decrease the likelihood that significant market decreases would place an institutional board in a situation in which its normal distribution policy would cause it to make distributions from endowment funds that are below historic dollar value. For an alert institutional board, however, this should not be a significant issue. Historic dollar value should always be tracked on a fund-by-fund basis, so the board should have sufficient information to enable it to avoid distributing from an endowment fund that is below historic dollar value.

Most institutional boards informally achieve both an inflation reserve and a smoothing of distribution levels by annually distributing between 4 percent and 7 percent of an endowment fund's average value over the preceding 24 to 60 months. This is merely the range of distribution levels and valuation time periods used by most institutional boards. It is not a statutory requirement. Typically, a board will choose a distribution level, perhaps 5 percent, and a valuation period, perhaps the previous 60 months, and use that distribution level and valuation period indefinitely. It is rare to find an institutional board routinely changing its distribution policies, though distribution policies should be reviewed at least once a year.

Related Accounting Standards. Within the last decade, the Financial Accounting Standards Board (FASB) promulgated three key UMIFA-related accounting standards that focus on reporting endowment-fund assets (see "For Further Information," page 8). These standards were promulgated to improve consistency among institutional financial statements that had become increasingly inconsistent due to varying interpretations of UMIFA.

While these three standards have succeeded in creating consistency among institutional financial statements, they have produced a number of undesirable and mostly unintended consequences. The three key standards are:

1. Statement of Financial Accounting Standard No. 117: Financial Statements of Not-for-Profit Organizations (FAS 117),
2. Statement of Financial Accounting Standard No. 124: Accounting for Certain Investments Held by Not-for-Profit Organizations (FAS 124), and
3. Statement of Financial Accounting Standard No. 136: Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others (FAS 136).

• **FAS 117** (on reporting appreciation) was enacted to enhance the relevance, understandability, and comparability of financial statements issued by nonprofit organizations. It requires an institution's financial statements to categorize donor contributions as permanently restricted, temporarily restricted, or unrestricted. Under FAS 117, only the historic dollar value of an endowment fund is considered permanently restricted. Endowment-fund appreciation is considered unrestricted if the applicable gift instrument does not establish a specific use and temporarily restricted if the applicable gift instrument does establish a specific use. For example, appreciation from an endowment fund that is simply for the benefit of a university would be unrestricted. Appreciation from an endowment fund that is for art scholarships would be characterized as temporarily restricted and would remain so until distributed to a worthy student.

FAS 117 also dictates that endowment-fund assets be characterized as temporarily restricted if the gift agreement provides that the distributions are not perpetually restricted but rather are only restricted for a term, such as five years. While such a fund would still be considered an endowment fund under UMIFA, it would not receive the same characterization under FAS 117 as would a permanently restricted endowment fund.

While the goal of FAS 117 is laudable, the standard has generated confusion with respect to unexpended endowment-fund appreciation. Few institutions spend all of an endowment fund's appreciation as it is earned. Most informally maintain an inflation reserve to preserve the purchasing power of endowment fund assets and a market-fluctuation reserve to smooth distribution volatility. These reserves are created informally because an institution's distribution policies are set low enough to allow some appreciation to remain in a fund and are based on a broad enough time-horizon to smooth the effects of changing market conditions.

Although UMIFA does not treat these informal reserves as adding to historic dollar value, boards often view these informal reserves as part of the historic dollar value of the endowment fund. Unless a particular reserve is dictated under the terms of the applicable gift instrument, however, it remains part of an endowment fund's realized or unrealized appreciation. Under FAS 117, if the applicable gift instrument does not establish a specific use for endowment-fund distributions, any informal reserve account is not considered part of historic dollar value and will be listed on the institution's financial statements as unrestricted assets.

Before FAS 117 was issued in 1995, institutions inconsistently reported endowment-fund appreciation. Most presumed that reserves were properly reported as permanently restricted assets and made little effort specifically to include reserve provisions in gift agreements. Instead, they preferred using gift agreements that adopted (or did not prohibit the use of) their distribution policies. One can imagine the impact that decades of inflation and market-fluctuation reserves might have on financial statements that one year reported those reserves as permanently restricted assets and the next reported them as unrestricted. While FAS 117 made financial statements more consistent among institutions, it also may have led to fictitious increases in unrestricted assets.

Recall that even if an endowment fund is above historic dollar value, standards of ordinary business care and prudence often dictate that an institutional board preserve a portion of endowment-fund appreciation primarily to offset the effects of inflation. Therefore, informal reserves that are not properly classified as additions to historic dollar value (but that also cannot be spent pursuant to both board policy and UMIFA's standard of care) arguably should not be reported as unrestricted net assets.

A final clarifying point: A financial accounting standard cannot change state law. If an endowment fund restricts the use of income from the fund to scholarships, then even if FAS 117 classifies the increase in the fund over historical dollar value as *temporarily* restricted, any use of that increase for a purpose other than scholarships would violate state law. In this sense, the modifier "temporarily" is meaningless.

• **FAS 124** (on reporting gains and losses), also promulgated in 1995, establishes standards for reporting gains and losses on endowment fund investments. FAS 124 requires that endowment-fund investments be recorded at fair market value each year. Unrealized gains are allocated to unrestricted net assets or temporarily restricted net assets, depending upon the endowment fund. Additionally, unless state law or the applicable gift instrument provides otherwise, endowment-fund losses first reduce temporarily restricted net assets and then unrestricted net assets. This reduction must be reflected even if the endowment fund has fallen below historic dollar value.

Therefore, when an endowment fund's value is below historic dollar value, an institution's unrestricted net assets *may* be artificially deflated. If an institution has a large endowment relative to its other assets, this readily could lead to a negative balance in unrestricted net assets. This negative balance does not prevent the institution from spending its "true" unrestricted net assets. FAS 124 specifically acknowledges that it does not create an obligation on the part of the institution to make whole an endowment fund that has fallen below historic dollar value. It is only an accounting standard implemented to improve consistency among the institution's financial statements.

But there are other practical side effects. A negative unrestricted net assets balance also can impede efforts to obtain credit. While a sophisticated lender should look past the financial statements that, though consistent with those of other institutions, are misleading, this is certainly an added burden on the institution.

Worse yet, donor relations are very likely to suffer. Few donors will understand or be willing to read any footnotes explaining the negative balance. In the current market environment, institutions may be tempted to modify their investment mix to heavily favor fixed-income securities to avoid the negative impact of FAS 124. This is certainly counter to the purpose of UMIFA, which was intended to free them from the need to invest slavishly for current income.

FAS 124 has resulted in the most significant and unfortunate consequences of the financial accounting standards discussed in this report. These consequences were predicted in the strenuous dissent of one of the FASB members, but the dissenter's valid concerns were summarily addressed and dismissed by the other FASB members. In paragraph 76 of FAS 124, FASB acknowledged that "[a] drawback of this method is that excess losses decrease unrestricted net assets even if the organization is not required by a donor-imposed restriction or law to use its unrestricted resources to restore immediately the value of the endowment fund to the level required by donor stipulations or law." However, the field test results indicated that, except in the early years of an endowment fund, incidences of excess losses will be few because "organizations generally accumulate net appreciation through policies that preserve and grow their endowment funds." The dissent could not have been more accurate. But it may have been understated. In the current environment, it is not only new funds that are affected.

As this report goes to press, the Dow Jones average has only begun to recover from a four-year low. Bear in mind that FAS 124 was drafted in the middle of the 1990s bull market. The optimism that characterized the markets in the 1990s very likely had an impact on the field testing that supported the conclusions made in FAS 124. In today's bleaker investment environment, FAS 124 simply does not work. Many endowment funds are now below historic dollar value, dragging down the book value of net unrestricted assets and damaging donor relations.

In responding to the current environment, an institutional board must do two things. First, it must decide, at least annually, whether it is going to continue its current spending policy or whether it is going to adapt it to changing circumstances. As an individual endowment account reaches or falls below historic dollar value, the institutional board must decide whether it is going to continue to use "natural law" income, whether it is going to forgo any income from the fund until it regains historic dollar value, or whether it is going to make a decision on each fund that has reached or fallen below historic dollar on a case-by-case basis.

Second, regardless of the decisions made in the first instance, the board must address donor expectations and concerns. Where donors to an endowment fund are still living, or where family members are living and continue to take an interest in the endowment fund created by their ancestors, expectations and concerns must be managed. This involves educating the individuals in the limitations of UMIFA and on the decisions the board has made with regard to its endowment funds. In many cases, one visit and one explanation will not suffice. It will take time for donors and family members to understand and appreciate, or at least come to accept, the board's decisions. In this educational process, institutional officials should not hesitate to point out the legal restrictions a given state's version of UMIFA places on the institution. They also may need to fur-

For Further Information

For the original draft of UMIFA as promulgated by the National Conference of Commissioners of Uniform State Laws, visit *www.law.upenn.edu/bll/ulc/fnact99/1970s/umifa72.htm*

For a summary of Financial Accounting Standard No. 117: Financial Statements of Not-for-Profit Organizations (FAS 117), visit *http://www.fasb.org/st/summary/stsum117.shtml*

For a summary of Financial Accounting Standard No. 124: Accounting for Certain Investments Held by Not-for-Profit Organizations (FAS 124), visit *http://www.fasb.org/st/summary/stsum124.shtml*

For a summary of Financial Accounting Standard No. 136: Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others (FAS 136), visit *http://www.fasb.org/st/summary/stsum136.shtml* ther emphasize the fiduciary duty the board owes to the organization with regard to its investment funds and the care and seriousness with which the institution's board makes decisions.

In the current environment, some donors or donor families unavoidably will be beyond convincing, and relations may be temporarily or permanently harmed. Where the donor is living and restrictions on the endowment can be released under the state's statute, this option can be presented to the donor. Where the donor is deceased, in which case the gift can be converted from endowment to unrestricted funds only through court action, the wisdom and likelihood of success for such an attempt, given UMIFA's prohibition on such an attempt, also can be discussed with the surviving family members and other individuals. In the final analysis, the board must make the decisions based on what is in the institution's best interest, and those charged with donor relations must do their best to help donors accommodate themselves to those decisions.

• **FAS 136** (on determining which institution reports endowment fund assets) may allow a bypass of FAS 124. That can be good news. Many endowment funds provide the institution with a variance power to determine which beneficiary among a class of beneficiaries will receive any endowment fund distributions made in a particular year. Occasionally, this variance power takes the form of a power to decide the relative percentages of any endowment-fund distributions made in a particular year that will be distributed to each beneficiary among a class of beneficiaries. FAS 136 provides that if an institution has a variance power over an endowment fund held for an educational institution, the institution must report the endowment fund assets on its own financial statements.

This, of course, will trigger the application of FAS 124. But if an institution does not have a variance power over an endowment fund held for an educational institution, FAS 124 does not apply. The institution simply offsets the value of the endowment fund by its obligation to distribute the assets of the endowment fund to the educational institution, causing no net change on the institution's financial statements. The educational institution for whose benefit the endowment fund was created will report an expectancy interest in the anticipated distributions from the endowment fund.

• **GAS 39** (on component units) is technically outside the scope of this report, but readers should be aware of it. In May 2002, the Governmental Accounting Standards Board adopted Statement No. 39, "Determining Whether Certain Organizations Are Component Units." It applies to financial statements for periods beginning after June 15, 2003. Basically, GAS 39 requires a public institution to report, as a component unit on its financial statements, the funds held by public or private supporting foundations that hold funds primarily or exclusively for the public institution.

If such a public institution's affiliated foundation primarily or exclusively holds endowment funds, however, GAS 39 may not require component reporting. This is because one of the three requirements set forth in GAS 39 states that the public institution must be entitled to a majority of the economic resources of the supporting foundation. Since endowment funds are not immediately distributable, a public institution is not entitled to a majority of the economic resources of an affiliated foundation primarily holding endowment funds. Therefore, the component-reporting requirement may not apply in such a situation. Recall, however, that FAS 136 would still require a public institution to report any expectancy interest in endowment funds held by an affiliated foundation and over which the foundation has no variance power.

Debate Over "Natural Income." Institutions increasingly are aware of the challenges of UMIFA compliance after the recent market downturns. Some, seeking to maintain certain programs and cultivate positive donor relations, continue to distribute traditional trust-law, or "natural," income from endowment funds that are below historic dollar value. Such "natural" income typically would consist of dividends, interest, rents, and royalties. New York Attorney General Elliot Spitzer recently issued an opinion letter concluding that such distributions are permissible in his state.

Unfortunately, Spitzer's opinion cited no authority. What this means to colleges and universities in New York is clear: Natural income from endowment funds that are below their historic dollar value may still be utilized for ongoing operations as prescribed in the governing gift document. As a general matter, this means that New York institutions have more flexibility than institutions in other states where the law or the attorney general's interpretations are unavailable or do not reach the same result. For institutions outside of New York, the opinion has no force and effect, though it could be cited as a non-binding authority in the context of an appropriate analysis of local law.

UMIFA does not explicitly address whether income may be distributed when an endowment fund is below historic dollar value. Two competing views of the issue can find support from a careful reading of UMIFA and its drafters' comments. The first view, apparently adopted by Attorney General Spitzer, focuses on language in Section 2 of UMIFA that allows a governing board to distribute funds "as permitted under other law." The second view, in my opinion somewhat more persuasive, relies heavily on the general intent of those who drafted UMIFA to create a self-contained system of laws governing the management of endowment funds. A third view, which has received inadequate attention, would take a more fact-intensive approach to applying the standard of prudence and care to each situation on a case-by-case basis. Each of these approaches to the issue will be addressed in turn.

Section 2 of UMIFA provides that the act "does not limit the authority of the governing board to expend funds as permitted under *other* law." (Emphasis added.) What exactly is "other law"? Those who have adopted Spitzer's approach apparently have concluded that "other law" refers to state-law concepts of private trust-accounting income. Under this theory, the trust-accounting income of an endowment fund has always been distributable, and nothing in the terms or history of UMIFA suggests that it was intended in any way to restrict what otherwise could be distributed. UMIFA was intended to liberalize distributions, and a restriction on distributions of natural, or trust-accounting, income would be contrary to the intent of UMIFA.

Perhaps UMIFA was meant not to supplement private trust law but to supplant it. The Prefatory Note to UMIFA implies that private trust law should not be applied to endowment funds. In fact, the Texas legislature, in adopting UMIFA, specifically provided that the Texas Trust Code does not apply to the administration of funds governed by UMIFA.

If UMIFA is a self-sufficient body of laws intended to govern all aspects of an endowment fund, then what can be distributed from an endowment fund is what UMIFA says can be distributed, and nothing else. In other words, UMIFA's failure to prohibit the distribution of natural income when the fund is below historic dollar value does not mean that such distribution is *permitted*. It is equally important to point out that UMIFA's failure to authorize the distribution of natural income where the fund is below historical value does not mean that such distribution is *prohibited*.

All that is clearly permitted is the distribution of "net appreciation" (regardless of whether the appreciation consists of trust-law income or principal) in accordance with Section 2 of UMIFA. A good argument can be made that UMIFA's failure to address even the concepts of principal and income and the allocation of receipts and expenses between principal and income means that trust-law income was not intended to be a relevant concept in administering endowment funds. What seemed to matter most to the drafters of UMIFA were the concepts of appreciation and historic dollar value. However, this interpretation is by no means clear.

This still leaves us, however, with the question of what the drafters meant by the phrase "other law." It may have been an acknowledgment of the possibility that other state laws might override UMIFA in certain circumstances. For example, endowment funds can actually be institutions in and of themselves. If such an endowment fund became contractually bound to provide a four-year scholarship to an individual, state contract law would seem to require that the fund make distributions to fulfill the terms of the scholarship, regardless of whether the fund had fallen below historic dollar value.

The Board's Standard of Care. The debate over the positions described above has had the unfortunate effect of shifting focus away from perhaps the most important consideration: the standard of care required of the institutional board. Whether that standard is supplied by UMIFA or by other state law, no one would dispute that in these investment and distribution matters, the institutional board at a minimum must exercise ordinary business care and prudence. Blanket authority to distribute trust-law income, whether the fund is above or below historic dollar value, smacks of having one's cake and eating it too. UMIFA

Guidelines for Board Committees

The bulk of this paper has dealt with the big-picture issues boards must consider, usually after an endowment gift has been finalized. But where there is an opportunity for governing board input into the policy-drafting process, the institution or its foundation should ensure that the following guidelines are considered by the board's investment, finance, or audit committee.

- If the donor wishes to create an endowment fund for a specific purpose, the institution may wish to consider advising the donor to include a provision preserving the donor's right to enforce restrictions or advise the donor to seek counsel before signing a gift instrument that does not give the donor the right to enforce restrictions.

- Does the donor want an inflation reserve, market-fluctuation reserve, or any other kind of reserve? If so, these reserves will be added to the historic dollar value of the endowment fund.

- The gift instrument should contain a merger clause that limits the restrictions to those specifically contained in the gift instrument, preventing additional terms from being implied in fund-raising or promotional literature.

- If the foundation will hold a variance power over the endowment fund, the foundation may wish to ask the donor to authorize the foundation to opt out of FAS 124 and/or FAS 117.

- The foundation might consider requesting authorization in the gift instrument to distribute income while the endowment fund is below historic dollar value.

- Donor relations might be helped by a provision that restrictions will be strictly obeyed and that, contrary to the practice of some institutional boards, restricted assets will not be distributed for general budget purposes.

was intended to free institutional boards from having to invest in fixed-income assets so that funds could be invested prudently with an eye toward long-term appreciation.

Yet giving a blanket authorization to distribute trust-law income in a down market is causing institutional boards to weight their investments more heavily toward income-producing assets—precisely the opposite effect intended under UMIFA. Moreover, FAS 124 has provided additional incentive to allocate investments to income-producing assets, because endowment-fund losses will be reflected as a decrease, even to a negative balance, in net unrestricted assets.

Does the institutional board violate the standard of care by further depleting a poorly performing fund and by investing the fund in a manner that will result in little long-term growth? By doing so, hasn't the board simply delayed, perhaps indefinitely, the time when the fund will be restored to historic dollar value? Is it prudent for the institutional board, in search of trust-law income, to convert equity securities (perhaps at the bottom of the market) to fixed-income securities (perhaps at the top of the market)? In some cases, it might be prudent to distribute trust-law income, even when the fund is below historic dollar value. In other cases it would be imprudent to do so. In any event, compliance with the standard of care in making distributions must be determined on a case-by-case basis.

One thing is clear, however. Although donor relations appear to be a factor in institutional boards' willingness to make distributions from funds that are below historic dollar value, donor relations will have no impact, in the eyes of an attorney general, on the institutional board's compliance with the standard of care. The attorney general will judge an institutional board's conduct based solely on how it has managed and distributed its funds—not on how it has managed to attract and retain donors.

A Unitized Investment Pool. Many institutions and foundations aggregate their endowment funds into a unitized investment pool. This is absolutely permissible. In doing so, however, each endowment fund's historic dollar value must be tracked, and distributions must not be made from an endowment fund that is below historic dollar value (subject to the preceding discussion of natural-income concepts).

Some institutions have suggested using a mutual-fund approach, allowing gains from older endowment funds to offset losses in newer endowment funds. To the extent a pool of endowment funds is not restricted to a specific use, this approach would work. But making distributions from a restricted endowment fund to offset losses in an unrestricted endowment fund would violate UMIFA. This conclusion is echoed in the New York attorney general's opinion letter. In his discussion of unitizations, Spitzer specifically noted that UMIFA uses the singular to refer to the terms "endowment fund," "gift instrument," "historic dollar value," and "institutional fund." As such, Spitzer concludes, UMIFA was drafted to govern distributions on a fund-by-fund basis, not on the basis of a pool of all endowment funds held by an institution.

Enforcement of Donor Restrictions. Donors may release restrictions found in the applicable gift instrument. But in many states, a donor may release restrictions only to the extent that such release does not cause the fund to cease to be an endowment fund. The ability to release restrictions is useful, of course, only if the endowment gift was made during the donor's lifetime and the donor is still living. Because most donors make endowment gifts upon death, the ability to request that a donor release certain restrictions is not a particularly powerful tool. Additionally, the most troubling issues facing endowment funds tend to be caused by accounting rules that can be circumvented if the gift agreement so provides but cannot be circumvented simply by the release of a restriction.

The doctrine of "*cy pres*" is alive and well under UMIFA. If an endowment contains restrictions that cause its purposes to be illegal or practically impossible, a court may reform the fund to cure the problem. The best example of such a situation is one in which a charity ceases to exist or ceases to perform the function for which the endowment gift was given. In such a case, a court either may modify the endowment fund to provide that it will benefit another institution with purposes most closely related to the purposes of the endowment fund, or it may divert the fund to another similar purpose at the original institution if the institution continues to exist.

In most states, the attorney general may sue to enforce all aspects of a charitable trust and may intervene in a pending proceeding to enforce a charitable trust. In most jurisdictions, the term "charitable trust" includes institutions and endowment funds.

Significantly, limited UMIFA case law indicates that donors lack standing to sue to enforce the terms of an endowment fund. In 1997, the Connecticut Supreme Court held that UMIFA's drafters did not intend to establish standing for a donor to bring an action to enforce the terms of a completed charitable gift.

The case involved an endowment gift from a grant-making foundation to a university. The gift instrument limited distributions to those to or for the benefit of students pursuing a medical-related degree. When the university closed its nursing school, it began making endowment distributions to its general operating fund. The foundation sued to enforce the restrictions. At the trial court level, the case was dismissed on a motion for summary judgment because UMIFA does not explicitly provide donor standing. The appellate court reversed this decision, finding that a statute that gives a donor the power to release restrictions must, by logical extension, have been intended to provide the donor with the power to enforce those restrictions.

The Connecticut Supreme Court reversed the appellate court, finding that donors do not have standing to enforce restrictions. The court reasoned that, because of the absence of a clear intention to overturn common-law rules of donor standing, which generally do not give standing to donors to enforce the terms of a charitable trust, UMIFA did not change the common-law rule, and the grant-making foundation therefore did not have standing.

Proposed Revisions to UMIFA. Early in 2002, a drafting committee of the National Conference of Commissioners on Uniform State Laws was established to consider amendments to UMIFA to take into account two uniform acts promulgated after the original UMIFA model law-the Uniform Prudent Investor Act (UPIA) and the Uniform Trust Code (UTC).

The committee's charge: Bring the investment provisions of UMIFA into conformance with those of UPIA, update the release-of-restrictions provisions of UMIFA to more closely conform with the UTC and other trust concepts such as the doctrine of *cy pres*, provide for some form of enforcement mechanism for donors, provide clarity to certain terms, and explore possible means of reconciling UMIFA with the various financial accounting standards discussed in this paper.

An initial draft of the proposed new UMIFA was made public in January 2003. Perhaps the committee's most regrettable comment is that it "has concluded to date that UMIFA cannot address the accounting treatment of restricted funds." Obviously, it is hoped that the committee rethinks this position.

In seeking to clarify when UMIFA applies to trusts and when it applies to nonprofit corporations, the committee noted that UMIFA historically has largely applied only to nonprofit corporations unless a trust was itself an institution. Under the proposed amendments, UMIFA still would apply to a trust only if it was an institution, but then only with regard to the spending rule announced in the new draft of UMIFA.

The proposed new spending rule seeks to focus institutions on a total-return investment policy. The concept of historic dollar value is abolished, and institutional boards are allowed to enact spending policies without regard to distinctions between income and principal in administering endowment funds. The actions of institutional boards are subject to a new standard of prudence, and actions will be considered prudent *only* 'if the amount expended is consistent with the goal of preserving the purchasing power of the endowment fund." The net effect of this provision would be to increase the theoretical ability to appropriate endowment for current needs, but in practice to reduce the ability of an institutional board to appropriate funds for current use. The field seems tilted in favor of long-term growth.

The revised standard of conduct, derived from UPIA, would require an institutional board to act as "a prudent investor would, by considering the purposes, distribution requirements, and other circumstances of the fund. In satisfying the standard, the governing board shall exercise reasonable care, skill, and caution." This seems to constitute a heightened standard from that currently in force under most existing UMIFA statutes and is more akin to standards governing the conduct of trustees of private trusts.

The amendments also broaden the definition of gift instrument to include electronic records of the fund, which in turn broadens the subject matter an institutional board must consider in making spending and investment decisions. Additionally, the new provisions require a board to review donated property and determine whether to retain the property, taking into account both the property's investment potential and the circumstances of the institution. In sum, boards must make decisions on disposition and retention of gifted assets on an asset-by-asset basis.

The new prudence standard would apply to an institutional board in making its decisions regarding delegation of investment management and would allow it to assess costs against an institutional fund only to the degree that those costs are "appropriate and reasonable" in relation to the institution's assets and purposes.

In reaction to controversial cases such as *Herzog* discussed earlier, the new proposed model law allows limited donor standing. Specifically, only a donor (not a donor's family or personal representative) would be allowed to enforce restrictions that the donor placed on an institutional fund for the lesser period of the donor's life or 30 years measured from the date of the gift. This limited power of enforcement would not prevent a donor from retaining additional enforcement powers in the gift document. The drafting is vague at this point. It seems clear that the drafters had in mind a 30-year period beginning from the date of a gift creating the fund. However, the provision does not expressly prohibit enforcement of supplemental gifts to the fund for a period of 30 years from the date of any supplemental gift. A clear cut-off date of 30 years from the establishment of the fund would prevent a rash of misunderstandings and conflicts between donors and institutions. Hopefully, the drafting committee will clarify this provision as the process continues.

Finally, the revised draft of UMIFA addresses the release of restrictions on use or investment of institutional funds. Currently, the standard by which a court may release a restriction is roughly in line with the traditional threshold for application of the *cy pres* doctrine. Under the proposed new standard, restrictions could be released upon a court finding that the restrictions are "unlawful, impracticable, impossible to achieve, or wasteful," which would replace the current phrase "obsolete, inappropriate, or impracticable."

Surprisingly, the new provisions would give an institutional board the power, where the donor is unavailable, to unilaterally release restrictions on institutional funds below a certain value, tentatively set at $100,000. This includes the power to release a provision restricting the fund to endowment, thus theoretically allowing the fund to be exhausted.

The committee has established a timetable, which concludes its work in August 2004. The new model act will then be presented to the National Conference of Commissioners on Uniform State Laws for formal approval and promulgation to the various states. Each state legislature will then determine whether and to what extent to adopt the new model law to replace existing law. Obviously, this process will take years, not months. Until then, current law will continue in full force and effect.

Those interested in expressing their opinions on these or other issues to the drafting committee should submit their comments, preferably before April 1, 2003, to the reporter for the UMIFA Drafting Committee, Prof. Susan N. Gary, University of Oregon School of Law, 1515 Agate St., Eugene, Ore. 97403.

Summary. UMIFA is an imperfect statute, as exhibited by the fact that the National Conference of Commissioners on Uniform State Laws is in the process of rewriting UMIFA. However, the flexibility it gives institutional boards is better than any existing alternative in most instances. Furthermore, in 46 states and the District of Columbia, it is the law. Consequently, it must be taken seriously by institutional boards, and endowment funds must be administered consistent with the terms of UMIFA as locally adopted. Of course, what proper administration requires or permits is a matter for endless debate, and it is with that observation that this phase of the debate concludes.

Summaries of State UMIFA Laws

Below are capsule summaries of the UMIFA legislation that has been adopted in 46 states plus the District of Columbia. The summaries and state statute numbers are intended to acquaint the reader with representative examples of UMIFA variations between states. They do not include UMIFA variations that, while in theory might be material, are in practice unlikely to be material and likely reflect nothing more than the grammatical and stylistic preferences of a respective state legislature. The reader is cautioned to retain qualified counsel to address the sometimes subtle nuances found in each state's version of UMIFA and consult the UMIFA model text.

Also excluded, for simplicity's sake, are the provisions adopted by numerous states that allow the foundation board to create reserve accounts for income and even to add portions of income to an endowment's principal.

• Alabama (Alabama Code §§ 16-61A-1 to 16-61A-8)

Alabama previously limited the scope of its version of UMIFA to educational institutions or institutions organized to support an educational institution. As of September 1, 2002, all institutions (as the term "institution" is defined in UMIFA) are subject to Alabama's version of UMIFA.

• Alaska

Has not adopted UMIFA.

• Arizona

Has not adopted UMIFA.

• Arkansas (Arkansas Code Annotated §§ 28-69-601 to 28-69-611)

No material variation from UMIFA.

• California (California Probate Code §§ 18500 to 18509)

While California made several changes to UMIFA upon adoption, the changes do not appear to be significant enough to have a material effect on most endowment funds. The changes may have substantial effect on certain less typical arrangements.

California's version of UMIFA does not include UMIFA's language providing that a foundation board's determination of historic dollar value made in good faith is conclusive. Instead, a foundation board's determination of historic dollar value is potentially more readily subject to challenge in California than in other states. In practice, this change is probably not material.

California's version of UMIFA slightly modifies gift instrument construction. UMIFA provides that a gift instrument that limits distributions to income without specifically electing out of UMIFA does not prevent distributions of realized and unrealized appreciation over historic dollar value. In California, a restriction to income found in a gift instrument executed *before* California adopted UMIFA *need not* be read to imply, by itself, a restriction on appreciation expenditures. A restriction to income found in a gift instrument executed *after* California adopted UMIFA *may not* be read to imply, by itself, a restriction on appreciation expenditures. Essentially, the presumption that a gift instrument was not intended to restrict appreciation expenditures is stronger for gift instruments executed after California adopted UMIFA than for those executed before California adopted UMIFA.

UMIFA explicitly releases a foundation board from investment restrictions imposed on fiduciaries. Instead, a standard of ordinary business care and prudence, similar to that imposed on corporate board members, is imposed on the foundation board. California has removed the language that explicitly releases a foundation board from investment restrictions imposed on fiduciaries.

California imposes an investment and distributions standard of care on a governing board that appears to be a stricter than the investment and distributions standard of care that UMIFA imposes on a foundation board. Instead of a standard of ordinary business care and prudence, California requires the care, skill, prudence, and diligence that would be used by a prudent person familiar with a foundation's purposes and operations. The foundation board also is specifically notified of its duty to balance the safety of funds against the risk to which funds are subject.

• Colorado (Colorado Revised Statutes Annotated §§ 15-1-1101 to 15-1-1109)

No material variation from UMIFA.

• Connecticut (Connecticut General Statutes Annotated §§ 45a-526 to 45a-534)

Connecticut explicitly adds charitable community trusts, as defined in Conn. Gen. Stat. Ann. § 45(a)-516, to the definition of "institution." Accordingly, funds administered by charitable community trusts are considered institutional funds and, if subject to appropriate expenditure restrictions, endowment funds governed by UMIFA.

Connecticut has adopted the standard of care set forth by the Uniform Prudent Investor Act ("UPIA"), Conn. Gen. Stat. Ann. §§ 45a-541 to 45a-5411, instead of the standard of care set forth by UMIFA.

A foundation board may accumulate so much of an endowment fund's net income as is prudent under the UPIA. This accumulation may either be held in an income reserve to be spent at an appropriate later date or may be added to principal. Connecticut's version of UMIFA also explicitly enables the donor to prevent the foundation board from accumulating income in a reserve or adding it to principal, presumably requiring the foundation board to always spend income.

• Delaware (Delaware Code Annotated, Title 12, §§ 4701 to 4708)

No material variation from UMIFA.

• District of Columbia (District of Columbia Code Annotated §§ 32-401 to 32-409)

No material variation from UMIFA.

• Florida

Florida enacted UMIFA but has recently repealed it, effective January 7, 2003.

• Georgia (Georgia Code Annotated §§ 44-15-1 to 44-15-9)

A foundation board may accumulate so much of an endowment fund's net income as is prudent under UMIFA's prudence standard. This accumulation may either be held in an income reserve to be spent at an appropriate later date or may be added to principal. Georgia's version of UMIFA also explicitly enables the donor to prevent the foundation board from accumulating income in a reserve or adding it to principal, presumably requiring the foundation board to always spend income.

• Hawaii (Hawaii Revised Statutes §§ 517D-1 to 517D-11)

Community foundations, as defined in § 170(c) of the Internal Revenue Code and that meet the single entity requirements of Treasury Regulation § 1.170A-9(e)(10-14), are considered institutions in Hawaii and are subject to Hawaii's version of UMIFA.

• Idaho

Excludes public endowment funds of the State of Idaho.

• Illinois (760 Illinois Compiled Statutes 50/1 to 50/11)

No material variation from UMIFA.

• Indiana (Indiana Code Annotated §§ 30-2-12-1 to 30-2-12-13)

"Institutions" that are subject to Indiana's version of UMIFA are (i) a community foundation or trust, (ii) an approved institution of higher education and its related foundations, or (iii) an organization that (a) is exempt under Section 501(c)(3) of the Internal Revenue Code, (b) has an endowment fund with a fair market value of at least $10 million, and (c) is not a religious organization. The definition of "institutional fund" includes a fund that is held exclusively for the benefit of a community foundation, even if the fund is held by a noninstitutional trustee.

A foundation board must specifically opt into UMIFA in its charter or bylaws; otherwise, UMIFA does not apply.

• Iowa (Iowa Code Annotated §§ 540A.1 to 540A.9)

No material variation from UMIFA.

• Kansas (Kansas Statutes Annotated §§ 58-3601 to 28-3610)

No material variation from UMIFA.

• Kentucky (Kentucky Revised Statutes Annotated §§ 273.510 to 273.590)

No material variation from UMIFA.

• Louisiana (Louisiana Revised Statutes Annotated §§ 9:2337.1 to 9:2337.8)

No material variation from UMIFA.

• Maine (Maine Revised Statutes Annotated, Title 13, §§ 4100 to 4110)

UMIFA limits the definition of "institutional fund" to those funds administered by institutions. Maine's version of UMIFA expands the scope of the definition of "institutional fund" to include funds administered by noninstitutional trustees for the benefit of an institution. Additionally, Maine has explicitly excluded funds held or created by a town or other municipality from UMIFA's provisions.

Unless explicitly stated otherwise by the donor, appreciation on investments of endowment funds, until appropriated by proper foundation board action, must be considered a donor restricted asset. This rule may affect asset characterization under FAS 117 and FAS 124.

• Maryland (Maryland Estates and Trusts Code §§ 15-401 to 15-409)

No material variation from UMIFA.

• Massachusetts (Massachusetts General Laws Annotated, Chapter 180A, §§ 1 to 11)

Massachusetts has implemented a rebuttable presumption that appropriation of net appreciation for expenditure in any year that is greater than 7 percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years, is imprudence on the part of the foundation board.

A foundation board may accumulate so much of an endowment fund's net income as is prudent under UMIFA's prudence standard. This accumulation may either be held in an income reserve to be spent at an appropriate later date or may be added to principal. Massachusetts's version of UMIFA also explicitly enables the donor to prevent the foundation board from accumulating income in a reserve or adding it to principal, presumably requiring the foundation board to always spend income.

• Michigan (Michigan Compiled Laws §§ 451.1201 to 451.1210)

No material variation from UMIFA.

• Minnesota (Minnesota Statutes Annotated §§ 309.62 to 309.71)

No material variation from UMIFA.

• Mississippi (Mississippi Code Annotated §§ 79-11-601 to 79-11-617)

No material variation from UMIFA.

• Missouri (Missouri Annotated Statutes §§ 402.010 to 402.060)

UMIFA does not apply to any public common school or public institution of higher education or a foundation chartered for the benefit of a public commons school or public institution of higher education. UMIFA also does not apply to any governmental entity or a foundation chartered for the benefit of a governmental entity. Finally, UMIFA does not apply to a private foundation.

The definition of "gift instrument" also includes an oral statement or condition expressed by the donor at the time of the gift if the oral statement or condition directs the institution to hold the gift as an endowment fund and is reduced to writing by the institution at the time of the gift.

A foundation board may accumulate so much of an endowment fund's net income as is prudent under UMIFA's prudence standard. This accumulation may either be held in an income reserve to be spent at an appropriate later date or may be added to principal.

• Montana (Montana Code Annotated §§ 72-30-101 to 72-30-207)

No material variation from UMIFA.

• Nebraska (Nebraska Revised Statutes §§ 58-601 to 58-609)

No material variation from UMIFA.

• Nevada (Nevada Revised Statutes §§ 164.500 to 164.630)

No material variation from UMIFA.

• New Hampshire (New Hampshire Revised Statutes Annotated §§ 292-B:1 to 292-B:9)

New Hampshire's version of UMIFA applies to funds held by a noninstitutional trustee for the benefit of an institution. New Hampshire specifically excludes funds held or created by a town or other municipality.

The foundation board may accumulate income in accordance with UMIFA's prudence standard and may hold the accumulated income in a reserve account or may add it to principal. A donor may also provide that income is not to be accumulated, presumably requiring the foundation board to always spend income.

New Hampshire explicitly sanctions pooling endowment funds with the funds of pooled income funds, charitable remainder unitrusts, and charitable remainder annuity trusts for investment purposes. Charitable lead trusts are not mentioned.

New Hampshire has implemented a rebuttable presumption that appropriation of net appreciation for expenditure in any year that is greater than 7 percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years, is imprudence on the part of the foundation board.

• New Jersey (New Jersey Statutes Annotated §§ 15:18-15 to 15:18-24)

No material variation from UMIFA.

• New Mexico (New Mexico Statutes Annotated §§ 46-9-1 to 46-9-12)

UMIFA does not apply to an institution that holds assets exceeding a value of $10 million and that is organized and operated for private educational purposes.

UMIFA does apply to certain funds established pursuant to Article 8, Section 10 and Article 12, Section 2 of the New Mexico Constitution.

The foundation board may accumulate income in accordance with UMIFA's prudence standard and may hold the accumulated income in a reserve account or may add it to principal. A donor may also provide that income is not to be accumulated, presumably requiring the foundation board to always spend income.

New Mexico has implemented a rebuttable presumption that appropriation of net appreciation for expenditure in any year that is greater than 7 percent of the fair market value of an endowment fund, calculated on the basis of market values determined at least quarterly and averaged over a period of three or more years, is imprudence on the part of the foundation board.

New Mexico imposes a heightened standard for delegation of investment and management functions. Among other things, the foundation board is obligated to review periodically any agent's compliance with the terms of the delegation. Agents are also subject to a heightened standard of conduct.

New Mexico explicitly imposes a duty on a foundation board to consider the effects of inflation and deflation when making investment and management (including expenditure) decisions. The standard of conduct is far more detailed than that found in UMIFA, providing a laundry list of considerations to be made in order to invest pursuant to what the statute calls "portfolio theory."

• New York (New York Not-for-Profit Corporations Law §§ 102, 512, 514, and 522)

New York imposes explicit restrictions on agents to whom investment or management powers are granted. It appears that most of the other changes are immaterial, though New York has recorded the different parts of its version of UMIFA in varying code sections, eliminating UMIFA's continuity and making accurate comparisons very difficult. New York is notorious for its complex not-for-profit-corporations laws that often differ from those found in other states. Qualified counsel should be consulted.

• North Carolina (North Carolina General Statutes §§ 36B-1 to 36B-10)

North Carolina includes funds held by a noninstitutional trustee for a publicly supported community foundation or community trust within the scope of UMIFA.

• North Dakota (North Dakota Cent. Code §§ 15-67-01 to 15-67-09)

A perpetual trust established by Article IX, Section 1 of the North Dakota Constitution is outside the scope of UMIFA.

• Ohio (Ohio Revised Code Annotated §§ 1715.51 to 1715.59)

No material variation from UMIFA.

• Oklahoma (Oklahoma Statutes Annotated, Title 60 §§ 300.01 to 300.10)

In Oklahoma, UMIFA does not apply to a public common school or a foundation chartered to benefit a public common school or a component of a public common school. Oklahoma's version of UMIFA also does not apply to any governmental entity or a foundation chartered to benefit a governmental entity or a component of a governmental entity, except for a foundation chartered for the benefit of a public institution of higher education. Finally, Oklahoma's version of UMIFA does not apply to private foundations.

Oklahoma's legislature removed the UMIFA provisions stating that representations made in institutional solicitations may become part of a gift instrument. The definition of "gift instrument" does include an oral statement or condition expressed by the donor at the time of the gift if the oral statement or condition directs the institution to hold the gift as an endowment fund and the oral statement or condition is reduced to writing by the institution at the time of the gift.

The foundation board may accumulate income in accordance with UMIFA's prudence standard and may hold the accumulated income in a reserve account or may add it to principal. A donor may also provide that income is not to be accumulated, presumably requiring the foundation board to always spend income.

• Oregon (Oregon Revised Statutes §§ 128.310 to 128.355)

No material variation from UMIFA.

• Pennsylvania

Has not adopted UMIFA.

• Rhode Island (Rhode Island General Laws §§ 18-12-1 to 18-12-9)

The base historic dollar value of an endowment fund in existence on May 4, 1972, is the fair market value of the endowment fund on May 4, 1972, or, at the foundation board's discretion, the fair market value of the endowment fund at the close of the institution's fiscal year for one of the last two fiscal years preceding May 4, 1972. Of course, historic dollar value may still be increased by additional gifts or additions to the endowment fund.

UMIFA provides that a foundation board's good faith determination of historic dollar value is conclusive. Rhode Island provides that a foundation board must periodically adjust an endowment fund's historic dollar value to reflect changes in the purchasing power of the endowment fund's historic dollar value. Because this particular provision refers to the purchasing power of the endowment fund's historic dollar value and not to the purchasing power of the endowment fund itself, the natural conclusion is that historic dollar value should be adjusted up or down at the rate of inflation or deflation.

• South Carolina (South Carolina Code Annotated §§ 34-6-10 to 34-6-80)

No material variation from UMIFA.

• South Dakota

No material variation from UMIFA.

• Tennessee (Tennessee Code Annotated §§ 35-10-101 to 15-10-109)

No material variation from UMIFA.

• Texas (Texas Property Code Annotated §§ 163.001 to 163.009)

Texas's version of UMIFA does not apply to private foundations. The statute explicitly states that the Texas Trust Code does not apply to endowment funds governed by Texas's version of UMIFA.

• Utah (Utah Code Annotated §§ 13-29-1 to 13-29-8)

Utah specifically provides that, for financial statement purposes, realized and unrealized appreciation are not to be treated as income and revenue from operations or as unrestricted assets (this latter provision probably circumvents the problems created by FAS 124).

• Vermont (Vermont Statutes Annotated, Title 14 §§ 3401 to 3407)

No material variation from UMIFA.

• Virginia (Virginia Code Annotated §§ 55-268.1 to 55-268.10)

The foundation board may aggregate endowment funds for purposes of determining historic dollar value and endowment fund appreciation (and therefore permissible distributions). This is not permissible in any other state.

• Washington (Washington Revised Code Annotated §§ 24.44.010 to 24.44.900)

No material variation from UMIFA.

• West Virginia

West Virginia's version of UMIFA applies to an endowment fund held by a noninstitutional trustee if the endowment fund is held for a community foundation or a community trust.

• Wisconsin (Wisconsin Statutes Annotated § 112.10)

No material variation from UMIFA.

• Wyoming (Wyoming Statutes Annotated §§ 17-7-201 to 17-7-205) No material variation from UMIFA.

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SHORT BIO:

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Terry Simmons is a senior partner in the Dallas-based 425-lawyer international law firm of Thompson & Knight L.L.P. where he has a national practice in charitable gift planning, exempt organizations law and estate planning. He represents individual clients, exempt organizations and for-profit entities in complex domestic and international transactions involving nonprofit/for-profit interaction, including related securities and banking issues, intermediate sanctions issues, unrelated business taxable income issues, and unrelated debt-financed income issues. He represents clients in the formation and representation of private foundations as well as supporting organizations and all other public charities in all aspects of exempt organization operations. He also represents clients in the formation and representation of other non-charity exempt organizations including social welfare organizations, trade organizations and political entities. He serves on numerous nonprofit boards and is a prolific writer in his practice areas, and is co-editor and co-publisher of *Charitable Gift Planning News*, a national newsletter covering tax and legal developments in the planned giving and exempt organizations fields. His fellow editors include Jerry McCoy, Erik Dryburgh, Katelyn Quynn, and Reynolds Cafferata. He speaks widely on the subject of philanthropy, including over 250 major presentations throughout North America over the course of his 27 years in practice. He holds a BBA degree from Baylor University, a J.D. degree from Baylor University School of Law, and an LL.M (Master of Laws) degree in Taxation from Southern Methodist University School of Law. He is listed in *The Best Lawyers in America*, 2006 (Trusts and Estates) and is listed among the *Texas Super Lawyers* by *Texas Monthly Magazine,* and was recently named one of *Worth Magazine's* "Top 100 Hundred Attorneys" in the magazine's December 2005 issue. He is licensed in Texas and Colorado, and with the opening of Thompson & Knight's New York office, anticipates admission to the New York Bar by mid-2006.

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State Regulation of Charitable Gift Annuities

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1. **Wayne is the new planned giving officer at a small college located in Indiana. He felt fortunate that Indiana does not require any registration to issue gift annuities, having heard tales of the difficulties of doing so in other states. Although a majority of the college's alumni remain in the state, he was surprised to discover in a recent review of the records that it has issued gift annuities in 15 states. This discovery followed shortly after learning that an organization needs to be compliant with the regulation in the states in which its donors reside, not just in its state of domicile.**

   Wayne is feeling a little less fortunate, and wonders what kind of mess the college is in.

   The first thing to do is determine the regulation of the states in which the college has issued. While it likely is non-compliant in some states, it is also likely that some of the states in which it has issued are like Indiana, and do not require any registration. State regulation concerning the issuance of charitable gift annuities can be broken down as follows:

   > ***Application for a certificate of authority (permit)***. These states may require a segregated reserve fund, impose investment restrictions on the reserves, and/or require a detailed annual reporting. There are eleven states in this group: Alabama, Arkansas, California, Florida, Hawaii, Maryland, New Jersey, New York, North Dakota, Washington, and Wisconsin.
   >
   > ***Notification to the state***. A charity must meet certain criteria, and in a few instances may need to complete some sort of annual filing. There are sixteen states in this group: Alaska, Connecticut, Georgia, Idaho, Iowa, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Tennessee, and Texas.
   >
   > ***Statutory criteria to meet, but no notification***. There are eighteen states in this group: Arizona, Colorado, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Nebraska, Oregon, Pennsylvania, South Carolina, South Dakota, Utah, Virginia, and Vermont.
   >
   > ***State law does not specifically address gift annuities***. Delaware, District of Columbia, Ohio, Rhode Island, West Virginia, and Wyoming.

   If annuities have been issued in any of the states that require either an application or notification, the next step would be to become compliant by completing the necessary filing. In the application states this means, among other things, providing information about its existing annuities and the reserves, and in some instances offering an explanation as to why annuities were issued without first obtaining a permit. However, although many states have the ability to impose fines for non-compliance, Washington state remains as the only one routinely fining charities. (Oregon had been as well, but effective January 1, 2006 it no longer requires an issuing charity to obtain a permit.)

What if it turns out that in one of the application states the college issued only one annuity, 10 years ago? Must it still register?

To be compliant it would need to register, as the statutes in the application states do not allow for issuance of some minimum number without the need to register. (While New York's statute provides that a charity need not obtain a permit until its required reserves exceed $500,000, that figure relates to annuities issued in all states – not just in New York – and the Department of Insurance has decided that a charity must file and be advised by the Department that it is under the threshold.) However, some organizations make the decision not to register and not to issue any additional annuities in the particular state. In doing so, the organization continues to be out of compliance, but it has in essence imposed its own "cease and desist" order on itself by not engaging in any further activity in the state.

2. **Alicia works for a national organization that began its gift annuity program about eight years ago. Prior to issuing any gift annuities the organization registered in all the states that required it. The organization has been issuing a steady number of annuities each year, but they are more heavily concentrated in certain states, and in fact there are 20 states in which the organization has not issued.**

   Alicia wonders whether it is possible to terminate any of the registrations, and whether there is any advantage in doing so.

   The key issue is whether the on-going requirements of ***maintaining registration*** (assuming there was a need to register) in the 20 states are unduly burdensome to the organization. For most ***notification states***, the only filing requirement is the initial one, and so while the organization may not have issued any annuities in the state, maintaining its compliance is not costing the organization anything in the way of time or money. There are two notification states that require re-notification each year (Montana and New Hampshire), and two others that require submission of the organization's audited financials each year (Georgia and Oklahoma). While completing these annual submissions each year is not particularly onerous, if the organization wanted to be free of the task it could advise the applicable insurance department that it will no longer be issuing in the state. (Simply ceasing the annual submission makes the organization non-compliant – it is not the preferred manner for withdrawing its previously stated intention to issue annuities in the state.)

   Of the ***application states***, four require fairly minimal annual reporting. Alabama and North Dakota require annual submission of audited financial statements, while Florida and Hawaii require submission of a form attesting to a charity's ongoing compliance with the statutory requirements. Alabama also requires renewal of the "restricted agent" status for those who sign annuity agreements on behalf of the organization and those who market annuities in the state, with a $50 per agent fee.

Other application states (Arkansas, California, Maryland, New Jersey, New York, Washington, and Wisconsin) have a detailed annual reporting requirement, involving either use of a specific state form or a statement from a CPA (either in the audited financial statements or separate). Washington and Wisconsin further require that an actuary verify the reserve requirement as part of the annual filing. Some states require reporting on a calendar-year basis, while others require it on a fiscal-year basis (see question seven for a listing of due dates). Late filings pose a risk of a fine – Washington has imposed fines of $1,000, increased to $2,500 if the filing is more than 30 days late).

Completion of the state-specific forms, in particular, can be time-consuming to complete, particularly if there is a high level of activity within the reserve fund (both in new and terminated annuities and in buying and selling of reserve assets). Outsourcing the completion of such forms can save staff time, but results in some cost to the organization, as does obtaining the actuary verification. And three states have annual fees: $117 in California, plus $60 for each new California annuity; $25 in Washington, plus $5 for each new Washington annuity; and $50 in Wisconsin.

Another potential cost involves the conducting of an ***audit*** of the organization's gift annuity program by a state insurance department. While most of the application states have authority to conduct audits, only New York and, more recently, Washington have routinely done so. The expense of such audits is borne by the charity. In lieu of a formal audit, the California Department of Insurance conducts a more thorough review of the required annual statements, and charities are billed for time spent on the review.

After considering the various factors set out above, Alicia's organization decides that it wishes to ***turn back its certificate of authority*** in one or more states. It will need to notify the applicable insurance department, in writing, that

- it wishes to return its certificate,
- it has no outstanding annuity liabilities in the state,
- it understands that it cannot issue annuities in the state without a certificate, and
- it understands that if in the future it wishes to issue gift annuities in the state it would have to reapply and obtain a new certificate prior to doing so.

It must also return the certificate or, if the certificate is lost, submit a notarized statement as to the reason the certificate is not being returned. The certificate cannot be returned so long as the organization has any existing annuities in the state.

3. State University is launching a gift annuity program, and wants to "do things right" from the beginning by completing the necessary registrations. SU has alumni located in all states, though in some states there are fewer than 100. The Development Office researched the cost for registration in all states, and was able to secure funds in this year's budget for completing them.

Should SU register in *all* states?

When determining in what states to issue gift annuities, it is important to understand ***what is involved in both the initial registration and in maintaining compliance***. The first step is to determine whether there are any states in which registration is not possible because of the inability to meet all the requirements. It would be expected that SU could generally meet the years in existence and unrestricted net assets requirements of all states, the highest of which are 10 years and $1,000,000, respectively. However, Maryland and Hawaii both have an in-state component to the years of activity requirement. In Maryland a charity must provide proof of activity related to the applicable registration category, which would be either educational or religious. While SU need not be offering classes in Maryland, it would need to provide proof of such things as recruitment activity, presentations at alumni gatherings, and/or collaborative projects conducted with, or programs sponsored with, Maryland institutions.

In Hawaii the in-state activity requirement may be met with either program services or fundraising. However, a charity must also have a specific net-worth in the state – $200,000 in cash, cash equivalents, or publicly traded securities held in Hawaii. The Development Office may find it difficult to persuade the Finance Office to permanently establish a bank or brokerage account in Hawaii.

Another aspect to be considered is whether there are any ***restrictions on the reserve assets***, beyond a need to segregate them. California, Florida, and Wisconsin all place specific limitations on how the reserve fund may be invested. In general, the investment limitations imposed are:

- government bonds allowed without limit;
- corporate bonds generally limited only as to percent in any one company, except in California where they are included in limit on publicly-traded securities;
- stock limited to 20 percent (Wisconsin) or 50 percent (California, Florida) of required reserve assets;
- mutual funds have various limitations including unlimited except a 10-percent limit on any one fund (Florida), an overall limit of 20 percent (Wisconsin), or as part of the stock limitation (California);
- real estate is not permitted as a reserve investment in California, and is limited to 5 percent by Florida and 20 percent by Wisconsin.

As California requires a "California only" reserve fund, the restrictions apply only to reserves held for California residents. The other two allow a charity the option of creating a state-specific fund; otherwise the investment restrictions apply to reserves held for all annuities. If SU does not have significant numbers of potential gift annuity donors in these states, it could be placing restrictions on its gift annuity program unnecessarily by registering where it is unlikely that it will ever issue an annuity.

Finally, in deciding where to issue gift annuities SU should also consider what is involved in maintaining the registrations, as noted in question 2.

Deciding whether to stay out of certain states involves somewhat of a cost/benefit analysis, but there is also a timing consideration. Supposing that SU does opt to stay out of certain states, but all of a sudden finds itself with an inquiry from a donor in one of them, asking about doing a gift annuity. If the donor resides in a notification state, SU can complete the notification concurrent with entering into the first annuity in the state. However, if the donor resides in an application state, SU needs to complete the registration prior to issuing the annuity – which could take, on average, six to twelve weeks, and significantly longer in New York and California. While in many instances the donor might be willing to wait until the registration is complete, that may not be the case if the donor makes contact in December and wants to make the gift that year.

4. **PANDA has been issuing gift annuities for 20 years, and is registered in all applicable states. Recently a decision has been made to issue all future annuities for the benefit of the organization through the PANDA Foundation. Clare has been assigned the task of switching the registrations, which she has been told needs to be completed within the next three months.**

Can Clare complete her task?

The first bad news for Clare is that registrations cannot be switched. While a change of name does not necessitate a new application, ***a certificate of authority cannot be transferred from one separate legal entity to another***. In each state in which it wishes to issue, the Foundation would need to complete registration on its own behalf. In doing so, the Foundation would need to meet all state requirements, including any relating to years of operation. This could be problematic if the Foundation has been recently created, as some states require the registering entity itself to have been in existence for the requisite period of time, and do not allow it to "piggyback" on the years of existence of a parent organization. In particular, the Foundation would need to have been in operation for three years to register in Washington, five years to register in Florida, and ten years to register in California, New York, and Wisconsin.

Once PANDA Foundation has registered appropriately in the states, it can then issue all future annuities for the organization. But as long as it has outstanding annuities, PANDA must also maintain its registrations, and continue to meet the annual reporting requirements. If the desire is for all annuity obligations to be moved to the Foundation, the existing annuities would have to be transferred from PANDA to PANDA Foundation, by "reinsuring" the PANDA annuities into the PANDA Foundation. This would entail board resolutions by both organizations regarding the transfer, as well as an agreement spelling out the details of the transfer. It would also involve obtaining the approval of the insurance departments in several states, which would require information relating to the reserve dollars to be transferred, as well as documenting consent of all donors to the transfer.

5. Marc is the planned giving officer at an organization that has issued gift annuities in most states but has registered in none. Marc has long felt uncomfortable about being non-compliant, but prior legal counsel had advised that registration was not necessary. This view was reinforced in the mind of Marc's direct supervisor, because she was aware that other "peer" organizations had likewise not registered. In addition, the finance office has always reacted negatively to the possibility of registration. Concerned about recent negative attention and scrutiny focused on charitable organizations in general, Marc wants to revisit the issue.

How does he make the case for registration?

There seems to be general consensus that ***a charity should register in the state(s) in which it is doing business***. The disagreement seems to come over what "doing business" means. From the states' perspective, it includes sending marketing materials into the state, visiting with prospective donors in the state, or any kind of communication with prospective donors within the state regarding a contribution for a gift annuity. A physical presence in a state – an office or a permanent staff person – is not necessary for a determination that a charity is doing business in the state and subject to its regulation.

Before raising the issue, Marc may wish to contact some of the "peer" organizations. He may find that many of them are among the increasing number in recent years that have registered or are in the process of registering. The decision to register may have been prompted by a change in legal counsel's opinion on the need to register, or concern that state enforcement may toughen. (To date most states have not imposed fines on charities for non-compliance, whether the charity comes forward or comes to the state's attention in another manner.) However, the most commonly stated reason for registering has to do with donor relations, and the sense that non-compliance is not the public face the organization wants to put forward.

With respect to the finance office, it may help Marc to try and understand what may be prompting the negative reaction. Often there are ***concerns about what registration will mean*** – segregation of assets, possible change in investments, annual reporting – and a perception that these are unduly burdensome. While it might not be possible to persuade the finance people that segregation of the reserve assets is a good thing, they might be persuaded that it isn't as bad as they had anticipated. As noted in question 3, there remain only three states with specific investment restrictions – California, Florida, and Wisconsin. The others either allow investment in accordance with the prudent investor standard (Arkansas, Maryland, New Hampshire, New Jersey, New York, and Washington), or are silent on investment of reserves. Segregation of the assets may also give the charity a better awareness of how its gift annuity program is doing, and allow for adjustment of the investments as needed. Although charities will reach different conclusions about what constitutes an appropriate asset allocation at any given time, it is probably prudent to invest gift annuity reserves more conservatively than the charity's endowment. Typically, charities distribute a percentage of the value of endowment assets based on a rolling average value, so distributions decrease when market values decline. However, the payments from gift annuities remain at the same level when the market value of reserves declines. Thus, gift annuity reserves invested heavily in equities are affected more severely in a prolonged bear market. Having a significant portion of reserves in fixed income investments with laddered maturities may protect the charity during those periods. A charity with a large gift annuity pool that has accumulated significant surplus reserves could afford to invest more aggressively than a charity with a small pool with marginally adequate reserves.

6. **The Jillie Foundation, located in Maryland, has supporters throughout the mid-Atlantic region. It is registered in Maryland, which is the only state in its area that requires any filing specific to issuance of gift annuities. Recently one of its gift annuity donors sent a change of address card, noting that she would now be permanently living in Florida, where she had been spending winters for the last several years.**

   Must the Foundation now register in Florida?

   The applicable ***state regulation is determined at the time the gift annuity is entered into***, based on the donor's primary residence, and is not altered by subsequent changes in address. Thus the Foundation does not become subject to Florida's regulation simply because one of its prior donors moves to that state. However, it may be faced with the issue of registration in Florida in the event this donor wishes to contribute for another annuity. As set out in question 3, the Foundation would need to determine whether it might have additional donors in Florida or, if not, whether it would be worth registering in the state to accommodate one donor. If it elects not to issue gift annuities in Florida, it should be prepared to discuss with the donor alternate ways of making a gift to the Foundation.

   Though not an issue in this example, the ***state of domicile at the time of the gift also anchors the reserves*** for the particular gift. Let's assume the Foundation is registered in California, and thus maintaining a California-only reserve fund in addition to an "all other states" reserve fund. If instead of moving to Florida the donor moved to California, the reserve assets would remain in the "all other states" fund, and should not be reported on the California annual statement form. Many organizations use administrative software programs to process annuity payments, prepare 1099-Rs, and calculate state required reserves. When state-specific funds are involved (in addition to California, a charity could have Florida and Wisconsin funds), it is important to specify the reserve state within the software. Otherwise the reserve calculation may be incorrect, if it uses a home address that may have changed over the years.

7. **Valerie was recently hired as the planned giving officer at ALPA. As she began reviewing various files, she came across references to registrations for issuance of gift annuities. When she asked a colleague about them, she was advised not to worry as the organization was already registered in all applicable states. Not being familiar with the registration process, Valerie made a note to herself to learn more**

about it when she had a chance. Unfortunately, before she could do so, she received notices from a few states regarding annual reports to be filed. With the help of the business office the reports were completed, but Valerie is worried what else might pop up.

What should she be aware of?

Most of the states with a more detailed annual reporting requirement will either send the form or send a notice that the form is available for download from the insurance department's website. However, regardless of whether the state sends a reminder, it is ultimately the charity's responsibility to timely submit any annual filing. Failure to do so, absent an extension from the state, may result in suspension or revocation of the certificate of authority and/or imposition of a fine. For several years now Washington has routinely assessed fines of $1,000 for a late or incomplete filing, with the fine increasing to $2,500 if the filing is more than 30 days late.

Whether the ***annual filing*** is a detailed annual statement, a re-notification, or submission of audited financial statements, a charity should have a tickler system that alerts the applicable person to both what is needed and to the due date. A listing of all states together, as below, might work well for a charity with a December 31 fiscal year end. Charities with a different fiscal year end may want two groups of states – those with a fiscal year reporting period and those with a calendar year reporting period.

State	Type of Filing	Due Date
Alabama	Audited financial/agent renew	FY + 60 days
Arkansas	CPA statement	FY + 60 days
California	Annual statement	FY + 120 days
Florida	Sworn statement	FY + 60 days
Georgia	Audited financial	When available
Hawaii	Annual statement	March 15
Maryland	CPA statement	FY + 90 days
Montana	Re-notification	March 1
New Hampshire	Re-notification	CY/FY + 4 mn/15 days
New Jersey	Annual statement	CY/FY + 120 days
New York	Annual statement	March 1
North Dakota	Audited financial	When available
Oklahoma	Audited financial	When avail. + 90 days
Washington	Annual statement	March 1
Wisconsin	Annual statement	March 1

Besides the annual reporting, Valerie should also be aware that when registering in certain states ALPA was required to put on file the ***forms of annuity agreements*** it would be using. Those states are: Alabama, Arkansas, California, Maryland, New Jersey, New York, North Dakota, Washington, and Wisconsin. If a charity wishes to make changes in its agreement forms it must submit new forms for review and approval, prior to beginning to use them. A charity that may have switched from its own forms of agreement to those contained in its gift calculation software should note that such forms are not, and cannot, be approved by the states on a global basis – they must be approved for use on a charity-by-charity basis. In addition to substantive changes, new agreement forms should be submitted if the charity's name or address changes. A copy of the agreement forms on file with each state, or at least a listing of the forms and an indication of when they were submitted, should be maintained either in a single registration file or in separate files for each state. Besides the agreements, these files should contain the certificate of authority or confirmation of the state's receipt of the notification, along with any other correspondence from the state relating to the registration.

Finally, Valerie should also know that as part of the registration in California and Wisconsin ALPA designated an ***in-state agent*** for service of process. If an individual with a connection to the organization was designated (as opposed to a commercial service), a periodic check should be made to determine if the designated person is still willing to serve in that capacity, is still at the same address, and, most importantly, is still alive. Any change in agent or in the agent's address should be communicated to the state.

NEW DEVELOPMENTS

Arkansas

As modified by SB 557 (effective August 13, 2005), Arkansas now allows charities to invest gift annuity reserves in accordance with the Arkansas prudent investor standard. This change did not substitute the prudent investor standard for specific investment restrictions, but rather added it as an option.

Impact: The change provides more flexibility to charities in the investment of their reserve funds, and eliminates the need to hold an "Arkansas only" fund (which was allowed, and which some charity's did as a way of minimizing the reach of Arkansas' investment restrictions). Generally, an organization that elects to follow the prudent investor standard will need to submit the following additional information, not previously required, as part of its annual report:

- a description of its investment philosophy and an indication of how the investments "are designed to meet future charitable gift annuity obligations,"
- information about members of its investment committee, including a description of each committee member's investment experience, and
- a certification from its Board attesting that the investments conform to the organization's investment philosophy and to the prudent investor rule.

The exception: a charity domiciled in a state that regulates investment of gift annuity reserves, including a state that uses a prudent investor standard, may invest in accordance with the laws of its state of domicile, without the need to provide additional investment information with the annual report.

California

Enactment of SB 271 (approved by the Governor on September 22, 2005) made a number of changes to California's gift annuity law. Taking effect immediately was the provision that allows charities to invest California reserve assets in mutual funds, without the need to obtain advance approval from the Department of Insurance. This followed a previous change (which took effect January 1, 2005) that increased the percentage of reserve assets that may be invested in equities to 50 percent.

Also included in SB 271 were changes in the gift annuity agreement provisions, which took effect January 1, 2006. The reasonable commensurate value paragraph is no longer required, but the agreement must be signed by the donor (this had been a Department of Insurance requirement for some years, but is now specifically noted in the statute) and include the following disclosure language, which must be in at least 12-point boldface type and on the same page as, and in proximity to, the donor's signature:

> **Annuities are subject to regulation by the State of California. Payments under this agreement, however, are not protected or otherwise guaranteed by any government agency or the California Life and Health Insurance Guarantee Association.**

Beginning January 1, charities no longer need to file a copy of each new California agreement. However, information about new annuities, and payment of a per-agreement fee (currently $60), will still be required on a quarterly basis, using the spreadsheet form introduced at the beginning of 2005.

Impact: The combination of the higher equity percentage and the ability to use mutual funds without advance approval is a welcome change, and should provide charities with the opportunity to invest their California reserves in a manner similar to the prudent investor standard allowed by many other states. With the removal of the reasonable commensurate value from the agreement, the Department of Insurance has also revised the form used for quarterly reporting of new annuities, so that the RCV is no longer required there either. And while normally a charity is required to submit new agreement forms for approval whenever it makes changes, in this instance it is not necessary to do so, as long as the only revisions are those required by the legislative change.

Hawaii

There have been two successive years of changes to Hawaii's gift annuity statute. In 2004 the law was amended with both the addition of new requirements and modification of existing ones. Legislation in 2005 (SB 693, effective June 17, 2005) clarified certain questions that remained after the 2004 revision. As the law now stands, a charity must have conducted business continuously in the state for at least ten years, but the activity may be related either to program services or fundraising. The net worth requirement in the state has been reduced from $5 million, to $200,000 in cash, cash equivalents, or publicly traded securities. A segregated reserve fund is still required, and must hold an amount calculated in accordance with an actuarial methodology determined by the Commissioner of Insurance, plus a surplus that is the greater of $100,000 or ten percent of the calculated reserve. (Note that reserve assets cannot be used to meet the net worth requirement.) Investment of reserves is to be in accordance with a prudent investor standard. Specific disclosure language must now be prominently included on the first page of the annuity agreement. A March 15 due date has been set for the annual statement, which is to be filed with the Department of the Attorney General.

Impact: The perspective of what the biggest change in the law is depends on where an organization is situated. For charities domiciled outside of Hawaii, the most significant change is the reduction in the net worth requirement. However, many mainland-based charities are still opting not to issue gift annuities in Hawaii, after weighing the need to establish a bank or brokerage account in the State against the few prospective donors in the state. For charities domiciled in Hawaii, the most significant change is the manner for calculating the reserves and the need to hold an additional surplus. As allowed under the revised law, the Commissioner of Insurance announced in October that the Annuity 2000 tables and a discount rate of 5.0 percent are to be used in the reserve calculation.

Oregon

A significant change in the state's gift annuity law took effect January 1, 2006, pursuant to legislation enacted in May 2005 (Chapter 31, 2005 Laws - HB 2092). Under the prior law a charity was required to obtain a certificate of authority from the state insurance division, and to file annually a detailed report on its annuity reserve fund. The new law removes both filing requirements. However, in order for the issuance of a gift annuity to not be subject to insurance regulation, a charity must have been in continuous operation for at least five years (reduced from 10 years, and no longer with a link to in-state activity), have a minimum of $300,000 in net assets (reflected in an annual audited financial statement), and maintain an adequate segregated reserve fund.

Impact: This is a significant de-regulation of gift annuities. For charities that were already registered, there may be a need to complete one final annual report for the fiscal year concluding in 2005, even if the report would be due in 2006. A charity should file the report, unless it has confirmed with the Insurance Division that it is not necessary to do so. Charities that were unable to register in Oregon due to an inability to meet the in-state activity requirement, should now be able to issue in the state.

State Filing Required (Department of Insurance)

I. STATE LAW REQUIRES SEGREGATED RESERVE, ANNUAL REPORTING, AND/OR DETAILED APPLICATION (11):

State	Years in operation	Board resolution	Disclosure in agreement	Reserve required	Investment limitations	Other registrations	Notes:
AL	---	---	yes	yes	---	---	Regulated by Securities Dept. rather than Insurance
AR	5	yes	---	yes[1]	yes[2]	yes[3]	[1] May elect to segregate AR annuitants; [2] Prudent investor standard allowed; [3] registration with Secretary of State
CA	10	yes	---	yes[4]	yes[4]	---	[4] CA annuitants only
FL	5	---	yes	yes[5]	yes[5]	yes[6]	[5] May elect to segregate FL annuitants; [6] registration w/ Dept. of State
HI	10 in HI	---	---	yes	---[7]	---	[7] Prudent investor standard; law requires $200,000 of assets in Hawaii
MD	10 in MD	---	yes	yes	---[8]	---	[8] Prudent investor standard
ND	---	---	---	yes	---	---	
NJ	10	yes	---	yes	---[9]	yes[10]	[9] Prudent investor standard; [10] registration w/ Div. of Revenue and Dept. of Law and Public Safety
NY	10	yes	---	yes	---[11]	---	[11] Prudent investor standard
WA	3	---	---	yes	---[12]	yes[13]	[12] Prudent investor standard; [13] registration w/ Secretary of State; organization must have $500,000 unrestricted net assets
WI	10	---	---[14]	yes[15]	yes[15]	---	[14] Newly registering charities may be asked to include disclosure; [15] may elect to segregate WI annuitants

II. STATE LAW PROVIDES FOR EXEMPTION - NOTIFICATION REQUIRED (16):

State	Years in operation	Board resolution	Disclosure in agreement	Reserve required	Available assets	Other registrations	Notes:
AK	3	---	yes	---	$300k	---	
CT	3	---	yes	---	$300k	---	
GA	3	---	yes	---	$300k	---	Annual submission of audited financial statement
ID	3	---	yes	---	$100k	---	
IA	3	---	yes	---	$300k	---	
MN	3	---	---	---	$300k	---	Regulated by Securities Dept. rather than Insurance
MS	3	---	yes	---	$300k	---	
MO	3	---	yes	---	$100k	---	
MT	3[16]	---	yes	yes[16]	$100k[16, 17]	---	[16] Waived if reinsured; [17] $100,000 in unrestricted assets or $300,000 net worth; annual renotification
NV	3	---	yes	---	$300k	---	
NH	3	---	yes	yes	$300k	yes[18]	[18] General registration with the Dept. of Justice; annual renotification; annuity rates must not exceed ACGA suggested rates
NM	3	---	yes	---	$300k[19]	---	[19] Either in unrestricted assets or reserve fund
NC	3	---	yes	---	$100k	---	
OK	3	---	yes	---	$100k	---	Annual submission of audited financial statement
TN	3	---	yes	---	$1 mil.[20]	---	[20] $300,000 for TN colleges or universities
TX	3	---	yes	---	$100k	---	

No State Filing Required (Department of Insurance)

III. STATE LAW PROVIDES FOR EXEMPTION - NO NOTIFICATION REQUIRED (18):

State	Years in operation	Board resolution	Disclosure in agreement	Reserve required	Available assets	Other registrations	Notes:
AZ	3	---	---[21]	---	$300k	---	[21] Detailed disclosure statement to donor prior to gift
CO	3	---	yes	---	---	---	
IL	20[22]	---	---	---	$2 mil.[22]	---	[22] Waived if annuities reinsured
IN	---	---	---	---	---	---	
KS	---	---	---	---	---	---	May voluntarily seek a "no objection" letter from Securities Dept.
KY	---	---	---	---	---	yes[23]	[23] Certain charities must file copy of Form 990 with Attorney General
LA	---	---	---	---	---	---	
ME	5	---	---	---	---	yes[24]	[24] Registration w/ Secretary of State (qualified as foreign corporation)
MA	---	---	---	---	---	---	
MI	---	---	---	---	---	---	
NE	3	---	---	---	---	---	
OR	5	---	yes[25]	yes	$300k	No	[25] Language modified when law changed 1/1/06
PA	3	---	yes	yes	$100k	yes[26]	[26] Certain charities must register w/ Dept. of State (general solicitation law)
SC	5	---	---	---	---	---	
SD	10	---	yes	---	$500k	yes[27]	[27] Registration w/ Secretary of State (qualified as foreign corporation)
UT	---	---	---	---	---	---	
VA	3	---	yes	---	$100k	---	
VT	3	---	yes	---	$300k	---	

IV. STATE LAW DOES NOT SPECIFICALLY ADDRESS GIFT ANNUITIES (6):

DE[28] DC OH[29] RI WV WY

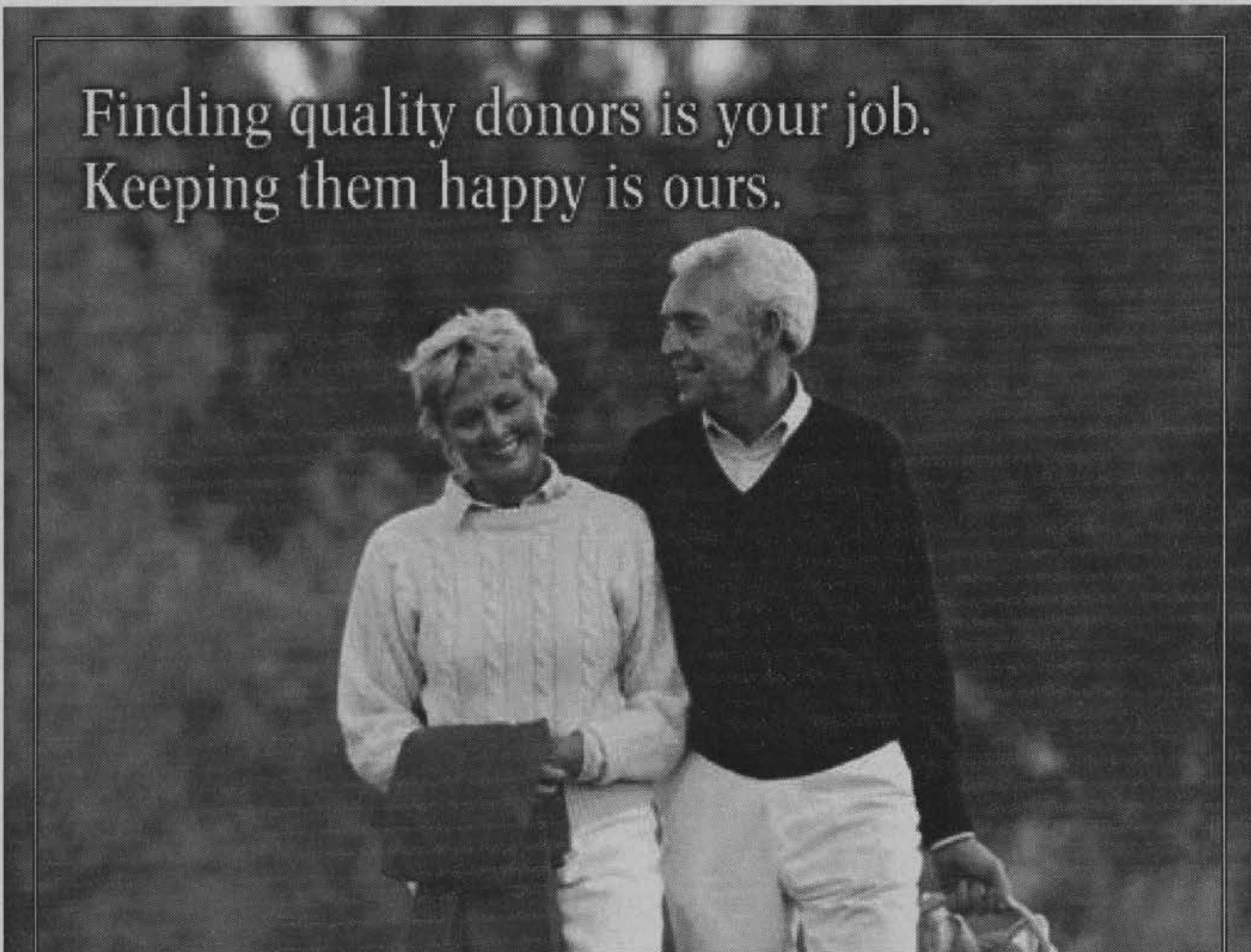
[28] Insurance Code definition of annuity excludes those issued by tax-exempt organizations.
[29] Ohio previously provided for an exemption from securities law under now rescinded administrative rule. Court of Appeals case decided in 2002 held gift annuities not subject to insurance regulation (Ohio Supreme Court declined to hear appeal).

Appendix 2

State Regulations of Charitable Gift Annuities

State	Contact State for Permit / Notice	Disclosure Wording	Effective Date of Law	State Contacts	
				Contact Name	Phone Number
AL	Notice	Yes	4/9/1997	Lisa Tolar	334-242-2379
AK	Notice	Yes	10/1/2001	Janice Stamper	907-269-7905
AR	Permit	No		Joe Musgrove	501-371-2766
AZ		Yes	4/9/1997		
CA	Permit	Yes		Carol Harmon	415-538-4420
CO	No	Yes	1995		
CT	Notice	Yes	1/1/2000	Nancy Monahan	860-297-3804
DE			[Silent State]		
DC			[Silent State]		
FL	Notice	Yes	5/15/1996	(no one person)	850-413-2430
GA	Notice	Yes	7/1/2000	Kimberly Raper	404-657-9205
HI	Permit	No		Paul Yuen	808-586-2790
IA	Notice	Yes	7/1/2001	James Thornton	515-281-4271
ID	Notice	Yes		Carol Anderson	208-334-4309
IL	No	No	1995	[See web site]	
IN	No	No		[Blanket Exemption]	
KS	No	No		Steve Wassom	785-296-3307
KY	No	No		[Blanket Exemption]	
LA	No	No		[Blanket Exemption]	
MA	No	No		[Blanket Exemption]	
MD	Permit	Yes	9/30/1995	Howard Max	410-468-2205
ME	No	No		[Blanket Exemption]	
MI	No	No		[Blanket Exemption]	
MN	Notice	No	1996	Diane Walters	651-296-4973
MO	Notice	Yes	8/28/2001	Al Shoemaker	573-526-5235
MS	Notice	Yes	7/1/2001	Mark Haire	888-236-6167
MT	Notice	Yes	4/24/2003	Christina Goe	406-444-4448

NC	Notice	Yes	11/1/1998	Carolyn Thomas	919-733-5060 Ext. 345
NE	No	No	1996	[Blanket Exemption]	
NV	Notice	Yes	10/1/1999	Lou Roggensack	775-687-4270 Ext. 245
NH	Notice	Yes	5/28/1999	Audrey Blodgett	603-271-3591
NJ	Permit	No		Adelaide Phelan	609-292-5427 Ext. 50328
NM	Notice	Yes		Diana Bonal	505-827-4561
NY	Permit	Yes	5/13/1999	John Lucchesi	212-480-4778
ND	Permit	Yes	1998	Leona Femling	701-328-2440
OH			[Silent State]		
OK	Notice	Yes	7/21/1998	Gloria Pontius	405-521-3966
OR	No	Yes	01/01/2006		
PA	No	Yes	12/16/1996		
RI			[Silent State]		
SC	No	No		[Blanket Exemption]	
SD		Yes	7/1/2001		
TN	Notice	Yes	6/12/2001	Phil Adams	615-741-1670
TX	Notice	Yes	9/1/1995	John Carter	512-305-7722
UT	No	No		[Blanket Exemption]	
VA	No	Yes	3/31/1996		
VT	No	Yes	7/1/2001		
WA	Permit	Yes		Kris Graap	360-725-7206
WV			[Silent State]		
WI	Permit			Steve Junior	608-267-4388
WY			[Silent State]		
Totals	9 18	29 15		[Full details at: http://www.pgresources.com/regs.html]	


Finding quality donors is your job.
Keeping them happy is ours.

Charitable Remainder Trust Basics

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Charitable Remainder Trust Basics

A. *CRT Fundamentals—A Quick Overview*

1. *CRT Defined*

(a) A CRT is a trust which provides for the payment of (i) a specified distribution, at least annually, (ii) to one or more beneficiaries, at least one of which is not a charity, (iii) for life or for a term of years (**not to exceed 20**), (iv) with an irrevocable remainder interest to be held for the benefit of, or paid over to, charity.

(b) The specified distribution to be paid at least annually must be either (i) a **sum certain** which is not less than **5%** nor more than **50%** of the **initial fair market value** of all property placed in trust (in the case of a charitable remainder annuity trust) or (ii) a **fixed percentage** which is not less than **5%** nor more than **50%** of the net fair market value of the trust assets **valued annually** (in the case of a charitable remainder unitrust).

(c) A **qualified** CRT is exempt from all taxes for any taxable year of the trust except a taxable year in which it has **unrelated business taxable income**.

(d) A **qualified** CRT is a trust with respect to which a deduction is allowable under IRC §§ 170, 2055 and 2522.

2. *CRT Regulatory Overview*

(a) *Tax Reform Act of 1969*

Prior to 1969, individuals were creating *inter vivos* and testamentary trusts with non-charitable income interests and charitable remainder interests and taking income, gift and estate tax charitable deductions. Without statutory guidelines in place to guarantee the charitable remainder interest, some of these trusts were manipulated so that there was very little which passed to charity at the end of the trust term. In order to create a better correlation between the charitable deduction and the amount the charity ultimately received, Congress in 1969 enacted IRC § 664 which sets forth the parameters for how a CRT must be structured in order to qualify for the income, gift and estate tax charitable deductions under IRC §§ 170, 2522, and 2055 and in order for the trust to be a tax-exempt entity.

(b) *Tax Reform Act of 1997 and the 1998 Final CRT Regulations*

By the early 1990s, certain abusive CRT techniques including the "Accelerated CRUT" were being marketed to very high net-worth individuals as vehicles for diversifying out of large concentrated stock positions with virtually no capital gains tax. For example, the Accelerated CRUT was a 2-year term, 80% payout CRT that manipulated the rules on the taxation of distributions out of a CRT to return approximately 90% of the contributed amount back to the Grantor tax free. This was at a time when the federal capital gains tax was 28%. In 1997, Congress amended IRC § 664, adding two additional requirements: (1) the 10% minimum remainder test and (2) the 50% maximum payout. On December 10, 1998, the Treasury issued final regulations addressing perceived abuses involving CRTs. The final regulations (i) provide rules for the timing of CRT distributions, (ii) prohibit the allocation of pre-contribution capital gain to trust income but permit post-contribution capital gain to be allocated to trust income and (iii) **make IRC § 2702 applicable to NICRUTs, NIMCRUTs and FLIPCRUTs**. These code changes and the Regulations have curbed abusive CRT planning. Unfortunately, the 10% minimum remainder test has made CRTs less attractive to individuals under the age of 50 (particularly if there is more than one non-charitable beneficiary), since it limits the payout percentage that can be chosen. On a more positive note, the final regulations provide for a new type of CRT which is a hybrid of a Standard CRUT and a NIMCRUT called a FLIPCRUT. The final regulations also liberalized the valuation rules on unmarketable assets.

3. *CRT Requirements*

(a) *Charitable Remainder Annuity Trust Only or Charitable Remainder Unitrust Only—No Combining*

The trust must be in the form of either a Charitable Remainder Annuity Trust (CRAT) or a Charitable Remainder Unitrust (CRUT) but not a combination of the two. Combining the characteristics of a CRAT and a CRUT will **disqualify** a CRT.[1]

(b) *Irrevocability*

The trust instrument must be irrevocable. See, e.g., Treas. Reg. § 1.664-1(a)(1)(i). However, certain individuals may retain the right to change charitable remainder organizations if such power is allowed under the terms of the trust instrument. Rev. Rul. 76-8. In addition, if language in the trust instrument permits, the trust may be amended (under limited circumstances) to bring the instrument into compliance with the requirements of IRC § 664.

(c) *CRT Payout*

Must be at least 5% (Minimum Payout) but not more than 50% (Maximum Payout).[2]

(d) *Non-Charitable Beneficiary*

A CRT must have at least one non-charitable income beneficiary (called the "Recipient" in the Regulations).

(e) *CRT - Trust Term Alternatives*

(i) Life or lives of non-charitable beneficiary(ies).

(ii) Term of years (not to exceed 20)

(iii) Some combination of (i) and (ii).

(f) *Charitable Remainder*

(i) At the end of the trust term, any property remaining in the trust must be distributed to one or more public charities and/or private foundations.

(ii) Grantor can designate in the trust instrument how the charity should use the remainder interest (e.g., scholarships, endowment fund, etc.).

(iii) Trust instrument must include a provision that if a designated charity does not exist or is not qualified at the time the remainder is distributed, one or more alternative qualified charities will receive the share of the disqualified or no longer existing charity.

(iv) The value of the CRT remainder interest is determined under IRC § 7520, which provides tables for valuing the charitable remainder using the applicable federal rate (AFR) in effect for the month of the gift to the CRT. The Grantor may also elect to use the AFR for either of the two preceding months. Additional contributions to a unitrust are valued at the time of the addition.

(g) *Tax-Exempt Trust*

A qualified CRT is a tax-exempt entity. There is typically no capital gain incurred by the Grantor upon the transfer of appreciated property to a CRT or its subsequent sale by the CRT trustee. **CAVEAT:** A CRT is fully taxable as a complex trust in any year in which it has unrelated business income as defined in IRC § 512.[3]

(h) *Restriction on Investments*

A trust is not a qualified CRT if the trust instrument includes a provision which restricts the trustee from investing the trust assets in a manner which could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets. Treas. Reg. § 1.664-1(a)(3).

(i) *Trust Must be a CRT from Time of Its Creation*

In order for a trust to be a qualified CRT, it must meet the definition of and function exclusively as a CRT from the date of creation of the trust. Treas. Reg. § 1.664-1(a)(4).

(j) *Governing Instrument Provisions*

All CRT trust instruments must include certain **mandatory provisions** required by the IRS in order to be qualified CRTs. In 1989 and 1990 the IRS issued its current model forms for *inter vivos* and testamentary CRTs. These model forms contain both mandatory and optional provisions. A CRT will be disqualified for failing to include a mandatory provision. The IRS has a no-rule position on issues covered by the model forms.[4]

(k) *Must Not Be Grantor Trust*

In order to be a qualified CRT, the trust must not be treated as a grantor trust under IRC §§ 671-678.[5]

(l) *Private Foundation Prohibitions*

CRTs are subject to the private foundation rules prohibiting self-dealing (IRC § 4941) and taxable expenditures (IRC § 4945). CRTs with a charity as one of the income beneficiaries are also subject to the prohibitions on excess business holdings (IRC § 4943) and jeopardy investments (IRC § 4944).

(m) *Unrelated Business Taxable Income*

Certain types of assets generate unrelated business taxable income (UBTI) when owned by a CRT. In any year in which a CRT has UBTI, the trust is fully taxable. This is a problem particularly if the CRT has UBTI in the year in which the low basis asset funding the CRT is sold.

(n) *Permissible Non-Charitable Beneficiaries*

(i) Individuals

(ii) Trusts and Estates. Payment to a trust must be limited to a twenty (20) year term, except that a CRT for the benefit of an incapacitated individual is not subject to the twenty (20) year term limitations but may be payable over the incapacitated person's lifetime. Rev. Rul. 76-270. For financially incapacitated persons, see Rev. Rul. 2002-20.

(iii) Corporations, Partnerships and LLCs (limited to twenty (20) year term).

(iv) No Pets Allowed

(o) *Who Can Act As Trustee of a CRT?*

(i) The Grantor (under most circumstances)

(ii) The Remainder Organization

(iii) An Independent Trustee (may be necessary with a retirement NIMCRUT or retirement FLIPCRUT)

(p) *CRT Reformation*

Under certain circumstances a nonqualified CRT can be reformed to make it qualified. IRC § 2055(e)(3). In recent years, the IRS has issued several private letter rulings approving the judicial reformation of CRTs that do not meet the IRC § 2055(e)(3) reformation requirements under the theory of "Scrivener's Error."[6]

(q) *Valuation of Unmarketable Assets*

If unmarketable assets are transferred to or held by a CRT, then, in order for it to be a qualified CRT, valuation must be performed exclusively by an independent trustee or determined by a qualified appraisal from a qualified appraiser. Unmarketable assets are assets that are not cash, cash equivalents, or other assets that can be readily sold or exchanged for cash or cash equivalents (e.g., real property, closely-held stock, tangible personal property).[7]

(r) *Spousal Right of Election*.

On March 30, 2005, the IRS issued Rev. Proc. 2005-24 adding significant new requirements for CRT planning for CRTs established on or after June 28, 2005. Unless the safe-harbor provisions of the revenue procedure are followed, a large percentage of CRTs established on or after June 28, 2005, will be disqualified from inception, resulting in the loss of the income, gift and estate tax charitable deductions and the taxation of all trust income and capital gains not paid out to the income beneficiary.

The revenue procedure is a response to the IRS's concerns about the State law regulating a surviving spouse's right of election. Generally, an individual is free to dispose of property any way the individual wishes. Most states, however, protect surviving spouses from being disinherited. Most non-community-property states have statutes providing the surviving spouse with an "elective share" of the deceased spouse's estate regardless of what the will states. This statutory right to a portion of the surviving spouse's estate is known as the "right of election." The statutes are the modern form of the common law doctrines of "dower" and "courtesy."

In some states, the elective share is limited to assets passing by will, otherwise known as the "probate estate." In a growing number of states, though, an estate is defined more broadly for purposes of computing the elective share and may include the right to elect against the assets of inter vivos CRTs. This is particularly so in states that have adopted the elective share provisions of the Uniform Probate Code, under which the surviving spouse has the right of election against a percentage of the "augmented estate." The augmented estate includes the deceased spouse's net probate estate as well as other specified non-probate assets, including the assets of a CRT.

The possibility that a surviving spouse could elect against the assets of a CRT is of significant concern to the Service. Internal Revenue Code Section 664 provides that no amount other than the annuity amount or the unitrust amount may be paid to or for the use of any person other than a qualified charitable organization. Rev. Proc. 2005-24 provides that the requirements of IRC Section 664 are not satisfied if a surviving spouse may exercise the right of election to receive an elective share that could include the assets of a CRT. According to the revenue procedure, the mere existence of the right of election, whether exercised or not, causes trusts created on or after June 28 to fail to qualify under IRC section 664.

This is a very harsh position on the part of the IRS, as it's relatively rare for a surviving spouse to elect against a deceased spouse's will.

Rev. Proc. 2005-24 provides a safe-harbor procedure that, if followed, will cause the right of election to be disregarded for purposes of determining whether a CRT created on or after June 28 will be considered a qualified CRT. To qualify for the safe-harbor, a spouse must irrevocably waive the right of election regarding the assets of the CRT to ensure that no part of the trust will be used to satisfy the elective share.

No waiver is required for CRTs established before June 28. Pre-June 28 CRTs are only disqualified if the surviving spouse actually exercises the right of election against the assets of the CRT. A waiver of right of election is also not required for CRTs established on or after June 28 if applicable state law would not allow a surviving spouse a right to elect against the assets of a CRT or in community property states where there is generally no right of election.

For those CRTs requiring a waiver under Rev. Proc. 2005-24, there are requirements in order to be protected by the safe harbor. The spouse must irrevocably waive the right of election to whatever extent necessary to ensure that no part of the trust (other than the annuity or unitrust interest of which the spouse is the named recipient under the terms of the trust) may be used to satisfy the elective share. In addition, the waiver must be valid under applicable state law, be in writing and be signed and dated by the spouse. The deadline for obtaining the waiver is six months after the due date (excluding extensions) of the CRT's Form 5227 (Split-Interest Trust Information Return) for the tax year in which the latest of the following occurs: (1) the creation of the trust; (2) the date of the grantor's marriage to the spouse; (3) the date the grantor first becomes domiciled or resident in a jurisdiction whose law provides a right of election that could be satisfied from the assets of the trust; or (4) the effective date of applicable state law creating a right of election.

A copy of the signed waiver must be provided to the trustee of the CRT and maintained "in the official records of the trust" so long as its contents may become material in the administration of any internal revenue law.

Rev. Proc. 2005-24 will create great uncertainty in CRT planning and will likely result in fewer CRTs being established. The IRS is creating a mountain out of a mole hill. It's relatively rare that right of election is even exercised—yet the revenue procedure disqualifies any post June 27 CRT because of the mere possibility that a right of election might be exercised. In addition, the revenue procedure does not provide a safe-harbor, even if a waiver is properly executed, when there is a change of circumstances, such as a change in applicable state law, remarriage or relocation to a state where the waiver would not be valid.

4. *Income, Gift and Estate Tax Consequences*

(a) *Income Tax Charitable Deduction (IRC § 170)*

(i) The Grantor is entitled to an income tax charitable deduction equal to the present value of the charitable remainder interest. The income tax charitable deduction must be at least 10% of the fair market value of the property contributed to the CRT (the 10% minimum remainder test). Income tax deduction is run off of cost basis rather than fair market value for certain types of property (ordinary income and tangible personal property) as well as for transfers of property that is not Qualified Appreciated Stock where a private foundation can be named as a remainder organization.

(ii) Charitable Contribution Percentage Limitations

(A) *CRT Limited to Public Charity Remainder Organizations*. If the trust instrument provides that only public charities can be named as remainder organizations, the Grantor's income tax charitable deduction will be limited to 30% of AGI for gifts of appreciated property held long-term and 50% of AGI for gifts of cash, with a 5-year carryforward for any unused deduction.

(B) *CRTs with Ability to Name Private Foundations as Remainder Organizations*. If the CRT trust instrument allows private foundations to be named as charitable remainder organizations, the Grantor's income tax charitable deduction will be limited to 20% of AGI for gifts of appreciated property held long-term and 30% of AGI for gifts of cash, with a 5-year carryforward for any unused deduction. Under certain circumstances, the income tax charitable deduction will be calculated on the Grantor's basis in the contributed property rather than the fair market value (i.e., any property which is not considered "Qualified Appreciated Stock" when contributed to a private foundation). IRC § 170(e)(5)(D). Qualified Appreciated Stock includes stock and mutual funds for which market quotations are available on an established securities market.

(b) *Income Taxation of Non-Charitable Beneficiaries*

Although the CRT itself is tax-exempt, the non-charitable beneficiaries' payments are taxed under a system unique to CRTs known as the 4 Tier System. IRC § 664(b); Treas. Reg. § 1.664-1(d). Non-charitable beneficiary payments are taxed as follows:

(i) First - Ordinary income to the extent of the CRT's ordinary income for the year and any undistributed ordinary income for prior years (Tier 1);

(ii) Second - Capital gain to the extent of the CRT's capital gain for the year or any undistributed capital gain for prior years (Tier 2);

(iii) Third - Tax-exempt income to the extent of the CRT's tax-exempt income for the year and any undistributed tax-exempt income for prior years (Tier 3); and

(iv) Fourth - Tax-free return of principal (Tier 4).

(v) Distributions in Kind. The unitrust or annuity amount may be paid in cash or in other property. If a distribution is made in property, the amount paid is considered an amount realized by the trust from the sale or other disposition of property. The basis of the property in the hands of the recipient is its fair market value at the time it was paid.[8]

In November 2003, the IRS issued proposed regulations for taxing distributions from CRTs. The proposed regulations detail how the tier system applies to dividends taxed at the new 15 percent rate, as well as to capital gain income taxable at different rates. The proposed regulations revise the rules for characterizing a CRT distribution under the tier system to take into account differences in the income tax rates applicable to items of income assigned to the same tier. The trust's income is first assigned to the appropriate tier: ordinary income, capital gain and tax-exempt, as under existing law. Then, within the ordinary income and capital gains tiers, income is treated as distributed from the classes of income in that tier, beginning with the class subject to the highest federal income tax rate and ending with the class subject to the lowest federal income tax rate. As a result of the proposed regulations, no portion of a distribution will be deemed to consist of tier two capital gain income until all tier one ordinary income has been exhausted, notwithstanding that some tier one income (qualified dividends) may be taxed at a lower rate than certain capital gains (for example, short-term capital gains). This favorable-to-tax payer provision contradicts the tier system's general tenet that the most highly taxed income is deemed distributed first. For example, suppose a CRT provides a $150,000 payment and the trust has $100,000 of interest income taxable at the 35 percent rate, $100,000 of dividend income taxable at the new 15 percent rate and $100,000 of short-term capital gains taxable at the 35 percent rate. The highest-bracket recipient will report $100,000 of interest income taxable at 35 percent and $50,000 of dividend income taxable at 15 percent. None of the payment is deemed to consist of short-term capital gain, because the payment did not exhaust all of the tier one income.

(c) *Gift Tax Consequences*

(i) Transfers to a qualified CRT are entitled to a gift tax charitable deduction for the present value of the charity's interest. **CAVEAT:** The unlimited marital deduction is only available when one or both spouses are the only non-charitable income beneficiaries.

(ii) Where there is an income beneficiary other than the grantor, there is a gift by the grantor to the other non-charitable beneficiary (other than a spouse) equal to the actuarial value of the other non-charitable beneficiary's interest. It is possible for the grantor (as long as the grantor is the initial beneficiary) to avoid gift tax by reserving the right exercisable only by Will to revoke only the other non-charitable beneficiary's interest.

(d) *Estate Tax Consequences*

(i) *Estate Tax Marital Deduction - IRC § 2056(b)(8)* - A CRT only qualifies for the unlimited estate tax marital deduction if there is no non-charitable beneficiary other than the Grantor's spouse (except the Grantor).

Examples:

(A) Grantor and spouse as only non-charitable beneficiaries does qualify for the marital deduction.

(B) Grantor and spouse and children as non-charitable beneficiaries does **not** qualify for the marital deduction.

(ii) *Mandatory CRT Estate Tax Payment Provision* - In order to be a qualified CRT, the trust instrument must include a provision that no estate taxes attributable to the CRT shall be paid out of the trust assets.[9]

5. *Other CRT Issues*

(a) *CRT Tax Filings*

(i) *Federal Form SS-4* - Application for a Taxpayer Identification Number

(ii) *Federal Form 709* - Gift Tax Return for any year there is a contribution to the CRT, unless CRT provides for ability to change charitable remainder organizations, resulting in an incomplete gift.

(iii) State Gift Tax Return - if applicable

(iv) *Federal Form 8283* - Valuing the gift

Note: With certain funding assets a qualified appraisal may be required. See Treas. Reg. § 1.170A-13(c).

(v) *Schedule A of Federal Form 1040* - Taking income tax charitable deduction

(vi) *Federal Form 5227* - Annual CRT Information Return

(vii) *Federal Form 1041*-A - Trust Accumulation of Charitable Amounts (filed annually unless all net income is required to be distributed currently)

(viii) *Federal Forms 1041 and 4720* in any year where there is UBTI

(ix) *Federal Form K-1* to income beneficiaries

(b) <u>*CRT Trustee's Obligations*</u>

(i) *Duty To Be Impartial* - CRT Trustee has an obligation to act impartially with respect to the interests of the charitable and non-charitable beneficiaries and may not invest in a manner that favors the non-charitable beneficiaries.

(ii) *Duty To Diversify* - CRT Trustee has a duty to diversify trust assets in a manner consistent with state law.

(iii) *Duty To Properly Administer CRT* - In *Estate of Atkinson v. Commissioner*, (CA-11) No. 1-16530, 10/16/02, the Eleventh Circuit upheld the Tax Court decision which disqualified a CRT where the Trustee failed to make the annuity payments.

(c) <u>*Multiple Grantor CRTs*</u>

Multiple Grantors to a CRT other than spouses may disqualify a CRT as a taxable association.[10]

(d) *Substantiation Rules*

The substantiation rules for certain charitable contributions under IRC § 170(f)(8) do not apply to CRTs.

(e) *Wealth Replacement Trust*

A wealth replacement trust is an irrevocable insurance trust created at the same time as the CRT to replace for the family the asset ultimately passing to charity. A portion of the after-tax CRT income is used to pay the premiums for the insurance owned by the wealth replacement trust. At the end of the CRT trust term (usually the death of the survivor of the grantor and his or her spouse) the assets in the CRT pass to charity and the assets in the wealth replacement trust pass to the grantor's children and/or grandchildren free of estate taxes.

(f) *Reasons for Establishing a CRT*

(i) Most Grantors, particularly after the Tax Reform Act of 1997, and capital gains tax reduction to 15% under the 2003 tax reform act, need a certain amount of charitable intent.

(ii) Tax-efficient diversification out of a concentrated low basis asset position.

(iii) Increase cash flow on a low or no dividend asset.

(iv) Estate Tax minimization using wealth replacement trust.

(v) Supplemental retirement planning using Retirement NIMCRUT or FLIPCRUT.

(vi) Business Succession Planning.

(vii) Income Tax Charitable Deduction.

B. *CRATs*

1. *CRAT-Defined (IRC § 664(d)(1))*

(a) An irrevocable trust;

(b) From which a sum certain (which is not less than 5% nor more than 50% of the initial net fair market value of all property placed in trust);

(c) Must be paid, at least annually;

(d) To one or more persons (at least one of which is not a charity);

(e) For the life or lives of such individual or individuals or for a term of years (not to exceed 20);

(f) Which upon the termination of the trust term, the remainder interest must be distributed to, or for the use of, a qualified charitable organization as defined in IRC § 170(c); and

(g) The value of the charitable remainder interest (determined under IRC § 7520) must be at least 10% of the initial net fair market value of all property placed in the trust.[11]

2. *Additional CRAT Restrictions (Not Applicable to CRUTs)*

(a) *5% Probability Test of Rev. Rul. 77-374*

CRATs are subject to a special rule which requires that there must not be more than 5% probability that the non-charitable beneficiary (or beneficiaries) will survive the exhaustion of the trust assets.

(b) *No Additional Contributions*

A CRAT cannot be qualified unless its governing instrument provides that no additional contributions may be made to the trust after the initial contributions.[12]

C. *CRUTs*

1. *Standard CRUT - Defined (IRC § 664(d)(2))*

(a) An irrevocable trust;

(b) From which a fixed percentage (which is not less than 5% nor more than 50%) of the net fair market value of the trust assets **as revalued annually**;

(c) Is to be paid, at least annually;

(d) To one or more persons (at least one of which is not a charity);

(e) For the life or lives of the individual beneficiary or beneficiaries or for a term of years (which does not exceed 20);

(f) Which upon the termination of the trust term, the remainder interest must be distributed to, or for the use of, a qualified charitable organization as defined in IRC § 170(c); and

(g) The value of the charitable remainder interest (determined under IRC § 7520) must be at least 10% of the initial fair market value of all property placed in the trust.[13]

2. *Other CRUT Issues*

(a) Additional Contributions are allowed to any type of CRUT at any time.

(b) There are 3 other types of CRUTs besides the STANDARD CRUT -- the NICRUT, the NIMCRUT and the FLIPCRUT (all discussed below).

3. *Net Income Only Unitrust -- No Makeup (NICRUT) - IRC § 664(d)(3)*

(a) The non-charitable income beneficiary is entitled to the lesser of (i) the stated percentage in the trust instrument or (ii) actual trust income. If the trust's actual income as defined in IRC § 643(b) is less than the stated percentage in the trust instrument, the income beneficiary only receives the actual trust income. Any deficiencies in distributions are lost, even if the trust's income exceeds the stated percentage in a subsequent year.

4. *Net Income with Makeup Unitrust (NIMCRUT) - IRC § 664(d)(3)*

(a) The non-charitable income beneficiary is entitled to the lesser of (i) the stated percentage in the trust instrument or (ii) actual trust income. If the trust income for the year is less than the stated percentage, the Trustee pays the income beneficiary only the actual trust income as defined in IRC § 643(b). The difference between the actual income distributed and the stated percentage is made up in later years, if trust income exceeds the stated percentage.

(b) Proceeds from the sale or exchange of any assets contributed to the trust by the Grantor must be allocated to principal and not to trust income at least to the extent of the fair market value of those assets on the date of contribution.

(c) Post contribution capital gain can be allocated to income if the trust instrument so provides. According to the IRC § 643(b) regulations, allocation must be mandatory, not at the discretion of the Trustee.

5. *FLIPCRUT - Treas. Reg. § 1.664-3(a)(1)(i)(c)*

(a) The 1998 final regulations provide for an additional type of CRUT called the "combination of methods" unitrust or the FLIPCRUT. A FLIPCRUT is a trust that starts out as either a NICRUT or a NIMCRUT. As of the first day of the calendar year following the occurrence of the "triggering event" defined in the trust instrument the trust switches to a STANDARD CRUT.

(b) The "triggering event" may be (i) a specific date, (ii) the sale of unmarketable securities held by the trust, or (iii) a single event whose occurrence is not discretionary with, or within the control of, the trustees or any other person (IRS examples include marriage, divorce, death, or birth of a child).

6. *CRAT vs. CRUT*

(a) The CRAT lets the charitable remainder beneficiary reap the benefit of all the appreciation in the trust (along with all risk of loss) while ensuring a fixed annual payment to the income beneficiary.

(b) The CRUT allows the non-charitable beneficiary to participate in any appreciation (or reduction in value), since the unitrust amount will either be increased or decreased each year depending upon the performance of the trust investments.

(c) Because the CRAT payment is fixed, it is most appropriate for elderly individuals (75 or older) who will not live long enough to see their purchasing power from the trust dramatically reduced. There is also not much possibility for creative CRT planning with a CRAT since payments never change.

7. *Which Type of CRUT to Choose*

(a) *STANDARD CRUT* - usually individuals 50 or older who want to (a) diversify out of a low basis concentrated publicly-traded security, (b) increase income and/or (c) do some estate planning.

(b) *NIMCRUT* - With the introduction of the FLIPCRUT in 1998, NIMCRUTs are now primarily used for income deferral purposes such as supplemental retirement planning.

(c) FLIPCRUT - Used when CRT is funded with real estate, closely-held stock, tangible personal property, as well as for supplemental retirement planning.

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[1] Treas. Reg. § 1.664-1(a)(2).

[2] See IRC § 664(d)(1)(A) (for CRATs); IRC § 664(d)(2)(A) (for CRUTs).

[3] IRC § 664(c).

[4] See Rev. Procs. 2003-53 through 2003-60 for model annuity trust forms and Rev. Procs. 2005-52, 2005-59 for model unitrust forms.

[5] Treas. Reg. § 1.664-1(a)(4).

[6] See, e.g., PLRs 200002029 and 200218008.

[7] Treas. Reg. § 1.664-1(a)(7).

[8] Treas. Reg. § 1.664-1(d)(5).

[9] Rev. Rul. 82-128.

[10] See PLRs 9547004 and 200203029.

[11] IRC § 664(d)(2)(D).

[12] Treas. Reg. § 1.664-2(b).

[13] IRC § 664(d)(2)(D).

COMPARING LIFE INCOME PLANS

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I. Introduction

A. What do we mean by "life income plan?"

1. Any arrangement, via trust, contract or otherwise, whereby one or more individuals will receive a stream of income for a period of time, and at the end of the time, remaining funds will pass to charity.

B. What are some reasons for using life income plans?

1. To avoid leaving large lump sum to children or other beneficiaries.
2. To provide for irresponsible beneficiaries.
3. To obtain charitable income tax or estate tax deduction.
4. To sell appreciated property and avoid capital gains.
5. To provide for disabled beneficiary.
6. To provide for both private beneficiaries and charity.
7. It is important to understand the donor's objectives, whether in the context of a lifetime gift or a testamentary provision. The specific objectives will help determine the best vehicle to use for the life income plan, or whether a life income plan is appropriate at all.

C. What are the common life income plans?

1. Gift Annuity
2. Deferred Gift Annuity
3. Pooled Income Fund
4. Charitable Remainder Trust
    a) Life vs. Term of years
    b) Unitrust vs. Annuity Trust
5. Discretionary Trust

D. There are other types of life income plans that are not normally thought of as charitable planned giving vehicles:

1. QTIP marital trust – provides income to spouse for her lifetime, and then distributes to the decedent's beneficiaries, which may include charity.

2. Generation skipping trust – usually provides discretionary or mandatory income to grantor's children, and remainder to grandchildren. It would be rare for this trust to have a charitable component.

3. Commercial annuity – provides fixed lifetime income to purchaser or his beneficiary. There is no remainder. Any profit goes to insurance company. There is no charitable component in this arrangement.

II. Charitable Gift Annuity

A. Fixed payout for one or two lives.

1. Fixed – no possibility for growth

2. Guaranteed? It's a general obligation of the charity, guaranteed by all of the charity's assets. What happens if charity goes bankrupt?

B. Tax effects

1. Charitable deduction available when annuity is established – Income tax deduction for inter vivos gift; estate tax deduction for testamentary gift. The deduction is equal to the difference between the face amount of the annuity and the "expected value" of the annuitant's payments, based on his or her life expectancy.[1]

2. Gift tax: If a donor established an annuity for someone other than himself (beneficiary), he may have made a taxable gift.

a) If the beneficiary is a successor annuitant after the donor himself, gift tax may be avoided by reserving the right to revoke the successor annuitant's interest.

b) If donor establishes immediate gift annuity for another beneficiary, the gift will qualify for the gift tax annual exclusion ($12,000). Note that a deferred gift annuity will not qualify for the annual exclusion.

c) If taxable gift is made, donor may claim some of his unified credit to avoid paying gift tax, but this may affect his ultimate estate tax liability.

[1] Reg. §1.170A-1(d); Reg, §1.101-2(e)(1)(iii)(b)(2); Reg. §20.2031-7

3. Capital Gains. If appreciated property is given in exchange for gift annuity, a bargain sale results, and capital gains tax is partially avoided.[2] The remaining capital gain is spread over the life of the annuity IF the donor is also the annuitant. If the donor is not the annuitant, all of the gain is taxable when the annuity is established.

4. For income tax purposes, annuity payments are partially tax-free return of principal.[3]

5. Estate tax

    a) If decedent was the only annuitant, there is nothing to include in the gross estate.

    b) If the decedent was an annuitant, and there is a survivor-annuitant, the value of the survivor-annuitant's interest is potentially subject to estate tax.

    c) If a spouse is survivor-annuitant, the spouse's interest qualifies for marital deduction under the QTIP provisions.[4]

    d) In the case of a testamentary annuity, the entire amount is includible in the decedent's gross estate, but a charitable deduction is available for the charitable interest, and, if spouse is the annuitant, a marital deduction would also be available.

6. The "10% rule" does apply to gift annuities. The present value of the charitable interest must be at least 10% of the gift amount. This is measured at the time the gift is completed – date of gift for a lifetime gift; date of death for testamentary gift.

C. Minimum investment is relatively small. Each charity sets its own minimum – ranging from $1,000 to $10,000. Administrative burden is relatively low and inexpensive because much of the process is automated, and the funds are invested as a pool.

D. Gift annuities can produce relatively high payment rates, especially at older ages.

E. What kind of property can fund the gift annuity?

    1. Cash

    2. Appreciated, publicly traded securities

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[2] Reg.§1.170A-1(d)(3); Reg. §1.1011-2(a)(4)(i).
[3] IRC §72.
[4] IRC §2056(b)(7)(C)

3. Real estate?

    a) There is no prohibition on funding with real estate. But problems may result for the charity.

    b) Property almost always nets less than appraised value after sale expenses. Charity may want to use discounted value.

    c) May take time to sell the property; annuity obligation starts immediately.

    d) May be OK if charity wants the particular property for its own use.

4. Closely held stock

    a) Marketability? Will corporation redeem the stock? Redemption will not cause capital gain to be immediately taxed to donor, providing charity is not obligated to sell the stock back to the corporation.[5]

    b) Subchapter S stock and unrelated business income. All pass-through income recognized by a charity as a Sub-S stockholder is unrelated business income, and the gain on the sale of the Sub-S stock by the charity is taxable unrelated business income.[6] Charity may be in a position to accept Sub-S stock for an annuity if it has any net operating losses from other UBI activities which can be used to offset the gain on the sale of the stock.

F. Contingent Beneficiaries – Beware of a testamentary distribution that reads "I leave 20% of my estate to XYZ Charity to establish a Gift Annuity in the name of Susan, but if Susan is not living, to establish a Gift Annuity in the name of John. If Susan predeceases the testator by even one day, John will receive lifetime income, but if Susan dies shortly after the testator, John will receive nothing. This is likely to cause a lawsuit. If testator wants John to receive income after Susan's death, he should create a two-life annuity. But that will result in a lower payout rate.

G. Cannot create annuity for more than two lives.

H. Cannot provide for multiple charities with a gift annuity. It is possible, though, to acquire gift annuity contracts from multiple charities.

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[5] *Palmer v. Commissioner,* 62 TC 684 (974); Rev. Rul. 78-197, 1978-1 CB 83.

[6] IRC §512(e)(1)

III. Deferred Gift Annuity – For the most part, the characteristics are the same as the Gift Annuity, with some important exceptions.

A. Payments start at a specified future date.

B. The flexible deferred gift annuity option. The IRS has approved a deferred annuity in which the donor does not have to choose in advance the starting date for payments.[7] The donor's deduction will be limited to the smallest deduction possible under the allowable payment schedules in the contract. In the so-called "deferred gift annuity tuition plan," the recipient who is entitled to a lifetime payout has the option to sell or assign his annuity to the college in exchange for a lump sum or installment payments, which are then used to fund tuition payments.[8]

C. Establishing a deferred gift annuity for a beneficiary other than the donor creates a potentially taxable gift which does not qualify for the annual exclusion. Annual exclusion applies only to gifts of present interest, and a deferred annuity is not a present interest. Donor can claim unified credit to avoid tax, but must report this gift on a gift tax return.

IV. Pooled Income Fund

A. General Description

1. A fund to which many donors contribute, and which has many beneficiaries.

2. Legal form is a trust. Trustee is the charity, or the charity's designate.

3. All income is paid out to the beneficiaries in quarterly installments, with a 5th make-up payment paid after the close of the year, within first 65 days of the next year.

4. Functions very much like a mutual fund, but it is not a mutual fund. Beneficiaries are assigned a certain number of "units" based upon the value of a unit at the time of the contribution. Income is divided among the beneficiaries on the basis of units held.

5. Donation is irrevocable. Upon death of beneficiary, value of his "units" is segregated and distributed to the charity.

B. It is possible to create customized pooled income funds with specific investment strategies. For example, a pooled income fund could "invest" in a dormitory, or other facility for the charity's use. However, a typical pooled income fund will be invested as a balanced portfolio, designed to produce

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[7] PLR 9743054

[8] PLR 9527033

income in the 4% to 6% range, and also designed to achieve some growth to the principal.

1. Payout to the beneficiaries is variable, dependent on actual income earned. This does not contemplate a total return or unitrust concept of income, but rather a dividends-and-interest concept.

2. Annual payment is not guaranteed.

3. Depending upon investment strategy, income payments may be expected to grow each year, but there is no guarantee. In any given year, income distribution could decrease.

4. Unit value may also increase or decrease from year to year, but, ideally, should increase over time.

C. Because the Pooled Income Fund is a separate trust, the funds are protected from the charity's general creditors in the event of bankruptcy or liquidation.

D. Tax effects

1. Tax deduction is available for contribution to the Fund. An inter vivos gift will create an income tax deduction; a testamentary gift will create an estate tax deduction.

2. Capital Gains completely avoided when funded with appreciated property.

3. All income received by beneficiaries is taxable as ordinary income.

4. Fund is prohibited from owning tax-exempt securities.

5. PIF is not a tax-exempt trust. Ordinary income is not taxed in the trust because of the income distribution deduction under §642. Long term capital gains are not taxed to the trust because they qualify for a charitable set-aside deduction. But the trust must pay tax on any short term capital gains accumulated in the trust, as well as any receipts which are not classified as accounting income (and therefore not distributed to beneficiaries) but are treated as taxable income.

6. If a donor establishes a PIF interest for himself and a successor beneficiary, the successor beneficiary's interest is a potentially taxable gift, unless the donor reserves the right to revoke the successor beneficiary's interest. The successor beneficiary's interest does not qualify for the annual exclusion, because it is not a present interest.

7. If a donor establishes a PIF interest for another beneficiary, with payments to that beneficiary to start immediately, he has made a

potentially taxable gift, but the gift is eligible for the annual exclusion up to $12,000 (or $24,000 with spousal gift-splitting.) In case of a taxable gift, unified credit can be claimed if available to avoid payment of tax.

8. Estate tax.

   a) If donor is the income beneficiary, the entire value of the PIF units will be included in his gross estate. If there is no survivor beneficiary, a full charitable deduction will be available, resulting in a wash.

   b) If there is a survivor beneficiary, full value of units is included in donor's estate, and partial charitable deduction is available.

   c) If survivor beneficiary is spouse, marital deduction applies if QTIP election is made.

E. PIF interest can be established for a relatively small amount, e.g., $10,000.

   1. Although the Fund is a separate trust, each beneficiary's interest is not a separate trust; all of the beneficiaries' interests are commingled in a single trust, and invested as a pool. Thus, administrative costs are relatively low.

   2. Minimum may be slightly higher than an annuity, because there is no option for annual payment. A $10,000 PIF interest will produce quarterly payments of approximately $125. A $10,000 annuity could be set up with an annual payment of $500, but that is not an option with PIF.

F. Just as in the case of an annuity, contingent distributions are problematic. Avoid a provision that says, "I leave 25% of my estate to the XYZ Charity's PIF to create a single-life income interest for the benefit of Susan, but if Susan is not living, create a single-life income interest for the benefit of John." If the donor wants to benefit both Susan and John, then a two-life PIF interest should be established. Unlike in the case of the annuity, Susan's income will not be reduced by adding John as a successor beneficiary. However, the charitable interest and the charitable deduction may be substantially reduced, depending on Susan's and John's ages.

G. A PIF interest can be set up for more than 2 lives. Furthermore, the PIF is not subject to the 10% rule. Together, these distinctives make it theoretically possible, to contribute funds to PIF with very little charitable interest and very little charitable intent on the part of the donor/ testator. While possible, this practice is not desirable, at least from the charity's standpoint, although the charity is not likely to be terribly harmed by this because of low administrative costs, and because the charity cannot lose money in the PIF. Charity will always get something, even if it's many years down the road.

H. Each PIF is run by or controlled by a particular charitable organization, and that organization is the remainder beneficiary. It is not possible to provide for multiple charitable beneficiaries through a single PIF.

V. Charitable Remainder Unitrust

A. General Characteristics

1. Separately managed trust.

a) Trustee may be charity, bank, or individual, including the donor.

b) Not subject to charity's general creditors.

c) Allows for customized investment strategies.

d) Requires larger minimum investment – e.g. $100,000, or much more if professionally managed.

2. Variable payout – a fixed percentage of Fair Market Value determined annually. Donor picks payout percentage, within limits.

3. CRUT can be established for one or two lives, or for a term of years up to 20. In theory, there can be more than 2 lives, but it must meet the 10% rule.

B. Tax effects

1. Charitable deduction available when established. For inter vivos gift, an income tax deduction is available; for testamentary gift, an estate tax deduction is available.

2. For gift tax purposes, a beneficiary's interest may constitute a taxable gift.

a) If the donor is the first beneficiary, he can avoid gift tax on the successor beneficiary's interest by reserving the right to revoke that interest.

b) A successor beneficiary's interest does not qualify for the annual exclusion. An immediate beneficiary's interest is a present interest and does qualify for the annual gift tax exclusion. However, funding a trust only to this extent may make the trust too small for management. However, a multiple year funding strategy using gift-splitting may be practical.

3. For estate tax purposes, if the donor retained an interest in the trust (e.g., as income beneficiary), the trust will be included in his gross estate for FET purposes. He will then be entitled to a charitable deduction calculated as of the date of death. The value of any successor beneficiary's interest is potentially subject to tax. If spouse is only beneficiary, marital deduction is available.[9]

4. Distributions to beneficiary are generally taxable as ordinary income, subject to 4-tier rule, which looks at current and accumulated income, and characterizes distributions in the following order:

   a) First, as ordinary income, to the extent of current or accumulated ordinary income in the trust.

   b) Second, as capital gain, to the extent of current or accumulated capital gain in the trust.

   c) Third, as tax exempt income, to the extent of current or accumulated tax-exempt income.

   d) Last, as return of principal, after all other tiers are exhausted.

5. CRUT is itself tax exempt, provided it incurs NO unrelated business income. One dollar of UBI will taint the entire trust and make it a taxable trust, forcing it to pay tax on any income or capital gain not distributed to the beneficiaries.

6. CRUT can be funded with appreciated property, and capital gains tax is completely avoided on the transfer and subsequent sale of the property by the trust. However, the capital gain becomes part of the 4-tier calculation, and subsequent distributions may carry out capital gain to the beneficiaries.

C. Funding the CRUT

1. Cash

2. Appreciated publicly traded securities

3. Closely held stock (But avoid Sub-S)

4. Real Estate

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[9] IRC §2056(b)(8)

D. Types of Unitrusts

1. Straight or Standard – STAN-CRUT – Pays fixed percentage of Fair Market Value determined annually (the "unitrust amount"). Can be invested for total return. Character as income or growth doesn't matter.

2. Net income unitrust – NI-CRUT – Pays lesser of unitrust amount or net income.

3. Net income with make-up – NIM-CRUT – Pays lesser of unitrust amount or net income, but can pay more than unitrust amount to make up a past deficiency.

4. Flip trust – begins life as a NI-CRUT, and changes to a STAN-CRUT after the occurrence of a triggering event, usually sale of real estate or other illiquid asset.

E. Investment characteristics

1. Ideally, trust should be invested to produce growth so that income variable income stream will keep pace with inflation.

2. The lower the payout rate, the more likely it is to achieve growth in the principal, and consequently in the future income stream.

3. Although income cannot be deferred, investment strategies can be employed to produce a quasi-deferral. This strategy works best with a NIM-CRUT, or a Flip Trust. Also, income distributions can be added back to the trust as additional contributions at the beneficiary's option.

F. The Charitable Remainder Trust may have multiple charitable beneficiaries, and the donor may reserve the right to change the charitable beneficiaries. Be mindful, though, of the distinction between public charity and private foundation. If it is possible to name a private foundation, the donor's deduction will be subject to the private foundation limitations.

VI. Charitable Remainder Annuity Trust

A. The Charitable Remainder Annuity Trust shares most of the characteristics of the Charitable Remainder Unitrust. Thus, all of the material above regarding tax effects, investment management, administration, etc. applies equally to the annuity trust, and will not be repeated here.

B. There are some significant differences between the Annuity Trust and Unitrust, some explicit, and some which arise because of differences in the way the two trusts are operated.

1. The Annuity Trust provides for a fixed payout. This is established at the outset of the trust, and will not change for the life of the trust.

    a) The payout can be stated as a percentage of initial fair market value, or as a dollar amount. In either case, once the dollar amount is established, the payout will be the same year after year.

    b) The payout must be at least 5% of the initial fair market value of the trust.

    c) There is no possibility for growth in the income stream.

2. The annual payment is "guaranteed," in the sense that it is not dependent on investment performance. However, the payment is guaranteed only by trust assets, and, depending on the amount of the payment, it is possible for an annuity trust to run out of money.

3. Funds cannot be added to an Annuity Trust after it is established. However, if the trust is funded as a result of the donor's death, even if the funding takes place in stages, all of the additions are treated as a single contribution, and date back to the date of donor's death.

4. The Annuity Trust follows the same four-tier system of taxation as the Unitrust. However, an Annuity Trust may be somewhat more likely to distribute principal, and thus carry out accumulated capital gain.

VII. Discretionary Trust

A. Discretionary trust is a generic term, and is not typically included in discussions of planned giving. However, it is useful to consider this type of trust along with the standard charitable vehicles, because sometimes it is the only plan that can accomplish the donor's objectives. The donor may have a secondary objective to benefit charity, and he can certainly do this through a discretionary trust.

B. There is no charitable deduction available for income or estate tax purposes for contributions or bequests to a discretionary trust, even if one or more charities may ultimately benefit from the trust. (An exception to this would be a wholly charitable trust, which could apply for §501(c)(3) status).

    1. The general rule is that no charitable deduction is allowed for gifts of a partial interest in property.[10]

    2. There are statutory exceptions to this general rule, and those exceptions allow a deduction for contributions to charitable remainder

[10] IRC §170(f); IRC §2055(e)(2)

trusts and pooled income fund.[11] But discretionary trusts do not meet one of these exceptions.

C. The discretionary trust is the most complex and most flexible life income vehicle.

1. Can have multiple beneficiaries, or contingent beneficiaries.

2. Can name a class of beneficiaries, e.g., "my descendants."

3. Can provide for multiple generations, limited only by generation skipping tax considerations, and the rule against perpetuities.[12]

4. Can provide for mandatory distributions of income, or the trustee can decide whether to distribute or accumulate income.

5. Principal may be invaded at the trustee's discretion, or subject to a specific standard.

6. Almost any provision imaginable can be included. But be careful about including impractical restrictions, controlling from the grave, or illegal restraints on alienation[13].

D. The discretionary trust is the ideal vehicle to provide for incompetent beneficiaries, such as minors, disabled persons, or elderly persons who may need to qualify for Medicaid.

E. Separately managed trust.

1. Selection of the trustee is important because of the discretionary powers.

2. Trust corpus must be large enough to justify management. Banks may require $1 million to manage; individual could manage a smaller trust.

VIII. Which Life Income Plan is Best?

A. How old is the beneficiary?

1. An older beneficiary (65, 70 or older) may benefit from the higher gift annuity rates.

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[11] IRC §170(f)((2); IRC §2055(e)(2).

[12] Common law rule against perpetuities provides that a trust must terminate no later than 21 years after the death of some person alive when the trust was created (or, when it became irrevocable). A wholly charitable trust is exempt from the rule, and may exist in perpetuity. Furthermore, several states have adopted statutes negating the rule against perpetuities in certain instances.

[13] For example, a provision that a piece of real estate can never be sold is probably unenforceable.

2. A younger beneficiary should be more interested in the growth that can be obtained in the Pooled Income Fund or Charitable Remainder Unitrust.

B. How much money is available to fund the plan?

1. If it's more than $100,000, a separately managed trust may be a possibility (unitrust, annuity trust)

2. If less than $50,000, must use Gift Annuity or Pooled Income Fund.

C. Does donor desire guaranteed payments for peace of mind?

1. Gift annuity – guaranteed by the charity, but not clearly protected from charity's general creditors. Important to investigate the financial strength of the charity.

2. Annuity Trust – guaranteed by assets in the trust, and protected from the charity's general creditors. However, trust could run out of money if payout too high, or trust is mismanaged.

D. Does the donor want (or need) inflation protection?

1. Pooled Income Fund should provide a growing income stream. Donor should investigate the investment strategy and experience of the PIF.

2. Charitable Remainder Unitrust – Distribution may keep pace with inflation IF the initial payout rate is not too high. A 5% trust is more likely to grow than a 9% trust!

E. Does the donor want the payments to continue for the lifetime of one or more individuals?

1. Gift Annuity limited to 2 lives.

2. PIF, CRT can be set up for one, two or more lives.

3. Gift Annuity and CRT subject to 10% rule.

F. Does the donor want to provide for multiple beneficiaries, or contingent income beneficiaries?

1. Term of years unitrust or annuity trust may be used for this purpose.

2. Discretionary trust may also be desirable if tax benefit is not needed.

G. Does the donor want to remember multiple charitable beneficiaries or reserve the right to change the charitable beneficiaries?

   1. CRT can benefit multiple charities, and donor can reserve right to change.

   2. Annuity, PIF limited to a single charity. Separate contracts or arrangements must be made with each charity. Some charities may not have a PIF, and some may not issue annuity contracts.

H. Might it be necessary to invade principal to meet beneficiary's needs? Only the discretionary trust offers this option.

I. Is a charitable deduction needed for income tax or estate tax purposes?

   1. Discretionary trust does NOT provide a tax deduction.

   2. CRT, Gift Annuity and PIF all provide charitable dedctions.

   3. Larger deductions result from:

      a) Older beneficiaries

      b) Fewer lives

      c) Lower unitrust percentage or annuity trust payout.

      d) Term of years trust may often provide the best deduction

J. What type of property will fund the plan?

   1. Real estate

      a) Charitable Remainder Trust is typically best for real estate.

         (1) Annuity Trust or STAN-CRUT can be problematic. Problem of how to make distributions to the beneficiary before the property is sold.

         (2) Flip trust is ideal for real estate. NI-CRUT or NIM-CRUT is also OK.

      b) It is possible to fund a Gift Annuity with real estate, but this can create problems for the charity.

      c) PIF can accept real estate if it is set up to do so. Usually, a separate PIF would be set up for the purpose of holding real estate.

2. Appreciated securities

    a) Complete capital gain avoidance in CRUT, CRAT or PIF. However, 4-tier system may result in some of the capital gains being distributed out in the CRUT or CRAT.

    b) PIF cannot accept tax-exempt securities. Also, PIF should be concerned about marketability and income potential. While PIF can accept closely-held stock, it would be inappropriate to do so if the other beneficiary's income stream would be impaired by doing so.

    c) Partial capital gain avoidance with Gift Annuity. Capital gain recognition will also be spread over the life of the annuity IF the donor is the annuitant.

3. Retirement assets, IRAs, etc.

    a) Consider CRUT or CRAT to avoid deferred income tax liability.

    b) PIF and Annuity do not offer the same result.

K. Who will be the income beneficiary?

1. If the beneficiary of an inter vivos gift is someone other than the donor, the gift tax consequences of the various plans differ somewhat. In general, avoid inter vivos gift of deferred gift annuity.

2. If beneficiary is not the donor, generally avoid funding annuity with appreciated property. Instead, use PIF or Charitable Remainder Trust, which avoids capital gain even if donor is not the beneficiary.

L. Is there a desire to defer the receipt of income?

1. Deferred gift annuity is obvious choice.

2. Consider also using NIM-CRUT and employing an investment strategy that minimizes income and maximizes growth.

IX. Which plan is best for the Charity?

A. Gift Annuity

1. Rates generally designed to produce 50% residuum at termination of the contract.

2. Exception: Rates are flattened at the very oldest ages, so residuum should actually be higher in those instances.

3. Note that the residuum for a gift annuity issued to a 35 year old is 50%, and the residuum for a gift annuity issued to an 85 year old is also 50%, but the present value (and risk) to the charity is vastly different in these two instances.

4. Charity can experience greater residuum to the extent it has superior investment performance or favorable actuarial experience. Conversely, the residuum can be eroded by poor investment experience or unfavorable actuarial experience. The charity bears the risk, and it is possible for the charity to lose money on an annuity.

5. Encourage use of ACGA rates, which are designed to protect charities.

B. Pooled Income Fund

1. Depending on investment strategy, fund should grow, and the amount charity receives upon beneficiary's death should be greater than the initial contribution.

2. At any rate, it is impossible for the charity to lose money on a PIF contribution.

3. Special purpose PIF may benefit charity by providing a building or other asset for its charitable purpose.

C. Charitable Remainder Trust

1. The ultimate benefit to charity will depend on the relationship between the payout rate and the investment performance.

2. Actuarial experience also has a bearing.

3. Charity cannot lose money on a CRT, but the benefit to charity in some instances may not justify the administrative costs, if the charity is acting as trustee and managing the trust.

4. If donor reserves the right to change charitable beneficiaries, the charity's interest may be vulnerable.

5. Donor may reserve the right to amend the charitable beneficiaries, so the charity's interest may not be irrevocable.

D. Discretionary Trust

1. This trust is not designed to benefit charity primarily. However, it is possible for charity to receive a substantial benefit from this type of trust. For example, a donor may be concerned about a disabled child, but may want any remaining funds to pass to charity upon the child's death. If child's needs are cared for by government or other sources, there may be substantial funds that pass to charity upon the termination of the trust.

2. In contrast, setting up a CRT for a disabled person may be a mistake, because the CRT is required to pay out the income, and this income may supplant government aid. (It is also possible in some instances to have the CRT income paid to a discretionary trust.)

X. Conclusion

A. All of the life income plans provide similar benefits, in that income is paid to a private beneficiary, and remainder to charity.

B. But the exact characteristics of the various plans differ substantially.

C. Before advising a donor, take the time to understand the entire situation:

1. Donor's objectives

2. Nature and amount of property available to fund the arrangement

3. Tax consequences

4. Identity, age, and health needs of the beneficiaries

Comparison of Life Income Plans

	Gift Annuity	Pooled Income Fund	Charitable Remainder Unitrust	Charitable Remainder Annuity Trust
Fixed or variable payment	Fixed	Variable	Variable	Fixed
Growth in income payout?	No	Likely	Possible, depending on payout rate	No
Payment guaranteed by charity's assets	Yes	No	No	No
Assets in fund/ trust protected from Charity's general creditors?	No clear answer	Yes	Yes	Yes
Tax deduction on funding	Yes	Yes	Yes	Yes
Capital gains on funding with appreciated property	Partial avoidance. Balance deferred if donor is the annuitant	Completely avoided	Completely avoided	Completely avoided
Taxation of income payments	Partially taxable; partially excluded	Fully taxable	Generally taxable. Some portion may be tax-free return of principal or capital gain	Some portion may be tax-free return of principal or capital gain.
More than two lives?	No	Yes	Possibly, but must meet 10% rule	Possibly, but must meet 10% rule.
Term of years?	No	No	Yes, up to 20	Yes, up to 20
Separately managed?	No	No	Yes	Yes
Minimum to create?	$5,000 or more	$10,000 or more	$50,000 or more	$50,000 or more
Payout rate	Suggested by ACGA rates	Actual income earned in trust	Determined by donor and charity when trust established	Determined by donor and charity when trust established.
Fund with real estate?	Depends on policy of individual charity	Depends on design of individual PIF	Yes	Only if income-producing or readily marketable
Fund with tax-exempt securities?	Yes	No	Yes, but be careful of capital gains	Yes, but be careful of capital gains

Building Bridges Through Philanthropy

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ADVANCED PLANNING
WITH DEFERRED 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) ACGA 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 reasons 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 from time to time by actuarial analysis performed by the American Council on Gift Annuities.

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.[1]

[1] 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 April, 2005 in exchange for an annual annuity of $720. Using an IRC §7520 CMFR of 5.0%, and Publication 1457, we determine that the applicable factor is 7.4093 which, when multiplied by the annuity amount, results in a present value of Tom's annuity of $5,434. The charitable deduction is the amount transferred, $10,000, less this amount, or $4,566. 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 $720; or $8,496. The exclusion ratio is the ratio of the investment in the contract of $5,434 to the expected return of $8,496, or 64%. Of the $720 Tom receives each year, 64%, 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.[2] 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.[3]

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 gift tax exclusion,[4] although this result is not entirely free from doubt.[5] A deferred annuity won't qualify for the annual exclusion because it is a future interest.[6]

   (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.[7] The donor can avoid creating a taxable gift by retaining in the gift instrument the right to revoke the survivor's interest.[8] 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.

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[2] IRC §72(b)(2).

[3] IRC §72(b)(3).

[4] PLR 8637084.

[5] Estate of Miriam Kolker, 80 TC 58 (1983).

[6] IRC §2503(b).

[7] IRC §2503(b).

[8] Treas. Reg. §2511-2(c).

(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.[9]

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.

(a) A CGA created solely for the spouse will qualify for the gift or estate tax marital deduction.[10]

(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.[11] 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 donors 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.[12]

(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.

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[9] IRC §691(c).

[10] Treas. Reg. §§ 2056(b)-1(g), Example 3; 2523(b)-1(b)(6)(iii).

[11] IRS §2523(f)(6).

[12] IRC §2056(b)(7)(C).

The gift to the husband will not qualify for the gift tax marital deduction because the husband has not been give the immediate right to receive income.[13] 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.[14]

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.[15] 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.[16]

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

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[13] Treas. Reg. §25.2523(f)-1(c)(2).

[14] Treas. Reg. §2056(b)-1(g).

[15] IRC §514.

[16] IRC §501(m).

described in IRC §514(c)(5). For this reason, most CGAs meet the four criteria in IRC §514(c)(5) described above.

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).[17] The basis of the property allocated to the annuity is determined as follows:

$$\frac{\text{FMV of Annuity}}{\text{FMV of Property}} \text{ X Adjusted Basis} = \text{Bargain Sale Basis}$$

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.[18]

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 $6,000 per year, resulting in an annuity with a present value of $64,471. Using the bargain sale rules, the portion of Billy's stock basis allocated to the sale portion of the transaction is 64.471% of $20,000, or $12,894. The difference between this and the value of the annuity, or $51,577, 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 54%, meaning that 46% of each annual payment of $6,000, or $2,760, will be taxable as ordinary income. Of the 54% that is not ordinary income, the gain of $51,577 divided by Billy's life expectancy of 19.9 years, or $2,592, will be long term capital gain and the remainder, $648, 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 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.[19]

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[17] IRC §1011(b).

[18] Treas. Reg. §1011-2(a)(4).

[19] Treas. Reg. §1.1011-2(a)(4)(iii)(b).

employer. He would like to commute the deferred gift annuity for payments over a five year period to bridge the period between full salary and when his social security and other benefits commence. Bruno determines that at age 60, he will have a life expectancy of 25 years and that the discounted present value of the right to receive $11,900 per year for 20 years (beginning at age 65)is $102,000. If this amount is paid by the college to Bruno with interest at 6% in five equal annual installments, he will receive $24,214 per year.

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.[20] 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 Bruno's case, the investment in the contract of $51,981 is recovered over the five year commuted payment period, so that $10,396 of each payment of $24,214 will be tax free.

2. **Penalty for Early Payments.** If an annuitant prior to age 59 ½ receives any amount under an annuity contract, the annuitant's tax is increased by 10% of such amount.[21] This penalty, which is in addition to the normal income taxes as summarized above, does not apply to the portion of the payment corresponding to the investment in the contract, but only to the portion deemed earned on that investment. While there are some exceptions to the general rule imposing the penalty, none of them apply to annuitants under age 59 ½ who commute their annuities in exchange for cash payments.

3. **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.[22]

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

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[20] IRC §72(e).

[21] IRC §72(q).

[22] See also GCM 39826.

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 Six: 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	$12,240	$3,800
Two	$25,000	$12,267	$3,600
Three	$25,000	$12,143	$3,450
Four	$25,000	$12,136	$3,275
Five	$25,000	$12,058	$3,125
TOTAL	$125,000	$60,844	$17,250

Betsy has shown Dr. Jane a system for setting aside $125,000 toward retirement, over a period of 5 years, almost half of which will be tax deductible. If this system is followed, Dr. Jane will create for herself retirement income of $17,250 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 3.6% after tax on her investments -- about 6% 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.**[23] 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 Five 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.

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. **PLR 9743054**. A DCGA with an elective starting date was approved by the IRS in this recent ruling, which states

   (a) The issuance of a DCGA with an elective starting date will not result in UBTI to the issuing charity.

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[23] The author wishes to express his appreciation to Frank Minton, with whom he worked in analyzing this type of DCGA.

(b) Income earned by the charity from investment of funds received from the donor in exchange for the DCGA will not be unrelated debt financed income under Code § 514(c).

(c) The annuity is a charitable gift annuity within the meaning of Code § 501(m)(5).

4. **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. In PLR 9743054, the IRS accepted this approach by ruling that a gift acknowledgement treating the deduction in this manner meets the requirements of Code §§ 170(f)(8)(B) and 6115(a).

5. This favorable treatment was reconfirmed by the IRS on similar facts in PLR 2004 49033.

Example Seven: 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
60	2,200
61	2,350
62	2,525
63	2,650
64	2,825
65	2,975
66	3,175
67	3,375
68	3,600

Payment Age	Annuity
69	3,850
70	4,100

For example, for a DCGA funded with $25,000, should Mark elect to begin receiving annuity payments at age 60, the annual annuity payable to him for his life would be $2,200.00. 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 $4,100. Based on these annuity rates, Mark's charitable deduction for an annuity starting at age 60 would be $10,148 ($25,000 less the value of the annuity, $14,852), while his deduction for an annuity starting at age 70 would be $14,095. Since, at the time of his contribution, Mark has the right to start the annuity at age 60, he is limited to the smallest possible deduction - - $10,148.*(See Appendix for sample annuity contract with elective starting date)*

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No. 007

ACGA COLLEGE

DEFERRED GIFT ANNUITY AGREEMENT

ACGA COLLEGE, a California nonprofit corporation ("ACGA COLLEGE"), agrees to pay BRUNO BIGTIME (the "Annuitant"), residing at 123 EASY ST., ANY TOWN, CALIFORNIA, an annuity in the annual amount of $11,900 for the rest of the Annuitant's life, in equal quarterly installments of $2,975 at the end of each calendar quarter, commencing on JUNE 30, 2021.

ACGA COLLEGE certifies that BRUNO BIGTIME (the "Donor") has contributed to ACGA COLLEGE cash in the amount of $100,000, receipt of which is acknowledged by ACGA COLLEGE.

The Annuitant's date of birth is April 15, 1956. The age of the Annuitant at the Annuitant's nearest birthday is 50.

The obligation of ACGA COLLEGE to make annuity payments shall terminate with the payment preceding the death of the Annuitant However, if the Annuitant dies before the commencement of the payments hereunder, ACGA COLLEGE is released from all obligations under this Agreement.

This right to receive payments under this annuity may not be assigned to any assignee other than ACGA COLLEGE.

Notwithstanding the preceding paragraph, the Annuitant may, at any time after the Annuitant attains age 59 ½ and not earlier than one year, nor later than 90 days, prior to the commencement date of payments hereunder, deliver to ACGA COLLEGE written notice of the election by the Annuitant to assign the Annuitant's right to receive payments hereunder. If this election is made by the Annuitant, ACGA COLLEGE agrees to purchase the rights of the Annuitant hereunder at a value determined using the applicable Internal Revenue Service tables to calculate the present value of the annuity. This agreed value shall, at the election of the Annuitant, be payable in cash by ACGA COLLEGE no later than 60 days from receipt of the notice from the Annuitant or in equal annual installments over a period specified in the election notice by the Annuitant of not less than four (4) years nor more than ten (10) years, with interest at 6%.

Attached hereto as Exhibit A is the Disclosure Statement required by the Philanthropy Protection Act of 1995. Donor acknowledges that Donor has received, read, and understood the Disclosure Statement. Donor also acknowledges that Donor has been provided with information relating to the tax aspects of this transaction for review with Donor's own legal, financial and tax advisors. Donor understands and acknowledges that Donor must consult with and rely exclusively on Donor's own advisors for advice concerning the tax aspects of this transaction.

This annuity shall be governed by the laws of the State of California.

IN WITNESS WHEREOF, ACGA COLLEGE has executed this instrument effective as of APRIL 15, 2006.

ACGA COLLEGE,
a California nonprofit corporation

By:____________________________________
JOHN DOE

DONOR

____
BRUNO BIGTIME

Annuities are subject to regulation by the State of California. Payments under this agreement, however, are not protected or otherwise guaranteed by any government agency or the California Life and Health Insurance Guarantee Association.

No. 008

ACGA HOSPITAL FOUNDATION DEFERRED GIFT ANNUITY AGREEMENT

ACGA HOSPITAL FOUNDATION, a California nonprofit corporation ("ACGA HOSPITAL FOUNDATION") agrees to pay to MARK MOREBUCKS (the "Annuitant"), residing at 123 EASY STREET, ANY TOWN, CALIFORNIA, an annuity for the rest of the Annuitant's life, in equal quarterly installments at the end of each calendar quarter, the amount of which shall be based on the year in which payments commence, as determined under the table contained in Exhibit A attached hereto.

To irrevocably elect the commencement date of payments hereunder, which shall be June 30 and which shall not be earlier than June 30, 2016, nor later than June 30, 2026, the Annuitant shall deliver written notice to ACGA HOSPITAL FOUNDATION no later than ninety (90) days prior to the desired commencement date.

ACGA HOSPITAL FOUNDATION certifies that MARK MOREBUCKS (the "Donor") has contributed to ACGA HOSPITAL FOUNDATION cash in the amount of $25,000 receipt of which is acknowledged by ACGA HOSPITAL FOUNDATION.

The Annuitant's date of birth is APRIL 15, 1956. The age of the Annuitant at the Annuitant's nearest birthday is 50.

The obligation of ACGA HOSPITAL FOUNDATION to make annuity payments shall terminate with the payment preceding the death of the Annuitant. However, if the Annuitant dies before the commencement of the payments hereunder, ACGA HOSPITAL FOUNDATION is released from all obligations under this Agreement.

This right to receive payments under this annuity is non-assignable.

Attached hereto as Exhibit B is the Disclosure Statement required by the Philanthropy Protection Act of 1995. Donor acknowledges that Donor has received, read, and understood the Disclosure Statement. Donor also acknowledges that Donor has been provided with information relating to the tax aspects of this transaction for review with Donor's own legal, financial and tax advisors. Donor understands and acknowledges that Donor must consult with and rely exclusively on Donor's own advisors for advice concerning the tax aspects of this transaction.

This annuity shall be governed by the laws of the State of California.

IN WITNESS WHEREOF, ACGA HOSPITAL FOUNDATION has executed this instrument effective as of APRIL 15, 2006.

ACGA HOSPITAL FOUNDATION,
a California nonprofit corporation

By:________________________________
BETSY FUNDRAISER

DONOR

____
MARK MOREBUCKS

Annuities are subject to regulation by the State of California. Payments under this agreement, however, are not protected or otherwise guaranteed by any government agency or the California Life and Health Insurance Guarantee Association.

EXHIBIT A Annual Annuity Based on Year of Starting Date	
If the year of commencement of the annuity is:	This will be the annual annuity amount:
2016	$2,200
2017	$2,350
2018	$2,525
2019	$2,650
2020	$2,825
2021	$2,975
2022	$3,175
2023	$3,375
2024	$3,600
2025	$3,850
2026	$4,100

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, $5,700 per year, resulting in an annuity with a present value of $70,852. The bargain sale ratio for allocating Billy's stock basis is 70.85%, resulting in $14,170 of his basis being allocated to the sales portion of the transaction. The resulting capital gain of $56,682 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 54%, meaning that 46% of each annual payment of $5,700, or 2,623, will be taxable as ordinary income. Treatment of the 54% that is not ordinary income is different for Billy and Jimmy. For Billy, the capital gain of $56,682 is divided by his life expectancy of 19.9 years, so that $2,846 is long-term capital gain each year, with the remaining $232 a tax-free recovery of Billy's basis in the stock. For Jimmy, the entire 54%, or $3,078, 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 $2,846 every year until the entire capital gain is recognized.

V. <u>Deferred Annuities</u>

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 Four: 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 $11,900 beginning at age 65, in exchange for a contribution of $100,000. Bruno will be entitled to claim a charitable deduction this year of $48,019.

B. **Commutation.** Deferral of the starting date for annuity payments to a fixed date in the future accomplishes the objective of matching the payments with the anticipated need for them. But what if there is an emergency – or simply a change in plans ? Would it be possible to build in greater flexibility? One way to build in greater flexibility is to include in the annuity agreement a clause allowing the annuitant to sell – or commute – the annuity contract at any time before payments are scheduled to begin..

Example Five: The college includes a provision in Bruno's annuity contract allowing Bruno the option of selling – or commuting – his annuity at any time before annuity payments begin, provided Bruno is at least age 59 ½ at the time. The formula for commutation is that the college 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 college will then pay this amount, either in a lump sum or, at Bruno's election, with interest at 6% in up to ten equal annual installments. *(See Appendix for sample annuity contract with commutation clause).* Bruno decides, at age 60, to cut back on the amount he works and reduce his salary from his

Evolving Planned Gifts—Case Studies

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Evolving Planned Gifts—Case Studies

1. In 1995, the chairman of the board of charity establishes a \$10,000,000 7% unitrust with zero basis stock. He and his wife, both 55 at that time, are the beneficiaries.

   In January of 2006, the Donor, no longer the chair but still a major force at the charity, approaches the president to discuss the unitrust which is now worth about \$18,000,000, and his net worth is in the \$1,000,000,000 neighborhood.

   He had been prowling through the "allied professionals" section of the charity's P.G. Web site and came across an article on planning with income interests.

   In the meantime, charity was in the throes of developing a plan to approach him for a significant lead gift for the new campaign.

Scenario 1: The Donor and his wife really don't need the income and wish to assign their income interest to charity.

(a) FMV of unitrust	\$18,000,000
Value of income interest (\$18,000,000 **less** \$4,295,700 Ch. ded.)	\$13,704,300
Tax-savings at 40%	<u>\$5,481,720</u>

(b) At creation of unitrust in 1995

FMV of unitrust	$10,000,000
Charitable deduction	$1,366,800
Tax-savings at 40%	$546,720

(c) Cash flow since inception of unitrust

The unitrust **grew at an average rate of 13% annually** over the 10 years to reach a value of $18,000,000.

Total before-tax distributions of	$9,248,250
After-tax value at 40% rate	$5,548,950
Present value	$4,097,242

(d) Total benefits ($5,841,720 plus $546,720 plus $4,097,242)	$10,125,682
(e) Not to mention, capital-gain tax "savings" of	$2,800,000

Scenario 2: Actually, and much to the chagrin of the president and the development staff, the Donor asked the president to have the charity "buy out" their income interest. So now, Donors would receive:

a. Results of sale of income interest

1. **To Donors:**

Value of income interest	\$13,704,300
Subject to 20% capital-gain tax (Rev. Rul. 72-243, 1972-1 CB 233)	<\$2,740,860>
Net proceeds	\$10,963,440
Plus, benefits 1(b) + (c)	\$21,635,842

Now, it becomes clear why Donor is worth a billion dollars.

1. **To Charity:**

Charity receives balance of (\$18,000,000 **less** \$13,704,300) or	\$4,295,700
Note: Initial charitable deduction was	\$1,366,800

b. Relative value of income interest

1. According to IRS tables, the present value of the income stream from the unitrust is $13,704,300.

2. However, whether received in installments from the unitrust for life or in a lump sum as sale proceeds, income and capital-gain taxes will have to be paid by the Donors.

3. To the Donors, one of the principal advantages of a lump-sum sale is that the sale locks in the current federal capital-gain tax rate at 15%. Future tax rates are at best uncertain.

   Nevertheless, the seller is going to net only 80%, or $10,963,440.

4. The charity after purchasing the income interest is going to free up the $4,295,700 locked up in the trust.

   (In this case, it would permit charity to avoid issuing bonds to finance the building project.)

5. Charity being tax-exempt will get to keep the entire income interest tax-free. So charity will get to keep the entire \$13,704,300 (plus the remainder), free of any erosion, but still have to pay for it.

6. So, somewhere between

   \$10,963,440 and \$13,704,300

   there should be a happy meeting-of-the-minds point where, charity pays **less**, and donors get **more**.

What would your charity offer?

And, what's the benefit of offering the seller a premium for the income interest before being asked?

7. Other reasons to sell income interest in CRTs.

8. The **present value** conundrum

$1,000 invested at an expected rate of return of 10% over one year would grow to $1,100

How much would you pay today for the right to receive $1,100 at the end of one year?

Present value for $1,100	discounted at
(a) $1,048	5%
(b) $1,000	10%
(a) $ 982	12%

See **Selling CRT Lead Interests**, Roger D. Silk and James W. Lintott, Trusts & Estates, August 2005, p. 37-43, see footnote 9 in particular, for an excellent explanation of this topic.

Scenario 3: Exchange income interest for a CGA

Considering the ages and wealth of the beneficiaries, this option is probably not attractive to them.

This option may be more appropriate to much older beneficiaries who have become risk averse and concerned about the stability of their income stream.

2. Q. The donor, aged 70, wants to give us $100,000. But she advised my colleague that she will likely lose her battle with a chronic health problem in the next three to five years—probably the lesser—versus the 17 years remaining life expectancy. So, she wants a payout—over a 3 to 5 year period—that equates as close as possible to the $110,000 she would receive if she lived the additional 17 years.

I can't imagine that we'd agree to a CGA or CRAT with terms like that. We'd barely break even. Not to mention that the payout rate would be way beyond ACGA guidelines.

Any ideas as to what vehicle might work in this situation and still meet the criteria for a charitable gift?

Is there something else that makes more sense? Should we realistically decline this gift?

A. **Why not suggest a 5% CRAT for life or 17 years—whichever is longer. This way, she'll be assured that the income will be paid for her life expectancy of 17 years. This would not work with a CGA because of the term of years aspect.**

A CRAT paying $17,000 a year for 5 years would not work because it fails the 5% probability test.

3. Q. André—Here is the response I received back from the donor explaining where she read this information—any thoughts?

A. **I found that tidbit in "Bob Carlson's Retirement Watch," a monthly newsletter. Vol 16, Issue 7, July 2005. The quote is "Charitable contributions are fully deductible under the AMT, except for some contributions of property. Most taxpayers do not have to reduce their charitable giving to avoid the AMT." This was in an article discussing deductions you cannot claim if you are subject to AMT.**

A. AMT Review:

1. Tax Rate: 26% on first $175,000

28% over that

2. Exemption: $58,000 marrieds phase-out over $150,000

$40,250 singles phase-out over $112,500

reduces exemption by $1 for every $4 of extra income.

Phase-out stops at $382,000 and $273,500 respectively.

3. Disallowed deductions:

1. Standard deduction or personal exemptions.
2. Medical expenses 10% of AGI or less.
3. State or local and other taxes.
4. Miscellaneous deductions.

4. Exercise of ISO results in subjecting gain to AMT even if not yet realized.

5. Interest on certain private equity in tax-exempt bonds is taxable.

4. Medicaid planning

A. Nonexempt asset divestiture to obtain Medicaid eligibility by the wealthy led Congress to impose periods of ineligibility

1. 36-month look-back period from date of **outright** transfers
2. 60-month from date of transfer to or from a **trust**

B. How it works

Amount and date of outright transfer	$240,000 on 1/1/06
Average monthly cost of nursing home care	$6,000

Waiting period
$240,000 over $6,000 = 40 but limited to 36 months

C. ***Planning pointer:*** Transferor can keep $216,000, move into nursing home on 1/1/06, run out of money on 1/1/09, and be eligible for Medicaid benefits immediately.

D. In some states (e.g., N.J., N.Y., Ohio, Wis., etc.) such planning is permitted to be done by **guardian** even if he/she is the child of the incompetent elder. Requirement:

1. Restoration of competency is virtually nil
2. Assets remaining after gifts adequate to meet need and maintain standard of living until eligibility,
3. Donees are natural object of incompetent's bounty
4. Transfer will benefit incompetent's estate
5. Incompetent if competent would make such gifts.
   See **In re Keri**, 181 NJ 50 (2004), **unanimous decision**

E. Implications for gift planning

5. Decedent owned 6.44% in a C corporation whose principal assets consisted of marketable securities valued at $188,000,000 and a built-in capital-gain tax liability of $151,000,000 (**Est. of Jellee**, TC Memo, 2005-131).

- Is the estate's $12,000,000 interest in C entitled to a discount for the potential capital-gain tax liability?

- Any other discount available?

- Impact on charitable bequests.

6. Does the value of a decedent's retirement account—comprised solely of marketable securities—qualify for FET discount to reflect income tax payable by beneficiaries upon receipt of distributions? (**Est. of Smith** v. U.S., S.D. Tex. 2004), TAM 200247001

- Willing buyer—willing seller test applies to assets and not to account holding assets. FIT paid by seller would not affect buyer's price.

- IRC §691(c)

7. **Donor owns X corp (sub S), a financial services company, that has a FMV of $10,000,000 and has been approached by a potential buyer about selling the business. Donor is contemplating a charitable gift of 100 shares of the 1,000 shares that he owns and has zero basis.**

A. Gift of stock before sale of X

Charitable contributions of 100 shares	$1,000,000
Minority & lack of marketability discount 30%	<$ 300,000>
Allowable charitable deduction	$ 700,000
Net tax savings 35% bracket	$ 245,000

Donor's gross from sale of company	$9,000,000
Capital-gain tax	<$1,350,000>
After-tax proceeds from sale	$7,650,000
Plus: tax savings	$ 245,000
Total after-tax proceeds	$7,895,000

B. Gift of cash proceeds after sale of X

After-sale proceeds from sale of 100 shares	$1,000,000	
Attributable capital-gain tax 15%	<$ 150,000>	
Net proceeds & charitable gift*	$ 850,000	
Net tax savings (35% of $850,000)	$ 297,500	vs. $ 245,000
Sale proceeds	$10,000,000	
Capital-gain tax	<$ 1,500,000>	
Net after tax	$ 8,500,000	
Less: charitable gift	$ 8,500,000	
Plus: tax savings	$ 297,500	
Total after-tax proceeds	$ 7,947,500	vs. $7,895,000
If S gives charity	$1,000,000	
Net tax savings (35% of $1,000,000)	$ 350,000	
or, **Less:** charitable gift	$ 1,000,000	
Plus: tax savings	$ 350,000	
Total after-tax proceeds	$ 7,850,000	vs. $7,895,000

*What's another benefit of a gift of proceeds instead of stock?

C. Results to Charity:

1. **Presale gift** of 100 shares to charity

S and charity sell their shares to buyer and charity receives	$1,000,000
If C corp., end of story, net to charity	$1,000,000
If S corp., **UBTI** at 34%	<$340,000>
Net to charity	$ 660,000

2. **Post-sale gift** to charity of proceeds

$850,000 charity nets, or	$ 850,000
$1,000,000, charity nets	$1,000,000

Summary of Options

	Gift of stock **before** sale 100 shares	Gift of net proceeds **after** sale ($850,000)	Gift of gross proceeds **after** sale ($1,000,000)
Donor receives:	$7,895,000	$7,947,500	$7,850,000
		+$52,500	<$45,000>
Charity receives:			
C Corp	$1,000,000 ?	$850,000	$1,000,000
		– $150,000	–
S Corp	$660,000*	$850,000	$1,000,000
		+$190,000	+$340,000

**Planning pointer:* 1. Can this adverse tax consequence be obviated?

2. What if donor contributed all of the S corporation assets instead of stock?

8. Charity accepts a large dairy farm operation for a 10.5% CGA from a farmer in another corner of the state. Within a year all the cows die. Farmer still alive and going strong at 92 when DO last saw him.

9. Midwest college writes a 12.5% CGA for a $5M shopping center. Recommended rate at 85 is 9.5%.

10. Donor in her 80s created a $75,000 CGA in May, and another one for $25,000 in June with Mega charity. She died in November. Her remaining estate valued at $98,000 was also bequeathed to Mega charity. Nursing home where she lived and died asks Mega charity to disclaim the $98,000 bequest on grounds that she had promised that portion to nursing home. Mega disclaims its interest.

Issues 1.

2.

3.

11. Gretta, aged 60, single, and committed to charity, calls to say she is ready and wants to create a $250,000 unitrust but does not really need the income for a few years. What do you recommend?

12. Donor aged 79 creates a two-life gift annuity for himself and his friend, aged 68, and funds it with $1.9M of municipal bonds. Within a year he funds another $1.3M CGA, again with municipal bonds. What gives?

13. Very wealthy board chair asked for a $5M commitment to a mini campaign within charity, can come up with only $2M cash and securities. Much of his wealth tied up with art hanging on the walls of his apartment and he is not willing to sell. Any suggestions?

14. Recent questions involving tangible personal property:

1. H buys for $50,000 a painting from W who created it. W includes X in her schedule E. H contributes painting to related charity. Is a charitable deduction allowable? How much?

2. A church minister is also a professional viola player in his free time and is quite busy. He would like to exchange the viola for a gift annuity. Cost $2,500, FMV $100,000.

3. Donor has an outstanding $5M pledge to museum. She would like to contribute a painting by a living artist valued between $6M and $7M to fulfill pledge. Museum will not accept painting, wants cash. Donor consigns painting to auction and directs that proceeds be distributed to museum. Donor does not care about charitable deduction.

15. Health and Education Exclusion Trust (HEET)

A. In addition to the $11,000 annual exclusion per donee, IRC §2503(e) provides an unlimited gift-tax exclusion for qualified medical and educational expenses paid directly to qualified medical and educational institutions on behalf of any donee.

1. Educational expenses limited to tuition.

2. Only medical expenses deductible under IRC §213(d) qualify.

3. Prepaid tuition expenses for two grandchildren qualified. If they failed to attend payments would be forfeited. (TAM 199941013)

4. Relationship between donor and donee not relevant.

B. The annual exclusion and payment for qualified educational and medical expenses are also excluded from generation skipping tax. So a grandparent can pay such expenses for living grandchildren and great-grandchildren.

C. Distributions from a trust to grandchildren to cover such expenses would be treated as "taxable distributions" subject to GST.

D. Distributions from a HEET directly to a qualified charity for tuition and medical expenses are excluded from GST.

E. A HEET could be set up in perpetuity to cover tuition and medical expenses for future generation and the distributions would not be subject to GST.

F. The HEET is immune from GST so long as there is a nonskip person floating around.

1. What happens when the last skip person permanently floats away?

   Answer: A "taxable termination" subject to GST, as the HEET now becomes a "skip" person

2. To prevent this from happening, the HEET must always have a nonskip person to prevent a taxable termination event from happening.

G. Charity is the perfect candidate.

1. By including charity as a beneficiary of a HEET, there will always be a nonskip person and a taxable termination cannot happen.

2. Make sure to provide for successor charities as beneficiaries in the event the initial charity or charities cease to exist.

H. Charity must be a meaningful beneficiary; otherwise it will be discarded under IRC §2652(c)(2) as a ploy to avoid GST, and the plan will collapse. To avoid such treatment:

1. Charity as a beneficiary from the inception of HEET

2. Annual 10% unitrust distributions, or 50% of income and 5% of principal distributions, have been suggested.

3. HEET as remainder beneficiary of a CLAT.

I. Funding of HEET

a. Annual exclusion transfers during life.

b. Testamentary transfer at death. Such transfers, however, would be subject to FET on initial transfer.

16. Give Bonds to Capture Gain, Eliminate Risk

A. As interest rates have dropped, the value of corporate and government bonds that pay higher than current market rates has increased. Investors who purchased bonds a few years back often have seen the value of those bonds go up significantly. Now, though, bondholders may feel as if they are sitting on a time bomb with three fuses.

1. Some of these bonds may be subject to provisions that allow the bond issuers to call in such bonds at par (face value).

2. Even if the bonds are not called, they will be worth their face value only if held until maturity.

3. If interest rates start to rise, investors will see their appreciation begin to melt away.

4. To capture the benefit of the appreciation, the owner has to sell the bond, which in turn will trigger capital-gain tax.

5. For these reasons, appreciated bonds can be an excellent choice to fund charitable gifts.

B. Calculating Value of Bonds

In 1984, an investor bought a newly issued $100,000 par value U.S. Treasury Bond with a coupon yield of 12.4% paid out semi-annually. The bond will mature in exactly nine years. The yield to maturity (**YTM**) on a comparable bond is currently at 4.12%.

Cost basis in 1984	$100,000
(8/12/03) value at 4.6% YTM	$171,318
Current value (8/25/05) at 4.02% YTM	$162,750
In nine years the bond will be redeemed for	$100,000

Calculator Method

Enter:

FV $100,000

I	½ of interest rate
N	Number of semi-annual payments
PMT	Amount of semi-annual payment

Then:
punch CPT, and PV

C. Outright gift option

FMV of 4.12% YTM bond	$162,750
Tax-savings in 35% bracket	$ 56,963
Capital-gain tax avoided	$ 9,413
Total taxes avoided	$ 65,376

D. Life-income option

A 78-year-old who owns such a bond would be receiving $12,400 annually over the next nine years. Life expectancy is 10.5 years.

No gift

Annual return	$12,400
Tax at 35%	$ 4,340
After-tax return	$ 8,060

E. Gift Annuity

1. Annual annuity			$13,020
Tax-free portion	$5,442	net	$ 5,442
Capital gain	$3,880	net	$ 3,298
Ordinary income	$3,698	net	$ 2,404
After-tax return for 10.5 years			$11,144
Thereafter, after-tax return			$ 8,463
2. Charitable deduction			$73,470
Tax savings at 35%			$25,715
Net return at 6% + 20% tax rate			$ 1,234
Total annual return for 10.5 yrs ($11,144+$1,234)			$12,378 + 54%
Thereafter ($8,463+$1,234)			$ 9,697 + 20%

E. Deferred gift annuity

A 60-year-old individual owning a similar bond can lock in his/her high return and "cash in" the capital gain with a **DGA.**

1. Annual annuity of 10.5% after a 10-year deferral			$17,988
Tax free	$3,990	net	$ 3,990
Capital gain	$2,846	net	$ 2,419
Ordinary income	$11,153	net	$ 7,249
After-tax annual return for 15.9 years			$13,658
2. Charitable deduction			$62,714
Tax savings at 35%			$21,950

Federal Estate Tax Returns 1999-2004

	1999				2000				2001			
	Exempt Amt: $650,000				*Exempt Amt: $675,000*				*Exempt Amt: $675,000*			
Size of gross estate	Gross estate for tax purposes		Charitable deduction		Gross estate for tax purposes		Charitable deduction		Gross estate for tax purposes		Charitable deduction	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
All returns, total.........	**103,979**	**$196,405**	**17,554** 16.9%	**$14,575**	**108,322**	**$217,402**	**18,011** 16.6%	**$16,092**	**108,112**	**$215,649**	**18,711** 17.3%	**$16,150**
$600 under $ 1,000	49,898	$38,959	6,640	$1,142	47,845	$38,598	5,820	$ 894	45,459	$36,954	6,463	$ 873
$1,000 under $ 2,500	40,771	60,534	7,354	2,381	45,248	66,946	8,144	2,559	47,300	70,299	7,844	2,896
$2,500 under $ 5,000	8,621	29,151	1,995	1,493	10,018	34,085	2,232	2,093	9,893	33,989	2,484	2,077
$5,000 under $10,000	3,049	20,751	896	1,415	3,386	23,287	1,062	1,989	3,550	24,229	1,151	1,835
$10,000 under $20,000	1,063	14,495	409	1,392	1,129	15,253	432	1,522	1,282	17,219	468	1,668
$20,000 or more...........	577	32,515	261	6,753	696	39,233	321	7,035	628	32,960	301	6,802
*	**		**		**		**		**		**	

	2002				2003				2004			
	Exempt Amt: $1,000,000				*Exempt Amt: $1,000,000*				*Exempt Amt: $1,500,000*			
Size of gross estate	Gross estate for tax purposes		Charitable deduction		Gross estate for tax purposes		Charitable deduction		Gross Estate for Tax purposes		Charitable deduction	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
All returns, total.........	**61,551**	**$181,002**	**11,482** 18.7%	**$17,146**	**66,044**	**$194,554**	**12,492** 18.9%	**$14,604**	**62,718**	**$192,636**	**11,559** 18.4%	**$14,958**
$625 under $ 1,000	46,361	68,576	7,688 16.6%	3,131	49,748	74,007	8,294 16.7%	2,742	49,974	70,145	7,433 14.9%	2,550
$1,000 under $ 2,500	9,882	33,618	2,097 21.2%	1,820	10,549	35,954	2,373 22.5%	2,303	10,887	36,985	2,339 21.5%	2,058
$2,500 under $ 5,000	3,439	23,598	970 28.2%	1,749	3,732	25,285	1,009 27.0%	1,687	3,806	25,957	1,041 27.4%	1,755
$5,000 under $10,000	1,198	16,188	420 35.1%	1,524	1,293	17,645	486 37.6%	1,575	1,315	17,907	456 34.7%	1,454
$10,000 under $20,000	671	39,022	307 45.6%	8,922	721	41,663	330 45.8%	6,297	736	41,641	330 44.8%	7,340
$20,000 or more...........												
*	**		**		**		**		**		**	

* *Dollar amounts in thousands*

** ***Dollar amounts in millions***

Investing to Maximize Remainder

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Investing to Maximize Remainder

Overview of Investment Planning for Planned Giving Programs

Investor Profile → Investor Objectives → Investment Context

Investor Profile
- Donor
- Institution
- Planned Giving Vehicle

Investor Objectives
- Donor
- Institution

Investment Context
- Fiduciary Standards
- Capital Market Considerations
- Tax Considerations
- Portfolio Management Vehicles
- Cost Considerations
- Execution Issues

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Who is the Investor?

Donor/Income Beneficiary

- Age
- Tax bracket
- Other income
- Risk tolerance
- Access to integrated planning

Investing to Maximize Remainder

Overview of Investment Planning for Planned Giving Programs

Investor Profile → Investor Objectives → Investment Context

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Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Who is the Investor?

Institution

- Stakeholders
  - Board
  - Planned Giving Officers
  - Administrative Staff
  - Investment Staff
- Size of program
- Risk tolerance

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Who is the Investor?

Planned Giving Vehicle

- Size
- Type
  - Gift Annuity
  - CRAT
  - CRUT
  - NIMCRUT
- Payout rate
- Tax characteristics of vehicle

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Who Bears the Risk?

Charitable Remainder Annuity Trust

- Fixed dollar payout to Donor
- Who bears the risk?
  - Market risk – Institution
  - Reinvestment risk– Institution
  - Inflation risk – Donor primarily, but also Institution
  - Payment volatility risk – No
  - Tax risk/uncertainty for Donor - Yes

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Who Bears the Risk?

Gift Annuity

- Fixed dollar payout to Donor
- General obligation of the Institution
- Who bears the risk?
  - Market risk – Institution
  - Reinvestment risk– Institution
  - Inflation risk – Donor primarily, but also Institution
  - Payment volatility risk – No
  - Tax risk/uncertainty for Donor - No

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Who Bears the Risk?

Charitable Remainder Unitrust

- Fixed percentage of annual value paid to Donor
- Who bears the risk?
  - Market risk – Shared between Donor and Institution
  - Reinvestment risk– Shared between Donor and Institution
  - Inflation risk – Shared between Donor and Institution
  - Payment volatility risk – Yes
  - Tax risk/uncertainty for Donor - Yes

Investor Profile → Investor Objectives → Investment Context

Who Bears the Risk?

NIMCRUT

- Payout to Donor equals net income of trust
- Who bears the risk?
  - Market risk – Institution
  - Reinvestment risk– Primarily the Donor
  - Inflation risk – Shared between Donor and Institution
  - Payment volatility risk – High over long term
  - Tax risk/uncertainty for Donor - Yes

Investor Profile → Investor Objectives → Investment Context

Who is the Investor?

Donor/Income Beneficiary

- High current income
- Growth of income
- Predictability of income
- Growth of remainder to fulfill charitable intent
- Preservation of charitable deduction (execution issue)

Overview of Investment Planning for Planned Giving Programs

Investor Profile →	Investor Objectives →	Investment Context
◆Donor ◆Institution ◆Planned Giving Vehicle	◆Donor ◆Institution	◆Fiduciary Standards ◆Capital Market Considerations ◆Tax Considerations ◆Portfolio Management Vehicles ◆Cost Considerations ◆Execution Issues

Investor Profile → Investor Objectives → Investment Context

Who is the Investor?

Institution

- Donor satisfaction
- Maximize remainder interest
- Preserve and enhance overall image of the Institution
- Stakeholder voices
  - Board
  - Planned Giving Officers
  - Investment Staff
  - Administrative Staff

Investing to Maximize Remainder

Overview of Investment Planning for Planned Giving Programs

Investor Profile → **Investor Objectives** → **Investment Context**

Investor Profile
- Donor
- Institution
- Planned Giving Vehicle

Investor Objectives
- Donor
- Institution

Investment Context
- Fiduciary Standards
- Capital Market Considerations
- Tax Considerations
- Portfolio Management Vehicles
- Cost Considerations
- Execution Issues

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Fiduciary Standards

Duties of Trustee – Common Law

- Duty to administer trust in accordance with its terms
- Duty to exercise care, skill, and prudence in administering trust
- Duty of loyalty to beneficiaries
- Duty to secure and safeguard trust estate
- Duty to segregate and identify trust assets
- Duty to account
- Duty to invest and make trust property productive

Investing to Maximize Remainder

Endowment vs. Planned Giving Program

	Endowment	Charitable Remainder Trust
Time Horizon	Perpetual	Finite - Life or Term of Years
Tax Status	Tax-Exempt	Taxable Distributions
Unrelated Business Income	Allowed (w/in IRS limits)	Prohibited (except gift annuities)
Pay Out Rate	One Rate/Spending Policy	Varies by Vehicle and Donor
Risk Tolerance	Institution's Risk Tolerance	Varies by Vehicle and Donor
Assets	One Large Pool	Many Small Pools
Liquidity Requirements	Unique to Institution	Varies by Vehicle
Return Requirement	Institution's Requirement	Varies by Vehicle and Donor
Investment Policy	One Policy	Policy for Each Trust and Separate Pool

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Fiduciary Standards

Uniform Prudent Investor Act – Codified in 35+ States

- **"A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution."**
- **Codifies Modern Portfolio Theory: "A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of the overall investment strategy having risk and return objectives reasonably suited to the trust."**
  - **Duty to monitor risk and return in total portfolio**
  - **No "per se" imprudent investments**

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Fiduciary Standards

Circumstances to be considered by trustee in making investment and management decisions under **Prudent Investor Act**:

- General economic conditions
- Possible effect of inflation or deflation
- * Expected tax consequences of investment decisions
- Role each investment plays within overall trust portfolio
- Expected total return from income and appreciation of capital
- * Other known resources of the beneficiary
- Needs for liquidity, regularity of income, and preservation or appreciation of capital
- An asset's special relationship or special value, if any, to the purposes of the trust or to one of more of the beneficiaries

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Capital Market Considerations

Overview

- Asset classes
- Impact of inflation
- Risk and return relationships
- Benefits of diversification
- Benefits of asset class combinations

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

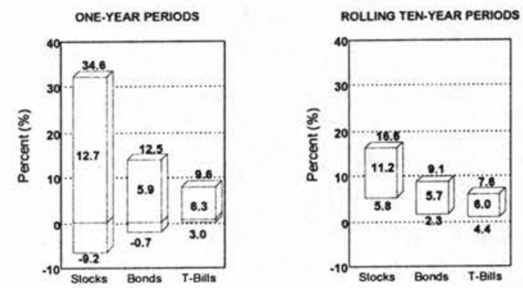
Fiduciary Standards

Other Duties and Permitted Acts of Fiduciaries Under **Prudent Investor Act**

- Duty to diversify trust investments -- unless trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying
- Duty of impartiality among beneficiaries
- Duty to secure investment services at reasonable cost
- Duty to use special skills -- a trustee who has special skills, or who is named trustee upon a representation thereof, has a duty to use those special skills or expertise.
- Authority to delegate investment management duties

Investing to Maximize Remainder

Benefits of Diversification *Risk/Return Relationships 1926 – Oct. 31, 2005*



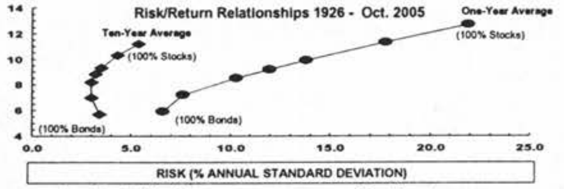
S&P 500 Index   Lehman Brothers Gov't/ Credit Index   90-Day T-Bills

* Lehman Gov't/Credit Index (1973 - present)
U.S. Long-term Corp. Total Return – Ibbotson Associates (1926 - 1972)

Note: The range of returns represents the average return plus or minus one standard deviation. Actual returns for any time period fall into this range 68% of the time

Investing to Maximize Remainder

Asset Class Combinations – Stocks and Bonds



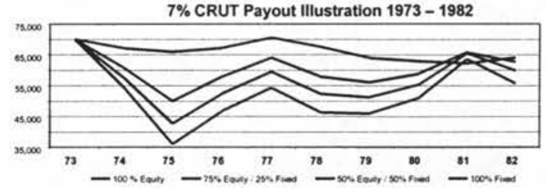
Ten-Year Rolling Average			One-Year Average		
Bonds/Stocks	**Return**	**Risk (±1)**	**Bonds/Stocks**	**Return**	**Risk (±1)**
(0/100)	11.2%	5.4%	(0/100)	12.7%	21.9%
(20/80)	10.3%	4.3%	(20/80)	11.3%	17.8%
(40/60)	9.3%	3.5%	(40/60)	9.9%	13.8%
(50/50)	8.8%	3.2%	(50/50)	9.2%	12.0%
(60/40)	8.2%	3.0%	(60/40)	8.5%	10.3%
(80/20)	7.0%	3.0%	(80/20)	7.2%	7.6%
(100/0)	5.7%	3.4%	(100/0)	5.9%	6.6%

Past performance is no guarantee of future results

Investing to Maximize Remainder

Investment Volatility Impacts Donor and Institution

7% CRUT Payout Illustration 1973 – 1982



	100% Equity	75/25	50/50	100% Fixed
Target Payment	$70,000	$70,000	$70,000	$70,000
High	$70,000	$70,000	$70,000	$70,000
Low	$36,084	$42,799	$50,018	$62,192
Largest Negative Change	($18,455)	($14,874)	($10,789)	($3,632)
Ending Value to Charity	$903,349	$981,083	$1,037,763	$1,083,575

For illustration purposes only. Past performance is no guarantee of future results.

Investing to Maximize Remainder

Investment Volatility Impacts Donor and Institution

Assumptions

- $1,000,000 Initial Amount
- Payout – 7% Unitrust
- Management Fee -- 50 Basis Points

Asset Allocations Analyzed

- 100% Equity
- 50% Equity / 50% Fixed
- 75% Equity / 25% Fixed
- 100% Fixed

Time Periods Analyzed

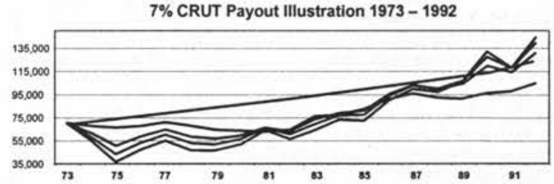
- 1973-1982 – Challenging Equity Market
- 1973-1992 – Improving Equity Market

For illustration purposes only.

Investing to Maximize Remainder

Investment Volatility Impacts Donor and Institution

7% CRUT Payout Illustration 1973 – 1992



	100% Equity	75/25	50/50	100% Fixed
Target Payment	$70,000	$70,000	$70,000	$70,000
High	$143,857	$139,052	$130,183	$104,264
Low	$36,084	$42,799	$50,018	$62,192
Ending Value to Charity	$2,057,806	$1,986,603	$1,857,583	$1,484,029

For illustration purposes only. Past performance is no guarantee of future results.

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Tax Considerations

Issues

- Donor's after-tax results are driven by Institution's investment strategy
- In general, commingling planned giving assets with endowment assets, ignores the tax ramifications to Donor or Institution
  - Donor - Taxable
  - Institution - Tax exempt
  - How can you reconcile?

Investing to Maximize Remainder

Why Does Tax-Efficiency Matter in CRTs?

The Four Tier Tax System

TIER I Ordinary Income
TIER II Capital Gains -- ST then LT
TIER II Tax Free Income
TIER IV Principal

Implications

- Distributions to beneficiaries are taxed on a "Worst-In-First-Out" basis
- If ordinary income items are not managed carefully, the LT capital gain can be "locked-in" the CRT

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Tax Considerations

Issues - Continued

- In order to maximize the results, you must know:
  - Donor/income beneficiary's tax bracket
  - Four-tier tax structure (CRTs) – four "buckets"
    - Ordinary income "bucket"
    - Capital gain "bucket"
    - Tax-exempt income "bucket"
    - Principal "bucket"

Investing to Maximize Remainder

Why Does Tax-Efficiency Matter in CRTs?

Initial Gift of Appreciated Asset	CRT Year 1 - End of Trust
Ordinary Income	**Ordinary Income** *• Dividends • Bond Interest* — *From Investment Activity*
Capital Gains *LT Capital Gain from Original Gift*	**Capital Gains** *ST/LT Capital Gains from Investment Activity LT Capital Gain from Original Gift*
Tax Free Income	**Tax Free Income** *Tax Free Income from Investment Activity*
Principal *Tax Basis from Original Gift*	**Principal** *Principal from Original Gift*

Investing to Maximize Remainder

Investment Context: Example of Tax Impact on Donor

Facts/ Assumptions

Size: $1,000,000
Type: CRAT
Payout: 8%
Asset Allocation: 70% Equity/30%Fixed

Bond Coupon: 5%
Dividend Yield: 2%
Federal Tax Bracket: 35%
LT Capital Gains Tax Rate: 15%

Bond Interest Income	$15,000	$15,000
Dividend Income	14,000	14,000
Total Interest and Dividends	29,000	29,000
Management Fee	(10,000)	(10,000)
Ordinary Income (net of fee)	19,000	19,000
Additional Distribution Amount Needed	61,000	61,000
Total Donor Payout	80,000	80,000
Donor Taxes		
• Ordinary Income Tax	6,650	6,650
• ST Capital Gains Tax	0	21,350
• LT Capital Gains Tax	9,150	0
Total Tax	15,800	28,000
Net to Donor	$64,200	$52,000
Difference	23.5%	

For illustration purposes only.

* Donor A: Investment strategy maximizes LT Capital Gains
** Donor B: Investment strategy creates ST Capital Gains

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Cost Considerations

Costs

- Investment management fees - All forms
- Transaction fees
  - Investment related
  - Administrative
- Tax compliance fees
- Cost of internal administrative staff, if appropriate

Issues

- Fiduciary duty to obtain services at reasonable cost
- Cost structure can become competitive advantage or disadvantage

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Portfolio Management Vehicles

Vehicles

- Mutual funds
- Bank common trust funds
- Pooled endowment funds
- Individually managed portfolio

Issues

- Control of
  - Asset allocation decisions
  - Diversification decisions
  - Tax implications of trading strategy
  - Costs
- Adherence to investment policy set for each trust

Investing to Maximize Remainder

Investor Profile → Investor Objectives → Investment Context

Do Costs Really Matter?

Assumptions

Beginning Balance: $1,000,000
CRUT Payout: 7%

Annual Return: 3% Income, 7% Growth
Time Period: 20 Years

Impact

	50 Basis	100 Basis	150 Basis
Total to Donor	$1,652,121	$1,554,063	$1,462,610
Total to Charity	$1,742,342	$1,575,345	$1,423,628

For illustration purposes only.

Investing to Maximize Remainder

Overview of Investment Planning for Planned Giving Programs

Investor Profile → **Investor Objectives** → **Investment Context**

Investor Profile
- Donor
- Institution
- Planned Giving Vehicle

Investor Objectives
- Donor
- Institution

Investment Context
- Fiduciary Standards
- Capital Market Considerations
- Tax Considerations
- Portfolio Management Vehicles
- Cost Considerations
- Execution Issues

Investing to Maximize Remainder

Bringing Order to this Investment Planning Chaos

The Solution
- Multiple asset allocation options at individual trust level
- Tax-intelligent investing is critical
- Administrative perfection
  - Timeliness
  - Accuracy
- Carefully study alternative cost structures
- Understand investment vehicle options

Investing to Maximize Remainder

Bringing Order to this Investment Planning Chaos

The Challenge
- Multiple investor profiles
- Multiple and often conflicting objectives
- Multiple tax considerations
- Demanding fiduciary standards
- Uncertain capital markets
- Portfolio management vehicles - Some appropriate, others are not
- Execution / Administrative issues

Investing to Maximize Remainder

Important Notes

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Indices shown are to make general risk and return comparisons. They are shown for informational purposes only and cannot be invested in directly.

Additional information is available upon request.

Asset Allocation in CRTs: Time Horizon, Payout, Risk

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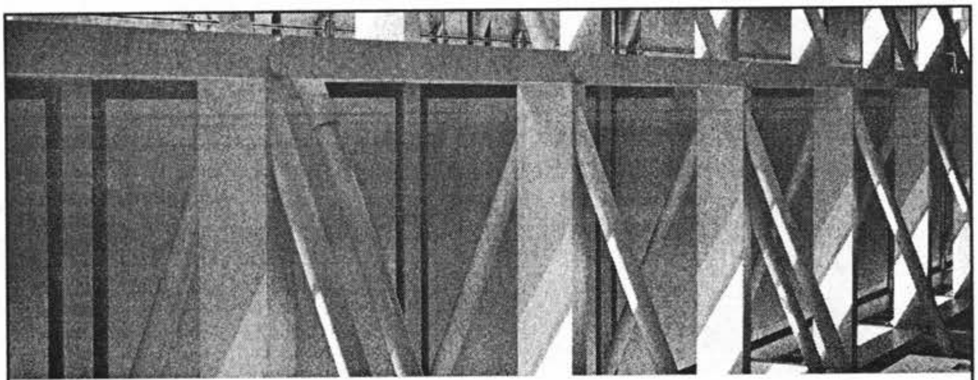

April 2006

Managing Risks in Charitable Remainder Trusts and Other Planned Giving Portfolios

Planned Giving Services

The BANK *of* NEW YORK.

Types of Risk

- Donor Relationship Risk
- Fiduciary/Administrative Risk
- Investment Risk

2

Section 1

Donor Relationship Risk

Fiduciary/Administrative Risk

3

Donor Relationship Risk

- Disclosure during proposal and closing process
  - Does donor understand the implications of the gift?
    - ·That it is irrevocable and they are surrendering control
  - How is income paid to them and in what amount?
    - ·Monthly, quarterly or annually
    - ·Unitrust – the amount changes each year
    - ·Annuity Trust – amount is the same each year
  - Tax consequences
    - ·Trust pays no tax BUT the income the donor receives is subject to income tax
  - Best Practice: Use a disclosure document even though not required by law

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Donor Relationship Risk

- Managing expectations
  - Investments may not perform as projected
    - ·Volatility of returns
    - ·Shorter time horizons
  - Changes in income payments
    - ·Unitrust or Net-Income trusts have variable income payments
    - ·Annuity payments don't change
  - Changes in taxation of income stream
    - ·Due to the Four Tiered tax system applied to charitable trusts, the taxation may change each year
  - Changes to the remainder gift to charity
    - ·Because investments are risky, the remainder is subject to this volatility
  - Best Practice: Use illustrations to show deductions and income streams

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Fiduciary Liability of Trustee/Advisor

- Administrative Responsibilities
  - Accepting, valuing and disposing of assets
  - Keeping track of donors/income beneficiaries
  - Trust distributions – monthly, quarterly, annually
  - Annual revaluation
  - Preparation of K-1s, 1099-R's for CGA's and 5227's for trust tax returns
  - Calculation of Gift Annuity Reserves as mandated by certain states
  - Preparation of annual state filings
  - Date of death valuation and distribution to remainder beneficiaries
- Investment Responsibilities
  - Adherence to the Prudent Investor Rule (State law)
    - Selecting a portfolio allocation that is prudent and reasonable given the payout percentage of the trust, the term of the trust, and the risk tolerances of the donor(s), the income beneficiary(ies) and the remainder charity(ies)
  - Monitoring investments and adherence to asset allocation targets
  - Responding to questions by the donor, income beneficiaries, and remainder charities

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Fiduciary Liability of Trustee/Advisor

Prudent Investor Rule - Example - Maryland Law:

§15-114. Guidelines and standards for investment of assets

(b) *In general.*- A fiduciary shall:

(1) Invest and manage fiduciary assets as a **prudent investor** would, considering the purposes, terms, distribution requirements, and other circumstances of the governing instrument and the nature of the fiduciary appointment;

(2) Exercise **reasonable care, skill, and caution regarding the anticipated effect on the fiduciary assets as a whole under the facts and circumstances prevailing at the time of any action by the fiduciary;**

(3) Invest and manage not in isolation but in the context of the fiduciary assets as a whole and as part of an overall investment strategy that incorporates **risk and return objectives** reasonably suitable under the terms of the governing instrument and the nature of the fiduciary appointment;

(4) **Diversify investments** unless, under the circumstances, the fiduciary reasonably believes it is in the best interests of the beneficiaries or furthers the purposes for which the fiduciary was appointed not to diversify;

...

(6) Pursue an investment strategy that considers both the reasonable production of income and safety of capital, consistent with the fiduciary's duty of loyalty and impartiality and the purposes for which the fiduciary was appointed;

(7) Act with prudence in deciding whether and how to delegate authority and in the selection and supervision of agents; and

(8) **Incur only costs that are reasonable** in amount and appropriate to the investment responsibilities of the fiduciary appointment.

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Fiduciary Liability of Trustee/Advisor

Prudent Investor Rule

(c) ***Review of investment decisions.*** - A fiduciary's investment decisions shall be judged in accordance with the following guidelines and standards:

(1) No specific investment or course of action is, taken alone, prudent or imprudent;

(2) The fiduciary may exercise reasonable business judgment regarding the anticipated effect on the portfolio of fiduciary assets as a whole under the facts and circumstances prevailing at the time of the decision or action;

...

(5) In making an investment decision, **the fiduciary may consider**, without limitation:

(i) General economic conditions;

(ii) The possible effect of inflation;

(iii) The expected tax consequences of investment decisions or strategies;

(iv) The role each investment or course of action plays within the investment of the portfolio of fiduciary assets as a whole;

(v) The expected total return of the investment including both income yield and appreciation of capital;

(vi) The reasonableness of any costs associated with the investment; and

(vii) The status of related assets of beneficiaries

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PANDORA'S CARRY-ON

9

Section II Managing Investment Risks

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Establishing a Process

- Develop an Investment Policy Statement
  - Identifies investment objectives
  - Defines asset allocation policy
  - Establishes procedures for selecting, monitoring and evaluating performance
  - Determines communications procedures both internally between finance and development and externally with third parties
- Setting an asset allocation
  - Determine the required return for each trust
    - Payout and expenses
    - Charitable Gift Annuities: What is your average payout?
  - Determine Time Horizon
    - Projected life of the beneficiary, joint lives or term of years
    - Charitable Gift Annuities: What is the average age of your annuitants? What is the average gift size?
  - Project expected returns for each asset class and associated risk
  - Select risk/return allocations appropriate to these two factors

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Establishing a Process

- Monitoring Performance and Reporting to Donors
  - Monitoring should be done quarterly by Finance or Planned Giving at the Non-Profit
  - Periodic investment reviews should be done by your Finance or Investment Committee
  - Donors should receive a summary annually that includes:
    - Market Value
    - Cash flow of additions and withdrawals
    - Performance of the portfolio
    - Current asset allocation
    - Any re-valuation information about payout for the coming year should also be included

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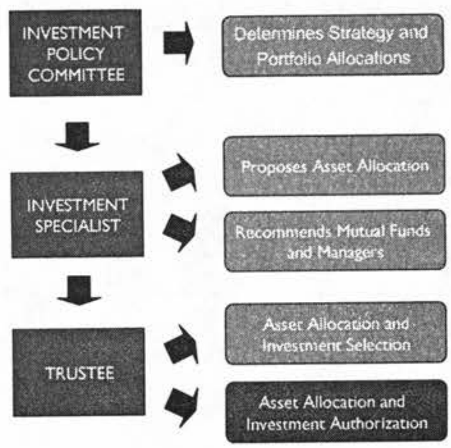
Investment Process

Investment Policy Committee
Examines economic, political, and social trends; develops forecasts for inflation, interest rates, and corporate profits. Determines our overall investment strategy and asset allocation.

PGS Investment Specialist
Applies strategy and portfolio allocations to planned gift vehicles. Selects and recommends mutual funds and manager choices for planned giving clients. Collaborates with the Trustee for optimal asset allocation and investment selection.

Trustee
As the fiduciary for planned giving vehicles, the trustee approves all allocation and investment selection decisions.



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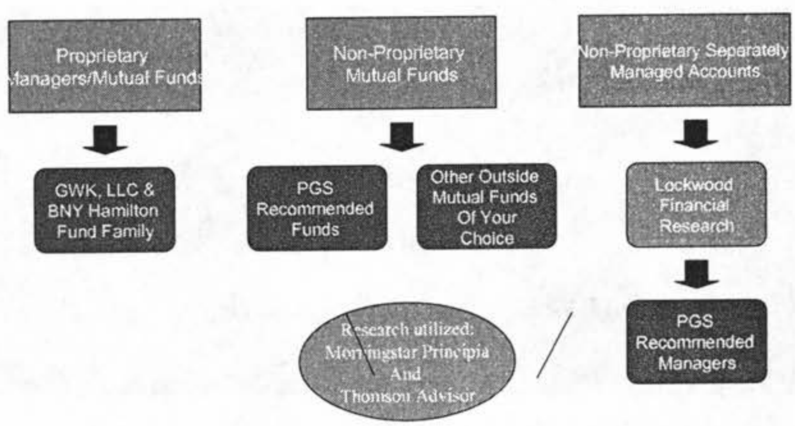
Investment Options



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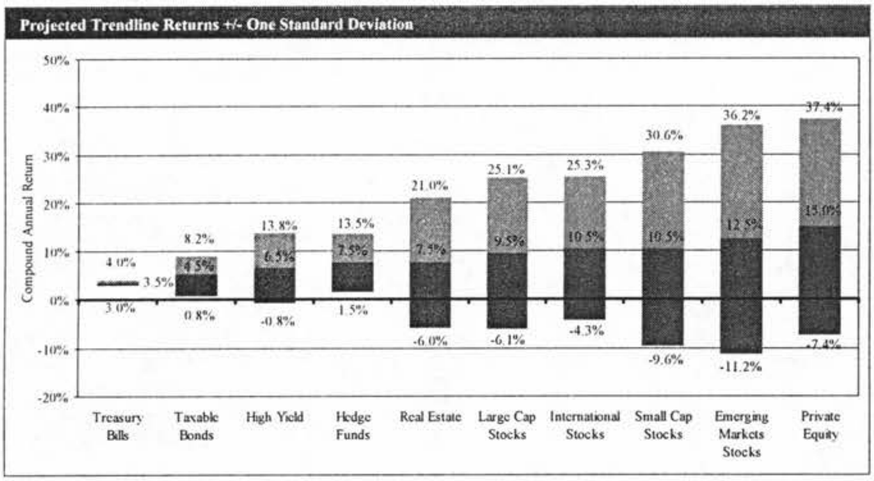
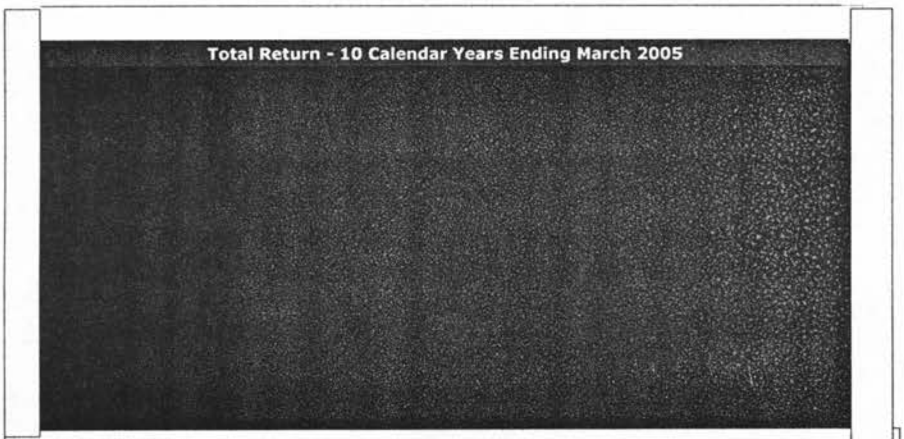
Financial Markets Forecast – Risk and Return



Note: Standard deviations are based on monthly data for the prior 10 years

15 100-E
V.3 12/05

Assets by Class and Capitalization



**Note: 2005 data is preliminary through March*
Arrows indicate advancing or declining rank from the previous calendar year
Sources: Standard & Poor's Corporation; Frank Russell Company;
Morgan Stanley Capital International; Lehman Brothers;
Wilshire Associates; Bureau of Labor Statistics.

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Correlation Matrix

Based on 10 Years of Historical Data
Through 3/31/2005

	Tax-Exempt Bonds	Investment Grade Bonds	High Yield Bonds	Hedge Funds	Real Estate	Large Cap Stocks	Small Cap Stocks	International Stocks (EAFE)	Emerging Markets Stocks	Private Equity
Tax-Exempt Bonds	1.0000	0.8892	-0.1078	-0.284	0.1109	-0.3812	-0.3783	-0.3596	-0.46	-0.3426
Investment Grade Bonds	0.8892	1.0000	-0.0687	-0.2844	0.0891	-0.3247	-0.3334	-0.3823	-0.4706	-0.3109
High Yield Bonds	-0.1078	-0.0687	1.0000	0.3741	0.4277	0.5923	0.5379	0.4548	0.5093	0.2066
Hedge Funds	-0.284	-0.2844	0.3741	1.0000	0.3841	0.612	0.7139	0.5779	0.6406	0.7316
Real Estate	0.1109	0.0891	0.4277	0.3841	1.0000	0.3507	0.5496	0.3101	0.3837	0.1239
Large Cap Stocks	-0.3812	-0.3247	0.5923	0.612	0.3507	1.0000	0.8873	0.853	0.6893	0.6253
Small Cap Stocks	-0.3783	-0.3334	0.5379	0.7139	0.5496	0.8873	1.0000	0.8168	0.7764	0.5776
International Stocks (EAFE)	-0.3596	-0.3823	0.4548	0.5779	0.3101	0.853	0.8168	1.0000	0.7531	0.5609
Emerging Markets Stocks	-0.46	-0.4706	0.5093	0.6406	0.3837	0.6893	0.7764	0.7531	1.0000	0.4345
Private Equity	-0.3426	-0.3109	0.2066	0.7316	0.1239	0.6253	0.5776	0.5609	0.4345	1.0000

Correlation measures the degree to which the price movement of one asset class is related to the price movement of another asset class. Correlation is used in portfolio optimization to minimize non-systematic risk (volatility that can be diversified away).

Recommended Portfolio Asset Allocations

ASSET CLASS	RISK/ RETURN PROFILE									
	Low		Low/Moderate		Moderate		Moderate High		High	
February 2005	Range	Target	Range	Target	Range	Target	Range	Target	Range	Target
Money Market	5-30%	5%	0-20%	5%	0-10%	5%	0-20%	5%	0-5%	5%
Fixed Income	45-65%	53%	30-50%	33%	20-40%	24%	10-30%	15%	0-20%	5%
Investment Grade		46%		25%		17%		9%		0%
High Yield		7%		8%		7%		6%		5%
Real Estate	0-10%	5%	0-10%	5%	0-10%	5%	0-10%	5%	0-10%	5%
U.S. Equities	10-40%	32%	20-50%	47%	30-60%	56%	40-70%	65%	50-80%	70%
Large Cap Value		14%		20%		23%		24%		25%
Large Cap Growth		14%		20%		23%		24%		25%
Small/Mid Cap Value		4%		4%		5%		9%		10%
Small/Mid Cap Growth		0%		3%		5%		8%		10%
International Equities	0-10%	5%	0-10%	10%	0-15%	10%	10-20%	10%	0-30%	15%
Developed Markets		5%		7%		[illegible]		7%		10%
Emerging Markets		0%		3%		[illegible]		3%		5%
TOTAL PORTFOLIO		100%		100%		100%		100%		100%
Expected Return		6.8%		8.2%		8.7%		9.3%		10%
Standard Deviation		7.5%		11.9%		13.8%		15.9%		18.4%

Recommended Asset Allocation Parameters

Asset Classes	Allocation Range	Representative Mutual Funds	[illegible]
Money Market	0% - 5%	BNY Hamilton	
Fixed Income	5% - 53%	Vanguard Dodge & Cox BNY Hamilton	Gannett Welsh & Kotler, LLC Madison Invest. Advisors Pacific Income Adv.
Investment Grade	0% - 46%		
High Yield	5% - 8%		
Real Estate	0% - 5%	T. Rowe Price	[illegible]
U.S.Equities	[illegible]	BNY Hamilton T. Rowe Price Stratton Vanguard	Gannett Welsh & Kotler, LLC JP Morgan Lotsoff
Large Cap Value	14% - 25%		
Large Cap Growth	14% - 25%		
Small/Mid Cap Value	[illegible]		
Small/Mid Cap Growth	0% - 10%		
International Equities	[illegible]	Templeton BNY Hamilton	Northroad Capital Mgt.
Developed Markets	[illegible]		
Emerging Markets	[illegible]		

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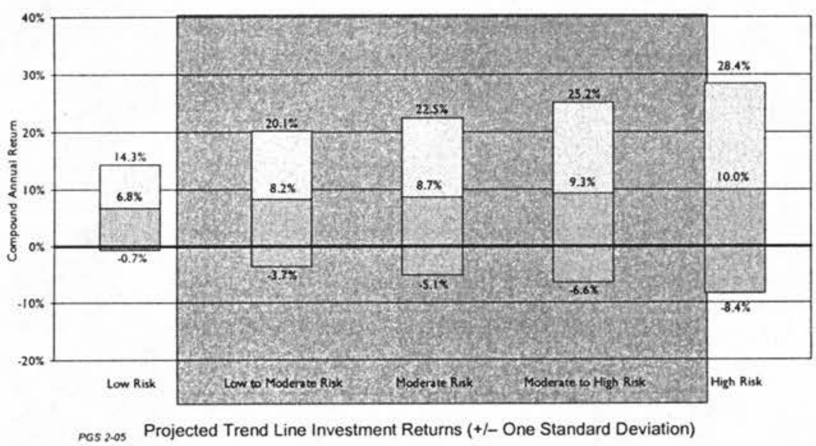
Risk/Return Profiles For Planned Giving Accounts



PGS 2-05 Projected Trend Line Investment Returns (+/– One Standard Deviation)

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Investment Criteria

Charitable Remainder Trust	Time Horizon ▪ Beneficiary Age ▪ Term of Years ▪ Joint Lives Required Return ▪ Payout Percentage/Effective Payout ▪ Expenses
Charitable Gift Annuity	Time Horizon ▪ Average Age of Annuitants ▪ Number of Annuitants Required Return ▪ Average Payout of Program ▪ Expenses Regulatory Requirements ▪ Nonprofit's Liability Related to the CGA ▪ Specific State Segregated Reserve Requirements
Pooled Income Fund	Required Return ▪ Maximize Income ▪ Minimize Corpus Erosion ▪ Expenses

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Time Horizon and Projected Life of Trusts

Projected Life (Yrs)	Time Horizon
22+	Long
14-21	Medium/Long
8-13	Medium
5-7	Medium/Short
2-4	Short

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Return Requirements

Payout range:	5.0% to 8.0%
Expense range:	1.25% to 1.4%
Required Return	6.35% to 9.4%

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CRT Profile Classifications

Time Horizon

Required Return		Short 1-4 Years	Short/Med 5-7 Years	Medium 8-13 Years	Med/Long 14-21 Years	Long 22+ Years
	PROFILE	Low	Low/Mod	Moderate	Mod/High	High
7.0% or lower	Low	Low	Low	Low/Mod	Moderate	Mod/High
7.0%-7.6%	Low/Mod	Low	Low/Mod	Low/Mod	Moderate	Mod/High
7.7%-8.4%	Moderate	Low/Mod	Low/Mod	Moderate	Moderate	Mod/High
8.5%-9.3%	Mod/High	Low/Mod	Moderate	Moderate	Mod/High	Mod/High
9.4 or greater	High	Low/Mod	Moderate	Mod/High	Mod/High	High

24 2-2005

Example

$100,000 Charitable Remainder Unitrust

75,75 year-old income beneficiaries – 16 year life expectancy (trust term)

6% payout, expenses 1.25%, minimum required return 7.25%

Trust would be invested in the moderate portfolio

		Short 1-4 Years	Short/Med 5-7 Years	Medium 8-13 Years	Med/Long 14-21 Years	Long 22+ Years
	PROFILE	Low	Low/Mod	Moderate	Mod/High	High
7.0% or lower	Low	Low	Low	Low/Mod	Moderate	Mod/High
7.0%-7.6%	Low/Mod	Low	Low/Mod	Low/Mod	Moderate	Mod/High
7.7%-8.4%	Moderate	Low/Mod	Low/Mod	Moderate	Moderate	Mod/High
8.5%-9.3%	Mod/High	Low/Mod	Moderate	Moderate	Mod/High	Mod/High
9.4 or greater	High	Low/Mod	Moderate	Mod/High	Mod/High	High

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Profile Performance Comparison*

As of December 31, 2005

Portfolio	'05 Q4	05 Qtr 4 Benchmark	1-Year	1-Yr Benchmark	3-Year	3-Yr Benchmark	5-Year	5-Yr Benchmark	10-Year	10-Yr Benchmark
Low Risk	1.30%	1.36%	4.88%	4.39%	10.50%	9.98%	6.47%	5.27%	8.41%	7.77%
Mod/Low Risk	1.48%	1.74%	5.79%	5.31%	13.16%	12.94%	5.82%	4.64%	9.31%	8.22%
Moderate Risk	1.53%	1.84%	6.05%	5.52%	14.29%	14.07%	5.52%	4.35%	9.77%	8.48%
Mod/High Risk	1.50%	1.91%	6.35%	5.70%	15.72%	15.52%	5.57%	4.36%	10.39%	8.76%
High Risk	1.54%	2.13%	6.90%	6.36%	17.16%	17.23%	5.40%	4.16%	10.87%	8.83%
PIF	0.74%	0.94%	3.90%	3.37%	8.83%	7.76%	7.24%	5.94%	7.75%	7.39%

	Avg. Expense Ratio	Standard Deviation	Beta
Low Risk	0.55%	5.66	0.93
Mod/Low Risk	0.62%	8.47	0.93
Moderate Risk	0.65%	9.75	0.92
Mod/High Risk	0.72%	11.07	0.91
High Risk	0.78%	12.53	0.91
PIF	0.48%	4.02	0.97

Definitions

Standard Deviation: Measures variance from the average return.

Beta: Measures risk relative to the market or sensitivity to market moves.

* Performance represents historic returns of currently recommended portfolio

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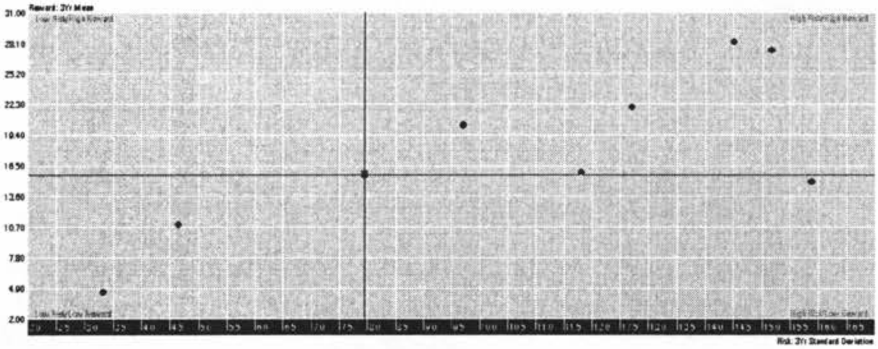
Risk/Return Profile: Moderate

3 Year Risk/Reward Scatterplot

	3Yr Standard Deviation	3Yr Mean
Portfolio	7.76	16.26
Benchmark: BlendMOD	7.95	15.62
Fund/Stock	--	--



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Trust Investment Projections - Example

- Unitrust Modeling
  - Donors ages are 75 and 75
  - Trust funded with $100,000 in appreciated securities with $25,000 cost basis
  - Payout is 6%
  - Tax Bracket is 33%
  - Moderate Portfolio Return is 8.48%
  - Management Expenses are 1.25%
  - Applicable Federal Rate (AFR) of 5.4% (the discount used for charitable trust calculations)

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Your Charity — April 2006

Life Income Projections

Summary of Benefits

ASSUMPTIONS:
Projection runs for 16 years.
Measuring lives age 75, 75.
Original principal is $100,000. Cost basis is 25%.
Donor income tax bracket is 33%, 15% for capital gains.
Beneficiary income tax bracket is 33%, 15% for capital gains.

	Charitable Unitrust 6%
Gross Principal	$100,000
Charitable Deduction	$43,951
Tax Savings	$14,504
Cost of Gift	$85,496
Income	3.00%
Capital Appreciation	5.48%
Sell Asset in First Year	Yes
Total Management Fees	$23,037
Total Before-Tax Benefit To Income Recipients	$104,834
Total After-Tax Benefit To Income Recipients	$83,820
Benefit to Charity	$120,294
Total Benefit	$204,114

IRS Discount Rate is 5.4%

The Bank of New York makes no representations with respect to the accuracy of the numbers in these illustrations, or to the probability of achieving the results depicted. The calculations are for illustration purposes only and should not be considered financial, legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift, and the manner in which your gift is invested.

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Your Charity — April 2006

Life Income Projections

Detailed Cash Flow Analysis

ASSUMPTIONS:
Projection runs for 16 years.
Measuring lives age 75, 75.
Original principal is $100,000. Cost basis is 25%.
Donor income tax bracket is 33%, 15% for capital gains.
Beneficiary income tax bracket is 33%, 15% for capital gains.
Management fees: 1.25% of principal

6% Charitable Unitrust

YR	Year-End Principal	Capital Apprec. (5.48%)	Income (3%)	Management Fees	Before-Tax Ben. Inc	After-Tax Ben. Inc (33%)
0	$100,000					
Sale						
1	101,162	$5,480	$3,000	$1,319	$6,000	$4,797
2	102,336	5,544	3,035	1,334	6,070	4,853
3	103,525	5,608	3,070	1,349	6,140	4,909
4	104,728	5,673	3,106	1,365	6,212	4,966
5	105,944	5,739	3,142	1,381	6,284	5,024
6	107,175	5,806	3,178	1,397	6,357	5,082
7	108,419	5,873	3,215	1,413	6,430	5,142
8	109,679	5,941	3,253	1,430	6,505	5,201
9	110,953	6,010	3,290	1,446	6,581	5,262
10	112,241	6,080	3,329	1,463	6,657	5,323
11	113,545	6,151	3,367	1,480	6,734	5,385
12	114,864	6,222	3,406	1,497	6,813	5,447
13	116,198	6,295	3,446	1,514	6,892	5,510
14	117,548	6,368	3,486	1,532	6,972	5,574
15	118,913	6,442	3,526	1,550	7,053	5,639
16	120,294	6,516	3,567	1,568	7,135	5,705
TOT	$120,294	$95,748	$52,417	$23,037	$104,834	$83,820

IRS Discount Rate is 5.4%

The Bank of New York makes no representations with respect to the accuracy of the numbers in these illustrations, or to the probability of achieving the results depicted. The calculations are for illustration purposes only and should not be considered financial, legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift, and the manner in which your gift is invested.

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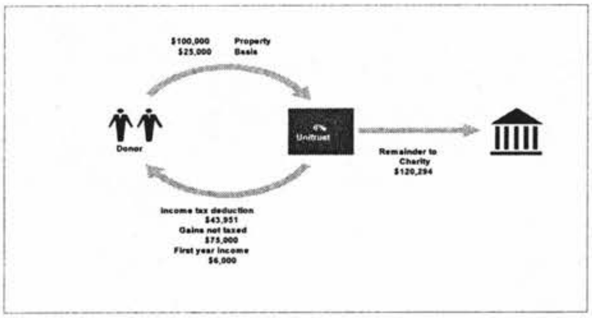
6% Charitable Remainder Unitrust

Your Charity
April 2006



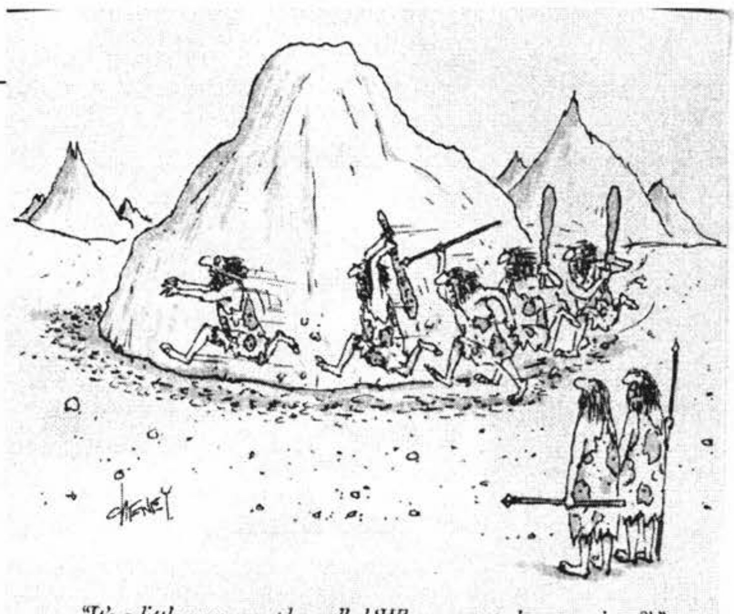
Benefits

Immediate
Income tax deduction of $43,951. May save up to $14,504. Pay no capital gains tax. May save up to $11,250

Annual
First year income of $6,000. Income will vary in future. Projected total after-tax income of $83,820 over 16 years

Future
Charity projected to receive $120,294 in 16 years. Reduced estate taxes and costs

31



"It's a little game we play called 'Who wants to be a survivor?'"

32

ETHICS IN PLANNED GIVING

Jonathan G. Tidd
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I. A TENTATIVE GUIDING PRINCIPLE

A. The Principle

A gift planning officer shall do nothing to mislead or otherwise potentially harm a donor or prospective donor.

Question: Any disagreement with this principle, as far as it goes?

B. Trying it on for Size -- Some Situations for Discussion

1. Basic facts: On 14 December, 580 shares of XYZ stock are wired DTC from Donor's account as a gift to Charity. On this date, the XYZ shares wind up having a mean value of $48,240.

   The shares arrive in Charity's account on 15 December. On this date, the shares wind up with a mean value of $52,120 but are sold by XYZ for $50,000.

2. Situation # 1: Charity issues a gift receipt to Donor that states in pertinent part:

   > *Thank you for your gift on December 15, 2006, of 580 shares of XYZ stock, which we have valued at $52,120 (average of high and low selling prices).*

   Any ethical concerns?

3. Situation #2: Charity issues a gift receipt to Donor that states in pertinent part:

   > *Thank you for your gift on December 15, 2006, of 580 shares of XYZ stock, for which we have credited you in the amount of $50,000 (net sale proceeds).*

   Any ethical concerns?

4. <u>Second fact pattern</u>: Donor, a resident of Washington state, sends a check for $50,000 to Charity, located in New York, to establish a gift annuity. The check arrives on December 14, 2006.

   a. Dawn, a gift officer for charity, in due course sends to Donor a computer illustration and cover letter stating that Donor's "charitable deduction" is $24,643.

      This figure is based on the October 2006 IRS discount rate of 5.8%.

      Any possible ethical concerns here based on the facts presented relative to the charitable deduction figure?

   b. Also in due course, Dawn sends a gift annuity disclosure statement to Donor, which does not mention Charity is not licensed to issue gift annuities in Washington.

      Any ethical concerns here?

5. Two (among many) other situations:

   a. Charity invites donors to make year-end gifts via credit card...without making full disclosure. See Rev. Rul. 78-38.

   b. Charity, in the interest of maintaining good donor relations, allows individuals who have private foundations to use foundation assets to pay for tables at Charity's annual gala dinner.

C. Fine Tuning Our Principle

1. What's wrong with this principle:

A development officer shall not intentionally or knowingly mislead a donor or prospective donor in such a way as possibly to lead or otherwise cause the donor to step into harm's way.

<u>The defense</u>: I didn't <u>mean</u> to cause the donor harm. I was just (a little) negligent.

2. Taking responsibility:

It shall be a gift planner's duty to take all reasonable steps -- including both continuing education and consultation with competent legal counsel -- to avoid misleading donors....

<u>Note</u> that we don't come to an understanding of ethics in gift planning until we come to an in-depth understanding of certain legal issues and certain donor behaviors.

<u>Note too</u> that some development operations are inherently unethical in operation because of their structure. <u>Example</u>: Charity has 6 gift officers whose chief job is to "sell" gift annuities -- to do this without adequate training, without a good written policy and procedure, and without access to competent legal counsel.

II. ANOTHER PROBLEM AREA -- GIVING LEGAL ADVICE

A. Tentative Principle

A development officer shall not give legal advice to a donor or prospective donor (or anyone else).

B. Some Situations to Consider

1. Providing certain computer illustrations (e.g., a life estate or CRUT illustration) without <u>very clearly</u> (a) highlighting assumptions that have been made, and (b) stating that the illustration is simply that -- and not legal advice.

<u>Footnote</u>: The Ohio State case.

2. Responding to a donor's question as to whether assets held in his revocable trust can be used to establish a gift annuity.

3. Advising a donor who is the trustee of her own real-estate-funded flip trust how to value trust assets, handle certain trust expenses, handle tax reporting for the trust, or how to compute the trust payout.

4. A charity's giving a CRT agreement, prepared by the charity and of which the charity is going to be trustee, directly to a donor for signature.

C. Question

How is it possible, given the tax-driven nature of gift planning, to avoid giving legal advice to donors?

<u>Suggestion</u>: Put it in writing, and set forth the appropriate disclaimer and caveats.

IV. MISCELLANY

A. The Core (*sine qua non*) of any Profession

An agreed-upon set of ethical principles and a mechanism for interpreting, applying and enforcing those principles.

B. Some Ethical Dodges (Missteps)

-- *But a lot of other charities do it this way.*

-- *Variation: We did it this way where I used to work (says your new boss).*

-- *We've always done it this way.*

-- *Variation: But we did it this way with the donor before.*

-- *How is the IRS going to find out about it?*

C. Law vs. Ethics

1. Unauthorized practice of law is not simply unethical -- it's illegal.

2. Filing a false tax return (e.g., for a flawed CRT) is not simply unethical -- it's illegal.

3. Certain life insurance schemes are not just arguably unethical -- they're arguably illegal.

D. The Appearance of Impropriety -- Two Examples

1. Gift officer accepts a non-token gift from donor.

2. Gift officer agrees to act as donor's executor.

E. The Need for a <u>Good</u> Policy and Procedure

Planned Giving Services

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Planned Giving Services

Because not all qualified Planned Giving prospects raise their hand.

*We received **tremendously positive feedback from our donors**. And, we're very happy with the quality and level of qualification of the leads we received from RuffaloCODY.*

They gathered a lot of information from our donors which we wouldn't have known. That helped us initiate quality conversations with our donors. And, during our subsequent follow-up calls, we were able to document several gift commitments.

Wendy Irving, Esq.
University at Buffalo

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RuffaloCODY's Planned Giving Services Division offers a full range of products and services to help you reach your most qualified donors and realize more planned gifts.

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File Analysis: RuffaloCODY will analyze your file to identify your best Planned Giving prospects, including our LifeStage Annual Fund analysis.

Planned Giving Marketing Audit: A comprehensive Planned Giving direct response plan that includes segmentation strategies.

Rel@y (E-mail Delivery System): Rel@y is perfect for supporting weekly Planned Giving e-mail programs.

For more information about how we can increase your Planned Giving program performance, call **Timothy Logan, ACFRE, Vice President of Planned Giving Services at 800.756.7483** or visit our website listed below.

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Stewardship: Listen with Your Eyes

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LISTEN WITH YOUR EYES

When my daughter Frances was three years old, she used to enjoy joining me in the kitchen when I came home from work, sitting on a stool and talking with me as I began to prepare dinner. One evening, as she was talking and I was chopping onions, she suddenly insisted, "Mommy, LISTEN to me!" "I am listening to you sweetheart, I replied patiently," continuing to chop and, admittedly, think about a gnarly meeting that afternoon. "No," Frances said. "Listen to me with your EYES." So I put down my knife, turned to lean against the counter, and looked directly into her eyes as she told me her story. She received what she needed, and I did too—a lesson about listening I hope never to forget.

I. FAMILY MATTERS

Over the nearly three decades of my work as a fund raising professional I have raised larger and larger sums of money, becoming finally as comfortable with the seven and eight figure gift as I am with the four and five figure gift. I have mastered the art of reading financial reports, planned campaigns, established and exceeded goals, and crunched numbers with an ease that would make Sister Mary Aloysius, my ever-suffering algebra teacher, proud. And yet I have finally arrived at one of the most important realizations of my career: my work is not about numbers. It is not about money. It is not even, at its heart, about asking.

To say that I have begun to realize that our work is about *giving* sounds far too elementary. What I mean is that I have begun to understand giving, or philanthropy, on a far deeper level than a set of goals would have allowed me to do. I have begun to understand that in the relationships we say our work is all about, the key is listening, not asking. It is about the need of an individual to bring meaning to his or her life. And I have finally begun to absorb that lesson we all instinctively know: if we come to a conversation with our donor armed with our own need—our organization's needs—but fail to listen for the need of our donor, we will have failed utterly. Now, ironically, I think less and less about money.

I grew up the oldest in a large family in which religion played a central role. It was my father who modeled the practices of our faith, its rituals and habits—prayer before meals, family rosary on Friday night. And it was my father who taught me about tithing. I learned about tithing not as giving, but as obligation, a kind of arrangement between my family and the church. My father did as he was told, no less but certainly no more.

It was my mother, the practical one, who taught me about giving—giving without thought to the limit of resources, giving as more. Giving as membership in community. Giving as an act of faith.

One summer in the 60s, when our town on the Indiana/Kentucky border was in the turmoil of the civil rights movement along with the rest of the nation, Mom decided that some of the less advantaged kids needed an organized activity that would be fun, offer them a focus, and keep them out of trouble. She volunteered to teach tennis at the city park. It was what she knew how to do, what she could give. When she arrived at the park for her first day of lessons with all five of us in tow, there was a large group waiting for her. But when she walked onto the court only a few of the children joined her. Mom realized instantly that none of them had rackets, and only a few had tennis shoes. She asked them to join her next week, and promised equipment and shoes if they came back. Then she drove to the office of the regional manager of Coca-Cola.

My mother didn't know the regional manager, and I'm sure she didn't have an appointment. But she did have a belief that if she could give her time all summer teaching the kids in our town, Coca-Cola could give the dollars it took to buy them rackets and shoes. She managed to convince the regional manager to join her. At the end of the summer she organized a tournament to thank Coca-Cola for their support. More than thirty years later the Coca-Cola Junior Tennis Tournament of Southern Indiana is still thriving, and Coca-Cola offers coaching and scholarships and winter training to children who show promise but need financial support to help them develop.

My mother gave more than she really had—a mother of five children with no money for babysitters really has no extra time—but in her giving she had faith that her gift could make a difference. The regional manager gave for similar reasons—faith in the conviction and tenacity of a woman he'd never met, belief that they might make a difference together. And I believe that they did.

Years later I led a research study on women and philanthropy while working at the University of California, Los Angeles. Through interviews and focus groups from San Diego to San Francisco I heard many similar stories—stories about actions, not amounts—in response to our probing on what influenced women to be exceptionally generous. One woman told a story about growing up in the Depression in a family that had very little. The mother always offered food to a hobo when one came to the door, and one day the woman's brother came running into the house and said "Mother the hobos have painted a yellow line in front of our house to tell the others that they can get food here! Do you want me to go outside and erase the line?" The mother paused and replied "But if you do that, how will they know where they can get fed?"

During this same period of time my husband and I were getting used to living in Los Angeles, learning the urban culture (we both came from rural communities) and making friends. One night over dinner a woman talked about several non-profit boards she served on and asked my husband which organizations he belonged to. When he replied none, she looked at him in shock. "Then how can you help people in the community?" she asked. I knew then why the question was so foreign to my husband. In the school he attended, as winter began, the principal made a few discreet calls to parents whose farms were doing well, and warm coats appeared for the children of families that could not afford them. All the people in town helped with this as a matter of being part of a community, the same way dropped groceries at the porch door of older residents. When we received a letter that a childhood friend had fallen sick with cancer we sent monthly checks out of our tight household budget to help with the family bills. My husband did not belong to an organization but rather to a community, and he understood all these actions as a responsibility of membership in that community. I might have called it generosity.

These stories confirm the research in the field of philanthropy that giving is most often influenced by family tradition, and that these traditions hold true no matter what the economic level. Not surprisingly, it's the values expressed by generosity, the actions as much as the amount given, which exert the greatest influence. And while traditions of giving are taught in families, we know that the impact of generosity is felt most often in communities.

Strong communities make for a strong society. Many years ago I had a friend who claimed that giving away money was like recycling—the wealth always returns to you. I don't know if she meant literal wealth or social wealth, but I've thought often about her comment, particularly when I listen to donors who talk about giving as an act of transformation rather than one of obligation.

We know from studies conducted annually by Giving USA that individuals represent 84% of the charitable giving in this country. In 2004 that giving amounted to a total of $208 billion, including bequests. But let's get practical—giving is not just a "feel good" activity. In her book *The Greater Good: How Philanthropy Drives the Economy and Can Save Capitalism*, Claire Gaudiani, a senior research scholar at Yale Law School, makes the argument that American philanthropy is an investment in society, its people and ideas and facilities. She claims that American philanthropy "created an environment where capitalism could flourish without destroying democracy." She asserts "generosity is one of the most widely shared values in our nation, reflecting our compassion and entrepreneurial spirit as well as our democratic values."

But are we generous because we are rich, or are we rich because we are generous? When Andrew Carnegie used his visionary generosity to establish a system of public libraries throughout the country, was he simply doing something good or was he also ensuring a society whose increased literacy would vastly improve its chances for new wealth creation?

Many believe that today we are entering a crisis of generosity. One of the greatest opportunities in our country's history—the transfer of wealth—also contains troubling signs: Estimates place this transfer over the next 50 years as $41 to $136 trillion. Yet giving remains as flat as it has been for the past 30 years. The average American still gives 1.8% of his or her personal income.

We have an important question to answer as a society: How will the affluent and their children remain as committed to sharing as in the past, to keeping wealth *building* and wealth *sharing* in balance? What will motivate them? And what is our role as fund raising professionals in that motivation? We know from our stories about family giving that it's important to see examples. Yet many now live in gated communities. Soon the last people who can remember the Great Depression will be gone. We know that church attendance is the single most reliable indicator of charitable giving—yet church attendance is in a significant decline in our nation. It may be that our work in support of philanthropy has placed us in a critical position today. We may find ourselves in the position of facilitator and teacher as much as resource-deliverer. Dollar by dollar, relationship by relationship, we may become the bridge-builders back to strong communities. Long after the financial reports are forgotten, and the largest gift announcement yesterday's news, this may turn out to be our most important role.

II. <u>LISTEN WITH YOUR EYES</u>

If we practice true listening, keeping our minds free of the list of things we want to accomplish with our donor on this visit, a space for potential surprises inevitably opens up.

A. What We Might Hear:

- What matters to our donor
- Meaningful moments that have shaped our donor's life and values
- What makes our donor wary or uncomfortable
- Our donor's passions

It's particularly important not to assume we already know our donor's passions through research, patterns of giving to other organizations, or previous conversations. In my own experience, it is rare that a donor is asked the open-

ended question about her or his passions. It is far more common that we make plans based upon our research and assumptions.

One particularly important woman in our community agreed to pay a visit to the museum as a courtesy to our new president. We knew we had an hour for a tour, then an hour for lunch in the president's office. We knew the executive director of her foundation would accompany our friend, and we had been cautioned that we were not to solicit. We also thought we knew what our friend loved.

Based on patterns of giving, we carefully planned and rehearsed a tour that focused on the educational aspects of our institution's mission. There were educators, gallery interpreters and children, artfully planted at every point along our carefully constructed route. When the woman arrived and I welcomed her, she began with a statement in a somewhat challenging tone: "I don't know what you have planned for me this morning, but I hope whatever it is it has nothing to do with kids. That's what everyone shows me, and I'm tired of it." I drew a breath as I felt my foundation manager freeze at my side. Then I smiled. "Why no, we actually didn't have one particular plan for you. We thought we'd begin by finding out what you might want to explore." As our new friend thought for a moment, then asked if we had historic photographs, I was pleased to tell her about our western history photography collection. We began walking slowly towards that research area, giving my foundation manager enough time to run ahead and locate the curator in charge. By the time we arrived he was ready with some of our best Ansel Adams photographs. As we concluded and walked away the Museum's Insect Zoo coordinator, a man with an irrepressible passion for his work, passed us. In his enthusiasm to show me our new elephant beetle he began to thrust it at our visitors as well. Surprised but fascinated, our friend asked where such things came from and what they ate.

Over lunch in the president's office our important visitor asked the president about her plans and ambitions. She nodded approvingly and commented that surely these things must cost a great deal to accomplish. She then looked across the table at her executive director and said, "I would like them to have a million dollars." My president and I were stunned. We received a significant unrestricted gift from that visit, and a year later a new member of our board. And we had not presented our visitor with a single child or education program.

B. When We Talk, What Do We Say?

A healthy respect for our donors is reflected in the language we use, both in speaking with our donors and in speaking with one another. We must use, at all times:

- Language that is honest, direct, inclusive

- Language that honors and strengthens a relationship rather than diminishing or demeaning it

BAD WORDS

- Get money from/out of
- Hit up
- Put the arm on
- Get into his pockets
- Owes us
- Should give, ought to give

GOOD WORDS

- Friend, relationship, support
- Consideration, hope, difference
- Meaningful, exciting, enduring
- Help, interested, joy
- Sustaining, involvement

I emphasize that we must guard how we speak about our work and our donors among ourselves because this establishes the discipline of good language and correct attitude. Our internal and external "face" cannot be separated—our donors will detect an attitude even if we think one is not revealed.

By the same token, we must guard against unfriendly or demeaning references among our volunteers or donors themselves. Sometimes these references come up out of nervousness or a false confidence. Whatever the reason, we must find a way to gently remind the speaker that we actually prefer to think about the approach or request as an opportunity. Provide them with both the correction and the language that is more honoring. They will understand that this is the way you will speak of them as well.

C. What Do We Need to Know?

"I've been learning how to give. It's something you have to keep working on because people like money the way they do their homes and their dogs."
Ted Turner

It is commonly received wisdom that our best prospects are our donors. However, we sometimes need to help prepare our donors for their giving. In order to more fully understand our donor's interests and motivations, it is important that we learn:

- Traditions that inform giving behavior
- Communities with which our donors have an affinity
- What matters to our donors (not to us)
- Transformation gifts—a few historical examples

- Transformational opportunities—within our own organizations

What matters to our donors (and not to us) would seem a common sense fundamental of our work, but it is surprisingly often overlooked.

At a university where I worked we talked occasionally about donors we had lost, either through death or diminished interest. One couple that had been very involved struck me and then, after the sudden death of the husband both the giving and the involvement had disappeared. I asked the widow if I might call on her. She seemed happy to agree.

What I learned made me sad, but offered a path back to the university. The widow stopped receiving invitations to the university dinners and receptions she and her husband had so enjoyed attending soon after her husband passed away. While we may have assumed she would feel awkward coming alone, she perceived that the university had abandoned her at precisely the time she needed friends and community the most. To make matters worse, she continued to receive solicitations and calls for appointments on behalf of the athletics program—a program she and her husband had generously funded, though primarily because of her husband's interests. She was angry that no one asked about her own interests, and simply stopped giving.

It was an easy next step for me to ask what her passions were. She was open and clear. As we began to explore that at the university she made her first gift on her own of $25,000. A few years later, after I had gone on to work at another institution, I learned that she made a gift of $18 million for a dance building, with studios and performance space, at the university. I was a guest at the opening dinner.

The thought about transformational gifts and opportunities is also an important one. Even if our donors may not be able to make a significant gift at this time—or ever—the power of helping them to see themselves, and their gesture of generosity, among those who have made great differences cannot be underestimated. The history of philanthropy is a truly inspirational one. Are we doing our own jobs to inspire? Are any of the needs of our organization truly transformational? If not, could these needs be packaged together in such a way as to move them to that next level? Even if our donor can only fund a small part of the transformational "picture," it is motivating for a donor to see their interest and its corresponding need in a larger transformational vision.

A few years ago I was disappointed to receive a rejection letter for a foundation grant that sought support for one of our long-standing education programs. When I called the foundation's executive director, with whom I had a good relationship, for feedback on "how to understand" the no, she replied that while *the program fit their guidelines, the board just couldn't get excited about the difference their funding could make. I asked if she thought board members were aware of our transformational initiatives, none of which fit the foundation's guidelines. After I described one in particular, and outlined how funding could be used, she agreed to go back to the board with this information. The board chair called a special meeting via teleconference with the foundation trustees, who agreed to invite a proposal from the Museum as a Special Project. We received funding for this proposal within three weeks, at an amount that was triple our original rejected request.*

III. <u>TALKING WITH OUR BODIES</u>

When my daughter Frances was pre-school age, she loved watching video movies. One day she brought one too me as her selection for the afternoon. I explained that she must have it confused with one of her Disney movies—this was a video without a real story, I explained, without…well, without people talking. The video was my copy of the Paris Opera Ballet. "Yes they are Mommy," she responded. "They're talking with their bodies."

We might all do well to think about the story others watch us telling.

A. What Do Our Donors Need to Know?

- That we will help create an enriching and joyful experience
- That we will honor their relationship with us and with our organization, both before *and* after their gift is made
- That we will recognize their interests and their generosity
- That we will be accountable for their interest
- That we will keep our promises

Often development professionals are perceived by donors as people looking to ask for something. In the best of circumstances we should be seen as facilitators of a meaningful and joyful experience. We should also be seen, and serve as, donor advocates within our institutions. We are the ones who will make sure our donors' interests are not forgotten long after their gift is made, who will see that they receive invitations and personal acts of thoughtfulness.

B. What is our Role?

As development professionals and donor advocates, we can create a climate for giving, both within our organizations and among the donors themselves. And we create this climate for all donors, small or large, known or unknown. In fact, it is sometimes the unknown donor, the people who challenge our assumptions, who need this climate the most.

Esther was for many years the administrative assistant in the university's graduate school of education. Over the years she had come to regard the students, and the work they went out into the world to do, with great respect. When her brother died and left her a very significant estate, she asked to have an appointment to speak with the dean. Since Esther was an administrative assistant the appointment was put off. Finally a junior assistant to the dean saw Esther. Insulted and hurt, Esther understood that she was being treated as an administrative assistant rather than a prospective donor. She was not "welcomed" into the conversation she wanted to have. And so Esther took her intended gift of a $2 million scholarship to her brother's university instead, establishing a fund in his memory there but forgoing the satisfaction of giving her generosity to the school she had served for so many years.

- Make our donors part of the process
- Make our donors equal partners
- Help our donors consciously identify themselves as philanthropists
- Participate in the donor's exploration
- Remember that donors do not arrive at generosity through a single conversation or decision but through an evolution of gifts and involvement, a pattern of growth

Not long ago I received a phone call from the current president of the first college I had served at more than twenty years earlier. He told me he wanted to thank me for the largest unrestricted gift in the college's history—the donor himself and a few staff members with long memories had prompted him to do so. The donor had been a student when I was on staff, a son of a wealthy family from whom we received annual gifts. I regularly took the son to coffee at the campus café, listening to his passion about social responsibility, talking to him about the difference philanthropy could make in the world and the responsibilities of inheriting great wealth. I simply hoped at the time that he would not walk away from his wealth but instead would use it wisely for those things he cared about. The president told me that the young man's long hair was now cut short; he was a member of the college's board of trustees (and attended meetings in a suit!) and, in making his recent remarkable gift, had demonstrated that he had learned our lesson well. It took decades, many other smaller gifts, and was long past "counting" towards any of my goals. But I think I was more proud of that giving than any other gift I had been part of.

C. What Do We Need to Do?

The simple answer to the question Why Do People Give is that they give because they are asked. But they say yes out of their belief in an organization, their desire to shape it, their determination to *continue* to believe. Many are also seeking stature among their peers, acceptance within the organization or the larger community. We know that not just asking, but setting the ask up correctly, is the key to success:

1. Know the Case for Support
    a. Have stories to share
    b. Use facts and figures as part of your stories
    c. Speak to impact on lives, your community
2. Know your Prospects
    a. Don't make assumptions
    b. Find the relationships
    c. Research the backgrounds
3. Involve your Donors
    a. Give them access to the institution
    b. Seek advice and feedback—informal as well as formal
    c. Engage as volunteers
4. Ask
    a. Make the appointment (and think carefully about the location)
    b. Decide who asks: the role of leadership
    c. Do the thinking—interest, need, strategy
    d. Prepare for questions or objections
5. Thank 5 Ways
    a. Personal
    b. Influencer
    c. Organizational
    d. Publication
    e. Donor Wall
6. Steward
    a. Keep your donor involved
    b. Communicate often
    c. Keep your promises!

During the height of the dot-com boom in the 90s, when it seemed that everyone had figured out how to become a millionaire, I met a friend for dinner in San Francisco. "Well, Dyan," he joked. "Are you still doing the Lord's work?" At that moment I was chagrined to reply that I was. Now, years later, I am happy to confirm that I still am. It is work that has staying power. And it is a joyful experience.

A Time for All Seasons: The Charitable Lead Trust

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CHARITABLE LEAD TRUSTS

I. Introduction and Overview

A. Generally

1. What is a Charitable Lead Trust (CLT)?
   - (a) Donor(s) transfer assets to a trust
   - (b) Irrevocably
   - (c) Trustee makes INCOME PAYMENTS TO CHARITY
   - (d) For a term of years, life or lives, or a combination of years and a life (or lives)
   - (e) Remainder passes as donor chooses (e.g., typically to children, grandchildren, or other family members in lower generation)
2. Opposite of charitable remainder trusts where INCOME PAYMENTS TO DONOR (or others selected by donor), remainder to charity.

B. Why Create a CLT?

1. Donative Intent: (i) no 20%, 30% or 50% limitations on adjusted gross income with a non-grantor CLT; and (ii) no need to carryover excess deductions.
2. Estate Tax Planning Tool: Property can pass estate tax-free to heirs.
   - (a) Example #1: (i) Dad and Mom have a gross estate of $3M, consisting of a farm worth $2M producing $127,500 of income per year and other assets worth $1M; (ii) Dad and Mom are both 70, with incurable cancer, don't want to work the farm, have each used up their $1M lifetime unified credit, have $2M in marketable securities (which meets their income needs) and have no insurance; (iii) Dad and Mom want to leave the farm intact to their two 35 year old sons (who are each earning $200,000 per year as plumbers), and pay no gift or estate taxes.
   - (b) Answer to Example #1: Have Dad and Mom gift minority interests in the farm to a Charitable Lead Annuity Trust, obtaining a 25% discount, whereby a charity of their choosing receives $127,500 per year for 16 years using 5% §7520 rate ("7520 Rate"), with the remainder, along with $2M of other assets, passing to their children estate tax-free (see, attached **Exhibit #1**).
3. Other Advantages:
   - (a) Foreign charity (if income tax deduction desired).
   - (b) Private foundation.
   - (c) Need massive tax deduction (see below).

C. Types of CLTs (see, attached **Exhibit #6**)

1. Annuity trust and unitrust
2. Grantor and non-grantor

II. Charitable Lead Annuity Trusts ("CLATs") and Charitable Lead Unitrusts ("CLUTs")

A. Must Be a Guaranteed Annuity Interest or Unitrust Interest - Otherwise, No Charitable Income, Gift or Estate Tax Deduction.

B. Annuity

1. Fixed dollar amount or % of fair market value ("FMV") of initial trust assets (no CRT 5% minimum payment required).
2. Payable at least annually.
3. For a term of years (no CRT 20 year maximum), life or lives (caveat: rule against perpetuities), or life or lives plus a term.
4. Payable out of principal if income not sufficient.

C. Unitrust

1. Fixed % of FMV determined annually (no CRT 5% minimum payment required).
2. Payable at least annually.
3. For a term of years (no CRT 20 year maximum), life or lives (caveat: rule against perpetuities), or life or lives plus a term.
4. Payable out of principal if income not sufficient (CRT "net income" is not permissible).

D. Charitable Beneficiaries

1. Annuity/unitrust amount must be paid to charity or charities qualifying as such under §§2522(a) and 2055(a).
2. Public v. private charities = §170(c) v. §170(b)(1)(A) for income and estate tax purposes.
    (a) Caveat: prohibited transactions of §§4941 et seq., especially re: §§4943 (excess business holdings) and 4944 (jeopardy investments), which do not apply to CRTs but do apply to CLTs.
    (b) Donor may reserve the right to himself or others to choose charitable beneficiary (but see later discussion for estate tax limitations). Caveat: Distinction exists for generation skipping transfer taxes ("GSTT") between named charitable income recipients (taxable termination) and unnamed income recipients (taxable distribution), especially regarding who pays tax (trustee v. skip person, respectively).
    (c) Generally, no payment other than to qualified charity - exception:
        (i) Separate share.
        (ii) Properly structured, can have payment to both private interest and charity.

E. The Remainderman (non-charitable)

1. Can specify individuals.
2. Can specify class.
3. Caveat regarding rule against perpetuities.

F. The Vehicle

1. Irrevocable Trust.

2. Exception = insurance company or regular issuer of annuities or unitrust interests.

G. Prepayment of Charitable Lead Trust Amount - don't try re: Rev. Rul. 88-27, but you can pre-pay without discounts.

H. Taxable Year Equals Calendar Year.

I. Additional Contributions
   1. Not with CLAT.
   2. Be careful with a CLUT, especially if trying to avoid grantor trust status for income and/or estate tax purposes.

J. Death Taxes
   1. Rev. Rul. 82-128 specifies that the survivor's income interest in CRT cannot be effective unless survivor pays death taxes.
   2. Ruling logically applies to CLTs.

K. Private Foundation Rules
   1. §4941 regarding self-dealing applies.
   2. §§4943 and 4944 regarding excess business holdings and jeopardy investments apply if CLAT's lead interest >60% of initial FMV of assets; see also §508(d)(2) which requires prohibitory language regarding §4941 et seq.

L. CLAT v. CLUT - Which to Choose?
   1. Use CLAT when interest rates low, because payments remain constant, despite appreciation - more to family remainderman.
   2. Use CLAT to avoid annual valuation.
   3. Compare tax deduction with canned software program (e.g., PG Calc).
   4. Calculation:
      FMV less present value of income flow = present value of remainder.

III. Grantor v. Non-Grantor CLTs - Income Tax Considerations

A. Summary of Tax Attributes
   1. CLTs are not tax-exempt like CRTs.
   2. Either the donor/grantor is taxed on income earned by the CLT, or the trust itself is taxed.
   3. Grantor CLT: grantor receives up-front tax deduction, but grantor is taxed on income of trust each year.
   4. Non-grantor CLT: grantor receives no up-front tax deduction, but trust is taxed on income each year, and is permitted a charitable deduction under §642(c) for amounts paid to charity.

B. Grantor CLTs - Income Tax Deduction:
   1. Requirement - donor must be treated as the owner of the trust under the grantor trust rules of §671 et seq.
   2. Grantor Trust Rules - see §671 et seq.
      (a) §673 - reversionary interests in excess of 5%.
      (b) §674 - power to control beneficial enjoyment.

(c) §675 - administrative powers (e.g., dealing for less than adequate and full consideration, borrowing without adequate interest or security, non-fiduciary ability to substitute assets)

(d) §676 - power to revoke.

(e) §677 - income can be distributed to or for the benefit of grantor or spouse

(f) Note: The ability of grantor to substitute property (in and of itself) may cause trust to be treated as a grantor trust under §675 but not cause inclusion in the gross estate of the grantor. Recent private letter rulings by the IRS have stated that the mere ability to substitute does not automatically guarantee the trust will be a grantor trust under §675; instead, it is now a "facts and circumstances" test.

3. Advantage - obtain up-front tax deduction in year of gift.

4. Disadvantages

(a) Donor/grantor taxed on trust income as it is earned.

(b) Death of donor/grantor causes recapture of tax deduction previously taken.

(c) Trust is not permitted any tax deductions.

5. Income Tax Deduction

(a) Public charity - limited to 30% of adjusted gross income ("AGI"), along with a 5 year carryover, because gift is not "to" charity, but "for the use of" charity.

(b) Private charity - likewise limited to 30% of AGI, unless funded with capital gain property which further limits deduction to 20% of AGI; note: there is some question regarding PLR 8824039 whether 5 year carryover applies to gifts "for the use of" private charities.

C. <u>Non-Grantor CLTs - Taxation of the Trust:</u>

1. §642(c) permits a trust or estate "...a deduction in computing its taxable income...[for] any amount of the gross income, **without limitation**, which pursuant to the terms of the governing instrument is, during the taxable year, [actually] paid for a purpose specified in §170(c)...." [emphasis added].

2. Therefore, a non-grantor CLT is <u>not</u> subject to the §170 percentage limitations.

3. WIFO - some question still remains as to whether or not the "worst in, first out" rules of §664 and the regulations thereunder govern CLTs (needless to say, the IRS says "no").

4. Throwback Rules - used to apply to excess income over amounts actually paid to charity; rules now revoked prospectively.

5. Unrelated Business Income Tax ("UBIT") - reduces the deduction for charitable distributions under Reg. §1.642(c)-3(d) and §681.

6. Alternate Minimum Tax ("AMT") - Historical Note: Previously, distributions by CLTs of appreciated property to satisfy annuity/unitrust obligations were <u>not</u> preference items according to the Senate Finance

Committee and PLR 9044047. In light of legislative changes, AMT is no longer a concern when there is a gift of an appreciated asset.

IV. Gift, Estate and Generation Skipping Tax Considerations

A. Gift Tax Implications

1. Calculation - the IRS determines the present value of the income interest being paid to charity (based upon the 7520 Rate, payout rate, and mortality rates), subtracts this amount from the fair market value (FMV) of the gifted asset, to arrive at the present value of the remainder interest.
2. Gift tax returns - are required for gifts if the present value of gifts to charity exceed $12K and/or the remainderman is not the donor.
3. The present value of the income interest - is deductible as a gift to charity.
4. The present value of the remainder interest -
   (a) Is a future gift, and thus the annual exclusion of $12K is not available.
   (b) Reduces the unified credit or results in the imposition of a gift tax.
   (c) Is available for the marital deduction under §2523 for U.S. citizens (caveat: non-citizen spouses).

B. Estate Tax Implications

1. Donor retains a reversionary interest and dies within the trust term - only the actuarial value of his reversionary interest, based upon the fair market value of the trust at the time of his death, is includible in his gross estate.
2. Donor does not retain a reversionary interest - a completed gift is made, but any appreciation in the FMV of the trust after date of the gift is not includible in his gross estate.
3. Donor retains strings - the donor will be deemed to be the owner for estate tax purposes and the full FMV of the CLT assets will be includible in his gross estate at date of death values if the donor retains any prohibited "strings" under §§2036, 2037, 2038 and 2041 (e.g., right to designate or change charitable beneficiaries or non-charitable remainderman, right to vote stock of assets held in trust, or being an officer or director of a private foundation to which the income is payable).

C. Generation Skipping Transfer Taxes

1. CLTs must run the gauntlet - GSTT usually will be involved in either the planning or the actual functioning of the typical CLT.
2. CLATs v. CLUTs - different treatment results regarding the allocation of the GSTT exemption, especially regarding the timing of the allocation.
3. "Taxable Termination" - if the charitable income recipient was identified in the CLT, a taxable termination has occurred at the end of the measuring period (term, lives, etc.) and the Trustee of the CLT is liable for the tax.
4. "Taxable Distribution" - if the charitable income recipient was not identified in the CLT, a taxable distribution occurs at the end of the measuring period and the skip person is liable for the tax.

V. Prohibited Transactions

A. §4941 - This section of the Code prohibits self-dealing transactions such as the sale, exchange, lease, lending of money, furnishing of goods and services, etc., between a private foundation (e.g., a CLT) and a disqualified person (e.g., the donor and his family). All of these prohibitions apply to a CLT. §4941 imposes a 2 tier tax on self-dealing transactions.

B. §4943 - §4947(a)(2) of the Code prohibits the CLT (as a private foundation) from "excess business holdings" as defined under §4943.

1. Excise Tax
   (a) A 5% excise tax is imposed on holdings in excess of "permitted holdings."
   (b) A 200% excise tax is imposed on excess business holdings if correction is not made.
2. Permitted Holdings under §4943(a)(1) and (2)
   (a) For a corporation, 20% of the voting stock, reduced by the percentage of voting stock owned by all disqualified persons (as defined in §4946(a)).
   (b) For a partnership, profits interest is substituted for voting stock.
3. Exceptions
   (a) Five year rule exception for gifts or bequests under §4943(c)(6).
   (b) Ten year rule exception for gifts or bequests, if Secretary allows continued ownership after the first five year period where there is a gift or bequest under §4943(c)(7).
   (c) Effective control exception under §4943(c)(2)(B) where other independent people are in control of the company, in which event the 20% rule can be changed to 35% by the Secretary. See also, Rev. Rul. 81-111; PLR 9250039; PLR 8407095.
   (d) Passive source (or income) exception under §4943(d)(3)(B) if 95% or more of the gross income of a business enterprise is "passive."
   (e) De minimus exception under §4943(c)(2)(C) (2% can be held by the CLT).
   (f) 90 day grace period exception to dispose of stock without violating §4943 under Treas. Reg. §53.4943-2(a)(1)(ii).

C. §4944 - §4947(a)(2) Prohibits Jeopardy Investments as Defined Under §4944 of the Code:

1. Excise Tax imposed on speculative investments
   (a) §4944(a)(1) imposes a 5% excise tax on the CLT (the private foundation) for any investment which jeopardizes the carrying out of the exempt purposes. §4944(a)(2) imposes a 5% excise tax on the foundation manager (i.e., the trustee) who willingly and knowingly participates in the investment, up to $5,000 per investment.
   (b) A tier two tax is imposed at a 25% rate if the tier one tax is not corrected under §4944(b).
2. Exceptions

(a) Treas. Reg. §53.4944-1(a)(2)(ii)(a) provides that §4944 will not apply to an investment made by any person which is later gratuitously transferred to a private foundation.

(b) Must distinguish between purchase of a jeopardy investment, as opposed to a gift of a jeopardy investment, followed by its retention. See, PLRs 8125038, 8038180 and 8035040, where the receipt and retention of a jeopardy investment by a CLT was approved. Note, however, that this area is far from being settled.

VI. Testamentary CLTs

A. Advantages - Testamentary v. Inter Vivos CLTs

1. Stepped up basis - the non-charitable remainderman will take any property in the CLT at its termination based upon the date of death value.

2. Assets required during life - many donors cannot afford to part with income-producing assets during life, but can do so at death.

3. Funding - certain assets, such as a promissory note, can be more easily funded at death, than during life.

B. Disadvantages - Testamentary v. Inter Vivos CLTs

1. Adjusted basis - many testamentary CLTs are funded for a term (versus for a life or lives), and thus the stepped-up basis argument above is not as favorable as it might appear, on first blush.

2. Reduced Taxable Estate - if a CLT is created during life, gift taxes are paid and the donor survives 3 years, the gift taxes paid will reduce the gross estate and thus reduce estate taxes when the donor dies.

3. Appreciation in value - if a CLT is created during life, the appreciation in value of the donated asset is not taxable in the gross estate of the donor. This can be very significant.

4. Zeroing out estate taxes - it is difficult at times for the executor and testator to calculate in advance the potential earnings of the assets to be used to fund the testamentary CLT. One can argue that the same difficulty exists, however, with an inter vivos CLT.

5. Unknown 7520 Rate - a very significant advantage of an inter vivos CLT is that the donor can make a gift to an inter vivos CLT when the 7520 Rate is low, thereby reducing the value of the remainder passing to heirs. This flexibility is usually not available to the decedent creating a testamentary CLT.

C. Caveat: Additional provisions need to be inserted into a testamentary CLAT which are not required in an inter vivos CLAT (e.g., tax clauses, formulas establishing amount to fund CLAT, etc.)

VII. Planning Considerations and Opportunities

A. Funding the CLT

1. Types of Assets

(a) Cash - simple and easy, but still subject to 30% of AGI limitation for gifts to grantor CLTs because deemed "for the use of."

(b) Tax exempt securities
  (i) A great vehicle to fund a CLT - set up so CLT is grantor trust - donor gets up-front income tax deduction, but does not have to pay income taxes each year, because income is exempt.
  (ii) Caveat: Rev. Rul. 60-370 (the "Pomona College Ruling") - however, probably doesn't apply because CLT isn't tax exempt as was CRT in ruling.

(c) Long-term Capital Gain Assets
  (i) Grantor Trusts - gain taxed to Donor.
  (ii) Non-Grantor Trusts - gain taxed to CLT at normal trust rates.
  (iii) Private charities - income tax deduction limited to 20% of AGI for grantor CLTs, with potentially no carryover (except for marketable securities).

(d) Ordinary Income Assets - for grantor CLTs, a deduction limited to 30% of AGI for grantor CLTs, but up to FMV (not adjusted basis) regarding §170(e), §170(f)(2)(B) and Reg. §1.170A-6(c)!

(e) Mortgaged Property - caveat:
  (i) Prohibited transactions - CLTs are subject to these rules
  (ii) Bargain sale rules (perhaps <u>not</u> with a grantor CLT).
  (iii) UBIT and reduction of charitable deduction for amounts paid to charity (regarding non-grantor CLT).

(f) Closely Held Stock
  (i) Problem is that the prohibition on excess business holdings (§4943) applies if lead interest exceeds 60% or if "all the income interest" isn't paid to charity.
  (ii) Prohibition - donor and/or related parties cannot retain more than 20% of company.
  (iii) Answers:
    a. Recapitalize and shift voting common stock away from disqualified persons (not too realistic); or
    b. Make sure charitable lead income interest is <60% and that all income paid to only to charitable beneficiaries (this prevents a zeroing out of remainder passing to heirs); or
    c. Make sure the CLT disposes of the stock within 5 years and falls within the exception for gifts under §4943(c)(4)-(6); or
    d. Make sure the CLT disposes of the stock within 10 years and the CLT obtains permission of the Secretary under §4943(c)(7) exception;
    e. THEREFORE, plan to have the stock redeemed within 5 or 10 years; however, this presents 2 more issues:

1) *Palmer v. Commissioner*, 62 T.C. 684 (1974), *aff'd* on another issue, 523 F.2d 1308 (8th Cir. 1975), Rev. Rul. 78-197 and *Blake v. Commissioner* [83-1 USTC ¶9121], 697 F.2d 473 (2d Cir. 1982), *aff'g* 42 TCM 1336 (1981) - make sure there is no legal obligation to redeem; and

2) §4941 and the regulations thereunder require either a redemption or sale to a non-disqualified person.

(g) Promissory Notes - see discussion below.

(h) Tangible Personal Property

(i) §170(a)(3) limitations do not apply because gift is one of present interest.

(ii) However, must reduce gift for income tax purposes by the amount of appreciation because not used for a related purpose.

(iii) Caveat: liquidity to pay charitable lead income interest.

2. Discounts

(a) Family Limited Partnership - when property is transferred to a limited partnership, and limited partnership interests are gifted to a CLT, a number of discounts may be available:

(i) Minority interests;

(ii) Marketability and liquidity;

(iii) Business risks; and/or

(iv) Key man.

(b) Benefits of a Discount - economic benefits of reduction in FMV of gifted asset "go right to the bottom line" and reduce the amount of the non-charitable remainder passing to family members. Compare the results in the attached **Exhibits #1 and #2.**

B. <u>Selecting the Trustee</u>

1. Estate Tax Issues - if the donor is the Trustee, significant estate tax issues arise if the donor as Trustee has any discretion re: allocation of payments or if assets in trust are closely held stock (i.e., 20% rule of §2036).

2. Simple answer - in normal situation, since donor is trying to avoid inclusion in his gross estate, do not let him be the Trustee - instead, if donor wants to regulate which charities benefit, consider a "Donor Advised Fund" (but be very careful, since this is a grey area).

C. <u>Structuring the Payments to Charity</u>

1. Zeroing out the Remainder Interest

(a) Selecting the 7520 Rate - with an inter vivos gift, the current month's 7520 Rate, or either of the prior two month's rate can be selected - choose the <u>lowest</u> 7520 Rate, because this minimizes the remainder passing to the non-charity.

(b) Use Discounts - see discussion above.

(c) Select a Payout for a Term of Years - use a term of years if the donor is older, or if the donor's death is imminent.

(d) Select a Payout for a Lifetime - use the donor's life as the measuring term if the donor is relatively young and yet the prognosis is death shortly (but not hopefully within 18 months).

2. Setting the Amount of the Payments to Charity

(a) Payments to approximate future trust income

(i) Payments are too high - assets will have to be sold and there will be adverse capital gains consequences if the assets have appreciated.

(ii) Payments are too low - throwback rules come into play

(b) Create CLT which provides for charitable <u>and</u> non-charitable income beneficiaries, with the latter only receiving income if there is a sufficient amount. Potentially, also provide for "make-up" for non-charitable income beneficiaries if there is insufficient income in prior years.

3. Avoiding private foundation prohibitions

(a) In PLR 9128051 the donor created a "formula" CLT so as to avoid breaching the 60% limitations of §4947 and thereby subjecting the CLT to the rules of §§4943 and 4944.

(b) See Conrad Teitell's suggested changes in his excellent treatise, "Charitable Lead Trusts," which is a must for the serious practitioner in this area.

4. Offsetting Gift Taxes and Income Taxes

(a) Offset gift taxes by a reduction in income taxes, where the facts are appropriate.

(b) <u>Example #2</u>: A donor contributes $2M of 4.25% tax-exempt securities to a Grantor CLAT which pays income to charity for 16 years, then remainder to the donor's children. Actuarially, the gift produces an income tax deduction of $938,340 (see attached **Exhibit #3A**), and an income tax (cash) savings of $469,170 at a 50% maximum effective rate. The gift tax is 50% of the present value of the remainder of $1,061,660, or $530,830, thereby essentially producing a "wash" in the taxes (see attached **Exhibit #3B**).

D. <u>Examples</u>

1. Sale Just Finalized!

(a) <u>Example #3</u>:

(i) Donor has long-term capital gain asset worth $1M, with adjusted basis of $100K, and has just sold for cash.

(ii) In the alternative, donor has an enforceable contract to sell, which under <u>Palmer</u>, Rev. Rul. 78-197 and <u>Blake</u> means the donor must pay capital gains tax.

(iii) Donor is in 20% capital gain tax bracket and owes $180K in capital gain taxes and wants you to make the problem go away.

(iv) Donor has other assets and doesn't need the cash for "other deals" and has $1M of annual income (and so doesn't need the income from the cash for support). Donor wants the $1M to pass to his grandchildren (ages 3 to 15) to provide for their educational needs.

(v) Donor and spouse have done no estate planning and have not used their unified credit or GSTT exemption.

(b) Answer to Example #3:

(i) Have the donor contribute the cash to a Family Limited Partnership, and then have the donor contribute his 99% limited partnership interest to a 10.77%, 10 YEAR GRANTOR CLAT. Note that the payout is really only 7% of the face amount.

(ii) Donor will get an up-front charitable income tax deduction of $550,615 (see attached **Exhibit #4A**), thereby eliminating all tax.

(iii) Have the donor and spouse allocate the unified credit to the extent of approximately $100K to the "Value of Remainder Interest" (see attached **Exhibit #4B**).

(iv) Select a knowledgeable trustee who will see that the prudent investment alternative is tax-exempt securities.

(v) $1M will revert to grandchildren at the end of the 10 year term.

2. Promissory Notes In Hand!

(a) Example #4:

(i) Same facts as above hypothetical regarding cash, but donor instead has just sold the asset on the installment basis in return for a promissory note ("P/N") with a face amount of $1M, payable over the next 20 years in annual payments of $101,852.

(ii) Long-term capital gain will be reported ratably for each installment, and interest will also be earned and reported as payments are made.

(iii) Assume that there is no way to avoid §453B and avoid recognizing the built-in capital gains of $900K - even dying will not help! (because the P/N is income in respect of a decedent in his estate and there is no step-up under §1014).

(b) Answer to Example #4:

(i) Currently, there are no capital gain taxes to pay due to §453.

(ii) During life, transfer the $1M P/N (which will be discounted to $650,000) to a 10.77%, 10 YEAR GRANTOR CLAT -

the P/N will not be accelerated under §453B, since the trust is a grantor trust.

(iii) Donor must pay income taxes for first 10 years to the extent of interest received and capital gain recognized, but this is positive since it reduces his gross estate without having to pay transfer taxes.

(iv) Donor will be entitled to an up-front charitable income tax deduction of $550,615 (see attached **Exhibit #4A**).

(v) At the end of 10 years, the P/N passes to grandchildren, who are taxed in lower income tax brackets.

(c) Example #5:

(i) A 75 year old donor has just lost her husband, and has been told she will die of cancer in the next two years.

(ii) Her gross estate is $3.5M; she desires to leave her remaining $1M unified credit to her son, give $1.6M to grandchildren and give the remainder to charity.

(iii) Her underlying assets consist of 20 year, 7% P/Ns with a face value of $1.8M from a recent sale of real estate, a home worth $600K, and investments worth $1.1M.

(iv) She does not want to pay any income, estate or GST taxes.

(d) Answer to Example #5 (not yet fully researched or tested, so be careful!):

(i) Have an appraiser value on a discounted basis the value of the P/Ns by 50% due to: (i) danger of not being paid, (ii) lack of security, and (iii) undivided interest.

(ii) During life, have the donor give 1/9th undivided interest in P/Ns (face amount of $200K, FMV of $100K) outright to charity and an 8/9ths undivided interest in P/Ns (face amount of $1.6M, FMV of $800K) to a 15%, 8.5 YEAR GRANTOR CLAT.

(iii) Take no charitable income tax deduction, thereby avoiding future recapture (?).

(iv) At death of donor, the grantor CLT turns into a non-grantor CLT, and all ordinary income and capital gains taxes on the P/Ns as payments are made will be offset to a great extent by corresponding charitable income tax deductions for payments by the CLT to charity.

(v) At the end of 8.5 years, the grandchildren will receive $1.6M interest in a promissory note – any GST taxes?! (see attached **Exhibit #5**).

(vi) In her will, have the donor give her home to son outright, along with $400K of investments, and give the balance to charity.

(vii) All estate taxes are avoided!

(viii) All income taxes, even on IRD items such as P/Ns, are avoided!

3. Land and Buildings Locked into Corporate Solution (S Corp)

(a) <u>Example #6</u> (PLR 9512002):

(i) Husband, Wife, Son and Daughter own all of the outstanding common stock of Corporation X, an S corporation.

(ii) X owns land, which is ground leased to Son's wholly owned corporation Y. Y has assigned its leasehold interest to an independent third party, Z. X has subordinated its fee simple interest in the land to banks, which loaned money to Z to build on the land; but X has no personal liability to repay Z's mortgages, the bank's only recourse being against Z and X's fee simple interest in the land. When the land lease ends, all improvements belong to X (as the landlord).

(iii) <u>OBJECTIVE: Husband and Wife want to transfer the land out of X, income, estate and gift tax free.</u>

(iv) Husband and Wife created a Family Foundation, which is a private foundation ("PF"), with Husband and Wife (and one other independent individual) as trustee.

(b) Answer to Example #6:

(i) Corporation X will create a CLAT, income to the PF, remainder to X.

(ii) Husband will resign as trustee and an officer of PF prior to the creation of the CLAT, whereupon Son and an officer of X will become trustees, along with Wife and the independent trustee.

(iii) X will sell its remainder interest in CLAT to Son for fair market value (which actuarially is less than 5%, based upon §7520 calculations).

(c) Results:

(i) Neither X nor any shareholder is treated as the owner under the grantor trust rules.

(ii) CLAT will be allowed a §642(c)(1) deduction for its payments to PF, despite existence of the mortgage, and despite the requirements of §§642(c)(4) and 681 which would seem to limit the deduction where UBIT and debt-financed property exists..

(iii) Regarding the mortgage on the Land:

a. CLAT will not recognize income upon receipt of the land;

b. X will not recognize gain upon its gift to the CLAT (despite the mortgage and §1011(b) and the regulations thereunder which require allocation of basis and deemed sale treatment), because there was no assumption of the mortgage, nor did the CLAT take subject to the mortgage;

c. No shareholder of X will recognize gain on the contribution of the land, because no property or economic benefit was received by the shareholders under §301; and

d. There is no violation of §4941, because the CLAT did not assume or take subject to the mortgage.

(iv) Son will not recognize gain upon the termination of the CLAT, when he receives the CLAT assets (presumably the land).

(v) The transfer of the land to the CLAT is a charitable gift (proportionately) by all shareholders of X under §2522.

(vi) The assets of the CLAT will not be includible in the gross estate of Husband under any section of the Code.

(vii) Each shareholder must reduce his or her stock basis to the extent of his or her pro-rata share of the value of the remainder (less than 5% of FMV).

4. Passing the Family Business to Heirs

(a) <u>Example #7</u> (PLR 9501038)

(i) Can be structured so that there are NO ESTATE TAXES; the trade-off is payments to charity for a period of time.

(ii) Facts: Dad wants to transfer the family business to the children, but cannot do so due to huge estate taxes. Let's assume that Dad and Mom are uninsurable, or could not afford the insurance. A significant problem arises with using any vehicle which would be subject to the excess business holding requirements of Sec. 4943.

(b) Answer to Example #7: Dad dies testate, survived by his wife and three children. His executor sells stock in the family business to qualified subchapter S trusts ("QSSTs") for his children for a promissory note. Then the Executor will fund a testamentary charitable lead annuity trust with the promissory notes from QSSTs.

EXHIBIT 1

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Summary of Benefits

8.5% Non-Grantor Lead Annuity Trust

ASSUMPTIONS:

Fixed Term	16 years
Trust Principal	$1,500,000.00
Cost Basis of Property	$150,000.00
Payout Rate	8.5%
Payment Schedule	quarterly at end

BENEFITS:

Gift Tax Deduction	$1,407,510.00
Annual Payment to CHARITY	$127,500.00
Taxable Portion of Principal	$92,490.00
Donor Prior Taxable Gifts	$2,000,000.00
Gift Tax Due in 2006	$42,545.40

IRS Discount Rate is 5%

EXHIBIT 2

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Summary of Benefits

6.375% Non-Grantor Lead Annuity Trust

ASSUMPTIONS:

Fixed Term	16 years
Trust Principal	$2,000,000.00
Cost Basis of Property	$150,000.00
Payout Rate	6.375%
Payment Schedule	quarterly at end

BENEFITS:

Gift Tax Deduction	$1,407,520.00
Annual Payment to CHARITY	$127,500.00

Taxable Portion of Principal	$592,480.00
Donor Prior Taxable Gifts	$2,000,000.00
Gift Tax Due in 2006	$272,540.80

IRS Discount Rate is 5%

These calculations are for illustration purposes only and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift.

EXHIBIT 3A

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Summary of Benefits

4.25% Grantor Lead Annuity Trust

ASSUMPTIONS:

Fixed Term	16 years
Trust Principal	$2,000,000.00
Cost Basis of Property	$150,000.00
Payout Rate	4.25%
Payment Schedule	quarterly at end

BENEFITS:

Income Tax Deduction	$938,340.00
Annual Payment to CHARITY	$85,000.00

IRS Discount Rate is 5%

These calculations are for illustration purposes only and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift.

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Charitable Deductions for $2,000,000 Gift

	Grantor Lead Annuity Trust
Payout Rate	**4.25%**
Fair Market Value of Gift	$2,000,000
16 Year Term+	-$938,340
Present Value of Non-Charitable Interest>>>>>>>>>>>>>>>>>>>>>>>>	**$1,061,660**

IRS Discount Rate is 5%

These calculations are for illustration purposes only and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift.

EXHIBIT 4A

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Summary of Benefits

10.77% Grantor Lead Annuity Trust

ASSUMPTIONS:

Fixed Term	10 years
Trust Principal	$650,000.00
Cost Basis of Property	$65,000.00
Payout Rate	10.77%
Payment Schedule	quarterly at end

BENEFITS:

Income Tax Deduction	$550,615.00
Annual Payment to CHARITY	$70,005.00

IRS Discount Rate is 5%

These calculations are for illustration purposes only and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift.

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Charitable Deductions for $650,000 Gift

	Grantor Lead Annuity Trust
Payout Rate	**10.77%**
10 Year Term	$650,000 -$550,615
Non-Charitable Interest for $650,000 Gift>>>>>>>>>>>>>>>>>>>>>>>>>>	**$99,365**

IRS Discount Rate is 5%

These calculations are for illustration purposes only and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift.

EXHIBIT 5

KALLINA & ASSOCIATES January 25, 2006

Deduction Calculations

Summary of Benefits

15% Grantor Lead Annuity Trust

ASSUMPTIONS:

Fixed Term	8.5 years
Trust Principal	$800,000.00
Cost Basis of Property	$80,000.00
Payout Rate	15%
Payment Schedule	quarterly at end

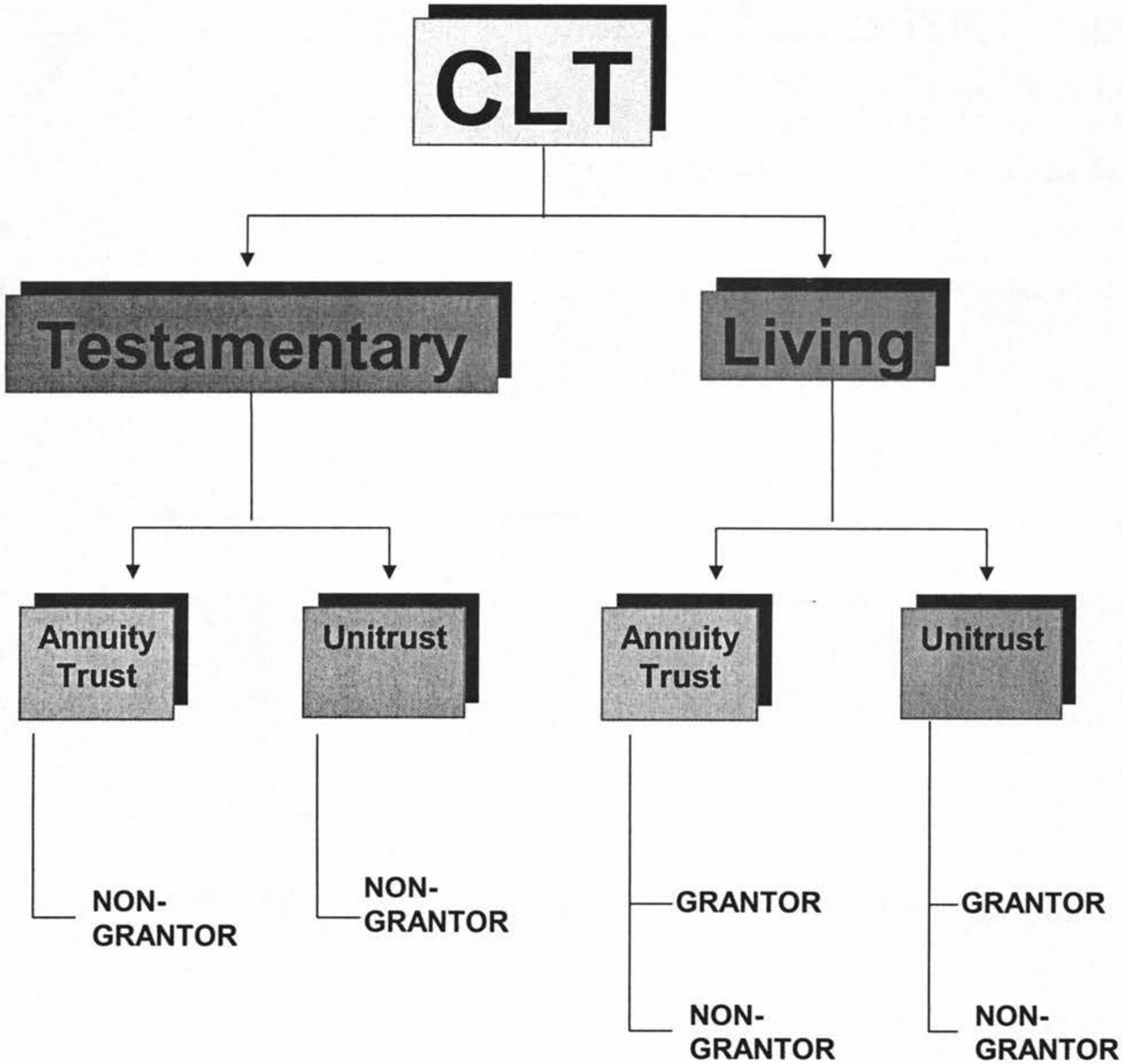
BENEFITS:

Income Tax Deduction	$800,000.00
Annual Payment to CHARITY	$120,000.00

IRS Discount Rate is 5%

These calculations are for illustration purposes only and should not be considered legal, accounting, or other professional advice. Your actual benefits may vary depending on the timing of the gift.

Exhibit #6


CLT
Testamentary
Living
Annuity Trust
Unitrust
Annuity Trust
Unitrust
NON-GRANTOR
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LOOKING THE GIFT HORSE IN THE MOUTH:

Drafting and Using Gift Acceptance Policies and Procedures

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LOOKING THE GIFT HORSE IN THE MOUTH:

Drafting and Using Gift Acceptance Policies and Procedures

I. Purpose and Benefits of Gift Acceptance Policies and Procedures

Drafting an effective set of gift acceptance policies and procedures ("GAPP") takes time and costs money. The institution's development department, its treasurer's office or business office and its governing board will be involved. The institution's legal counsel should also review the document because a GAPP raises a number of legal issues. Do the benefits of a well-crafted GAPP justify the time and expense involved?

The answer is certainly yes. A GAPP, if carefully thought out and diligently followed, will very likely enhance an institution's ability to attract gifts and maintain a following of loyal donors. In addition, effective use of these policies and procedures can help an institution avoid damage to the reputation of its fundraising program, disputes with donors, costly litigation, and legal liability.

A. Enhance the Effectiveness of the Institution's Fundraising Program

A GAPP assists the institution's development department.

1. Defines the scope of development efforts

A GAPP should specify what types of gifts an institution will accept and in what circumstances it will accept them. This information helps development officers know what types of gifts they should explore with donors. Without this information, or with only vague or incomplete information, development officers will shy away from gifts they are not sure the institution wants.

2. Promotes good donor relations

Adopting and using a GAPP promotes good donor relations in a number of ways.

a. Allows prompt response

A GAPP tells the institution's development officers what types of gifts are acceptable and the step-by-step procedure for approval and implementation. This information helps the development officer respond promptly to a donor's inquiries. Obviously, the response will be slower, and probably somewhat garbled, if the institution has to make up the policy for a particular type of gift on the spot.

b. Conveys confidence

The GAPP gives a development officer the confidence to speak with authority about the types of acceptable gifts and the steps involved in making them. Some gifts will require internal review before the institution can decide whether, and on what terms, to accept. Nevertheless, the GAPP reduces uncertainty because it allows the development officer to explain to the donor the steps the institution must take in order to reach a decision.

c. Avoids confusion and backtracking

A donor's confidence in an institution's fundraising program will deteriorate rapidly if the development officer confidently states that the proposed gift is acceptable but later sheepishly explains that the gift needs further review, or will only be acceptable under conditions that were not mentioned before. A well-drafted GAPP should eliminate this type of problem.

B. Avoid Unwanted Gifts

Sometimes, gifts which initially seem attractive turn out, on closer inspection, to be suspect, risky, or otherwise undesirable. A GAPP helps the institution weed out these "problem" gifts and decline them, rather than discover their unsavory features after it is too late. In addition, some institutions are not equipped to handle the more complicated and sophisticated types of gifts. A GAPP allows an institution to decline these gifts or arrange for a third party trustee without offending the donor.

1. Problem gifts

No set of guidelines will eliminate all problem gifts, but a GAPP will help an institution address some commonly encountered situations, such as the "donor" who lacks genuine donative intent, the donor who is institution shopping, and the donor who proposes a gift that may leave family members disgruntled and/or combative.

2. Gifts beyond the institution's capabilities

Charitable institutions vary widely in their staffing, resources, experience and sophistication. Some institutions may be ill-equipped to accept certain kinds of gifts. The process of drafting a GAPP helps an institution evaluate its capabilities and avoid gifts it cannot handle. That in turn helps the institution avoid the disputes, expense, and potential liability that can result from mismanaged planned gifts. Some examples of gifts an institution may not wish to accept or administer:

i. Charitable lead trusts

ii. Charitable remainder trusts

iii. Any type of trust or charitable gift annuity ("CGA") arrangement funded with assets other than cash and publicly traded securities

iv. Gifts of real estate

C. Avoid Liability and Losses

Avoiding problem gifts (B. above) can go a long way toward reducing exposure to liability. Problem gifts, almost by definition, are those that have a higher than normal probability of generating litigation. There are, however, other types of liability that a GAPP can help the institution avoid.

1. Environmental liability

The GAPP should require that all proposed gifts involving real estate must receive appropriate environmental review before acceptance.

2. Partnerships

Some types of partnership interests require the partners to make contributions to the partnership. A GAPP should establish procedures for review of proposed gifts of partnership interests.

3. Bargain sales

In any bargain sale, including a gift annuity transaction, the institution buys something for less than its supposed fair market value. If the institution miscalculates the value, it suffers a loss when it sells the purchased/donated item for less than it paid. The GAPP should establish procedures for evaluating proposed bargain sales and criteria for acceptance.

4. S corporation stock

A gift of S corporation stock carries potential tax liability for the donee institution. The portion of the corporation's taxable income allocable to the institution as a shareholder constitutes unrelated business taxable income ("UBTI"). The institution will have this taxable income whether or not it receives a distribution from the corporation. Thus, unless the organizational documents of the corporation require a distribution sufficient to pay tax, the institution may face tax liability without the cash to pay it. A GAPP should establish procedures for review of proposed gifts of S corporation stock.

II. Decision-Making Authority and Procedures

A GAPP creates a hierarchy of decision-making procedures within an institution's corporate structure. The institution's governing board must comply with applicable state law in adopting the GAPP, modifying it later if appropriate, and providing in the GAPP itself for delegation of certain kinds of decision-making authority. In addition, the GAPP should establish clear lines of authority and decision-making procedures.

A. Approval and Modification of the GAPP

The GAPP is a policy of the institution. As such, it should be adopted by a resolution of the institution's governing board.

1. Procedure for adoption

The procedure for adoption of the GAPP will depend in part on the institution's articles of incorporation and bylaws. Normally, the governing board may approve a policy such as a GAPP by majority vote. *See* Minn. Stat. § 317A.237.

2. Emergency amendments

Typically, an institution's bylaws provide for an executive committee which can act between regular meetings of the full board. In the case of a gift which requires immediate action, the executive committee can act if necessary. When the GAPP is drafted, the institution's legal counsel may wish to provide that the executive committee can modify or depart from the GAPP in emergency situations. Such a provision must, of course, be consistent with the institution's articles of incorporation and bylaws.

B. Levels of Decision-Making Authority

The GAPP should explain who has authority to decide whether to accept various kinds of gifts. Typically, there are three levels of decision-making authority. The governing board itself will decide the most complex cases and the ones that have the most significant implications for the institution; a gift acceptance committee will handle intermediate situations; and the vice president for development (or comparable officer) will have authority to accept the most routine kinds of gifts. In divvying up the turf between these three decision makers, the board should strike an appropriate balance between efficiency and due diligence.

1. Governing board

   The board can reserve for itself whatever decisions it deems appropriate. In addition, it can give to the other decision makers the discretion to refer particular cases to it for a decision.

2. Gift acceptance committee

   In the GAPP, the governing board can establish a gift acceptance committee to which it delegates decision-making authority with respect to certain types of gifts. Another option would be to delegate these powers to an existing committee.

   a. Typically, the gift acceptance committee would consist of the VP for development, the treasurer or someone else in the treasurer's or business office, and perhaps one or two members of the board who have appropriate expertise.

   b. In some states, the governing board of a nonprofit corporation can create a committee not all of whose members are board members, and the board can delegate any powers to it. *E.g.,* Minn. Stat. § 317A.241.

   c. The board has responsibility to oversee the activities of the gift acceptance committee. Typically, adequate oversight will involve review of all actions taken by the gift acceptance committee between regular board meetings.

d. The gift acceptance committee would typically review and make decisions regarding the following kinds of gifts, referring particular cases to the board as it deems it appropriate:

i. Gifts of real estate

ii. Gifts of tangible personal property that require the institution to incur substantial costs

iii. CRTs where the institution will act as trustee, co-trustee or successor trustee

iv. Gifts that involve contracts or other documents under which the institution assumes a legally binding obligation

v. Transactions with potential conflict of interest that could give rise to IRS sanctions and penalties

vi. Gifts that will generate UBTI for the institution

vii. Gifts that present any special risk of liability.

3. Vice president for development

The vice president for development would typically have authority to accept certain routine types of gifts. Examples would be gifts of publicly traded securities not subject to any Security and Exchange Commission ("SEC") restrictions and charitable remainder trusts funded with such securities and/or cash where the size of the trust, ages of the income beneficiaries and payout rate all fit within guidelines established by the GAPP.

C. Consultation with Institution's Legal Counsel

When should the institution consult with legal counsel who has expertise in charitable gift matters? Section VII.B below discusses the role of the institution's counsel in drafting and reviewing all legal gift documents. In some cases it makes sense to involve legal counsel earlier in the process – when the gift is being planned and/or reviewed for possible acceptance. A typical GAPP would require involvement of the institution's legal counsel in reviewing and deciding whether to accept the gift in the following situations:

1. CGAs and CRTs funded with assets other than cash and unrestricted publicly traded securities

2. A gift of any asset with restrictions on sale or transfer

3. All CLTs where the institution will act as trustee

4. CLTs funded with nonliquid assets, whether or not the institution will act as trustee

5. Any gifts identified as "problem" gifts under the screening procedures discussed in Section V below

6. Gifts of closely held business interests

7. Large or complex gifts of tangible personal property

8. Funding of testamentary CRTs with retirement account assets

9. Gifts with unusual or complex restrictions attached

III. Acceptable Types of Gifts, Criteria for Acceptance and Implementation Procedures

What follows is a fairly typical set of criteria for acceptance of gifts. It would be suitable for a major charitable institution that has the resources and expertise to handle virtually all types of charitable gifts. Smaller institutions and those with less experience or fewer resources should consider a GAPP under which they will not accept some of the more sophisticated types of gifts listed below. In some cases the criteria and procedures for particular types of gifts are stated as questions because the specifics will vary from institution to institution.

A. Cash

1. How should checks be made payable?

2. To whom should checks be delivered?

B. Publicly Traded Securities

1. Acceptability

   a. Unrestricted publicly traded securities – normally acceptable

b. Publicly traded securities subject to SEC restrictions – review by gift acceptance committee

2. Acceptance Procedure

a. Broker-to-broker transfer to institution's brokerage account

b. Delivery in person – unendorsed stock certificate and signed stock power

c. Delivery by mail - unendorsed stock certificate and signed stock power mailed in separate envelopes by registered mail

3. Disposition of donated securities

a. The institution should **not** have a standing policy to sell all donated securities immediately upon receipt. That raises pre-arranged sale issues. *E.g.*, *Ferguson v. Commissioner*, 174 F.3d 1004 (9^{th} Cir. 1999); Rev. Rul. 78-197, 1978-1 C.B. 83.

b. The GAPP should give an officer (and one or two backup officers) the authority to determine the disposition of each gift of securities.

c. It is permissible to state that the **normal policy** of the institution is to liquidate donated securities as soon as feasible. A problem arises only if that is an absolute rule.

C. Real Estate

1. Acceptability

a. What types of real estate interests will be accepted, *e.g.*, developed, undeveloped, undivided fractional interests, remainder interests in personal residences and farms?

b. Is there a minimum acceptable fair market value?

c. Should the institution obtain an appraisal before accepting?

d. Should the institution require that the donor pay for a title search and title policy?

2. Review procedure

The gift acceptance committee should review all proposed gifts of real estate. Prior to acceptance the committee should obtain, conduct, and/or review the following:

a. The terms of any mortgage

b. The property's carrying costs, *e.g.*, maintenance, insurance, property taxes, etc.

c. The most recent property tax statement

d. Satisfactory visual site inspection by employee or authorized agent of institution

e. Satisfactory environmental review by professional environmental consultant

f. Confirmation that donor has satisfied all mortgages, including tax liens, prior to transfer

3. Factors to consider in deciding whether to accept

a. Will the institution use or sell the property?

b. How marketable is the property?

c. Are there restrictions on the use of the property?

d. Does the property present any special risk of liability?

4. Transfer procedure

a. Legal counsel should draft a deed to transfer the real property or the real property interest from the donor to the institution or to the trustee of the split-interest trust, as the case may be. Typically, the donor's counsel will draft the deed. The GAPP should specify under what circumstances, if any, the institution will pay for its legal counsel or local counsel of its choosing to prepare the deed.

b. In the case of a transfer to a split-interest trust, the attorney who drafts the deed should determine the correct designation of the transferee under applicable local law.

c. If the donor gives the institution a remainder interest in a personal residence or a farm, the donor and the institution should also enter into an Agreement of Life Tenant and Remainderman which specifies the respective rights and responsibilities of the donor and the institution. In the case of a gift of an undivided fractional interest, the parties should enter into a similar type of agreement.

D. Tangible Personal Property

1. Related use vs. unrelated use

   Distinguish between gifts the institution will use in furtherance of its tax-exemption purposes ("related use gifts") and those it will sell ("unrelated use gifts"). IRC § 170(e)(1)(B)(i).

2. Related use gifts – factors in deciding whether to accept

   a. Prior to acceptance, VP for development confirms with appropriate personnel that the institution will in fact use the gift property in its programs.

   b. Deciding whether to accept a gift of tangible personal property which the donor expects the institution to put to a related use can pose a serious dilemma for the institution, especially where the donor is likely to make other gifts later on. Donors who are attached to art collections, book collections and similar items are often convinced that those collections will be valuable in the institution's program, but the institution may think otherwise. Before accepting, the institution should be sure it will be able to find a legitimate use for the gift.

   c. Gifts of tangible personal property for a related use often involve substantial ongoing costs for the institution. For example, a gift of an art collection requires the institution to expend funds for display, storage, insurance, and maintenance. The institution may wish to consider including in the GAPP a maximum amount of annual carrying costs it will absorb in connection with any such gift. The GAPP should state that if the threshold is exceeded the institution will accept the gift only if the donor also gives liquid assets sufficient to create an endowment fund which will cover the carrying costs indefinitely.

3. Acceptance procedures

   a. A deed of gift should be prepared by counsel for the donor or the institution. It should describe the donated property with a reasonable degree of specificity, and it should give the donee institution the right to immediate possession.

   b. If the institution will put the gift to a related use, the institution should provide the donor with a letter explaining what that use will be.

E. Closely Held Business Interests

The gift acceptance committee should review and pass judgment on all proposed gifts of closely held business interests.

1. Types of interests

   a. Acceptable (subject to review)

      i. Closely held stock

      ii. Limited partner interests in limited partnerships

      iii. Interests in limited liability companies

      iv. Debt instruments issued by closely held businesses

   b. Unacceptable

      General partnership interests

2. Factors to consider

   a. Restrictions that would prevent the institution from realizing a financial benefit, *e.g.*, by a sale.

   b. Is the donated interest reasonably likely to provide a substantial return to the institution?

   c. Will the interest generate UBTI, other undesirable tax consequences or other liabilities?

3. Acceptance procedures

   a. Legal counsel (typically the donor's) should review the closely held business entity's organizational documents to determine what procedures are required in order to transfer the interest in question to the institution. In some cases, approval of the institution's governing board or owners (*e.g.*, shareholders, partners or unit holders) will be required.

   b. In some cases, filings may be required with the Secretary of State.

F. Charitable Gift Annuities ("CGAs")

1. Acceptable types of gift property

   a. Cash and publicly traded securities not subject to SEC restrictions are normally acceptable.

   b. Proposed gifts of real estate and other nonliquid assets to fund CGAs raise difficult questions:

      i. Should the institution **ever** accept real estate for a CGA?

      ii. If the answer is yes, will the institution reduce the gift annuity rate to reflect the fact that the sale price will be unknown at the time it obligates itself with respect to the annuity rate, and if so, by how much?

      iii. If the answer is yes, will the institution insist on a deferred gift annuity to reflect the fact that the timing of a sale may be hard to predict. If the institution adopts a deferred gift annuity requirement, how long should the deferral period be?

2. Minimum funding amount

   Most institutions will not write CGAs for a transfer of property worth less than $10,000.

3. Minimum age of annuitants

   a. What should minimum ages for annuitants be?

   b. Should the minimum age be different for one-life and two-life annuities?

   c. Should the minimum age be different for immediate and deferred CGAs?

   d. What is the minimum age of annuitants at which payments under a deferred CGA will begin?

4. Reserves

   Will the institution hold the entire transferred amount as a reserve until all the annuitants have died?

G. Charitable Remainder Trusts ("CRTs")

The question here is not whether the institution should accept the gift. The gift will normally consist of a distribution of liquid assets when the trust terminates. Instead, the question is whether the institution will act as trustee, co-trustee or successor trustee. Admittedly, there will be rare cases in which a donor funds a CRT with a nonliquid asset and the trust terminates before the nonliquid asset is sold. Those cases will raise the same gift acceptance questions as an outright gift of the same kind of asset.

1. Criteria for acceptance of trusteeship

   a. The value of the assets with which the CRT will be funded. A typical minimum amount is $100,000.

   b. The number and ages of the beneficiaries. Many institutions will accept trusteeship of a CRT with at most two income beneficiaries. A minimum age of 55 is common.

   c. The institution should be designated as the irrevocable remainder beneficiary of at least some specified percentage, typically 50%.

   d. The institution should establish a minimum present value for the remainder interest, as computed under IRS tables.

2. Funding assets

   a. The institution will accept trusteeship of a charitable remainder annuity trust ("CRAT") **only if** the trust is funded with cash and/or unrestricted publicly traded securities.

   b. The institution will accept trusteeship of a charitable remainder unitrust ("CRUT") funded with cash and/or unrestricted publicly traded securities.

   c. Will the institution accept initial trusteeship of a CRUT funded with nonliquid assets, *e.g.*, real estate or closely held business interests? If so, it should do so only if the trust is structured as a flip unitrust. *See* Treas. Reg. § 1.664-3(a)(1)(i)(c). Some institutions will not accept initial trusteeship, but will agree to be successor trustee after the nonliquid asset is sold for cash. Before allowing the donor to set up a flip CRUT with the institution as successor trustee, the institution should have the trust agreement reviewed by its legal counsel to be sure that the document satisfies the governing instrument requirements for a CRUT and gives the institution the right to review all trust records before accepting the successor trusteeship.

3. Successor trusteeship and co-trusteeship

   a. The GAPP should provide that the institution will review all trust records and tax returns before agreeing to accept a successor trusteeship.

   b. The gift acceptance committee should decide whether to accept appointment as a co-trustee on a case-by-case basis. Factors to consider include:

      i. The identity of the other co-trustee and the likelihood that the trustees will be able to cooperate.

      ii. Any provision that gives the co-trustees unequal power, authority and/or responsibilities.

      iii. The inclusion in the trust agreement of a provision that exonerates one co-trustee from liability for actions taken by the other co-trustee in which the first co-trustee did not participate or acquiesce.

iv. A provision allowing the institution to resign its trusteeship simply by giving notice to the other co-trustee without the need for a court hearing.

4. Implementation procedures

If the institution will act as trustee, it will be responsible or partly responsible for several steps in the process of creating and funding the trust:

a. Obviously, a trust agreement will need to be drafted. Because the donor and the institution, as trustee, are both parties to the document, the question is whose legal counsel should draft it (and by implication who should pay for the drafting). Even in cases where the donor's legal counsel will draft, the GAPP should require that the institution's attorney will review the trust agreement before the institution executes.

b. **The donor should not transfer the funding asset to the institution/trustee until both parties have executed the trust agreement!**

c. Before the trust agreement is executed, the institution should put in place any necessary accounts or other mechanisms to receive the funding asset, *e.g.*, a temporary brokerage account at the donor's brokerage firm in cases where the trust will be funded with marketable securities.

H. Charitable Lead Trusts ("CLTs")

1. General policy on trusteeship

Every institution does (or should) want to be the beneficiary of CLTs, the more of them the better. The question is whether to act as trustee. The threshold issue is whether the institution is **ever** willing to act as trustee of a CLT. If an institution decides that it will at least consider acting as trustee, the factors discussed in H.2 below will be relevant in making that decision on a case-by-case basis. However, a review of those same factors may also help the institution decide whether, as a matter of policy, it should always decline to act as trustee of CLTs, referring the donor to a bank or trust company instead.

2. Criteria for acceptance of trusteeship

a. Who are the remainder beneficiaries? They will experience the cumulative impact of the trust's investment performance (good or bad) at a single point in time – when the trust terminates. Typically, the remainder beneficiaries will be the donor's children or grandchildren. What does the institution know about their attitude toward it and toward the CLT arrangement?

b. How long is the trust term? This can cut either way. A shorter term gives the children or grandchildren less time to become impatient to receive their distribution, but it also gives the trustee less time to recoup any losses from bad years in the market.

c. Is the CLT to be funded during the donor's life or at death? If during life, what is the donor's basis in the funding assets? Low basis assets limit the trustee's ability to diversify the trust's portfolio.

d. Sometimes donors propose to fund CLTs with nonliquid assets such as real estate or closely held stock. In proper circumstances this can be a viable plan. It is not for the faint of heart, however. An institution should agree to accept trusteeship in this type of case only after very careful review and consultation with its legal counsel.

3. Implementation procedures

These are the same as those for CRTs discussed above.

I. Gifts by Will or Revocable Trust

1. Accepting appointment as trustee or executor (officer of institution)

When, if ever, will the institution or an officer of the institution act as trustee, and when, if ever, will an officer act as executor of a donor's estate? The GAPP should answer these questions. Many institutions will act as co-trustee of a donor's revocable trust only if the institution's role is limited to investment management and administrative tasks, and does not include responsibility for decisions about the personal care of an incapacitated donor.

2. Acceptable gift assets

a. Cash and publicly traded securities

These will normally be acceptable.

b. Nonliquid assets

Before accepting a gift of a nonliquid asset under a will or revocable trust, the institution should conduct the same review as it would with a lifetime gift of the same asset. The institution can disclaim the gift, if appropriate, within the time limit prescribed by state law.

c. Accepting trusteeship of testamentary trust

If a donor approaches the institution about becoming the trustee of a testamentary CRT or CLT where the institution will be the beneficiary (or a substantial one), the institution should use the same criteria and decision-making procedures as those discussed above for lifetime CRTs and CLTs.

3. Implementation procedures

a. Providing for an outright testamentary gift in the donor's estate planning document normally involves a simple codicil or revocable trust amendment. Such documents should be drafted by the donor's legal counsel, and the donor should pay for them. The institution should have sample language on hand for pecuniary amount and residuary bequests which it can provide to the donor's attorney. If the donor asks the institution to have its legal counsel prepare such a document, refer to the discussion at 3.c below.

b. If the donor wishes to set up a testamentary CRT or CLT, it may make sense for the institution's legal counsel to draft the relevant provisions for review by the donor's counsel. In many cases, the institution's counsel will have more expertise in this area than the donor's attorney, who may be a generalist.

c. Testamentary CRT or CLT provisions or entire sample estate planning documents prepared by the institution's legal counsel **must** be provided directly to the donor's attorney for review and discussion with the donor. If the institution provides such provisions or documents directly to the donor, there is a risk that the donor will execute them or incorporate them into a document without consulting his or her own attorney. In that case, the institution's legal counsel may be involved in a violation of the rules of professional conduct because of the obvious conflict of interest. In addition, the gift may be subject to a challenge on the grounds of undue influence because the institution's legal counsel represented the donor.

J. Life Insurance

1. Lifetime gifts

a. Gifts of paid up whole life policies are normally acceptable, but the institution should not agree to keep the policy in force. Instead, it should retain the flexibility to cash in the policy if it concludes it would be in its financial interest to do so.

b. If premiums remain to be paid, the gift acceptance committee should review the policy to determine whether acceptance would be advantageous. The institution should not agree to pay future premiums but should retain the ability to surrender the policy for its cash value at any time.

2. Gifts of proceeds

Being named as a beneficiary under a life insurance policy which the donor continues to own would seem to have no downside.

3. Implementation

To transfer ownership of a policy to the institution, a donor will normally have to execute forms provided by the insurance company that issued the policy. It makes sense for the GAPP to require that the institution review this document before the donor submits it to the insurer.

K. Retirement Accounts

1. Outright gift at death

Being named as a beneficiary of a donor's retirement account is approximately the same from the institution's point of view as being named the beneficiary of a bequest of cash or other liquid assets in the donor's will or revocable trust. Such gifts are acceptable and should be encouraged.

2. Testamentary CGAs and CRTs funded with retirement accounts

Here again there is no downside to being named as the beneficiary. Acceptance in the case of a CGA should be based on the criteria for other types of CGAs as described above. Criteria for acceptance of trusteeship of the CRT should be based on the normal criteria for trusteeship of a CRT. The principal issues raised by these types of gifts have to do more with implementation than with acceptability.

3. Implementation

A transfer of retirement account assets at death, either outright to charity or to fund a CRT or CGA, requires a properly executed beneficiary designation for the account in question. In theory, this process should be as simple as the execution of a beneficiary designation for an insurance policy. Because retirement accounts constitute income in respect of a decedent which carries potential income tax liability, however, the drafting of beneficiary designations for retirement accounts raises special issues. The GAPP should require that all retirement account beneficiary designations that make gifts to the institution or to a CRT for its benefit should be reviewed by the institution's legal counsel.

L. Other Types of Gifts

No GAPP can cover every type of gift a donor and a donor's advisors can dream up. Proposals for unusual gifts should be handled on a case-by-case basis by the gift acceptance committee and/or the board of directors.

IV. Restricted Gifts

Donors can specify how the institution will use their gifts and the rate at which the institution will expend the funds. In the absence of an "escape clause" in the gift instrument (discussed below), the institution is legally bound to comply with the donor-imposed restriction unless the donor later consents to a change or a court authorizes one. Thus, restricted gifts **really are** restricted. It is important that an institution's GAPP provide for adequate review to determine that the institution can live with the proposed restriction.

A. Restricted Nonendowment Gifts

If a donor imposes a restriction only on the institution's use of the gift, the institution is free to expend the entire amount currently, provided that it spends the gift for the designated use. The main issue is whether the institution can live with the use restriction.

1. Guidelines

   The GAPP should clearly state that the institution will not accept gifts subject to restrictions that:

   a. Impose an undue administrative burden on the institution

   b. Involve unlawful discrimination of any kind

   c. Otherwise violate any applicable federal or state law

   d. Are inconsistent with the institution's mission and/or ethical standards

   e. Would prevent or impede the institution from seeking other gifts

   f. Are likely to generate adverse publicity for the institution

2. Pre-acceptance procedure

   The GAPP should designate an officer of the institution (preferably an officer not affiliated with the development department) who will consult with relevant personnel to determine that the institution can and will use the gift for the designated purpose. That officer should report to the gift acceptance committee, and the committee should make the final decision.

B. Restricted Endowment Gifts

Strictly speaking, an endowment fund is any fund not wholly expendable on a current basis. Thus, an endowment fund could be expended over a specified term of years. Most endowment funds, however, are managed to provide support indefinitely. The institution withdraws an amount each year which is designed to preserve the fund's inflation-adjusted purchasing power.

1. General endowment gifts

Many institutions maintain a general endowment fund. Gifts to it are unrestricted as to use, so the institution is free to spend the annual withdrawals for whatever purposes it chooses. Gifts to the general endowment do not raise any special issues, but of course should be governed by the institution's policies and procedures for outright gifts in general.

2. Restricted endowment gifts

Donors often wish to make gifts to create endowment funds for specific purposes. Typically, they also wish to have the fund named after them or after relatives they wish to honor.

a. Proposed use restrictions on endowment gifts should be subject to the same review as restrictions on nonendowment gifts, as described in IV.A above.

b. With a restricted endowment gift, it is also important to ask whether the proposed fund will be adequate to carry out the designated purpose. When an endowment is designed to provide support of a fairly general nature, *e.g.*, for the chemistry department of a university, the adequacy of the fund is not really an issue. It simply provides more support for the designated department. On the other hand, a fund to endow a chair or a scholarship must be of a certain size in order to be adequate. The GAPP should establish threshold amounts for endowment funds of that type.

c. The institution will also wish to establish a minimum for all types of restricted endowments in order to avoid having many small endowment funds each of which adds to the institution's administrative burden.

C. The Gift Agreement

The gift agreement states how the institution will use the restricted gift. If the donor is creating an endowment fund, the gift agreement will also state how the institution will manage the endowment. Because an institution's needs and programs change over time, the gift agreement should be drafted to give the institution as much flexibility as possible to deal with changes in circumstances.

1. If possible, the institution should negotiate with the donor for an "escape clause" in the gift agreement. It gives the institution

discretion to determine whether the original use of the fund designated in the gift agreement has become impractical, and if so, to determine what new use is appropriate.

2. An endowment fund agreement should give the institution as much flexibility as possible with respect to its spending policy for the fund. Major institutions now typically provide in their endowment fund agreement that the institution will withdraw an annual amount from its endowment funds determined by the spending policies adopted by its board of directors. Agreements that allow the institution to spend the income but require it to preserve the principal are outmoded. Agreements that describe in detail the institution's **current** spending policy are inflexible.

V. Screening for "Problem" Gifts

A GAPP is no substitute for common sense and intuition when it comes to sniffing out "problem" gifts. Nevertheless, a set of screening guidelines can help attune development officers and the gift acceptance committee to this issue, remind them that not all gifts are desirable, and help the decision makers deal with a few common types of problem gifts.

A. Lack of Donative Intent

There are at least two profiles for the donor who is not really a donor.

1. Business owner looking for yet another deal

   a. This individual is the owner of a closely held business.

   b. He or she will be advised by legal counsel who is not familiar with sophisticated charitable gifts.

   c. The donor will view the gift arrangement, usually a CRT, as if it were an installment sale. The donor's primary interest will be how long it will take to recoup the full value of the donated asset, with interest. In other words, the donor literally wishes to come out ahead financially, despite the charitable gift.

2. The aggressive tax planner

   This donor is typically quite wealthy and is advised by sophisticated (or pseudo-sophisticated) tax planners who are very aggressive.

a. The gift arrangement the donor and the advisor propose is a novel use (or misuse) of an existing charitable gift vehicle. Typically, it will be complex and will appear to have magical properties. Somewhat like the procedures of medieval alchemists, it will appear to generate money out of nothing.

b. Sometimes the institution's role in the charitable gift arrangement will be mysterious. This is often an indication that the scheme (or scam) requires the participation of a Section 501(c)(3) organization in form only. The lack of economic substance to the charity's involvement in the "gift plan" may be a tip-off that the proposal is abusive.

3. Screening guidelines

The institution will probably not want to be involved with either of these types of donors. The first will waste the institution's money on preparation of gift proposals, then walk away when it turns out that the gift does not allow him to come out ahead. With the second, there is a risk of a challenge from the IRS. If the gift plan blows up, the donor will not be forgiving and will be looking for someone to hold liable. Although the institution will probably have to spend some time and money assuring itself that it does not want to deal with these donors, it should avoid being sucked into expensive and lengthy planning. A set of screening guidelines might look like this:

a. Does the donor have a pre-existing connection with the institution?

b. Do the donor's comments and questions suggest that the donor believes he can come out ahead financially because of the charitable gift?

c. Does the donor's proposal for the structure of the gift fall clearly within the relevant legal authorities?

d. Does the institution's legal counsel on charitable gift matters believe the structure of the gift arrangement is legitimate and not abusive?

e. Is the institution's role in the gift proposal obscure or mysterious?

f. Does the proposal pass the smell test?

B. The Institution Shopper

Some individuals have genuine donative intent but are shopping for the best deal, *e.g.*, the best gift annuity rate or CRT payout. Institutions will not always be aware that a donor is shopping. In addition, these situations sometimes involve donors with an ongoing connection to the institution. Even so, a GAPP can make such cases easier to handle by establishing upper limits on CGA and CRT payout rates, for example.

C. Family Beneficiaries

Most split-interest charitable gifts have a single donor or married donors as the noncharitable beneficiaries. Although donor/beneficiaries can sometimes become disenchanted with the gift arrangement, their donative intent and connection with the institution usually make it possible to resolve their concerns satisfactorily. When the donor's children, grandchildren or other relatives are beneficiaries, on the other hand, the risk of a serious dispute, and even litigation, increases substantially. Although an institution will not wish to rule out such gifts, it should scrutinize them especially carefully. A GAPP can establish useful guidelines. Screening questions could include the following:

1. Do these family-member beneficiaries have a connection with the institution?

2. Will the family member beneficiaries receive other substantial gifts from the donor, during lifetime or at the donor's death, or does the planned gift comprise the bulk of their inheritance?

3. Has the donor discussed the gift plan with the family member beneficiaries, and are they supportive of it?

4. What type of gift plan is involved? How much opportunity does it give the family beneficiaries to complain? For example, CGAs and CRATs probably present less risk than CRUTs. Arguably, CRTs present less risk than CLTs.

VI. Pledges

A pledge to make anything other than an unrestricted gift of cash or unrestricted publicly traded securities should receive the same review and be subject to the same criteria as a current gift of the same type. Pledges also raise several issues of their own.

A. Written Document

All pledges should be in writing and should state clearly all the terms of the pledge, including the amount of the pledged gift, timing of installments and the use to which the institution will put the gift.

B. Binding or Not?

It is possible for a pledge to be legally binding on the donor (and the donor's estate). If the institution relies on the donor's pledge, it will typically become binding when the institution acts in reliance. It is also possible for a pledge to become binding if the pledge agreement constitutes a contract because it contains mutual promises by the donor and the institution. For example, the donor might promise to make a gift, and the institution might promise to build a building and name it after the donor. It should be possible to prevent a pledge from becoming legally binding by stating in the gift agreement that it is not intended to be so. Which approach is better?

1. Protection for the institution

   If the donor's pledged gift will fund a major capital project and the institution is entering into construction contracts in reliance on the pledge, making the pledge binding will obviously protect the institution.

2. Flexibility for the donor

   Donors sometimes find it impossible or impractical to fulfill their pledges, either because of financial reversals or because of disaffection with the institution. If the pledge is binding yet the institution later releases the donor, does the donor have forgiveness-of-indebtedness income? *See* IRC § 108(e)(2). If the donor has made a legally binding pledge to make an outright gift and later wishes to satisfy part of the pledge with a CRT, doing so, according to the IRS, will result in an act of self-dealing. *E.g.*, Priv. Ltr. Rul. 97-14-001. If the pledge is not binding, the donor has the flexibility to use the CRT.

VII. Implementation and Processing of Gifts – General Considerations

A. Donor's Legal Counsel

1. Encourage donor to obtain representation

In the case of complex outright gifts and all deferred gifts, *e.g.*, CRTs, CLTs, remainders in residences and farms, the institution should inform the donor in writing near the beginning of the gift planning process that:

a. The institution and its legal counsel do not represent the donor in connection with the gift.

b. The donor should consult his or her own legal counsel about the gift.

2. Written confirmation or waiver

Some institutions ask the donor either (i) to provide the name of the donor's counsel in connection with the gift or (ii) to state that the donor has received the institution's suggestion that the donor obtain legal counsel and has decided not to do so.

3. Referrals

If the donor asks for referrals, the institution should consult with its legal counsel and obtain more than one name. The names should be provided to the donor with a disclaimer that the institution and its legal counsel are making no representations regarding the adequacy of representation.

B. Drafting Gift Documents

1. Institution's counsel

In all cases where the institution is a party to a gift document, *e.g.*, a CRT or CLT agreement, the institution's legal counsel should draft or review the document.

a. In the case of CGAs, it will normally be adequate if the institution's counsel prepares or reviews CGA forms and the institution prepares CGAs by filling in blanks in the forms.

b. If the institution's counsel prepares the document, it should provide the document directly to the donor's legal counsel. Except as explained in B.2 below, the institution's counsel could, instead, send the document to a development officer at the institution with a written disclaimer that the document has been prepared solely on behalf of the institution and that the donor should have his or her own legal counsel review it. The development officer can then forward the documents to the donor with a copy of counsel's disclaimer or a similar disclaimer attached.

c. The institution's counsel should draft all documents unless the donor objects. Drafting is normally less expensive than reviewing and correcting documents prepared by the donor's counsel, who will typically have less expertise in charitable gift planning.

d. The institution will not provide gift document **forms** to donors or their legal counsel. Doing so would raise a host of liability issues.

2. **Major exception** – illustrative estate planning documents

Development officers sometimes find it useful to provide prospective donors with sample wills or revocable trusts which illustrate how complex charitable gifts, typically CRTs or CLTs, can be incorporated into their estate plans. Presenting a donor with a sample estate planning document prepared by the institution's legal counsel raises unique issues.

a. Wills and revocable trust agreements are essentially unilateral documents. Therefore, it is **critical** that sample estate planning documents prepared by the institution's counsel be provided directly to the donor's counsel for review. For the institution to provide such sample documents directly to the donor but not to his or her counsel would involve the institution's attorney in a serious conflict of interest. Such an approach would also provide ammunition to any disgruntled relative who might wish to bring a claim of undue influence against the institution in an attempt to have the gift rendered void.

b. Sample estate planning documents should be provided only when they will include the terms of sophisticated charitable gift arrangements, *e.g.*, CRTs or CLTs, and only if the institution will be a beneficiary.

C. Fees

The GAPP should state clearly how fees will be allocated between the donor and the institution.

1. Drafting and review

   Each party should pay the fees for its own counsel's role in the process, *i.e.*, either drafting or review. The institution should not agree to pay the donor's legal fees. Doing so would have income tax consequences for the donor, might be inconsistent with the institution's Section 501(c)(3) status, and might lend credence to a claim of undue influence on the part of the institution in acquiring the gift.

2. Qualified appraisal

   a. In the case of outright gifts, the donor should bear the entire cost of the qualified appraisal.

   b. In the case of CRTs and CGAs, the donor and the institution (or the trust, if applicable) can share the cost equally because both parties have the need for an appraisal. This is true even though the institution or the trustee of the CRT need not necessarily obtain an appraisal that satisfies the qualified appraisal requirements.

3. Environmental audit

   This is an expense of the institution.

D. Gift Receipts

The institution should have in place a foolproof procedure for providing donors with the appropriate receipts well before the donor must have them in hand for IRS purposes.

1. Date of gift

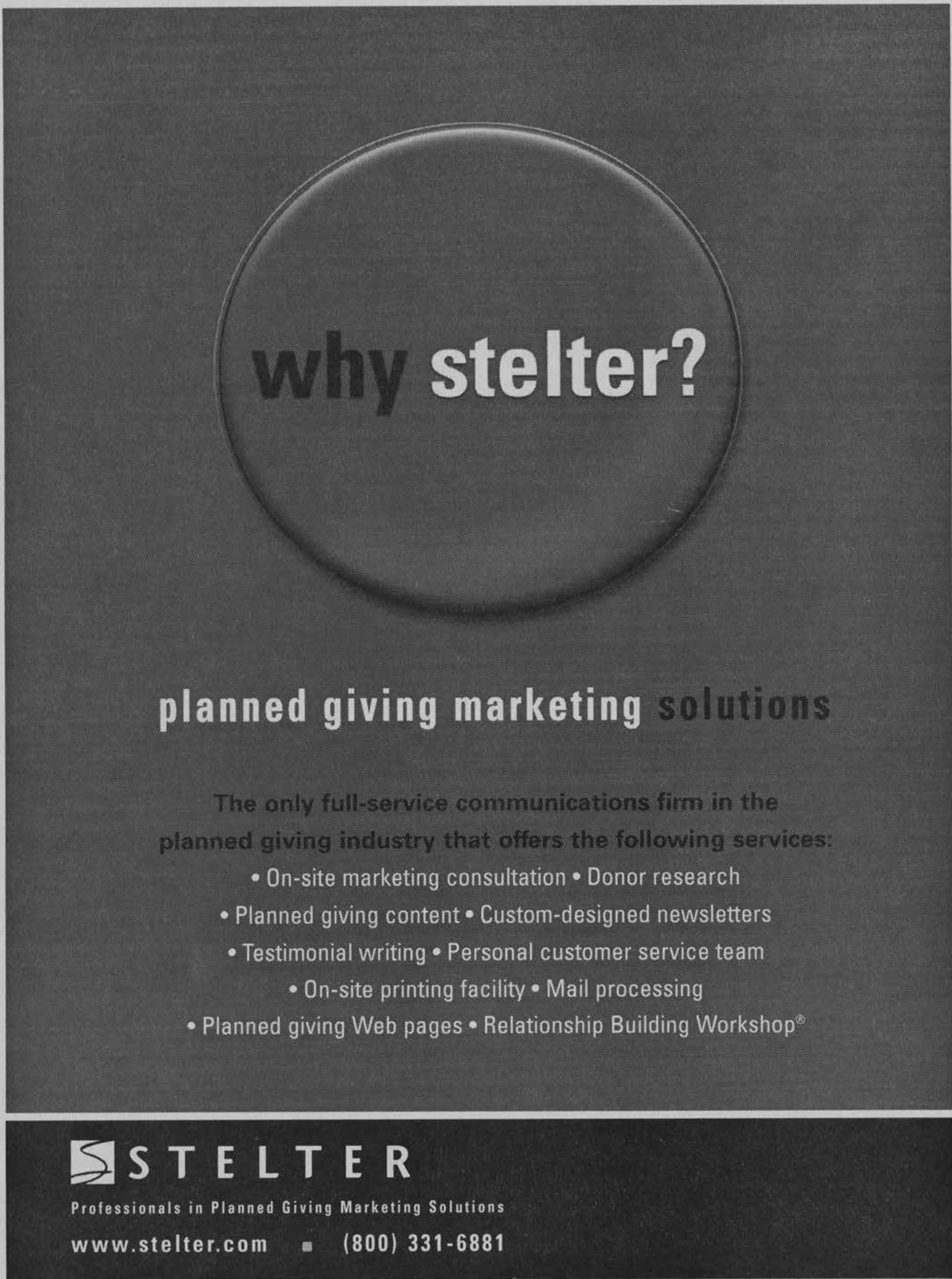
   Oddly enough, IRS regulations do not explicitly require that gift receipts give the date of the gift, although this may be implied by the requirement that the receipt give "a description" of the gift property. In cases where the donor is concerned about the timing of the gift, the institution should avoid making statements that imply a legal conclusion about the date the gift was completed. Instead the institution should simply state the facts, *e.g.*, that stock was received in its brokerage account on such-and-such a date or that it received a deed or stock certificate by mail or courier on such-and-such a date.

2. Valuation

The IRS does not require that the institution's receipt value the gift property but only that the receipt give a description of the donated property. Institutions should studiously avoid stating a value in the receipt. Doing so could be construed as a representation by the institution as to how the gift should be reported on the donor's tax return.

E. Reports to Donors

The GAPP should set out procedures for reporting to donors and beneficiaries on the status of endowment funds, CRTs and CLTs. This procedure and the reports should be informative but not unduly burdensome to prepare. The institution should inform the donor about the type and timing of its reports **before** the gift occurs.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Paradigm Shifts in Planned Giving

Introduction

This presentation will examine nine key trends in planned giving programs across the country from the year 2000 through 2005. The initial interviews were conducted during the summer of 2004. Participants were interviewed again during the first quarter of 2006 to assess any changes that had occurred during the 18 month period since the initial interviews. The trends were tabulated from interviews with 30 planned giving professionals. These professionals included representatives from 24 outstanding planned giving programs at large and small charities across the nation in the areas of higher education, healthcare, social services, a theological seminary, the arts, and community foundations. They also included five national planned giving consultants (including the presenter of this presentation) and one practicing attorney who have collectively represented hundreds of additional charities across the nation.

The interviewees were provided an extensive questionnaire which they used to facilitate discussions with the presenter or filled out and returned. The names of the interviewees, their organizations, and a copy of the questionnaire are found at the end of this presentation.

Once the data was collected and combined, trends emerged which have been identified and articulated below. The trends were then analyzed and finally categorized, revealing critical paradigm shifts and a thoughtful look at the future of planned giving and the planned giving industry. While this was by no means a statistically valid study, the breadth of planned giving experience represented by the individuals interviewed makes the resulting conclusions drawn from their comments relevant to the successful current and future practice of planned giving and therefore, difficult to dismiss.

Special thanks is given to Betsy Mangone who participated in the original interviews in 2004 and who co-wrote and co-presented the original presentation of this material dealing with trends between 2000 – 2004.

A. Top Nine Trends in Planned Giving Programs: 2000 – 2005

1. Direction of planned gift closures: 2000 - 2005

a. 2000 – Summer 2004. In nonprofit organizations across the country, both large and small, there has been a general change in the number of planned gifts being completed since the heydays of the 1990s. Statistics from the charities and consultants are set out below:

- Fifty percent of charities surveyed said their planned gift closures were slightly up since 2000, but gave many caveats to this general statement

- Fifty percent of charities surveyed said their planned gift closures were approximately the same as they had been in 2000, again with some caveats
- The five consultants surveyed reported closures from their nonprofit clients that were down, static or slightly up since 2000.

The caveats from charities with slightly higher gift closures are summarized as follows:

- All had fluctuations in four years and were down at times
- The majority recently experienced these increases (less than two years)
- Some charities experienced revenue growth because major and planned gift numbers were combined and total gifts from both categories were up, or because a small number of large and unusual outright gifts were counted as planned gifts
- Only one charity experienced growth in all planned giving categories
- Most program revenues were up because of maturing bequests - not newly created gifts.

The caveats from charities with gift closures generally the same as in 2000 are summarized as follows:

- Many institutions were up in maturing bequests, bequest expectancies, and/or gift annuities, or at least remained the same in some of these categories, but their overall numbers remained static due to fewer charitable remainder trusts (CRTs) being established
- One charity kept its numbers in the "same" category because they booked two very large CRTs that had been created in the 1990s and were managed by outside Trustees. These were booked in 2003 and 2004 because the donors named this charity as an irrevocable beneficiary of these trusts in 2003 and 2004, thus allowing the gifts to be counted on the charity's books.

The following caveats generally applied to all the individual charities represented in this survey:

- Charities with historically active CRT programs saw significant decreases in the number of CRT closures from earlier years
- Most charities were either in campaigns, recently finishing campaigns, or preparing for a campaign
- Most charities had longevity within their planned giving staff
- Most charities either had successful ongoing collaborations between their major and planned gift functions, had combined their major and planned giving functions or both functions resided in the same person
- Most individual charities had mature, healthy planned giving programs

- The overwhelmingly majority of charities had strong support and commitment for their planned giving programs from their boards and senior staff leadership.

The consultants added the following caveats:

- The increases in most of these programs were very recent and most programs have had significant fluctuations during these four years
- There is some belief that many of these charities have kept their programs static or have slightly increased gift closures because donors in general are more sophisticated and are self-selecting more often when they learn, for example, that a charity they care about has begun a charitable gift annuity program. Many of these charities may have been helped by the extent of public information about planned giving that is currently available; not so much by how proactively these charities are marketing their planned giving programs
- Many programs are slightly up because of a more "immediate gift" culture
- All consultants acknowledge that there are many programs across the nation whose numbers and dollars of planned gift closures have decreased during this time period.
- Many of the charities represented by the consultants are smaller charities and many are also newer planned giving programs. Consequently, having a consultant audit, train, and assist in some planned giving functions helped focus these programs and probably assisted with gift closures.

b. Summer 2004 – December 2005

Information to be provided at Conference.

2. Types of Planned Gifts Being Closed

Interviews with both charitable representatives and consultants generally bore out the same findings: the most common planned gifts being closed in 2004 and 2005 were bequest expectancies, followed in most cases by charitable gift annuities. Generally, these planned gifts were also the most common in 2000, though some charities have seen an increase in gift annuities since 2000 due to their intensive marketing efforts.

All the charitable representatives and consultants whose charities marketed CRTs stated they had experienced much fewer CRT closures and much less interest in CRTs, particularly between 2002 – 2005.

Many interviewed had seen their wealthier donors migrating to donor advised funds or creating family foundations and supporting organizations.

Even in the low-interest rate environment from which we are just now emerging, there were no reports of a surge in charitable lead trusts.

3. Philanthropic Cultures of Nonprofit Organizations

Interviewees were asked to choose one or more words (from five choices) to describe their organizations' philanthropic culture. The findings are set out below:

- Most interviewees chose *cash culture* as at least one of their choices
- Many said *cash culture* had been a more recent phenomena, becoming more prevalent in 2002 and after.
- The next most common choice was *balanced* and/or *progressive/visionary*
- Charities citing strong support from organizational leadership consistently chose *progressive/visionary and balanced* answers. If they also chose cash culture, this was not a negative to them, as it was to some that chose only *cash culture*
- In most *balanced* or *visionary/progressive* programs, major and planned gift officers worked collaboratively
- Higher education charities interviewed consistently chose *balanced* and/or *progressive/visionary* as their first choice.
- Consultants consistently chose *cash culture* or *schizophrenic* to describe the philanthropic cultures of their nonprofit clients.
- Consultants were more concerned about the philanthropic cultures of their clients, many of whom represent healthcare, social service organizations and the arts.

4. Budget Trends

Questions about planned giving budgets divided the budget into four categories: personnel, marketing, travel, and continuing education.

- There were significant differences in the answers of the charitable representatives and the consultants
- Only one charity had increases in every budget category
- Only one charity had decreases in every budget category; however, the decreases had been across the board in that institution
- Institutional budget constraints and budget freezes were common among all institutions, at least for certain time periods since 2000
- Programs (large and small) with strong institutional support were satisfied with their overall budgets and had been given increases in some areas. Even if they'd had to reduce budgets in certain areas at some point, they

knew these reductions were temporary and, in most cases, budget dollars were now being given back or budgets increased

- No programs with strong institutional support had cut personnel – most had increased personnel in the past four to five years, in great part due to ongoing capital campaign needs
- The great majority of individual charities had increased personnel budgets; a few had remained the same but each of theses programs believed they had adequate staff and did not need to hire more
- The consultants consistently stated their clients' budgets were down in all areas in the initial interviews
- Some consultants believed this decline was cyclical; as the economy improved and gift revenues increased, budgets would again rise
- Consultants have seen relationship-building become more difficult for many charities due to budget cuts in marketing and travel
- Consultants believed that for their clients, planned giving was commonly in competition with other aspects of fundraising to get budget dollars
- One consultant stated a significant number of charities were either cutting or reassigning people to do other things as well as planned giving, or they were seeing institution-wide budget cuts.

5. Donor Trends

Donor trends were discussed throughout the various questions in the survey. Though donors are all unique, age categories are proving to have significant bearing on many donor attributes. Consistent trends are set out below:

Generally

- There was a significant change in the mood of Americans after 9/11 with enormous anxiety and lack of security
- Anxiety has lessened greatly since there have been no more attacks on American soil; however, the lack of security is still evident among many donors
- 2004 interviews revealed greater emphasis on the short-term, since at any moment, lives might be turned upside down in a catastrophic event
- Moving into 2006, many donors are again looking to more long-term strategies for their finances, goals and lives
- Greater propensity to hold onto assets; therefore, an increasing unwillingness to tie up assets irrevocably
- More donors are becoming engaged in giving back and are wanting to find meaning through giving, but many are still holding onto their assets – having lost the naivety that their funds will always be available
- Most donors are wanting increasing control over their gifts;
- Women are increasingly becoming proactive in their own giving, and their issues are centered less around tax issues and more around mission and a vision to create positive change

- More sophisticated donors are often relying more on the advice of their personal advisors rather than the information provided by the charity.

Wealthy Donors

- Wealthier donors appear to be making philanthropic decisions more on a "macro" basis than institution by institution
- They are tending to create their own philanthropic vehicles, such as donor advised funds, family foundations and supporting organizations, keeping charity close to home instead of giving to specific charities, except through grants
- Giving is becoming more of a rallying point for families, a way to keep the family together, having them travel in good circles with good people, doing good things
- Their driving force is more a recognition of their mortality and a desire to decide where assets go at their deaths
- Tax decisions are not playing as crucial a role in their giving because of a lowering of all the brackets.

World War II Donors

- They are dying
- World War II generation donors continue to make more undesignated gifts and to more commonly give to larger, more established charities
- They continue to remain loyal to institutions, to a great degree
- Do not tend to have so many advisors
- Are concerned about having "enough" so they are not a burden on family
- Are more loyal, so are more reluctant to promise something to charity if they aren't sure they can fulfill it financially.

Baby Boomers

- A large portion of baby boomers continue to spend a larger amount of their assets on themselves and their families, leaving less available for charitable endeavors
- Being the first generation to rebel against the "old age" stigma, they are not as willing to plan for their long-term futures: savings are at an all-time low while significant dollars of the more affluent are being funneled into travel, the cosmetic surgery industry and "living the good life"
- When giving to charity, they tend to be more directive about how their gift dollars are spent; undesignated gifts are much less common; loyalty to institutions is waning
- They tend to be more sophisticated and financially savvy
- They are more technologically savvy
- They want more information about charities and want to be more involved, asking about who's in leadership, financial health of institution; strategic plan of institution; in short, are looking for more accountability from charities

- They are raising expectations of what charity should accomplish with their gifts
- There appears to be a greater desire for more personal recognition
- They are giving to more local interests and tending to be more "hands on" with the charity
- They have a healthy dose of skepticism about large organizations (including charities) because of the corporate (and charitable) scandals
- As a group, they tend to have less disposable income, higher consumer debt, and bigger wish lists than the WWII generation
- They tend to be more entrepreneurial and independent than precious generations.

Younger Donors

- Younger donors are often not as engaged with institutional mission and vision
- They are the most educated and savvy about nonprofits in general because many were required to be involved in social projects in school consequently, based on their experiences, they may become more supportive or more skeptical, depending on those experiences
- Many younger donors are entering their charitable giving years with considerable debt from school, real estate, and credit cards.

6. Marketing Trends

- Many charities interviewed have been more actively marketing gift annuities, looking for creative ways to address their donors' uncertainty with their investments
- Some larger charities are being more intentional about gift annuity marketing because of the downturn in CRTs
- Some charities have basically stopped marketing CRTs to mass audiences, opting instead for more rifle-shot approaches (i.e., owners of real estate in areas where prices are escalating)
- The old planned giving newsletter format is becoming increasingly ineffective as an educational tool about gift vehicles because the market is becoming saturated, and response rates are lower. Therefore some charities are reducing the number of issues sent to constituents
- Marketing materials are becoming more mission-based, less technical, with an emphasis on the practical
- Prospecting may be moving more toward internal marketing; i.e., going to major gift officers to get prospects
- Technology is poised to play a major role in future marketing, with most charities either having some web-based marketing, or actively pursing the opportunity.

7. Relationships between Planned Giving Officers and Major Giving Officers

- Most charities and consultants were moving away from the technically driven planned giving programs, focusing more on a donor-centered approach to planned giving which included relationship building and finding the best gift to meet the needs of the donor
- Most charities surveyed were actively collaborating with major gift officers in some formal way to better accomplish the goals of the donor and the charity
- Some of the largest charitable institutions are leading the way by combining the major and planned giving functions at their organizations, including some of the largest organizations
- Charities are focusing more on the whole subject of philanthropy, not just specific gift vehicles, which lends itself more appropriately to collaboration between planned and major gift officers
- Planned giving departments and officers are training major gift officers to spot and qualify planned giving candidates
- Consultants working with smaller charities are encouraging the combining of the planned and major gift functions when a giving officer must wear more than one hat
- Charities that are collaborating or combining the planned and major gift functions are seeing gift numbers rise and more good prospects coming into the pipelines, due in large part to the strong cultivation techniques of major gift officers.

8. Professional Advisors and For-Profit Service Institutions

- The private sector is much more involved in setting up and managing charitable trusts than they were in earlier years
- Many charities surveyed stated that a larger percentage of their gifts are coming from professional advisors
- All charities are seeing more charitable trusts being managed by outside trustees
- Most charities (other than the larger ones), are moving away from serving as trustee for charitable trusts, leaving that function to the for-profit institutions
- Most charities surveyed had active professional advisor programs and were working more closely with professional advisors
- A significant number of former planned giving officers in nonprofit organizations have moved to the for-profit service side, taking with them the skills of gift planners and the understanding of charitable intent
- Several individuals surveyed said the trend is moving in the direction of professional advisors having greater influence over how gifts are being managed and structured
- Planned giving officers and professional advisors are working more collaboratively together than at any time in our history, in great part due to

charities' engagement of these advisors, understanding they are the "gatekeepers" of many donors.

9. **Mission Eclipses the Technical**

- Charitable representatives and consultants are more consistently saying that planned giving is first about the relationship with the donor
- Charitable gift vehicles are no longer being thought of as an end unto themselves, but as tools to help donors meet their goals
- Donors are receiving more of their information on gift vehicles and their technical aspects from their professional advisors or from the web in the privacy of their homes. Consequently, gift planners are realizing they are the only ones who must market the charity's mission
- Relying on extolling tax benefits to potential planned gift donors is waning, especially in recent years when these benefits have eroded
- Because of the prevalence of for-profit planners in the technical discussions of gift vehicles, the planned giving officers' influence is coming more from extolling the charity's mission, understanding the donor's values and being comfortable with the technical and financial aspects of giving, but no longer necessarily executing the transactions.

B. Analyzing the Trends

1. **Direction of planned gift closures since 2000**

2. **Types of Planned Gifts Being Closed**

3. **Philanthropic Cultures of Nonprofit Organizations**

4. **Budget Trends**

5. **Donor Trends**

6. **Marketing Trends**

7. **Relationships between Planned Giving Officers and Major Giving Officers**

8. **Professional Advisors and For-Profit Service Institutions**

9. **Mission Eclipses the Technical**

C. The Future of Planned Giving

1. **Within nonprofit organizations**

2. **As an industry**

3. Paradigm Shifts

D. Strategies for the Future

Interviewees

1. Ingrid Blanton, *Director of Planned Giving*
   Colonial Williamsburg Foundation, Williamsburg, VA
2. Aviva Shiff Boedecker, *Director of Gift Planning,*
   Marin Community Foundation, Larkspur, CA
3. Karen Browning, *Director of Gift and Legacy Planning*
   The Nature Conservancy, Arlington, VA
4. Joseph O. Bull, *Director of Planned Giving*
   The Ohio State University, Columbus, OH
5. Susan Montgomery-Clark, *Director of Planned Giving*
   St. Vincent's Hospital, Birmingham, AL
6. Charles Collier, *Senior Philanthropic Advisor*
   Harvard University, Boston, MA
7. Jeffrey W. Comfort, *Senior Director of Gift Planning*
   Georgetown University, Washington, D.C.
8. Don C. Cramer, *Vice President for Gift and Estate Planning,*
   Texas Baptist Children's Home and Family Services, Round Rock, TX
9. Pamela J. Davidson, *Consultant and Charitable Gift Planner*
   Davidson Gift Design, Bloomington, IL
10. Laura Hansen Dean, *President and CEO*
    Community Foundation of Southern Indiana, New Albany, IN
11. Lori J. Goldstein
    Chicago Public Radio, WBEZ, Chicago, IL
12. Susan Gutchess, *Director of Gift Planning Administration*
    The Nature Conservancy, Arlington, VA
13. Marjorie Houston, *Director of Gift Planning*
    Wheaton College, Norton, MA
14. Ron Imbach, *Director of Planned Giving*
    Volunteers of America, Alexandria, Virginia
15. Cam Kelly, *Director of Planned Giving and Bequests*
    Smith College, Northampton, MA
16. Stephen Link, *Vice President of Development*
    St. Luke's Hospital and Health Network, Bethlehem, PA
17. Scott R. Lumpkin, *Associate Vice Chancellor*
    University of Denver, Denver, CO
18. Betsy Mangone, *Vice President of Philanthropic Services*
    The Denver Foundation, Denver, CO
19. Kathryn W. Miree
    Kathryn W. Miree & Associates, Inc., Birmingham, AL
20. Philip Purcell, *Vice President for PG and Endowment Resources*
    Ball State University, Muncie, IN
21. Terry L. Simmons, *Senior Partner*
    Thompson & Knight, LLP, Dallas, TX
22. Gordon P. Smith, *Director of Planned Giving*
    National Jewish Center, Denver, CO

23. Jeffrey W. Smith, *Vice President and Trust Counsel*
    Baptist Foundation of Texas, Dallas, TX
24. W. Peter Sommerfeld, *Associate Director of Planned Giving*
    OHSU Foundation, Portland, OR
25. Lorraine S. Wiedorn, *Director of Planned Giving*
    Lehigh University, Bethlehem, PA
26. Ken Wolfe, *Senior Director of Planned Giving*
    Colonial Williamsburg Foundation, Williamsburg, VA
27. Lynda Wright, *Director of Gift and Estate Planning*
    Iliff School of Theology, Denver, CO
28. Craig C. Wruck
    Kaspick & Company, Woodbury, MN
29. Chris Yates, *Director of Planned Giving*
    Stanford University, Stanford, CA
30. Al Zimmerman, *Vice President for Planned Giving*
    OHSU Foundation, Portland, OR

Planned Giving Questionnaire

Name:
Current Institution and Title:
Years in Planned Giving Field:
Other Institutions Served and Titles:

1. What has been the overall direction of your organization's planned gift closures since January 1, 2000? (circle one)

   Up   Down   Same   Random

2. What, in your opinion, has been the reason for this trend?

3. What are the most common planned giving vehicles you have been closing with your donors during the past year?

4. Are these vehicles the same or different from four years ago? Why?

5. How would you describe your organization's culture relative to philanthropy? (circle one or more, then elaborate)

   Cash culture   Schizophrenic   Aggressive

   Progressive/Visionary   Balanced

6. Has your planned giving budget increased, decreased or remained static in the past four years?

   - Personnel:
   - Marketing:
   - Travel (for fund raising):
   - Continuing education:

7. What were the reasons for your budget variations (if any) and how have these changes (or lack of changes) impacted your planned giving program?

8. Is your organization currently in a campaign? If so, what is the nature of the campaign (capital needs, endowment, etc.), including amounts; and are planned gifts part of the campaign?

9. If planned gifts are part of the campaign, what types of gifts are being counted?

____ Irrevocable gifts only

____ Irrevocable gifts subject to certain limitations (please elaborate)

____ Irrevocable and revocable gifts (wills, insurance policies, etc.)

____ Other (please elaborate)

10. If planned gifts are part of the campaign, do you have a dollar goal or % of the campaign you are expected to raise through completed planned gifts?

11. How has this campaign affected your planned giving program? (please elaborate)

Helped Hurt No Effect

12. Which of the following external factors (if any) are affecting your donors' willingness to create planned gifts? (please check all that apply)

Revocable Gifts (wills, etc)		*Irrevocable Gifts* (Charitable trusts, gift annuites, etc.)
____	Reduction in capital gains tax	____
____	Reduction in income tax rates	____
____	Increase in estate tax exemption amounts	____
____	Potential estate tax repeal	____
____	Uncertain economy	____
____	Global events (post 9-11 world, war in Iraq, etc.	____
____	Personal comfort level	____
____	Other (please specify)	____

13. Please elaborate on <u>*how*</u> you see the external factors you checked affecting your donor base and your planned giving program.

- In the short term:
- In the long term:

14. What worries you about your donors/prospects?

    - Today
    - In the future

15. What are your organization's current planned giving priorities?

16. Are these priorities different or the same as they were four years ago and why?

17. Do you believe a planned giving paradigm shift is occurring in the planned giving industry? Why or why not?

18. If you see a shift, what is the nature of that shift, in your opinion?

19. Have you or are you employing strategies to deal with this supposed shift? If so, please share any strategies you deem appropriate to share.

20. What are your predictions about:

    - The future of planned giving?
    - The future of the planned giving industry

Bequest Administration: Using Detective Skills to Avoid Problems in Probate

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Importance of Bequests

- Number 1 source of PG revenue
- Often the largest gift
- Majority of $$ come from wealthy, but majority of gifts come from average folks
- Lifetime Gifts vs. Bequest Gift

Estates Closing in 12 Months

OSU Degree	Bequest	Lifetime Outright Gifts
1. None	$10 million	$ -0-
2. BS '32	$ 2 million	$ 200
3. BS '36	$ 1 million	$ 462
4. BS '33	$ 838,000	$ 7,000
5. BS '34	$ 750,000	$20,680
6. BS '40	$ 738,000	$ 14
TOTALS	$15,326,000	$28,356

A. The Sharpe Group reports:

1. Bequests will continue to be the largest source of planned gift revenue for many years
2. According to IRS data, realized bequests are typically number 2-3 times more than newly- created CRT's, gift annuities and pooled income fund additions and are larger in dollar value
3. Surveys reveal that the majority of wealthy individuals intend to include charity in their estate plans; however, only 20% (+ or-) of all estate tax returns claim a charitable deduction
4. Charities with well-established PG marketing programs report that 25% (+ or -) of their annual total gift receipts come from realized bequests, while the national average as reported by *Giving USA* is 7% to 9%
5. 70% of charitable bequests come from the estates of women
6. Most bequest donors made lifetime gifts; inverse relationship between size of lifetime gifts and size of bequest gift (see Ohio State chart above)
7. Wills containing charitable bequests are generally executed 4-7 years before death
8. Average age at time of will execution = 75-85; average age at death = 80-90

B. NYU's Largest Gift

1. A 1922 alumnus, Julius Silver, died at the age of 101 in 2002
2. Mr. Silver received an annual scholarship of $77.50 and a student loan of $100
3. He gave over $850,000 during his lifetime; bequest provision of $150 million
4. Income will be used for 25 years to endow 150 faculty chairs…the principal will remain intact. How's that for stewardship?

C. *Planned Giving in The United States: A Survey of Donors* (NCPG, 2001)

1. Average age of individuals at time of making first charitable bequest provision = 49
2. Average age of bequest donors = 58
3. 65% of bequest donors are under the age of 65
4. Average income of bequest donors = $75,900…72% under $100,000

D. Estates valued at $20 million or more account for less than 1/2 of 1% of estate tax returns each year yet provide more than 40% of the total dollar value of charitable bequests. (*Giving USA 2005)*

Estates Closing in 12 Months

OSU Degree	Bequest	Lifetime Outright Gifts
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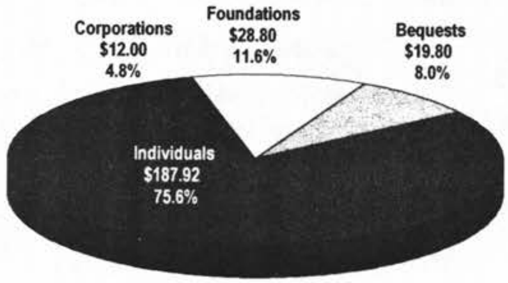
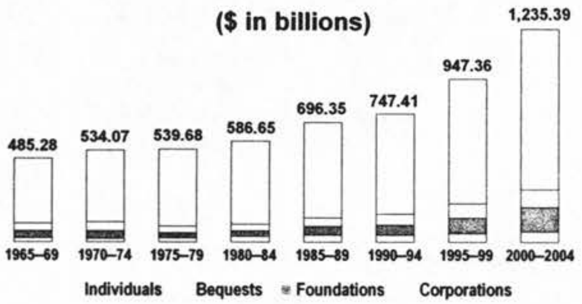
TOTALS	$15,326,000	$28,356

2004 CONTRIBUTIONS- *Giving USA*



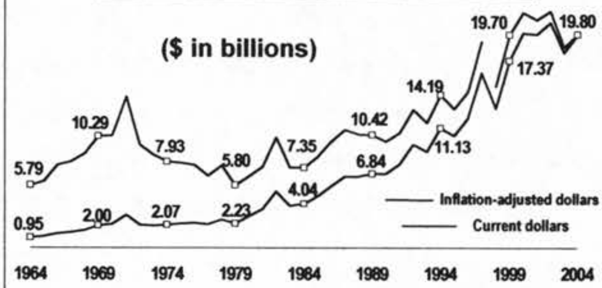
TOTAL GIVING BY SOURCE BY FIVE-YEAR SPANS IN INFLATION-ADJUSTED DOLLARS, 1965–2004

($ in billions)



Giving USA uses the CPI to adjust for inflation.

Charitable Bequests- *Giving USA*



Early Use of Detective Skills

- Uncovering bequest expectancies
- Discovering harsh restrictions
- Discovering unacceptable property
- Stewardship can begin
- Bequest can increase
- Current gifts may result

- Some of your PG marketing budget should be devoted to uncovering bequest expectancies. This process may help to diffuse future problems and generate positive current outcomes.

- Sometimes a bequest may contain provisions which violate your charity's policies or produce consequences which the donor does not want, even though the restriction is perfectly legal.

  - *Ohio State Example:* donor's attorney drafts will with a bequest to establish a scholarship endowment for students from a sparsely populated region who major in a narrow field. While perfectly legal and valid, a review of records showed that the scholarship would have been awarded about three times in the preceding two decades. When the donor was shown this fact, she realized that her true intention was to help students complete their education. She had her attorney amend that portion of her will to expand the scope of the scholarship. Had we not learned of this provision until after donor's death, it would have been a much more difficult situation.

- Sometimes donors wish to give you property that your charity is not equipped to take.

- It is always nice to thank a person to their face for their generosity. It makes both the donor and the philanthropic officer feel better.

- When a donor knows that their gift will be well stewarded, and the donor's belief in the charity's mission increases, a larger bequest can be a result.

- In a similar vein, donors often appreciate the opportunity to see their philanthropy in action, and a strong relationship built with a bequest donor can lead to current giving.

The Active Estate File: List of Probate Documents

- Need to open a file for tracking
- Documents Charity can and should receive and review

For all estate gifts which are still in process, each charity should keep a file of documents that enable the charity to monitor the probate administration process to ensure that the charity receives all that it's entitled to under the decedent's estate plan, and in a timely manner.

There are a number of Probate documents that charities are entitled to receive from the executor or attorney of an estate when the decedent has named a charity as a beneficiary under a Will which is being "probated" in Probate Court. These include:

1) The Notice of Administration of the Will: This is usually a copy of a probate court form which states when the decedent died, the appointed executor and when the decedent's Will has been filed in Probate Court. The pro-active estate attorney attaches a copy of the Will with the Notice. If not, request one from the attorney or obtain a copy from Court, as the Will becomes a public record once filed in Probate Court.

2) Last Will and Testament: The Will details the type of bequest which has will be given to your charity. More importantly, the language clearly states the name of the charity, the amount of the bequest (or type, if a residuary or contingent gift), and any specific uses or restrictions for using the gift.

3) Inventory: The Inventory lists all the decedent's probate assets, as date of death and places a value on them that follows standard tax valuation guidelines. Beneficiaries are entitled to a copy of the Inventory and, rather than obtaining it from Probate Court, it's customary for charities to request this document from the estate attorney. Standard protocol can be to make this request in a follow-up letter to the attorney, immediately after the charity has received the Notice of Administration.

4) Final Accounting: The Final Accounting and Petition to Court to Close the Estate is due six or twelve months from when the executor was appointed. Executors usually wait until the Probate Judge has approved the Final Accounting before distributing the estate assets. If this distribution is made before the IRS has sent the estate a "closing letter" approving the estate tax return, the Executor may have beneficiaries sign an "early distribution" agreement stating that beneficiaries will return all or some of the bequest if future funds are needed to pay additional estate taxes. Charities should review the Final Accounting to ensure that the fees paid to the executor and estate attorney, as well as estate expenses, are reasonable.

Contents of Donor's General "Estate File"

When a charity has been notified of its beneficiary status under a decedent's Will, it should create a hard, paper file under the donor's name containing the following:

- Relevant lifetime correspondence from the decedent.
- Copy of Decedent's Last Will and Testament and any codicils to the Will
- Copy of the Inventory and related property appraisals
- Copy of all accountings.
- Copies of any receipts signed by the charity for partial distributions.
- Copies of all checks received or documentation on stock and other assets received in-kind
- Copies of any endowments established to use the bequest monies.
- Copies of all correspondence sent to and received from the executor, the estate attorney and any other beneficiaries.
- Copies of thank you letters and other stewardship correspondence from the charity to family or friends.
- Copies of court and attorney correspondence for all other legal matters, with a tickler system for reviewing the status monthly.
- Copy of the decedent's death certificate and obituary, if obtained.

Monitoring Issues in the Active Estate File

WHAT THE CHARITY SHOULD DO AFTER IT RECEIVES NOTICE AS ITS STATUS AS A BENEFICIARY UNDER A WILL

Developing a good calendar "docket" system is essential to pro-active bequest administration. It is imperative that all estates be regularly monitored to ensure that all funds due the charity are received in a timely manner and that no issues arise that could later jeopardize the planned gift or your charity.

Using Detective Skills to Avoid Problems in Probate

During donor's lifetime, donor notified Charity of a planned gift/bequest coming through donor's Will (probate estate). Charities usually receive notice of donor's death from family member or an obituary. After learning of the donor's death, development officers should gather as much information as possible on the deceased donor, family and friends.

Detective skills 1 & 2

1) OBITUARY: Obtain obituary from newspapers in cities where donor lives, lived or vacationed (i.e. Florida city for "snowbirds"). Obituaries typically list the decedent's family, cities of residence, and charitable interests. This same information may also be given in greater detail in memorials to donor published in trade magazines or newsletters a few months after death.

2) DEATH CERTIFICATE: If the city, county or state of death is known, obtain a death certificate on the decedent about four weeks after death. Death certificates are available from the county health department in the county where donor died. At a later date, the State Department of Health will also store a copy of the death certificate. The death certificate lists cause of death, date of birth, date of death, age, maiden name, name at date of death (i.e. for remarried female donors), location of death, parents name, location of death and the "informant" (family member, friend, executor or physician who first became aware of donor's death). The informant is often a valuable resource of information regarding the family or friends.

Detective Skills 3 & 4

3) PHONE BOOK (!!): If the donor's name is somewhat unusual, check the phonebook for listings of other relatives. Be sure to review the phone books in the decedent's town of death, his prior city of residence (if retired) and his city of birth, as relatives likely remain in the donor's hometown.

4) ONLINE RESOURCES: Check the Internet's White Pages for the decedent's last address and phone number. A few months after death, also check the free Social Security Index (http://ssdi.rootsweb.com/?o_xid=0028727949&o_lid=0028727949) to obtain the state of death, date of birth and date of death. Go to a reputable search engine and do a general search under the donor's name for listings of his community involvement, gifts to charities, professional affiliations and obituaries.

Detective skills 5 & 6

5) EXECUTOR: To determine the name of the executor, Charity makes contact with family listed in obituary OR contacts funeral home. Also, review the lifetime correspondence from donor. Oftentimes, the donor will have had his attorney write the charity to make the latter aware of a future planned gift from the donor. If the donor has sent a copy of his Will to the charity during lifetime, note if any of its pages indicate "Prepared by Joe Bull, Esq., of the Law Firm of Bull, Bull, and Bull, LPA". Most often, the attorney who prepared the Will also served as a witness to it, so check the signature page of the Will for the attorney's name.

6) PROBATE DOCUMENTS: Within three to four months of death, most executors will "open" the probate estate in Probate Court by filing a copy of the Will. All probate documents relating to a decedent's estate are public record so write or visit the Court to obtain a copy of the Will and of any documents identifying the executor, estate attorney, next of kin and the beneficiaries named under the Will. Minimal fees are charged for copies of these documents.

*A few months later, obtain a copy of the Inventory of probate assets for an estimate of the total probate estate. This will help your charity estimate their residual portion if named a residual beneficiary, subject to debts and other costs that will ultimately reduce the estate.

Detective skills 7 & 8

7) PUBLIC RECORDS: If the Inventory does not list real estate as a probate asset, search the County Auditor and County Recorder's records for copies of deeds.

8) ATTORNEY FOR ESTATE: Check the local and state bar associations for the attorney's vita, including his alma maters and charitable affiliations. It is often helpful in the future to know if the attorney is an alumnus of your university, donor to your organization or on one of the boards of affiliated institutions. The website for Martindale-Hubbell (www.martindale.com) can also yield relevant information, as can the bio section of the attorney's law firm website.

Elements of a Probate Estate
& Executors

Elements of a Probate Estate^

•Decedent's Will is filed with the Probate Court

• Decedent's probate assets (property) is located, gathered and valued by executor ("inventoried")

• Decedent's debts are paid.

• Decedent's remaining assets are distributed as the Will directs, according to the Court's rules and approval.

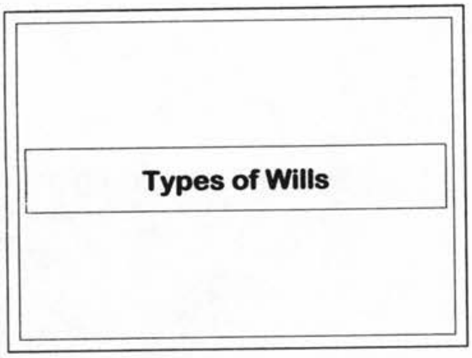
^ For purposes of this presentation, only estates with Wills will be discussed—if donor dies without a Will then his/her property passes to heirs according to state law.

Executor

•Person whom decedent named to have authority to carry out the terms of the Will.

•Executor can be an individual or an institution (i.e. a bank or trust company)

•Sometimes called "personal representative" or "administrator" in other states.



Types of Wills

•Typed or word-processed Wills—the most commonly accepted format, as long as the witnessing and other signing procedures match state law.

•Handwritten Wills (Holographic Wills)—accepted in a few states

•Oral Wills—usually only accepted under limited circumstances, i.e. when uttered by a member of the military before leaving for active duty, or when mortally wounded.

•Audiovisual Wills (videotaped)—not yet authorized as valid by any state legislature.

Categories of Beneficiaries

Primary beneficiary –the first level of beneficiaries listed to receive the decedent's probate assets

Contingent or alternate beneficiary—the person or organizations who are listed to receive assets if a primary beneficiary predeceases the donor.

Validity of Will
& Will Contests

Will Validity & Will Contests

To make a valid Will, you must be:

1. An adult (18 yrs or older, in most states); and

2. Of "sound mind"

- Sound mind typically means that you understand what a Will is, what it does and that you are making one, and also that you have knowledge about the kind of property you own and how you would like to distribute it.
- The remaining issues involve understanding the relationship to those in your family for whom you would normally provide in a Will (i.e. spouse or children).
- Most probate judges will not invalidate a Will unless there is strong evidence of the Will writer's incompetence, and usually the latter must have been corroborated by a physician or other trusted professional.

Categories of Beneficiaries

•Primary beneficiary –the first level of beneficiaries listed to receive the decedent's probate assets

•Contingent or alternate beneficiary—the person or organizations who are listed to receive assets if a primary beneficiary predeceases the donor.

Types of Bequests

•Specific bequest –property decedent has specifically identified in the Will to pass to a beneficiary (i.e. "$10,000 to my son, David" or "My land at 1475 Smith Street to my neighbor, Jesse James")

•Residuary bequest – property going to a beneficiary after specific bequests and debts are paid (i.e. "After the above $10,000 is distributed to my son, David, the remainder of my estate goes to the XYZ Charitable Foundation" or "…the remainder of my estate to be split evenly among the following beneficiaries: XYZ Charity, ABC Foundation, and the LMNOP Foundation). Residual estates can also be left to beneficiaries in percentages (i.e. "The remainder of my estate to be split as follows: 1) 25% to the San Francisco Area Humane Society 2) 25% to the Columbus Area Humane Society and 3) 50% to the Franklin County Zoo).

Residuary bequests are not guaranteed as they are paid after specific bequests, debts, estate taxes, attorney fees and executor fees.

•Contingent bequests: Such bequests are dependent on a future event or action (i.e. "I leave all my stock to my wife, Susan, or, if such beneficiary does not survive me, to the Ohio State University Foundation")

Debts: Claims of Creditors

Certain types of debts have precedence over payment of bequests, which can affect what a charity receives, if the probate assets are insufficient. For example, in Ohio, the following debts must be paid first before bequests can be distributed:

1) Cost and expenses of the estate administration
2) The first $2,000 of funeral expenses
3) Allowance of support to the surviving spouse and minor children
4) Debts entitled to preference under the laws of the US (i.e. taxes)
5) Expenses of the decedent's last illness 6) an additional $1,000 in funeral expenses
6) Personal property taxes and obligations to the state
7) Debts for manual labor performed for the decedent within 12 months of death and
8) Other debts which have been presented to the estate and finally allowed.

Insolvent Estates

In some instances, the decedent's probate assets are less than his debts and bequests. In that instance, debts are paid first then specific bequests paid then residual bequests paid.

Probate Assets: Which assets go through Probate Court Administration?

- Sole ownership: assets held individually by the decedent---when ownership is not shared with another individual or spouse.
- Tenants in common: assets in which the decedent owns a percentage (i.e. checking account owned 50% by the decedent and 50% by the decedent's child)

- Sample probate asset categories: Real estate, stocks, bonds, mortgages, notes, cash, insurance payable to the estate and tangible personal property.

Non-Probate Assets: Assets that Pass outside of Probate

1) Assets owned by the decedent's trust at the time of the decedent's death

2) Joint Tenancy with Rights of Survivorship: assets that vest (transfer) to the surviving owner upon the other owner's death . Also called "joint with rights of survivorship assets" or JTROS (i.e. real estate, bank accounts and automobiles can be titled in this manner). * The language for titling such assets varies from state to state.

3) Life insurance that names a specific beneficiary other than the decedent's estate

4) Individual retirement accounts (IRAs), annuities, pensions and other employer death benefit plans that name a specific beneficiary other than the decedent's estate

5) Transfer on Death (TOD) accounts: accounts that are titled in the decedent's name during lifetime but that vest (transfer) to a beneficiary upon the decedent's death. Also called "Payable upon death assets" (i.e. POD savings bonds)

6) Tenancy by the Entirety: special form of joint tenancy with right of survivorship that is limited to married couples. *The language for titling such assets varies from state to state.

Estate Taxes & How they affect bequests to Charities

In 2006, the gross assets of an estate that exceed $2 million are taxable at the federal estate tax level.

•Federal estate taxes are due nine months from the decedent's date of death. However, extensions of time to pay are often granted to the estate if the estate is still dealing with complicated issues such as business valuations or if delays in identifying, valuing or selling assets have occurred.

•Because estate taxes have precedence for payment over bequests, some executors, especially trust companies acting as executors, will not distribute bequests to beneficiaries until the estate taxes are paid.

•Some executors are very conservative and will not distribute to beneficiaries until the estate tax return is filed and approved by the federal and state taxing authorities. Or, the executor will distribute to beneficiaries but only after beneficiaries sign an agreement to return the assets if the estate tax amount is revised by the taxing authority.

•However, charitable gift bequests are usually paid as soon as the estate taxes are paid because charitable gifts are not a taxable asset on the estate tax return, so the executor rarely has liability for revising the charitable deduction if the estate tax return is audited and amended.

Sample Timeframe for Will Bequests coming to Charity

1) Decedent dies on December 31, 2005

2) Will is probated (filed in Probate Court) on January 2, 2006

3) Executor appointed same day, January 2, 2006

4) Notice of Will's filing is sent within two weeks, or by January 15, 2006, to all beneficiaries named in the Will, as well as to all others who would have inherited if the decedent had died without a Will. [ORC 2107.19]

5) Executor must file the Inventory of probate assets within three months of his appointment, or by April 2, 2006 [ORC 2109.58]

6) Executor is not authorized to distribute any assets to beneficiaries until after the Inventory is filed. After the Inventory is filed, some executors may make a partial distribution of assets to beneficiaries.

7) Unless a Court extension is provided, the executor must terminate the estate and distribute* all assets within six months of his appointment, or by July 2, 2006.

*If an estate tax return is due, most executors extend the closure of the probate estate until after they file the estate tax return in month nine following the decedent's death.

8) Creditors must file their claims against the estate within six months of the decedent's date of death [ORC 2117.06 (B)]

9) Executor must file the state and federal estate tax returns within nine months of date of death, or by September 31, 2006.

10) The federal and state taxation departments typically take three- to six-months to review the estate tax returns and either send the executor an approval "closing letter" or request an audit of the estate.

11) If the return is approved, executors are in the position to distribute all remaining assets, which is about 12-15 months since the Executor's appointment, which would be around January 2, 2007 or March 2, 2007.

Sample Timeframe for Will Bequests Coming to Charities (Under the Ohio Revised Code or "ORC")

[[-------/--------/--------/--------/--------/--------/--------/--------/--------/--------/--------/--------/--------/--------]

Month 1	Month 12 or 15
Date of Death	*Date of Final Distribution to Beneficiaries*

Who Is Responsible for Distribution of Gifts to Charities?

1) The Executor
2) The Attorney representing the Executor or the Estate
3) The Probate Court [Ohio Revised Code 2101.24 (B)(1)(b)]
4) The Attorney General of the State in which the decedent died:

A. The attorney general may investigate transactions and relationships of trustees of a charitable trust for the purpose of determining whether property held for charitable, religious or educational purposes is being properly administered in accordance with fiduciary principles as established by the courts and statutes of this state." [Ohio Revised Code 109.24]

B. The attorney general is a necessary party to and shall be served with process…in all judicial proceedings, the object of which is to….(C) Construe the provisions of an instrument with respect to a charitable trust; (D) Determine the validity of a will having provisions for a charitable trust.

C. Ohio Revised Code 109.30 dictates that the **Executor** is responsible for giving the Attorney General notice of a Will's probate (filing) in Probate Court: "After admission to probate of a will creating or purporting to create a charitable trust that must be registered under section 109.26 of the Revised Code, or containing a gift valued in excess of one thousand dollars to any charitable trust, notice shall be given to the attorney general, as well as to the persons specified in division (A)(1) of section 2107.19 of the Revised Code, in accordance with that section."

Issues that can Compromise an Probate Estate Gift 1 & 2

1. Assets left to charity which are not described in specific enough terms, leaving room for debate among beneficiaries: "I leave 40 acres of my 100-acre farm to the Ohio State University" If the donor did not stipulate which 40 acres, then the Executor may have greater insight so the charity should always begin with a written, dated inquiry to the Executor. Or, the charity can request that the Probate Court take the authority to decide. Some charities will also put the Attorney General's Office on notice, in case the issue needs to be taken to a Court hearing.

2. Assets left to charity having a contingency which is hard to track: "I leave my farm to my four sons for as long as they continue to farm the land. If they ever stop farming the land, then the property is to transfer to the Ohio State University." In this instance, the charity can track in Probate Court and in the County Recorder's office the language in the deed transferring the real estate from the donor's name to the sons to ensure that the restrictive clause is included. In Ohio, for example, the Probate Court requires that all real estate distributed through the Will be reviewed and approved through Probate Court, so the overseeing judge should examine the "Certificate of Transfer" before approving it. Usually, a quick call to the Estate Attorney will resolve the matter. If not, the charity can bring the matter to the Court's attention or ask the Attorney General to become involved. Note, however, that this Will language may also require that the charity do an annual review of the farmland's use to see if the contingency has occurred which could cause the title to transfer to the charity (i.e. the sons stop farming the land).

Issues that can Compromise an Probate Estate Gift 3 & 4

3. <u>Assets which may not pass to a charity until another beneficiary has passed away</u>: "I leave my beach home in Naples, Florida to the Ohio State University, but allow my spouse to maintain a life estate in the property until her death." The charity needs to ensure that the probate process transfers title to the property, subject to the life estate. THEN, the charity needs to find a reliable way to track that the property is being maintained (the terms of who pays taxes, maintenance and repair fees is usually laid out in the Will or can be agreed to in writing after the donor's death). More importantly, the charity needs to find a way by which to tactfully follow spouse. Problems arise when the spouse vacates the property but does not die, as hazy Will language can make it indeterminate as to who is then takes possession or takes over maintenance of the property.

4. <u>Assets which are being ill-managed by the Executor</u>: The initial inventory lists the value of assets as of date of death. If a great proportion of the probate assets are stock which will be specifically distributed to the charity, it may want to communicate frequently with the Executor to ensure that the timing of distribution does not adversely affect the charity. (This is vital when the security at issue is one with greatly fluctuating values.) Or, as an alternative, the charity can offer to receive an equivalent distribution of cash rather than wait for the stock to be distributed. A slow-moving or inexperienced executor can also cause the sale of real estate, held by the estate, to be greatly diminished. A prudent move from the onset is for the charity to contact the estate attorney to express an interest in periodic updates on the sale of the real estate or other asset

Issues that can Compromise an Probate Estate Gift 5 & 6

5. Assets which the Executor is not distributing timely: If a decedent owned stock under individual stock certificates, it can be quite an administrative nightmare for the Executor to fill out the various forms and attachments to have each security transferred to the charity. To move things along, the charity can offer the services of its Legal Department of Gift Processing Department to assist with the transfer process so that the receipt of the stock is done more quickly. (Robert Edgerley example)

6. Assets which can not easily be held or liquidated by the charity: If the charity discovers that the Will will cause the charity to receive an unwieldy asset (i.e. real estate that may have environmental problems), the charity should consider negotiating to receive another asset, preferably cash, of similar value. Oftentimes, this requires the court's approval or approval by all other beneficiaries who will be impacted by such a move. Some executors, rather than having to deal with selling real estate or unusual tangible property—coin collections, for example—will offer to distribute the asset directly to the charity. Unless the Will directs this "in-kind" distribution, the charity is better off to decline the gift and ask that the property be liquidated with all the other probate assets, and the cash proceeds be distributed to the charity.

Issues that can Compromise an Probate Estate Gift 7 & 8

7. Assets which can not be used as the Donor specified: Many gifts come with "use" strings attached. For example, a donor leaves $100,000 to a University to establish an endowed scholarship for female students studying Home Economics. Current federal and state law may prohibit such limitations or restrictions on scholarships. Charities should consult with their attorney before accepting these gifts. Typically, the Attorney General and Probate Court considers the Will language as a "contract" so it cannot be altered without Court approval and typically not unless all other affected beneficiaries agree to any changes in usage of the funds. Charities that accept such gifts then later use them in ways not in agreement with the Will language could face future lawsuits from family members, the executor or other interested parties. (site Princeton case?) If a restriction is designated by the donor that the charity cannot fulfill, the charity may need to decline the gift.

* Early in the probate process, charities should request from the Executor a copy of the Will and other correspondence relating to such specific use gifts so that "use" problems can be identified and addressed early in the game.

8. When the donor's estate plans do not fulfill planned gift obligation which the donor listed during lifetime, i.e. the insolvent estate. Charity needs to decide if it wishes to make a formal claim against the estate or negotiate a compromise with the estate, outside of Probate Court's purview. Unless the charity has truly relied on the future planned gift to complete a major project, most charities do not "go after" the gift in Probate Court, because of the negative publicity it may bring the charity.

Issues that can Compromise an Probate Estate Gift 9 & 10

9. Unauthorized signing of "Receipt and Release" documents. Many trust institutions are starting to ask charities to sign receipts for distributions, which also embed indemnification language. These receipts "forever release the executor/institution" from future liability for having made this distribution to the charity, and can bar the charity from contesting the amount or finality of distributions at a later date. Whenever such language is included in a receipt, charities should closely review them, preferably with legal counsel, before signing them to ensure that all of the charity's rights are being met.

10. Will contests brought on by family members, friends or partners. In almost all states, the burden is upon the contesting party to show cause for why the Will filed in Court is not valid. The executor and estate attorney typically handle the rebuttal of the Will contest but beneficiaries are also wise to check their files for correspondence and documents which provide historical information on the bequest.

Using Detective Skills in Stewardship of Bequest Gifts

- Executors
- Surviving Spouse
- Surviving Children
- Internal Constituents

A. Executors are important in expediting the administration of a decedent's estate

1. Many PG officers have anecdotal stories about the slower than molasses executor
2. Executors should be treated like donors
3. If the executor is an attorney, she/her likely has other clients who are potential donors

B. What should you do when you are expecting a bequest and learn that the surviving spouse "got it all"?

1. Dig as deeply as you can without causing problems.
2. Consider that the decedent created a QTIP trust for the surviving spouse
3. QTIP trusts provide income to the surviving spouse, but the trust principal is distributed to the wishes of the first spouse upon the death of the second spouse.
4. Attempt to develop a strong relationship with the surviving spouse.

C. Children often wish to support those projects supported by their parents. Multi-generational philanthropy is a growing trend.

D. Suppose that a long-time benefactor informed you of the details of her bequest. Upon her death, those at the charity charged with implementing the program to be supported by this bequest begin to make detailed plans for the use of these funds. Further suppose, that several months after her death, you receive word from the executor that the actual bequest is substantially different in form from what the donor told you. What do you do as the philanthropic officer? Maintaining cordial relationships with those internal to your organization is often as important as maintaining those type of relationships with donors.

Will Contests

- Joe Bull's Unscientific-Yet-Uncorrelated Rule of Thumb
- Estate of Olsen v. Texas A&M Fdn.
- Estate of Gray v. Birmingham-Southern College

A. Estate of Olsen v. Texas A&M Foundation

1. C.E. Olsen was a member of the A&M baseball team in the 1920's. Over his lifetime he contributed nearly $800,000 to the University, and the Aggie baseball stadium is named in his honor.

2. At age 91, he executed a will which went into effect after his death at age 97. This will bequeathed $1.1 million to the Foundation. A Foundation official, who was a longtime friend of Mr. Olsen's was present when Mr. Olsen executed his will.

3. Mr. Olsen's son contested the will, alleging that his father did not have adequate mental capacity and that he was the victim of undue influence from the Foundation.

4. The court found that the Foundation acted in good faith and did not exert undue influence on Mr. Olsen. It also found that Mr. Olsen lacked the mental capacity to execute a will. As a result, the court ordered that the $1.1 million go to Mr. Olsen's son

B. Estate of Gray v. Birmingham-Southern College

1. Corinne Norton Gay's second husband, an alumnus and trustee of the College, died in 1966. Soon thereafter, the College began what became a 29-year relationship with Ms. Gay.

2. During that period of time, the College: named its campus center after her and her late husband, hung her portrait in the campus center, named her to its board of trustees, made her a lifetime trustee and granted her an honorary doctorate.

3. Ms. Gay died at the age of 85 in 1995. Her will provided gifts to the College that totaled $12.4 million.

4. Two of Ms. Gay's nephews contested this bequest to the College. They alleged that namings and board appointments constituted undue influence ("fraud, manipulation and deception of a weak old lady"), that she lacked mental capacity to execute her will and that there was a conflict of interest as two lawyers who represented the College drafted her will.

5. The case made it all the way to the Supreme Court of Kentucky, which upheld the will as written.

When Charity Contests a Will

- Yeshiva University v. Estate of Joel Jablonski
- Dickinson College v. Estate of Robert Waidner
- Barnes Foundation in Philly

A. Yeshiva University v. Estate of Joel Jablonski

1. The University anticipated an approximate $6 million bequest from Mr. Jablonski. When the bequest was actually distributed, it was for much less.

2. The University sued claiming that Mr. Jablonski's lifetime gifts to relatives decreased the value of his estate, which reduced the amount of the charitable bequest.

3. The parties reached an out-of-court settlement.

B. Dickinson College v. Estate of Robert Waidner

1. Mr. Waidner was a 1932 alumnus of the College who had amassed a fortune in excess of $20 million by the time of his death in 1999.

2. During his lifetime, Mr. Waidner was very involved with his alma mater. He was a trustee for 43 years, an emeritus trustee for the final 8 years of his life, a generous donor whose philanthropy was honored by the naming of the College's Admissions House and Library. He received an honorary doctorate in 1995.

3. Mr. Waidner's will left charitable bequests to the College, the Greater Baltimore Medical Center and the Baltimore Symphony Orchestra. The College then sued the two Baltimore attorneys who drafted this will, claiming that the attorneys pressured Mr. Waidner to add the hospital and symphony.

4. The parties reached an out-of-court settlement. While no specific dollar amounts were given, the College announced that amount it received in the settlement constituted the largest gift in the College's history.

Reimagining Reinsurance

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Academy of GIFT PLANNING

Presentation description

Charities that participated fully in past historic bull markets have found that the performance of their gift annuity reserve is magic no longer. Even a few bad years can decimate reserves and erode board support for this popular giving technique. Today, volatility in the equity and interest rate markets adds even more risk, and those who in the past rejected reinsurance out-of-hand now have good reasons to reevaluate that decision given an era of heightened fiduciary responsibility.

As you seek a potential competitive advantage in this market, take the time to learn how elective and mandatory gift annuity reinsurance practices will impact a charity's marketing, gift illustrations, and donor relations. If a well-managed gift annuity program is key to your organization's development and future – whether your organization reinsures or not – explore and understand risk management through the eyes of state regulators and reinsurers.

1 To whom does this presentation apply?

Consider the following Gift-PL exchange that appeared on July 15, 2004.

> John Payton, Point Loma Nazarene University, Arcadia, CA:
> It is happening. Our new CFO is questioning our ability to offer gift annuities because of the 10% investment restriction. We have a couple of annuitants approaching 100 and one at 101. They are getting high payouts and we are going in the hole on them. [H]elp me make a case for staying the course" [with ACGA] rates. I fear a knee-jerk reaction.
>
> Roger Ellison, West Texas Rehabilitation Center Foundation, San Angelo, TX:
> I would imagine that on occasion a charity might "go in the hole" on a particular gift annuity or even a few, just as they might "come out smelling like a rose" on those who depart prematurely…. I remember the donor who looked me in they eye and told me, "You know, if I live long enough, you guys are going to lose money on me." I told him, "We'll take our chances." We did, he didn't, and we didn't!

Losing money on a gift annuity program – which is best described as the inadequate handling of a charity's fiduciary responsibilities – is not something any of us wishes to see. In the broadest sense, all in the gift planning community want to see widely noticed success with all the plans of giving and among our peers. Beyond that, donors and board members for each individual charity that issues gift annuities reasonably expect the outcomes to be positive and in the range of expectations set on the dates those contracts are issued.

So on the micro level, any charity that has issued or plans to issue gift annuities and deferred payment gift annuities needs to evaluate how its gift annuity program is positioned. And in the macro view, every gift planning practitioner has a stake in the success of these programs collectively. None of us will benefit from investment, administrative, or marketing practices that deliver minimal returns or actual losses to either the gift annuity reserve or the charity. The only reason we issue gift annuities is to generate income for charity.[1]

Given that the American Council on Gift Annuities cites 1843 as when the first U.S. gift annuity was issued, it is somewhat remarkable that more than 160 years later some charities are just now "getting into" the business. Of course, not all contemporary not-for-profit organizations record their history as far back as the Charitable Library Society in Concord, Massachusetts (1795) and the Female Association for the Relief of Women and Children (1800). And we have seen the number of IRS-registered charitable entities surge by 76% in just ten years and now total of some 1.5 million. Some of the newer charities seek to be involved in life income gifts in order to gain what they perceive as a competitive foothold in fund-raising.

There are also charities that have dabbled in the gift annuity business, issuing a few contracts over the years as their financial development programs emphasized life income giving or as donors requested them. On one hand, we might say that it is good that these organizations stepped up to meet donor demand and could benefit from advertising planned giving concepts. On the other hand, those that dabble may subject the organization to significant and unforeseen risks.

What are those risks? Often it relates to the issuance of contracts that results in an unbalanced portfolio of obligations, meaning that the value and duration of payment obligations are skewed compared to expectations. Imagine the situation where a few annuitants have taken out so many gift annuities with one charity that they actually outnumber the contracts issued to other individuals. You may think that implausible, yet I know of one charity that for 13 years has had only one donor (and her 19 gift annuities) comprise its entire gift annuity portfolio. Another problem can result from a handful of very large contracts that can have far reaching implications for the mortality experience for the pool of annuities. This may also be extreme, yet consider the charity that recently had 85% of its portfolio value in multiple two-life gift annuities with one individual and his children.

These matters also have a current, issue-oriented aspect. Charities that have been issuing gift annuities for some time may want to "grow" their programs and expand issuance into more highly regulated states without overburdening their investment practices. Others experienced sharply negative portfolio results within the past six years as fixed income yields dropped and stayed near all-time record lows around the time broad equity market indices fell by over 38% from 2000 through 2002.

This is becoming a bigger topic in the professional community, as donor's legal and financial advisors are looking more seriously at the credit risk their clients have with certain charities. Though we live in an era of heightened accountability, determining how well charities have managed their gift annuity reserve is not information that is

[1] Read that sentence again.

readily available to most inquirers and this has the potential to erode confidence in any given charity's gift annuity program.

2 Review of the key aspects for investing and administering a gift annuity

The Prudent Investor Rule (Restatement, Third of Trusts §227 (1990) requires the exercise of reasonable care, skill, and caution. It applies to investments not in isolation but in the context of the portfolio (in this case, the gift annuity reserve) and as a part of the overall investment strategy of the charity, incorporating risk and return objectives that are reasonably suitable for the portfolio.

Note that some might argue against application of the Prudent Investor Rule with respect to gift annuities because the Rule is generally applied to trustee duties. It is important to recognize that all gifts made to charitable organizations are, by definition and common law practice, gifts "in trust" because the assets must be used in furtherance of the charitable purposes. And therefore it is generally accepted that split interest gifts like gift annuities and charitable remainder trusts are similarly treated for the purposes of the Prudent Investor Rule. The duties that fall to the charity under gift annuity arrangements are no less consequential than those when the charity serves as trustee. In addition, the donors and annuitants enjoy the guarantee of the charity's full faith and credit to the obligation and this enhances the importance of the charity performing its fiduciary duties well.

You gotta fight every day to keep mediocrity at bay...
Got to fight with all your might not to get in the bleeding heart's way.
– *Van Morrison, Keep Mediocrity At Bay (2005)*

One responsibility contained within the Prudent Investor Rule is impartiality. The charity has an affirmative duty to invest in a manner that will provide reasonable total return and protect the value of the property to which it has been entrusted.

The charity may also delegate responsibilities when it is prudent to do so. It does not transfer the obligation to personally administer the gift annuity reserve in prudent fashion, but it has the discretion to delegate one or more of its responsibilities (such as investment or administration). Note that the charity can make an imprudent decision to delegate, for example, if it chooses an unqualified individual or firm as investment advisor for the gift annuity reserve. It can also imprudently fail to delegate, as when a charity relies on its ill-prepared business office to handle the issuance of checks and tax forms and accounting for payments containing ordinary income, capital gain, and return of principal.

Further, the charity may seek and accept advice from others (in this case, financial specialists) provided that their advice involves reasonable expense that is necessary and appropriate. Presently, the American Council on Gift Annuities (ACGA) projects the total expenses for investment and administration of gift annuities at 100 basis points (1.00%) annually charged against the gift annuity reserve. However, the actual costs may be considerably higher. For start-up and smaller programs, as more than a few financial services firms publish schedules with fees for these services at or exceeding 200 basis points, and handling this business internally can certainly involve hidden direct and indirect expense as staff work up a learning curve. On the other hand, actual costs may be lower, as financial services firms will make accommodation to existing endowment or retirement plan clients and take on administration of gift annuities and investment of the reserve for fees reported to be under 50 basis points.

Also recognize that over time, fees for administration and investment services may increase or decrease dramatically. The competitive nature of the business could cause pricing "spreads" to narrow considerably as they have on Wall Street in the past 20 years. Conversely, the complexity of the job has the potential to push expenses higher.

Another responsibility is one of productivity... managing the gift annuity reserve consistent with the fiduciary duties of caution and impartiality. Of particular interest with gift annuity reserves is the duty to pay close attention to wasting assets. Specifically, any charity has the duty to either sell so-called depleting assets or use accounting or other practices that protect the corpus. By design the gift annuity contains the element of depletion and the ACGA recommended maximum rates make broad assumptions about returns and costs and yield a corpus that approximates 50% depletion.

In setting recommended rates, the ACGA makes exceptional effort to consider historical investment performance using asset allocations that may be used by many of its reported 1,500 members. Under the current (July 2004, confirmed through June 2006) assumptions the gift annuity reserve is invested for the life of the contract (for one life annuitants aged 51 to 86 and two-life contracts with the younger annuitant aged 58 or less) as follows:

- 55% in 10-year Treasury bonds, generating an average annual total return of 4.00%
- 40% in equities, generating an average annual total return of 9.00%
- 5% in cash, generating an average annual total return of 1.00%

[Those wanting more detail on the rate and earning assumptions can purchase a paper on the subject from the ACGA for $25 ($15 for ACGA members).]

In any given year it is probably not prudent for the charity board, investment committee, or portfolio manager to expect it will attain total return results matching these projections.

Finally, consider the impact of mortality variances. The ACGA uses life expectancy based on Annuity 2000 tables (recognized by the IRS) using female mortality plus 18 months. That may provide your board or finance committee with a sufficient comfort level yet consider how static that projection is. In the past 50 years the life expectancy of 50 year-old American women has increased 21% (from 26.8 to 32.3 years). In that same period the life expectancy of 70 year-old American women increased 35% (from 11.7 to 15.7 years). Public health experts generally agree that life expectancies will continue to increase and more rapidly.

Now consider the impact on your favorite charity's gift annuity reserve in the event that investment returns fell short (or administrative costs ran high) by 20 to 30% over an interval. Then imagine that two of these factors went against the portfolio at once. Prudent fiduciaries will address the concerns of even the most bearish charity treasurer.

Remember that the ten-year backdrop to this is the increased issuance of gift annuities in the face of the extended decline of interest rates to historic lows and exceptional volatility in the equity markets. The popularity of the gift annuity could suggest that they may be too attractive in the minds of donors. Just as Roger Ellison's donor *expected* the foundation to lose money on him, most of us have found little resistance to this giving technique compared to other life income and end-of-life plans. The simplicity of the plan may not be the only reason gift annuities are easy to promote. It may be that these donors are the ones feeling like they are giving charity the sleeves from their vest.

3 Recent historical investment returns

After the unprecedented bull market in equities from 1995 to 1999, when 20% and 30% returns were practically routine, it seemed that anyone with a pot of money and a brokerage firm could manage a gift annuity program profitably. Well, if you like it on the upside then you have to like it on the downside, right? The next three years (2000 through 2002) brought double-digit losses in equities before they came roaring back in 2003.

One aspect of investing that is troubling for a gift annuity program is volatility, and that is exactly what those past ten years brought. Consider this: The Dow Jones Wilshire 5,000 Index from 1994 through 2005 posted an average total return of 11.14% and yet we'd be foolish to project this as an expected 12 year average return. That's because looking at either side of it the two years nearest to that 11.14% average were +21.21% and +6.38%.

To put volatility into perspective, assume you have budgeted your development office based on 11.14% revenue growth annually. You'd feel pretty successful when you beat that target by 90% or more and maybe even a bit smug if you did it six out of 12 years. And yet gains escaped you in four of the years and you even lost ground three consecutive years with "revenues" ranging from –11% to –21%.

Also, don't think that this volatility applies only to equity investments. Only once in those 12 years was the bond market (measured by the Lehman Long Treasury Index) close to the 12-year average total return of 7.98%. (Remember as well that during these 12 years we saw the most prolonged and strongest bull market in bonds in 50 years.) Twice in 12 years did the average money market return for a single year land within 100 basis points of the 3.47% 10-year average.

Obviously, those organizations that have the foresight to issue large numbers of gift annuities right before the markets bless their investments tend to win, provided the annuitants aren't particularly long-lived. And the charity that loads up at the gift annuity window as returns dip will get behind early and require protracted bull markets and/or an early death for many annuitants to realize the longed-for 50% residuum. If those presumptions seem far fetched, just have a look a the following investment returns that model the ACGA-recommended gift annuity reserve.

Twelve years of total return investment data

	Equities*	Treasurys**	Cash***	Reserve****
2005	+ 6.38%	+ 6.50%	+ 2.20%	+ 6.2%
2004	+ 2.48%	+ 3.54%	+ 0.82%	+ 3.0%
2003	+ 31.64%	+ 2.48%	+ 0.44%	+ 14.0%
2002	– 20.86	+ 16.79	+ 1.00	+ 0.9
2001	– 10.97	+ 4.21	+ 3.44	– 1.9
2000	– 10.89	+ 20.27	+ 5.70	+ 7.1
1999	+ 23.56	– 8.74	+ 4.49	+ 4.8
1998	+ 23.43	+ 13.52	+ 4.84	+ 17.1
1997	+ 31.29	+ 15.08	+ 4.90	+ 21.1
1996	+ 21.21	– 0.87	+ 4.80	+ 8.2
1995	+ 36.45	+ 30.69	+ 5.37	+ 31.7
1994	– 0.06	– 7.64	+ 3.65	– 4.0

* Total return, Dow Jones Wilshire 5000 Index
** Total return, Lehman Long Treasury Index
*** Total return, average Money Market fund
**** Total return, ACGA portfolio (40% equities, 55% bonds, 5% cash)

What do these numbers mean to us? Assume you can match the ACGA recommended investment allocations, indexed returns, and administrative costs.

- Say you had a relatively young group of annuitants in 1994, and held to the data for exactly 10 years. Most people would say you're in good shape now, as you've increased the reserve to 142% of what it was in 1994 *and* at the same time you were paying annuitants, trimming 12 years off your payment obligations.
- Now consider a single contract, say a typical $40,000 two-life contract issued today to a Ron and Jacquelyn Hyde, ages 80 and 81. If the next six years are <u>exactly</u> like the past six years (except that the mortality and ACGA assumptions don't change) the value you'll have a reserve for the Hyde's contract is $32,670. This is about 80% of the expected residuum with about 50% left of their 12-year statistical life expectancy at issue date. Note however that having survived another five years the Hydes are expected statistically to live another 8 years, yet the Hyde's expected joint life expectancy has increased by nearly 20%.

By now you may feel a headache coming on as you wonder why we're slogging through all this data. The point is that the margins for error in investing gift annuity reserves are relatively small. At the same time, we simply must acknowledge the potential for exceptional volatility in the equity, fixed income, and money markets and recognize that increased longevity (i.e., reduced mortality) is a significant financial risk to the charity.

4 Risk, reward, and the impact of large samplings and small portfolios

"My own people did it to me just 'cos they could
They sold me out.
So believe brother, it could happen to you
They sold me out.
For a few shekels more, they didn't even think twice,
Just for a few shekels more, another minute or two in the spotlight."
– Van Morrison, They Sold Me Out (2005)

We understand what it is to take a calculated risk. We apply business judgment based on certain known or anticipated outcomes, assess the potential reward, consider how to recoup or overcome losses, and make a decision to move ahead or not. The more we know in advance, the better the probability of making a justifiable decision, though that doesn't assure it will be considered a good decision viewed in the rear view mirror.

For example, a key element in establishing gift annuity rates is life expectancy based on mortality experience. Insurance company actuaries who look at mortality are examining data on a million or more individuals and we can agree that the sampling here is sufficiently large to have a nominal margin for error. They also must adjust their analysis to reflect mortality of the whole sampling as well as that segment that has or will purchase insurance products. These self-selecting individuals are likely to skew the mortality results somewhat based on the unique characteristics they have within the entire sampling.

Consider then not just the mortality tables for all Americans, but also mortality of subsets like insurance purchasers and gift annuitants. We know that about 85% of American adults own life insurance contracts; we have no reliable data indicating the proportion of annuitants. Granted, the ACGA does use the longer-lived female mortality and then further extends life expectancy by another 18 months. And we can hope the "law of large numbers" will be there to help us. [An aside: The law of large numbers essentially says that there is safety in quantity by virtue of the fact that more data points we have the more likely our data will conform to a larger sampling. In other words, the more gift annuities issued by the organization, the more likely the portfolio will begin to resemble the average mortality.]

What is the impact here? Well, the American Council on Life Insurance indicates there are some 350 million life insurance policies in force and that each US household owns an average of $178,600 of life insurance. Compared to that large universe, the ACGA claims some 1,500 members and from the 1999 survey found a median of 26 gift annuities in force. It is hard to derive a lot of confidence in comparing two dissimilar pools, one having millions of data points and $14.0 trillion of insurance policies, the other having dozens of data points and a portfolio of perhaps $1.0 million gift annuities.

The point is that we take it as a given that we will typically end up with a 50% residuum based on the assumptions. Inherent in those assumptions is that we will experience some results that exceed the 50% residuum and some that fall short.

5 Choosing the right gift annuitants

My friend Phil Karno, founder of Anchor Gift Annuity Reinsurance Services, posed the following question while speaking at the 2004 NCPG national conference. Which of the following gift annuity programs do you think would have the best odds of attaining the average 50% residuum?

1. This charity has 26 single life gift annuities in force. All 26 annuitants are females and each was under the age of 70 at the time the contract was issued. Each one remains active and in excellent health.
2. This charity has 26 single life gift annuities in force. All 26 annuitants are males and each over the age of 80 at the time the contract was issued. All the annuitants continue to drink alcohol and smoke to excess as they have throughout their lives.
3. This charity has 26 gift annuities in force. There is a mix of males and females ranging in age from 63 to 85. The health conditions of the group range from outstanding to very ill.

Charity # 2 may appear to some as the most lucrative program due to limited mortality expectations, however how many charities target hard-drinking men over 80 years old? Charity #3 has the better-balanced portfolio and has the only realistic chance of meeting the objective. Even #3 will have some of its 26 contracts that under-perform and some that over-achieve.

6 What happens with reinsurance?

First, what happens without reinsurance? Clearly there is more to the process than simply receiving a gift of cash or other property, making payments to one or two annuitants for life, investing the proceeds, sending annual tax forms, and waiting for the annuitants to pass away. These are important tasks, of course, yet the charity that self-insures assumes the responsibilities of an insurance company. This is why many state regulators treat charities like insurance companies.

Here are some hard questions to test an organization's competence in managing a program:

- Is the gross value of the gift placed into a segregated gift annuity reserve?
- Have any past contracts varied from the ACGA recommended rates?
- Is performance measured annually for the entire reserve from the inception of each contract, and against the ACGA annually assumed returns?
- How has the charity board and management assessed and addressed the risks (mortality, investment, inflation) inherent in issuing gift annuities (and presumably reflected in your gift acceptance policies)
- Is there the expertise to adapt to sudden changes in the gift annuity market, particularly related to state regulation, mortality shifts, and contract size?

- Does an audit of the portfolio reveal that it is approximating the 50% residuum objective?
- Can the charity reinsure the portfolio today and show a profit?

Essentially, these are questions that test whether an organization is following the best practices encouraged by the ACGA. Unless every one can be answered in the affirmative year after year, the charity may not be operating with competence and consideration of reinsurance becomes necessary.

The more risk we control the better we manage our gift annuity reserve. How might we seek to control mortality risk, for example?

The following standard mortality chart assumes a charity issues 100 single-life contracts to annuitants at ages 65, 70, 75, 80, 85. It shows the number of annuitants that are expected to be alive at the end of the 1st, 5th, 10th, 15th, and 20th contract year.

Issue Age	Living After 1st Contract Year	Living After 5th Contract Year	Living After 10th Contract Year	Living After 15th Contract Year	Living After 20th Contract Year
65	99.4	96.6	91.2	82.4	68.4
70	99.1	94.5	85.4	70.9	50.4
75	98.4	90.3	75.0	53.3	29.3
80	97.2	83.0	59.0	32.4	12.9
85	94.9	71.1	39.1	15.6	4.1

To explain what this means, note on the chart that for issuance at age 65, where after 10 years we have 91 annuitants still alive and receiving annuity payments and after 20 years only 39 of these annuitants survive. Contrast that to issuance at age 75, where after 10 years we have 75 annuitants still alive and receiving annuity payments, and after 20 years only 29 of these annuitants survive.

7 Three common arguments about reinsurance

"If the annuitant dies within the early contract years we lose the money that we paid for the reinsurance contact."

To make a decision about reinsurance, it helps to think like an insurance underwriter. That chart helps with calculating the values given some assumed rates of return and permits business modeling for a gift annuity program to and project best- and worst-case outcomes. An example analysis follows using these assumptions: An investment return of 6.5% on the self-managed reserve fund, a 7.2% return on a residuum growth fund, and a 10.4% payment to the annuitants. Mortality occurs at the end of a year.

Your charity issues 10 single-life contracts to people aged 85 year olds in the amount of $10,000 each.

- At the end of the 1st contact year one annuitant dies and you withdraw $9,610 from your reserve.

- At the end of the 5th contract year two more annuitants die and you withdraw an additional $15,558 from your reserve.
- At the end of the 10th contract year three more annuitants die and you withdraw an additional $14,211 from the your reserve. [At this point your self-managed gift annuity program has yielded your charity $39,379 and you sill have $18,948 in your reserve.]
- At the end of the 15th contract year two more annuitants die and you withdraw another $1,136 from your reserve. [There are still two gift annuities active.]
- At the end of the 20th contract year the remaining annuitants die. The problem is that between the 15th and 20th years these contracts had negative cash flow amounting to ($10,282).

The net return from these ten gift annuities was $30,233.

Alternatively, had you reinsured these 10 gift annuities paying a 75% premium (not uncommon) of the $100,000 original gift total and then placed $25,000 in the residuum growth fund. Using the financial estimator known as the Rule of 72s (money accumulating at the rate of 7.2% annually will double in 10 years) your $25,000 would have grown to $50,000 at the end of the 10th contact year, a net return in excess of the non-reinsured experience.

We can argue over the assumptions and calculation methodology, yet some practical business model is needed to forecast the profitability of a gift annuity program, whether self-insured or reinsured. After all, there is only one viable reason for having a gift annuity program, and that is to bring income to the charitable organization. And sound stewardship demand that we locate the more effective (some might say profitable) practices and utilize them when they give a clear advantage.

"If the insurance company goes out of business we are still liable for all ongoing payment to each annuitant for life."

It is plainly true that the charity is contractually obligated to pay the donor whether the reinsurance company is standing behind the contract or not. However, the premise is somewhat doubtful... in that there is not a single example of this ever happening in more than 150 years of gift annuity history. Given their financial underpinnings and strength, any of the top 50 life insurance companies are less likely to go out of business than almost any charity issuing gift annuities. Insurance companies have inherent competitive advantages:

- Insurance companies have "critical mass," dealing in billions of dollars of annuities annually versus charities working with much smaller amounts
- Insurance companies are heavily regulated and examined not only by government and by the public through financial rating services
- Shareholder oversight and governance far exceeds that by charity trustees and the advisors for annuity donors
- Insurance companies spend more on financial management control systems
- Insurance companies are able to hedge the mortality losses from their annuity obligations through life insurance, while charities cannot

- Insurance companies fully understand the complexities of the annuity business while many charities have only a limited knowledge and experience with gift annuities

"Do all the rules really apply to us?"
The elements of any gift annuity reinsurance contract are specified in IRC 170(f)(10). Essentially, the charity must own the reinsurance annuity contract, hold all the benefits from that contract, and the reinsurance contract must mirror the gift annuity contract in timing and amount of payments. In California, the reinsurance contract holder may reduce its reserve fund under California Insurance Code Section 11523.5 by filing a copy of the contract. Besides California, Illinois, New York, and Wisconsin also provide protection for annuitants and regulate the contracts.

8 Choosing reinsurance companies

Rating services attempt to measure the financial strength of the insurance companies and the ability to meet company obligations. Some insurance company rating services to consider:

A.M. Best Company, Inc	www.ambest.com
Duff & Phelps	www.duffllc.com
Fitch	www.fitchibca.com
Moody's Investors Services	www.moodys.com
Standard & Poors	www/stamdardandpoors.com
Weiss	www.weissratings.com

These services use letter/number ratings to indicate the financial strength of the companies. Ratings normally range from Superior to Poor to Suspended. A "warning list" may also be issued meaning that a company's current rating is under review and may be downgraded.

Confine your business to companies with a "Superior" or "Excellent" rating and pay attention to the narratives associated with each rating. These narratives give a better understanding of the company's financial condition, though all in this ratings cadré are recognized as financially stable. (A summary of the A.M. Best rating system is found in Appendix C.)

Also review a company's Comdex score (see www.lifelinkcorp.com). The Comdex is not a rating itself, but a composite of all the ratings that a company has received. The Comdex ranks the companies on a scale of 1 to 100, in relation to other companies that have been rated by the services. The Comdex is an effort to reduce the confusion over ratings using a different scale.

Once quality (measured by comparative ratings) is resolved, the next consideration is often price of the reinsurance contract premium. Companies can vary widely here from time-to-time and in various age brackets, calling to mind the company's portfolio of life insureds through which annuity losses are hedged. Comparison-shopping among reinsurers is likely to be a rewarding exercise.

Some people say you can make it on your own, oh you can make it if you try
I know better now; you can't stand up alone
Oh baby that is why I'm real real gone
I can't stand up by myself, don't you know I need your help
You're a friend of mine, and I'm real real gone.
– Van Morrison, Real Real Gone (1990)

The insurance company partner of a charity must also provide additional value beyond competitive premium and apparent quality. It is important that it also understand the charitable market.

- Is the contract compliant with regulations governing the use of the company contract to offset state reserve requirements?
- Will the company stand behind the charity when a government agency questions the contract under state law compliance matters? (Note that most state insurance departments do not issue written notices to insurance companies whether contracts meet the state reinsurance requirements.) Compliance issues are thorny; don't take on face value a statement that a contract is believed to be compliant.

Are company services able to meet the charity's, donor's, and annuitant's needs?

- Does it perform regular Social Security sweeps to find annuitants that may have died?
- Are they compliant under the Patriot Act?
- Does the company bring knowledge of the charitable market to the table?
- Does the company permit use of the company name in gift annuity promotions?
- Does the company provide the charity with marketing help?

9 Implications for marketing

Some charities reinsure all gift annuities and deferred payment gift annuity obligations. It may be an investment decision, a risk avoidance decision, or one arrived at because donors wish to have some or their entire gift applied for use immediately. Reinsurance may provide some relief in regulated states by allowing the charity to issue the contract without serious investment restrictions on the balance of the portfolio.

Other charities reinsure certain contracts where they feel the risk is appropriately reduced by doing so. This may mean reinsuring gift annuities over a certain gross dollar value or fraction of the total gift annuity portfolio, or for annuitants with life expectancies exceeding some defined term.

Regardless how a charity uses reinsurance, this has implications for its marketing materials. It is an important fact of stewardship, and positions the charity's policies in full view of the donor and his/her advisor. It provides the opportunity to demonstrate that the board has weighted the advantages and disadvantages of reinsurance in light of its investment objectives and annuity obligations. It announces its findings through the policies it adopts. Prospective donors and advisors can evaluate these policies, and they may find comfort in the charity taking steps to avoid becoming overextended and working with a sound partner. These decisions must to be communicated in the advertising messages about gift annuities for they can be important considerations in the eye of the prospect.

The role reinsurance plays, as mentioned earlier, needs also to become part of the Philanthropy Protection Act disclosure statement given to prospective gift annuity donors with a gift proposal or at another time in advance of executing an agreement or funding the arrangement.

There is one additional marketing piece that needs to reflect the charity policies on reinsurance, and that is the computer-generated gift illustration.

It is a long-standing principle (see Rev. Rul. 62-137, 1962-2 C.B. 28) that when a charity requires the annuity payment obligation to be reinsured with a commercial insurance company then calculating the donor's income tax charitable deduction is a simple subtraction snap. For example, if the donor transfers cash in the amount of $40,000 to the charity and the reinsurance premium paid is $23,000, the donor's deduction is $17,000.

Such simplicity fits right in with the gift annuity concept. Yet it can also cause problems for the gift planning officer and donor's advisor who may be unaware of how this fact is reflected in the output of common planned giving software. The defaults of these programs assume gift annuities are not reinsured, so output from the illustrations and projections will reflect the "typical" (meaning not reinsured) situation. However, with the caveat that generalizations are dangerous in the insurance field, the reinsurance premium is generally lower than the calculated charitable deduction for a non-reinsured gift annuity.

In fact, side-by-side comparisons of the software illustrations for reinsured and non-reinsured gift annuities show quite a different picture in both the deduction calculation as well as the exclusion ratio. This triggers two responsibilities for the charity. First, if reinsurance is a standard practice then the charity has a duty to disclose that to the prospective donor. Next, to present an accurate picture of the financial impact of the gift, the gift planning officer and donor's advisor need to have the cost of the reinsurance premium before running the illustrations. On the other hand, if reinsurance becomes a case-by-case investment decision for the charity then it seems appropriate to include that fact with the standard disclosures and permit the donor and advisor to review the standard calculations.

What are the primary differences? Look at the following actual case from January 2004 when Jerry Attrick (thankfully not his real name), age 90, gave $63,000 to the Excellent

Charities Foundation in exchange for a monthly annuity for himself paying $7,119.00 annually which issued at the recommended ACGA maximum rate of 11.3%.

	Standard	Reinsured
Present value of annuity	$27,721.39	$35,112.00
Charitable gift value	35,278.61	27,888.00
Income paid to Jerry over 5.5 years	$39,154.50	$39,154.50
Annual payment – ordinary income*	$ 1,573.30	$ 99.67
Annual payment – return of principal	5,545.70	7,019.33
Exclusion ratio	77.9%	98.6%

* Over a statistical life expectancy of 5.5 years

The obvious differences relate to Jerry's income tax consequences and preferences. Compared to the standard gift annuity contract, when reinsurance is mandated his charitable deduction will be lower by 21%. If Jerry is in the maximum bracket and itemizes his deductions this could cost him $2,587 in federal tax savings related to that deduction. On the other hand, if he survives to his life expectancy the higher exclusion ratio on the reinsured annuity delivers barely any ordinary income and this reduces his federal tax payments by $2,837 in that time.

The financial differences to the Foundation have the potential to be more striking.

	Standard	Reinsured
Income paid by Foundation over 5.5 years	$39,154.50	$ 0.00
Residuum value in 5.5 years	31,500.00*	36,482.76**

* Using ACGA assumption of approximately one-half of initial amount

** Using ACGA assumption of 5.00% net total return compounded annually

If Jerry and his tax advisor are looking for tax benefits there may be a nominal bias toward the standard gift annuity. If Jerry is looking for the way to maximize the residual value of his gift and/or to minimize the risk his longevity might cost the charity, he will prefer the reinsured approach.

The better gift planning practitioners know that their proposals, illustrations, and projections are intended to give the most fair and accurate method of evaluating the proposed gift. Programs that mandate reinsurance must reflect the lower deduction and higher exclusion ratios.

10 Final thoughts

Aging donors informing us that, "Growing old is not for sissies." The corollary might be, "Managing investment, mortality, and inflation risk for a selected number of elderly annuitants is not for amateurs."

More than a few charities are involved in gift annuities without doing enough due diligence, and these are the ones likely to experience nominal or negative results if one of the four primary variables goes against them for as few as three or four years. Should two or more variables knock these folks around for any interval a program launched to generate revenue easily becomes a large expense over a protracted period. This is bad for the careers of the gift planning officers and charity executives and bad for business among advisors who approved of their clients' gift annuities.

Whatever it takes to fulfill his mission, that is the way we must go
But you've got to do it your own way, tear down the old, bring up the new.
– Van Morrison, When Will I Ever Learn to Live In God? (1989)

Reinsurance is not a silver bullet for risk, and unceasing prayer for consistent profitable markets is not an investment strategy. The board and management of a charity have an affirmative duty to make an informed business decision about issuing and managing a gift annuity program. Advisors to donors and charities will look for stability and credibility, seeing that a gift annuity reserve deserves no less attention than a permanent endowment. Organizations like the ACGA and the NCPG will do well to encourage members to go beyond the prescribed best practices to assure positive outcomes for donors, advisors, and charities.

Appendix A:

Request for proposal: Investment management and administration of planned gift assets

1 Organizational information

1.1 Provide a brief history of your organization that sets out your experience, expertise, client base, and any proprietary products and services or unique characteristics that might distinguish your organization from other financial service providers.

1.2 Include a copy of your most recent annual report and all relevant audited financial information and statements, and information related to insurance coverage for your organization and other organizations you may engage to provide services for our institution.

1.3 Describe the structure of your organization and responsibilities held by those persons handling the investment, administration, and custody of assets.

1.4 Provide a copy of your current organization chart including the names of contact individuals, their position titles, and levels of experience and expertise. Include those persons with whom there would be occasional contact, such as legal counsel and tax statement preparers.

1.5 Include statements related to professionals and other staff in your organization as they relate to our institution's account. In particular, discuss the number of other accounts our institution's relationship manager(s) will handle and how your organization plans to maintain continuity servicing its accounts in the event our relationship manager(s) is(are) reassigned or leave your employment.

1.6 Provide audited information illustrating the total number of institutional accounts and total planned gift assets presently under management. Include the number of clients and total value of assets for each of the following categories.

- 1.6.a Charitable remainder trusts
- 1.6.b Gift annuity reserves
- 1.6.c Pooled income funds
- 1.6.d Charitable lead trusts
- 1.6.e Endowments
- 1.6.f Donor advised funds
- 1.6.g Other institutional accounts

1.7 Provide names and contact information for five or more clients for which your organization provides services that are similar to those contemplated for our institution.

2 Investment management

2.1 Detail your philosophy and approach in the investment of a charity's life income assets.

2.2 What recommendations, capabilities, and preferences do you commonly have regarding the following?

- 2.2.a Mutual funds, either proprietary or those widely available funds
- 2.2.b Planned gift assets commingled with endowment or common trust funds
- 2.2.c Planned gift assets separately managed

2.2.d Trusts containing hard-to-value assets, tax exempt securities, and real property

2.3 Provide details on the past one, three, five, and ten years of performance history after fees by the investment managers and/or mutual funds your organization has used the most (i.e., largest amounts purchased) for all clients with planned gift assets.

2.4 What is your organization's position regarding investment of charitable trust assets in fixed income, large capitalization equities, small capitalization equities, foreign stocks and bonds, real estate, and venture capital arrangements?

2.5 How often do you propose to monitor our institution's investment managers and assets allocations, and who provides these services and recommendations?

2.6 Does your organization have any restrictions concerning certain times when gift assets may be invested?

2.7 Describe procedures you propose for transmitting planned gift assets to your organization.

3 Administrative and custodial services

3.1 Trust administration and accounting

3.1.a Provide a list of the services and documents you provide for charitable trusts, gift annuity reserves, pooled income funds, and any other assets you anticipate managing for our institution.

3.1.b Indicate the frequency of 3.1.a above and provide sample reports.

3.1.c When do you normally issue reports following the end of an accounting period?

3.1.d To assure accurate accounting information, how do you conduct internal reviews and audits on planned gift assets?

3.1.e Describe your ability related to planned gift assets such as income-only unitrusts, makeup provisions, liquidation of remainders, and payment of trust fees.

3.2 Data processing

3.2.a Indicate your proposal as it relates to on-line inquiries and modifications to your organization's data system for accounting information, asset descriptions, and performance.

3.2.b Advise your organization's limitations and flexibility for custom reporting and transmission of information.

3.3 Performance monitors

3.3.a Provide the amount of information you propose for planned gift assets by investment manager, type of gift, individual trust or annuity account, asset class, and type of security.

3.3.b Indicate the frequency for 3.3.a above.

3.4 Disbursements

3.4.a Describe your abilities related to check preparation and direct deposit.

3.4.b For 3.4.a above, indicate additional services such as sending checks to our institution prior to normal distribution dates, including this institution's materials with checks and deposit notices, and indicia or logos indicating this institution as payor.

3.4.c Provide your procedures concerning transfers following termination of an income beneficiary's interest.

3.5 Annual reports

3.5.a Indicate any IRS required tax reports you will provide, when they will be sent, and by whom they are to be prepared.

3.5.b Do you provide state and federal fiduciary tax returns?

3.5.c Provide specimen annual statements and explain their contents related to an income beneficiary's balances and activity.

4 Contacts with a charity's donors and prospects

4.1 State whether your organization will act as trustee or co-trustee for a charitable remainder trust or charitable lead trust.

4.2 Describe the circumstances under which your organization may meet or communicate directly with a donor or prospect to our institution.

4.3 Indicate any materials you will provide that assist donors and prospects concerning tax deduction calculations, gift analysis, or related information.

5 Fees and charges

5.1 Provide a schedule that discloses all fees and charges that are related to the services you propose to provide our institution

5.2 For 5.1 above, disclose any internal fees related to certain mutual funds, common trusts, and transaction costs.

5.3 Provide a detailed miscellaneous fee schedule (including wire charges, multiple beneficiary fees, termination fees, set up fees, tax return fees, state reports and filings, additional report copies, etc.).

5.4 Indicate when all fees and charges are calculated, as well as how and when they are billed.

5.5 Provide a specimen contract, letter of intent, or other documents you may propose if this institution becomes a client.

6 Engagement

6.1 Explain how you approach the transition to your organization if our institution becomes a client.

6.2 Indicate the personnel assigned to each client.

6.3 Describe education and training your organization provides to staff at our institution.

6.4 Describe the information your organization requires for each type of asset and type of planned gift held for our institution.

6.5 Provide information regarding additional services or materials your organization provides related to the transition of assets and accounts into your control.

Appendix B:
Request for proposal from the insurance company's perspective

1. Gift annuity reinsurance
   - Provide a brief history of your gift annuity program
   - Provide a copy of your gift annuity business plan complete with program objectives and limitations
   - Provide a current census of your gift annuity program
   - Provide a brief description of your organization's risk tolerance and insurance company rating requirements
   - Provide time-line requirements

2. Gift annuity program development
   - Why do you need a gift annuity program?
   - What goals have you set for your gift annuity program?
   - Provide a realistic view of your donor base
   - In which states do you expect to issue gift annuities?
   - Assess your organization's gift annuity in-house expertise
   - Discuss your organization's gift annuity tracking system

3. Gift annuity marketing and sales
   - Discuss your organization's marketing background
   - Provide a summary your gift annuity-marketing plan
   - Offer evidence of legal compliance in state where registration is required
   - Provide analysis of your organization's sales effectiveness
   - Provide information on your contact management system
   - What ongoing gift annuity sales training will you do?
   - What gift annuity illustration software will you use?
   - What marketing research capabilities does the organization have?

Appendix C:

GUIDE TO BEST'S RATINGS

A Best's Rating reflects an independent opinion, based on a comprehensive quantitative and qualitative evaluation, of a company's balance sheet strength, operating performance and business profile. Best's Ratings are not a warranty of a company's financial strength and ability to meets its financial obligations.

Financial Strength Ratings

A **Best's Financial Strength Rating** is an opinion as to an insurer's ability to meet its obligations to policyholders.

	Rating	Descriptor
Secure	A++, A+	Superior
	A, A-	Excellent
	B++, B+	Very Good
Vulnerable	B, B-	Fair
	C++, C+	Marginal
	C, C-	Weak
	D	Poor
	E	Under Regulatory Supervision
	F	In Liquidation
	S	Suspended

Rating Modifiers

"u"	Under Review
"pd"	Public Data
"s"	Syndicate

Affiliation Codes

"g"	Group
"p"	Pooled
"r"	Reinsured

Not Rated Categories (NR)

NR-1	Insufficient Data
NR-2	Insufficient Size and/or Operating Experience
NR-3	Rating Procedure Inapplicable
NR-4	Company Request
NR-5	Not Formally Followed

Long-Term Credit Ratings

A.M. Best uses its long-term credit rating scale when assigning:

- **Debt Ratings** (an opinion as to the issuer's ability to meet its financial obligations to security holders when due) and
- **Issuer Credit Ratings** (an opinion as to the ability of the rated entity to meet its senior-most obligations).

	Rating	Descriptor
Investment Grade	aaa	Exceptional
	aa	Very Strong
	a	Strong
	bbb	Adequate
Non-Investment Grade	bb	Speculative
	b	Very Speculative
	ccc, cc, c	Extremely Speculative
	d	In Default

Ratings from "aa" to "ccc" may be enhanced with a "+" (plus) or "-" (minus) to indicate whether credit quality is near the top or bottom of a category, and a "u" modifier for Under Review. Ratings shown as (*italicized*) denote indicative shelf ratings.

Short-Term Credit Ratings

A **Best's Short-Term Credit Rating** is an opinion as to the ability of an issuer to honor obligations having maturities generally less than one year, such as commercial paper.

	Rating	Descriptor
Investment Grade	AMB-1+	Strongest
	AMB-1	Outstanding
	AMB-2	Satisfactory
	AMB-3	Adequate
Non-Investment Grade	AMB-4	Speculative
	d	In Default

Rating Outlook

Best's Ratings (A++ to D, aaa to c and AMB-1+ to AMB-4) are assigned a Rating Outlook that indicates the potential direction of a company's rating for an intermediate period, generally defined as the next 12 to 36 months. Rating Outlooks are as follows:

Positive	Indicates a company's financial/market trends are favorable, relative to its current rating level, and if continued, the company has a good possibility of having its rating upgraded.
Negative	Indicates a company is experiencing unfavorable financial/market trends, relative to its current rating level, and if continued, the company has a good possibility of having its rating downgraded.
Stable	Indicates a company is experiencing stable financial/market trends and that there is a low likelihood that its rating will change in the near term.

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 Version 090203

Effective Online Planned Giving Strategies

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Senior – Friendly Web Design

Characteristics of Seniors

Just prior to his 80th birthday, a news reporter asked former President Reagan how it felt to be turning 80. He responded, "Well, it sure beats the alternative."

In this and other respects, there are many good characteristics of aging. Senior Americans quite often have stability, financial security and time to visit friends and family. However, there are also characteristics of aging that need to be considered in designing web sites for seniors.

First, vision progressively declines with age. Seniors no longer have the visual capabilities that they had as teenagers. For example, the ability to distinguish colors and general visual acuity decline as we grow older.

Web sites need to use a very clean and simple design in order to allow good visual reference. The graphics need to be bright and cheerful. Backgrounds normally will be white or a high–contrast color. The primary red, green and blue colors will be used frequently. Finally, the navigation system and layout must be clear and easy to understand.

Web Layouts for Seniors

The overall layout should use substantial white space. Text should be broken up into short paragraphs with a line between paragraphs. The text must be sufficiently large and readable so that a senior feels comfortable with the layout.

There should be continuity between the pages. That is, the location of a button or link to the home page should be in the same place on every page. The pages should enable the use of a "Back" button so that the senior can conveniently move back to prior pages. Links to future pages should be usually at the lower right portion of the screen, similar to turning the page on a book.

By using the same layout, colors, and button or link locations on each page, it is easy for the senior to move back and forth through the site. If possible, the articles and pages should be limited to approximately two screens. If an article is fairly long, it is better to break the article into sections and use link or "Next" buttons to move to the next page.

Web Style for Seniors

Sites should be designed with clear backgrounds. Background graphics and patterns on which text or graphics are displayed can be quite confusing for seniors. While the new Flash technology is wonderful for the Disney.com site and other sites for younger persons, it must be used carefully on sites for seniors. While graphics technology continues to evolve and Flash can make a site very attractive, the navigation must remain very clear and simple with the newer technology.

It is better to stay with one or two basic fonts. Most text is easily readable in a Sans Serif font. These typically are labeled Swiss or Arial. Titles and captions may use a Serif font such as Times Roman. All fonts should be sufficiently large so that they may be comfortably read on a screen. Fortunately, the resolution of most screens is improving. Most seniors will use an 800x600 resolution screen and quite a few will be on a 1024x768 resolution screen.

Generally, flashing or blinking banners are not helpful. Flashing and blinking elements are both distracting and may cause visual problems for seniors.

Links or buttons should be highly visible with good contrast. They need to be easy click targets for the senior friend.

In selecting colors, remember to use high contrast. The two highest contrast colors are black text on a white background or yellow text on a blue background. Be careful not to use yellow or light text on a light background. Remember, the goal is to make the screen as easy to read as possible.

Usability for Seniors

The above characteristics are found in sites that are frequented by seniors. When there are new articles or options, it is desirable to either have a "new" graphic or a date that shows that the information has been updated. The senior friend may then easily see that this is an article or information that has not been previously viewed and will select and view the article.

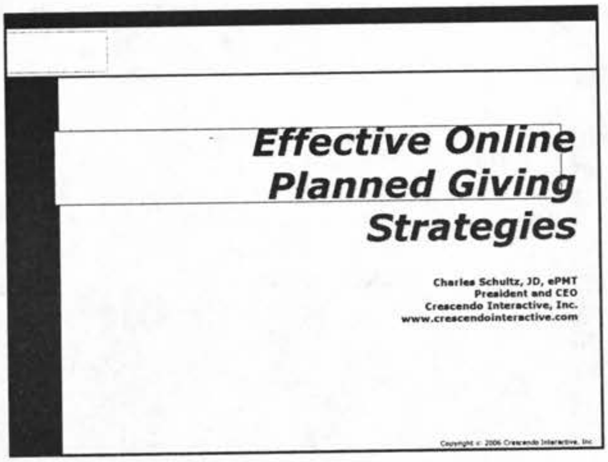
A search engine can make various parts of the site easy to find. To some extent, a navigation bar is also helpful. The search engine or navigation bar may lead quickly to sections of the site with the desired information.

The quality control process always needs to be undertaken to minimize broken links. One of the most frustrating experiences on any web site is to find exactly the information that you are seeking and then to discover that the link is broken. By having testers check the links regularly, you can minimize the risk of frustrating your senior friends.

Finally, test download speed with a dial-up modem. Within 12-24 months, many seniors will have cable modems, DSL or other broadband options. However, the majority at present are using a 56K dial-up modem. The page loading speed should be tested with a dial-up modem.

Senior–friendly sites are an important broad marketing method for gift planners. To be used effectively, it is essential for the gift planner to learn the basics of communication on the web. Most web sites today are created by young webmasters in their 20's. Quite often, these webmasters have a very different worldview from your average 80-year-old donor.

Therefore, it is essential that gift planners take an active role in the design and implementation of a web site. The young web developer can produce an excellent site but will need regular input from the gift planner so that the site truly is "senior–friendly."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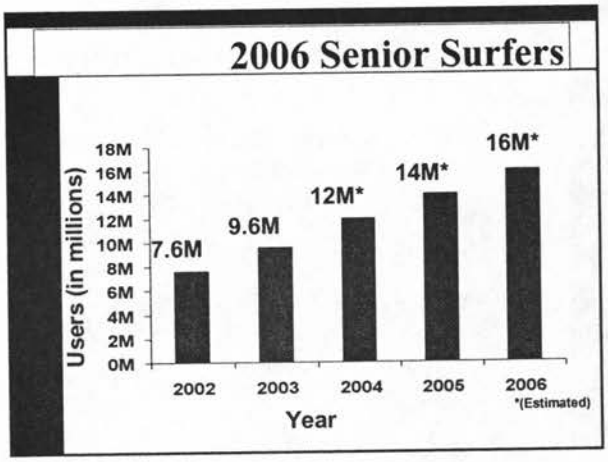
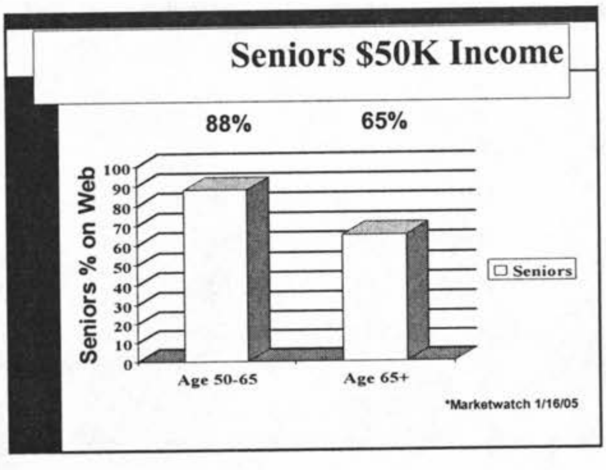
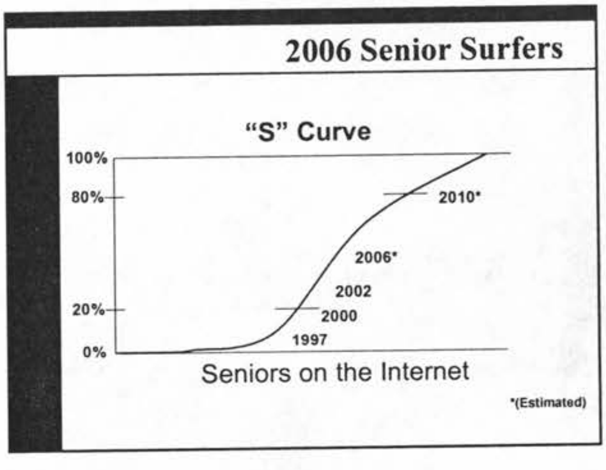

2006 Senior Surfers
Users (in millions)
18M
16M
14M
12M
10M
8M
6M
4M
2M
0M
7.6M
9.6M
12M*
14M*
16M*
2002
2003
2004
2005
2006
*(Estimated)
Year


Seniors $50K Income
88%
65%
Seniors % on Web
100
90
80
70
60
50
40
30
20
10
0
Seniors
Age 50-65
Age 65+
*Marketwatch 1/16/05


2006 Senior Surfers
"S" Curve
100%
80%
20%
0%
2010*
2006*
2002
2000
1997
Seniors on the Internet
*(Estimated)

Senior Expectations

Surfing Travel, News and Medical Sites

1. Rotating Content
2. Interactive Presentations
3. Streaming Video

eGift Questions

- What is an eGift?
- When will we see eGifts?
- How to close eGifts?

Senior-Friendly Web Site

Reaching Your Planned Giving Donors on the Web

Characteristics of Seniors

- Vision is Less Precise
- Difficult to See Colors
- Need High Contrast
- Prefer Primary Colors
- Need Easy Navigation

Senior Friendly

- Substantial White Space
- Short Paragraphs
- Back and Forward Buttons
- Similar Layouts and Colors

Web Styles For Seniors

- Clear Backgrounds
- Minimum Flashing Text
- One or Two Fonts - Large
- Contrasting Colors

Web Usability

- Check For Broken Links
- Test With 56K Modem
- Communicate with Webmaster
  - Designers - 20 to 30
  - Viewers - 60 to 90

eMarketing Strategies

Web Site Goals:

- Attract Visitors
- Make Friends
- Facilitate Donors

Web Site "Look and Feel"

- Same Colors
- Organization Logo
- Web Site Header/Colors

Motivating Donor Stories

- Highlight Donor Benefits
- Mission of Charity
- Heart-Strings Appeal

Amazon.com

	Low									High
Content	1	2	3	4	5	6	7	8	9	10
Readability	1	2	3	4	5	6	7	8	9	10
Navigation	1	2	3	4	5	6	7	8	9	10
Overall	1	2	3	4	5	6	7	8	9	10

Vanguard.com

	Low									High
Content	1	2	3	4	5	6	7	8	9	10
Readability	1	2	3	4	5	6	7	8	9	10
Navigation	1	2	3	4	5	6	7	8	9	10
Overall	1	2	3	4	5	6	7	8	9	10

WebMd.com

	Low									High
▸ Content	1	2	3	4	5	6	7	8	9	10
▸ Readability	1	2	3	4	5	6	7	8	9	10
▸ Navigation	1	2	3	4	5	6	7	8	9	10
▸ Overall	1	2	3	4	5	6	7	8	9	10

AARP.org

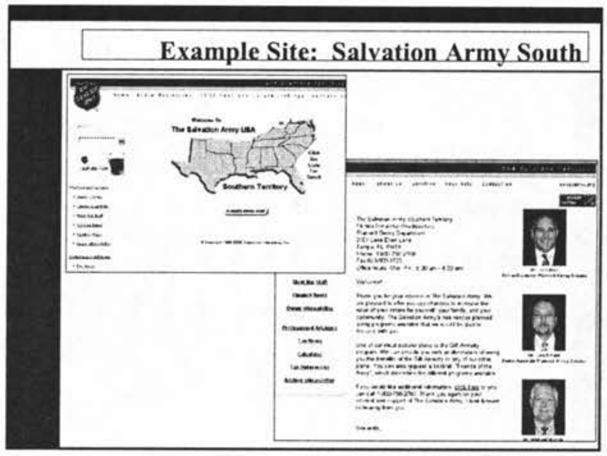
	Low									High
▸ Content	1	2	3	4	5	6	7	8	9	10
▸ Readability	1	2	3	4	5	6	7	8	9	10
▸ Navigation	1	2	3	4	5	6	7	8	9	10
▸ Overall	1	2	3	4	5	6	7	8	9	10

eMarketing System

- 1. Interactive Website
- 2. eMail Newsletters
- 3. eLiterature
- 4. Teleconferences/Seminars
- 5. eProposals

Example Site: Texas A&M University

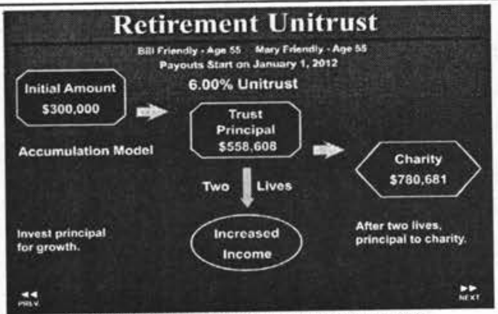

Example Site: American Bible Society
Good News for Everyone
Heart Inspires Generosity


Example Site: Salvation Army South
Southern Territory


Example: University of Hawai' Fnd.
FOUNDATION
Welcome to the UH Foundation Office of Gift Planning

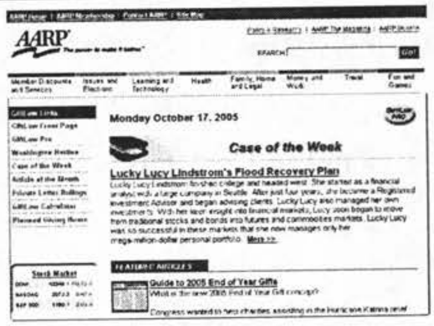

Example Site: Arthritis Foundation
ARTHRITIS FOUNDATION
Wednesday September 28, 2005
Taxes
Hurricane Katrina Relief Tax Package
Medical Billing Help
An Independent Woman
Stock Market

Example Donor Illustration



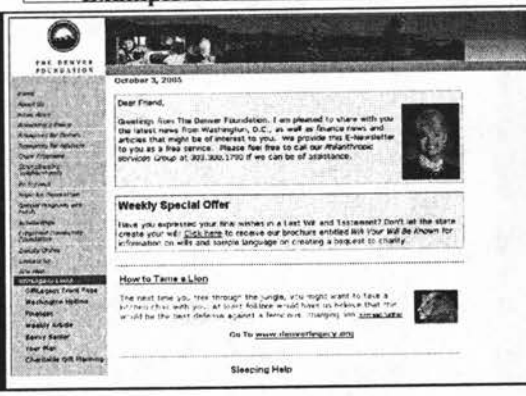
After the income has been paid for the selected life or lives, the remainder is distributed to charity. Hopefully, this trust has earned more than the payout and there will be some growth of principal. This growth benefits both family and charity.

Example Site: AARP



E-Mail Newsletters

Example Site: The Denver Foundation



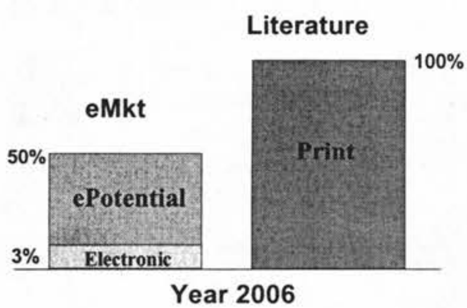
eNewsletter Contacts

- Existing List - "Opt In" with and "Opt Out"
- Postcard Offers
- Seminar Contacts

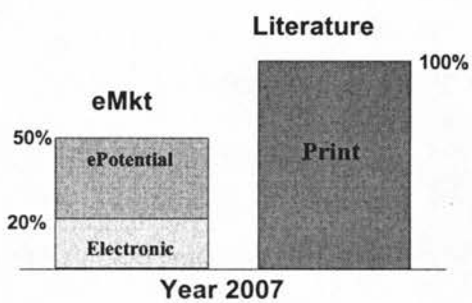
Component Literature

Make your Literature eLiterature

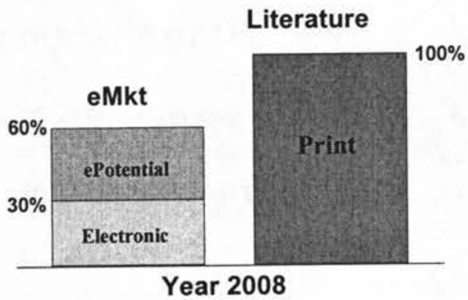
Transition to eMarketing



Transition to eMarketing



Transition to eMarketing



ePostcard

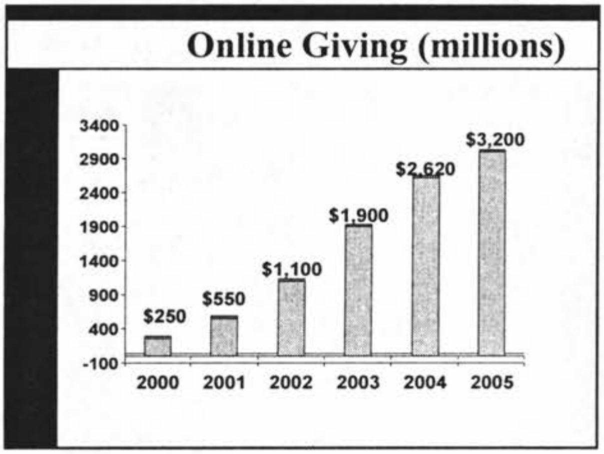
- Enclose with Mailing
- eMail to List
- Space Ad
- Seminar Handout
- Receipt Stuffer

eBrochures

- Gift Annuity
- Unitrust
- Annuity Trust
- Wills

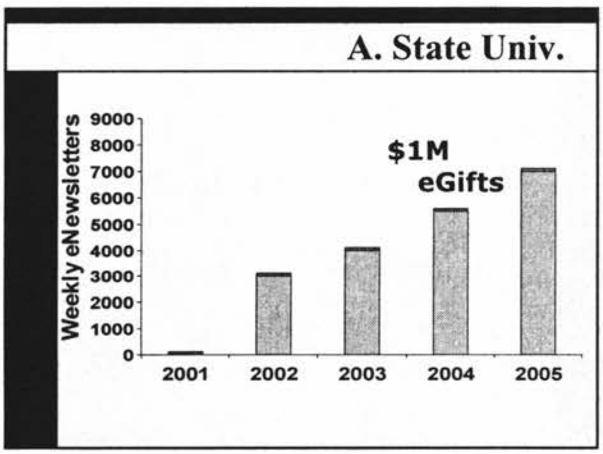
eMarketing Evaluation

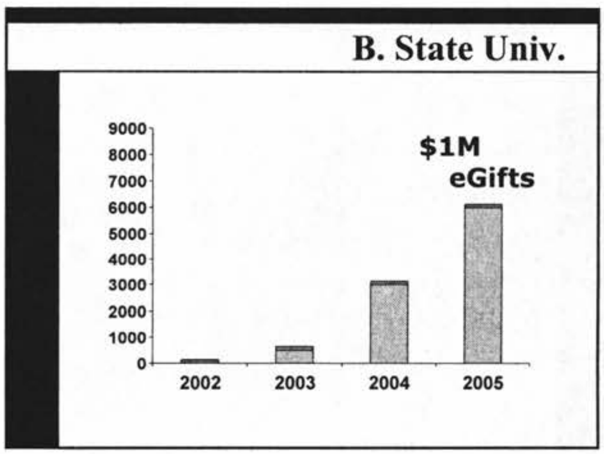
Are you reaching your ePotential?



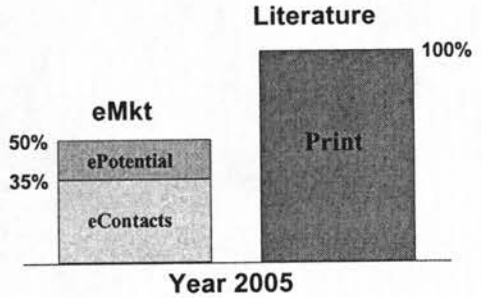
eSuccess

1. 1. eMarketing System
2. Circ. - eNewsletter
3. Annual eGifts $1M





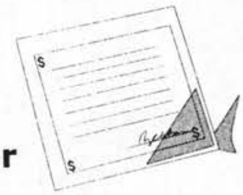
35% -- Doubled Planned Gifts



Same Page

VP Development

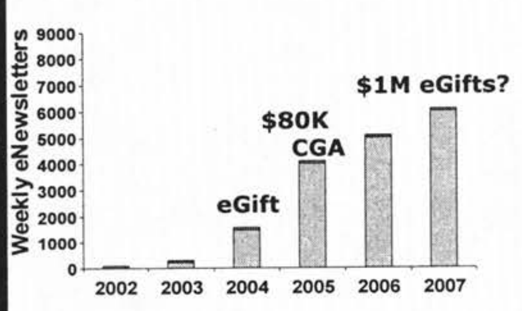
Webmaster



Gift Planner

Communications

C. Private Univ.



eSuccess

1. 1. eMarketing System

2. Circ. - eNewsletter

3. Annual eGifts $1M

Happy eMarketing!

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MAKING THE TRANSITION FROM CURRENT TO PLANNED GIFTS

Robert F. Sharpe, Jr.
President
The Sharpe Group
Memphis • Washington, DC

I. Introduction.

A. Importance of planned gifts

1. Growing source of income

2. Bequests and gift annuities are bulk of income for most

3. Charitable remainder trusts and pooled income funds may enjoy new growth as baby boomers age

B. Growth being driven by various factors

1. Economics.

a) Lack of growth in equity markets makes some more hesitant to make outright gifts.

b) Low interest rates create interest in gift annuities and certain other deferred gifts.

2. Demographics.

a) Aging of donor population.

b) Younger donors more financially sophisticated.

3. Changes in fund development strategies.

a) Greater role for planned gifts in capital campaigns.

b) More gifts feature both current and deferred elements.

C. Keys to success.

1. Maximize current gifts.

2. Encourage bequests and deferred gifts

3. Do not consider these efforts to be mutually exclusive.

4. Recognize that deferred gifts do not have to be deferred for a lifetime.

II. Review of Types of Gifts and Lifecycle of Donors.

A. Donors make three types of gifts.

1. Regular gifts.

a) They are relatively small.

b) Repetition is often anticipated at the time the gift is made.

c) Usually unrestricted and made in the form of cash.

d) Fundraising methods are speculative with emphasis on acquisition and upgrade of donors.

e) Example - I give $100 each year to an organization I support and I expect to repeat with occasional increases from year to year.

2. Special gifts.

a) Larger than regular gifts.

b) Repetition anticipated, but not as frequently.

c) Typically made in response to being asked to meet a need.

d) More likely to be in the form of property.

e) Often completed in context of a campaign or through other relatively aggressive methods and usually not deferred for more than a pledge period.

f) Fundraising methods are usually more transactional in nature.

g) Example - I give $15,000 to an organization over three years to help meet the need for a new facility.

3. Ultimate gifts.

   a) The largest gift one is capable of forming the donative intent to make.

   b) Will usually be a "once in a lifetime" decision.

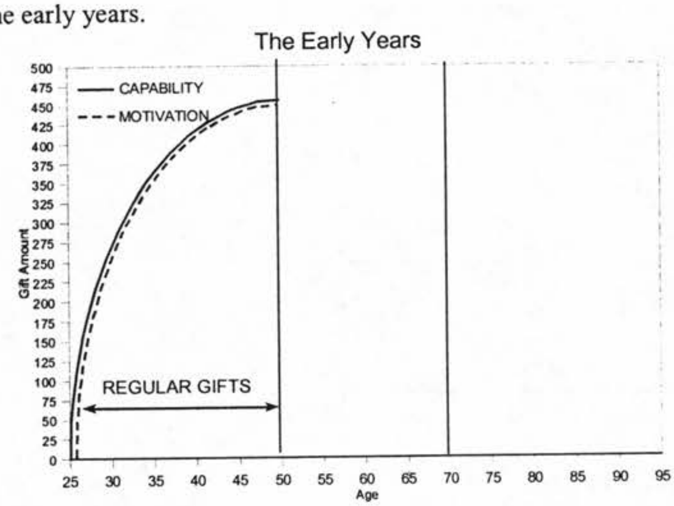
   c) These gifts tend to evolve over time and fundraising methods tend to be more stewardship and relationship oriented.

   d) For most persons the magnitude of the ultimate gift is such that it can only be made through the estate.

   e) Example - Some day I may wish to give $100,000 to endow a program of special interest to me.

B. There is a natural relationship between timing and types of gifts as depicted in the "life cycle" of a typical donor.

1. The early years.



   a) Emphasis on acquisition and upgrade.

   b) Making the case.

   c) Important to build increased motivation as financial capabilities grow.

   d) Challenge in today's environment is shaping message to acquire younger donors while retaining base of older donors.

e) Most donors are only prospects for regular gifts during early years.

f) Many are starting families and purchasing homes while they may still be repaying student loans.

g) Goal is to create pattern of regular, unrestricted gifts.

(1) As much as possible.

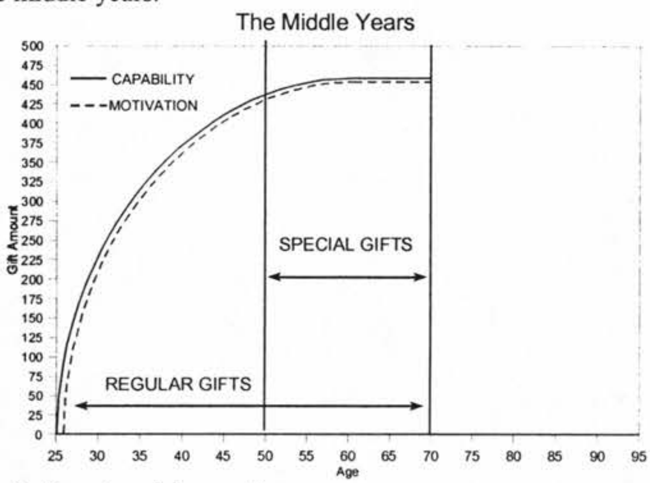
(2) As often as possible.

h) Most gifts made from income and occasionally from property.

(1) This group will be open to new ways to give.

(2) Will use debit cards, credit cards, will give online.

2. The middle years.



a) Regular giving continues.

(1) For many this is the most generous time in life.

(2) More assets invested in growth mode.

(3) Appreciated property thus a greater factor.

(4) Most persons too young for ultimate gift.

b) Large outright gifts have traditionally been made in the 55 to 65 age range as most persons are still thinking in terms of a life expectancy of 20 to 30 years or more.

   (1) Will live long enough to "make it back."

   (2) If considering a life income gift they may contemplate living long enough to receive more than they contributed.

   (3) Critical to understand the time value of money and whether it is working for or against the charitable recipient in a given situation, especially when working with donors in this age range.

c) The bulk of the nearly 80 million persons born between 1946 and 1964, the "baby boomers," are already in or are entering this age range. They may or may not give as generously as past generations have at this stage in life.

   (1) Many postponed marriage.

   (2) They began families later than their parents.

   (3) Children now consuming capital as well as income.

      (a) Higher education expenses.

      (b) Weddings.

      (c) Down payments for homes.

   (4) Eldercare an increasing concern for those whose parents are "running out of money.

   (5) Some baby boomers are watching inheritances eroded by lower investment returns that necessitate capital encroachment by their parents that may also erode inheritances.

   (6) Parents may be choosing between leaving inheritances to their children and monetizing their assets to provide income.

(7) Retirement is looming.

(a) This group may have suffered greatest losses as a result of market corrections. Many had large portions of their retirement assets in equities.

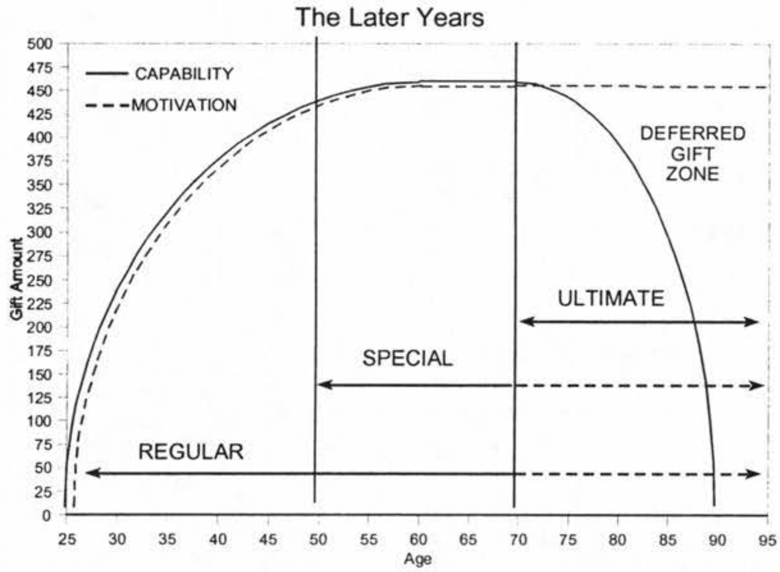
(b) Census bureau reports that 40% of women and 17% of men age 50 will live to be 100.

(8) Combination of factors may "tarnish" the "golden years" for many in this age range in coming years.

(a) New techniques may be required to obtain capital gifts.

(b) The baby boomers can be expected to be more receptive to more creative gift planning options.

3. The later years.



a) Regular giving may diminish or lapse.

(1) May be less disposable income.

(a) Incomes reduced by lower returns on investments.

(b) Medical and other expenses are increasing.

(2) Exceptions.

(a) Wealthier.

(b) Healthier.

b) Special gifts less likely for many.

(1) Perception among some that they have less capability to give.

(2) In reality, donors may have more assets than in earlier stages of life.

(a) Older persons tend to invest more conservatively.

(b) In many cases they sold out of equity positions before the fall in market values, as they needed to move to investments that yielded more income.

C. Four fears that compete with current giving.

1. Dying too soon.

a) Before providing for spouse.

b) Before providing for parents.

c) Before providing for children.

d) Before providing for grandchildren.

2. Living too long.

a) Fear of outliving resources is powerful motivator.

b) The wealthy are not immune.

3. Catastrophic illness and other emergencies.

a) Full coverage of medical expenses is rare.

b) Federal policy changes may make wealthy more vulnerable.

4. Mental and/or physical disability.

    a) Many worry about this.

    b) Most older persons are not incapacitated.

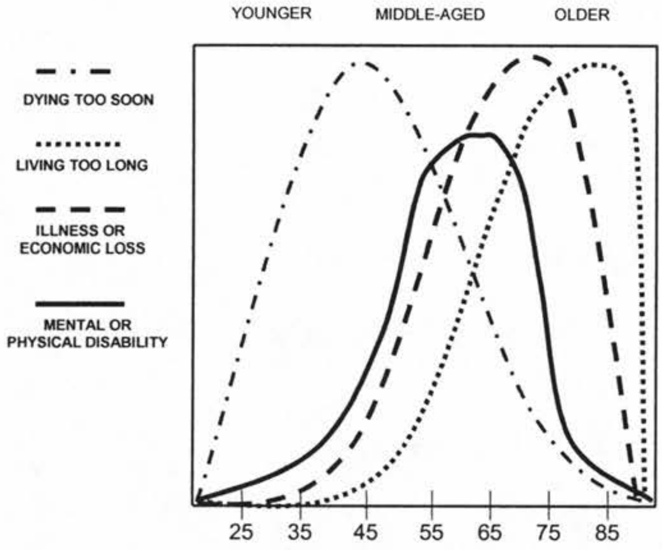
    c) Tremendous fear for childless persons or those estranged from family. Will increasingly be a factor when working with aging baby boomers.

D. Various financial concerns assume different levels of importance depending on age, wealth, and other factors.

    1. To a large extent a function of age.

    2. Wealth also plays a role.

    3. Note that these concerns converge in various ways in the 50- to 75-age range.



E. Understanding the economic concerns that may be competing with the desire to make a relatively larger gift in light of age and wealth factors are the key to "diagnosing" a particular donor's situation and "prescribing" an appropriate solution.

1. Must be able to recognize the issues facing donors.

2. Must understand the tools that are available.

   a) Their strengths.

   b) Their limitations.

3. Must know when to act independently and when to rely on advisors and/or others.

F. Gift planning solutions, like donors, share certain characteristics surrounding their timing and capacity for economic impact.

1. Some gifts are immediate.

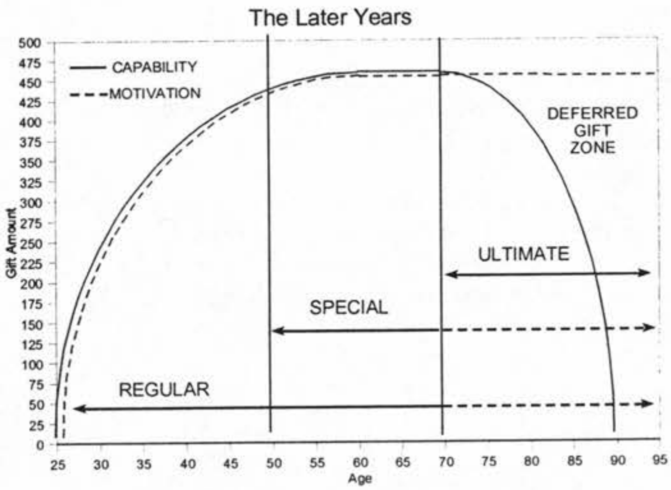
2. Some gifts only occur over time.

3. Some gifts involve complete transfer of assets.

4. Some gifts provide for transfers of partial interests.

III. Managing the Transition From Current to Deferred Gifts.

A. Important to anticipate and manage the "downgrade" process.



1. Recognize longevity of giving.

2. Recognize cumulative giving.

3. Emphasize memorial gift motivation.

4. Turn down current gift "volume" while increasing deferred gift communication.

5. Thank all older donors.

B. Be aware of changing lifestyles.

1. Most of the elderly are female.

2. Many are widows.

3. More will have had multiple marriages.

4. Baby boomers will retire differently.

a) Some will retire earlier.

b) Some will retire later.

c) Can be expected to combine retirement planning and charitable giving in different ways.

d) Many will be providing for parents and children while planning their own retirement.

Example:

Mary and Bert, age 59 and 57, have three children, the youngest of which has recently completed her education. They recently sold their home for $650,000. They paid $250,000 for the home twenty years ago. After expenses they netted $350,000. This was at least $100,000 more than they ever expected to realize from the sale of their home. They are also pleased that they will owe no federal capital gains tax on the sale proceeds. The funds are now invested in relatively short-term, fixed income investments yielding 3%.

Bert's mother, age 87, has now exhausted her savings. Bert has been giving her on average about $800 a month from his after-tax income. He has been asked to make a gift of $50,000 to a charitable interest that is conducting an endowment campaign. He doesn't see how he can do both.

After consulting with representatives of the charity and his advisors, he decides to use a portion of the cash from the home sale to fund a $100,000 gift annuity that will pay his mother 10.2%, or $10,200. This amounts to $850 per month in spendable income for his mother.

The gift will result in a charitable income tax deduction of $54,000, saving him income taxes of about $18,000. The remaining $46,000 represents a taxable gift to his mother. He has not used any of his $1 million gift tax exemption amount so he will owe no gift tax.

If the charity earns 6% on the gift annuity funds for the six years his mother is expected to live, there will be approximately $65,000 remaining at the end of her life. The value of this amount discounted at 4% is $53,000. Under the gift crediting guidelines of the charity, Bert is offered and he accepts recognition for a gift of $50,000.

C. Emphasize stewardship.

1. Discover those who have made bequest provisions and/or funded other planned gifts.

    a) Only a small percentage of bequest donors will notify in advance.

    b) Charitable recipient will generally know about gift annuities and pooled income gifts.

    c) This is increasingly not the case where charitable remainder trusts, lead trusts, bequests, and other gifts that donors create with the help of their advisors.

2. Where bequests are discovered in advance, they tend to be larger than ones that are received without prior notification.

   Example:

   Mrs. Jordan, a widow age 78, has recently been diagnosed with an illness that her physicians have told her will in all likelihood take her life in less than two years. She decides that she should meet with her attorney and review her estate plans. As part of that process her attorney asks her if her charitable interests have changed from a will that she executed some 15 years ago that left all of her assets to her husband and included residual bequests to a number of organizations only if her husband should predecease her.

   After careful consideration she does, in fact, decide to alter the charitable beneficiaries that were included in her previous will. As she has gotten older, she has lost touch with a number of the organizations that were included in prior wills. A number of them are, in fact, no longer communicating with her. This is due to the fact that she has stopped giving to a number of them due to decreased discretionary income as she has invested more conservatively and her healthcare costs and other living expenses have increased. Only two of the charities she named in the earlier will have discovered her as a bequest donor and continue to communicate with her as a member of their planned gift recognition societies despite the fact that she no longer makes current gifts to them.

   The principal beneficiaries of her new will are organizations and institutions that she still supports and feels most strongly will make a difference in the world in the near term, as she now knows the funds she is bequeathing will be received in a relatively short period of time. One of the bequests adds to a fund created by her husband in his will, which he completed some seven years prior to his death when he was in good health. While she is not particularly interested in this organization, it was one that her husband believed in and she decides to add to his bequest primarily out of her love for him and the desire to further preserve his memory. She also retains her bequests to the two organizations that discovered her intentions and have continued to maintain contact with her over the years.

   While the value of her estate has not increased significantly in recent years, there are fewer charitable interests named in her final will and they will thus receive larger bequests as a result of their efforts to maintain their relationship with her in her later years.

D. Differentiate your program from others.

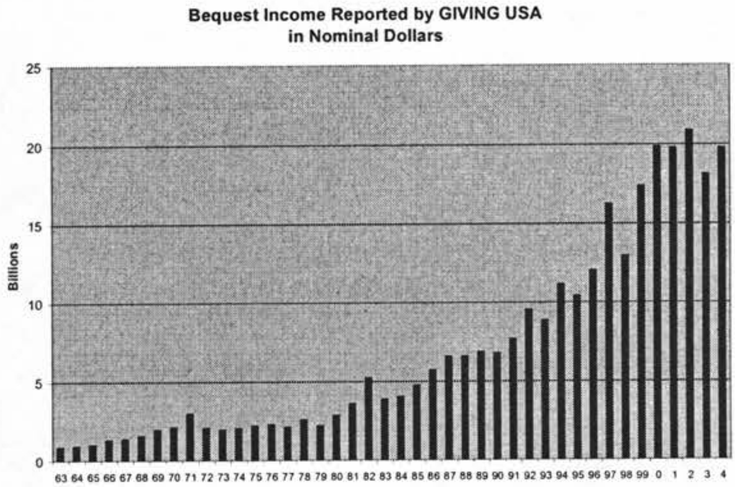
1. There is increasing competition for planned gifts.

2. There has been a large increase in for profit and nonprofit entities engaged in various aspects of planned gift development.

    a) In 1986, there were approximately 13 planned giving councils with 400 members.

    b) Today, there has been a nearly thirty-fold increase in membership to 11,000 members and ten-fold increase in councils to a total of 130.

3. During the same time the amount of planned gift income has tripled.



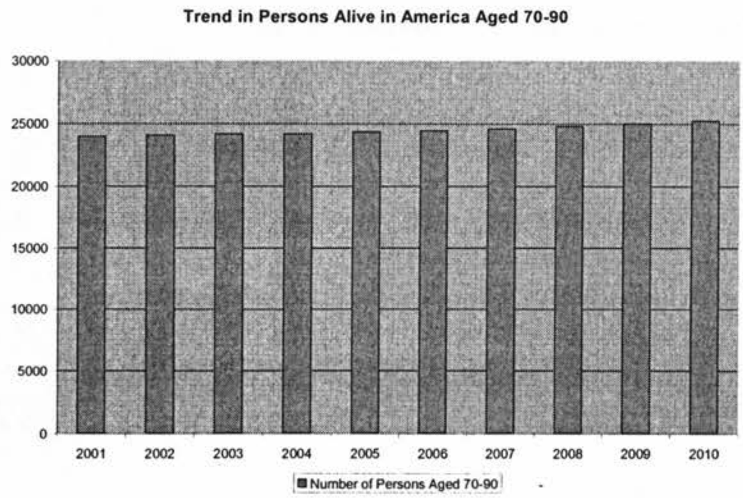
4. Note that the American Council on Gift Annuities reported that the number of organizations issuing gift annuities has doubled over the past ten years and increased by one-third over the past five years. See acga-web.org.

    a) 1994 - 2,000 issuers

    b) 1999 - 3,000 issuers

    c) 2004 - 4,000 issuers

5. According to the census bureau the number of persons in America in the key age range of 70 to 90 is static or declining.



6. Less tax incentives than in the past.

    a) Phase out of estate tax.

    b) Over 98% of those who die will not be subject to federal estate tax.

7. Will be more important than ever to balance mission and method of making gifts.

8. Remember the "anatomy of a gift."

    a) **Who** makes it?

    b) **Why** do they make it?

    c) **What** do they give?

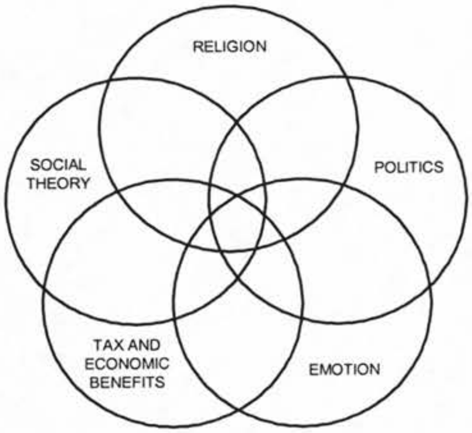
    d) **When** do they give it?

    e) **How** do they make the gift?

9. Increasingly the what, when and how will not be sufficient to be the "why."

E. Understand the multiple motivations for gifts.

1. Religious beliefs.
2. Social theory.
3. Political theory.
4. Emotions.
5. Tax savings and/or other economic benefits.



F. Understand the proper role of recognition.

1. Only one of many motivators for planned gifts.
2. Of no importance to many.
3. Don't overemphasis planned gift recognition societies.
4. When people accept recognition for planned gifts they usually do so after they have been motivated to make the gift for other reasons.

G. Key is to maximize market share among the small percentage of persons who decide to elevate charitable interests to the status of family members and include them in their estate plans.

1. Communicate appropriate gift planning ideas to the right people at the right point in life using the right means of communications.

2. Many will act but never inform you.

3. Be prepared to work with those who respond favorably over the remainder of their lifetime.

IV. Conclusion.

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